

**Valuers' Negligence: the permissible "margin of error"
July 2010**

This note provides a summary of the recent decision in *K/S Lincoln and others v CB Richard Ellis Hotels Limited* [2010] EWHC 1156 (TCC), which confirmed that whilst a valuer might be in breach of duty because he fell below the standard of a reasonable valuer in his methodology, that valuer will not be liable in negligence if it can be shown that, notwithstanding the error, the valuation figure that he produced was within a reasonable bracket.

Facts

Briefly, Danish investors K/S Lincoln and others ("K/S Lincoln") bought four budget hotels in the UK. Each hotel was bought subject to a lease for a term of 25 years containing turnover rent provisions.

CB Richard Ellis Hotels Ltd ("CB Richard Ellis") were expert hotel valuers who acted for a variety of parties with an interest in these and four other related properties. CB Richard Ellis were instructed to provide valuations of the four hotels.

K/S Lincoln sought in excess of £4 million in damages from CB Richard Ellis for professional negligence. There were two elements to the claim:

Negligent misstatement - K/S Lincoln alleged that they would never have bought the hotels if they had realised that, because of the unusual feature of the lease arrangements, the base rent was not likely to be exceeded by the (higher) turnover rent, at least in the medium term, and that therefore, in the absence of a rent review provision, there would be no, or very little, prospect of rental growth. The Claimant alleged that they were misled into thinking that there would be rental growth by mis-statements in CB Richard Ellis' valuation reports.

Negligent valuation outside the permissible margin of error - K/S Lincoln alleged that the valuations for the four hotels were too high and outside any permissible bracket/margin of error. It was common ground that a key factor in identifying the value of a hotel is its net initial yield, which is stated as a percentage. That percentage is then translated into a multiplier which, when multiplied by the annual rent, produces the valuation figure. The lower the yield percentage, the higher the multiplier, and therefore the higher the value of the hotel. It was the Claimants' case that the Defendants' yield figures, which were all in the region of 6.25%, were much too low and should have been in the region of 7% and, for Bradford, 7.25%.

Decision

Mr Justice Coulson found that both claims failed. With regard to the second claim, the court found that the valuation was within a 10% margin of error in respect of the investment property, and therefore the valuer was not negligent. The reasoning in respect of the second claim is explored below:

Key issue - whether the valuation fell within the margin of error

Coulson J considered the case law and applied the analysis of the court in *Goldstein v Levy Gee (a Firm)* [2003] EWHC 1574 (Ch) (01 July 2003) (a case concerning valuation of shares), who had applied the decision of the Court of Appeal in *Merivale Moore plc v Strutt & Parker*. In *Merivale Moore plc v Strutt & Parker* [1999] 2 EGLR 171 the Court of Appeal found that a discrete breach of duty in arriving at a valuation figure would not give rise to liability, unless the valuation figure produced by the breach was outside the permissible bracket (margin of error).

The line of authority for this approach starts with *Singer & Friedlander v. John D Wood & Co* [1977] 2 EGLR 84 In that case Watkins J said:

"The valuation of land by trained, competent and careful professional men is a task which rarely, if ever, admits of precise conclusion. Often beyond certain well-founded facts so many imponderables confront the valuer that he is obliged to proceed on the basis of assumptions. Therefore he cannot be faulted for achieving a result which does not admit of some degree of error. Thus, two able and experienced men, each confronted with the same task, might come to different conclusions without anyone being justified in saying that either of them has lacked competence and reasonable care, still less integrity, in doing his work."....

...."Any valuation that falls outside the permissible margin of error brings into question the competence of the valuer and the sort of care he gave to the task of valuation."

Position of a professional valuer

Coulson J stated that a professional valuer, asked to value a property, is in a slightly different position from other professionals. He knows that ultimately all that is likely to matter will be the final figure he puts on the asset being valued. He knows that in the commercial world, his clients may not understand or even look at the text of his report or the methodology that he has adopted to arrive at his valuation. Particularly in property valuation, all that usually matters is the result: the figure on the last page of the report.

This is rather different from the position of other professionals, for example, an architect's design advice may be judged by reference to a whole raft of factors (structural, aesthetic, economic) and whether the design is permissible under planning or building regulations.

Accordingly, it seems only a matter of common sense that, in the ordinary valuation case, the valuer's performance should be judged by reference to the final figure, not the minutiae of how he or she got there.

Loss suffered

Coulson J stated that it is often quite easy to point to particular aspects of a valuation process in any given case which were less than satisfactory. In the present case, the Defendants went about some aspects of their work in a sloppy fashion, doubtless a reflection of the rumbling dispute about their fees from an earlier report they had done. But if, on analysis, their final valuation was within a reasonable bracket, then what would be the effect of a finding of breach which did not take the valuation outside a reasonable bracket? Where would such a finding lead? What loss would be caused? Save in an exceptional case, if the valuation was within a reasonable bracket, any discrete breaches would not have caused any loss and therefore there could be no finding of liability in any event.

The appropriate margin of error

Coulson J reviewed the case law on the appropriate margin of error and found that, as a matter of general principle, the position to be taken from the authorities was as follows:

- (i) for a standard residential property, the margin of error may be as low as plus or minus 5%;
- (ii) for a valuation of a one-off property, the margin of error will usually be plus or minus 10%;
- (iii) if there are exceptional features of the property in question, the margin of error could be plus or minus 15%, or even higher in an appropriate case.

In the present case, Coulson J found that the margin of error should be at least 10% either side of the correct valuation figure. The valuation was within this range, and therefore CB Richard Ellis had not acted negligently. This was despite the fact that they employed an over-complicated methodology and failed to take account of the shortfall clawback provision when they undertook their valuations.

Conclusion

The general test in cases of professional negligence is whether the individual met the standard of the ordinary skilled man exercising and professing to have that special skill. In *Bolam v Friern Hospital Management Committee [1957] 2 All ER 118* it was found that a person will not be guilty of negligence if he has acted in accordance with a practice accepted as proper by a responsible body skilled in that particular art. Putting it the other way round, he is not negligent, if he is acting in accordance with such a practice, merely because there is a body of opinion that takes a contrary view.

As illustrated by this case, valuation cases differ from this. If a valuation figure falls within the permissible margin of error, as a general rule that will be decisive, and the valuer will not be negligent in respect of this figure. If a valuation figure falls outside the margin of error, the standard of care exercised by the valuer will need to be analysed, and an assessment will need to be made as to whether or not the valuer acted negligently.

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