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WHAT'S THE DAMAGE? COURT OF APPEAL GUIDANCE ON QUANTIFYING LOSS AND COLLATERAL BENEFITS

In *Swynson Ltd v Lowick Rose LLP [2015] EWCA Civ 629* the court had to consider whether a lender could recover damages from a firm of accountants where the accountants' negligence had caused the lender to make loans which were then repaid by the borrower in the context of a refinancing. A majority of the Court of Appeal held that the repayment of the loans did not need to be brought into account when quantifying the lender's claim against the accountants. In other words, the accountants were liable for the full amount of the loans, despite the fact that they had been repaid.

THE FACTS

Between 2006 and 2008 Swynson Limited (Swynson) lent £19.75m to Evo Medical Solutions Limited (EMSL), initially to enable EMSL to facilitate a management buyout of an American company called Evo and thereafter to alleviate Evo's on-going cash flow problems. A firm of accountants, Hurst Morrison Thomson (HMT, now named Lowick Rose LLP), produced a negligent due diligence report which Swynson had relied upon in entering into the original loan. HMT failed to report a difference between Evo's actual and forecast working capital, which had a material adverse impact on Evo's cash flow post completion of the management buyout.

Swynson was indirectly owned by Mr Hunt. Mr Hunt believed that the only way to protect the initial investment was to continue to support Evo financially, initially by procuring that Swynson lent sums to EMSL which in turn provided financial support to Evo.

In 2008 there was a refinancing. Mr Hunt, personally, made funds available to EMSL so that EMSL could repay the 2006 and 2007 loans from Swynson. This was because Mr Hunt had by this time become a majority shareholder in EMSL, meaning that Swynson and ESML were now connected entities. As a result, unless a restructure took place, tax would be payable on interest due from EMSL to Swynson even though EMSL continued to be in default.

Evo's financial difficulties continued and the company was eventually wound down. The 2008 loan from Swynson to EMSL and the loan from Mr Hunt to EMSL remained outstanding. Swynson sued the negligent accountants, HMT, for all the amounts it had lent to EMSL between 2006 and 2008, including those that had been repaid by EMSL in the 2008 refinancing. HMT argued that it was only liable for the outstanding 2008 loan made by Swynson, as EMSL had repaid the other loans to Swynson at the time of the refinancing.

COLLATERAL TO THE LOSS (OTHERWISE KNOWN AS *RES INTER ALIOS ACTA*)

In some circumstances, the loss a claimant will suffer as a result of a defendant's breach can be avoided. How that loss was avoided will dictate whether or not the avoided loss will be taken into account in assessing the damages payable by the defendant.

Where the loss is avoided as a result of an event which is collateral to the defendant's breach, the damages payable by the defendant will not be reduced by the amount of the avoided loss. Where the loss is avoided as a result of an event arising out of the defendant's breach and in the ordinary course of business, the damages payable by the defendant will be reduced by the amount of the avoided loss.

DECISION

A majority of the Court of Appeal (Lord Justice Davis dissenting) held that HMT was liable to Swynson for all the loans made between 2006 and 2008, and the amount of damages should not be reduced to reflect the fact that the 2006 and 2007 loans were repaid by EMSL (using funds advanced by Mr Hunt) during the refinancing.

- Although the 2008 refinancing (by which the 2006 and 2007 loans were repaid) could be said to have arisen out of HMT's breach, it was not in the ordinary course of business. The court referred to and relied on the fact that there was no prospect of selling EMSL's debt to a third party for anything like its true value (so EMSL had no way to mitigate its loss), and the refinancing was not therefore something EMSL could have procured in the ordinary course of business.

- Had Mr Hunt, in an act of benevolence, given Swynson sums directly to balance its books (as opposed to lending sums to EMSL to repay the loans to Swynson), HMT's liability would not have been reduced. The fact that the payment to Swynson was structured through EMSL should not affect the outcome, otherwise form would triumph over substance.

- It was contrary to the ordinary man's sense of justice, reasonableness and public policy that sums Mr Hunt was "driven" to provide to help Swynson due to the difficult position in which it found itself as a result of HMT's negligence should be treated as benefiting HMT.

COMMENTARY

This is a helpful authority for dealing with cases where, although the claimant has taken no steps to mitigate its loss, some or all or its loss has been avoided. Even though the Court of Appeal reached a "just" answer in this case, it did not reach a consensus and Lord Justice Davis provided a well-reasoned dissenting judgment.

The case serves as a helpful reminder to give thought to the impact any restructure or refinancing might have on any potential legal claims.

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