Titan Europe 2006-3 Plc v Colliers International UK Plc (In Liquidation)

[2015] EWCA Civ 1083

This case concerned two principal issues. Only one of these, the question of whether the defendant valuer had been negligent, formed the ratio of the decision. The wider implications of the point dealt with in obiter dicta, however, that of the claimant's title to sue, make it worthy of note in its own right. Titan, the claimant in the original action, was suing Colliers for the negligent valuation of a large commercial property on Fűrther Strasse in Nuremberg, containing warehousing, offices and a department store. The mortgage secured against that property formed part of a securitisation arrangement under which Titan (a Special Purpose Vehicle) acquired a package of loans and commercial mortgage backed securities (CMBS), and issued these to Noteholders, who invested in those securities. Whilst Titan was obliged to distribute any proceeds of realisation to the Noteholders, it remained the legal and beneficial owner of those securities. Colliers, the defendant valuers, contended that they had not been negligent and that, even if they had, Titan had no title to sue because it had suffered no loss; that loss falling instead on the Noteholders. Its argument on this point was bolstered by the fact that the particular arrangement in question was one of "no recourse", meaning that Titan's liabilities could not exceed its assets. The Court's decision on the negligence point is of obvious importance to the parties involved: its views on title to sue are of broader significance to the securitisation industry more generally.

<u>Negligence</u>

At trial, Blair J found for the claimants, holding Colliers to have been negligent in their valuation of the Nuremberg property. The Court of Appeal, in a decision delivered by Longmore LJ, disagreed on the basis that it had reached a different conclusion about what was the "correct" value of that property. It was accepted, both at first instance and on appeal, that the business of property valuation ("appraisal" in the US) is a tricky one. To that end, both courts adopted a process of identifying a range of values known as a "bracket" within which a valuation would be deemed reasonable:

> If the valuation is within the range, then the valuation will not be found to have been negligent even if some aspect of the valuation process can be criticised as having fallen below reasonably competent standards. [1]

Even those making valuations outside this bracket could avoid liability if they demonstrated that they had used reasonable care and diligence in so doing.[2] It was accepted by counsel for Titan that the appropriate bracket in this case should be 15% either way; a common industry norm for unusual or unique properties. The point of distinction between trial and appeal was therefore what the correct valuation of the property was on the evidence, with the Court of Appeal making

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[1] Blair J in *Titan Europe 2006-3 plc v Colliers International UK plc* [2014] EWHC 3106 Comm. at [127], referred to by Longmore LJ at [6]

[2] See *Capita Alternative Fund Services (Guernsey) Ltd v Drivers Jonas* [2011] EWHC 2336 (Comm) at [145].

it very clear that it was not interfering with Blair J's findings of facts, but with the inferential conclusion he reached on their basis. Colliers' liability at trial had been based on a finding that the correct value of the property at the time it was valued was EU 103 million. The Court of Appeal, however, felt that it was "inconceivable that the 'correct' value could be as low as EU 103 million"[3] and that EU 118 million "is a more likely value that EU 103 million. This figure places Collier's valuation of EU 135 million within the 15% bracket."[4] It was perhaps in recognition of the difficulty of the exercise that the Court made the further point:

> We are conscious that the figures fall somewhat narrowly rather than generously into the bracket selected by the judge but they speak for themselves and a narrow success is still a success. It must also be remembered that the market was a rising market.[5]

Given the potential volatility of the commercial property market (not to mention its actual volatility at the time in question), there is much to be said for the Court of Appeal's pragmatic inferential approach to this issue.

<u>Title to sue</u>

Although not a point necessary to decide, given the Court's decision on the negligence issue, the question of Titan's title to sue was considered significant enough for some robust and relatively extensive obiter dicta. In deciding this point, the Court of Appeal emphasised that Titan remained the legal owner of the loans notwithstanding the securitisation process, referring as it did so to Blair J's judgment in the court below:

> Titan's case (which was not disputed at trial) is that under English law it remains the legal and beneficial owner of its rights relating to the [securitised loans]. This is because, whilst it has assigned security rights to the [investors] it says that these are not legal assignments as they concern part of a debt…and no notice has been given to [the debtor]. They were equitable assignments by way of charge only, with no obligation to give notice of the assignment.[6]

From a conceptual point of view, this should be dispositive of the question, given that

> [i]t is a commonplace truism of property law that the owner of property has rights of suit for substantial damages in respect of any actionable negligence, see eg *The Sanix Ace* [1987] 1 Lloyds Rep. 465. In our judgment, the same applies to rights of suit in relation to loans and the securities underlying them. The choses in action owned by Titan in this respect are just as much property as any other sort of property Titan's title to theses choses in action entitles it to sue for damages if it has a cause of action at all.[7]

The simplicity of this conclusion, however, is potentially obscured by the commercial realities of the situation. The principal counter to such a proprietary analysis can be found in Colliers' contention that the real loss occasioned by the (ultimately non-negligent) valuation fell not on Titan, but on the Noteholders instead. It argued, therefore, that the Noteholders had their own

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[3] At [16].
[4] At [18].
[5] At [23].
[6] [2014] EWHC 3106 (Comm) at [95].
[7] At [30].

cause of action and Colliers should not be exposed to double liability, making reference as it did so to *The Albazero,* in which Lord Diplock explained the House of Lords' motivation as being one to avoid the "complications, anomalies and injustices that might arise from the co-existence in different parties of rights of suit to recover…a loss which…one..alone has sustained." [8] (In making this point, Colliers was no doubt galvanised by the fact that any such claims by Noteholders would by this point have been time-barred, to say nothing of the logistical difficulties of proving a causal link between the loss of any given investor and the defendant's valuation, relating as it did to only one of several loans involved in the securitisation.) The flaw in the argument is obvious, as Longmore J made clear at [32], in pointing out that the case before the Court of Appeal was "different from the Albazero in which the claimant …had not merely parted with the risk in the goods but also with the property." As the Court had already established that Titan had not parted with the property in the loans and securities, this was a case easily distinguished.

The wider argument about the Noteholders' title to sue, however, was lent more weight by the specific contractual arrangement between Colliers and Credit Suisse (the originator of the securitisation and the transferor of the valuation-affected loan to Titan), in which, under the heading "Liability and Publication", Colliers acknowledged that

> this certificate will be used by Credit Suisse First Boston…in evaluating a request for a loan to be secured by the property. This certificate is addressed to, and may be relied upon by:…any actual or prospective purchaser, transferee, assignee…of the loan.[9]

This would appear on its face explicitly to give the Noteholders (inter alia) title to sue, and seems to be the reason why the Court of Appeal declined categorically to rule out any action by a Noteholder. The Court did, however, go as far as to say that such a claim may well be defeated by the doctrine of reflective loss, drawing an analogy between the relationship Noteholders have with issuers and the relationship between shareholders and the companies in which they have invested. This doctrine, which prevents a party from recovering damages where her loss is merely reflective of another's, is a phenomenon most often encountered in the realm of companies and their shareholders. It was set out in straightforward terms by Lord Bingham in *Johnson v Gore Wood*:[10]

> (1) Where a company suffers loss caused by a breach of duty owed to it, only the company may sue in respect of that loss. No action lies at the suit of a shareholder suing in that capacity and no other to make good a diminution in the value of the shareholder's shareholding where that merely reflects the loss suffered by the company. A claim will not lie by a shareholder to make good a loss which would be made good if the company's assets were replenished through action against the party responsible for the loss, even if the company, acting through its constitutional organs, has declined or failed to make good that loss. So much is clear from *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) [1982] Ch 204* , particularly at pp 222-223, *Heron International* , particularly at pp

[8] [1977] AC 774 at p.848E.
[9] Excerpted at [28].
[10] [2002] 2 AC 1 at 35.

> 261-262, *George Fischer* , particularly at pp 266 and 270-271, *Gerber* and *Stein v Blake* , particularly at pp 726-729. (2) Where a company suffers loss but has no cause of action to sue to recover that loss, the shareholder in the company may sue in respect of it (if the shareholder has a cause of action to do so), even though the loss is a diminution in the value of the shareholding. This is supported by *Lee v Sheard* [1956] 1 QB 192, 195-196, *George Fischer* and *Gerber*. (3) Where a company suffers loss caused by a breach of duty to it, and a shareholder suffers a loss separate and distinct from that suffered by the company caused by breach of a duty independently owed to the shareholder, each may sue to recover the loss caused to it by breach of the duty owed to it but neither may recover loss caused to the other by breach of the duty owed to that other.

Applying this to the facts of *Titan* leaves very little room for any argument that the Noteholders' loss was anything other than reflective of that suffered by Titan. This question of the nature and location of loss is one of the most salient elements of the title to sue question. The reduction in the value of the Noteholders' investments was not "separate and distinct" from the reduction in the value of the securities held by Titan, since the link between the two was inextricable (albeit, as outlined above, almost impossible to quantify in terms of the effect of the loan in question on any particular investor).[11] What room there is for such an argument lies in the "non-recourse" nature of the arrangement between Titan and its investors. In other words, as is common in the issue of commercial mortgage backed securities (CMBS), the liabilities of Titan, as a non-recourse SPV, could not exceed its assets. On one economic view of the world, therefore, it could not suffer a factual loss in its own right. But what is invisible to the accountant is conspicuous to the lawyer, and Titan had nonetheless acquired a chose in action worth less than what it had paid for it:

> It is…not correct to say that Titan suffered no loss. It suffered a loss when it acquired the loans…The price it paid for the loans was too high. Titan's relationship with the Noteholders is analogous to that of a company with its shareholders; no one suggests that, because the shareholders may be the ultimate losers in a case of this kind, the company has not suffered a loss.[12]

It was accepted by both parties that, according to the contractual framework of this securitisation (which was not especially unusual in form), any damages payment received by Titan was to be treated as a receivable, subject to its obligation to pay investors in accordance with the payment "waterfall". The payment waterfall simply describes the priority of payments made to investors, determined by the level of risks (and therefore returns) agreed to by each. Ultimately, therefore, the Noteholders in this case would benefit from Titan's successful action. The fact that this would be the result on these specific facts, however, was deemed to be "a matter with which Colliers should have no legitimate concern".[13]

The existence of the waterfall provision is nonetheless both a legitimate and important concern in offering a reason to regard the result in *Titan* as being correct. According to Gullifer and

[11] See Blair J in *Titan Europe 2006-3 v Colliers International UK plc* [2014] EWHC 3106 (Comm) at [104].
[12] At [38].
[13] At [27].

Payne, "tranched" securities, such as those issue in *Titan*, have the following characteristics:

> [T]here is a pre-set order of payment to different groups of investors in the securities, laid down in a 'waterfall' clause. The senior ranking tranches are paid first…, followed by lower ranking tranches…, followed by 'junior' notes. The greater risk in holding lower-tranched notes is offset by a higher rate of interest payment.'[14]

This arrangement establishes the relative interests of various Noteholders, differentiating returns in accordance with the terms of issue. Were the Noteholders to have been recognised as having title to sue in their own right in *Titan*, these terms, and the relative positions of investors determined by them, would have been circumvented. It is entirely correct, therefore, that the relationship between an issuer and its Noteholders is *res inter alios acta* as far as the defendant in a negligence action, properly brought by the legal-title-holding issuer, is concerned. This might appear less intuitively acceptable in a situation wherein the SPV is not compelled by its Cash Management Agreement to distribute any judgment sum to its investors because it then looks in factual terms as if the SPV has received a windfall. Such arrangements must, however, remain independent of the question of the issuer's title to sue because that is a question answered by reference to property rights and those property rights should not be subordinated to third party contractual rights. Similarly, the fact that Titan was a "non-recourse" SPV must remain *res inter alios acta* for the purposes of establishing its title to sue; another point made by the Court of Appeal, (and illustrated by reference to *Interallianz Finanz AG v Independent Insurance Co Ltd*),[15] before it concluded ultimately that "we would…put primary emphasis on the fact that Titan were [sic] the owners of the loan and of the securities. That of itself gave Titan not only its right to sue not also the right to recover substantial damages."[16]

Essentially, the title to sue question on the facts of *Titan* was an easy one to answer at the outset. What is more, it did not even require an answer, given the Court's conclusion on the anterior issue of negligence. It is perhaps not surprising, therefore, that, having decided that the question was one worth exploring in any event, the Court of Appeal went on to engage with the opposing arguments, rather than to dismiss them outright in the wake of a decisive proprietary analysis. Unusual is the case whose obiter dicta renders it more worthy of note than its ratio decidendi, but *Titan* is just such a case, and worthwhile for it. Whilst it seems that issuers under CMBS schemes were originally conceived as passive entities, unconcerned by any rights they might or might not have,

> [t]imes change, financial environments may change dramatically and CMBS schemes created in one era have had to adapt to new conditions. In the current environment, there are more loan defaults, property values are more unstable and borrowers may be unexpectedly at risk. One consequence is that Issuers may need to call upon assets beyond the loans themselves, specifically rights of action associated with those loans.[17]

Consequently, it matters very much not just whether Issuers have rights of action, but precisely

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[14] L Gullifer and J Payne, *Corporate Finance Law*, 2nd edn (Hart, 2015), 469.
[15] 30th May, 1997.
[16] At [37].
[17] N Rushton, 'The consequences of an issuer in a CMBS having its own rights of action" [2015] *Journal of International Banking and Financial Law* 22, 22.

why they have those rights. On this, the Court of Appeal in *Titan* has provided valuable guidance.

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