Property Valuations: The Role of the Margin of Error Test in Establishing Negligence

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This paper aims to examine critically the use made of the 'margin of error' principle as a test of negligence in property valuations. In particular, it considers whether the 'bracket' of 10-15 per cent which is routinely accepted by judges in the UK is justified by reference to existing empirical studies of valuation variation.

The paper traces the development, status and current operation of the margin of error principle through case law in the UK and Australia, noting that the principle was originally put forward by valuers appearing as expert witnesses in negligence actions. It then reviews the previous empirical work on valuation variation carried out in the UK, concluding that the valuation variation studies are more relevant than other studies of valuation accuracy to the point at issue. The valuation variation analysis includes previously unpublished data, including the performance of expert witnesses themselves, where the paper identifies a striking contrast between the experts' assertions as to the size of 'error' which suggests negligence and the range of valuations actually put forward by those same experts.

The preliminary analysis of Australian cases indicates a number of differences in approach by both judges and expert witnesses from that in the UK, including the use of multiple experts for each side and an emphasis on the method rather than the result to determine negligence. This leads to conclusions which are different for each country.

For the UK, the conclusions are that the margin of error principle is lacking in any empirical basis and indeed runs counter to the available evidence. Its use as a means of establishing negligence by a valuer is fundamentally flawed. It is also concluded that the advice given to the judges by expert witnesses is flawed and may call into question their ethics and/or competence. For Australia, the conclusions are that the approach taken by the courts appears to be much closer to that recommended by this paper — namely, that the valuation figure should not be determinative of negligence by the valuer, and that the performance of Australian expert witnesses displays a greater level of consistency between their valuations.

1. INTRODUCTION

In the case of *Singer & Friedlander Ltd v John D Wood & Co*,[1] an English court first accepted the concept of the 'margin of error' in a professional negligence action brought against a property valuer. That concept involves the proposition that, in considering whether a valuer exercised reasonable skill and care in carrying out a valuation, it is legitimate to determine the extent to which that valuation departs from the 'true value' of the property. In summarising the evidence put forward by the expert valuation witnesses in that case, Watkins J stated:

> The permissible margin of error is said by Mr Dean [the defendants' expert witness], and agreed by Mr Ross [the employee of the defendants whose valuation provoked the legal action], to be generally 10 per cent either side of a figure which can be said to be the right figure, ie, so I am informed, not a figure which later, with hindsight, proves to be right but which at the time of valuation is the figure which a competent, careful and experienced valuer arrives at after making all the necessary inquiries and paying proper regard to the then state of the market. In exceptional circumstances the permissible margin, they say, could be extended to about 15 per cent, or a little more, either way.[2]

In the 20 years since the *Singer & Friedlander Ltd* decision, the English courts have applied and developed the margin of error principle. Not surprisingly, given the close relationship between the Australian and UK legal systems, with judgments in one jurisdiction being quoted as guidance within the other, the concept has also been applied in the Australian courts. In this period, expert witnesses have routinely put forward their opinions as to the size of bracket which would be appropriate in a particular case. However, it does not appear that this expert evidence has made any explicit use of the empirical research which has been carried out into the actual performance of valuers. This is somewhat surprising, to say the least, since research into valuation accuracy, variation and bias has been debated within real estate markets in the UK since the mid-1980s.

The debate started with Hager and Lord.[3] They cast doubt upon the valuers'

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1. [1977] 2 EGLR 84.
2. Ibid, 85.
3. D Hager & D Lord *The Property Market, Property Valuations and Property Performance Measurement.* (London: Institute of Actuaries, 1985).

ability to identify accurately the most likely selling price ('valuation accuracy') from the fact that ten valuers determined substantially different valuations from each other ('valuation variation'). A more important concept for investment analysts is that any valuation inaccuracy does not exhibit a tendency consistently to overvalue or undervalue property in comparison with the 'correct' valuation ('valuation bias').

Although there is no suggestion that the research findings have overtly affected the evidence put before the courts in negligence actions, it appears that the research itself may have been coloured by the researchers' perception of the legal position. In particular, the literature contains a number of references to the idea of an 'acceptable' range of valuations.

For example, Hager and Lord perceived five per cent to be the expected variation: 'Our feelings from informal discussions were that the range of the valuations for any particular property would be about five per cent either side of the average value'.[4]

At about the same time Mackmin suggested that valuers would accept this test, 'because the valuer's belief is that he or she will be valuing to within five per cent'.[5] Nothing much has changed in the latest studies on valuation variation. Hutchinson states: 'These levels of accuracy fall short of the contention that valuers can value to within five to 10 per cent of market value'.[6] He adds: 'For professional credibility, the range of valuations should be within a narrower range. Variations in excess of 10 per cent must be viewed with some concern as this may prompt legal action from dissatisfied clients'.[7]

Brown, Matysiak and Shepherd sum up the perception held by many in the UK real estate market — namely, that a variation of more than 10 per cent either side of what is regarded as a 'correct valuation' may expose the valuer to the risk of being found guilty of negligence:

> Although valuers may, on average, be able to interpret information in the same way this does not imply that all valuers will have the same view concerning a valuation. There will, therefore, be uncertainty concerning individual valuations. This is generally accepted in the market and has given rise to the widespread belief that valuers should be able to value within a range of five to 10 per cent of the mean

4. Ibid.
5. D Mackmin 'Is there a Residential Valuer in the House?' (1985) 4 Journal of Valuation 384-390.
6. N Hutchison, B MacGregor, N Nanthakumaran, A Adair & S McGreal *Variations in the Capital Valuations of UK Commercial Property* (London: Royal Institution of Chartered Surveyors, 1996).
7. N Hutchison 'How Much Do Valuers Vary in their Valuations of Commercial Property?' in *Research Findings No 2* (London: Royal Institution of Chartered Surveyors, 1996).

> value. These figures appear to have been established in an arbitrary manner. Nevertheless the suggestion has been that any valuations which lie outside this range imply that the valuers are being negligent in the way they estimate values.[8]

Apart from these brief references, there has been no serious attempt to carry out a close comparison of the valuation accuracy literature and the margin of error concept in valuation negligence cases. The two things are, however, inextricably intertwined, with one informing the other. This leads to two main conclusions. First, wherever the margin of error is an issue in litigation, research findings of what is 'normal' valuation variation or error in the particular type of case should be incorporated into the evidence laid before the court. Secondly, if tests for variation within the valuation accuracy debate are to be based upon the true legal position (rather than upon figures plucked randomly from some notion of the margin of error within negligence cases), a detailed examination of the margin of error within cases is necessary to identify precisely what the true legal position is.

The overall aim of this paper is, therefore, to compare the current implementation of the margin of error principle with the actual ability of valuers to determine the value of property interests.

In order to achieve this aim, Part 2 of the paper identifies the development of the margin of error concept within the context of the standards expected from a competent valuer and sets out the present position from the latest cases. It addresses questions regarding the legal principles, the use of errors as evidence of negligence, the identification of the correct valuation and the size of the acceptable bracket, and the role of the expert witness in advising the court on these matters. Part 3 briefly summarises the valuation process issues related to the margin of error before reviewing the findings of the valuation accuracy and, more importantly, variation studies. Part 4 includes a detailed examination of valuations put forward by expert witnesses and identifies some significant divergences between their valuations and their assertions on how accurate their colleagues in the witness box are expected to be. Part 5 draws together the implications of the findings for valuation negligence, the margin of error and valuation variation with the aim of influencing the advice to judges from expert witnesses, informing the expectations of all those involved in valuation negligence and providing better criteria for the examination of valuation variation.

This paper only briefly addresses the more fundamental issues of the concept of the margin of error. It assumes that it will continue to be applied in cases in the UK in the future. This assumption should not go unchallenged, however, and is

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8. G Brown, G Matysiak & M Shepherd 'Valuation Uncertainty and the Mallinson Report' in *Cutting Edge Conference* (Bristol: Royal Institution of Chartered Surveyors, 1996).

the ubject of other work by the authors. In professional negligence actions not involving property valuations, attention is focused on the method, not the result, and it is difficult to understand why property valuers seem to be treated differently from others. But, as Part 2 demonstrates, the trend in judgments suggests that the concept is alive and kicking in the English courts and will continue to be applied for the foreseeable future.

2. THE LEGAL FRAMEWORK

(i) Professional negligence —setting the standard

In professional negligence cases not involving property valuations, the attention of the court will invariably be focused on the way in which the defendant has carried out the relevant task, rather than on the result which has been achieved. This approach, which has been regarded as appropriate for at least 150 years, is exemplified by the judgment of Lord Denning MR in *Greaves & Co (Contractors) Ltd v Baynham Meikle & Partners*:

> Apply this to the employment of a professional man. The law does not usually imply a warranty that he will achieve the desired result, but only a term that he will use reasonable care and skill. The surgeon does not warrant that he will cure the patient. Nor does the solicitor warrant that he will win the case.[9]

The basic principle stated here is well known. However, it is worth emphasising the additional point that, in general, professional persons are not taken to guarantee even *partial* success in achieving a desired result for the client. Thus, there is no implied guarantee by a surgeon that the patient with a shattered leg will recover 80 per cent mobility; nor by a lawyer that the client will be awarded 75 per cent of the damages claimed; nor by an estate agent that a house will be sold for 90 per cent of the asking price. The point is that such questions are never even asked in the context of a negligence action; the court instead looks at what the professional person actually did and compares this with what (on the basis of evidence from expert witnesses) it believes a reasonably competent member of the relevant profession would have done.

On turning to negligence actions against valuers, it appears at first sight that exactly the same rules apply. In *Banque Bruxelles Lambert SA v Eagle Star Insurance Co Ltd*, Sir Thomas Bingham MR in the English Court of Appeal offered the following description of the duty which is owed by a valuer to a mortgage lender:

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9. [1975] 3 All ER 99, 103-104.

> To take reasonable care to give a reliable and informed opinion on the open market value of the land in question at the date of valuation. In the ordinary way [the valuer] does not warrant that the land would fetch on the open market the value he puts on it, any more than a medical practitioner warrants that he will cure a patient of illness.[10]

A similar line was taken by Orde J, sitting as a deputy judge, in *UCB Home Loans Corp Ltd v Roger North & Associates*:

> It is to be emphasised that valuers accepting a commission do not undertake a standard of care which is higher than is normal and reasonable to others of their calling. Still less is it required of them that they would necessarily hit any target arrived at by a consensus of expert opinion or that they would produce a figure of valuation which comes within range of any sum subsequently realised by a sale when the property is tested in the market, any more than a surgeon who undertakes treatment or surgery guarantees a cure.[11]

This concentration in the valuation context on method rather than result is hardly surprising, given that there appears to be a widely held judicial view that valuation is a subjective process. As Goddard LJ put it in *Baxter v FW Gapp & Co Ltd*:

> Valuation is very much a matter of opinion. We are all liable to make mistakes, and a valuer is certainly not to be found guilty of negligence merely because his valuation turns out to be wrong. He may have taken too optimistic or pessimistic a view of a particular property. One has to bear in mind that, in matters of valuation, matters of opinion must come very largely into account.[12]

In *Singer & Friedlander Ltd*, Watkins J took a similar line:

> 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 any one being justified in saying that either of them has lacked competence and reasonable care, still less integrity, in doing his work.... Valuation is an art, not a science. Pinpoint accuracy in the result is not, therefore, to be expected by he who requests the valuation.[13]

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10. [1995] 2 WLR 607, 618.
11. [1995] EGCS 149.
12. [1938] 4 All ER 457, 459.
13. Supra n 1, 85-86.

In Australian cases, where *Baxter v Gapp* has frequently been approved, the imprecise nature of valuation also appears to have gained acceptance, albeit not quite so overtly as in England. As Gobbo J expressed it in the Supreme Court of Victoria in *Re an Appeal by Derham Brian Leeming, Registered Valuer, from a Decision of the Valuers Qualification Board*:

> It is not an answer to a case of negligence to say that there was an error of judgement, for the craft of the valuer has so much individual judgement involved in it that it would be possible to answer almost any case of negligence by pleading error in judgement. But there may be circumstances where the valuer, having considered what method should be adopted, reached the view on adequate material before him that a particular method should be preferred over another. That might in fact amount to an error in judgement, but it would not ordinarily constitute negligence.[14]

In another unreported decision, *Oakminster Ltd v CW Mansell, Leotta & Associates Pty Ltd*, Giles J in the Supreme Court of New South Wales acknowledged that, in the exercise of valuers' professional analysis of expense items bearing on the choice of capitalisation rate in valuing a hotel, 'minds can differ'.[15]

The views thus expressed are shared by higher courts, at least in England, as evidenced by recent dicta from the Court of Appeal: 'Valuation is not an exact science; it involves questions of judgment on which experts may differ without forfeiting their claim to professional competence'.[16] Similarly: 'Valuation is not a science, it is an art, and the instinctive "feel" for the market of an experienced valuer is not something which can be ignored'.[17]

(ii) The margin of error principle

(a) The basic concept

Notwithstanding the judicial remarks quoted above, the courts in both England and Australia have in recent years come to accept that, in valuation cases, there is or at least may be a link between error and negligence. (As will be seen, however, the two jurisdictions differ in their view as to the *nature* of that link.) Stemming from the courts' treatment of valuation as a matter of opinion has come the idea

14. (Unreported) Vic Sup Ct 17 Dec 1982.
15. (Unreported) NSW Sup Ct 27 Apr 1989 no 28399.
16. *Zubaida v Hargreaves* [1995] 1 EGLR 127, 128.
17. *Craneheath Securities v York Montague Ltd* [1996] 1 EGLR 130, 132.

that the legitimate range of opinion about any particular property is not without limits, and that any valuation which falls beyond those limits will normally have been arrived at negligently. An early example of such reasoning may be seen in a passage from the judgment of du Parcq LJ in the English Court of Appeal in *Baxter v Gapp*:

> Gross overvaluation, unless explained, may be strong evidence either of negligence or of incompetence. I have no doubt that there was in this case gross overvaluation, and one looks to see whether or not there is any explanation of it, and whether or not it can be seen that the defendant has failed to take any steps which he ought to have taken, or to pay regard to matters to which he ought to have paid regard.[18]

For the last 25 years or so, this passage has been routinely cited with apparent agreement by judges in both England and Australia. Moreover, the idea expressed there, that the value placed upon a property may itself be 'strong evidence' of negligence by the valuer, may also be seen in what is usually regarded as the birthplace of the margin of error principle in its modern form. This is the case of *Singer & Friedlander Ltd*, where Watkins J reported the expert witnesses as agreeing that, '[a]ny valuation falling outside what I shall call the "bracket" brings into question the competence of the valuer and the sort of care he gave to the task of valuation'.[19] Later in his judgment, Watkins J returned to this theme:

> There is, as I have said, a permissible margin of error, the 'bracket' as I have called it. What can properly be expected from a competent valuer using reasonable skill and care is that his valuation falls within this bracket.[20]

It should be emphasised that, in *Singer & Friedlander Ltd* at least, the 'margin of error' or 'bracket' theory was not put forward initially by the judge as a proposition of law, but was merely a suggestion as to what could be expected of reasonably competent valuers, offered by expert witnesses who were themselves experienced members of the valuation profession. Examination of the subsequent English cases suggests that, among such expert witnesses, the principle itself is unanimously accepted. There is no recorded instance of an expert witness seeking to deny that the margin of error is a valid indicator for or against negligence on the part of a valuer. Interestingly, however, no expert has ever sought to justify the basic proposition (ie, that all competent valuations will fall within an identifiable range) by reference to any empirical evidence. It remains a matter of pure assertion.

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18. [1939] 2 All ER 752, 758.
19. Supra n 1, 85.
20. Ibid, 86.

(b) Legal status

It is worth pointing out that in *Singer & Friedlander Ltd*, as in the earlier case of *Baxter v Gapp*, it was not suggested that a valuation falling outside the prescribed 'bracket' would *automatically* be regarded as negligent, but merely that it would 'bring into question' the skill and care with which it had been carried out. Moreover, in two English cases which were decided not long after *Singer & Friedlander Ltd*, the judges appeared very reluctant to accept that a finding of negligence can be based merely on the amount of the defendant's valuation, asserting that there should always be evidence as to what exactly the valuer has done which is culpably wrong.[21]

This more limited view of the legal significance of the 'bracket' has, almost without exception, been faithfully followed by the Australian courts, who have insisted on seeking evidence of a valuer's negligence in the method adopted and not merely in the result achieved. A good example of this insistence is provided by the remarks of Gobbo J in *Re an Appeal by DB Leeming*:

> It is, of course, understandable that the gross overvaluation might be used as affording prima facie evidence of negligence. A Valuers Qualification Board may reasonably resort to such overvaluation where a valuer chose not to reveal at all what enquiries, if any, he had undertaken, what sales evidence, if any, he had analysed and what method, if any, he had adopted. But where the valuer in question provides evidence of the steps that he took and that evidence is accepted, as is substantially the case in this hearing, the fact of overvaluation, even a substantial overvaluation, must inevitably diminish in weight.... It needs to be noted that the enquiry postulated by the Valuation of Land Act [1978] is whether or not the valuer has been guilty of negligence or incompetence in the making of any valuation. The enquiry is not whether the figure returned was such as to amount to negligence or incompetence. This serves to emphasise that the only use that can be made of the ultimate figure is as providing evidence that there had been negligence in the making of the valuation or that the valuation must have proceeded upon some basic error.[22]

A similar line is evident in what is generally regarded as the leading Australian authority in this area, *Trade Credits Ltd v Baillieu Knight Frank (NSW) Pty Ltd*.[23] The defendants there had valued property for mortgage purposes in 1981 at $850 000. When the lenders brought an action alleging negligence, the valuations

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21. *Corisand Investments Ltd v Druce & Co* [1978] 2 EGLR 86; *Belvedere Motors Ltd v King* [1981] 2 EGLR 131.
22. Supra n 14.
23. (1985) Aust Torts Reports ¶ 80-757.

put forward by the plaintiffs' expert witnesses ranged from $550 000 to $600 000, while the defendants' expert witness valued the property at $650 000. Clarke J, having quoted from *Baxter v Gapp*, decided that the defendants' valuation, which was 22 per cent higher than that provided by their own expert, could legitimately be described as 'a gross overvaluation'. In spite of this, however, the judge insisted on seeking the basis for a finding of negligence in the way in which the defendants had carried out their valuation (in particular their reliance on two inappropriate comparables).

In the light of these and other authorities, the Australian legal position has been summarised by Joyce and Norris[24] as follows: a court faced by an apparent overvaluation should not immediately conclude that the valuer has been negligent, but should look behind the figure in order to see how it was arrived at. Only if this enquiry reveals no explanation for the overvaluation, for example because the valuer does not provide any evidence as to the methodology or calculations, is the court entitled, though not bound, to infer negligence.

The position adopted by the courts in these Australian cases is in stark contrast to that of their English counterparts. An examination of the recent English case law reveals that, while a few judges continue to insist on examining the valuer's methods and calculations for evidence of negligence,[25] most appear to accept the basic idea of a 'range of valuations which a competent valuer might reasonably have reached'.[26] Once that concept is accepted as valid, the obvious implication is that a valuation which falls outside the range cannot have been reached by a competent valuer; in short, there has been negligence.

This majority approach may be exemplified by quotations from the judgments in two recent cases in the Queen's Bench Division of the High Court. The first is *Legal & General Mortgage Services Ltd v HPC Professional Services*, in which counsel for the defendant valuers argued that negligence could only be established by showing both that a valuation lay outside the permitted bracket and that it had been negligently arrived at. To this, the deputy judge responded:

> I do not accept that, where the figure under attack has been shown to be outside the acceptable bracket [the wrong result] a plaintiff has the additional burden of showing why the valuer reached that result [the wrong method].[27]

24. LT Joyce & KP Norris *Valuers Liability* 2nd edn (Canberra: Aust Institute of Valuers and Land Economists, 1994).
25. Eg *Craneheath Securities Ltd v York Montague Ltd* supra n 17, Jacob J; *United Bank of Kuwait v Prudential Property Services Ltd* [1994] 2 EGLR 100, Gage J.
26. This quotation from the Court of Appeal is typical: see *Nykredit Mortgage Bank Plc v Edward Erdman Group Ltd* [1996] 1 EGLR 119. See now [1998] 1 All ER 305 (HL).
27. (Unreported) QBD (Eng) 20 Feb 1997.

The second case, *Lewisham Investment Partnership Ltd v Morgan*,[28] arose out of a rent review in which the market rent fell to be determined by an independent expert. Having made his determination, the expert was sued for negligence by the landlords, who alleged that the rent fixed was unreasonably low as a result of various negligent errors by the expert. Having referred to previous English authorities on the margin of error approach, Neuberger J said:

> I consider that the appropriate course for the court to take in this case is to consider first whether any of the specific allegations of negligence are made out. However, my conclusions on the specific allegations will not necessarily be the end of the inquiry.... Even if the defendant was not negligent in respect of any of the specific allegations, the plaintiffs could still succeed on the basis that his overall figure was outside the permissible bracket.[29]

As to the current *status* of the margin of error principle, some judges are careful to emphasise that they are merely reflecting the evidence put forward by expert witnesses or that the principle is 'common ground between the parties'. However, a number of other judges, especially in recent cases, appear to have abandoned this stance in favour of treating the proposition as one of law. For example, in *Abbey National Mortgage Plc v McCormick & Merrifield*, the deputy judge stated categorically that 'it is clear from the authorities that an error of 25 per cent either way would constitute negligence and breach of duty in the ordinary course of events'.[30]

As noted earlier, the Australian courts have remained almost wholly true to the original margin of error principle, by which a large error could be regarded as providing some evidence that the valuer had been negligent. Just occasionally, however, one finds an Australian judge letting fall a remark which echoes the more extreme position taken in England. In *Duncan & Weller Pty Ltd v Mendelson*, for example, Kaye J, on appeal, explained why the trial judge had found the defendant negligent in estimating what it would cost to complete a building in the course of construction:

> His negligence was found by the learned judge to have been in making an estimate of the completion cost which was so disproportionate to the real cost of completion as to lead to the conclusion that he did not exercise the required degree of care.[31]

Similarly, in *Oakminster Ltd v CW Mansell, Leotta & Associates Pty Ltd*, Giles J noted the discrepancy between the capitalisation rate adopted by the

28. [1997] 2 EGLR 150.
29. Ibid.
30. (Unreported) QBD (Eng) 15 Feb 1996.
31. [1989] VR 386, 390.

defendant and that put forward by the expert witnesses (including the defendant's), but concluded that: 'I would not be prepared to find that the capitalisation rate of 22 per cent was one which lay outside the area of the prudent valuer's judgement'.[32]

The strongest Australian echoes of the English position are perhaps those found in the judgment of Lindgren J in *MGICA (1992) Ltd v Kenny & Good Pty Ltd*. His Honour, having expressly agreed that valuation is a 'very inexact science' and the impression which a particular property makes on individuals is a highly subjective matter, continued:

> On the other hand, it is not in issue that the property had a market value; that it is part of the expertise of the valuer of real estate to arrive at an opinion as to the amount of that market value; that although different valuers exercising due care and skill cannot be expected to arrive at the same figure, there is a range outside which the opinions of valuers so conducting themselves will not extend.[33]

We would not suggest, on the basis of such slender evidence, that the Australian courts are on the verge of surrendering to the English version of the margin of error. The point is rather that phrases such as 'a range outside which the opinions of valuers ... will not extend' sound very like their English equivalent: 'a range of valuations which a competent valuer might reasonably have reached'.[34] And such a concept, as shown above, can lead all too easily to the conclusion that a finding of negligence requires nothing more than proof that the defendant's valuation fell outside that range.

(c) Other effects and implications

For the purpose of this paper, the most significant application of the margin of error principle in litigation is in providing evidence of negligence on the part of a valuer. However, there is also some authority in the English case law for the converse proposition, namely, that where a valuer's final figure falls within whatever bracket has been deemed appropriate, proof of errors in the supporting calculations will not be enough to enable a plaintiff to succeed in an action for negligence. The first clear expression of this view is to be found in the case of *Mount Banking Corp Ltd v Brian Cooper & Co*, where the deputy judge said:

> If the valuation that has been reached cannot be impeached as a total, then, however erroneous the method or its application by which the valuation has been reached, no loss has been sustained because ... it was a proper valuation.[35]

32. Supra n 15, 51.
33. (1996) 140 ALR 313, 335.
34. Ibid.
35. [1992] 2 EGLR 142, 145.

It is clear from the context in which these remarks were made that the deputy judge in *Mount Banking* would have regarded any valuation within the bracket as 'unimpeachable' — and this is certainly the way in which his statement has been interpreted in at least two later cases. The first of these was *Legal & General Mortgage Services Ltd v HPC Professional Services*,[36] where the plaintiff lenders sought to argue that a valuer's negligence could be established from evidence of errors in methodology or calculation, even where the final figure lay within the appropriate bracket. However, this line of argument was specifically rejected by the deputy judge.

The second case, and currently the most recent pronouncement on this subject, was *Lewisham Investment Partnership Ltd v Morgan*, where Neuberger J stated:

> If I were to conclude that the defendant was negligent in respect of one or more of the specific allegations, it would still be necessary to consider whether his valuation fell within the permissible bracket because, if it did, then the defendant would still escape liability.[37]

In taking this line, Neuberger J relied on the fact that, in *Craneheath Securities Ltd v York Montague Ltd*,[38] an earlier decision of the Court of Appeal, Balcombe LJ described the *Mount Banking* proposition as 'self-evident'. However, closer examination reveals that Balcombe LJ's remarks were applied, not to every valuation within the bracket, but only to those which were 'correct'. Similarly, in *South Australia Asset Management Corp v York Montague Ltd*, Lord Hoffmann said:

> The valuer would not, in my view, have incurred any liability if one or more of his comments had been wrong but (perhaps on account of a compensating error) the valuation was correct.[39]

It is suggested that, while a valuer cannot be held liable for a negligently produced valuation which fortuitously turns out to be 'correct' (if only because the negligence will have caused the client no loss), it would be quite wrong to attach a similar immunity to valuations which merely fall within the bracket. According to Lord Hoffmann, in delivering the judgment of the Privy Council in *Lion Nathan Ltd v CC Bottlers*,[40] a court should normally assume (on the basis of probabilities) that the true value of a property lies at the mean of the range of values which are regarded as acceptable. Thus, if the defendant negligently produces a valuation

36. Supra n 27.
37. Supra n 28.
38. Supra n 17.
39. [1996] 3 All ER 365, 381.
40. [1996] 1 WLR 1438, on appeal from the Court of Appeal (NZ).

which deviates from that mean, albeit by a relatively small amount, the plaintiff can legitimately claim to have suffered as a result of the negligence.

One further use which has been made of the 'bracket' is worth mentioning. Where a claim is brought against a valuer by a mortgage lender, it is sometimes necessary for the court to decide whether, had it not been for the negligent overvaluation of the property, there would have been a smaller loan or no loan at all. (This is sometimes expressed as the difference between a 'transaction' and a 'no transaction' case.) In reaching a decision on this issue, the courts in a number of cases have asked the hypothetical question of what would have happened, not if the lender had received a 'correct' valuation, but rather if it had received the highest valuation which would be consistent with the exercise of reasonable skill and care (ie, the top of the bracket). This approach received support from Staughton LJ in the Court of Appeal in *Nykredit Mortgage Bank Plc v Edward Erdman Group Ltd.*[41] It was also explicitly adopted in *Nyckeln Finance Co Ltd v Stumpbrook Continuation Ltd*[42] and *Mortgage Funding Corp Plc v Conway.*[43]

It is suggested that the apparent logic of this approach is seriously undermined by the insistence of judges in other cases that, once it has been decided that the case in question is a 'transaction' case (ie, one where a mortgage loan *would* have taken place, albeit at a lower level), the lender's damages should reflect the difference between what has been lent and lost on the basis of the negligent overvaluation and what would have been lent and lost on the basis of a *correct* valuation. This formulation was explicitly preferred to the alternative (ie, what would have been lent and lost on the basis of the *highest non-negligent* valuation) by Gage J in *United Bank of Kuwait v Prudential Property Services Ltd*[44] and, more significantly, by Lord Hoffmann in *South Australia Asset Management Corp v York Montague Ltd.* In the latter case, the following appeal to probability was offered in justification:

> But once the valuer has been found to have been negligent, the loss for which he is responsible is that which has been caused by the valuation being wrong. For this purpose the court must form a view as to what a correct valuation would have been. This means the figure which it considers most likely that a reasonable valuer, using the information available at the relevant date, would have put forward as the amount which the property was most likely to fetch if sold upon the open market. While it is true that there would have been a range of figures which the reasonable valuer might have put forward, the figure most likely to have been put forward would have been the mean figure of that range. There is no basis for calculating damages

41. Supra n 26.
42. [1994] 2 EGLR 143.
43. [1995] EGCS 47.
44. Supra n 25.

upon the basis that it would have been a figure at one or other extreme of the range. Either of these would have been less likely than the mean.[45]

(d) Operation of the principle

In order to apply what has become known as the 'margin of error' or 'bracket' approach to a case of alleged negligent valuation, a court must first reach a decision as to the range of values which reasonably skillful and careful valuers could have ascribed to the particular property on the date in question. In some cases a range is all that is decided; more often, however, the court will rule on both the 'true value' of the property and the 'bracket' around that value within which all competent valuations should fall.

Where a court *does* seek to identify 'true value', the question which arises is how this should be done. The case law returns no clear answer to this question, although a remark of Watkins J in *Singer & Friedlander Ltd* may be of some assistance. The judge there referred to 'a figure which can be said to be the right figure; that is, so I am informed, not a figure which later, with hindsight, proves to be right but which at the time of valuation is the figure which a competent, careful and experienced valuer arrives at after making all the necessary inquiries and paying proper regard to the then state of the market'.[46] Such a figure is of course hypothetical, and it is thus inevitable that the court will be heavily influenced by the evidence as to value which is provided by the parties' expert witnesses, who are of course subject to cross-examination.

Expert evidence in these cases will normally consist of an opinion as to the validity or otherwise of the defendant's valuation (including, for example, a detailed scrutiny of the method adopted and of any comparables used by the defendant), a retrospective valuation of the property by the expert and a suggestion as to range of values which might legitimately (and competently) have been attributed to that property on the relevant date. According to Lord Hoffmann in *South Australia Asset Management Corp v York Montague Ltd*[47] this last factor may be of considerable importance since, as noted below, his lordship regarded a property's 'true value' as the mean of the range of figures which competent valuers could have ascribed to it on the date in question. Examination of the case law reveals, not surprisingly, that judges sometimes reach a finding as to the true value of the property in question which agrees entirely with the opinion expressed by one of the

45. Supra n 39.
46. Supra p 157.
47. Supra n 39.

expert witnesses. On other occasions, the judge's ruling may fall somewhere between the figures which the opposing expert witnesses have proposed.

A valuer might feel instinctive surprise that, when a court is looking for 'true value', little or no account is taken of subsequent transactions involving the property, but it is important to remember that most professional negligence claims against a valuer consist of an allegation that a transaction (usually a purchase or a loan) has been entered into on the basis of a negligently incorrect valuation. There would therefore be no point in looking to *that* transaction for evidence of the property's true value — the plaintiff's whole complaint is that it should have been very different. It follows that studies of valuation *accuracy* (which compare valuations with subsequent prices achieved) are not of direct relevance when deciding, for instance, the size of the bracket which may reasonably be adopted in any given case. The extent to which such studies may nevertheless provide *indirect* assistance is considered in Part 3 below.

It is perhaps more surprising that, in cases involving mortgage lenders, the courts very rarely seek to identify the true value of the property at the date of the defendant's valuation by working backwards from the price at which the property is finally sold after it has been repossessed from a borrower in default. While in theory such a calculation should be possible, it appears to be regarded by judges as too uncertain to provide any worthwhile evidence.

Whether or not a court feels it necessary to decide on the true value of the subject property, it must rule on the size of 'bracket' which is appropriate in the particular case. The traditional starting point on this issue is *Singer & Friedlander Ltd,* where (as noted above)[48] Watkins J said:

> The permissible margin of error is said ... to be generally 10 per cent either side of a figure which can be said to be the right figure.... In exceptional circumstances the permissible margin ... could be extended to about 15 per cent, or a little more, either way.

In that case, which concerned the valuation of a large rural site intended for residential development, the judge was not in fact called upon to decide whether the circumstances were 'exceptional'. However, it is noticeable that, in subsequent English cases involving commercial property, a bracket of more than 10 per cent has usually been adopted (and has indeed frequently been agreed by the parties' expert witnesses). This is found especially in cases concerning residual valuations, since it appears that the courts are well aware of the sensitivity of these to relatively minor changes in the underlying assumptions. The Court of Appeal in *Nykredit*

48. Supra p 157.

Mortgage Bank Plc v Edward Erdman Group Ltd noted that, when two example valuations before the court were compared, they showed that a difference in gross development value of 17 per cent, with almost identical costs and profits, led to a difference in residual land value of 114 per cent. Even more striking, the court in that case was shown the details of five different residual valuations of the same site (which had been carried out by leading firms) and found that, by taking the highest and the lowest figure from the five for each element in the valuation, one could arrive at residual site values of either £4 734 422 or £65 666. The reaction of Staughton LJ was: 'Which, as Euclid would say, is absurd!'[49]

Examples of the higher 'brackets' adopted in commercial property cases include *Corisand v Druce & Co,*[50] where the plaintiff agreed that 15 per cent was appropriate on the valuation of a hotel; *Mount Banking Corp Ltd v Brian Cooper & Co,*[51] where the plaintiff accepted 17.5 per cent on a residual valuation; and *Private Bank & Trust Co Ltd v S (UK) Ltd,*[52] where the parties agreed that the valuer was entitled to a bracket of 15 per cent around a residual valuation, carried out in a falling market, which was itself expressed as a range (between £1.35 million and £1.45 million). On the other hand, it may be noted that the trial judge in *Nykredit Mortgage Bank Plc*[53] refused to allow a margin of more than 15 per cent on what was clearly a very difficult residual valuation, describing the plea of the defendants' expert witness for a bracket of some 18.7 per cent as too generous. Moreover, in *Nyckeln Finance Co Ltd v Stumpbrook Continuation Ltd*[54] (which concerned an equally difficult residual valuation), the expert witnesses agreed that the appropriate bracket was a mere 10 per cent.

In relation to residential property, both judges and expert witnesses are sometimes minded to allow a somewhat smaller margin of error, notwithstanding the view expressed by Staughton LJ in *Beaumont v Humberts*[55] that 10 per cent seems a high standard to impose. In *BNP Mortgages Ltd v Barton Cook & Sams,*[56] for example, the expert witnesses agreed that on a standard estate house the acceptable margin might be no more than five per cent, and a bracket of roughly this size was actually applied by the judge in *Axa Equity & Law Home Loans Ltd*

49. Supra n 26.
50. Supra n 21.
51. Supra n 35.
52. [1993] 1 EGLR 144.
53. Supra n 26.
54. Supra n 42.
55. [1990] 2 EGLR 166.
56. [1996] 1 EGLR 239.

v Goldsack & Freeman,[57] despite his acknowledgement that this was a case where the valuer would not have had access to any true comparables. In normal circumstances, however, it appears that a 10 per cent margin of error will be fairly readily accepted, rising towards 15 per cent if the type of property or the state of the market is such as to present the valuer with a particularly difficult challenge. In the recent case of *Legal & General Mortgage Services Ltd v HPC Professional Services*,[58] where the defendant had valued an unusual house at £400 000, the plaintiff's expert witness was prepared to accept a bracket from £200 000 to £300 000 (equivalent to 20 per cent). The judge, however, was convinced by the defendant's expert that the true value of the property was £350 000 and that the defendant's valuation therefore fell within the slightly more modest bracket which he proposed (from £300 000 to £400 000, equating to 14.3 per cent).

For all this apparent flexibility in selecting an appropriate bracket for a particular valuation, one fact stands out: no English judge has adopted a margin of error greater than 15 per cent in the absence of an explicit concession by the plaintiff that a larger figure was appropriate. In *UCB Bank Plc v David Pinder Plc*,[59] a deputy judge applied a 20 per cent bracket to a freehold restaurant property situated in an area where freehold properties were very rare. However, it is not clear from the reports so far available whether this figure was chosen with the agreement of the parties.

The question of what margin of error is appropriate in any given situation, which has become a routine part of English litigation between lenders and valuers, features much less prominently in Australian cases. Nor is this surprising, in view of the more limited effect which is given to the 'bracket' by the Australian courts. Nevertheless, the law reports reveal occasional discussion of this issue by the parties' expert witnesses. In the leading case of *Trade Credits Ltd v Baillieu Knight Frank (NSW) Pty Ltd*, for example, Clarke J pointed out that '[n]one of the valuers regarded a figure of 22 per cent [the difference between the defendants' valuation and that provided by their own expert witness] as representing a permissible margin of error'.[60] The judge recorded that the expert witnesses had put forward acceptable margins of error ranging from five per cent to 15 per cent and noted that 'those who opted for higher margins paid particular regard to the difficulty of valuing the subject property which was thought to be quite unique'.[61] More recently, in

57. [1994] 1 EGLR 175.
58. Supra n 27.
59. [1997] EGCS 179.
60. Supra n 23, 69 529.
61. Ibid.

Flemington Properties Pty Ltd v Raine & Horne Commercial Pty Ltd,[62] the judge cited expert evidence to the effect that, while ordinarily valuers might be expected to reach values about 10 per cent above or below an approximate median value, a larger variation might be expected in respect of the property with which the case itself was concerned. This was because of the size of the land, its zoning and use and the fact that the market was flat and there was limited sales evidence.

3. THE VALUATION PROCESS AND VALUATION VARIATION

Part 2 of this paper raised a number of questions concerning the application of the margin of error in practice. If valuers are to be judged by the result of their valuations, all parties involved in the action need to be aware of the nature of the question being asked of the valuer and the limitations of that result. The question being asked relates to the basis of valuation and the limitations of the result relate to the ability of the valuer to assess accurately the value in accordance with the basis.

(i) Basis of valuation

Almost without exception, the correct basis of valuation for the normal purposes of financial statements, sale, acquisition and loan is market value, which is an identification of exchange price in the market place as at the date of valuation. Despite the current different wording of definitions of 'market value' in different countries, there is increasing convergence towards an international definition and no dispute regarding the nature of the concept.

Theoretically, the correct test for the true value of the property should be the sale price in the market place. However, valuations carried out in accordance with the current international 'market value' definition are subject to two major problems of comparability with sale prices.

First, market value is a single snapshot in time of the exchange price value of a commodity which takes time to transact. A valuation which is not influenced by a subsequent sale price needs to be carried out at least three months and probably more before completion, as the price has to be agreed well in advance of completion to enable the legal process to operate. But, as the valuation is only relevant to the day on which it was undertaken and is an attempt to isolate the 'best price' in the

62. (1997) 148 ALR 271.

market place on the date of the valuation, theoretically it has no shelf-life.

Secondly, it has been claimed that market value is an unrealisable number.[63] This is due to the assumption which states that the property transaction has just been completed on the valuation date but that the property was placed on a market which was in the same state as on the valuation date. This is artificial, as a property being completed on the valuation date would most likely have been placed on a market in a different state. It may also lead to a valuation which lags the current market by the period between the sale being agreed and completion (although the definition is intended to be a current price).

For the reasons of both time delay and the unrealisable nature of a market valuation conducted correctly within the definition, it would be difficult to judge the correct figure even if a sale had taken place at the precise time of the negligent valuation. If a sale had taken place at the time of the valuation it would have influenced the valuation. In a recent study of residential valuations in the UK,[64] Gronow concludes that the prospective sale price should be withheld from valuers due to its influence on loan valuations. In the case of negligent valuations, the use of a sale price at the same time as a valuation to indicate the correct value is even less attractive, as part of the claim may be that the transaction took place precisely because of the allegedly incorrect valuation.[65] Valuations are an integral part of the operation of the market and, as such, may affect the market and prices within it.

A third more practical reason is that the problems noted above relate to a sale taking place at or around the same time as the valuation. In individual cases, the valuation and any former or subsequent sale may be years apart or a sale may not yet have taken place.

Despite the problems with using sale prices as evidence of value in individual cases, there have been a number of studies of valuation accuracy. There are also, albeit fewer, studies of valuation variation. The next section briefly describes the results of these studies and discusses whether they provide any useful data to the courts when assessing true values and margins of error.

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63. N Crosby, N French & CWR Ward 'Valuation Accuracy: A Self-fulfilling Prophecy?' *Cutting Edge Conference* (London: Royal Institution of Chartered Surveyors, 1994).
64. SA Gronow, JA Ware, DH Jenkins, OM Lewis & NI Almond *A Comparative Study of Residential Valuation Techniques and the Development of a House Value Model and Estimation System* (Pontypridd: Glamorgan University, 1997). Subsequent debate on this paper involving both academics and practitioners indicates widespread disapproval of this suggestion as misunderstanding the nature of a loan valuation. That debate is outside the scope of the present paper.
65. See supra pp 167-169.

(ii) Accuracy and variation in valuations

(a) Accuracy — valuations against prices

There have been a number of empirical studies which have examined data sets to determine the accuracy of valuations compared to sale prices. In the UK[66] these include Brown,[67] Drivers Jonas[68] with regular updates, Matysiak and Wang,[69] MacAllister,[70] Brown, Matysiak and Shepherd,[71] and Blundell and Ward.[72]

Other contributions to the debate include Lizieri and Venmore-Rowland[73] (who question some of the statistical methodology and analysis in Brown), Drivers Jonas, and Crosby, French and Ward (who question the independence of valuations and sale prices due to the property valuation process).

The empirical studies are not particularly helpful for the issue examined in this paper. Because of the nature of the process described above, all of the accuracy studies need to identify valuations which are independent of the sale price; that is, where the prospective sale price is not known at the date of valuation. Because of this, the sale and the valuation are not in the same time frame. In the Drivers Jonas study, the valuations were carried out at least four months and on average 9.7 months before the sale date. In the studies carried out by both Matysiak and Wang and Blundell and Ward, the valuations were carried out between three and six months prior to the sale date.

Comparing the raw data of sale prices and valuations, Drivers Jonas found that the number of valuations which fell within +/- 10 per cent of the sale price was 30 per cent. The number of valuations falling within +/- 20 per cent was 67 per cent. Thus 33 per cent or one-third of valuations fell outside the 20 per cent bracket. These figures hide a distinctive trend. Since 1992, the proportion of

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66. At the time of preparing this paper, no studies of valuation accuracy or variation had been undertaken in Australia. However, at the same conference as this paper was presented, two papers based on Australian data were also presented. These are discussed by the authors in an as yet unpublished paper which will appear in the Land Economics Review.
67. G Brown 'Property Investment and Performance Measurement: A Reply' (1985) 4 Journal of Valuation 33-44.
68. Drivers Jonas *The Variance in Valuations* (London: Investment Property Databank, 1988).
69. G Matysiak & P Wang 'Commercial Property Market Prices and Valuations: Analysing the Correspondence (1995) 12 Journal of Property Research 181-202.
70. P MacAllister 'Valuation Accuracy: A Contribution to the Debate (1995) 12 Journal of Property Research 203-216.
71. Brown et al, supra n 8.
72. GF Blundell & CWR Ward 'The Accuracy of Valuations: Expectation and Reality' (unpublished, 1997) Journal of Property Research.
73. C Lizieri & P Venmore-Rowland 'Valuation Accuracy: A Contribution to the Debate (1991) 8 Journal of Property Research 115-122.

valuations within 20 per cent of the sale price has increased to 80 per cent.[74] Between 1982 and 1991 the number of valuations within +/- 20 per cent averaged only 63 per cent.

As expected in the rising market of 1988 and 1989, Drivers Jonas found that the number of valuations within 20 per cent of the sale price reduced considerably: only 56 per cent in 1988 and 52 per cent in 1989.

Matysiak and Wang, using a database of 317 sales between 1973 and 1991 from the JLW Property Performance Analysis System, concluded that the probability of achieving a valuation within +/- 10 per cent of the sale price was only 30 per cent; between +/- 15 per cent was 55 per cent; and between +/- 20 per cent only 70 per cent.

Blundell and Ward used the same database but had access to transactions on 747 properties over the period 1974 to 1990. The valuation to sale time lag was also between three and six months. The sale price was on average seven per cent higher than the valuation, but the standard deviation was over 18 per cent. Around 20 per cent of the valuations were more than 20 per cent different from the sale price; four per cent more than 20 per cent higher than the sale price; and 16 per cent were more than 20 per cent less than the sale price. This figure of around 20 per cent matches the estimate of Matysiak and Wang. Only 35 per cent of the valuations were within 10 per cent of the sale price.

The number of valuations outside any percentage +/- parameters from the sale price is a function of valuation inaccuracy and time. It is possible to adjust for the problems of time delay by taking into account market movements over time. Despite the problem with the different market movements of individual locations relative to the whole, some clues to valuation inaccuracy remain. Blundell and Ward adjust their data for these time problems and predict that valuation bias exists at about three per cent (valuations lower than prices) and also suggest variation at the +/- 10 per cent and +/-20 per cent brackets. They suggest that around 15 per cent of valuations will be outside 20 per cent either side of the mean and nearly 45 per cent will be outside the 10 per cent bracket. But adjusting for time raises significant problems of individual locations experiencing value change at differing rates than for the average of the portfolio and this will not be offset by any portfolio effect.

Due to the difficulties of comparing valuations and prices described above, the courts in England have tended to adopt evidence of value from expert witnesses as the approach to identifying true value, rather than use evidence of subsequent sale prices. Preliminary analysis of decisions in the Australian courts suggests a similar pattern.

74. This is also true of the 1996 transactions.

Table 5: Size of bracket suggested by experts and applied by English courts

	Frequency of opinion/decision		
Size of bracket	**Plaintiff bracket**	**Defendant bracket**	**Decisions**
Bracket < 10%	4 (21.1%)	3 (20.0%)	0 (0.0%)
Bracket 10%	7 (36.8%)	2 (13.3%)	7 (50.0%)
Bracket 10 - 14.99%	5 (26.3%)	3 (20.0%)	2 (14.3%)
Bracket 15%	1 (5.3%)	5 (33.3%)	3 (21.4%)
Bracket 15 - 19.99%	2 (10.5%)	2 (13.3%)	1 (7.1%)

In the last 20 years there have been more than 30 cases in the High Court in England in which the margin of error has been an issue. Detailed analysis of these cases, with a view to identifying the role of expert valuation witnesses in the judicial process, is the subject of a forthcoming paper by the current authors. However, the examination so far carried out (and illustrated in Table 5) reveals that, often on the advice of expert witnesses, the bracket applied by the courts has ranged from a minimum of five per cent to a maximum of 17.5 per cent. In the majority of cases in which the judge has ruled on the extent of the bracket, the result lies between 10 per cent and 15 per cent either side of what is found to be the 'true value' (or either side of the midway point in cases where no decision was reached as to the true value). Moreover, while individual experts may occasionally demand (or concede) a wider bracket, there is no recorded instance of anyone favouring a figure in excess of 20 per cent. It appears therefore that, to date, 20 per cent has been universally regarded as the absolute limit.

These figures provide an intriguing background against which to consider the actual performance of those expert witnesses in the very cases in which they gave evidence. Since the role of an expert witness is to inform the court and not to act as advocate for the plaintiff or the defendant,[83] it might be expected that they would always provide an objective valuation falling within whatever bracket around the true value is regarded as appropriate in the particular case. On the other hand, given the acknowledged room for a divergence of opinion as to values and the source of their instructions (and fees), it might be realistic to assume that the

83. WH Rees 'The Resolution of Valuation Disputes: The Position of the Expert Witness' (1994) 12 Journal of Property Valuation & Investment 9-20.

expert witnesses' valuations would fall at the extreme ends of this acceptable bracket. Either way, any expert witness who put forward a valuation outside the acceptable bracket would surely call into question their competence as a valuer and their ability to pronounce on the acceptable variation allowed for by their colleagues.

Thirty-two cases were examined for the valuations put forward to the court by the 64 experts involved. The results are set out in Table 6. The conclusions to be drawn from these figures are startling. Even assuming that the true value lies midway between the two expert witness valuations in any given case (on the basis that they will be as far from the mean as possible), the average bracket necessary to accommodate their valuations is nearly +/- 25 per cent, with more than 30 per cent of experts differing by over +/- 25 per cent. Of course, if one of those valuations is closer than the other to the true value, then the error of the latter assumes even greater proportions. Moreover, if the opposing valuations are *not* assumed to lie at opposite extremes (but, say, in the centre of their respective ranges), then the overall bracket doubles in size.

Table 6: Comparison of expert witnesses valuations in English cases involving margin of error [84]

Analysis	Result
Average bracket needed to accommodate expert witnesses	23.22%
Standard deviation of average bracket	12.06%
Maximum bracket	68.29%
Minimum bracket	3.70%
Average bracket residual valuations	28.09%
Average bracket residential valuations	16.67%
Frequency bracket +/- 0-4.99%	3%
Frequency bracket +/- 5-9.99%	6%
Frequency bracket +/- 10-14.99%	16%
Frequency bracket +/- 15-19.99%	25%
Frequency bracket +/- 20-24.99%	19%
Frequency bracket more than +/- 25%	31%

84. This analysis of cases is by the authors.

Table 7: Difference between expert witnesses in Australian cases

Case / Court	Plaintiff expert's valuation $	Defendant expert's valuation $	Difference between experts	Comment
Cash Resources Aust Pty Ltd v Ken Gaetjens Real Estate Pty Ltd[85] (Supreme Court, SA)	1 600 000	2 000 000	11.11%	The trial judge held that a difference of $2.2m from $2m was substantial.
Flemington Properties Pty Ltd v Raine & Horne Commercial[86] (Federal Court, NSW)	9 900 000	12 265 700	10.67%	
MGICA (1992) Ltd v Kenny & Good Pty Ltd[87] (Federal Court, NSW)	3 900 000	4 500 000	7.14%	The trial judge decided on $4m. The plaintiff's experts said no more than $4.5m.
Average difference			**9.64%**	

What is clear is that valuers appearing as opposing expert witnesses routinely agree between themselves as to the size of bracket which would be appropriate, in the full knowledge that this bracket is far too small to accommodate both of their valuations, with the implication that one or both of them is guilty of negligence.

The research team has also undertaken desk-based research into the Australian cases using Lexis. While not suggesting that it is even remotely comparable to the comprehensive nature of the case identification process undertaken in the UK, these cases do give some indication of the performance of expert witnesses in Australian cases. The number of cases found is far smaller than in the UK using the same search basis. From over 80 transcripts, only three cases could be found where full details of property valuations by expert witnesses for both sides were provided.

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85. (1994) Aust Torts Reports ¶ 81-276.
86. Supra n 62.
87. Supra n 33.

In none of the three cases identified above does the difference between expert witnesses approach the average difference for the UK experts and the average difference is less than half that of their UK counterparts.

The application of the margin of error (or bracket) in Australian cases is discussed more fully in the next section but the cases do reveal some information. In *MGICA (1992) Ltd v Kenny & Good Pty Ltd*[88] the plaintiff's expert witness implied a bracket of 15.4 per cent, which tended to confirm the bracket of 15 per cent suggested by the defendant's expert. The 7.14 per cent difference between the experts' valuations was comfortably within these tolerances. The judge, perhaps influenced by the similarity of the expert valuations in this case, decided that the value lay between $3.8 million and $4.2 million, a bracket of only five per cent. In *Challenge Bank Ltd v VL Cooper & Associates Pty Ltd,*[89] the plaintiff's expert implied a bracket of 17.07 per cent.

5. AUSTRALIAN AND ENGLISH PRACTICES: A COMPARISON

As emphasised earlier, the analysis of the Australian case law is of a preliminary nature. Nevertheless, if the cases examined are typical, they reveal a number of important differences in both law and practice between Australia and England.

As far as the law is concerned, there is some authority in England for the view that, where a valuation is found to lie outside whatever bracket has been held appropriate, a finding of negligence will automatically follow. In Australia, by contrast, a finding that a valuation is outside the bracket is only a first step to determining that it was negligent. In Part 2 of this paper it was concluded that the approach adopted by the valuer would also have to be investigated and found wanting.

In relation to practice, there appears to be a difference in the number of expert witnesses called by the parties. In England, it is normal for each party to call one such witness. In the Australian cases examined, it would appear to be routine to call more than one witness.

These different legal interpretations and practical applications may combine to explain in part the very different performance of the expert witnesses in the two countries. In England, although it is clearly the legal duty of the expert to inform the court rather than to act as advocate for the client, the fact that the question whether a valuation falls inside or outside the bracket may finally determine the

88. Supra n 33.
89. [1996] 1 VR 220.

case puts considerable pressure on the expert to persuade the court towards his or her point of view. In Australia, by contrast, the bracket is less significant to the outcome of the case, so the pressure to ensure that the defendant's expert valuation places the defendant's valuation inside the bracket (and vice versa) is also less. The fact that a number of expert valuations are prepared for each side may also lead to each expert being more objective, knowing that the parties' advocates may try to use valuation discrepancies to discredit an individual expert's opinion.

The use of multiple experts in Australia may also have a more subtle impact on the way in which a court arrives at both the true value of the property in question and also the appropriate bracket. In England, judges use the two expert valuations to determine the true value of the property and the testimony of expert witnesses to determine the bracket. The problem then becomes the variation of the defendant's valuation from the true value, which is similar to the two valuation problem discussed in Part 3. In Australia, the use of multiple expert witnesses appears to lead to a situation whereby the judge starts to create a picture of the range of values that a set of competent valuers could come to. In *Challenge Bank Ltd v VL Cooper & Associates Pty Ltd*,[90] for example, the judge accepted the view of the plaintiff's valuers that the value was between $170 000 and $240 000. As the defendant's valuation was outside this bracket at $310 000, the judgment was that the plaintiff had established a breach of the duty of care. In *Flemington Properties Pty Ltd v Raine & Horne Commercial Pty Ltd,* Lehane J decided that the defendant, who had approached the valuation in the correct manner, was not negligent even though his valuation was 'greater than the "worst case assessed", on any basis, by any of the valuers who gave evidence'.[91] This valuation was 10 per cent greater than the next highest valuation. However, in the case of *Cash Resources Australia Pty Ltd v Ken Gaetjens Real Estate Pty Ltd,*[92] Bollen J decided that a valuation 10 per cent above that of the highest expert valuation was a substantial difference, despite the claim of that particular expert witness (instructed by the defendant) that it was not a very great difference. It would appear that there may be some leeway for defendants to stray outside the full range of expert witness valuations on the grounds set out by Lehane J in *Flemington Properties Pty Ltd*:

> It is true, of course, that if several valuers valuing the same property on the same basis at the same date produce different assessments, it does not follow that only one is right, that any of them is wrong or that any of the valuers was negligent.[93]

90. Ibid.
91. Supra n 62, 290.
92. Supra n 85.
93. Supra n 62, 290.

In this context, his Honour does refer to the acceptable ranges of figures and margins of error set out in other cases in both Australia and the UK.

While these discussions on the different legal interpretations and use of expert witnesses may help explain the differences in the performance of expert witnesses, they do not excuse them. In England, expert witnesses routinely inform judges of the tolerances within which they believe valuers should perform. It is a basic tenet of the law of professional liability that a defendant is to be judged according to the standard of the ordinary competent practitioner. If the judges, informed and succoured by the parties' expert witnesses, persist in applying the margin of error concept, the ordinary competent practitioner should be able to value consistently within the bracket. (In fact, he or she will need to be able to value within it every time, since negligence cases are decided on one performance, not an acceptable percentage of 'hits on target'.) A significant proportion of valuations put forward by expert witnesses in the English cases exhibit discrepancies far in excess of any margin of error for which those witnesses contend.

Two rather distasteful conclusions immediately present themselves. First, the divergences could result from incompetence on the part of some of the expert witnesses who are unable to value to the standard imposed by the law upon the defendant and for which many of them will be contending. Secondly, the divergences could occur because some of the expert witnesses are fitting their evidence to suit the exigencies of the instructing parties' case, producing artificial disparities which do not reflect the expert's professional judgement.

These criticisms cannot be applied to the Australian expert witnesses. Although the acceptable bracket in Australia seems very similar to that in the UK, the expert witnesses tend to be inside these brackets rather than outside them and in no case has the difference in the experts exceeded any margin of error argued for by the experts. The preliminary analysis of cases in Australia suggests that the performance of Australian expert witnesses has been a model of professionalism. Their valuations are within acceptable tolerances.

However, other more worrying issues raised by this research relate to the attitude of some judges in Australia. It has been suggested above that the divergence of a valuation from other valuations provided by experts is used in determining negligence. For example, in *Oakminster Ltd v CW Mansell, Leotta & Associates Pty Ltd*, Giles J found that a valuation approximately nine per cent from the right figure would not have been negligent, but that a valuation carried out in the same way at 18 per cent above was negligent. In adopting an approach, the effect of which was as if they had used a capitalisation rate of 20.3 per cent instead of 22 per cent, the valuers had 'departed from the practice of a prudent valuer'.[94]

94. Supra n 15, 53.

15 per cent lying outside the +/- 20 per cent range from the average valuation.

However, the Hutchison study was of up to 10 valuations of the same property. The way in which valuation negligence has been tested in the UK is, in essence, a two valuation variation test (the correct valuation and the alleged negligent valuation). Therefore, the set of unpublished data, where two independent valuations of the same property at the same time had been carried out, which revealed an average variation of 8.6 per cent, more closely mimics this phenomenon. Although 43 per cent of the valuations were within +/- five per cent of each other, 31 per cent were outside +/- 10 per cent, 23 per cent were outside +/- 15 per cent and 12 per cent were outside +/- 20 per cent. In other words, one in three were outside 10 per cent and one in every ten outside 20 per cent. This dataset is taken over a very restricted time frame in the mid-1980s. However, these results are consistent with the Hutchison study, especially as most investment portfolios would be dominated by reversionary (or over-rented) properties, given the normal rent revision process in the UK market.

Due to the use of more expert witnesses in the Australian negligence cases, the Hutchinson study has a greater bearing on their interpretation of the bracket. The similarity in the interpretation of the results renders the debate about which type of variation study is appropriate as evidence within negligence cases academic. However, the valuation accuracy and variation debate in the UK reveals some extreme disagreements on the methodology to be adopted to analyse both valuations against valuations and valuations against sale prices, resulting in some significantly different results from the same or similar data. This debate may culminate in some alternative analyses of the data reported in this paper which may in turn suggest different results concerning the extent of variation in valuations.

An examination of the valuation negligence cases in the UK shows that the normal margin of error is 10 per cent, rising to 15 per cent where the valuation is considered difficult. In no case has more than 17.5 per cent been decided upon and the research team are unaware of any agreement between the parties to a case of more than 20 per cent. In Part 4, an analysis of the valuations put forward by the 64 expert witnesses in the 32 UK cases studied for this paper was reported. Even assuming that each expert would be on the extreme of any acceptable bracket (given the source of their instructions but also their duty to advise the court) their valuations exhibit an average difference from the mean of the two valuations of over 23 per cent. In over 90 per cent of cases, the difference exceeded 10 per cent and in 50 per cent of cases it exceeded 20 per cent.

In the Australian cases, the expert witnesses showed a much lower variation from each other — less than half that of their English counterparts. However, the sample is so small that the conclusions concerning the differences in Australia set out in Part 4 are put forward merely as hypotheses to be tested with additional case identification and analysis.

In Part 5, some explanations of why these hypotheses might be true were suggested. The almost universal acceptance of the margin of error in England as either the only or most influential evidence of negligence, coupled with what appears to be the almost universal acceptance that it lies between 10 per cent and (at the very most) 20 per cent, leads to the conclusion that pressure would be placed on the experts to prepare valuations which assist their clients rather than objectively inform the courts. The lower emphasis placed upon the concept in Australia and the use of a number of experts by both plaintiff and defendant places less pressure on experts to act as advocates and thus leads to more objective valuations.

This paper has not focused on the fundamental point, namely, whether any valuer should be judged by the result rather than the approach. It has addressed the secondary issue of how the margin of error concept, given its existence, is applied in the two related legal jurisdictions of Australia and England. The available valuation variation empirical data suggests that the standards adopted by courts in both countries are unattainable by competent valuers all of the time and the evidence of the valuations of expert witnesses in England adds further evidence for this conclusion. Alternatively, it suggests that expert witnesses are routinely not fulfilling their duty to the courts.

One conclusion of this research could be that the margin of error should be extended. However, to do this would require assumptions as to how many valuations are carried out negligently as a proportion of the whole. For example, how many of the 240 valuations in the Morgan[100] data set analysed in Part 3 were in fact negligent? Alternatively, is it acceptable to suggest that probably one in ten valuations are negligent and that therefore the margin of 20 per cent should become routine, rather than an absolute maximum as at present? The authors do not think that such a suggestion is sustainable.

The difficulties with using these results to determine the appropriate margin of error suggests that, if it cannot be determined satisfactorily, it should cease to be used at all. If, for example, it became more generally accepted that the bracket merely provided prima facie evidence for or against negligence, and it was assumed that the empirical data was typical of a set of competent valuations (ie, free of negligent valuations), it could be suggested that three standard deviations from the mean would encompass all competent valuations. This would lead to a bracket of around +/- 35 per cent. This bracket would enable the two rather distasteful conclusions concerning the integrity and/or competence of UK expert valuation witnesses to be withdrawn.

100. Supra n 78 and Table 2 supra p 180.

However, this is not the conclusion that is drawn. The main conclusion of this research, which did not initially aim to question the whole concept, is that the margin of error concept is fundamentally flawed as a means of defining the professional standard legally required of valuers and that the application of the margin of error has no rational basis. The valuation profession in the UK is largely responsible for the creation of the bracket. Use of the empirical data set out in this paper, tied to the analysis of the legal framework, may lead first to more reasonable standards being applied within the concept but ultimately to its destruction. Only then will valuers be judged by the standards applied to almost every other profession; that is, by focusing on the way in which the professional task has been undertaken rather than on the result which has been achieved.

The Duty of Solicitors to Give Tax Advice: Recent Developments

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Do solicitors have a duty to advise their clients how best to avoid paying taxes? In Bayer v Balkin *(1995), a judge of the Supreme Court of New South Wales suggested that they do, but he later felt compelled to withdraw the suggestion. As a result the law has been left in some confusion. In this article a Perth QC clears up some common misconceptions regarding the duty of solicitors to give tax advice and comments on some recent cases which have dealt with this controversial issue.*

THE DUTY of solicitors to give tax advice to their clients has been confirmed in an English decision. In addition, an interesting decision of some relevance to this issue has been handed down by the Supreme Court of Western Australia. Both cases are considered in this article, together with a controversial decision of the Supreme Court of New South Wales, *Bayer v Balkin.*[1]

JUSTICE COHEN'S REMARKS IN BAYER v BALKIN

In his reasons for judgment in *Bayer v Balkin*, Cohen J of the Supreme Court of New South Wales made the following observation:

> It may once have been considered that it was the duty of citizens and residents of a country to make their proper contribution to the revenue so as to enable the

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† Queen's Counsel. An earlier draft of this paper was published in *Brief* Vol 25 No 1 (Perth: WA Law Soc, 1998) 25, and also in *Tax Week* Issue 11 (Sydney: CCH, 1998) 117.

1. (1995) 95 ATC 4609.

> government to run the country for the benefit of its inhabitants. It now seems to be accepted, with the imposition of high rates of tax upon those who are most able to contribute to that revenue, that there is a duty on persons such as accountants and solicitors to advise their clients how they can avoid, as far as possible, making what the government regards as a proper contribution. That duty to advise has not been contested in these proceedings.[2]

In August 1996, I attended the Australian Bar Association conference in San Francisco. At the convention dinner, I found myself sitting next to a gentleman who turned out to be Justice Cohen of the Supreme Court of New South Wales. When I told him that I had recently read his judgment in *Bayer v Balkin*, and written an article about it,[3] he acknowledged that his remarks had caused some controversy in Sydney. He added that his comments about the duty to avoid tax were the only part of the long reasons for judgment which he had not supported by quoting authorities. This was because he regarded the point he was making as 'obvious', and thus not in need of further elaboration. He went on to say that he had subsequently requested the Public Information Officer of the Supreme Court to issue a press release in defence of his comments, with the result that a newspaper had written up his explanation on the basis that he was 'joking' when he made the comments in his reasons for judgment. He had therefore decided that in future he would not seek to explain his judgments publicly.

In July 1997, the Chief Tax Counsel of the Australian Taxation Office issued a statement in relation to the matter, part of which said as follows:

> These remarks [in the judgment of Cohen J] have been quickly picked up by some commentators. What has not been picked up is the public statement by the Supreme Court to the effect that the judge was speaking 'ironically'.
>
> The only reference to that statement that I [the ATO's Chief Tax Counsel] have found appears in the *Sun Herald* for 29 October 1995, as follows:
>
> 'When he said last month that accountants and solicitors now appear to have a "duty" to advise their well-heeled clients on how to avoid paying taxes, the judge was speaking ironically. The tax-avoiding chicanery of lawyers and accountants is abhorrent to Justice Cohen, advised Ms Nelson [Public Information Officer of the Supreme Court of NSW] after reading last week's item headlined, "Legal View on Tax Avoidance".'[4]

The clear views expressed by Cohen J in his reasons for judgment have since been separately and independently reinforced in a recent English decision.

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2. Ibid, 4617.
3. *Brief* Vol 2 No 6 (Perth: WA Law Soc, 1996) 17.
4. *Weekly Tax Bulletin* No 36 (Sydney: Aust Tax Practice, 1997) ¶ 965.

ENGLAND: *HURLINGHAM ESTATES v WILDE & PARTNERS*

The case in point is *Hurlingham Estates v Wilde & Partners,*[5] a decision of Lightman J in the Chancery Division of the High Court of Justice in England. The facts are as follows.

Hurlingham claimed damages against its former solicitors for breach of the contractual duty of care and the tort of negligence. The solicitors acted in a transaction involving the purchase of shares in a company, the purchase of a lease of shop premises and the grant of a sub-lease of the premises. The structure of the transaction, so far as it involved the purchase of the lease, the grant of the sub-lease and the payment of £200 000, resulted in Hurlingham being assessed for a tax charge totalling nearly £70 000. If a different structure had been adopted (as it could have been), exposure to this tax would have been avoided.

The issues were twofold: one of fact — namely, whether the solicitors, when they accepted instructions at a charge-out rate of £200 (A$450) per hour, obtained the agreement of the clients that their instructions should be limited by excluding any duty to advise on tax and that the clients should look elsewhere for tax advice; and one of law — namely, whether, in the absence of such a limitation on the duties they assumed, there was a duty on the part of the solicitors to advise or warn Hurlingham of its exposure, or the existence of the risk of exposure, to such a tax charge.

The charge arose under section 34(1) of the Income and Corporation Taxes Act 1988 (UK) which provided, in effect, that where a lessee paid a premium under a lease for a duration of less than 50 years, the landlord should be treated for tax purposes as becoming entitled to an additional amount of rent calculated under a statutory formula by reference to the amount of the premium. In the present case, although the £200 000 was paid for a mixture of three purposes, the Inland Revenue, having regard to the structure of the transaction, treated the full £200 000 as additional rent which gave rise to the £70 000 tax charge. Hurlingham accepted that the assessment by the Inland Revenue was correctly made.

The reasons for judgment of Lightman J are so relevant and pertinent to solicitors generally that it is worthwhile quoting them at length. The first remarkable feature of the case to which the judge drew attention was this:

> Mr Rowe, who was at the material time the conveyancing and commercial partner of the solicitors —

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5. [1997] 1 Lloyd's Rep 525.

> (1) had (as he told me) next to no knowledge of tax law and was quite unqualified to give tax advice or to appreciate, or give any warning as to, the existence of any risk of any adverse tax consequences in any transaction, save on the simplest sale of residential property; and
>
> (2) was unaware of the provisions of rule 6 of the then current Solicitors' Practice Rules 1988, prohibiting solicitors accepting instructions from two or more clients where there is a conflict of interest between them.
>
> There was accordingly no appreciation on his part of the tax risks involved in the transaction, or that there plainly was (in respect of the transaction relating to the premises) an objectionable conflict of interest between the clients....
>
> Since the practice of conveyancing and commercial law must necessarily involve time and again considering the tax implications of proposed transactions and decisions, I find it difficult to comprehend how a solicitor possessed of no real knowledge of tax law can be allowed to occupy such a position, at any rate in a case such as the present where he does not have the necessary tax law back-up; certainly it must be questionable whether he should be allowed to do so if any regard is to be paid to the safety of the public.[6]

The second remarkable feature discussed by Lightman J dealt with the extent to which it is necessary to record any agreement with a client that the tax advice, which could ordinarily be expected to be provided, will not be provided. The judge said:

> There is no written record of the alleged (but disputed) agreement to limit the solicitor's duties. Any such agreement must plainly, if it is to have any legal effect, be clear and unambiguous: the client must be fully informed as to the limited reliance he may place on his solicitor and the reason for it (ie, the solicitor's lack of any basic knowledge or competence), that this limitation is not a normal term of a solicitor's engagement, and that the client may be better advised to go to another solicitor who is not so handicapped and can be retained with no such limitation on his duties. Common sense requires that all these matters should also be recorded in an attendance note of the meeting where they are discussed and agreed, and should subsequently be recorded in a letter to the client. The letter is required, not merely to evidence what has been agreed but to ensure that, after receipt of the letter, the client can consider (and discuss with others) the position and its implications away from, and free from any constraints imposed by, the presence of the solicitor. These are elementary precautions to ensure that the client gives a fully informed consent to a potentially disadvantageous arrangement when there is an obvious potential conflict between the interest of the solicitor (in retaining his client's work) and the client (in obtaining the best, or at least competent, service and advice).[7]

6. Ibid, 526.
7. Ibid.

Lightman J was satisfied that there was no such agreement limiting the solicitor's duties. Mr Rowe, the solicitor, assumed the full role in the transaction and the responsibilities to be expected of a solicitor having the conduct of it. However, the judge went even further:

> I should add that even if (contrary to my holding) the clients had at the meeting entered into some such agreement as suggested by Mr Rowe that he be retained subject to a limitation on his remit, I doubt if he could have established that there was any fully informed consent on the part of the clients. Conspicuously, he failed to tell them that the lacuna in his legal knowledge was not one to be expected of a solicitor having the conduct of a transaction such as that now to be undertaken by him on their behalf and that the clients' interest might (indeed did) require them to instruct another solicitor who was competent and would not need to insist on such a limitation on his services and duties.[8]

In deciding the issue of law, Lightman J stated:

> There were no specific terms of the solicitors' retainer limiting what would be the ordinary duty of a solicitor instructed on such a transaction. There was no specific reference to tax on 29 May 1991 [the date of the original instructions], but that does not mean that Mr Rowe did not assume responsibilities to advise as to tax. There was no reason or justification for Mr Rowe assuming that Hurlingham would be seeking any taxation advice on the transaction from its accountants or auditors or anyone else and Mr Rowe had no reason to believe that Hurlingham was possessed of any expertise in matters of taxation: everything was placed in Mr Rowe's (apparently safe) hands. Mr Rowe should have appreciated (and I think did appreciate) that Hurlingham needed his advice and services to avoid any unnecessary tax risk, a risk the existence of which would necessarily elude them. In these circumstances I have no doubt that he owed a duty to advise how the transaction should be structured, and to advise that the structure in fact adopted exposed Hurlingham to the tax charge, which (by common consent) by alterations to the form rather than the substance of the transaction could have been avoided.[9]

It is worthy of note that, in the last sentence of this passage , the judge extended a solicitor's duty to advising how to minimise or avoid tax by changing the 'form' of a transaction, despite its 'substance'.

In conclusion, Lightman J gave judgment for Hurlingham for the sum claimed. He stated:

> I hold that Mr Rowe without any 'health warning' to Hurlingham accepted instructions and acted in a matter in respect of which (as he knew) he was unfit and unqualified to act and by reason of his negligence occasioned to Hurlingham

8. Ibid, 529.
9. Ibid, 530.

> the avoidable loss in respect of which Hurlingham claims recovery. Hurlingham is accordingly entitled to recover by way of damages the loss and incidental costs incurred together with interest.[10]

There is no reason why the decision in *Hurlingham Estates*[11] should not, and would not, be fully adopted and applied in Australia. Everything which Lightman J said as to the duty of solicitors has equal application to practitioners in this country. Practitioners are therefore warned that it is their duty in acting for clients in transactions which could create a potential tax liability –

(a) to structure the transaction in such a way as to avoid that liability; or
(b) if they are unable to give such advice themselves, either
    (i) to tell the client to instruct some other competent solicitor; or
    (ii) to seek the assistance of another practitioner (eg, a tax partner in the same firm or a barrister) who can provide that tax advice.

WESTERN AUSTRALIA: *BRIAR HOLDINGS v CAPOLINGUA*

An indication of the type of case which may arise is given by the facts in a case recently decided by Master Bredmeyer of the Supreme Court of Western Australia in *Briar Holdings v Capolingua*.[12] Although the defendant in that case was an accountant, exactly the same issue could arise for a solicitor. A partnership (consisting of Mr and Mrs Kommer, Mr Milner and another) retained Mr Capolingua as their accountant and tax agent. The partnership approached Capolingua for advice on a proposal by Capolingua that the partnership transfer its business to a company. Capolingua was requested to advise on the financial and taxation consequences of the transfer. It was pleaded that it was a term of the retainer that Capolingua would advise them with a reasonable degree of skill and care as to how to minimise their tax exposure and the best structure for their affairs from a tax perspective. It was also pleaded that Capolingua owed the partnership a duty of care to that effect.

Capolingua advised the partners to acquire a shelf company, become directors and shareholders of the company and sell their business to the company. The partners accepted that advice, a shelf company (Briar Holdings) was acquired and the partners became the directors and shareholders of that company. The assets of the partnership were sold to the company at a purchase price which was an unsecured

10. Ibid.
11. Ibid.
12. (Unreported) WA Sup Ct 25 July 1997, no 970368.

debt payable by the company upon demand by members of the partnership. By suggesting this course, the accountant turned the business, a capital gains tax-exempt asset, into a post-CGT asset.[13]

The company and the former partners pleaded that Capolingua breached his contractual retainer and his tortious duty to exercise reasonable skill and care in carrying out this transaction in that he failed to structure the transaction so as to obtain the 'rollover' relief provided in section 160ZZN of the Income Tax Assessment Act 1936 (Cth). It was pleaded in the alternative that he failed to give an election notice to the Commissioner of Taxation for the purposes of taking advantage of that relief, as prescribed by sections 160ZZN(2)(h) and (13). It was further pleaded that Capolingua failed to refer the partners to an experienced accountant or solicitor for advice on the tax consequences of the transfer.

Section 160ZZN gives rollover relief on the transfer of an asset from individual taxpayers to a wholly-owned company. It provides that where a taxpayer owns a pre-CGT asset and disposes of that asset to a company under certain conditions, then the company is also deemed to have acquired the asset before 20 September 1985 (ie, the company is deemed to have acquired a CGT-free asset). The conditions for such a transfer are these:

- the taxpayer sells the asset to the company;
- the consideration for the disposal is to consist only of shares in that company;
- the taxpayer is to become the beneficial owner of all the shares in the company; and
- the taxpayer is required to give notice in writing to the Commissioner of Taxation on or before the day of lodgement of his tax return for the year in which the disposal takes place, or within such further period as the Commissioner allows, of his/her election to apply section 160ZZN to the disposal.

The section applies to individual taxpayers and partners. Where partners who own pre-CGT assets sell those assets to a company, the ex-partners have to own all the shares in the new company, and each ex-partner has to hold the shares in the company in the same proportions as he/she held his or her interest in the partnership. The partners have to elect that the section is to apply to them by notifying the Commissioner in the manner stated.

The case came before Master Bredmeyer by way of an application by Capolingua to dismiss the plaintiffs' action under Order 20, Rule 19 of the Rules of the Supreme Court (WA), and/or under the inherent jurisdiction of the court, for failing to disclose any reasonable cause of action.

13. A 'post-CGT asset' is one which is acquired and disposed of on or after 20 Sept 1985: Income Tax Assessment Act 1936 s 160L(1).

Capolingua succeeded in having the action dismissed. It was unnecessary for the Master to consider the substantive tort and contract liabilities. Generally, an assessable capital gain does not arise until the asset is realised (ie, 'disposed of').[14] The Master held that the loss of the opportunity for future rollover relief was, at the present time, entirely speculative. No loss or damage had yet been suffered by the plaintiffs and hence their causes of action in contract and tort were not complete. The loss of the CGT-free status was not itself a loss or damage. It was a hypothetical loss only, and not a sufficient actual loss to enable the court to engage in the exercise of examining the loss of an opportunity in assessing the quantum of damages. In principle, the court would not embark on an enquiry into what the plaintiffs' loss or damage might be if they were to sell the business or the shares for a gain at some time in the future. Master Bredmeyer concluded that that was speculative, hypothetical and a waste of the court's time and resources. If and when the plaintiffs sold the business or their shares, that would be the appropriate time to bring the action.

The plaintiffs' alternative argument, that they were entitled to a declaration that Capolingua was liable to indemnify them in respect of any capital gain which might be included in their assessable income as a result of disposing of the business or the shares at some future time, was also rejected by the Master. Whether the plaintiffs sell their business or shares in the future and make a gain subject to CGT is hypothetical. If and when they do sell at a gain, the plaintiffs can sue the defendant in negligence for damages.

Master Bredmeyer held that the plaintiffs' causes of action were not time-barred because they were not yet complete. It is only when the business or the shares are sold at a profit, and CGT is incurred, that the causes of action will crystallise. Far from being time-barred, the six year time period has not yet commenced to run. In dismissing the action, he held that the plaintiffs would be free to bring a similar action in the future if and when they sold their business or the shares at a capital gain.

CONCLUSION

Clearly, the position is that solicitors have a duty to advise their clients on the tax aspects of whatever matter they are acting in. Alternatively, they must obtain from another tax-competent practitioner the necessary specialist tax advice for the benefit of the client. Failure to do this could result in the solicitors being held liable to the client for negligence and/or breach of contract.

14. Income Tax Assessment Act 1936 ss 160Z(1), (2) and 160ZQ(1).