LEGAL NOTEBOOK

Recent cases, headline issues and new legislation

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HUNT & HUNT LAWYERS V MITCHELL MORGAN NOMINEES PTY LTD (ACN 108 571 222) AND ORS – HIGH COURT APPEAL

Snapshot

Readers of this journal may recall the judgment of *Mitchell Morgan Nominees Pty Limited v Vella* [2011] NSWCA 390, which we covered in the Legal Notebook section of the March 2012 edition. That judgment provided some support for the proposition that in certain circumstances, specific individuals in a lending transaction may not be concurrent wrongdoers.

On 12 December, 2012 the High Court of Australia heard the appeal by Hunt & Hunt Lawyers (Hunt & Hunt) from the above judgment. A key issue in the appeal was the proper approach to applying the proportionate liability provisions found in the Civil Liability Act 2002 (NSW) (CLA) and equivalent provisions in other Australian jurisdictions. Given the importance of this issue – including to the property valuation industry – members of DLA Piper's Litigation and Regulatory team were at court for the hearing.

Whilst the court was receptive to both parties' submissions, our observers report that the court did not seem indisposed to Hunt & Hunt's submissions, especially those regarding the adoption of a "substance over form" approach when seeking to interpret the relevant legislative provisions. In contrast, there were times when the court appeared somewhat troubled in accepting the more narrow or "technical" submissions of the respondents, including Mitchell Morgan Nominees Pty Limited (Mitchell Morgan).

The court has reserved its judgment and we expect that judgment will be delivered in the coming months. However, we take this opportunity now to provide a preliminary review of what occurred in the High Court. A further update will be provided once judgment has been delivered.

Readers should not reach any conclusions based on our observations.

Facts

Allessio Vella and Angelo Caradonna were involved in a joint venture. As a result of this relationship, Mr Caradonna fraudulently obtained possession of certificates of title to properties owned by Mr Vella. Unbeknownst to Mr Vella, yet with the assistance of Mr Caradonna's solicitor, Lorenzo Flammia, Mr Caradonna applied for mortgage finance in Mr Vella's name to, amongst others, Mitchell Morgan.

Mr Flammia made misrepresentations to Mitchell Morgan's solicitors, Hunt & Hunt, that he had witnessed the relevant documents provided in support of the mortgage application. The mortgage was approved and registered. Mitchell Morgan paid more than $1 million into Mr Caradonna and Mr Vella's joint account. Mr Caradonna then withdrew these funds, which were not repaid. Although the mortgage was duly registered, it was worded (by Hunt & Hunt) so as to only secure money payable by Mr Vella to Mitchell Morgan.

At first instance

At first instance (*Vella v Permanent Mortgages Pty Ltd* [2008] NSWSC 505), Young CJ in Eq of the Supreme Court of New South Wales held that as Mr Vella was not a party to the fraud, no money was in fact owed and therefore the mortgage secured nothing and should be discharged.

Hunt & Hunt was held to be liable to Mitchell Morgan in negligence as it had failed in its responsibility to protect Mitchell Morgan from fraud because it should have prepared a mortgage containing a covenant to pay a stated amount. Young CJ in Eq also held that Hunt & Hunt was a concurrent wrongdoer together with Mr Caradonna and Mr Flammia for the purposes of Part 4 of the CLA. Young CJ in Eq assessed Hunt & Hunt's responsibility at 12.5%, with Mr Caradonna and Mr Flammia bearing 72.5% and 15% respectively.

The New South Wales Court of Appeal

The New South Wales Court of Appeal (*Mitchell Morgan Nominees Pty Ltd & Anor v Vella & Ors* [2011] NSWCA 390) overturned the initial decision on the basis that Mr Caradonna and Mr Flammia did not cause the same loss as Hunt & Hunt, as required by the relevant provisions of the CLA.

This meant that whilst Mitchell Morgan's claim against Hunt & Hunt was still an apportionable claim, Mr Caradonna and Mr Flammia were not concurrent wrongdoers in respect of it. As a result, Hunt & Hunt's liability to Mitchell Morgan increased from 12.5% to 100%.

In reaching this decision, the Court of Appeal found that:

- there is a well-recognised difference between "damage" and "damages"; the former being the personal,

proprietary or economic interest that is harmed and the latter being the money sum that is awarded in respect of that harm
- in pure economic loss claims, damage should not be identified at the general level of being financially worse off. Rather, it is necessary to identify (at the correct level) the economic interest and the harm to it

On the facts of the case, the damage caused by Mr Caradonna and Mr Flammia comprised of Mitchell Morgan advancing the loan funds when it would not otherwise have done so. However, the damage caused by Hunt & Hunt's negligence was that Mitchell Morgan did not have the benefit of security for the money paid out.

THE HIGH COURT OF AUSTRALIA

A primary focus of the submissions before the High Court related to whether Mr Caradonna and Mr Flammia were concurrent wrongdoers in respect of Mitchell Morgan's claim against Hunt & Hunt.

It was common ground that in order for them to be classified as such, Mr Caradonna and/or Mr Flammia must be "a person who is one of two or more persons whose act(s) or omission(s) caused, independently of each other or jointly, the damage or loss that is the subject of the claim": section 34(2) of the CLA.

Hunt & Hunt submissions

Hunt & Hunt noted that the CLA does not define "damage or loss". However, given the various provisions of the CLA, that phrase should be equated with "harm". On that basis, Mitchell Morgan's "harm" upon entry into the loan transaction on the faith of an inadequate security was the inability to recoup the loan advanced. Hunt & Hunt then submitted that the appropriate question was whether Mr Caradonna and/or Mr Flammia "caused, independently of each other or jointly", Mitchell Morgan's inability to recoup the loan advance.

THE COURT ULTIMATELY FOUND THAT THE VALUER WAS "GROSSLY NEGLIGENT" AS HE HAD VALUED THE WRONG PROPERTY AND FAILED TO APPRECIATE VARIOUS ISSUES WITH RESPECT TO THE CHARACTERISTICS OF THE SUBJECT PROPERTY

Hunt & Hunt focused attention on the fact that the words "independently or jointly" make it clear that the proportionate liability regime can apply to either joint or several concurrent wrongdoers. In that way, the CLA does not require that one concurrent wrongdoer contribute to another's breach. Rather, the CLA only requires a concurrence of liability in respect of "the damage or loss that is the subject of the claim".

Hunt & Hunt therefore further submitted that the mortgage was ineffective for two reasons:

1. The loan agreement was void.
2. The mortgage instrument was inappropriately drafted.

As part of that submission, Hunt & Hunt accepted that whilst Mr Caradonna and Mr Flammia were responsible for item one, Hunt & Hunt was responsible for item two. However, both items were necessary for Mitchell Morgan to suffer the "harm" of being unable to recoup the loan advance. When viewed in that matter, the acts and/or omissions of Mr Caradonna and Mr Flammia were clearly "a" cause of Mitchell Morgan's inability to recover the loan advance – and Mr Caradonna and Mr Flammia were therefore concurrent wrongdoers.

Indeed, Hunt & Hunt submitted that no "loss" had occurred until the point when recoupment under the loan had been rendered impossible. Hunt & Hunt drew support for this submission from the comments of Gaudron J in *Kenny & Good Pty Ltd v MGICA* (1992) Ltd (1999) 199 CLR 413 at 424 (Kenny & Good).

It appeared that the overall flavour of Hunt & Hunt's submissions was therefore to focus on the unitary nature of the loan transaction. That is, whilst there may be separate parts to a single transaction, that does not mean that acts and/or omissions in respect of such separate parts cannot still cause, independently of each other or jointly, the same damage or loss. In the words of Hunt & Hunt's Queen's Counsel, D.F. Jackson, QC (*Hunt & Hunt Lawyers v Mitchell Morgan Nominees Pty*

IT IS COMFORTING THAT THIS ISSUE WILL BE THE SUBJECT OF DETAILED CONSIDERATION BY AN INCISIVE JUDICIAL COMMENTARY FROM THE HIGHEST COURT IN AUSTRALIA

Ltd (ACN 108 571 222) & Ors [2012] HCATrans 344 (appeal transcript) at lines 243 to 246 and 286 to 289):

> "… this is a case where, in our submission, it was clear that the loan would not be made without the mortgage security, and the mortgage security of course would not be required unless there was a loan…
>
> "The essential question is whether the acts or omissions of the suggested concurrent wrongdoers caused the same loss, but one asks what is the loss in each case? Why is it not simply the inability to recover the money lent…?"

In short compass, Hunt & Hunt submitted that the legislation does not require an identity of particular causes of action. Rather, "the question is one of identifying that there is a similarity of loss" (appeal transcript at lines 740 and 741).

Mitchell Morgan submissions

Mitchell Morgan agreed with Hunt & Hunt's submissions that the court is required to identify whether the acts and/or omissions of Mr Caradonna and Mr Flammia caused the damage or loss that was the subject of the claim by Mitchell Morgan against Hunt & Hunt.

However, Mitchell Morgan submitted that there was one further matter that required identification; namely, whether there was "identity of damage or loss" between that caused by Mr Caradonna and Mr Flammia and that caused by Hunt & Hunt. Mitchell Morgan appeared to focus attention on the fact that whilst the words "independently of each other or jointly" make it clear that while the proportionate liability regime can apply to either joint or several concurrent wrongdoers, there must still be a clear and precise "causal" nexus.

In short, Mitchell Morgan argued that Hunt & Hunt's failure to draft an appropriate security was a different cause of economic loss to Mr Caradonna and Mr Flammia fraudulently inducing Mitchell Morgan to advance loan funds. In that way, Hunt & Hunt's focus on the general "harm" that it caused to Mitchell Morgan was too broad because it did not precisely identify the economic loss to Mitchell Morgan. Mitchell Morgan focused on the (apparent) difference between economic loss as a result of being unable to recover loan funds pursuant to a mortgage and economic loss as a result of being unable to realise the security property pursuant to a mortgage.

In summary, Mitchell Morgan's submissions appeared to focus on a "closer analysis" of the nature of the loan transaction. That is, the separate parts of a single transaction. In the words of Mitchell Morgan's Queen's Counsel, Mr B.A.J. Coles, QC (appeal transcript at lines 1692 to 1705):

> "The loss sought to be recovered from Hunt & Hunt is the loss occasioned by the fact that there is no person who has to pay the money and there was, if Hunt & Hunt had done its job properly, not a person but a parcel of land, an asset that could be accessed and realised and turned into money, so that you did not need a person. You had an asset. Hunt & Hunt lost us the asset by not having a mortgage. So, that is a different loss, in our respectful submission.
>
> "One is the loss of an accessible and ready and willing person or defendant. The other is the loss of a proprietary entitlement, a registered proprietary entitlement with statutory attributes of the kind I have said. That is why it is different, in our respectful submission. That is why they are not the same loss. So, the loss, in our respectful submission, is not related to or dependent on the sources of the potential recovery…"

The court's reactions

Whilst the court listened intently to both parties' submissions, our observers report that the court did not seem indisposed to Hunt & Hunt's submissions, especially those regarding the adoption of a "substance over form"

approach when seeking to interpret the relevant legislative provisions. The court seemed to respond positively to Hunt & Hunt's submissions that it would be inappropriate to divide a loan transaction into its individual components (of serviceability and security or the promise to pay and the actual repayment).

In contrast, there were times when the court seemed to have reservations in accepting Mitchell Morgan's more narrow or "technical" submissions. This was especially so when Mitchell Morgan sought to draw an (in our respectful view) artificial distinction between loss and damage that may flow from only one component of the loan transaction, as opposed to loss and damage that may flow from the loan transaction – albeit for a variety of reasons.

Impact

The court has reserved its judgment on the appeal. We expect that the court will deliver a judgment in the coming months. Regardless of the result, this judgment will help to provide clarity to those affected by such legalistic/technical disputes – especially valuers.

Whilst it remains uncertain as to whether the court will accept the broader interpretation as submitted by Hunt & Hunt, or the narrower interpretation submitted by Mitchell Morgan, it is comforting that this issue will be the subject of detailed consideration by an incisive judicial commentary from the highest court in Australia.

Naturally, we will provide a further update following the delivery of the court's judgment.

Regardless of one's views on the merits of these arguments (especially those in the areas of valuers' and/or solicitors' liability), practitioners still need to apply significant forensic attention when advising their clients and pleading proportionate liability.

In that light, it is important to note that the more favourable proportionate liability cases of *Chandra v Perpetual Trustees Victoria Ltd* [2007] NSWSC 694 and *Kayteal Pty Ltd v John Joseph Dignan & Ors* [2011] NSWSC 197 (Kayteal) (reported in the September 2011 edition of *ANZPJ*), have not yet been expressly overruled.

As it appears that those cases can be distinguished on their facts, there remains scope to apply proportionate liability in suitable cases.

HUNT & HUNT WAS HELD TO BE LIABLE TO MITCHELL MORGAN IN NEGLIGENCE AS IT HAD FAILED IN ITS RESPONSIBILITY TO PROTECT MITCHELL MORGAN FROM FRAUD

For example, in Kayteal the plaintiff lender lent $780,000 to a borrower secured by a mortgage over four lots. This loan was in reliance upon a valuation by the defendant valuer, who valued the four lots at $1.2 million total. In fact, the four lots were only worth $52,000. The borrower defaulted and was unable to repay the mortgage debt, so the lender sued the valuer and the lender's solicitors in the mortgage transaction.

The court ultimately found that:

- the valuer was "grossly negligent" as he had valued the wrong property and failed to appreciate various issues with respect to the characteristics of the subject property, even when those issues were brought to his attention by the lender's solicitor
- the borrower had intentionally misled the lender, because he must have known that the valuation was erroneous (as he had purchased the property only two months earlier for $52,000)
- the lender's solicitors (in their role as the solicitors for the lender in the mortgage transaction) were also negligent as they had failed to advise of matters discovered or discoverable from usual enquiries which cast doubt on the reliability of the valuation

As a result of the above and pursuant to proportionate liability law, the solicitor's responsibility was held to be 12.5%, while the valuer (who, as outlined above, was "grossly" negligent) was held to be 40% responsible. The borrower's responsibility was 47.5%, reflective of his fraudulent/intentional misrepresentations as to his assets, liabilities and the value of the subject lots. ■