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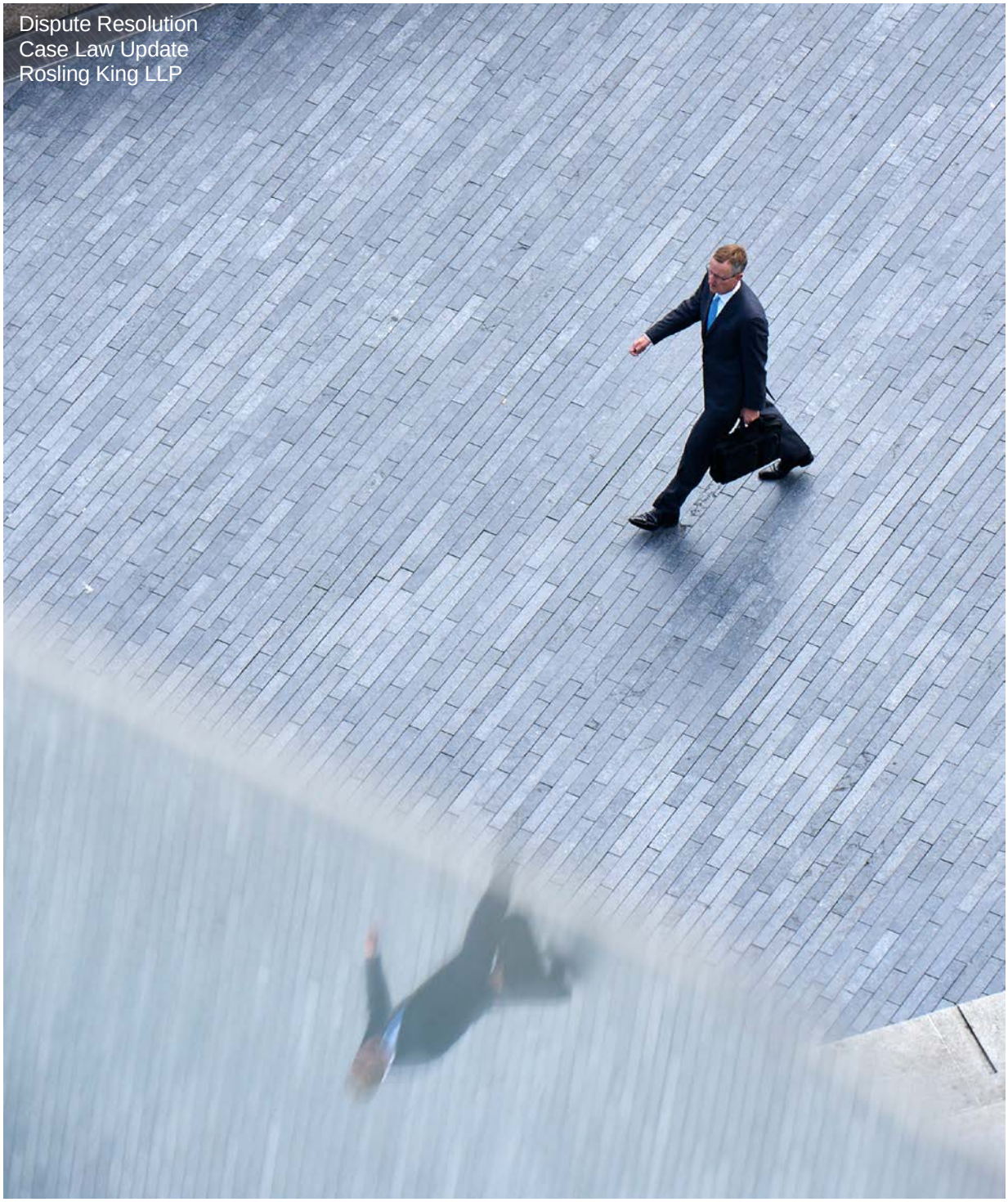

The Facts

In or around October 2006, Mr Hunt caused his company, Swynson Ltd ("Swynson") to lend £15m to Evo Medical Solutions Ltd ("EMSL") for a period of a year to enable a buy-out of an American company, Medical Industries America Inc, trading as Evo ("Evo"). Prior to the buy-out, Swynson instructed an accountancy firm, Hurst Morrison Thomson, now Lowick Rose LLP ("Lowick"), to carry out due diligence on Evo.

In the course of 2007 Evo was on the brink of insolvency, resulting in EMSL defaulting on the loan. Mr Hunt therefore caused Swynson to make a loan of £1.75 to EMSL.

In 2008, a further loan of £3m was made, as a result of which Mr Hunt became the controlling shareholder of EMSL. However, Evo's financial position did not improve and none of the loans were repaid. Later that year, the 2006 and 2007 loans were refinanced. Mr Hunt loaned £18.663m to EMSL on the condition that the advance would be applied to redeem the 2006 and 2007 loans. EMSL duly complied with this condition. The purpose of the loan was to clean up Swynson's balance sheet and reduce its tax liability. Eventually EMSL ceased trading, unable to meet its liabilities.

Swynson and Mr Hunt brought a claim in negligence against Lowick for damages of £16.157m, being the principal amount of all the loans, less sums received under the management's personal guarantees and the value of recoveries from cash and assets in the hands of Evo. It was accepted by the Court that it was always Mr Hunt's intention to bring a claim against Lowick and that, when he lent the monies to EMSL to repay the 2006 and 2007 loans, he did not think doing so would impact on his potential claim against them.

It was common ground that Lowick's due diligence was carried out negligently, as they failed to draw Swynson's attention to fundamental problems with Evo's finances and that, but for that failure, the transaction would not have proceeded.

At first instance and on Appeal, it was held that the repayment of the 2006 and 2007 loans were collateral to the loss caused to Swynson as a result of Lowick's breach of duty and did not extinguish Swynson's loss. It was found that only the 2006 loan was made in reliance on Lowick's report, whilst the 2007 and 2008 loans were recoverable as the cost of reasonable steps taken in mitigation.

The Supreme Court's Decision

There were three issues before the Supreme Court:

1. Whether Swynson's loss had been extinguished by EMSL repaying the loans;

2. Whether Swynson could recover from Lowick under the principle of transferred loss;

3. Whether Lowick were unjustly enriched by Mr Hunt's loan to EMSL to repay Swynson

and whether Mr Hunt was subrogated to Swynson's claim against Lowick.

The Supreme Court unanimously allowed Lowick's appeal and held the following:

1. The refinance discharged the very liability which gave rise to Swynson's loss. Mr Hunt's loan to EMSL was not an indirect payment to Swynson, even though it ultimately reached them. In fact, Mr Hunt's loan to EMSL and Swynson's loans to EMSL were distinct transactions between different parties, each of whom gave valuable consideration. Mr Hunt's loan was not attributable to Lowick's breach of duty and so could not be deemed to constitute mitigation.

2. In order to recover under the principle of transferred loss, Mr Hunt would have to show that the purpose of engaging Lowick, or any aspect of the 2008 loan, was to benefit him. He failed to do so. His loss arose out of his loan to EMSL in 2008, which was not made in reliance upon Lowick's due diligence. Further, Lowick did not owe a duty of care to Mr Hunt.

3. It was held that Lowick were not unjustly enriched, as the refinancing was not a defective transaction. Mr Hunt received the whole of the benefit from the transaction for which he intended i.e. EMSL had repaid the loans to Swynson and removed a large non-performing debt from Swynson's books, Mr Hunt obtained security over EMSL's assets, and gained a tax advantage. In these circumstances, subrogation was not being invoked for its proper purpose, namely to replicate as far as possible the element of the transaction whose absence made it defective. Instead, it was being invoked to enable Mr Hunt to benefit from Swynson's claims in respect of an unconnected breach of duty, under a different transaction made between different parties.

The Supreme Court was sympathetic to the fact that, if the transaction had been structured differently (i.e. had Mr Hunt paid the loan monies direct to Swynson, as opposed to indirectly paying it via EMSL), liability might not have been discharged. However, the Supreme Court was of the view that the fact that a transaction could have been structured differently does not mean that it must have the same consequences as if it had been differently arranged.

Commentary

The Supreme Court's decision serves as a warning to investors and lenders to give careful consideration to the consequences of any restructuring or refinancing, lest they unintentionally extinguish future potential claims. However, this claim is fact specific and somewhat unusual, so it is likely that it will be distinguished from other refinancing claims against negligent professionals.

For further information, please contact Georgina Squire or the Partner with whom you usually deal.