Feature

KEY POINTS

- Recent syndicated loan decisions have suggested that it is possible for an arranger (*qua lender*) to sue for loss suffered by participants in the loan.
- These cases apply the so-called principle of *res inter alios acta*, and focus on determining if the participation (whether by way of a novation, assignment or sub-loan) is "collateral".
- Such an inquiry is inherently unpredictable. The courts should avoid asking whether the transaction is "collateral". Even in its true context – that of avoided losses – the *res inter alios acta* principle has been found to be unwieldly and unpredictable.
- In line with the modern approach to damages, the court should focus solely on whether the arranger has suffered any loss itself.

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# Syndicated loans and the *res inter alios acta* principle: when can an arranger claim for loss it did not suffer?

This article reviews a spate of syndicated loan cases where the courts have applied a so-called *res inter alios acta* principle to allow an arranger to claim for loss it did not suffer. It is questionable whether the use of this principle is consistent with the law of damages and the general approach to recovery of third party loss.

It is not uncommon for lenders in a syndicated loan to sue professionals involved in such a loan or similar funding transactions for negligence in the provision of material information.

In a spate of cases culminating in *Titan Europe 2006-3 plc v Colliers International UK plc* [2014] EWHC 3106 (Comm), the English courts have applied a so-called *res inter alios acta* principle, allowing an arranger, *qua* lender, to sue and recover for itself losses suffered by the secondary lender (a sub-participant, assignee or novatee). The premise for this is that transactions between the arranger and subsequent or secondary lenders are collateral, and should not reduce the notional loss caused to the arranger by the negligent act.

It is suggested that the application of the *res inter alios acta* principle is problematic. It should rarely be possible for an arranger to be awarded damages in full from a negligent professional where its risk (or part thereof) has been passed on to a participant bank. The principle ignores the developments in the law of damages, which has moved towards a focus on the claimant's true loss.

## *TITAN EUROPE 2006-3 PLC v COLLIERS INTERNATIONAL UK PLC*

The *res inter alios acta* principle was most recently applied in *Titan Europe 2006-3 plc v Colliers International UK plc* [2014] EWHC 3106 (Comm). This concerned a securitisation transaction, in a form not dissimilar to an acquisition finance syndicated loan. The broad transaction structure was for Credit Suisse to provide loans to certain European companies backed by mortgages over their commercial property. Titan Europe, a special purpose vehicle, would then obtain a senior tranche of the loans and in turn issue floating rate notes to investors. When the underlying borrowers went insolvent in 2008, Titan Europe sued Colliers International for negligent overvaluation.

On the facts, the court found Colliers International to be negligent. Of particular interest however, is the court's conclusion on the issue of loss. Titan Europe had issued the notes on a non-recourse basis. The court found that Titan was an "economically neutral conduit" – it had raised money from the noteholders which was used to purchase the portfolio of loans, and the notes were structured such that the noteholders would have no recourse against Titan's own assets.

Notwithstanding this, the court held that the fact that Titan Europe issued securities on a non-recourse basis was "irrelevant and falls within the principle of *res inter alios acta*". Since, it was reasoned, the non-recourse nature of the notes issue arises out of contractual arrangements with third parties, the fact that Titan Europe itself did not suffer any loss was not a bar to its claim. The court found that loss had occurred to Titan Europe "the moment it purchased" the senior tranche of the loan as it acquired a "chose in action worth less than the price it paid".

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## THE SO-CALLED *RES INTER ALIOS ACTA* PRINCIPLE

*Titan Europe* suggests that it is possible for an arranging bank to sue a negligent professional and recover for itself losses suffered by other participants on the basis of a so-called "*res inter alios acta*" principle. The latin phrase is an abbreviation of the maxim *res inter alios acta alteri nocere non*

*debet* which means "persons are not to be prejudiced by the acts or words of others, to which they were neither party nor privy, and which they consequently had no power to prevent or control". In other words, a collateral act or transaction (eg the novation, assignment or sub-participation) should not be brought into the mix when considering the loss suffered by the initial counterparty.

In the context of syndicated loans, a subsequent participation (a term used broadly here) is considered *res inter alios acta* if it is found to be collateral to the original transaction – that is to say, even though the claimant's loss has been reduced because it has transferred part of its interest in the loan, that reduction is not taken into account.

Titan Europe is not the first (and may not be the last) decision to encounter this principle. It follows a couple of other earlier decisions. In *Banque Bruxelles Lambert SA v Eagle Star Insurance Co Ltd* [1995] 2 All ER 769 (QB), the claimant acted as arranger in a syndicated loan for the purchase of commercial properties, and held an interest in the loan itself. The loans amounted to 90% of the valuation of the commercial properties, which were security for the loan. Subsequently, the borrower defaulted. Banque Bruxelles claimed against the borrower's insurers and the property valuer.

As against the valuer, Banque Bruxelles claimed the full amount of the loan despite the fact that one tranche of its commitment was novated to Sanwa Bank, and another tranche was novated to a group of lenders. It was argued by the bank that the bank's participations were *res inter alios acta* and should not preclude a claim by it for all losses arising from the valuer's negligence. This argument was rejected. In the judge's view, *res inter alios acta* embraces circumstances in which a third party, or an extraneous event, intervenes to provide a plaintiff with some form of indemnity, in whole or in part, for the loss which the defendant has caused. The law ignores the intervention so that the plaintiff remains entitled to recover from the defendant the full amount of the loss or damage initially suffered. Here, however, the principle could not apply as it would mean "applying a fiction: treating the third parties' losses as Banque Bruxelles'" (p 802H).

A different result was obtained in *Interallianz Finanz AG v Independent Insurance Company Ltd* [1997] EGCS 91, where the claimant, Interallianz, entered into participation agreements with several lenders after the loan had been agreed and before it had knowledge of the valuer's negligence. Here, the court accepted the claimant's argument that the sub-participations were *res inter alios acta*. The valuation report was addressed to Interallianz alone and the valuer was at no time aware that Interallianz intended to pass on its valuation report to other lenders.

In *VTB Capital plc v Nutritek International Corp and ors* [2011] EWHC 3107 (Ch); [2012] EWCA Civ 808; [2012] 2 BCLC 437, the principle was invoked both at first instance and on appeal in the context of a back-to-back lending arrangement. In seeking to resist VTB Capital's application to serve *ex juris*, the defendants argued that VTB Capital had suffered no loss under the relevant participation and facility agreements; all monies provided by VTB Capital to the defendants were to be provided by VTB Moscow in a back-to-back arrangement. The argument thus went that any loss arising from the alleged misrepresentation were losses suffered by VTB Moscow and not VTB Capital. Applying *Interallianz*, the judge explained that the relationship between the lender (VTB Capital or Interallianz) and the participants (VTB Moscow or the other banks) was one of debtor and creditor and thus was *legally independent* from the relationship between the lender and borrower.

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## INHERENT DIFFICULTIES OF *RES INTER ALIOS ACTA* PRINCIPLE

As the above cases show, the focus of the *res inter alios acta* principle is on whether the act of subsequent participation is collateral, instead of directly identifying the party which has suffered loss. But the definition of what is "collateral" is elusive and potentially makes the outcome arbitrary.

The odd results likely arise from the uneasy transplant of a principle used in a different context, that of mitigation and avoided losses. It is trite that in contract or tort a claimant is under a duty to mitigate its damages. A claimant must take reasonable steps to do so. If in doing so the claimant avoids certain losses, these avoided losses are taken into account and ultimately reduce the damages payable by the defendant. But there is an exception to this – where the loss-reducing event is considered collateral, the court will ignore that event.

Despite the apparent utility of the principle, it is beset with problems of uncertainty. As *McGregor* explains the principle's demerit is that it gives no indication of how the rule operates and of what solutions would be reached when applying it to particular circumstances. Indeed, as will be seen, the line between those avoided consequences which are collateral and those which are not is an exceedingly difficult one to draw.

The difficulty with the avoided losses principle is best exemplified by *The New Flamenco* (*Fulton Shipping Inc of Panama v Globalia Business Travel Sau (formerly Travelplan sau) of Spain (The New Flamenco)* [2014] 2 Lloyd's Rep 230 (HC); *Fulton Shipping Inc of Panama v Globalia Business Travel Sau (formerly Travelplan sau)* [2015] EWCA Civ 1299 (CA)). Here, charterers made early redelivery of a vessel which had two years to run on its charter. The owners accepted this anticipatory repudiatory breach as terminating the charterparty. There being no available market for substitute charter at the time, the owners

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sold the vessel for about US$ 23.7m. It turned out that if the owners had sold the vessel at the end of the charter period, in 2009, they would have only fetched US$ 7m, which meant the owners made a profit of about US$ 16.7m from its early sale.

The arbitrator held that this profit should be taken into account in assessing damages, while the High Court judge considered the sale to be collateral, since it was lacking in a causal nexus. The Court of Appeal reversed the High Court's decision, holding essentially that as a matter of fact, the sale did arise as a consequence of the early redelivery and the owner's gain should be accounted for. The Court of Appeal concluded that whether a benefit was to be accounted for depended simply on whether the act taken arose from the consequences of the breach – and that no refinements of this test from *British Westinghouse* aided the enquiry.

The state of the current authorities suggests that it is only possible to frame the principle broadly. This is because in applying the principle, the courts are attempting to do justice, by recourse to public policy reasons, in the uncommon situation that a claimant's losses have been reduced by an event seemingly unconnected to the wrong. The aim is to strike the right balance between allowing the claimant a windfall and allowing the defendant the benefit of an extraneous loss-reducing event. This was confirmed by Sales LJ in a recent Court of Appeal decision, where he explained that the balancing act is influenced by notions of "justice, reasonableness and public policy": *Swynson Ltd v Lowick Rose LLP (in liquidation – formerly known as Hurst Morrison Thopson LLP)* [2015] EWCA Civ 629.

## LOSS AS THE CENTRAL QUESTION

Principle suggests that the real question to be asked is whether the loss being claimed is indeed a loss suffered *by the claimant*. The aim of the law of damages is to compensate the innocent party no more and no less than he has lost. The Court of Appeal's recent decision in *The New Flamenco* on avoided losses and recent developments in connection with the breach-date rule echo this.

The previously immutable breach-date rule is now only a starting point, with the courts willing to consider events occurring after the date of breach and not grope in the dark if this leads to a more accurate determination of the quantum of compensation. It is therefore important to distinguish the cases where the risk of loss has been passed on to a third party, and no loss is actually suffered by the claimant. Thus, the argument in *Titan Europe* that damage was suffered by the claimant at the moment of the negligent act while correct, does not take into account the fact that the loss did not eventuate – it was passed on before the claimant suffered actual loss. As *McGregor* explains: the potential future loss has not materialised so that there was no loss rather than a loss mitigated.

Therefore, it is submitted that in cases where the loss has not actually been suffered by the claimant, the claimant should not be allowed to pursue such a claim.

## TRUE *RES INTER ALIOS ACTA* CASES?

True *res inter alios acta* cases are concerned with preventing the defendant from unfairly being given credit. It has been suggested that in the context of syndicated loans, the principle is not engaged in cases of novation or assignment. But it is further contended that the collateral principle does not apply in sub-loans made *before* the breach is discovered. This resonates deeply with notions of fairness: a claimant should be awarded damages only in respect of its *actual loss*, and the reduction of loss resulting from a sub-sale should be taken into account.

A sub-loan is not sufficiently distinct or independent a transaction. When an arranging bank has decided to sell off part of its interest in the loan, it normally does this to reduce commercial risk in connection with the loan. Risk may arise due to the borrower's financial deterioration, market forces, but also, misreporting of the borrower's financial position at the outset or negligent valuation in the underlying security. A transfer seeks to pass on any risk latent in the transaction. While this is not mitigatory in the strict sense of steps taken *after* the discovery of a breach, it is sufficiently proximate to be steps taken to reduce losses. The fact that there is typically a liquid secondary market further means that a sale of its interest is not an act which the arranger would be fortunate to conclude. Sub-loans granted after the event, such as that in *Interallianz* merit further consideration. But such transactions may more likely qualify as collateral transactions.

Given that the court seeks to ensure that the claimant is not put in a better position than if the contract had been performed, the touchstone should always be whether it can fairly be said that all or part of the loss in respect of which damages are claimed has either not been suffered or has been avoided or is offset by a gain made.

## CONCLUDING REMARKS

It is not surprising that the *res inter alios acta* principle, which is used in a different context, has been transplanted and invoked in cases concerning third party loss. Broadly speaking, it appears to be a loss-apportioning mechanism. But its structure, as applied in the syndicated loans cases, is clearly inapposite, and circumvents asking key questions such as the actual occurrence of loss. Notwithstanding the type of transaction – whether a novation, assignment, or sub-loan before or after the event – the courts should focus on whether the arranger has itself suffered loss, and if it has, ask if the collateral transaction qualifies as an avoided loss. ■

*Further Reading:*

- The consequences of an Issuer in a CMBS having its own rights of action [2015] 1 JIBFL 22.
- Cases Analysis [201] 1 JIBFL 48.
- LexisPSL: Banking & Finance: How will CMBS transactions affect professional negligence claims?