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Assignations, Metaphysicians and Black Holes:

Pegasus Management Holdings SCA v Ernst & Young [2012] 2 B.C.L.C. 734

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Introduction

Civil litigators may face the problem of assignment of causes of action and the potential problem of "black holes" that can arise in relation to damage as between the assignor and assignee. In *Pegasus*, Mann J. in the Chancery Division robustly rejected an attempt to argue that an assignment removed the loss from the assignor and thus left the assignee with no loss on which to sue.

Background

The second claimant, B, had sold his electronic manufacturing business and wanted to invest the proceeds but avoid an immediate capital gains tax charge. He was advised by the defendant accountant, EY, to incorporate a Luxembourg company, P, in which he would be the sole shareholder, so that he would obtain rollover relief by buying qualifying investments. EY advised B that P required to buy the shares of qualifying companies, and that in turn the assets and trading activities of those companies would have to be hived up into P so that it could carry on the trade itself. As a result the goodwill of those companies did not figure in the share purchase but would appear when those companies were sold, attracting a possible tax liability that could have been avoided, on P and B's argument, if EY had advised that P purchase assets rather than shares. The claimants also argued that EY failed to advise that the potential tax liability could be avoided by hiving the assets back down to newly incorporated subsidiaries. The critical factual issue in Pegasus was that, while some tax liability had already crystallised, the full extent of any extra tax liability would not be known for some time. P and B sued EY for negligent advice.

Although the action had been raised by P as the person to whom EY owed duties of care, and by B as sole shareholder of P, it was recognised that B could not sue as well as P. In 2010, P had gone into liquidation and had transferred its assets to another company, I. The assets transferred included the cause of action against EY, for a nominal consideration, and the shares in certain companies which would accrue the potential tax liability if sold. The asset transfer was voluntary as part of a reorganisation and not a commercial arm's length deal. P sought leave to substitute I as the claimant in its place; EY opposed the amendment on the subtle ground that as P could no longer show any loss from the alleged negligence, and since I could only sue for P's loss, the action was no longer sustainable. The interlocutory judge rejected that argument on the ground that, if EY was correct then losses which had previously existed (on the pleadings) would have disappeared into a "black hole" which was contrary to authority. EY appealed to Mann J.

The arguments

EY argued that I could only claim for loss suffered by P; the claim based on potential tax liability was a claim for future or consequential loss which would be assessed at trial in light of events that had happened by then; as a result of the assignment any loss arising from the tax liability will not be suffered by P but by I; and P's loss will be nil and an action to claim those losses was unsustainable.

P in turn argued that a person with a cause of action based on damage to property did not lose that cause of action by giving away the property, otherwise the claim would fall into a black hole; and the loss was actual and not contingent, even though the loss could not be absolutely finalised because steps were being taken to mitigate it. P had a valid cause of action before the assignment which I could maintain after the assignment.

The authorities

In *GUS Property Management Ltd v Littlewoods Mail Order Stores Ltd*, 1982 S.C. (HL) 157, the pursuers claimed that the defenders and its contractors had damaged the pursuers' property during the course of piling works carried out on the defenders' property. When the property was damaged it was owned by a subsidiary of the Great Universal Stores group but had been subsequently conveyed to the pursuers along with an assignation of all claims arising out of the piling works carried out by the defenders. The action was raised by the pursuers as assignees. The Lord Ordinary rejected the defenders' plea of no title to sue, the First Division reversed his decision and the House of Lords restored it. Lord Keith of Kinkel said at 177 that the issue was whether the pursuers were pursuing a claim which the original owner of the property could have pursued at the date of the assignation. He noted that the general rule was that an owner of property did not lose title and interest to sue if the damaged object was disposed of in an arm's length transaction since the difference in price due to the damage represented the best measure of damage. Where property was disposed of, for example, gratuitously, or it was transferred by operation of law, for example via intestate succession, it would be "absurd … to suggest that the claim to damages would disappear … into some legal black hole so that the wrongdoer escaped scot-free". He held that, as the property was transferred as an internal group transaction without reference to its true value, the transfer had not destroyed the original owner's right of action which could then be competently assigned to the pursuers.

In *Linden Gardens Trust Ltd v Lenesta Sludge Disposal Ltd* (1992) 57 B.L.R. 57, contractors failed to remove asbestos from a building in breach of contract but, before that breach was discovered, the property was sold at full value to the claimants who subsequently incurred the cost of remedying that breach. The Court of Appeal held that the original owners acquired a right to substantial damages for the breach of contract and did not lose it when they disposed of the property for full value so that the claimants as assignees were entitled to enforce the original owners' claim; it was immaterial that the claimants had paid for the remedial works but would be relevant to establishing the cost which the original owners would have incurred had they undertaken the work (Staughton L.J. at 92, Sir Michael Kerr at 97–98).

In *Offer-Hoare v Larkstore Ltd* [2006] 1 W.L.R. 2926, an engineering report instructed by owners of a development site negligently stated that the site was suitable for development. After the owners had assigned the site to the defenders for full value, the site's unsuitability became apparent and the assignees sued the engineers who prepared the negligent report. The engineers argued that, as the damage occurred after the assignment, the owner had not suffered substantial damages and the assignee could not recover more than the assignor. Rix L.J., rejecting this argument, said at [85] that underlying cases such as *GUS Property Management* and *Linden Gardens Trust*

"can be heard the drumbeat of a constant theme … that the courts are anxious to see, if possible, that where a real loss has been caused by a real breach of contract, then there should if at all possible be a real remedy which directs recovery … towards the party which has suffered the loss."

He added that privity of contract should not become "an instrument of maladministration and injustice".

Decision

The judge at [19] said that *GUS Property Management* clearly favoured the claimant because there was damage to property. That property was transferred for a consideration which can be treated as nominal (because it was an inter-group transfer); the transfer of the property was followed by an assignation of the cause of action. At [24] he said that *Linden Gardens Trust* demonstrated that an assignee could recover what an assignor would have been able to recover. At [30(c)] he concluded that where a wrong had been committed in relation to property and loss was capable of arising as a result, an assignment whether gratuitous, for part-value or full value did not mean that the assignor no longer suffered loss:

"Whatever the metaphysicians may say, the law says that the loss flowing can and should still be treated as a loss of the assignor which the assignee can recover. Black holes are to be (as all black holes should be) avoided where possible."

At [33] Mann J. rejected EY's arguments as being the application of logic to an unjustifiable end. EY argued that, assessed as at the date of trial, P had suffered no loss since the future potential loss was unquantifiable; it also argued that P's loss fell within the general rule that denied a right to recover loss if a third party made good the loss. The judge held that no distinction was drawn between the type of property (land, chattels, shares or anything else) nor between direct and future, consequential loss: "the 'black hole' avoidance analysis was equally applicable to both sorts of loss" (at [39]). There was also no reason in legal principal why the law would treat the transfer of the affected property as the same as the loss being removed by a third party (at [40]). The amendment to substitute I in place of P was allowed.

Conclusion

Pegasus confirms the court's willingness to apply the "black hole" avoidance analysis to assignment situations in what appears to be a policy approach designed to support the legal concept of assignation rather than one founded on strict legal principles.