

Appraisers in Arbitration: What Areas of Service Might Valuers Provide?

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Abstract

Alternative dispute resolution (ADR), which includes negotiation, mediation, and arbitration, presents a growing area of need for the skills of valuation professionals. This article introduces practitioners to some of the concepts of arbitration and the ways in which the professional can provide services in this area.

Introduction

Valuation professionals are consistently seeking to expand their areas of practice. Successful practitioners explore ways to apply their knowledge and experience to respond to the needs of clients and solve problems relating to property valuation.

Alternative dispute resolution (ADR), which includes negotiation, mediation, and arbitration, presents one growing area of need for the skills of valuation professionals. This article will introduce practitioners to some concepts of arbitration and the ways in which the professional can provide services.

Valuers' Services in Arbitration

In addition to preparing appraisal reports for lending, decision-making, financial reporting, and various other uses, valuation professionals often serve as expert witnesses in courtroom trials, administrative hearings, ad valorem tax appeal settings, and other proceedings. Some practitioners provide such services as one part of their overall practices, while others do most of their professional work providing litigation services. ADR provides opportunities for valuers to

expand their services beyond what is often thought of as the "typical" appraisal practice, in which the valuation professional is retained to value one or more properties and deliver reports expressing value opinions within a certain time period. Both in litigation and ADR work, the valuer has the opportunity to become involved in a larger process, of which the appraisal report is only a part.

Arbitration offers valuers three ways to become involved: as an expert valuation witness, as an arbitrator, or as a consultant. Each of these roles will be briefly described here. It is imperative that the appraiser understand which of these roles he or she is being retained to fill, as each requires the professional to provide different types of services, perform different tasks, and comply with different Standards. This is not always easy to discern, as lawyers often use the words "appraiser" and "arbitrator" as interchangeable synonyms. During our initial conversations with potential clients, we valuers often need to ask about the specific tasks that we are expected to perform in the course of the engagement so we can figure out which chair we are expected to sit in. (See Exhibit 1.)

One source of potential confusion is the fact that the rules of the particular arbitration process are frequently included in the terms of the lease

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Exhibit 1 Which Chair to Choose?



or other contract that is the basis of the dispute between the parties. Reasons why the language in the contract may be confusing to valuation professionals include:

- The controlling lease or other contract may pre-date current usage.
- The drafters of the controlling documents were not sensitive to valuation terminology.
- The drafters of the controlling documents were not sensitive to valuation definitions.
- The drafters of the controlling documents were not familiar with valuation Standards.

The following examples present lease language that might cause a valuation professional to be confused about the role he or she is expected to play in an arbitration. The first two examples describe “baseball arbitration,” in which the arbitrator selects the amount or opinion presented by one party or expert witness. This form of arbitration is frequently used, as it is often a less expensive form of arbitration.

Lease Language Examples

The following examples are based on actual lease provisions, and are the examples used in the Appraisal Institute’s Guide Note 16, Arbitration.

Baseball Example 1

The lease states:

Minimal Annual Rent shall be determined by appraisal. Each party appoints an appraiser and a third is selected by the process described in the lease. The party-selected

appraisers will exchange appraisal reports with one another and submit their reports to the third appraiser. The third appraiser will choose the most reasonable of the two appraisals within 10 calendar days. “The third appraiser’s decision on which appraisal is the most reasonable will be final and binding on the parties, and will be based solely on the [third] appraiser’s review of the two appraisals.”

This lease clause is unclear. How is “the most reasonable” appraisal to be determined? Is the third “appraiser” to provide an independent appraisal opinion by reviewing the two appraisal reports and then providing his or her own opinion of value by agreeing with one of the two value opinions? Or is that third “appraiser” to provide an arbitration award by selecting the amount that will resolve the dispute based on the weight of the evidence presented?

Baseball Example 2

The lease states:

Renewal FMRV (fair market rental value) is to be determined by each party selecting a real estate professional with at least 10 years’ experience in the property type at the relevant location and the selected Qualified Professionals shall each submit a memorandum to the third arbitrator, copy the landlord and tenant. Further evidence is to be presented at the arbitration hearing in the form of oral testimony and opening and closing arguments of counsel for each party. After the close of the arbitration hearings, the third arbitrator “shall choose the estimate set forth in either Landlord’s or Tenant’s memorandum, whichever the third arbitrator believes most accurately reflects the fair market rental value of the Premises in accordance with Article xxx for the subject term... and such choice shall be binding on Landlord and Tenant.”

In this example, the use of the phrase “the third arbitrator” implies that all three valuation professionals are “arbitrators,” while in the first example all three were referred to as “appraisers.” This clause creates confusion about the tasks to be performed by the two professionals who are to each produce a “memorandum.” The general language might be interpreted to mean that these are two expert witnesses, each of whom is to provide an appraisal report and then testify about the contents of the appraisal report.

Three-Person Panel Example

The lease states:

Arbitration and Appraisal. The arbitration of disputes or appraisal of value...The party desiring such arbitration or appraisal shall...appoint a disinterested person with recognized competence in the field involved as one of the arbitrators or appraisers...and such three arbitrators or appraisers shall as promptly as possible determine such matter...Landlord and Tenant shall each be entitled to be represented by counsel at the arbitration or appraisal and to present evidence and argument to the arbitrators or appraisers.

The confusion here is whether the parties have agreed to an appraisal or arbitration scenario, as this clause appears to apply to either dispute resolution process. Without input from the parties to the dispute and their counsel, the valuation professionals could have a difficult time figuring out what each of them is to do in this situation.

The following language taken from a recent lease may indicate an attempt to use terms as defined in the appraisal profession, but the result is confusing:

The function and authority of the Impartial Person shall be only as herein provided, and he shall not act as an arbitrator or appraiser.

It is very difficult to know which tasks to perform if a valuer is instructed to be neither an arbitrator nor an appraiser in the arbitration.

Even when the controlling language is clear, it might be helpful to envision the table where the arbitration will take place, typically in a conference room, and to identify which chair you will be seated in. If you are seated alone, or with two others at the head of the table, you are in the seat of an arbitrator; if you are seated along one of the longer sides of the table, with the attorneys, you are either a testifying expert witness or a consultant (see Exhibit 2).

Let's assume first that the valuer is serving as an expert witness, since that role is probably the most familiar to appraisers. The witnesses are typically retained by counsel on behalf of one of the parties to the dispute. Using the frequent arbitration scenario of a rent re-set pursuant to a ground lease, space lease, or net lease, the attorneys for

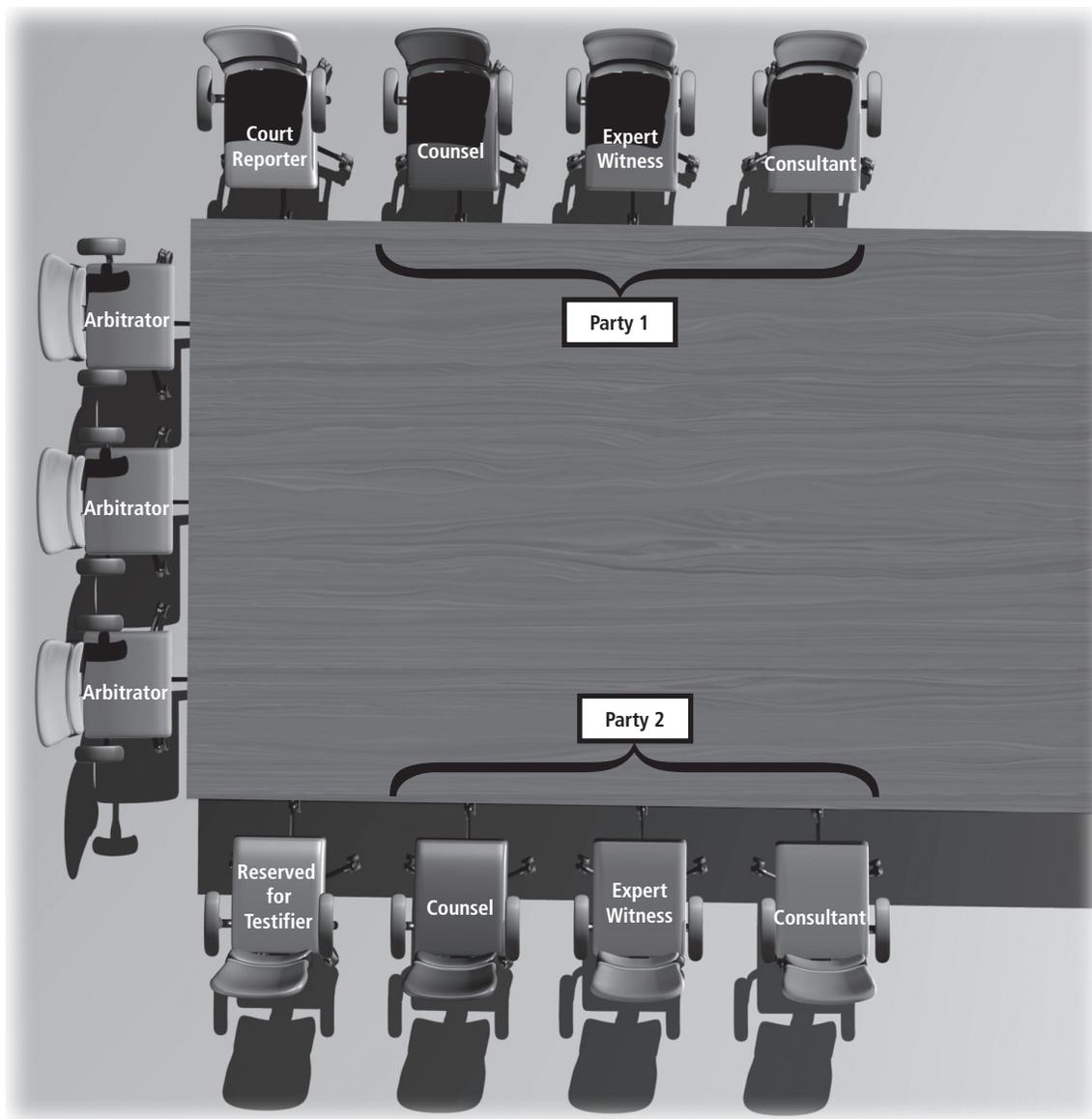
the landlord or the tenant will interview and engage the experts. Broadly stated, the testifying experts will be asked to opine to market value or market rent, as required by the lease in question, and to present that opinion in a report that will be exchanged with the opposition. In most instances, the testifying experts will also prepare rebuttal (review) reports opining to the quality and accuracy of the appraisal report submitted by the opposing expert. Finally, the valuer will likely testify at the arbitration hearing. For reasons that will be discussed in subsequent chapters, expert appraisal witnesses are required to comply with professional valuation Standards, including the Standards applicable to the development and reporting of value and review opinions.

Now let's assume the valuer is serving as an arbitrator. He or she may be retained on behalf of one of the parties to the dispute, or on behalf of both. The arbitrator may also be selected by or through one of the arbitration organizations, such as the American Arbitration Association (AAA), or appointed by a judge. The arbitrator(s) will be expected to be impartial neutrals who read and listen to all evidence presented and to all motions and arguments presented by counsel, and then arrive at an "award," which is defined by *Black's Law Dictionary* as "[a] final judgment or decision, esp. one by an arbitrator or a jury."¹ Most often, valuers serving as arbitrators are required to comply with the ethical and competency requirements of valuation Standards, but no performance Standards will apply to their work.

Valuation professionals are retained as arbitrators and/or testifying expert witnesses in nearly all arbitrations addressing property values; it is not as common to retain valuers as consultants in arbitrations. When we are engaged to serve as

As always, when valuers seek the advice of parties and their counsel, we must be aware of the inherent conflict between appraisers and lawyers. When we are "acting as appraisers" we are required to be independent and impartial, while attorneys are required by applicable ethical canons to be advocates for their clients' positions. This conflict is addressed in relation to various examples, but it is a good idea to keep it in mind right from the start. This conflict is not likely to arise when the basic procedure of the dispute resolution process is the issue, but it may.

1. *Black's Law Dictionary*, 10th ed. (St. Paul, MN: Thomson Reuters, 2014), 164.

Exhibit 2 Layout of a Typical Arbitration Hearing Room

consultants, the tasks we might perform are as varied as the parties and attorneys who retain us. The term “consultant” is not defined in the sixth edition of the Appraisal Institute’s *Dictionary of Real Estate Appraisal*, *Black’s Law Dictionary*, the Standards of Valuation Practice (SVP), or in the Uniform Standards of Professional Appraisal Practice (USPAP). Many common English dictionaries define a consultant as “a person who provides expert advice professionally,” or something to this effect. Two significant distinctions between the expert witness and the consultant or

“consulting expert” retained on behalf of the same party are that the work of the consultant is not discoverable (made available to the opposing party) and the consultant will not be called to testify at any hearings. In other words, the work of the consultant is to assist the attorney(s) who engaged that valuation professional, and not to directly assist the trier of fact.

If the related engagement letters and other documents that control a particular arbitration do not make it clear what role each of us is expected to play in the process, the valuation

professionals retained in a matter often discuss this among themselves and try to sort it out. If this does not resolve the questions, the attorneys are brought into the conversation. These questions have been so murky in some arbitrations that the interpretation of the confusing language has been brought to court for a judge to interpret.

Let's walk through a hypothetical situation together. Our hypothetical buy/sell contract clause tell us:

Buy/Sell: At any time either Partner may invoke this section by giving notice to the other Partner. The notice should designate a qualified appraiser to value the Property. The other Partner will likewise appoint a qualified appraiser, and then the two appraisers will select a third appraiser. Each party shall be responsible for the cost and fees of its own appraiser and shall equally share the cost and fees of the third appraiser. When the three appraisers conclude their determinations of the Buy/Sell Price, the initiating Partner would have the right of first refusal to either buy or sell the interests of the other Partner....

Arbitration: Any action to enforce or interpret this Agreement, or to resolve disputes with respect to this Agreement, or between or among the Partners, shall be settled by arbitration in accordance with the rules of the American Arbitration Association. Any party may commence arbitration by sending a written demand for arbitration to the other parties. The substantive law of the State of XXXXXXXXX shall be applied by the arbitrator(s) to the resolution of the dispute. The parties shall share equally all initial costs of arbitration. The prevailing party shall be entitled to reimbursement of attorney fees, costs, and expenses incurred in connection with the arbitration. All decisions of the arbitrator(s) shall be final, binding and conclusive on all parties.

Appraisers are different from many other experts and arbitrators in that they are required to comply with valuation Standards in performing their work. In our example, the three appraisers have each been granted the MAI designation by the Appraisal Institute, and so they must comply with the Appraisal Institute's Code of Professional Ethics (CPE) plus valuation Standards. Another difference for valuers is that the decision to provide services as independent professionals in compliance with applicable Standards

or as advocates is dependent on the expectations of their clients; this is not a choice we make for ourselves. The decision we make for ourselves is whether to accept the assignment or not.

USPAP's Advisory Opinion (AO) 21 explains:

Public trust requires that when an individual is expected to perform with the ethics and competency of an appraiser, he or she will do so. An individual who agrees to perform a valuation service as an appraiser has a duty to comply with the ethics and competency that the public expects from an appraiser. This obligates the individual to comply with USPAP in performing the service.

The definition of an appraiser in conjunction with the need for public trust establishes the "expectation" as the basis for the obligation to comply with USPAP.²

That the intended users expected the service providers to be acting as appraisers is clear in the engagement letters, all of which include the requirement that the services being engaged comply with USPAP. Let's further assume that no letter references arbitration services or any services other than appraisal. In addition, the three valuers acknowledged that they were performing appraisal services in compliance with USPAP and the CPE, as each of the three appraisal reports contains that affirmation in each respective Certification.

This intended user expectation is further supported by the language in the buy/sell contract itself, as it uses only the term "appraiser" and not "arbitrator." That the valuers apparently considered themselves "appraisers" throughout this assignment is shown in the final letter delivered to the parties. The letter, signed by the three valuers, is not styled as an arbitration award; it simply states that "The Buy/Sell Price is...." Each valuer's signature includes his appraisal designation.

AO-21 gives the following advice:

Intended user expectations for valuation services performed in compliance with USPAP are created when an individual represents that he or she is acting as an appraiser in a service. For example, these expectations can arise when an individual advertises or solicits as an appraiser (such as telephone listings, professional directories, business cards, stationery, or office signage),

2. USPAP Advisory Opinions, 2018–2019 ed. (Washington, DC: The Appraisal Foundation, 2018), AO-21, lines 57–62.

holds appraiser accreditation from a licensing agency, or maintains membership in a professional appraiser organization. An individual's identification as an appraiser in a given valuation service establishes a justifiable expectation that the valuation service will be performed in compliance with USPAP.³

Even if the valuers were "arbitrators" after the appraisal reports were exchanged, they were still required to be "neutral" and not be advocates for their clients' positions, as the hypothetical includes the provision that the "rules of the American Arbitration Association" are to be followed.

Our hypothetical agreement provides that "[a]ny action to enforce or interpret this Agreement, or to resolve disputes with respect to this Agreement...shall be settled by arbitration in accordance with the rules of the American Arbitration Association." So these rules must be consulted for guidance. "Just as the parties may limit by contract the issues which they will arbitrate, so too may they specify by contract the rules under which that arbitration will be conducted. This flexibility allows contracting parties to select the most appropriate rules to govern their arbitration."⁴

The AAA's Glossary of Dispute Resolution Terms found in *A Guide to Arbitration and Mediation for Business People* presents this definition: "[a]rbitration is a submission of a dispute to **one or more impartial persons** for a final and binding decision."⁵ (emphasis added)

The AAA's *Commercial Arbitration Rules and Mediation Procedures* effective October 1, 2013 ("AAA Commercial Rules") would apparently apply to our hypothetical arbitration. These rules provide:

Where the parties have agreed that each party is to name one arbitrator, the arbitrators so named must meet the standards of Section R-18 with respect to

impartiality and independence unless the parties have specifically agreed pursuant to Section R-18(b) that the party-appointed arbitrators are to be non-neutral and need not meet those standards.⁶

According to Section R-18 of the AAA Commercial Rules, Disqualification of Arbitrator, "Any arbitrator shall be impartial and independent and shall perform his or her duties with diligence and in good faith, and shall be subject to disqualification for... partiality or lack of independence."⁷ (emphasis added)

Section R-19 of the AAA Commercial Rules then addresses "Communication with Arbitrator," stating:

(a) No party and no one acting on behalf of any party shall communicate *ex parte* with an arbitrator or a candidate for arbitrator concerning the arbitration, except that a party, or someone acting on behalf of a party, may communicate *ex parte* with a candidate for direct appointment pursuant to R-13 in order to advise the candidate of the general nature of the controversy and of the anticipated proceedings and to discuss the candidate's qualifications, availability, or independence in relation to the parties or to discuss the suitability of candidates for selection as a third arbitrator where the parties or party-designated arbitrators are to participate in that selection.

(b) Section R-19(a) does not apply to arbitrators directly appointed by the parties who, pursuant to Section R-18(b), the parties have agreed in writing are non-neutral. Where the parties have so agreed under Section R-18(b), the AAA shall as an administrative practice suggest to the parties that they agree further that Section R-19(a) should nonetheless apply prospectively.⁸

Advice from the AAA goes beyond the language of the Commercial Rules, stating that "Finally, even in cases in which party-appointed arbitrators are serving as non-neutrals, the AAA rec-

3. USPAP Advisory Opinions, AO-21, lines 63–69.

4. Stephen Smerek and Daniel Whang, "Preemption and the Federal Arbitration Act: What Law Will Govern Your Agreement to Arbitrate?" *ABA Section of Business Law* (March 2006), <http://apps.americanbar.org/buslaw/newsletter/0051/materials/pp7.pdf>, citing to *Vol/Information Sciences, Inc. v. Board of Trustees of Leland Stanford Jr. University*, 489 U.S. 468, 479 (1989).

5. *A Guide to Commercial Mediation and Arbitration for Business People* (New York: American Arbitration Association, 2013), 7.

6. *Commercial Arbitration Rules and Mediation Procedures* ("AAA Commercial Rules") (New York: American Arbitration Association, 2016), R-13(b), p. 16, www.adr.org/sites/default/files/Commercial%20Rules.pdf.

7. AAA Commercial Rules, R-18(a), p. 18.

8. AAA Commercial Rules, R-19(a) and (b), p. 18.

ommends that parties agree to not communicate ex parte with their party-appointed arbitrator after the appointment procedures in the rules have been completed.”⁹

This advice is referencing the AAA Commercial Rule that provides that “[t]he parties may agree in writing, however, that arbitrators directly appointed by a party pursuant to Section R-13 shall be non-neutral, in which case such arbitrators need not be impartial or independent and shall not be subject to disqualification for partiality or lack of independence.”¹⁰ As our hypothetical includes no such written agreement, the AAA Rules would have all three valuers, even if serving as arbitrators, be impartial and independent.

Now let’s add one more wrinkle. Remember that sentence in the agreement that says, “The substantive law of the State of XXXXXXXXX shall be applied by the arbitrator(s) to the resolution of the dispute.”? Suppose the state is one like California, which has a statute that includes this definition: “‘Agreement’ **includes but is not limited to agreements providing for valuations, appraisals and similar proceedings** and agreements between employers and employees or between their respective representatives.”¹¹ This has been interpreted to mean that appraisal processes in contracts are considered to be arbitrations.

Thus, the inclusion in section 1280, subdivision (a), of “agreements for providing for valuations and appraisals” within the definition of arbitration agreements was in direct response to the Commission’s recommendation that the California statute be amended to include a provision which expressly extends the coverage of the statute to appraisals and valuation proceedings....we conclude the 1961 statute erased the judicial distinction between agreements to arbitrate disputes and agreements providing for independent examina-

tions by way of valuations, appraisals and similar proceedings, such as audits, and brought such agreements within the arbitration law.¹²

Would that mean that our appraisers are arbitrators if they are in California? If this is an arbitration, would the AAA Commercial Rules apply as stated in the hypothetical clause, or would California law apply, as also stated in that clause? (“Any action...shall be settled by arbitration in accordance with the rules of the American Arbitration Association...The substantive law of the State of XXXXXXXXX shall be applied by the arbitrator(s) to the resolution of the dispute.”) Arbitrators, attorneys, and judges have expressed various opinions on this question of exactly what rules or laws control which portions of ADR, and if you are involved in an arbitration where these types of questions arise, they should be addressed by the arbitrator(s) as soon as possible. If deemed helpful, advice of counsel should be sought in the form of briefs on the issue. What is important to remember is: regardless of the label attached to us or the work we are doing, arbitrator/arbitration or appraiser/appraisal, we must comply with valuation Standards in addition to the other laws, regulations, or rules that may apply to the assignment. “Thus, arbitral immunity attaches not because of the professional credentials of the arbitrator, nor because of the ethical canons of the profession to which the arbitrator may belong. Rather, arbitral immunity¹³ attaches simply by virtue of the fact that a proceeding is deemed to be an arbitration. (§ 1280.1.)”¹⁴

So whichever decisions you may have made as we worked through this situation, we all would have ended up in the same place: whether the valuers are labeled “appraisers” or “arbitrators,” they are required by valuation Standards and the AAA Commercial Rules to be independent.

9. *A Guide to Commercial Mediation and Arbitration for Business People*, 21.

10. AAA Commercial Rules, R-18(b), p. 18.

11. California Code of Civil Procedure §1280(a).

12. *Coopers & Lybrand v. Superior Court*, 212 Cal. App.3d 524, 533–34 (Cal. Ct. App. 1989).

13. Arbitral immunity is protection afforded to arbitrators under both federal common law (the legal precedent created by appellate court opinions) and under the statutory or common law of most every state that has considered the topic. It protects arbitrators from being sued by parties to the arbitration, or by other participants, when the party doesn’t like the result or some other aspect of the arbitrator’s decision-making. For a discussion of arbitral immunity, see chapter 11 in *Appraisers in Arbitration* (Chicago: Appraisal Institute, 2018).

14. *Coopers & Lybrand v. Superior Court*, 212 Cal. App. 3d 524 (Cal. Ct. App. 1989).

About the Author

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Additional Resources

Suggested by the Y. T. and Louise Lee Lum Library

American Arbitration Association

<https://www.adr.org/>

American Bar Association, Section of Dispute Resolution

https://www.americanbar.org/groups/dispute_resolution.html

Appraisal Institute

- **Lum Library** [Login required]
Information files—Appraisal practice/expert testimony
- **Professional practice**
 - Guide Note 16: Arbitration
<https://www.appraisalinstitute.org/assets/1/7/guide-note-16.pdf>
 - Standards of Valuation Practice and Valuers Code of Professional Ethics
https://www.appraisalinstitute.org/assets/1/29/AI_SVP_VCPE_2016.pdf

ArbitrationNation—Blog on legal issues related to Federal Arbitration Act

<https://www.arbitrationnation.com/>

Financial Industry Regulatory Authority—Arbitration and Mediation

<http://www.finra.org/arbitration-and-mediation>