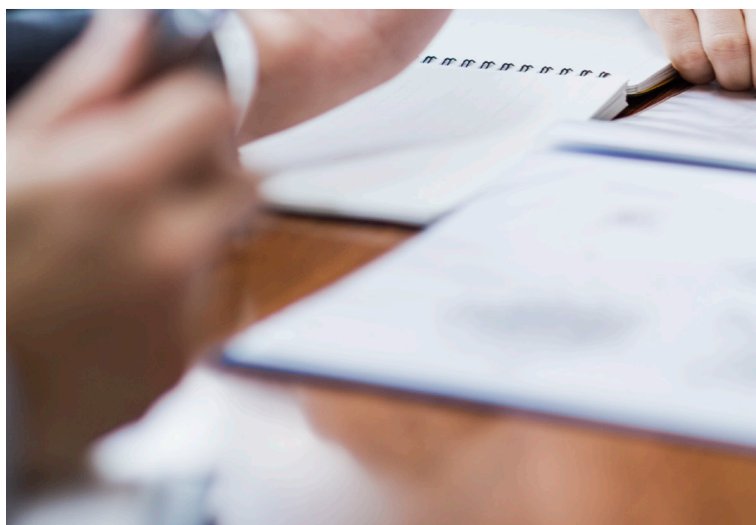


# Guide Note 16

## Arbitration<sup>1</sup>



## Introduction

Real estate valuation professionals (“Valuer” or “Valuers”) are often retained to provide services in arbitration matters<sup>2</sup> either as arbitrators or expert witnesses<sup>3</sup>. Arbitration is a process in which the parties to a dispute agree to present their case to one or more arbitrators who render a final decision to resolve the dispute.

When parties have a dispute, they often find themselves in litigation after one party sues the other. Parties and their attorneys are increasingly using methods to resolve disputes without going to trial. The Courts have encouraged the use of these alternate processes and have upheld arbitration awards. The use of arbitration is accepted by the parties to the dispute, their attorneys and the Courts because arbitration permits the parties to have more control over some procedural and

administrative aspects of the resolution dispute procedure than if they had gone to trial, arbitrations are frequently less expensive and produce more timely results than litigation, and issues arbitrated do not use time on crowded Court calendars.

Arbitration is similar to a trial, but is a somewhat more flexible process where the parties can agree on procedure and on which issues to arbitrate. Arbitration hearings, which are conducted in conference rooms and not courtrooms, are less formal than a trial in that the rules of evidence may be considered but are not mandatory. As in a trial, written and oral evidence is presented, depositions are permissible, and experts typically review and comment on the opposing expert’s report (this is typically labelled a “rebuttal” report in litigation and arbitration). Arbitration awards generally are binding and final, and can be vacated (overturned)

# GUIDE NOTE 16

## Introduction (continued)

by a court only on narrow grounds which are typically limited to lack of appropriate disclosure of conflicts by an arbitrator and awards made by the arbitrator(s) that go beyond the jurisdiction of the arbitrators.

The decisions made by arbitrators are presented to the parties in documents called “awards,” and awards may offer a party relief in the form of monetary payment, other type of relief (for example, to compel or stop certain activities), or to resolve any question the lease or contract controlling the arbitration requires to be answered by arbitrators.

The two most commonly used types of awards are:

- “standard,” a statement of the amount of any relief granted, or type of relief if not monetary. A standard award is typically short statement, with no explanation of the rationale for the result.
- “reasoned,” according to the American Arbitration Association (AAA) commercial rules, means “a written explanation of the award.”<sup>4</sup> These arbitration rules provide that a reasoned award is permitted only when the parties request a written explanation of the award prior to the appointment of the arbitrator(s). A “reasoned award” is not an opinion of value communicated in an appraisal report; this is addressed below.

What services can a real estate valuation professional provide in an arbitration matter, and what standards and ethical rules apply? This is a vital issue, as a valuer providing a service in an arbitration potentially may find him- or herself acting within any one of the three “circles” presented in USPAP Advisory Opinion 21:

- performing an appraisal and/or appraisal review in compliance with certain Rules and Standards,
- making arbitral decisions communicated in awards while acting as an appraiser so that certain Rules apply but no Standards apply, or
- making arbitral decisions communicated in awards while *not* acting as an appraiser so that neither Rules nor Standards apply other than the duty to not mislead.

## What Does the Potential Client Expect?

The first issue to be considered is the expectation of the potential client regarding the Valuer’s role in the process.

The standards’ definitions of “valuer” and “appraiser” start with “One who is expected to...” On the basis of those definitions, “any potential client of [a Valuer] should be able to expect a certain level of professionalism from anyone representing himself or herself as an appraiser.”<sup>5</sup>

USPAP Advisory Opinion 21 further explores this expectation and states “In summary, expectation [of the intended user] is the basis for determining when an individual providing a valuation service is acting as an appraiser.”<sup>6</sup> The intent of the potential client controls the decision, and not the intent or preference of the Valuer. The client seeking a Valuer to serve as an arbitrator would do so because of a Valuer’s education, knowledge, and independence, i.e. because of the expectation that the Valuer will be “acting as an appraiser.”

This concept is confusing because the USPAP discussion of “acting as an appraiser” is often mistakenly thought by Valuers to be equivalent to “does the individual have an appraiser designation or license?” or “is the individual providing an appraisal?” However, this fails to consider the standards’ definition of “appraiser” or “valuer” which address independence and competence rather than licenses, designations, or services provided. Thus, one may be “acting as an appraiser” (independent and competent) but not providing value or appraisal review opinions.

USPAP defines “appraiser” as “one who is expected to perform valuation services competently and in a manner that is independent, impartial, and objective,”<sup>7</sup> and “appraisal” as “the act or process of developing an opinion of value; an opinion of value.”<sup>8</sup> When performing an appraisal, a Valuer develops and reports an opinion of value.

Black’s Law Dictionary defines “arbitrator” as “a neutral decision-maker who is appointed directly or indirectly by the parties to an arbitration agreement to make a final and binding decision resolving the parties’ dispute,” and “arbitration” as “a dispute-resolution process...” the result of which is an “award.”

When serving as an arbitrator, a Valuer is rendering a final, generally binding decision to resolve a dispute and communicating that decision in a written, signed document called an “award.” The distinction is that the Valuer is “acting as an appraiser,” but not providing an appraisal or appraisal review opinion. Therefore, when “acting as an appraiser” and serving as an arbitrator, competency and ethical requirements must be met. But there are no applicable Standards or Standards Rules<sup>9</sup> to comply with as appraisal or review opinions are not being provided by the Valuer.

The next question to be addressed is the expectation of the potential client regarding the type of service the Valuer is being asked to provide.

# GUIDE NOTE 16

## Are You Providing an Opinion or a Decision?

The Valuer must clarify whether he or she is being engaged as a valuation expert witness or as an arbitrator.

Confusion may arise as prospective clients sometimes use the words “appraiser” and “arbitrator” interchangeably, and the leases and other contracts setting forth the terms of the arbitration proceedings also use the terms as synonyms; it sometimes happens that the term “appraiser-arbitrator” is used and this term is by definition inaccurate, as a valuation professional can provide services as one or the other, but generally not both at the same time. The instances in which a Valuer might provide both value or review opinions and an arbitration award are established by statutes in certain jurisdictions or by the lease or other contract controlling the proceeding.

The Valuer must clarify whether he or she is expected to provide valuation opinions or arbitral decisions in any given proceeding in order to competently develop and provide those opinions or decisions, as well as to properly identify which ethical rules and standards and laws or regulations are applicable.

## Which Tasks Are You Performing?

Practitioners in different professions often use the same terms and phrases as Valuers but with different definitions and meanings. The clearest way to discern whether a Valuer is being considered as an expert witness or as an arbitrator in situations where the language is unclear, is to reach agreement with the prospective client on which services he or she is expected to provide in the course of the matter. Some long-term ground and net leases that describe arbitration procedures were drafted as far back as the 1960s, when valuation terminology was not as specifically defined as it is now.

If the prospective client is seeking a valuation expert witness in an arbitration, the Valuer would typically be expected to provide the following services:

- Perform an appraisal pursuant to the requirements in the lease, contract or other document that sets forth the requirements for the arbitration that complies with applicable standards (if USPAP, Standard 1)
- Prepare a written report that typically will be exchanged with the opposing party and submitted to the arbitrator(s) and that complies with applicable standards (if USPAP, Standard 2)
- If asked to prepare a “rebuttal” report, review and opine with regard to the opposing expert’s appraisal report (If USPAP, Standard 3, as “rebuttal” is the arbitration procedure term for “appraisal review”)
- Present oral testimony at an arbitration hearing (the controlling document or rules of arbitration may permit or require a deposition be taken of expert witnesses, in which case deposition testimony will also be provided)

If the prospective client is seeking an arbitrator, the Valuer would typically be expected to provide the following services:

- Interact with the parties and their counsel to establish the ground rules for the arbitration process
- Conduct a preliminary hearing to clarify and confirm:
  - Issues to be arbitrated
  - Will award be reasoned or not
  - Number and length of briefs and reply briefs to be submitted
  - Dates for submissions and replies
  - Times for property visits by arbitrators and by experts (generally not at the same time). The arbitrator would likely not be focused on the same property characteristics as the expert valuation witness.
  - Location and length of the arbitration hearings, as well as how time is to be divided among the parties
  - General housekeeping issues for the hearings, including court reporter
- Decide any pre-hearing issues (it is not unusual for the lease or other controlling document to be vague with regard to date of value to be determined, highest and best use requirements, property characteristics to be considered or not in the valuations, etc.) and prepare interim awards on these points
- Conduct the arbitration hearings (Arbitrators are the triers of fact, or the “judge”)
- Render a decision and write the final award, and do not develop and report an appraisal or appraisal review

# GUIDE NOTE 16

## A Final Award is not an Opinion of Value

One reason for the confusion in this area is that the decisions required from the arbitrators as described in the controlling documents often use the word “value” although the expectation is not that the arbitrators will perform an appraisal. This collision of common English usage and valuation terminology often causes unintended results in arbitration awards if the arbitrators think they are to provide an appraisal opinion, albeit with a rather unusual scope of work, and so think they must comply with applicable reporting standards in writing the award. It is not unusual for a lease to require the arbitration panel to provide an award of “fair market value” or “fair market rent” of a specified ownership interest in an identified real property asset as of a specific date, and yet this is not expected to be, nor should it be, an appraisal opinion.

The arbitration award sets forth an amount determined to be appropriate to settle the dispute based on an assessment of the evidence presented in the arbitration and the terms of the lease or other controlling documents. The final award does not communicate what the arbitrators might determine the market value of the asset to be if they had individually or collectively performed an appraisal.

## Which ethical rules and standards must Valuers follow?

When providing expert valuation opinions, a Valuer must comply with:

- Appraisal Institute Code of Professional Ethics (CPE)
- SVP or USPAP:
  - SVP
    - Standard A (when value opinions are provided)
    - Standard B (when rebuttal (review) opinions are provided)
    - Standard C
  - USPAP
    - Ethics Rule
    - Competency Rule
    - Record Keeping Rule
    - Scope of Work Rule
    - Jurisdictional Exception Rule<sup>10</sup>
    - Standard 1 (when value opinions are provided)
    - Standard 2 (when value opinions are provided)
    - Standard 3 (when rebuttal (review) opinions are provided)
- Certification Standard

When serving as an arbitrator, a Valuer must:

- If “acting as an appraiser” comply with:
  - Appraisal Institute Code of Professional Ethics (CPE)
  - USPAP
    - Ethics Rule
    - Competency Rule
    - Jurisdictional Exception Rule<sup>11</sup>
- If not “acting as an appraiser” (valuer), valuation standards and the CPE do not apply.<sup>12</sup>

# GUIDE NOTE 16

## Are there any arbitration laws or regulations that would apply to Valuers?

Every state has adopted an arbitration law, and either that law or The Federal Arbitration Act, US Code, Title 9 is likely applicable to any given arbitration. These laws address the requirements of arbitrators and not the requirements of those presenting testimony in an arbitration. The Federal and state laws are very similar in many respects, and set forth the ethical duties of the arbitrators, including the requirements for disclosure of potential conflicts of interest. The disclosure requirements are much broader than those required when a Valuer is performing appraisal or appraisal review services. Therefore, Valuers must learn which laws or regulations apply and comply with all disclosure requirements which generally include a duty to investigate potential conflicts arising from relationships of immediate family members and members of the arbitrator's household. The laws also typically provide a maximum number of days for these disclosures.

The road map for Valuers providing either expert valuation opinions or arbitration decisions is typically contained in the lease or other contract stipulating that arbitration is to be used to resolve specified disputes.

The following examples are based on actual lease provisions. Typically the parties and attorneys know whether they are seeking valuers to provide appraisal opinions or arbitration decisions; however, the language in the controlling leases is often unclear and the language used by potential clients in the retention process is often equally imprecise. Examples of commonly encountered imprecise language follow.

### Baseball<sup>13</sup> example #1

Lease: 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"

Service provided: Appraisal by the party-selected appraisers serving as valuation experts and appraisal review by the third. Standards A and C (SVP) or Standards 1 and 2 (USPAP) are applicable to the party-selected valuers' work and Standards B and C (SVP) or Standard 3 (USPAP) apply to the work of the third arbitrator.

### Baseball example #2

Lease: 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."

If all three Qualified Professionals are valuers, services provided:

1. Each of the two party-selected valuers will be performing appraisals to determine fair market rental value using the definition contained in the lease, and communicating those opinions in reports that must comply with applicable valuation standards. The fact that the lease implies that all three Qualified Professionals are arbitrators does not change the fact that the two party-selected valuers are providing value opinions. Further, the fact that the lease labels the appraisal report as a "memorandum" does not change the fact that Standards A and C (SVP) or Standards 1 and 2 (USPAP) apply to the development and communication of the opinions.)
2. The description of the duties to be performed by the third Qualified Professional (consider evidence presented in the appraisal reports prepared by the valuation experts plus other oral testimony and arguments) indicates that this valuer is serving as an arbitrator and not providing value opinions. This arbitrator decides the amount that represents "fair market rental value" as defined and described in the lease. The arbitrator does not perform an "appraisal" or an "appraisal review" as defined in standards, but makes a decision based solely on the evidence presented and prepares a written award presenting that decision.

# GUIDE NOTE 16

## Three person panel example

Lease: “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”.

Service provided: It depends on whether the parties have agreed to an appraisal or arbitration scenario as this clause appears to apply to either dispute resolution process. The typical result of this type of clause is that an arbitration is conducted, with each party presenting valuation and other experts to a three-person arbitration panel that considers all written expert and rebuttal reports plus oral testimony, exhibits and legal arguments presented at the arbitration hearing. The services provided by valuers in that situation are:

1. The valuers retained as experts will develop opinions of value and submit reports as well as review the report(s) of the opposing valuation expert. The review opinions are typically presented in a report labeled as a rebuttal report; however Standards B and C (SVP) or Standard 3 (USPAP) are applicable to those review opinions and reports. Standards A and C (SVP) or Standards 1 and 2 (USPAP) are applicable to the value opinions and reports.
2. The valuers retained to serve as arbitrators will consider the written and oral evidence presented and arrive at a decision presented in writing in the form of an arbitration award. This is an arbitration award even if the award contains the word “value;” the award is not an appraisal report and the decision is not an opinion of value developed in compliance with valuation standards.

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<sup>1</sup>Arbitration is an alternate dispute resolution process that is controlled by statutes, regulations, leases and other forms of arbitration agreements. This Guide Note has used the most typical arbitration scenarios as examples; however, the procedure followed, the formality of the process, and the specific services to be provided by both the valuation experts and the arbitrators may be different from the examples presented. It is the responsibility of the Valuer to determine what is expected in each situation and then to provide the required services in compliance with applicable standards.

<sup>2</sup>This Guide Note is focused solely on arbitration, and not other types of alternate dispute resolution processes such as mediation, appraisalment, etc.

<sup>3</sup>This Guide Note is applicable to arbitrations conducted pursuant to US laws and rules of arbitration; it may or may not be applicable, in whole or part, to arbitrations conducted pursuant to laws and rules outside the U.S.

<sup>4</sup>Black’s Law Dictionary, Tenth Edition, defines “reasoned arbitration award” as “An arbitration award in which the arbitrators explain the rationale for their decision.”

<sup>5</sup>The Appraisal of Real Estate, 14th Edition, Appraisal Institute, Chicago, IL, 2013, p. 2.

<sup>6</sup>2016-2017 USPAP Advisory Opinions, Advisory Opinion 21, “USPAP Compliance,” at lines 75-76, The Appraisal Foundation, Washington, DC.

<sup>7</sup>The SVP definition of “valuer” is virtually the same: “One who is expected to provide Services in an unbiased and competent manner.”

<sup>8</sup>The SVP definition is virtually identical.

<sup>9</sup>Thus, under the SVP Standards A, B and C do not apply and under USPAP Standards 1, 2 and 3 do not apply.

<sup>10</sup>Although the Jurisdictional Exception Rule applies, there have been no reported instances where applicable arbitration laws or regulations created such an Exception.

<sup>11</sup>Although the Jurisdictional Exception Rule applies, there have been no reported instances where applicable arbitration laws or regulations created such an Exception.

<sup>12</sup>A Valuer may be retained due to knowledge based on a different profession such as broker, leasing agent, property manager, etc., or retained as a non-neutral arbitrator.

<sup>13</sup>Baseball arbitration (typically where the arbitrator selects the amount or opinion presented by a party or expert witness) is becoming more frequently used as it is often a less expensive form of arbitration.