OPTIMUM RESOLUTION OF NEGLIGENT VALUATION DISPUTES

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ABSTRACT

This paper examines the issue of disputes arising from allegations of negligence in valuation. It discusses the nature of the disputes, why they occur and their typical characteristics. These characteristics are seen frequently to render litigation a doubtful model for resolution of such disputes. The authors consider alternative methods of dispute resolution, including mediation, mini-trial, the use of a valuation expert to assist the decision-maker and the creation of specialist tribunals.

Keywords: Legal liability, negligent valuation, dispute resolution.

INTRODUCTION

Allegations of negligent valuation will occur. First, professionals make mistakes. The leading English legal text on professional negligence (Jackson and Powell, 1997) contained in its first preface the truism that "There is hardly any professional man who does not from time to time do that which the courts would castigate as negligent". While many of these mistakes will be capable of being corrected, some will not. Second, clients and others, such as lending institutions to whom reports are shown, rely upon the valuations. Clients sustain losses in some of the transactions in which they engage. They then wish to re-coup or at least partly offset those losses. Third, valuers, as professionals, represent an eligible target and potential source for recovery for clients or third parties who have sustained losses. Valuers routinely carry professional indemnity insurance, which constitutes the 'pot of gold' which the claimant seeks.

By no means all the allegations of negligence against valuers will be well founded. Investors and lenders can sustain losses through their own incompetence. The cause of the losses may be sheer misfortune, unforeseeable market movement or may even be a cynical device to try to avoid or delay payment of fees owed to the valuer.

A distinction may be drawn between two types of negligent valuation case. While periods of economic volatility, especially a buoyant market followed by a sharp fall and prolonged depression, unquestionably generate 'waves' of similar claims (Connell, 1990; Evans, 1993; Crosby et al, 1998a), there can also be identified a category of routine claims which are largely unrelated to market movement (although at the margin, adverse economic conditions tend to encourage claims, since favourable market trends can mask losses) and which depend more on individual circumstances and, frequently, individual human error. Standard texts on legal responsibilities of surveyors and valuers in the UK (Murdoch and Murrells, 1995) and in Australia (Joyce and Norris, 1994) contain many such examples. They may relate to inadequate knowledge of the market, insufficient time or resources for the

collection of evidence or calculation, out of date understanding of methodology or law, or succumbing to pressure exerted by a client or other interested party. Of course, there is no reason why one or more of these features should not also figure in one of the 'post-crash' cases, but this type of case is not reliant on market volatility. A sufficiently serious error is capable of causing loss under any conditions.

The central issue for this paper is how disputes relating to allegations of negligent valuation should be resolved. Before considering the options as to methods of dispute resolution, it will be appropriate to consider the need for them and the characteristics of the disputes, since these will influence the choice of mechanisms for optimum dispute resolution.

THE NEED FOR DISPUTE RESOLUTION MECHANISMS

If allegations of professional negligence are made, they are likely to give rise to disputes. There may be cases where the valuer against whom the allegation is made is prepared to admit responsibility and fault, and offer the assistance or compensation sought, although the role of professional indemnity insurers means that that decision is usually taken away from the valuer. In many cases, the valuer will dispute some or the entire claim on moral or legal grounds or both. The defence may be to deny a legal duty of care altogether: *Blake v Barking and Dagenham.*

The valuer may admit that the duty of care exists, but deny that it has been breached, in that the standard of professional conduct achieved meets that of the ordinary competent practitioner: *Bolam v Friern Hospital Management Committee* and *Chin Keow v Government of Malaysia.* It is by no means an easy matter either in law or in practice to show that a valuer has been negligent. As Mocatta J said in *Shacklock v Chas Osenton, Lockwood and Co.*, "I do not think that [the defendant's] valuation can be faulted legally so as to show that he was professionally negligent...merely by going through these items and criticising them meticulously and suggesting that they are on the high side". Against this must be noted the 'margin of error' concept which has been employed both in the UK in cases such as *Mount Banking v Brian Cooper and Co* and in Australia, albeit in a modified form, in cases such as *Trade Credits Ltd. v Baillieu Knight Frank (NSW) Pty Ltd.* and *MGICA (1992) Ltd. v Kenny and Good Pty Ltd.* In theory at least, the margin of error ought to make establishing breach of duty by a valuer easier and less dependent on subjective considerations of fault. In reality, the concept has been fraught with difficulty in its application in both jurisdictions (Crosby et al, 1998b; Crosby et al, 1998c), so the propensity for dispute about professional standards in valuation is probably as great as ever.

Disputes can also arise out of the issue of causation, specifically the extent to which negligence, even if admitted, has caused the loss suffered. The House of Lords complicated rather than clarified this issue in *South Australia Asset Management Corporation v York Montague*, where the liability of valuers for all losses resulting from a negligent valuation was in question, including those additional losses caused by a sharp deterioration in the market. The House of Lords drew a distinction between a valuer acting as adviser, who would be responsible for all losses flowing from the original negligence once proven, and a valuer merely supplying information, whose liability would be limited to the actual consequences of that information being incorrect, if so proven. While this may have enabled the litigation in question to be

decided, this aspect of causation is seen as likely to generate further disputes about the role in which a valuer was acting in any given situation, especially when the market cycle again replicates the conditions which gave rise to the *South Australia* case, i.e. the 'boom-crash' scenario (Murdoch, 2001).

There may also be disputes about specific defences, which the valuer would wish to offer to the claim, such as the passage of time, as in *Mullins Investments Pty Ltd v Richard Ellis (WA) Pty Ltd* in Western Australia or *Horbury v Craig Hall and Rutley* in the UK. The defence of contributory negligence, involving as it does an accusation against the accuser, is also a recipe for dispute. Such a defence has been available to New Zealand valuers since *Kendall-Wilson Securities v Barraclough* in 1986, but it was not until the early 1990s, with cases such as *PK Finans International (UK) Ltd v Andrew Downs and Co. Ltd.* and subsequently the *South Australia Asset Management* case, that such a contention became recognised in the UK.

The subject of negligence is emotive, with its associations with incompetence and moral blame. The stakes can be very large, both financially and in terms of professional reputation. The subject matter is often subjective; Lindgren J in *MGICA v Kenny and Good* called valuation a "very inexact science", although in the case of *Cash Resources Australia Pty Ltd. v Ken Gaetjens Real Estate Pty Ltd*, the Supreme Court of South Australia appears to have taken a much harder line as to how much inexactitude was permissible.

THE NATURE OF NEGLIGENT VALUATION DISPUTES

The emotive nature of the allegations against the valuer is a key factor to note when considering negligent valuation disputes. It is axiomatic that allegations of negligence by professional people are painful, virtually always for the accused and sometimes for the accuser, who may, for example, be a client of long-standing.

In common law countries like Australia, New Zealand and the UK, the claimant can only succeed in making good a claim for professional negligence by attacking the conduct and the competence (even if it is specific rather than general) of the professional. To succeed in law, which would normally be the requirement for a pay-out under a professional indemnity policy as well as for victory in court, the claimant must devote resources to criticism of the valuer (or other professionals) and must inflict some damage or lose. The outcome for the professional can be devastating, as for example in Watkins' treatment of the defendant valuer in *Singer and Friedlander v John D Wood*. In carrying out a residual valuation for a residential development site, the valuer should have contacted the local planning authority regarding plot density ratio, infrastructure and the future prospects for development. Watkins said he found himself driven to a "drastic conclusion". The valuer "failed to persuade me that he at any time telephoned the planning department of the Gloucestershire County Council...He has, I regret to say, in an effort to avoid a finding of professional negligence yielded to the temptation of doing that which I am sure is contrary to his usual inclination and standard, that is to say, he claims to have done that which he did not do. To put it bluntly, he has told me an untruth". It is to avoid a disastrous result of this kind, combining defeat with public castigation, that the defendant is fighting.

To obtain a true picture of what is at stake, however, the claimant's position must also be understood, since that can also contribute significantly to the contentiousness of the dispute. It is not possible to generalise. At one end of the size spectrum are some huge commercial losses, usually sustained by lenders. *In Nyckeln Finance Co Ltd. v Stumpbrook Construction Ltd.*, the Swedish lenders advanced £21 million (approximately A$55 million) on the strength of a valuation of £30.5 million (approximately A$80 million) commissioned by the borrowers and faxed to them in Sweden in May 1989. The security was an office block in central London, which was sold in July 1992 on the borrower's default for £3.1 million. (approximately A$8.1 million). But, however large the lender's losses, they remain ultimately commercial losses in a risk-prone business. At the other end of the scale in size terms are the residential cases like *Perry v Sidney Phillips* and *Kenney v Hall Pain and Foster*, where the financial losses might be small in money terms, but would constitute a family's only major asset.

From the substance of the dispute, it is possible to make some observations. The claimants against valuers will nearly always be lending institutions or individuals. The lenders may have commissioned the valuation from the valuers, or they may have relied upon a valuation prepared for the borrower, in which case any claim they have will be in tort rather than contract. The individual will either have commissioned the valuation or will have relied in making the decision to purchase the property upon the loan valuation commissioned by the lenders. This latter possibility has been upheld in cases like *Smith v Eric S Bush* and *Yianni v Edwin Evans*.

The disputes themselves are sometimes a mixture of law and fact, although the majority are disputes as to fact. The rules on the existence of the duty of care and how its extent can be restricted, e.g. by the use of disclaimers, are fairly well established. The tests for required standard of conduct and the margin of error principle are reasonably clear in law, (the former, at least), but are both complex. Issues of causation and damage are also well established in law, albeit complex, but there is scope for argument about reliance and about quantum of loss. As has been stated, the defence of contributory negligence is no more and no less than an accusation of negligence in itself, with similar scope for factual disagreement and subjectivity. The relative importance of factual issues in proportion to legal issues is of importance in the next stage of the discussion, which is to examine the options for dispute resolution in view of the nature of those disputes.

DISPUTE RESOLUTION: THE COURTS

At first sight, the answer to the question as to how negligent valuation disputes should be resolved is obvious. The optimum method of resolution is by agreement through negotiation. If settlement cannot be reached, the parties have a long-established, officially sanctioned route open to them, namely the court system. It has a number of features to recommend it. Above all, the court system has expertise in dealing with legal issues. However, serious reservations do exist about the appropriateness of the judicial system as a means of dealing with negligent valuation disputes. The Woolf Report on Civil Justice in the UK in 1996 was highly critical of practical aspects of the litigation system, reflecting long-standing dissatisfaction amongst its consumers: "it is too expensive in that the costs often exceed the value of the claim; too slow in bringing cases to a conclusion and too unequal; there is a lack of equality between the

powerful, the wealthy and the under-resourced litigant. It is too uncertain; the difficulties of forecasting what litigation will cost and how long it will last induces the fear of the unknown; and it is incomprehensible to many litigants" (Woolf, 1996). In the US, "There are few things managers dread more than litigation. Even petty cases have a way of damaging relationships, tarnishing reputations and eating up enormous sums of money time and talent" (Allison, 1990). These types of criticism are common in most commercial sectors and beyond; they are nonetheless valid.

But more specific doubts about litigation exist in the context of negligent valuation disputes. Whereas the Allison-type criticisms can be, and have been, to some extent, addressed by reform of efficiency, other flaws are more fundamental. Valuation is a highly technical subject and one in which the courts are almost entirely in the hands of expert witnesses. This has been a source of concern to the judges themselves. In *Leigh v Unsworth*, His Honour Judge Everett recognised the weakness of his position: "since we are dealing with the standard of care required in a professional man in connection with a profession in which of course the court is not expert, the court has to depend upon expert evidence itself, because the test is of course an objective one – what was required in the particular circumstances of the case to discharge the duty of care, or comply with the implied term, by the defendant. In some ways it may be thought that it is not an entirely satisfactory way of resolving disputes of this kind..."

Crosby et al (1999) recorded large discrepancies between valuations carried out by expert witnesses for claimant and defendant respectively. These discrepancies and a survey of the views of valuers, judges and arbitrators suggested widespread lack of confidence in the objectivity of the expert evidence presented in court. The study has been extended to Australia and recently reported (Crosby et al, 2001). While no fraudulent intent was imputed (usually), there was a strong impression that the lack of objectivity of many experts could confuse or even actively mislead the court. The Commercial Court judges in their evidence to the Woolf Inquiry (Woolf, 1996) had alleged widespread failure to maintain the required degree of impartiality, noting in particular their "polarisation of issues and unwillingness to concede issues from the start" and their "insufficient observance of the confines of expert evidence and expansion into the realms of rival submissions".

The in-house journal of the Bar put it in stronger language (Counsel, 1994). "Expert witnesses used to be genuinely independent experts. Men of outstanding eminence in their fields. Today they are in practice hired guns: there is a new breed of litigation hangers on, whose main expertise is to craft reports which will conceal anything that might be to the disadvantage of their clients". Sir Thomas Bingham, presiding in the Court of Appeal in *Abbey National Mortgages plc v Key Surveyors Nationwide Ltd.* described "The experience of the courts over many years" as follows: "For whatever reason, and whether consciously or unconsciously, the fact is that expert witnesses instructed on behalf of parties to litigation often tend, if called as witnesses at all, to espouse the cause of those instructing them to a greater or lesser extent, on occasion becoming more partisan than the parties". A similar complaint was made by Wright in the first instance hearing of *Arab Bank plc v John D Wood*: "The court has not been assisted by the tendency which I detected in all the expert witnesses who gave evidence before me to take upon their own shoulders the mantle of advocacy and themselves to seek to persuade the court to a desired result rather than to offer

dispassionate and disinterested assistance and advice to the court to enable it to arrive at a fair and balanced view of the conflicting contentions of the parties".

DISPUTE RESOLUTION: ARBITRATION

Given the difficulties identified with litigation, it remains to consider possible alternative approaches. The UK, following the Woolf Report, has moved towards encouragement of a single expert in the belief that "There must be at least a reasonable chance that an expert appointed by the court, with no axe to grind but a clear obligation to make a careful and objective valuation, may prove a reliable source of expert opinion". Unfortunately, this much-advocated reform (Lord Woolf is said informally to have mentioned valuation as a strong candidate for this type of approach) is fraught with difficulty. Crosby et al (1999) discovered widespread resistance to a single expert witness, giving rise to the likelihood that the parties will still retain their own. Joint-appointed experts are likely to prove hard to agree, and the courts in the UK at least have shown little enthusiasm for the French model of the court-appointed expert (Cohen, 1997). There is the added difficulty that the margin of error research suggested that the startling divergences between expert witness valuations tended to be reduced where **more** experts were involved, as was noted in the Australian cases studied (Crosby et al, 1998c). So moving towards one expert is likely to increase concerns about the reliability of the valuation against which the defendant's performance is judged.

But objectivity and technical accuracy are not the sole reasons for turning from litigation to an alternative approach. It was observed above that the emotive nature of negligent valuation disputes makes the public arena especially traumatic. A study of the Valuers Registration Board cases reported in the New Zealand Valuers Journal (Lavers, 1994), albeit before a different tribunal, emphasises the harrowing effects of public condemnation. The cases of *Henry Simkin* and *Stephen Mihaljevich* both contain forthright criticism of a "basic lack of knowledge of the property market...and a deficiency of fundamental research", while in the *Francis Evans* case, the valuer was described as "completely out of his depth".

For reasons of privacy and personal dignity alone, arbitration may have a claim to be preferable to litigation. Arbitration objectively assesses the arguments on both sides of a dispute, and is an alternative to expensive and long-winded court proceedings, aiming to resolve an allegation in a quicker, confidential and more cost-effective way.

The parties have the ability to agree upon the appointment of the Arbitrator, who should have specialist knowledge of the area of dispute, and in the absence of any agreement, the decision has to be referred to an independent third party. Arbitration therefore has the advantage of, or at least the potential for, a decision-maker who is a valuation expert. This is likely to command confidence in the decision reached. The expertise issue was also noted by Judge Everett in *Leigh v Unsworth*: "it would be helpful for the court to have...an independent qualified assessor". But arbitration is not a panacea and is in fact not extensively used for resolution of negligent valuation disputes.

Part of the problem lies in its similarity to litigation in terms of cost, delay and procedural complexity. A comparison of a 5 day arbitration and a 5 day court hearing

in the UK showed estimated costs of £47,000 (approximately A$122,700) for the arbitration and £44,000 (approximately A$115,000) for litigation (Bingham, 1992). But arbitration has other potential deficiencies. Some observers criticise the quality of the arbitrators. Lawyers involved in technical arbitrations put it thus: "The arbitration process has flaws that the aggrieved participant is not happy about. The process of selecting the arbitrator is not sophisticated. Often the arbitrator doesn't have a proper view of the merits. Often he splits the costs and the decision perhaps 60/40. People who have experienced it are not likely to want to use it again" (Brooker, 1997).

DISPUTE RESOLUTION: OTHER METHODS

Dissatisfaction with the above two traditional methods of dispute resolution has led to the encouragement of alternative approaches. Alternative Dispute Resolution (ADR) is a body of dispute resolution techniques "that can potentially settle a dispute without immediate recourse to litigation or arbitration. Unlike these, most forms of ADR will not necessarily lead to a resolution that is binding upon the parties. Its main purpose is to create a forum where a neutral seeks to facilitate a settlement. He does so by encouraging the parties to identify mutual interests that may subsequently form the basis of an agreed settlement, thereby creating an environment conducive to the achievement of just such a result. ADR avoids trappings of litigation and arbitration, such as the adversarial nature of proceedings, lengthy court appearances and procedural complexity, by making clear from the commencement of the process that the third party is not vested with the power to impose a binding decision." (Thomas, 2000). ADR allows both parties to have a real input into the case presented. ADR can also maintain a relationship between parties who need to work together in the future, such as a lending institution and a firm of valuers.

In the majority of instances, in the absence of any contractual agreement, the parties to a dispute have voluntarily to agree to proceed to ADR, rather than enter into litigation or arbitration. Agreement post-dispute can be particularly difficult, as the parties may have adopted an entrenched position.

ADR is not appropriate for some disputes. The most obvious examples are situations where one of the parties wishes to establish a legal principle or precedent or to obtain disclosure of documents. The process may not also assist a dispute where further time is required to obtain vital information or when an injunction is needed. Some commentators consider that it is also not appropriate to use where there is a distinct imbalance of power between the two parties.

Australia has been at the forefront of developing and implementing ADR and is probably second only to the US in the strength of the ADR culture. This has largely been confined to specific sectors. The Australia monograph in the 20-country study carried out by Commission W100 of the Conseil International du Batiment records the development of ADR in construction (Watts, 1998). The Monash University Centre for Commercial Law had previously recorded the fact that "more than 85 percent of identifiable ADR is taking place within the construction/civil engineering industry" (Rickert, 1990). The Institute of Arbitrators Australia's Rules for the Mediation of Commercial Disputes offer the possibility of "a high success rate...the costs of the process are small compared to more formal arbitration and litigation processes"

(Watts, 1998) and the Australian Commercial Disputes Centre (ACDC) has produced commercial mediation guidelines.

In the UK, since its inception twenty years ago, the Royal Institution of Chartered Surveyors (RICS) Dispute Resolution Service has developed into the UK's pre-eminent provider of arbitrators, experts and mediators. The Service aims to promote all methods of ADR, and in 2000, handled 9,146 cases. At the present time, however, it would not appear that ADR is commonly used for negligent valuation disputes.

Mediation is the most common form of ADR. It is particularly suitable for negligent valuation disputes, as it is a confidential process whereby parties to a dispute invite a neutral individual, who usually has expertise, in the subject area of the dispute, to facilitate negotiations between them, aiming to achieve a resolution of their dispute. The mediator will not propose his own terms or remedy. Upon agreement, both sides sign a settlement agreement and are bound to uphold it. The RICS estimate in the UK that the current success rate for mediation is in excess of 90%. Mediation has much to commend it as a means of addressing the requirements of privacy, speed, cost, flexibility and expertise, and it is not coincidental that it is "by far the most popular form of ADR" (York, 1996). While some commentators note that it is "a consensual process which depends upon the willingness of the parties to enter and continue negotiations" (York, 1996), this does not mean that it is necessarily unsuitable for emotive subject matter, such as valuation. In New South Wales, the Land and Environment Court introduced an in-house mediation mechanism for planning and environmental disputes, which can be highly contentious.

This technique can be contrasted with a further form of ADR known as conciliation. The difference to the two processes is that once the conciliator has met with both parties, he may take a relatively activist role, putting forward terms of settlement or an opinion on the case. A proposal for settlement will be based upon his fair assessment of the case, and he will encourage the parties to try and resolve the dispute using his proposal as a starting point, for further negotiation.

A further form of ADR is known as an executive tribunal or mini-trial, which can be viewed as a more formalised version of mediation. Each party presents its case to a panel consisting of an independent chair and senior management representatives from each of the parties. The senior management representatives should not have previously been involved in the events leading up to the dispute and must have sufficient authority to settle. After the presentations and questioning, the panel retires to discuss the dispute. The chair may act as mediator to help the representatives negotiate a settlement or may give them a non-binding evaluation if they request it.

This procedure was largely introduced to Australia by Sir Laurence Street, the Chief Justice of New South Wales, who undertook an adaptation of it called 'senior executive appraisal', "a less adversarial, more consensus orientated process than the American mini-trial" (Watts, 1998). This is likely to be of interest where there is genuine uncertainty as to the probable legal outcome of a dispute and can bring a recalcitrant party face-to-face with the legal realities of the respective cases. It may be observed also that Australia has favoured the development of specialist mechanisms such as the Land and Environment Court (Stubbs, 1998) and the tribunals under the State of Victoria's Building Act 1993 (Lovegrove, 1997). These have the real

advantages of tribunal expertise and relative efficiency in terms of cost and time. The procedure may also protect a continuing business relationship between the two parties. As a panacea for dealing with negligent valuation disputes, they may lack privacy; in the Land and Environment Court mediation hearings, third parties are virtually encouraged to be involved and they do require legislative will and Parliamentary support to put in place.

CONCLUSION

Given that negligent valuation disputes will occur, the question must be answered by any developed society as to how they are to be resolved. This cannot simply be a matter for professional bodies, since there are issues of civil justice, chiefly of recoverability of compensation, to be addressed. A previously reported study of the hearings of the New Zealand Valuers Board was nevertheless illuminating of some of the characteristics of typical negligent valuation disputes. In addition, it is necessary to have regard to the features of negligent valuation disputes in order to decide upon their optimum resolution. Traditionally, those cases not resolved by negotiation have been litigated. While the kind of legal issues involved in some negligent valuation disputes make the courts a suitable medium, litigation has some qualities which raise serious questions about its appropriateness. The process of establishing responsibility almost inevitably involves damaging, perhaps destroying the professional credibility of the defendant. In turn, allegations of contributory negligence, such as by a lender, can involve damage to the commercial reputation of the claimant. There are particular difficulties inherent in the role of expert witnesses in proving or disproving factual negligence, especially in maintaining objectivity. Yet judges rely heavily on the expertise of expert witnesses, the more so in technical subjects like valuation. Their lack of expertise is not helpful to confidence in the system. The cost, delay and proceduralism of court hearings are well documented and much criticised.

Arbitration has offered an alternative dispute resolution mechanism, often at a cheaper cost and providing a speedier result than litigation. Costs, however can escalate, particularly when counsel and expert witnesses are instructed to appear at a hearing. Increasingly, arbitration tends to be conducted in a manner similar to court proceedings, and as a result, the process rarely brings an early result.

The requirements of negligent valuation disputes may render ADR a more eligible approach. Techniques such as mediation, conciliation and the use of an executive tribunal have developed in certain specialist sectors in the US, in Australia and more recently, in the UK, encouraging parties to find a creative solution to their problem. The characteristics of these techniques, namely privacy, speed, third party expertise and a less formalistic approach, fit more closely with the characteristics of negligent valuation disputes examined in this paper. In the absence of a specialist tribunal like the Land and Environment Court, it is probable that it is in structured mediation or executive tribunal that solutions offering optimum resolution of negligent valuation disputes will be found.

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