Engagement agreements revisited

Three provisions that probably aren't in your engagement agreements — but perhaps should be

by Peter T. Christensen

"Get it signed and keep a signed copy in the work file," advised attorney and former appraiser Lindsay McMenamin about engagement agreements when I talked to her in 2013 in preparation for my first article on the topic for *Valuation* magazine (see "Rules of Engagement": http://bit.ly/2oxhF7q).

Four years later, it's worth revisiting the topic. The valuation profession has encountered new challenges and different legal tactics. Accordingly, the language used in engagement agreements needs to evolve. Here, I'll discuss three new provisions that appraisers should consider. But first, a review of engagement agreement basics.

The basics

Appraisers aren't required to use engagement agreements by federal or state law, nor by the Uniform Standards of Professional Appraisal Practice or the Appraisal Institute's Standards of Valuation Practice and Code of Professional Ethics. However, experienced practitioners and legal counsel agree that well-crafted engagement agreements can assist appraisers by identifying the basic items needed in appraisals to satisfy professional standards, clarifying for client and appraiser the work that will be done, enabling smoother collection of fees, and helping appraisers successfully defend against lawsuits.

Good engagement agreements present a

strong professional image, and at a minimum they should clearly state:

- Client name.
- Property identification and property type.
- Interest to be valued.
- Intended use and users.
- Type and date of value.
- Assignment-specific requirements, including those mandated by USPAP or other applicable standards.
- Anticipated scope of work.
- Date of delivery.
- Appraisal fee and payment terms.
- Any prior service regarding the subject property if the assignment is performed under USPAP.

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I recommend appraisers spend time fleshing out the explanation for scope of work. In many of the claims we receive, I see very generic descriptions of the appraiser's scope of work in engagement agreements and in completed reports for even the most complex assignments. Often, the description is just the generic scope of work statement copied and pasted from the standard Fannie Mae Form 1004.

A good scope of work description provides details about the work the appraiser will perform for a specific assignment. For example, in an engagement agreement for an appraisal review, it would be prudent for an appraiser to clearly state whether the scope of work will include an independent search for and analysis of market data, or whether the work will be limited to the information presented within the appraisal under review. When a reviewer fails to provide that specificity and a claim occurs asserting that the reviewer failed to identify a deficient appraisal because more appropriate sales comparables existed, the plaintiff and their experts almost certainly will argue that the reviewer should have conducted independent research. A good scope of work description informs the client in plain English what you propose to do, the degree of your inspection of the property (if any), your anticipated research and the level of detail in which the results will be reported. (For more information, see *Scope of Work*, Second Edition, Appraisal Institute, 2016; http://bit.ly/2pr1APO.)

Your client should acknowledge in the engagement agreement that the appraisal or appraisals you perform will be subject to the statements and limiting conditions.

McMenamin's advice about making sure clients sign engagement agreements and appraisers keep a copy bears repeating. There have been many situations where appraisers or valuation firms had excellent engagement agreements that should have helped defend against legal claims but ended up useless because they weren't signed. I see this story played over and over again, even with large and sophisticated firms.

Beyond the basics

Recent liability claims have exposed new areas that many appraisers can better address in their current engagement agreements. Here are three provisions appraisers should consider including.

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1 A provision that connects your engagement agreement with the appraisal report and makes your limiting conditions more effective.

If you'd like your limiting conditions and other reporting to have maximum legal value, your client should acknowledge in the engagement agreement that the appraisal or appraisals you perform will be subject to the statements and limiting conditions. For example, if appraisers are accused of failing to identity a title problem, they typically will defend themselves by pointing to a limiting condition in the report stating that they have no responsibility for determining matters concerning title. However, unless the statements and conditions are incorporated into the engagement agreement, a plaintiff client could argue that the limiting condition was not part of the contract, which would make it more difficult for the appraiser to prevail at an early stage of the case — if at all.

The following provision is a good way to connect your engagement agreement with your report:

> **Appraisal Statements and Conditions.** The appraisal performed under this Agreement will be subject to all statements, assumptions, limiting conditions and other conditions (collectively, "Appraisal Conditions") set forth in the appraisal report. Client agrees that Client will review the Appraisal Conditions upon receipt of the report and that Client's use of the appraisal will constitute acceptance of the Appraisal Conditions. The Appraisal Conditions shall be considered as being incorporated into and forming part of this Agreement with respect to the appraisal in which they are contained and to the services relating to that appraisal. *[Consider adding:* "Appraiser's anticipated Appraisal Conditions at this time are attached and incorporated into and form part of this Agreement. Additional Appraisal Conditions may be developed during performance of the appraisal and set forth in the report."*]*

Part of making appraisal statements and conditions more effective is making them easier to enforce in disputes involving third parties that may have received a copy of your report and then claimed they relied on it for one purpose or another (whether an "intended use" or not). Include a provision in the report itself stating that any party that receives the report and uses or relies on it acknowledges that such use or reliance is subject to all of the statements and conditions stated in the report.

A straightforward provision to accomplish that purpose could read:

> **Acceptance of Appraisal Statements, Conditions and Assumptions.** Any use of or reliance on the appraisal by any party, regardless of whether the use or reliance is authorized or known by Appraiser, constitutes acceptance of, and is subject to, all appraisal statements, limiting conditions and assumptions stated in the appraisal report.

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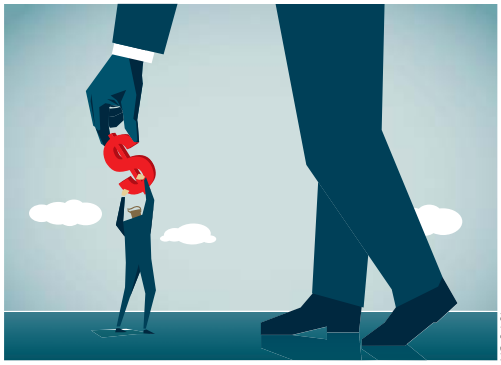
2 A provision that creates a maximum time frame for pursuit of legal claims.

Many professional liability lawsuits are filed against appraisers more than five years — sometimes even 10 — after the appraiser delivered the report. Appraisers are often disturbed to learn that the statutes of limitations that apply to professional liability lawsuits offer little help. The reason: Whatever the statute of limitations may be (usually two to four years), in most states that period commences under a "discovery rule," meaning that the period starts when the plaintiff discovered or should have discovered the alleged errors or damages. However, appraisers have the ability in most states to contractually change the applicable statute of limitations with their engagement agreements. Even when such a time limitation may not be completely enforceable under a given state's law, the presence of the limitation can still work to the appraiser's benefit by dissuading parties with frivolous claims from filing a legal action.

The following provision seeks to create a two-year period in which lawsuits may be pursued following delivery of the appraisal. It's advisable to include such a provision in both the engagement agreement and the report itself to address third-party claims:

> **Maximum Time Frame for Legal Actions.** Unless the time frame is shorter under applicable law, any legal action or claim relating to the appraisal or Appraiser's services shall be filed in court (or in the applicable arbitration tribunal, if the parties to the dispute have executed an arbitration agreement) within two (2) years from the date of delivery to Client of the appraisal report to which the claims or causes of action relate or, in the case of acts or conduct after delivery of the report, two (2) years from the date of the alleged acts or conduct. The time frame stated in this section shall not be extended by any delay in the discovery or accrual of the underlying claims, causes of action or damages. The time frame stated in this section shall apply to all non-criminal claims or causes of action of any type.



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3 A provision that addresses the specter of litigation from investors suing appraisers for profit.

The phenomenon of mass litigation against appraisers began in 2014 when several investment entities calling themselves "claim servicers" filed more than 450 professional liability cases against residential appraisers. Often oper-

Changes ahead

The three provisions I recommend here are the subject of hard work of an AI work group tasked with both updating existing engagement agreement materials and developing a set of terms and conditions that can become part of both engagement agreements and appraisal reports.

The AI work group on engagement agreements is led by 2015 AI President M. Lance Coyle, MAI, SRA, and comprises Paula K. Konikoff, JD, MAI, AI-GRS; Stephanie Coleman, MAI, SRA, AI-GRS, AI-RRS; AI General Counsel Jeffrey E. Liskar, Esq.; AI Associate Counsel Christina Mitakis, Esq.; and myself.

The work group hopes to have its materials available soon.

— Peter T. Christensen

One way to protect against such litigation is to prevent lender-clients from assigning lawsuit claims to investors.

ating under interrelated management, these entities have names like "First Mutual Group" and "Llano Financing Group," and their business plan involved getting lenders to assign them the right to sue appraisers over defaulted loans. These entities aren't the first to sue appraisers for profit, but they have been the most aggressive and prolific. They currently are failing in the venture, thankfully, but they seem to be in a continuous state of reinvention, so there may be similar approaches in the future or attacks outside the residential loan arena.

One way to protect against such litigation is to prevent lender-clients from assigning lawsuit claims to investors. The following provision should be included in the report to be effective with parties other than your client:

No Assignment of Claims. Legal claims or causes of action relating to the appraisal are not transferable or assignable to a third party, except: (i) as the result of a merger, consolidation, sale or purchase of a legal entity, (ii) with regard to the collection of a bona fide existing debt for services but then only to the extent of the total compensation for the appraisal plus reasonable interest, or (iii) in the case of an appraisal performed in connection with the origination of a mortgage loan, as part of the transfer or sale of the mortgage before an event of default on the mortgage or note or its legal equivalent. ◀

About the Author

Peter T. Christensen is LIA Administrators & Insurance Services' general counsel. LIA manages the Appraisal Institute's endorsed E&O program for appraisers.