Gut check

Beware reliance language that can substantially increase liability risk

by Peter T. Christensen

Earlier this year, a national bank notified appraisers bidding for commercial assignments that they would have to include a wordy new "reliance" provision in their reports. Some appraisers were taken aback by the language. A few, guided by their instinct for self-preservation, decided against accepting work for the bank. Their gut told them — correctly — that the language substantially increased their liability risk.

The bank's requested reliance language, which I've shortened here, included the following:

> In connection with a proposed extension of credit in the form of (or a proposed investment in) a loan, debt issuance or other financing and secured … by the real property ("Property") which is the subject of this report ("Report"), or by pledges of direct or indirect ownership interests in the Property owner … (in any such case, the "Financing"), or the proposed issuance of any securities and secured or otherwise backed … by the Property or the Financing (the "Securities"), this Report, and the information contained therein, may be used and relied upon by the addressee(s) of this Report, their affiliates, successors and assigns, and:
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> (a) [Bank], as Administrative Agent for the benefit of any lenders, from time to time, party to the Financing;
> (b) any actual or prospective purchaser of, or investor in, the Financing (or any portion thereof or interest therein by way of participation, syndication or otherwise);
> (c) any actual or prospective financing source for any such purchaser or investor;
> (d) any servicer of the Financing or the Securities;
> (e) any trustee of the Financing or the Securities;
> (f) any rating agency actually or prospectively rating the Financing or the Securities;
> (g) any underwriter of, or placement agent for, the Financing or the Securities;
> (h) any institutional provider of any liquidity facility or credit support for the Financing or the Securities;
> (i) the respective affiliates of each entity referenced in clauses (a)-(g) above;
> (j) the respective officers, directors, employees, agents, advisors and counsel of each person or entity referenced in clauses (a)-(i) above; and
> (k) the respective successors and assigns of each person or entity referenced in clauses (a) through (i) above.
>
> This Report has no other purpose and should not be relied upon by any other person or entity.

Any party listed in the bank's reliance language could be in a position to pursue legal claims against the appraiser if a party contends it suffered harm resulting from a deficient valuation.

The bank's reliance language is a variation of provisions required by many clients engaged in securitizing or syndicating commercial and multifamily property loans. It is commercially reasonable to expect that financial institutions underwriting such loans would need to provide appraisals to purchasers of or investors in the loans and that, to some extent, these parties downstream from the appraiser's client need to be able to use and rely on the appraiser's work product. That is part of the business value of appraisal services.

At the same time, it's important that appraisers and their clients recognize the liability ramifications. The primary risk posed by the bank's language and similar provisions is that the appraiser is opening the door wide for any of the enumerated parties to have standing to bring a professional negligence and/or negligent misrepresentation claim against the appraiser. Under most states' court-made common law, a professional — such as an appraiser — has potential liability to the parties that the profes-

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sional knows will use or rely on the professional's work, or reasonably expects will do so. Accordingly, any party listed in the bank's reliance language could be in a position to pursue legal claims against the appraiser if a party contends it suffered harm resulting from a deficient valuation. This risk may or may not be acceptable to an appraiser, but the appraiser should, at least, be cognizant of it. Is the risk balanced by an acceptable fee?

Appraisers also should evaluate the details of proposed reliance language. The bank's language in this case, frankly, is sloppy for the bank's apparent purpose of securitizing loans, and exposes appraisers to risks beyond those necessary to the bank's own business. Lawsuits against appraisers often involve parties and transactions that appraisers or clients never contemplated. The bank's language here could expose an appraiser to claims by parties that don't have a connection to financing arranged by the bank. For example, if this bank decided not to extend financing, the report could be picked up by another lender — perhaps a hard-money lender — with or without the appraiser's knowledge. If that hard-money lender or its investors made a loan and claimed to suffer a loss, they too could argue that the loose reliance language gave them a basis for relying on the report. Beyond that, it's conceivable that legal counsel for a borrower (or guarantor of the borrower's loan) might try twisting the language to support their own claims.

Accordingly, in this real-life example, a couple of appraisers wrote back to the bank and requested that the bank allow them to (a) clarify that the reliance language only applies to the proposed debt-based financing by the bank for which the appraisal was performed, and (b) include the following clarification at the end of the provision to eliminate potential misinterpretation:

> Under no circumstances shall any of the following parties be construed as a person or entity referenced in clauses (a) through (k) above or otherwise be entitled to use or rely on the appraisal or this Report: (i) the borrower(s) on the Financing, (ii) any guarantor(s) of the Financing, or (iii) principals, shareholders, investors, members or partners in such borrower(s) or guarantor(s).

To its credit, the bank listened to the appraisers and agreed to the change. The change, of course, still doesn't eliminate a great deal of the risk that flows from reliance language. To do that, appraisers would need to consider adding provisions to the engagement agreement and reports that might limit the appraisers' liability to parties other than the client, or place a time limitation on claims. ◂

About the Author

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