

NEGLIGENT MISREPRESENTATION AND THE 'SPECIAL RELATIONSHIP'

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"THE DUTY OF CARE IMPOSED BY THE LAW OF NEGLIGENCE, INCLUDING NEGLIGENT MISREPRESENTATION, REACHES BEYOND THE CLIENT-APPRAISER RELATIONSHIP."

In addition to the standards dictated by the *Canadian Uniform Standards of Professional Appraisal Practice (CUSPAP)*, appraisers have a common law duty of care that is delineated by contract and by the law of negligence and negligent misrepresentation. Contractual duty of care is dictated by the terms of an appraiser's contract with a client, but the duty of care imposed by the law of negligence, including negligent misrepresentation, reaches beyond the client-appraiser relationship.

The elements of negligent misrepresentation

An appraiser is liable for negligent misrepresentation when the following circumstances exist:

- there is a 'special relationship' between the appraiser and another party;
- the appraiser makes an untrue, inaccurate, or misleading statement;
- the appraiser acts negligently in making the misrepresentation;
- the party receiving the misrepresentation reasonably relies on the misrepresentation; and
- the reliance results in damages to the receiver of the misrepresentation.¹

A 'special relationship' exists and a duty of care arises when two factors are present:

- the appraiser ought reasonably to foresee that the receiver will rely on a representation; and
- the receiver's reliance on the representation is reasonable in the circumstances.²

Negligent misrepresentation in an appraisal context

Court cases reinforce that there is no liability for negligent misrepresentation unless there is a 'special relationship' between the appraiser and the party alleging a loss.

In *Grey Mortgage Investment Corp. v. Campbell & Pount Ltd.*,³ [Grey], the plaintiff Grey Mortgage Investment Corp., a secondary mortgage lender, foreclosed on borrowers who had granted mortgages as security. The amount recovered in the foreclosure proceedings was much less than the opinions of market value expressed in appraisal reports prepared by the defendant appraisers. The appraisals were prepared upon instructions from the primary lender National Trust and the owners of the properties securing the loans. The plaintiff sued the appraisers alleging negligent misrepresentation. The court held that there was no liability for negligent misrepresentation because, in the circumstances, there was no 'special relationship' and the court was not persuaded that the plaintiff had proved the appraisals contained negligent statements.

On the question of 'special relationship,' the court referred to an earlier case that indicated a broad range of potential parties to whom an appraiser might owe a duty of care:

... an appraiser of real estate owes a duty of care not only to the client on whose instructions he prepares his appraisal but to all other persons to whom it may be shown and who might be expected to

rely on it in dealing with the subject matter by way of purchase, mortgage, security or otherwise ...⁴

However, the defendant appraisers relied upon the decisions of the Supreme Court of Canada in *Cognos* and *Hercules* (cited above) to argue that, in light of statements in the appraisals limiting who could rely upon the appraisals, no 'special relationship' arose in favour of the plaintiff. At paragraph 17 of *Grey*, the court posed the question as follows:

17 Assuming the appraisals were a gross overvaluation or were negligently prepared, the first questions then are whether the defendants ought reasonably to have foreseen that someone other than National Trust (for whom the first appraisal was prepared) or [the owners] (for whom the other appraisals were prepared) would rely on the representations and, if so, was the reliance of the plaintiff reasonable in the particular circumstances of this case?

With respect to the appraisal prepared for National Trust, the court concluded that the Limiting Conditions requiring the author's written consent before anyone except National Trust used the report was sufficient warning to limit reliance to National Trust. However, the court took a more expansive view when considering the appraisals prepared for the owners.

The court held that the defendant appraisers ought to have anticipated the owners might make use of the appraisal reports in a variety of ways including persuading a lender to advance funds. Since the first branch of the 'special relationship' test was satisfied in relation to the appraisals prepared for the owners, the court had to consider the second branch, namely, whether it was reasonable in the circumstances for the plaintiff to rely upon the appraisals prepared for the owners. The court concluded it was not reasonable. On the evidence, the plaintiff was interested in the market value at the date of the loan, whereas the conclusions of market value in the appraisals were as at dates prior to the loan date. Further, there

was a warning in the Limiting Conditions that the market value estimate expressed as at the date of the appraisal could not be relied upon as of any other date except with the further advice of the appraiser. The Limiting Conditions also stated that use of the appraisals prepared for the owners was limited to the client, or, where the client was a mortgagee, the mortgagee's insurers and the borrower. The court found that the plaintiff chose to ignore the qualifications in the appraisal report.

A recent application – Ryan Mortgage

The 2016 decision of the British Columbia Supreme Court in *Ryan Mortgage Income Fund Inc. v. Alpine Credits Limited*⁵ [*Ryan Mortgage*] does not specifically reference the 'special relationship' requirement in negligent misrepresentation, but the court implicitly gave effect to the concept and the appraiser avoided liability.

In *Ryan Mortgage*, the appraisal firm (the 'Appraiser') prepared an appraisal report in 2007 for 11 lots. In 2010, the Appraiser prepared an updated appraisal for the same 11 lots, rendering an opinion of market value at \$1.3 million. The court found that the true market value was probably only \$678,000. The difference in value was explained by the Appraiser failing to adjust for the lots being in a floodplain and not accounting for a bylaw passed in 2009 preventing building in the floodplain. The court concluded that the Appraiser was negligent, but despite this finding, the court ruled that the Appraiser was not liable to Ryan Mortgage Inc. ('Ryan'). One might ask how the Appraiser escaped liability. The answer requires a closer look at the facts.

The defendant Alpine Credits Ltd. (Alpine) is a mortgage broker that sells mortgages to Ryan. In November 2010, Alpine loaned \$618,000 to two borrowers on the strength of the 2010 updated appraisal. A mortgage of the 11 lots secured the loan. Alpine then assigned the mortgage to Ryan for \$615,000.

Both the original appraisal and the updated appraisal were prepared at the

request of the borrowers. A copy of the updated appraisal was conveyed to Alpine with a Reliance Letter from the Appraiser that read in part as follows:

... I hereby advise that this appraisal may be relied upon by your financial institution for financing purposes. The valuation methods used and the final estimate of value arrived at would have been the same had this appraisal report been prepared at the request of ALPINE CREDITS LTD.

There was no Reliance Letter in favour of Ryan Mortgage.

In 2012, the borrowers defaulted and Ryan commenced foreclosure proceedings. During the conduct of sale of the 11 lots, Ryan and Alpine learned that the lots were in the floodplain and that the prohibiting bylaw was in place at the date of the updated appraisal. Proceeds from the sale of the 11 lots was net \$201,585.

It was common ground at trial that Ryan had no claim in negligence or negligent misrepresentation against the Appraiser because Ryan did not receive a Reliance Letter similar to the one provided to Alpine. The court stated at paragraph 22 of the *Ryan Mortgage* decision that, absent such a letter for Ryan, the Appraiser's duty, under a negligence analysis, did not extend to Ryan. The pivotal, though unexpressed, element in *Ryan Mortgage* was the absence of a 'special relationship' between Ryan and the Appraiser, without which the former could not rely upon the Appraiser's report.

In an attempt to circumvent its lack of a basis for a negligence claim against the Appraiser, Ryan alleged breach of contract against Alpine causing Alpine to claim indemnity against the Appraiser for negligently preparing the appraisal. However, the court held that the breach of contract claim could not succeed because, under the arrangements between Ryan and Alpine, Alpine was only required to obtain a current appraisal from a qualified real estate appraiser. Alpine had not provided a guarantee or warranty that the conclusion of market value in the appraisal was the true market value.



Ryan attempted to amend its claim at trial to allege that Alpine had a duty to provide a properly prepared appraisal, but the court did not allow the amendment. The court held that it would be prejudicial to the Appraiser to have to answer to a whole new allegation at that point in the litigation, particularly when there was no evidence to support the allegation that Alpine's duty was to provide a properly prepared appraisal.

In summary, the Appraiser escaped liability for what, on the evidence, was a negligent appraisal report because the Reliance Letter did not extend to Ryan and the contractual relations between Ryan and Alpine did not require a properly prepared appraisal.

Clearly, the limited nature of the Reliance Letter was extremely valuable to the Appraiser.

Closing

CUSPAP Practice Notes 16.12 and 16.13 provide guidance with respect to limiting the parties that can rely upon an appraisal report. Of course, the guidance is useful, but *CUSPAP* does not have priority over the conclusions of the courts.

Courts will look at all the circumstances in a particular case to determine if a 'special relationship' exists and to determine the scope of that relationship. Reliance statements in appraisal reports will be closely scrutinized by judges in order to decide if the wording adequately specifies who can and cannot rely upon an appraisal. Consequently, template language provided in *CUSPAP* must be read carefully before inclusion in an appraisal report to determine if tailoring for a given situation is needed.

End notes

¹ *Queen v. Cognos* 1993 CarswellOnt 972 (S.C.C.) [*Cognos*] at para. 34.

² *Hercules Management Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165 (S.C.C.) [*Hercules*] at para. 24.

³ 2002 BCSC 685 at para. 14.

⁴ *Grey* at para. 14 quoting from *Esselmont v. Harker Appraisals Ltd.* (1979) CarswellBC 228 (B.C.S.C.).

⁵ 2016 BCSC 1582.

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