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Arbitration Versus Appraisement

The difference between the processes of arbitration and appraisement is not well understood. The distinction, however, may influence future approaches used to resolve real estate conflicts.

Arbitration is defined by both case law and the statutes. Texas case law defines *arbitration* as the voluntary submission of a controversy to persons selected by the parties to investigate and to determine the matter and render a decision. It is intended to avoid the formalities, delay, expense and vexation of ordinary litigation (*Temple v. Riverland Co.*, 228 S.W. 605).

Texas statutes define *arbitration* as a forum where parties and counsel present their positions before an impartial third party who renders a specific award (see Texas Civil Practices and Remedies Code [TCP&RC], Section 154.027[a]).

Arbitration is not new to Texas. The settlement of disputes by arbitration is sanctioned by the Texas Constitution, Article XVI, Section 13. The Texas Constitution imposes a legislative duty to pass laws necessary and proper to allow conflicts to be decided by arbitration when the parties elect this method.

Two Texas statutes provide for arbitration. One is the Alternative Dispute Resolution Procedures Act (ADR) found in TCP&RC, Chapter 154; the other is the General Arbitration Act (GAA) found in the TCP&RC, Chapter 171.

Several differences distinguish the two. A few are mentioned here.

The ADR requires a pending dispute. The GAA is applied broadly to encompass any matter over which opinions differ.

The ADR applies to the subject matter of **any** pending suit. The GAA explicitly excludes certain controversies:

- collective bargaining agreements between an employer and labor union;
- personal contracts for the purchase of real or personal property, services or credit where the consideration is $50,000 or less;
- workers' compensation claims and
- personal injury cases.

Note. The second and fourth items may be subject to arbitration if the parties agree in writing with the consent of their respective counsel.

The ADR can be used only after litigation has begun. The GAA allows for parties, when entering contracts, to agree to arbitrate future contractual disagreements. Also, under the GAA, any existing controversy may be submitted to arbitration if a written agreement is entered.

However, under the GAA, the courts will not enforce an agreement to arbitrate if grounds exist in law or equity to revoke the contract or if the agreement to arbitrate was unconscionable when made.

Note that prior to September 1, 1987, the GAA provided, **"No agreement described in Article 224** [the General Arbitration Act at that time] **shall be arbitrated unless notice that a contract is subject to arbitration under this act is typed in underlined capital letters, or is rubber-stamped prominently, on the first page of the contract."** This restriction was repealed by the 70th Texas Legislature in 1987.

The ADR arbitration award is not binding unless the parties so stipulate in writing in advance. If the parties agree to settle based on the ADR arbitration procedure, the court, at its discretion, may incorporate the award in a final decree. Otherwise, it is enforceable as a contract.

Under the GAA, as amended in 1995 and 1996, an enforceable agreement to arbitrate confers jurisdiction on the court to enforce the agreement and enter a judgment on the award. Upon application of either party, the court shall confirm the award, and it is enforceable as any other judgment.

The ADR contains five procedures for settling disputes: mediation, mini-trial, moderated settlement conference, summary jury trial and arbitration. The GAA's sole means of rectifying disputes is arbitration.

Arbitration under ADR is relatively new, having been codified in Texas in 1987.

Arbitration under the GAA has been a part of Texas statutory law since 1966.

Appraisement, on the other hand, has two definitions. The familiar definition is "an estimate of value." This is the process customarily used to determine property values for loans, taxes, partitioning and other purposes.

The less familiar definition of appraisement is "the agreed method of ascertaining value, stipulated in advance, with the object of preventing future disputes" (*Arbitration and Award*, Section 1, 7 *Texas Jurisprudence Third).*

The definition is similar to arbitration, but several distinctions are notable even though Texas decisions use the terms interchangeably (see *Smith v. Southern Land Dev. Co.*, 385 S.W. 2d 552).

In 1910, the U.S. Supreme Court noted two differences between appraisement and arbitration in *Omaha v. Omaha Water Company*, 218 U.S. 180. One deals with the procedure, the other with the scope of inquiry.

As to the procedure, the parties to arbitration are asking for a process similar to a judicial inquiry. The parties want to present witnesses and evidence and to cross-examine opponents' witnesses. With appraisement, no hearing, presentation of witnesses or taking of evidence is involved. The parties are asking that a contractual provision such as the price or amount of casualty loss be determined according to a prescribed method.

As to the scope of inquiry, arbitration is much broader. With arbitration, the parties are asking for a determination of whether liability exists and, if so, to what extent. Under appraisement, the liability is acknowledged. The sole goal is determining the amount.

Early Texas case law supports this view. In *Scottish Union and Natural Insurance Company v. Clancy*, 8 S.W. 630 (1888), an insurance company made written demand on the insured for an appraisal of a fire loss, as provided in the insurance policy. The insured refused. For this reason, the Texas Supreme Court subsequently denied the insured recovery.

The high court distinguishes carefully the third-party responsibilities. In appraisement, they determine only the amount of liability. In arbitration, they resolve both the issue of liability and the amount.

"Appraisement can not be used when the issue of liability is disputed."

With the advent of the ADR and the GAA, the notoriety of appraisement has diminished somewhat. However, appraisement remains a viable option for resolving disputes when only the amount of the liability is at issue. In real estate matters, appraisement helps the parties resolve questions of liability arising under insurance policies and construction contracts, to name a few.

Insurance Policies

The finality of appraisement is perhaps the most frequently invoked in the context of insurance policy claims as noted earlier in *Scottish Union*. The following is the process detailed in a Texas homeowner's insurance policy.

If an insured casualty loss occurs, the homeowner must submit a "proof of loss" to the insurance company. Under oath and to the best of the insured's knowledge, the actual cash value and the amount of loss to each item must be estimated. Depending on the policy endorsements, the insured may need to estimate the replacement value.

After the proof of loss is filed, the insurance company's adjuster views the damages and estimates the loss to the same items. If the homeowner does not agree with the adjuster's estimate, and if a settlement can not be reached, either party can demand an appraisement.

Each party selects a competent, independent appraiser within 20 days after the written demand is made. The chosen appraisers then select a third party as an umpire. If the appraisers can not agree on an umpire within 15 days, either party may request a district court judge to make the selection.

Each appraiser estimates the loss. Differences are submitted to the umpire who ultimately resolves the discrepancy. The decision (award) is binding on both parties.

Each party pays its own appraisers and bears the expenses of the umpire equally. ("Understanding the Texas Homeowner's Insurance Policy," Real Estate Center publication 883, details this and other matters covered by homeowner's insurance.)

Construction Contracts

Recent decisions addressing amounts owed on construction contracts reveal that the appraisements by project engineers

are not subject to judicial review.

In *Westech Engineering v. Clearwater Constructors, Inc.*, 835 S.W. 2d 190 (1992), the defendant challenged the trial court's holding as final and binding the project engineer's determination that the defendant failed to supply the quality of equipment specified in a contract. In upholding the trial court's decision, the appellate court borrowed language from a 1941 Texas Supreme Court decision, *City of San Antonio v. McKenzie Construction Company*, 150 S.W. 2d 989: "When parties to a building contract agree to submit questions which may arise thereunder to the decision of the engineer, his decision is final and conclusive; unless in making it he is guilty of fraud, misconduct, or such gross mistake as would imply bad faith or failure to exercise honest judgment. . . . [A] decision . . . as this . . . cannot be set aside . . . simply by proving that some other engineer would have acted differently or given a different decision."

Using Appraisement Today

Real estate practitioners may wish to use appraisement to avoid both protracted litigation and the formalities of arbitration, yet achieve a final determination of the amount owed on a contract. However, appraisement can not be used when the issue of liability is disputed, only when the sole issue is the extent of the liability.

Property taxes appear a prime candidate for appraisement. Property owners realize they owe the taxes. The sole question is how much. Unfortunately, this does not seem to be a viable alternative. However, according to the Texas Tax Code, Section 42.225, property owners who appeal an appraisal review board order may ask the court to submit the issue to nonbinding arbitration under ADR.

If appraisement is incorporated into an agreement, the following are suggestions for drafting the provisions.

- Select language from recent appraisement cases suitable to the circumstances. Copy the language verbatim. Case precedents will uphold the finality of the appraisement.
- Use more than one appraiser when possible. The procedure outlined in homeowners' insurance policies is a good example. The method connotes fairness and makes the process more appealing. However, include a way to remove a gridlock when the appraisers can not agree. The use of an umpire as described in insurance policies is one alternative.
- Introduce appraisement to new areas of real estate. Recently, the Hawaii Supreme Court ruled that successive rental rates to be determined by appraisement are binding.
- Make the appraisement provisions clear and conspicuous. Although no Texas statutes or cases mandate this rule, former provisions to the GAA quoted earlier did. Play it safe. Make all parties aware of the provision and insure that they understand appraisement is final and binding.
- Address the uncooperative party. If a party refuses to choose or agree on an appraiser, or if a party withdraws an appraiser during the process, permit the single or remaining appraisers to decide the matter. The uncooperative party waives all rights to protest the outcome. Cite cases that support the position, such as the *Omaha* case discussed earlier.

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