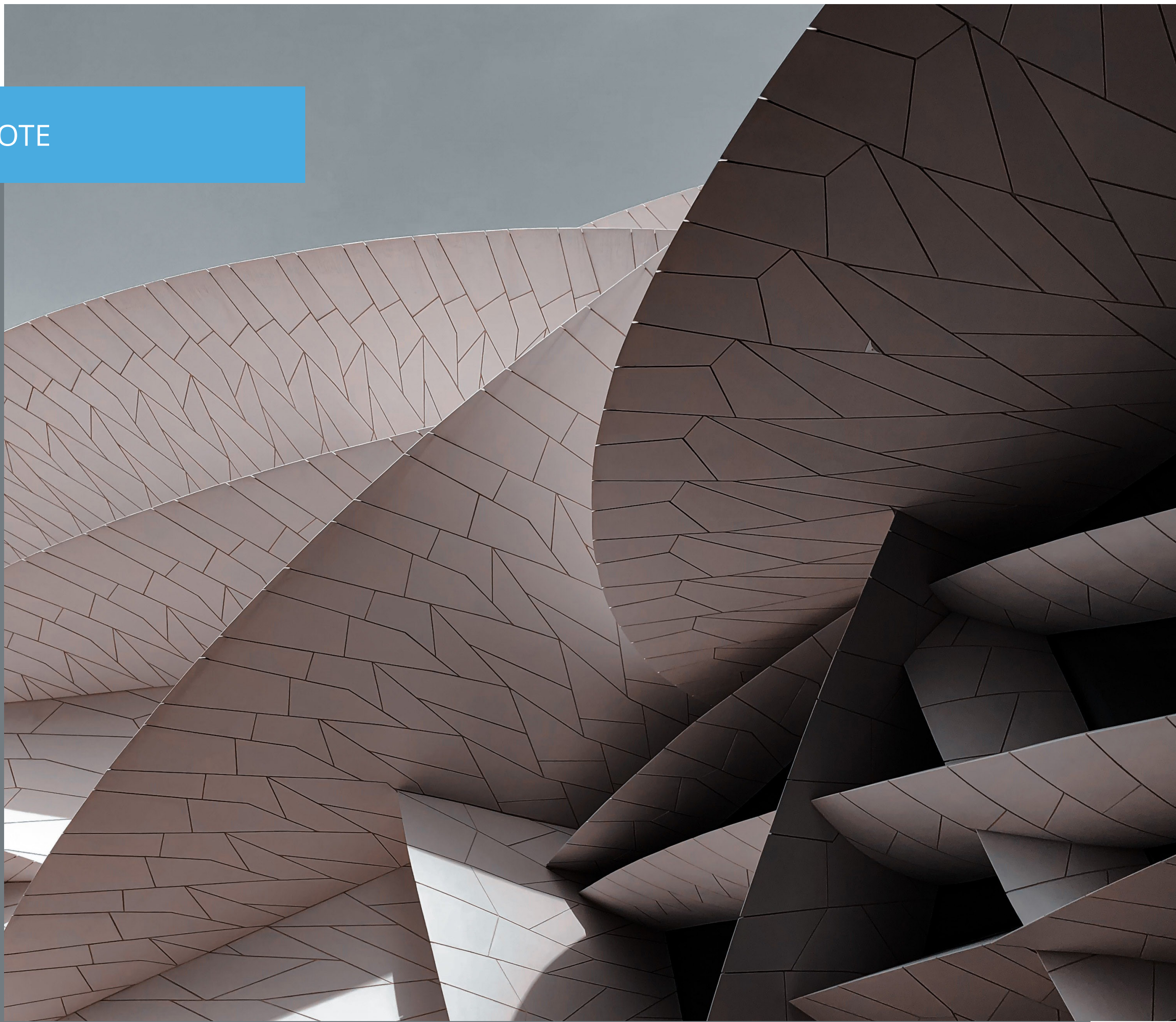
GUIDANCE NOTE



Risk, liability and insurance

UK

1st edition, April 2021

RICS

RISK, LIABILITY AND INSURANCE

RICS guidance note, UK

1st edition, April 2021

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Definition and scope

RICS guidance notes set out good practice for RICS members and for firms that are regulated by RICS. An RICS guidance note is a professional or personal standard for the purposes of *RICS Rules of Conduct*.

Guidance notes constitute areas of professional, behavioural competence and/or good practice. RICS recognises that there may be exceptional circumstances in which it is appropriate for a member to depart from these provisions – in such situations RICS may require the member to justify their decisions and actions.

Application of these provisions in legal or disciplinary proceedings

In regulatory or disciplinary proceedings, RICS will take account of relevant guidance notes in deciding whether a member acted professionally, appropriately and with reasonable competence. It is also likely that during any legal proceedings a judge, adjudicator or equivalent will take RICS guidance notes into account.

RICS recognises that there may be legislative requirements or regional, national or international standards that take precedence over an RICS guidance note.

Document status defined

The following table shows the categories of RICS professional content and their definitions.

Publications status

Type of document	Definition
RICS Rules of Conduct for Members and *RICS Rules of Conduct for Firms*	These Rules set out the standards of professional conduct and practice expected of members and firms registered for regulation by RICS.
International standard	High-level standard developed in collaboration with other relevant bodies.
RICS professional statement (PS)	Mandatory requirements for RICS members and RICS-regulated firms.
RICS guidance note (GN)	A document that provides users with recommendations or an approach for accepted good practice as followed by competent and conscientious practitioners.
RICS code of practice (CoP)	A document developed in collaboration with other professional bodies and stakeholders that will have the status of a professional statement or guidance note.
RICS jurisdiction guide (JG)	This provides relevant local market information associated with an RICS international standard or RICS professional statement. This will include local legislation, associations and professional bodies as well as any other useful information that will help a user understand the local requirements connected with the standard or statement. This is not guidance or best practice material, but rather information to support adoption and implementation of the standard or statement locally.

Glossary

Alternative dispute resolution (ADR)	The process of resolving disputes, including negligence disputes, other than by litigation. See Appendix E.
Arbitration	A private dispute resolution process. See Appendix E.
Assignment	The process whereby the benefit of all or part of a contract, is transferred by one of the original parties to a 'third party'. If a contract is assigned by the client, the assignee is effectively treated as the member's client. Assignment can be prevented by express words in the contract. See Appendix C.
Bilateral loan	A simple type of commercial loan. See Appendix C.
Bracket	The bracket of hypothetical reasonable valuations used to assess whether the valuation actually given was negligent. See Appendix A.
Claims made	The basis on which most professionals' (and all members') professional indemnity insurance is provided. It means that the relevant policy for any claim is the policy in place when the claim is made (not when the work is provided to the client, or any other time). See section 6.
Commercial mortgage-backed security (CMBS)	A type of finance transaction. See Appendix C5.
Delict	Used in Scots law instead of 'tort'.
Desk-top valuations	Valuations conducted without a site visit.
Disclosure	Permitting advice to be seen by or disclosed to a third party (i.e. a person or entity who is not party to the member's contract of engagement) without assumption of a duty of care. In the context of litigation, this can also refer to the parties' obligations to preserve and provide relevant documents.
Duty of care	The duty in 'tort' assumed by a professional to observe the skill and care of a 'reasonable' professional in providing professional services. Such a duty may in certain circumstances be assumed to a 'third party' as well as to the professional's contracted client.
Engagement letter	A letter issued by a member that records the contract with the member's client. It may be accompanied by terms and conditions. See section 5.
Expert witnesses	Members giving independent expert evidence to courts and tribunals.

Indemnity	A contractual agreement sometimes given by a party providing professional services to 'hold harmless' or 'make whole' the client in respect of the client's losses arising from the matter. See paragraph 2.6.4.
Joint and several liability	The liability partners have to claimants for claims against the partnership, co-defendants and 'joint tortfeasors' have to claimants. See paragraph 6.3.
Joint tortfeasors	Parties (usually professional firms) who take on responsibilities 'jointly and severally' to a particular client or claimant, when they work alongside each other. See joint and several liability and paragraph 5.3.
Liability cap (or limitation of liability)	A contractual agreement that a client can only claim damages up to the amount agreed, even if the law would otherwise award a greater sum in damages. See section 3 and Appendices B and C.
Limitation periods	The periods specified by statute and the common law for a claimant to commence legal proceedings. The periods vary depending on the type of claim and the type of services provided. When the period is over, the claim becomes 'statute barred' and, while the claimant can still pursue the claim, they will not be entitled to recover any damages. See paragraph 2.7.
Limited Liability Partnership (LLP)	A type of legal entity for carrying on business, governed in the UK by the **Limited Liability Partnerships Act 2000**. Unlike a partnership, an LLP does have a legal existence as an entity separate from its partners (called 'members' in an LLP), and it is that entity which enters contracts and provides services. Practicing through an LLP is an effective and recognised way for partners in professional firms to manage the risks associated with personal liabilities.
Mediation	A principal form of ADR. See Appendix E.
Members (LLP)	See Limited Liability Partnership. Although many firms that operate as LLPs still refer to their principals as 'partners', the technically correct term for the principals of an LLP is 'members'.
Mezzanine loan	A high risk/high reward form of lending. See Appendix C4.
Negligence	Negligence is a 'tort'. In the case of a professional, negligence is a failure to provide services with the standard of skill and care that would be expected from a reasonable body of the professional's peers.
Professional indemnity insurance (PII)	Insurance to cover the cost of compensating clients for loss or damage resulting from negligent services or advice provided by a business or an individual.

PII limit	A firm's PII limit is the maximum amount the firm's PII insurer will pay in the event of a claim. It is sometimes wrongly confused with a liability cap. See section 3.
Pre-Action Protocols	The regime applicable to legal disputes in England and Wales whereby parties exchange correspondence and documents before commencing formal legal proceedings, with a view to avoiding altogether the need for formal legal proceedings if possible. There is a specific Pre-Action Protocol applied to professional negligence claims. See Appendix C.
Proportionate liability	Liability that is limited to the damage actually caused by the particular defendant. A 'proportionate liability clause' is a contractual mechanism whereby the liability of a member can be limited to the member's proportionate liability. See section 5.3.
Residential mortgage-backed security (RMBS)	A type of finance transaction. See Appendix B.
Run-off insurance	A form of insurance that can be bought to provide cover for claims arising after a firm or individual has ceased trading. Members have a particular need for it because a member's PII is provided on a 'claims made' basis, meaning that there will only be insurance cover for a claim if there is a policy in place when the claim is made – even if the claim is made after the member (or firm) has ceased practice. See section 7.
SAAMCO Cap	An important principle in the common law of damages, which ensures that surveyors can only be liable for the losses they can properly be said to have caused. See A1.2.
Securitisation	A type of commercial finance transaction whereby a primary lending bank bundles loans, and sells them to investors. See Appendices B1 and B2.
Security agent (also known as 'collateral agent')	In a syndicated lending situation, the party that holds the collateral on behalf of the lenders.
Sub-limits	Specific limits within a PII policy for certain specified types of claims, such as loss of documents.
Syndicated loan	A commercial loan that is shared by a group of lenders. See Appendix B2.
Third party/third parties	Anybody who is not a party to the contract. Usually this means anyone who is not the member's client. Examples include the borrower, in a situation where the member's client is a lender. See section 5 and Appendices A, B1 and B2.
Third party reliance	Third party reliance happens when a 'third party' relies on advice that has been prepared for a member's client. See section 5.

Tort	The umbrella term for all civil wrongs recognised by law other than breach of contract. The most commonly referred to tort is the tort of negligence. See section 2.
Unlimited round the clock reinstatements	The name given to a type of Indemnity Limit whereby layers of insurance are provided by different insurers and each Layer steps down as its underlying limit of indemnity is exhausted. When the final Layer of the total Indemnity Limit has been exhausted, the Indemnity Limit shall start from the beginning and back around to the original Primary Layer of Insurance.

1 Introduction

1.1 Scope and purpose

1.1.1 RICS has a responsibility, under its Royal Charter, to maintain standards in surveying services in the public interest. It is important to maintain the usefulness of the surveying programme for the public, to ensure the profession is diverse and sustainable, and the risk associated with providing professional advice and services is properly identified, fairly apportioned and properly managed.

1.1.2 This guidance note is intended to assist both RICS-regulated firms and their clients to understand the main risks and liabilities associated with professional services provided by RICS members. It guides firms in the negotiation of equitable contracts with clients and the avoidance of major risks and pitfalls.

1.1.3 RICS recommends that RICS-regulated firms take a fresh look at the way in which they conclude contracts with their clients. RICS-regulated firms are encouraged to revisit their own standard terms and conditions, and the basis on which they engage with their clients, in light of this guidance note.

1.1.4 After considering this guidance and the appendices to it, RICS-regulated firms may decide to take advice on specific aspects of their practice from their insurance brokers and/or legal advisers.

1.1.5 The document does not extend to providing guidance on quality assurance issues; that is the role of sector specific standards, for example, **RICS Valuation – Global Standards** (Red Book Global Standards).

1.1.6 Members' attention is also drawn specifically to RICS standards on professional behaviour, in particular the **RICS Rules of Conduct** and the current edition of **Conflicts of interest,** RICS professional statement.

All RICS-regulated firms need to ensure they have adequate and appropriate professional indemnity insurance in place that complies with the requirements of the **RICS Rules of Conduct** and the **RICS minimum terms and requirements**. See also the current edition of **RICS Professional Indemnity Insurance requirements.**

1.1.7 This guidance note supersedes *Risk, liability and insurance in valuation work*, 2nd edition, RICS guidance note.

1.2 English law/Scots law

This guidance is based primarily on English law. Some key differences in Scots law are identified but RICS-regulated firms are recommended to take specialist advice on issues of Scots law. Similarly, although Northern Irish law is very alike to English law, firms in Northern Ireland are recommended to take specialist advice on issues of Northern Ireland law.

1.3 Effective date

This guidance note is effective from 1 April 2021.

2 The court's approach to professionals' liabilities

2.1 Breach of contract

2.1.1 The primary basis for a claim against a professional is for breach of contract. If the professional enters into a contractual obligation to do something, and fails to meet that obligation, either properly or at all, the other party (or parties) to the contract will be entitled to bring a claim for breach. Usually, this is a claim open exclusively to the professional's clients: only clients are party to the professional's contract and, therefore, only they may take action against the professional for breach of any obligations arising under that contract.

2.1.2 Whether its terms say it or not, a contract for professional services is usually considered to be subject to an 'implied term' that the services to be provided by the professional will not fall below the standards of skill and care expected from a reasonable body of the professional's peers. In effect, this means that the professional undertakes not to act negligently.

2.2 Negligence

2.2.1 In addition to claims for breach of contract, professionals may also be sued in 'tort'. A 'tort' (the term 'delict' is used in Scots law instead of 'tort') is an umbrella term for all civil wrongs recognised by the law, other than breach of contract. When referring to claims against professionals in tort, it usually means claims for the tort of negligence. In practice, a tort claim holds a professional to the same standard of care as the implied contractual term not to act negligently, as referred to above. The test the courts will apply when considering whether a professional person is in breach of their tortious duty is whether no reasonably competent professional would have acted in the same way, or provided the same advice, that the defendant professional did.

2.3 The differences between contract claims and negligence claims

2.3.1 As already noted, a claim for breach of contract can usually only be brought by a party to the contract, i.e. the client. A professional person can be sued in negligence by any third party (i.e. those who are not party to the contract) to whom they have expressly accepted a duty of care, or to whom the court says they have assumed a duty of care.

2.3.2 In English law, it can be a difficult legal question to know whether a duty of care is owed to any particular third party, particularly where a claimant argues that the court ought to impose such a duty on the professional person. When asked to consider whether a duty of care arises, the courts will see if a similar duty has been imposed in previous cases and, if not, they will consider whether:

a the damage suffered by the claimant was reasonably foreseeable as a result of the defendant's actions

b the parties were in a relationship of sufficient proximity, so the defendant could have anticipated their actions would cause loss to the claimant and c it is fair, just and reasonable to impose a duty on the defendant.

2.3.3 The one situation in which members need to be particularly careful is where they are asked to permit third parties to rely on their advice. If the member does consent to reliance by a particular third party, they will probably be considered to owe that third party a duty of care, therefore, enabling that party to sue the member for negligence, if the member has not exercised reasonable skill and care in carrying out their work.

2.3.4 There are some technical legal differences between claims for breach of contract and claims for the tort of negligence, but the claims are similar, and it is therefore, very important that a member does not lightly accept a duty of care to a third party, because in large part of the practical consequence is to enable that party to have the same rights as a client. A third party who attains that status may also not be bound by the terms of the member's contract or terms of engagement, including any liability cap; and may have an extended period in which to bring a claim. See Section 4 for more information on third-party reliance.

2.4 Damages

2.4.1 The remedy for breach of contract and for the tort of negligence is basically the same. If the claimant proves their case, damages will be awarded against the member to the extent necessary to put the claimant in the position they would have been in had the contract been performed fully and not been breached, or if the negligent act had not been committed. More information about the case law that applies to the calculation of damages is provided in Appendix A1.2, and for building surveying in Appendix B2.2.

2.4.2 In order to be recoverable under a claim for breach of contract, the loss suffered must have been in the reasonable contemplation of the parties at the time the contract was agreed. For example, if a surveyor fails to report a defect that has to be put right, the existence of which has an impact on the value of the property, both parties will have anticipated at the point the contract was agreed that the client would suffered a loss when purchasing the property with the defect. But if the client seeks to claim damages for the fact they were unable to let the property while the defect was being repaired, then only if the surveyor was aware at the time the contact was agreed that the client was planning to let the property will the client be able to recover any loss of rent.

2.4.3 For a claim in tort, the test is whether the nature of the loss suffered could reasonably have been foreseen by both the surveyor and the claimant at the time the professional acted in breach of duty.

2.4.4 Any losses that fall outside the relevant test will not be recoverable. Generally, claims will be for financial loss. There are circumstances in which other losses (i.e. loss of amenity) can be compensated but these are more unusual.

2.5 The purpose of the work

2.5.1 Although a member may not have full visibility of what a client hopes or intends to use their work for, they should record what they consent to it being used for. They should consider including wording along the following lines:

> 'Where you have explained to us the purpose for which you require our advice, we consent to its use solely for that purpose. If you rely on our advice for any other purpose, we shall

not have any liability to you for any losses caused by you using our advice for that other purpose'.

2.6 The legal entity that provides the professional services/personal liability

2.6.1 In general, a claimant will bring any negligence claim concerning professional work against the entity that provided the services. If the client is bringing the claim, this will mean the claim will be brought against the entity that entered into the contract with the client. Usually, this will be the member's firm.

2.6.2 If a firm carries on practice as a partnership, and it is the partnership that enters into the engagement with the clients, the partners are individually responsible for the firm's liabilities, including claims. This means that, if a claim succeeds against a partnership for, say, £500,000 in damages, the claimant can choose to enforce that award of damages against as few or as many of the partners as it wishes, until the full amount is paid. The partners are able to insist on sharing partnership liabilities according to their partnership agreement and partnership law, but vis-a-vis the claimant, they each have 100% liability. In Scotland, the position is different because, unlike in England and Wales, a partnership is a separate legal entity from the partners in the partnership. Scottish firms should take specialist advice about the implications of this.

2.6.3 By contrast, if the firm's business is conducted through a Limited Liability Partnership (LLP) or a Limited Liability Company (LLC), that should mean that the partners in the firm (strictly speaking, they are called 'members' in an LLP, but they are usually still referred to as partners) and the directors of the company, are not personally liable for the firm's debts. This should also mean that they are not personally liable for any liabilities the firm has for professional negligence claims. Therefore, from a risk perspective, the use of an LLP or an LLC confers a significant advantage.

2.6.4 Occasionally, claimants try to bring claims against individual partners, or individual employees, even if the services are provided by an LLP. This means that it is prudent to include a clause in the terms of engagement excluding all personal liability; see section 5 for more information on addressing contractual terms.

2.6.5 In the majority of cases, the member/firm will of course look to its professional indemnity insurance to respond to any claim and this is addressed further in section 6.

2.7 How long after the services a claim can be brought

2.7.1 Statutory limitation periods control the time allowed for a claimant to commence court proceedings. Commencing court proceedings is what is meant by 'bringing a claim' – merely issuing a letter of claim will not suffice.

2.7.2 The limitation period for bringing a claim against a member for breach of contract will expire six years from the date on which the member performed the service required under the contract, for example by providing the survey or valuation report. Members in Scotland should refer to paragraphs 2.7.10–12.

2.7.3 Where the claim is brought as one for the tort of negligence, rather than for breach of contract, the period will often be longer, because the right to bring a claim will not arise until the claimant actually suffers a loss as a result of relying on the advice of the member. This requirement for a loss to arise almost always leads to a delay in the commencement of the six-year period.

2.7.4 By way of example, in respect of professional negligence cases relating to loan valuations the courts have held that a basic comparison be made between:

a the amount of money lent by the lender that it would still have had in the absence of the loan transaction and

b the value of the rights acquired, namely the borrower's covenant and the true value of the overvalued property.

The cause of action in tort arises (and the six-year period starts running) at the point at which the lender can be said to have suffered a loss due to the negligent valuation, because the amount owed (including any accrued interest) exceeds the value of the property and the borrower's covenant. By contrast, in contract the six-year period would start running earlier, at the point at which the valuation is undertaken.

2.7.5 In addition, in 1986, an important change was made to the **Limitation Act 1980** to allow an extra period for a claim to be brought, because it was seen to be unfair that the six-year period could run out before the claimant realised they were legally entitled to bring a claim. Since then, a claimant who brings a claim in negligence has the opportunity to bring that claim up to three years after the date on which the claimant learned (or could reasonably have found out) about their entitlement to bring the claim. This three-year period applies even if it results in a period longer than the conventional six-year period referred previously, but it is subject to a 'long-stop' period of 15 years from the date of the negligent act. This is the position in claims for financial loss or property damage; a different statutory regime applies to personal injury claims. This also does not reflect the position in Scotland: members there should seek their own advice on the applicable limitation period for claims in tort.

2.7.6 These two points can lead to complex factual and legal issues, particularly in determining when the claimant actually suffered loss and when the claimant acquired the knowledge necessary to bring a claim. Those issues are beyond the scope of this guidance, but the important point to emphasise is that, in some situations, a claim relating to professional services can be brought more than six years after the member provided their advice to the client. Once the defendant has raised an argument about limitation, the burden then rests on the claimant to establish that the cause of action accrued on a date within the limitation period

2.7.7 Additionally, where a professional is retained to provide services under a deed (which is a special type of contract), the limitation period would be 12 years from the date of breach.

2.7.8 There are two important consequences arising from the limitation periods referred to above. The first relates to insurance. Section 6 is devoted to PII, but the fundamental point that must be made is that PII is provided to firms and members on a 'claims made' basis. This means that, in order for there to be insurance for a claim, there must be an insurance policy in place when the claim is made, regardless of when the services were provided. For example, for services provided in 2021, the firm should continue buying insurance every year until at least 2027. There is still a risk of a firm or its partners being sued if it ceases practice during that intervening period, which is why RICS requires firms to buy 'run-off' PII to cover the period after ceasing practice. RICS' regulatory requirement for run-off cover is contained in the current edition of Professional Indemnity Insurance requirements. A firm should undertake a risk assessment about whether run-off cover is required for a longer period of time to cover the 'long-stop' period of 15 years.

2.7.9 The second consequence concerns document retention. Given the 'long stop' date of 15 years, RICS recommends that members retain their files for 15 years after providing any professional services, to ensure that they have the records necessary to respond to a claim. Any updated advice provided in connection with earlier services should also be retained for 15 years from the date of that advice, as a new limitation period will apply to each new piece of advice provided to a client.

2.7.10 In relation to claims in Scotland, the applicable period for claims in contract or for the tort of negligence is five years. As in England, this period does not begin until the claimant has incurred a loss, which may not be the point at which professional services were provided. However, the Scottish courts have taken a stricter approach to what is considered to be a 'loss' and there is no requirement for the claimant to recognise that something is a loss at the time so long as they are aware the loss has been incurred. For example, in the context of an overvaluation claim, the loss can occur (and so this time period begin to run) when the property is purchased for an excessive value even if the claimant is not aware it has been overvalued, because the claimant is aware of the purchase price having been paid. There is, therefore, less scope for Scottish claimants to extend the period in which a claim can be brought as described in paragraph 2.7.5. The loss must, however, be something more than just the fee paid to a professional for their services.

2.7.11 It has been recognised that this approach can produce an unfair result for claimants. This area is due for reform following the passing of the **Prescription (Scotland) Act 2018**, however, this has not yet come into force and, at the time of writing, it is not clear what the timescale for this is.

2.7.12 In Scotland, all claims for financial loss or property damage are subject to an overall 'long-stop' period of 20 years.

3 Liability caps

3.1 A liability cap is a contractual agreement that a client can only claim damages up to the amount agreed, even if the law would otherwise award a greater sum in damages.

3.2 As a profession, surveyors have been slower than some to embrace the use of liability caps, but liability caps are now used more and more frequently by members. One of the most important purposes of this guidance note is to explain what liability caps are and how they work, and to encourage RICS-regulated firms to use them.

3.3 RICS recommends to RICS-regulated firms the use of liability caps, where legally permissible and following the principles of good practice set out in this guidance note, as a way to manage the risk in professional work, and to ensure that there is a fair allocation of risk and reward between members and their clients.

3.4 This guidance note contains some additional, more specific guidance about capping liability in valuations in both the residential and commercial context in Appendices B and C.

3.5 Capping liability is a common way to regulate risk in a client relationship. Legally, liability caps are enforceable as long as they are properly incorporated into the contract, and they are at a 'reasonable' level. Extra care is required when dealing with a consumer, particularly as any contract between a business and a consumer will fall within the jurisdiction of the Competition and Markets Authority, which has wide powers to challenge the conduct of any business that is seeking to impose terms that cause unfair detriment to consumers. Detailed advice on whether a liability cap will be acceptable when contracting with a consumer client is given in Appendix B3. RICS-regulated firms and members must also ensure that any liability cap does not contravene the rules about acting with integrity and having proper regard to standards of service in the **RICS Rules of Conduct**.

3.6 If it is drafted properly, a liability cap specifically applies even where an RICS-regulated firm or member has conducted their work negligently. RICS recommends using a liability cap along the following lines:

> 'RICS recommends the use of liability caps to RICS-regulated firms as a way in which to manage the risk in professional work. Our aggregate liability arising out of, or in connection with, these services, whether arising from negligence, breach of contract, or any other cause whatsoever, shall in no event exceed £[x]. This clause shall not exclude or limit our liability for actual fraud and shall not limit our liability for death or personal injury caused by our negligence.'

3.7 It is important to distinguish between a liability cap and a firm's professional indemnity insurance limit:

- The insurance limit is set out in the firm's insurance policy and is fixed on the annual PII renewal; it is the maximum amount insurers will pay in any particular claim.
- A liability cap is an agreement between a member and their client, fixed when they enter into an engagement for professional services.

3.8 The two are not really related, and there is no legal or regulatory reason why a liability cap needs to be anywhere near as high as the insurance policy limit. It would be unwise to agree a liability cap greater than the insurance policy limit, but it would still be better from a risk perspective than not agreeing one at all.

3.9 If a claim arises for an amount greater than the agreed liability cap, and the client tries to challenge the liability cap, the court will need to ask:

a whether the liability cap was properly incorporated into the contract and

b whether the level of the cap was at a 'reasonable' level when it was agreed.

3.10 Some of the factors the court will consider in determining reasonableness are set out in 3.11, but essentially, in a contract that has been freely negotiated between two commercial parties, the court will usually find liability caps to be enforceable.

3.11 The level of a liability cap is a matter for each member to negotiate with their client. In doing so, some assistance can be derived from the key factors the court will look at in deciding whether a cap is 'reasonable', some of which are set out below. All of these are to be judged as at the time the engagement was entered into between the member and client:

- **The level of risk in the engagement.** This includes the purpose of the instruction, the time available to complete the work, the scope and complexity of the instruction and the parties who may rely on the work.
- **The level of fees.** Seeking to cap liability to an amount less than the anticipated fee will generally not be reasonable. However, there is no reason for the liability risk to be disproportionate to the reward.
- **The limit on the professional indemnity insurance policy, and the cost to the firm of buying the insurance.** The limit of PII cover is a factor the court may take into account when considering the reasonableness of a cap but, as stated previously, there is no need for the cap to be the same level as the insurance limit, or even necessarily near it. For obvious reasons, it would be unwise to agree to a cap in excess of the insurance limit.
- **The potential liability that might be incurred without a cap.** This factor should cause firms to consider what loss their client may incur if their work is negligent, but again, there is no need for the cap to be at or necessarily near that figure. The guiding principle is reasonableness, and parties are free to negotiate any figure that together they consider to be reasonable.
- **The degree of sophistication and the relative bargaining position of the parties to the contract.** If the court forms the view that the provider of services has imposed a liability cap on a customer who had limited or no bargaining power, that will increase the chance of the cap being held to be unreasonable. This may require particular consideration if the client is a domestic consumer, but it is less likely to be an issue if the client is a commercial organisation that has a similar bargaining position to the RICS-regulated firm, or a stronger one.
- **How effectively the cap is brought to the client's attention.** Best practice is to draw a client's attention to a liability cap, particularly the first time it is incorporated into a contract; it should not be 'buried away' in fine print.

3.12 The level of the liability cap can be negotiated on different bases, including, for example, as a multiple of the proposed fee, a percentage of the anticipated level of value to be reported, or a percentage of the amount intended to be loaned (in the case of valuations for loan security purposes). In construction projects the level of the cap may be related to the value of the construction contract. Some further guidance is given in Appendix B (residential) and Appendix C (commercial). In Appendix B3 it is noted that particular caution must be exercised when setting liability caps with 'consumers' (i.e. those who are not acting in the course of a trade or profession, which may include buy-to-let clients). RICS recommends that RICS-regulated firms obtain legal advice when seeking to impose a liability cap in a contract with a consumer, particularly given the potential involvement of the Competition and Markets Authority.

3.13 The terms of master contracts that seek to set a liability cap at the same level across differing instructions from a particular client should be considered very carefully, because the question of what level of liability cap is reasonable may vary from one instruction to another.

3.14 If a liability cap, or the basis for calculating the liability cap, is included in a firm's standard terms and conditions, rather than being included in an engagement letter that is specific to a particular instruction, it should be in a prominent position. RICS recommends that RICS-regulated firms refer to any liability cap in the engagement letter, to ensure it is given sufficient prominence to satisfy the rules on enforceability. It may improve a firm's position further to refer to the existence of the liability cap in the body of any report or written advice.

3.15 There are some circumstances in which the use of a liability cap is limited or prevented by law. For example, valuation reports prepared for inclusion within prospectuses under the Financial Conduct Authority (FCA) Listing Rules may not exclude liability to parties other than the addressee of the report (see UK VPGA 2 of the *RICS Valuation – Global Standards 2017: UK national supplement*). Specialist legal advice may be required in such situations. See above and Appendix B1 in relation to 'consumers'.

3.16 In law, any clause that attempts to exclude liability for personal injury or death or fraud will be unenforceable and members should make clear that caps do not extend to these liabilities.

3.17 Where RICS-regulated firms are asked to provide multiple pieces of work (for example, valuations or surveys) under one instruction, the engagement letter should set out whether the agreed liability cap applies to each piece of work, or to the whole engagement 'in the aggregate'. A cap expressed to be 'in the aggregate' provides more certainty to the member as to the maximum liability for the whole instruction or retainer with a client, where as an each and every basis would be in respect of each piece of work provided.

3.18 In some situations, the law permits a professional to go beyond capping or limiting liability by excluding legal liability altogether. The most common situation in which members do so is if they provide advice without charging a fee. RICS-regulated firms who are no longer able to obtain insurance for risks relating to fire or where they are providing a valuation in reliance on an EWS1 form may also seek to exclude liability for any claims that would be caught by such exclusions. It may also be reasonable to exclude liability altogether in other client contracts, but this would usually be possible only where your client is a business user, not a consumer. To maximise the chances of such a complete exclusion being enforceable, RICS recommends that members should ensure the exclusion of liability is in writing and is specifically drawn to the attention of the recipient of the advice. (Where a member provides advice free of charge, they should still ensure that the advice given falls within the scope of their business services, as defined by their policy, or they may have no insurance in the event that the person who received and relied on their advice makes a claim.)

4 Third-party reliance

4.1 As explained in section 2, a third party is any party who is not party to the member's contractual engagement, i.e. parties other than the firm's client. By way of example, if the firm's client is a lender, third parties may include the borrower, or another lender or investor who is investing in the lender's loan. If the client is a purchaser or property owner they may wish for successors in title to be able to rely on the professional's advice.

4.2 Members are regularly asked by their clients to agree to permit third parties to rely on their advice. RICS-regulated firms should appreciate the risks in permitting third-party reliance and make a decision to permit third-party reliance only on an informed basis. In particular, members should be aware that third-party reliance can come in different guises. For example, it could be incorporated within the original terms of engagement for an instruction (including by way of obligations to provide reliance letters or collateral warranties to third parties in future) or could arise subsequently where members agree (expressly or impliedly) that a third party may rely on their advice.

4.3 This guidance note contains some additional, more specific guidance about third-party reliance in valuation generally and in the residential and commercial contexts in Appendix A.

4.4 Permitting third-party reliance is different from merely permitting a third party to 'see' or to have 'disclosed' to them the advice, as it does not automatically give rise to a legal duty to the third party. However, RICS-regulated firms should still take care even in allowing this, because there is a risk this might be construed as the same thing as permitting reliance, particularly if it is obvious that the third party will in fact be relying on the advice. If firms do agree that advice may be 'shown to' or 'disclosed' to a third party, they would improve their position by making it clear (in writing), not only to their client but also to the third party, that this is being permitted without assumption of any legal liability to that third party. It is recognised this may not be possible in all circumstances, but it is important that regulated firms understand the risks entailed. Firms should also make clear in their contracts/engagement terms that their advice may only be relied on by the named client so as to ensure that they are aware of and have control over future requests for third party reliance.

4.5 Client relationships should be based on mutual trust. Permitting third-party reliance can expose members to third parties whom the firm does not know, who might look on the advice very differently, and who might have a different attitude to bringing claims against a firm.

4.6 Permitting third parties to rely on advice has the effect of permitting them to be treated as the member's client. There are the following risks:

- Some of the third parties with whom advice is shared might be based in different jurisdictions, and may try to bring claims before the courts of those jurisdictions, with very different laws from the laws that govern the relationship between members and their clients. It is also possible that such claims may not be covered by the member's PII if they are brought in jurisdictions that do not fall within the geographical limits of the PII policy.
- Members' contractual terms of engagement (including the terms set out in this guidance, such as a liability cap) may not be binding on the third parties. In addition, some of the legal defences members might be able to raise if faced with a claim from a client may be more difficult to raise in response to a claim from a third party.

- Regulated firms should think carefully about whether they had communications with the client at the time of providing the advice that might affect the way in which the advice should be used. It may be necessary for those communications to be passed to the third party so that the advice is placed in the proper context. If so, firms should try to influence the way in which the advice is passed to the third party, to ensure that, where possible, the advice is passed on together with those other communications only.
- Permitting reliance by third parties who are in a different position from the client (such as the property owner, where the client was the lender) may expose members to claims of a different type.
- RICS-regulated firms' PII may impose specific conditions concerning third party reliance and may exclude indemnity in relation to certain third-party claims – see paragraph 4.10.

4.7 If firms do agree to permit third-party reliance, they should be as specific as possible about who the permitted third parties are, by clearly stating the named individuals or entities that will be entitled to rely on their advice, so far as is possible – permitting an entire 'class' of third parties to rely on the advice will add greater risk and should, therefore, be avoided, where possible. Appendix C8 comments on what RICS-regulated firms should do if asked to issue a fee invoice to a third party.

4.8 Where RICS-regulated firms do permit third party reliance, this should be done in a way that is recorded and ensures:

- the third party is bound by the terms and conditions of the firm's contract with its client (including the liability cap) and any liability cap is in aggregate in respect of claims by the original client and third parties
- the third party understands and acknowledges (if it is the case) that the firm has not provided fresh advice and the effective date has not changed simply by the act of permitting third party reliance
- the purpose for which the advice has been provided has not altered simply by permitting third-party reliance
- the member will not have a liability to the third party greater than that it would otherwise have had to its client and
- that if there have been any changes to the advice given these are communicated clearly to the third party as well as the original client.
- Where possible, the member should ask the third party to sign a letter stating the basis on which they will be entitled to rely on the advice, to confirm their acceptance of each of the points above.

4.9 In considering whether to permit third-party reliance, it is important for RICS-regulated firms to bear in mind the scope of their PII. The **RICS minimum terms and requirements** permit PII insurers to limit the cover available for claims brought by third parties to whom the contract has been assigned; the RICS minimum terms and requirements require cover for assignments only where given to a financier or funding party and for only two successive assignments. Firms should take specialist advice from insurance brokers or solicitors if they decide to permit third-party reliance in the course of their practice, as they may need broader insurance cover.

4.10 This is particularly important if RICS-regulated firms permit reliance on valuations for the purposes of the securitisation of loans, loan syndication, stock exchange listing and other investment memoranda. Depending on their structure, those processes may entail transfer of loans, and assignment to the buyer of the loans of the ability to bring negligence claims against the original valuer. If a firm has only the 'two assignments' cover of the Minimum Terms, that may not be enough. Firms should, therefore, review their individual insurance arrangements to verify whether they are suitable for their practice.

4.11 If a fee is being paid by a third party, it is important that members consider whether their client requires that third party to be entitled to rely on the advice. If not, the engagement letter and advice should make that clear, because otherwise the third party may seek to argue that they are entitled to rely on the advice by reason of having paid the fee.

4.12 Like all decisions involving risk, members should consider whether permitting third-party reliance should, where practical or possible, command an additional fee to cover the relevant insurance cost and any additional risk.

5 Contractual terms

5.1 Engagement letter

5.1.1 An engagement letter is the contract between the member and the client and sets out the scope of the appointment (i.e. what it is that the member/firm has agreed to do) and the terms governing the appointment.

5.1.2 It is also an important opportunity for the member to regulate the risks that attend the engagement, and that opportunity should not be passed up.

5.1.3 Before turning to the terms of engagement, it should be noted that ultimately there is no compulsion on the part of RICS-regulated firms to accept a professional instruction. Where, in the member's opinion, the risks and rewards are not balanced, the member should consider whether it is appropriate to accept the instruction.

5.1.4 In this section, there are the clauses of an engagement letter that are the most important from a risk perspective. Where appropriate, an example clause is given after the explanations. These clauses are generic examples only and will not suit all situations; RICS-regulated firms should consider taking legal advice on their requirements for specific situations.

5.1.5 Although the words 'clause' and 'contract' are used, the engagement letter can have the appearance of any other business letter. There is no particular form in which the clauses need to be set out, though it is important that clauses which exclude or limit a member's liability are reasonably prominent.

5.1.6 Many firms choose to prepare standard terms and conditions for all retainers. This enables engagement letters for individual matters to be prepared easily, by reference to those standard terms and conditions, and it will usually mean that negotiation with the client at the outset of each new matter can be confined to the key points specific to that matter.

5.1.7 Frequently, a client will ask a member to agree to provide services on the basis of the client's own standard terms and conditions, which might include a service level agreement or master services agreement, the terms of which will bind both parties for the duration of the specific agreement. The question of whose terms and conditions prevail is a subject for commercial negotiation with the client (and members should ensure that it is made clear which terms will prevail), but if the client's terms and conditions prevail, members should read them and bear in mind that, like every contract, their terms should be capable of negotiation. Where the client wishes to have a standard service level agreement in place, this will help facilitate instructions for the period of its duration, but the member should still read its terms carefully prior to signature and, where appropriate, seek to negotiate those terms, to ensure that they fairly apportion risk and reward between the parties and are legally complaint (for example for building control activities, which must adhere to *The Building (Approved Inspectors etc.) Regulations* 2010 and the *Building Control Performance Standards*).

5.1.8 Even where a firm or member does have standard terms and conditions, there are at least three key terms that should be considered from a risk perspective in the context of every instruction, as set out below. These terms should be regarded as related, and, therefore, considered alongside one another in the context of each instruction.

1 The scope of the work.

2 The basis on which the fee will be calculated.

3 The liability cap (see section 3).

5.1.9 When negotiating terms of engagement, a firm or member should ensure that the terms are clearly established and understood by the respective parties.

5.2 Contracting entity/exclusion of personal liability

5.2.1 The engagement letter should state the entity that is entering into the contract to provide the services.

5.2.2 The firm's name shown on the front/back of any written report should be consistent with the engagement letter. This is important for the reasons given in section 2.7.

5.2.3 The engagement letter can include a clause that expressly prevents any of the firm's individual partners or employees being named as a defendant in any claim brought relating to the services. This requires wording along the following lines:

> 'None of our employees, partners or consultants individually has a contract with you or owes you a duty of care or personal responsibility. You agree that you will not bring any claim against any such individuals personally in connection with our services.'

5.3 Proportionate liability

5.3.1 Sometimes the services of a member are provided in a particular matter alongside those of other professionals, such as other surveyors, solicitors, architects, engineers, etc. If the client sues more than one of these professionals, all of the defendants can in some cases be categorised as 'joint tortfeasors', or all be held liable for the same damage. If that happens, and the claimant succeeds in a claim against more than one of them, the claimant can choose to enforce 100% of its judgement against as few or as many of the defendants as the claimant wishes to. If one of the defendants is unable to pay a fair share of the claimant's loss (for example, if that party has no insurance and/or is insolvent), the others are required to step in and meet the judgement in full. This may mean, for example, that even though an engineer was also responsible, the member has to pay all of the loss because the engineer has gone insolvent and does not have run-off insurance.

5.3.2 It is possible to contract out of this effect, by including a clause in the engagement letter which says that, even if the member is negligent, the extent of the member's liability is restricted to the loss which can properly be said to have been caused by that negligence. Note that such a clause is different from a 'liability cap' (see section 5.4). A proportionate liability clause would be along the following lines:

> 'If you suffer loss as a result of our breach of contract or negligence, our liability shall be limited to a just and equitable proportion of your loss having regard to the extent of responsibility of any other party. Our liability shall not increase by reason of a shortfall in recovery from any other party, whether that shortfall arises from an agreement between you and them, your difficulty in enforcement, or any other cause.'

5.4 Liability caps

5.4.1 Section 3 is devoted to liability capping clauses, and the subject is also addressed in Appendix B and Appendix C. However, these clauses are also included in this section, because, together with the fee clause and the scoping clause, liability caps are one of the three clauses of engagement that RICS-regulated firms should consider from a risk perspective in accepting every instruction, rather than being left for inclusion in standard terms and conditions.

5.5 Fees

5.5.1 The fee to be charged should be considered in the context of every instruction, and not left for inclusion in standard terms and conditions, even with regular clients.

5.5.2 The size of the liability risks attendant on professional services can be disproportionate to the fee charged. Accordingly, those members who are responsible for pricing professional work within a firm should ensure that they are aware of the cost to their firm of buying and maintaining professional indemnity insurance, as well as all other costs of the business.

5.5.3 See Appendix C8 if asked to issue a fee invoice to a third party.

5.6 Scope of work

5.6.1 The firm should consider the scope of work that it is intended will be provided for the fee, and then ensure the client's expectations in that regard are the same as the firm's. For example:

- What is the nature of any inspections or investigations to be conducted?
- Will the work include any measuring services?
- Will the member need to call on other specialist input (for example, from other surveyors) from within the firm?

5.6.2 Frequently, claims arise because of a mismatch between the work the member intended to do to provide the services, and the work the client anticipated the member would do. The engagement letter is the member's opportunity to ensure that the client's expectations match those of the member as to what the member is going to do and, just as importantly, what the member is not going to do.

5.6.3 The 'scoping' process should be aligned with the process of calculating an appropriate fee and liability cap (see section 3).

5.6.4 The scoping process is also a good opportunity for the member to state those areas of specialist work the member is not going to deliver in this instruction. The member may believe the client knows that these specialist works are being provided by other specialists, but it is preferable to state this in express terms.

5.7 Dispute resolution

5.7.1 If no other provision is made, the default position in England and Scotland is that disputes between members and their clients are to be referred to the courts, for litigation. It is possible for a contract to provide for the use of alternative dispute resolution which can be a quicker and cheaper option. Appendix E addresses this subject.

5.8 Third-party reliance

5.8.1 Section 4 is dedicated to the subject of third-party reliance. RICS-regulated firms should include a clause in their engagement letters that prevents third-party reliance. This can be included in a firm's standard terms and conditions. For completeness, this clause should be replicated in a prominent position in the body of any report as well. The clause can be along the following lines:

> 'Our advice is provided for your benefit alone and solely for the purposes of the instruction to which it relates. Our advice may not, without our written consent, be used or relied on by any third party, even if that third party pays all or part of our fees, or is permitted to see a copy of our advice. If we do provide written consent to a third party relying on our advice, any such third party is deemed to have accepted the terms of our engagement.'

References to advice should be amended as appropriate – for example, for valuation work they should reference 'our valuation'.

5.9 Governing law and jurisdiction

5.9.1 Some clients (or third parties who bring claims against a an RICS-regulated firm) may try to bring claims in their 'home' jurisdiction. If successful, members might find themselves being judged under a different system of law from that with which they are familiar or had in mind when they accepted the relevant instruction. It is also possible that the member's PII will not cover the claim, if the policy contains geographical limitations on cover.

5.9.2 Members can prevent this happening in the majority of cases by including a simple clause stating that the contract, and any claims arising from the professional services, are subject to the exclusive jurisdiction of the courts of England and Wales, and English law. This is even necessary within the United Kingdom: for example, if valuing a Scottish property, or sending a valuation to a client in Northern Ireland, this may create uncertainty as to governing law and jurisdiction, so it is recommended to include an express choice. The clause can be along the following lines:

> 'Our contract with you for the provision of these services is subject to English law. Any dispute in relation to this contract, or any aspect of the services, shall be subject to the exclusive jurisdiction of the Courts of England and Wales, and shall be determined by the application of English law, regardless of who initiates proceedings in relation to the services.'

5.9.3 This clause can be adapted for Scottish use by replacing 'English law' (in both places) with 'Scots Law' and 'the Courts of England and Wales' with 'the Courts of Scotland', though in Scots law, there are differences as to what makes up the contract with a member and how the contract is concluded; specialist Scots law advice should be sought.

6 Professional indemnity insurance (PII)

6.1 All RICS-regulated firms need to ensure they have adequate and appropriate professional indemnity insurance in place that complies with the requirements of the **RICS Rules of Conduct** and the **RICS Professional Indemnity Insurance requirements**.

6.2 Insurance is a key part of managing risk. That firms maintain insurance is also in the interest of a firms' clients and, therefore, the reputation and standing of the profession. This is one of the main reasons RICS takes a role in ensuring that firms are adequately insured.

6.3 All RICS-regulated firms should be aware of the following points about PII:

- In arranging PII, RICS-regulated firms should ensure the amount of cover purchased is consistent with the nature of the firm's practice and proportionate to the risks taken by the firm and consistent with **RICS Professional Indemnity Insurance requirements**.
- Limits of indemnity may be on an any one claim basis or an aggregate plus unlimited 'round the clock' reinstatements basis. These have very similar effects, but the latter refers to the reinstatement of an aggregate limit following a loss or claim. If a firm obtains cover on an aggregate 'round the clock' reinstatement basis they need to ensure that they receive clear guidance as to how reinstatement of the limit will be applied and satisfy themselves that it complies with the terms set out under the **RICS minimum terms and requirements**, and provides appropriate cover for their professional business. Firms also need to ensure that each excess layer follows the terms and conditions of the primary policy.
- When choosing the level of insurance that is required, it is important to consider the effect of the aggregation clause in the policy. This clause will typically provide that where a number of claims arise from the same originating source or cause, such as a repeated error or omission, then all claims will be treated as one, attracting only one limit of indemnity, which may be insufficient.
- RICS-regulated firms' risk management must not begin and end with putting in place professional indemnity insurance, because insurance is a contract that contains limits, conditions, and exclusions: it is not a guarantee, and it will not cover everything. Careful attention to the terms of engagements (including the use of liability caps), and ensuring consistent quality in surveying practice and reporting, continue to be fundamental to effective risk management.
- When signing contractual documents, firms should bear in mind the policy coverage in respect of contractual liabilities, specifically the contractual liability exclusions of the policy such as express guarantees, fitness for purpose obligations and the exclusion of liability where there has been reliance on an EWS1 form (or as revised) and the valuation report does not exclude liability to the lender or any person deriving title to the mortgage.
- At the time of this publication, there have been a significant number of claims notified to the PII market involving cladding and fire safety, which involve a number of different professional services firms. Under **RICS minimum policy wording**, insurers are allowed to insert fire safety exclusions on policies, however, such exclusions should not apply to professional business on buildings of four storeys or fewer. In the event insurers impose specific terms in respect of fire safety or if a complete exclusion is

imposed on a firm's PII policy, it is recommended that firms consider carefully the impact this will have on their business. A firm's PII broker should be able to advice on safeguarding measures to put in place to mitigate risk in this area.

- Claims on a firm's PII directly affect the cost and terms of insurance in the future. In practice, that means it is in the interests of the firm's partners and senior staff to maintain an active involvement in risk management, so as to minimise claims under the policy.
- RICS-regulated firms' PII policies typically are provided on a 'claims made' basis, almost invariably on an annual basis. This means the policy that responds to a claim is the annual policy in force when the claim is made, regardless of when the relevant work was done. This offers great simplicity, but it does entail some pitfalls; in particular, if a firm were to allow its insurance to lapse from a certain date, it would have no insurance cover for claims made after that date.
- RICS-regulated firms should ensure at all times that in the event of the firm's practice ceasing, there will be 'run-off insurance' in place to protect the firm's partners and its customers. There will remain a risk of claims against the firm and its partners for at least six years after a cessation, and those claims may not be covered if the firm does not have run-off insurance for the duration of that period. This is a subject that should be considered by all firms at all times, not only those for whom a practice cessation is an obvious or imminent threat. Six years should be looked on as a minimum, because it is possible that claims may be brought more than six years after the date which services were provided (see section 2.7).

6.4 RICS requires RICS-regulated firms to put in place run-off cover. In addition to the consequences detailed in paragraph 6.3, a failure to comply with this obligation may be a disciplinary matter. Insurers should provide a £1,000,000 aggregate limit in all policies for a period of six years for consumer claims from the expiry date of the policy in force at the time of cessation, which should be included automatically in the **RICS minimum policy wording**. However, firms must continue to obtain and purchase run-off cover for longer periods than six years, or with higher cover levels, if they deem that adequate and appropriate. Firms are also required to purchase appropriate cover for commercial claims, which insurers are not currently expected to provider automatically under RICS minimum policy wording

6.5 All insurance policies will have an uninsured excess (or deductible) that is payable by the firm, a limit on the maximum amount the insurers will pay on any single claim, and may have an overall maximum amount the insurers will pay in a single policy year. Sometimes policies are also subject to 'sub-limits' relating to certain types of claims, such as loss of documents. The policy excess may now apply to defence costs for each claim made, even where a claim is successfully defended. Therefore, firms need to consider what financial impact this may have given they may now be liable to pay more excesses in one policy year.

6.6 Although larger firms sometimes have designated partners or employees who manage the firm's insurance arrangements, it is important that all partners and senior members are involved to an appropriate extent and have at least a working knowledge of the firm's professional indemnity insurance, including the cost of arranging it, and the points set out above. This is to ensure that:

- they comply with the requirements of the policy, including giving appropriate disclosure to the insurers and giving prompt notification of claims, and circumstances that may give rise to claims
- they are able to have informed engagement with clients about allocation of risk in their firm's engagements and
- they more readily appreciate the importance of prudent risk management and the use of appropriate terms of engagement including liability caps.

6.7 Firms should always consider consulting with an insurance broker with a demonstrable understanding of the sector in which the member operates. An insurance broker should be able to explain how to ensure the member's risk profile is presented to insurers in the best way to give an accurate representation of how the business manages risk with a view to ensuring appropriate cover and value for money.

7 Conclusion

7.1 Effective risk management is a dynamic process. It is intended that this guidance note, and the other materials referred to in this document, will equip RICS-regulated firms and their clients to understand the issues they address, but they cannot be a substitute for RICS-regulated firms and individual members constantly seeking to identify the risks that confront their practice, and to take steps to control and manage those risks. For further guidance on dealing effectively with complaints and claims, RICS-regulated firms and members are referred to the current edition of **Complaints handling**, RICS guidance note.

7.2 This is the responsibility of all members: a responsibility they owe to their profession, to their clients, and to all participants in property markets.

7.3 By necessity, the coverage of some subjects in this guidance is brief. As well as taking steps generally, RICS-regulated firms should take a fresh look at the terms and conditions on which they engage with their clients. In doing so, members are encouraged to take specific legal advice on the particular points to which their practice gives rise.

Appendix A: Valuations

Members' attention is drawn to the extensive guidance in **RICS Valuation – Global Standards** (Red Book Global Standards) on engaging with clients and writing valuation reports. Members' attention is drawn specifically to the following:

- VPS 1: Terms of engagement (scope of work)
- VPS 3: Valuation reports

All RICS-regulated firms and members are required to comply with Red Book Global Standards when undertaking valuations. RICS advises members to resist any requests from clients to diverge from Red Book Global Standards requirements. There is further guidance on this issue for residential valuers in section A1.

Members who undertake valuations to which the requirements of Red Book Global Standards apply must join **RICS Valuer Registration** (VR).

A1 The court's approach to professionals' liabilities

A1.1 The standard of care of a valuer: the 'bracket'

The courts expect valuers to achieve the standard of skill and care expected from a reasonable body of the valuer's peers. Whether a claim against a valuer is brought for breach of contract or in tort, the question the courts ask is whether the valuation given was one that no reasonable valuer in the actual valuer's position could have given. The courts invite expert evidence from other, independent valuers ('expert witnesses') to assist their decision-making in each case.

In reaching a decision on this issue, the courts recognise there is subjectivity in valuation: two valuers may reach different valuations of the same property at the same time without either of them being negligent. The usual question the courts ask is what are the maximum and minimum valuations that could be given by a reasonable valuer in the defendant valuer's position. To be found negligent, the defendant's valuation must generally have fallen outside that range, or 'bracket', of hypothetical reasonable valuations.

As well as deciding what the 'bracket' is for a particular valuation, and whether the valuer's valuation falls within the bracket, the courts may sometimes also consider whether there were any specific errors made by the valuer in the course of the valuation. If there were, that could increase the chances of the valuation being held to be outside the bracket. This means that a valuer cannot focus purely on the end figure; the process followed by the valuer and the text of a valuation report are also important. For example, while it is not automatically negligent for the valuer to have adopted an alternative methodology to the norm, when good robust evidence to support a conventional methodology is available, the case of **Barclay Bank Plc v Christie Owen & Davies Ltd (t/a Christie & Co) [2016] EWHC 2351** found the only acceptable reasons for not using the conventional methods are:

a if there is evidence that other methodologies are used in the market or

b if there is better available evidence that might support a more robust valuation on some other basis.

A1.2 Damages

The SAAMCO Cap: the most important principle in the law of damages as it presently applies to property valuers. The SAAMCO Cap (the name comes from the House of Lords decision in **South Australia Asset Management Corp v York Montague Ltd [1996] 3 All ER 365)**, in which the method for calculating damages in claims against valuers was established). This usually restricts the damages for which a property valuer can be held liable to the difference between the valuer's valuation figure and the figure the court decides was the actual value of the property at the date of the valuation.

For example, if a valuer values a property at £140,000 but the court decides the valuation was negligent and the actual value was £100,000, the maximum damages for which the valuer can be liable is £40,000 (plus interest), even if the client's losses are higher than that amount. Importantly, this means that valuers are not generally liable for additional losses suffered by their clients by market depreciation in the property between the date of the valuation and the date of the claim. It should be noted that the application of the SAAMCO Cap provides no scope for any damages awarded against the defendant to be reduced to reflect any contributory negligence on the part of the claimant.

It is important to note that the SAAMCO Cap is based on the principle that providing a valuation is only, in legal terms, providing 'information'. The cap does not apply if a valuer goes beyond the provision of information and advises a client whether to proceed with a transaction. The case of **BPE v Hughes-Holland [2017] UKSC 21** indicates that, where a valuer provides only part of the material on which a claimant relies when deciding how to proceed, that will be treated as giving information. Only in cases where the valuer advises the claimant on the whole transaction and how the claimant should proceed will the valuer be treated as giving advice. Valuers should therefore be careful to ensure that they do not cross this line.

A1.3 The purpose of the valuation

A valuation report and engagement letter must state the purpose for which a member has provided a valuation (Red Book Global Standards VPS 1, paragraph 3.1). RICS recommends that, where possible, members should be more specific than saying only that a valuation is provided, for example, 'for secured lending purposes' (see section 4 – Third-party reliance and section 5 – Contractual terms). Although a member may not have full visibility of what a client hopes or intends to use the valuation for, they should record what they consent to it being used for. This provides protection, for example, against a valuation 'for secured lending' being used for a potential subsequent decision for the same purpose, where there may have been a change in circumstance that might be material to the valuation date. They should consider including wording along the following lines (again, secured lending is used as an example):

> 'Where you have explained to us that the valuation is required for your use in a particular secured lending transaction, we consent to its use solely for that purpose. Where you have not instructed us as to the purpose for which the valuation is required, we consent to its use only in a single secured lending decision.'

A2 Liability caps

Red Book Global Standards requires valuers to include a statement in their terms of engagement and within the valuation report, setting out any limitations on liability that have been agreed. VPS3, paragraph 1.2 of Red Book Global Standards provides guidance where, due to the client's standard reporting form or format, it is not possible to provide this statement within the valuation report.

There are some circumstances in which the use of a liability cap is limited or prevented by law. For example, valuation reports prepared for inclusion within prospectuses under the FCA Listing Rules may not exclude liability to parties other than the addressee of the report (see UK VPGA 2 of **RICS Valuation – Global Standards 2017: UK national supplement**). Specialist legal advice may be required in such situations. See above and Appendix B1 in relation to 'consumers'.

A3 Third-party reliance on valuations

This guidance note contains some additional, more specific guidance about third-party reliance in the residential and commercial contexts in Appendix B and Appendix C respectively. One of the points made in the residential context is that RICS recognises there is a practice of permitting valuations of residential properties provided to lenders to be disclosed to the borrower/purchaser. In certain circumstances, this may extend the duty of care to that borrower/purchaser.

Other than where the practice identified in A2 is adopted by agreement between firms and their lender clients, valuers should not permit third party reliance and terms and conditions should exclude third-party reliance, with any exceptions made clear, taking into account the points highlighted below and in section 5.

Permitting third parties to rely on a valuation has the effect of permitting them to be treated as the member's client. There are the following specific risks in this practice in relation to valuations:

- Permitting disclosure in the regulated investment context may entail regulatory risk (i.e. exposure to the risk of regulatory investigations) as well as more conventional liability risk.
- Some of the third parties with whom valuations are shared might be based in different jurisdictions, and may try to bring claims before the courts of those jurisdictions, with very different laws from the laws that govern the relationship between members and their clients. It is also possible that such claims may not be covered by the member's PII, if they are brought in jurisdictions that do not fall within the geographical limits of the PII policy.
- Members' contractual terms of engagement (including the terms set out in this guidance note, such as the liability cap) may not be binding on the third parties. In addition, some of the legal defences members might be able to raise if faced with a claim from a client may be more difficult to raise in response to a claim from a third party.
- Members should be particularly careful if they are asked to give consent to third-party reliance at a date later than the effective date of their valuation. Valuers will improve their position in that situation if they tell both the client and the third party, in writing, that they have not re-valued the property, and the valuation may already be out of date, because the effective date of the valuation has not changed. If any changes have been made to the report these should be clearly communicated in writing to the third party as well as the client.
- Members should think carefully about whether they had communications with the client at the time of submitting the valuation that affect the way in which the valuation should be used. It may be necessary for those communications to be passed to the third party so that the valuation report is placed in the proper context. If so, members should try to influence the way in which the valuation report is passed to the third party, to ensure where possible the valuation report is passed on only together with those other communications.
- Permitting reliance by third parties who are in a different position from the client (such as the property owner, where the client was the lender) may expose members to claims of a different type.

- Members' PII may impose specific conditions concerning third party reliance on valuations, and may exclude indemnity in relation to certain third party claims – see paragraph 4.10.

If members do agree to permit third-party reliance, they should be as specific as possible about who the permitted third parties are – permitting an entire 'class' of third parties to rely on the valuation will add greater risk. Appendix C8 comments on what members should do if asked to issue a fee invoice to a third party.

RICS recommends that where members do permit third-party reliance, this is done only in a way that ensures:

- the third party is bound by the terms and conditions of the firm's contract with its client (including the liability cap)
- the third party understands and acknowledges (if it is the case) that the firm has not conducted a fresh valuation and the effective date has not changed simply by the act of permitting third-party reliance and
- the purpose for which the valuation has been provided has not altered simply by permitting third-party reliance.

In considering whether to permit third-party reliance, it is important for members to bear in mind the scope of their PII. This is particularly important if members permit reliance for the purposes of the securitisation of loans, loan syndication, stock exchange listing and other investment memoranda. Depending on their structure, those processes may entail transfer of loans, and assignment to the buyer of the loans of the ability to bring negligence claims against the original valuer. If a firm has only the 'two assignments' cover of the minimum terms, that may not be enough. Members should, therefore, review their individual insurance arrangements to verify whether they are suitable for their practice.

If a valuation fee is being paid by a third party, it is important that members consider whether their client requires a third party to be entitled to rely on the report. If not, the engagement letter and valuation report should make that clear, because otherwise, the third party may seek to argue that they are entitled to rely on the report by reason of having paid the fee.

A4 Terms of engagement

The focal document in the contract between the valuer and the client is known as the 'letter of engagement'. Recording the terms of contract in an engagement letter is required by **RICS Valuation – Global Standards** (Red Book Global Standards). Red Book Global Standards PS2 section 7.1 states:

> 'It is fundamental that by the time any written *valuation* is concluded, but prior to the issue of the report, all the matters material to the report have been fully brought to the client's attention and appropriately documented'.

Even where a firm does have standard terms and conditions, there are at least three key terms that should be considered by the firm from a risk perspective in the context of every instruction, as set out below. These terms should be regarded as related, and therefore considered alongside one another in the context of each instruction.

1 The scope of the work: the requirements for a valuation engagement letter in scoping each instruction are set out in full in Red Book Global Standards.

2 The fee: Red Book Global Standards also requires that the engagement letter specify the basis on which the valuation fee will be calculated. Fees are also addressed later in this section.

3 The liability cap: liability caps are discussed in section 3.

The firm should consider the scope of work that it is intended will be provided for the fee, and then ensure the client's expectations in that regard are the same as the firm's. See section 5.6, by way of specific examples:

- What is the nature of the inspection to be conducted?
- Will the valuation include any measuring services?
- Will the valuer need to call on other specialist input (for example, from quantity surveyors) from within the firm?

See Appendix C8 if asked to issue a fee invoice to a third party.

The scoping process is also a good opportunity for the valuer to state those areas of specialist work the valuer is not going to deliver in this instruction. The valuer may believe the client knows that these specialist works are being provided by other specialists, but it is preferable to state this in express terms. For example, if the valuer is not going to carry out the following services, the valuer should consider saying so in terms:

- Inspect the property in person (i.e. the valuer is to carry out a desk-top valuation only).
- Measure the property.
- Inquire into the accuracy of planning information provided to the valuer.
- Comment on condition.
- Examine the structural soundness of the property.
- Comment on the strength of a tenant's covenant in valuing a property that has been let.
- Inquire into the accuracy of passing rental figures provided to the valuer.
- Read leases or other legal documents other than where the valuer has expressly undertaken to do so.

Members' attention in this regard is also drawn to VPS1 Terms of engagement (scope of work) of Red Book Global Standards.

A4.1 Third-party reliance

Valuers should include a clause in their engagement letters that prevents third-party reliance. This can be included in a firm's standard terms and conditions. For completeness, this clause should be replicated in a prominent position in the body of the valuation report as well. Stating the position clearly, and in all documents to which the third party might refer, is the best policy, for example making clear via a number of express statements within the report that the purpose of a report is to enable a bank to consider the loan application only. The clause can be along the following lines:

> 'Our valuation is provided for your benefit alone and solely for the purposes of the instruction to which it relates. Our valuation may not, without our written consent, be used or relied on by any third party, even if that third party pays all or part of our fees, or is permitted to see a copy of our valuation report. If we do provide written consent to a third party relying on our valuation, any such third party is deemed to have accepted the terms of our engagement.'

Appendix B: Residential valuations and building surveys

This appendix is intended to provide guidance to valuers advising in residential mortgage valuation and 'consumer' work (as opposed to commercial lending situations and other commercial valuation situations, addressed in Appendix C). RICS recognises that there is not a hard and fast distinction between 'commercial' and 'residential', and it may be helpful for valuers to read both appendices.

B1 Issues specific to valuations in the residential sector

B1.1 Buy-to-let properties

Valuations of buy-to-let properties carried out for lenders in connection with the mortgage loan process have been a source of many claims against valuers. This includes claims by borrowers who have received a copy of the valuation provided to their mortgage lender, and have then sought to argue that they relied on the valuation.

The current legal position is that a valuer appointed by a lender in a buy-to-let transaction will not owe a duty of care to the borrower. The valuer's only duty is to the lender, unless the valuer is appointed directly by the borrower or expressly permits the borrower to rely on the valuation.

It is important for members who provide valuations for buy-to-let transactions to consider whether their insurance provides cover for valuations for commercial lending. While buy-to-let properties are residential properties, insurers may take the view that the valuation is for the purpose of commercial lending, if the borrower is seeking to purchase a portfolio of properties for the purposes of running them as a commercial venture. If a member is instructed to carry out such a valuation, they should check whether their policy provides cover for such valuations, and if they are under any doubt, raise this point with their insurance broker to ensure they are not left without cover in the event of a claim.

B1.2 Houses in multiple occupation (HMO)

The number of HMOs continues to rise and valuations of these properties present unique risks for valuers. In recent years, some professional indemnity insurers have begun to treat HMOs as valuations for commercial lending on the basis that the value of the property, at least in part, relies on its ability to generate income. In light of this, members whose professional indemnity cover is limited solely to valuations for residential lending should consult with their brokers and/or professional indemnity insurers regarding coverage of any claim before agreeing to value an HMO.

B1.3 Securitisation

Securitisation involves banks selling bundles or 'books' of loans to investors. It has been used extensively since the mid-2000s, particularly by banks operating in the sub-prime market. Banks continue to produce packaged products comprised of residential mortgage loans, often referred to as residential mortgage-backed securities (RMBSs), which are sold on to third-party investors.

To facilitate securitisation, lenders often request that valuers permit third parties to rely on their valuations. This presents a clear risk for valuers who may then face claims by parties who were not clients of the valuer. The issues and risks presented by third-party reliance are discussed in section 4; in summary valuers should not permit third-party reliance.

The typical form and structure of securitised loans is set out in some detail in Appendix C. Where packages of loans, whether commercial or residential, are sold repeatedly, these transactions will usually also entail repeated assignments of the right to sue the valuer who provided the original valuation. There are three practical points coming out of this:

1. Some professional indemnity insurance policies provide cover for a restricted number of assignments (the **RICS minimum terms and requirements** requires cover for two). Members should check what their policies provide.
2. Members should consider including in their engagement contracts an express prohibition on the assignment of their contract without their consent. See paragraphs 4.9 and 4.10 and the sample wording included under section C2.
3. Where possible, members should include any terms and conditions limiting or excluding liability in the valuation report itself, to ensure that any third party that comes to rely on the report is aware of the limits or exclusions.

B2 Nature of building surveyors' liabilities

This part explains the key principles that apply to claims against members relating to residential building surveys and what action members should be taking to limit their risks in this regard.

B2.1 The standard of care

In cases where a claimant alleges that a surveyor failed to identify a specific defect at a property, the claimant has to show – by using expert evidence – that no reasonably competent surveyor would have failed to identify and report on that defect.

The type of report the surveyor is instructed to produce will affect the extent of the inspection required. For mortgage valuations and inspections, a brief and reasonable visual inspection, which enables the surveyor to provide a valuation and general guide as to the property's condition, is sufficient. By contrast, a surveyor carrying out a building survey is expected to inspect all visible parts of the property, although not unexposed parts. The surveyor is not expected to test the services at a property as part of a building survey.

For HomeBuyer Reports, the surveyor is required to exercise the same standard of care that would apply to a building survey, within the agreed confines of the inspection.

Building surveyors should ensure that clients are aware of the different types of survey available, and consider the type of property (in particular whether it is unusual on the grounds of age, value, type of construction, whether it is a listed building etc) and RICS guidance when recommending the appropriate level of survey. Members should recommend a full building survey where necessary, and record that they have done so.

Members should also recommend that the prospective purchaser obtain any relevant warranties or professional consultant's certificate where it is appropriate to do so, for example, when dealing with a new build, or a recently extended/refurbished property (particularly if the works were significant in scale or structural significance). This could ultimately protect both the purchaser and the member.

A surveyor will be at risk of a finding of negligence if they fail to identify defects that would have been observable, had the inspection of the property been in accordance with the standards identified above or if, having identified a potential concern, the surveyor does not carry out further investigations or advise that further investigations ought to be undertaken.

To ensure that the extent of the inspection is clear, the engagement letter and report to the client should clearly record any limits to the inspection, including any areas of the property that will not be inspected and any issues that will not be dealt with in the report. The report should also include appropriate disclaimers in relation to hidden defects and recommend that any potential risks are investigated further by a specialist.

B2.2 Damages

For claims arising from the failure to identify and report on specific defects at a property, the case of *Watts v Morrow* [1991] 1 WLR 1421 provides that the measure of loss is the diminution in the property's value caused by the defect on which the surveyor failed to advise. In other words, the value of the claim will be the difference between the value of the property as described in the surveyor's report (without accounting for the defect) and the value of the property in its actual condition (subject to the defect the surveyor ought to have reported), as at the date of the report.

The issue of the quantification of damages for claims relating to a negligent survey has recently been reviewed by the Court of Appeal in the case of **Large v Hart & Anor [2021] EWCA Civ 24**. In that case, the judge at first instance found that the surveyor had failed to follow a trail of suspicion that would have led him to warn the claimant purchasers that the property might have problems with damp. More importantly, the judge held that the surveyor had been negligent in failing to warn the claimants to obtain a Professional Consultant's Certificate (PCC) before proceeding with the purchase, to protect their position in the event there were any defects with the subject property, which had recently been refurbished. The judge noted the usual measure of damages, established the in the case of Watts v Morrow, but found that the surveyor's failure to provide this advice meant that, when calculating the claimant's loss, it would be appropriate to take into account not just the defects that the surveyor ought to have reported, but all defects with the property.

The rationale for this decision was that, had the surveyor provided that advice, the claimants would either have been able to seek recourse against the architect for any latent defects under the PCC, or the transaction would not have proceeded in the first place. This logic was upheld by the Court of Appeal, taking into consideration the case of *South Australian Asset Management Corp v York Montague Ltd* (see paragraph in A1.2). The Court of Appeal found that, in failing to advise the claimants to obtain a PCC, the surveyor had given advice, rather than information, so that he should be liable for all the consequences of that advice being wrong. It is therefore important to keep in mind the distinction between 'advice' cases – where are surveyor advises the client on a course of action – and 'information' cases – where they simply provide comments on the condition of the property, as that may have an impact on the level of damages payable in the event of a claim.

Claimants will often seek to recover the cost of remedial works needed to repair or remove the defect (known as rectification costs). Those costs are rarely awarded and will only be considered by a court in cases where diminution in value would be an inappropriate measure of loss.

B2.3 Limitation

Limitation periods for negligence claims on building surveys are the same as for valuation claims: see section 2.7. In brief, the limitation period for advancing a claim in contract against a surveyor is six years from the date of the surveyor's report, and for claims in tort, the period is six years from the date when the claimant first suffered a loss. For claims brought by the owner of a residential property, this will usually be the date on which the property was purchased.

The period for a negligence claim can be extended if there was a delay in the claimant spotting the defect and finding out about their claim: they will have three years from the date when they found out or should have found out. This extended period is subject to a 'long stop' period of 15 years from the date of the negligent act regardless of when the claimant found out about their claim. This will usually mean 15 years from the date of the survey report.

Given the 'long stop' date of 15 years, members should retain their files for 15 years after carrying out a survey, to ensure that they have the records necessary to respond to a claim. Any updated advice provided in connection with an earlier survey should also be retained for 15 years from the date of that advice as a new limitation period will apply to each new piece of advice provided to a client.

B2.4 Third-party reliance

The issue of third-party reliance and the risks to valuers is discussed in section 4.

RICS recognises that there is a practice of permitting valuations of residential properties provided to lenders to be disclosed to the borrower/purchaser, and that sometimes this is done on a basis that permits the borrower to rely on the valuation, i.e. extending the duty of care to that borrower. Members should ensure, wherever they can, that if they do permit borrowers to see their lender valuation reports, they make it clear to the borrower (whether in the report itself, or a letter to the borrower, or both) whether the borrower is entitled to rely on it or not.

The same third-party reliance issues affect surveyors when providing surveys of residential properties to lenders. Members should ensure the engagement letter and report clearly records that the survey is provided for the use of the addressee only and that no third party may rely on it.

B3 Liability caps

When providing valuations and surveys of residential properties, members will often be dealing with clients who are 'consumers' (i.e. those not acting in a business, trade or professional capacity). Buy-to-let investors may be regarded as consumers in this context.

The use of terms in consumer contracts that exclude or cap liability is controlled strictly by law. All contractual terms in consumer contracts must meet a test of fairness. Contractual terms that exclude or restrict liability where one of the contracting parties deals as a consumer or on the other's written standard terms of business must be fair and reasonable, having regard to all the circumstances known to the parties, or within their contemplation, at the time the contract was made. The party seeking to rely on a particular term has to be able to prove that it is reasonable.

Contract terms that have not been individually negotiated – for example, terms that have been drafted in advance and that a consumer has not been able to influence – will be deemed unfair if they cause a significant imbalance in the parties' contractual rights and obligations, to the detriment of the consumer. If deemed unfair, the terms will cease to bind a consumer.

Members should not attempt to limit liability by reference to a multiple of the fees for a residential survey or valuation, particularly where the fee for the job is modest. Such clauses are likely to fail the test for reasonableness and fairness, particularly in a consumer context. Limits by reference to the value of the property, or agreeing a reasonable share of responsibility for the cost of repairs in any survey claim, are more likely to be regarded as fair and reasonable, but again this will depend on the level agreed. Further, any clause would have to be drawn specifically to the client's attention, not buried in small print, and even then it would always be subject to a reasonableness and fairness test.

Appendix C: Valuations for commercial lending

This appendix is intended to offer guidance to valuers providing advice in commercial lending situations and other commercial valuation situations (as opposed to residential mortgage valuation and 'consumer' work, which is addressed in Appendix B). RICS recognises there is not a hard and fast distinction between 'commercial' and 'residential', and it may be helpful for valuers to read both appendices. This appendix provides guidance for professionals acting in the UK but may have broader applicability across jurisdictions.

Generally, valuations for loan security purposes constitute the highest risk category of valuations undertaken by Registered Valuers.

Within that category, the liability risk for the valuer increases as:

- more parties are permitted to rely on the valuation
- the level of debt increases (particularly when the loan-to-value ratio increases) and
- investment instruments such as bonds are issued and secured on the debt, particularly if those instruments are issued in public markets.

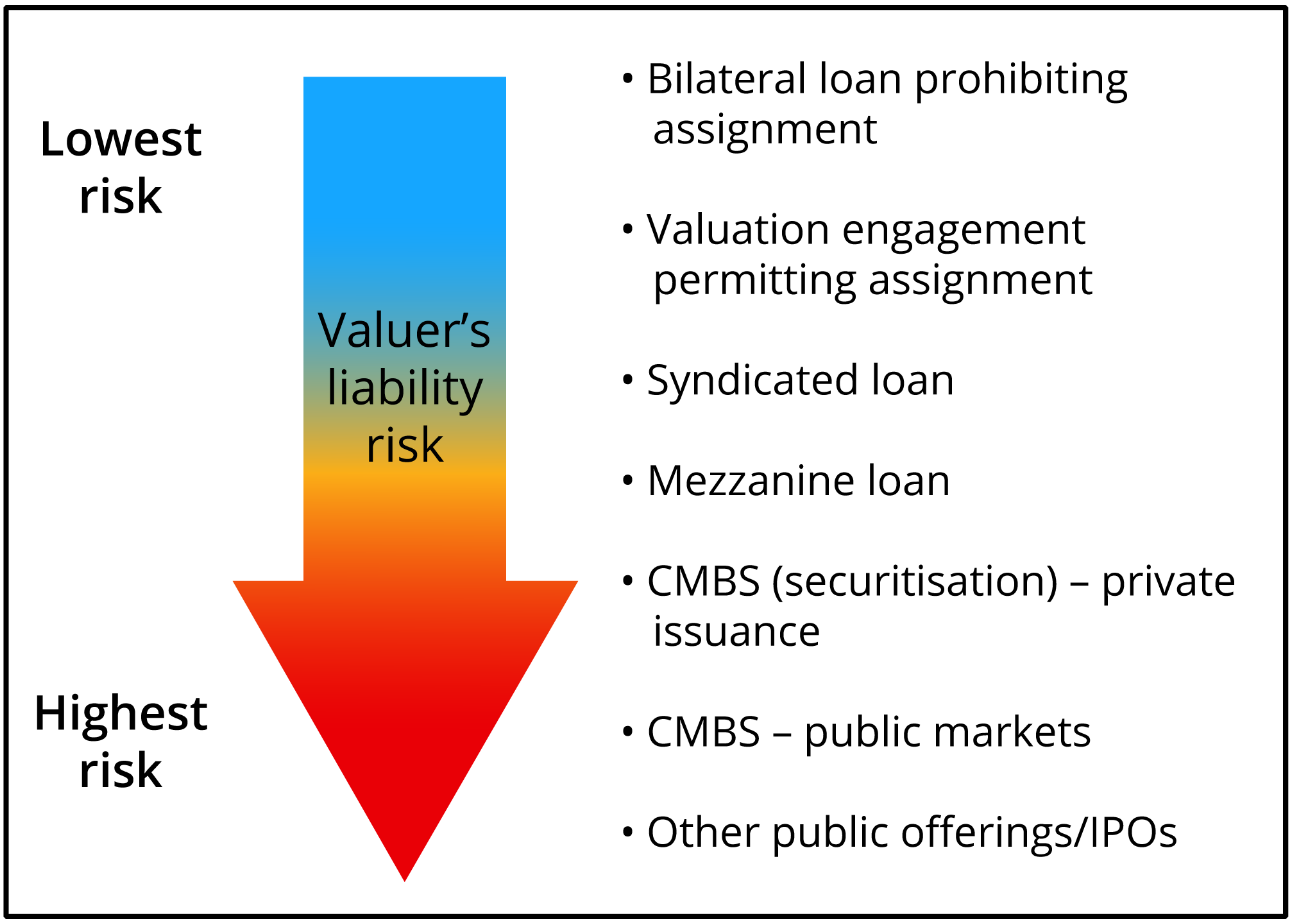

Figure 1: Valuer's risk – indicative only

A valuer’s risk can also be significantly increased by third parties (i.e. individuals and companies who are not party to a valuer's engagement contract) being permitted to rely on the valuation. This opens up the possibility of the valuer's liability to those third parties for the tort of negligence – see sections 2.4 and 4.

Members should adopt as a default position in their terms of engagement that the valuation is to be relied on only by the lender client who directly instructs the RICS-regulated firm. Members should understand the risks of broadening the permitted reliance, and only consent when they have understood those risks.

The core concepts and lending structures members would need to understand are described in this section. However, members should appreciate that lender clients will have taken legal advice on these structures, and it is important that members do the same before permitting reliance on a broader level. It is beyond the scope of this guidance note to give members anything more than a general understanding of the risks and basic terminology.

In more sophisticated and higher value loan structures, members’ liability caps become increasingly important. The other clause of the engagement contract that is very important is what it says about assignment (see C2).

C1 Bilateral loans

A bilateral loan is the simple situation where one lender lends 100% of a loan amount to one borrower. From a structural perspective, these are the least high risk secured lending valuation engagements for valuers. As there is only intended to be one lender client and the engagement is a relatively simple one, the instruction will in many cases be covered by an umbrella service agreement or other standardised documentation. If this is the type of loan that a lender client is making, members should ensure that their engagement contract reflects this, and does not include consent to the use of the valuation in other, more sophisticated, lending transactions.

One specific point that is relevant even in the bilateral loan context, and is equally relevant in all of the more complex situations addressed below, is whether the lender client can use the valuation report for additional lending decisions made after the initial loan, without further reference to the valuer. It would be risky for a lender to try to do this without consulting the valuer further, but members should ensure that wherever possible their engagement letter and report record the lending decision for which the valuation is to be used, for the avoidance of any doubt. See section 2.5.

C2 Assignment of your valuation engagement contract

The engagement between members and their clients for the preparation of a valuation is a contract. See section 2 for the basic principles concerning the contract.

In general, as a matter of English law, the benefit to a client of the contract can be assigned by the client to a 'third party' (i.e. someone who is not already party to the contract), unless the contract expressly prohibits assignment.

When a lender client sells a book of loans, one of the assets it will typically wish to sell with that book of loans is the benefit of the engagement contracts with the relevant valuers. In such a transaction, the assignment of the contract with the valuer would typically be part of the loan sale agreement. In general, if the valuer’s contract does not prohibit assignment without the valuer’s consent, the client would not have to seek consent to that assignment, or involve the valuer in that process in any way. The valuer should receive notice of the assignment, but in practice, may not even be notified until long after the loan sale, and usually, will not be able to object.

This means that members may effectively end up in a contract with a party they do not know, without knowing it has happened.

However, this will not be possible if members include a clause in their terms of engagement by which they prohibit assignment of their engagement contract without their consent. Typical wording to use for this purpose would be as follows:

'[Client's name/you] may not assign this valuation engagement, or any of its rights or obligations under this valuation engagement, without the prior written consent of [valuation firm/us].'

If members do not prohibit assignment, they should at least give thought to including a mechanism to ensure that any assignees are expressly bound by the original instruction terms (including the liability cap). This should happen as a matter of law, but the safest course is to deal with it expressly in the engagement contract.

Note that the concept of assignment is a different legal concept from 'third-party reliance', which is the process whereby a valuer can acquire non-contractual legal liability to a third party who is permitted to rely on the valuation, or to whom the valuer assumes a 'duty of care'. That subject is addressed below.

C3 Syndicated loans

Syndicated loans are loans where there is a group or syndicate of lenders. This structure is usually used for higher value loans than bilateral loans. It may be one of two broad types:

1. a 'pre-syndicated loan' (also known as 'club deals'), where the syndicate is formed before the loan is made or
2. a 'post-syndicated loan', where the syndicate is formed after the loan has been made, and the lender 'sells down' or 'novates' a part of the loan to each member of the syndicate.

In the case of a pre-syndicated loan, the valuer will typically enter into an engagement contract with all of the syndicate members (or with the syndicate lead as agent for all of the members). In a post-syndicated loan, the valuer will not necessarily even know about the proposed syndication when the valuation instruction is received. However, the syndicate members will wish to ensure that they are legally entitled to rely on the valuation and typically they will seek confirmation of this directly from the valuer.

Valuations for syndicated loans may be commissioned under bespoke engagement contracts with the valuer, an umbrella service agreement, or an existing service agreement may be supplemented with clauses specific to the engagement. Whenever members enter into an engagement contract, they should look on it as an opportunity to ensure that their liability cap and fee are proportionate to the risks to the firm.

If providing a valuation for a syndicated loan, members should think about how to make sure all of the lenders are bound in to the terms of their engagement contract (and if some of those other lenders are also clients of the firm, members should ensure that the terms for this contract prevail over the general terms in any service agreements with those clients). If liaising only with the lead lender as agent for all the lenders, members should ensure that the lead lender has confirmed that all lenders who wish to rely on the valuation are bound by the member's terms of engagement, including the liability cap. If this is not possible, members should consider a direct agreement with each party confirming those terms, and their report should state clearly that no party may rely on their valuation without their express permission and without being bound by their terms of engagement, including their liability cap.

See section 3 about liability caps.

C4 Valuations for mezzanine financing

Mezzanine finance is used in situations where a higher loan-to-value (LTV) is required by the borrower or, for example, where the value of the project is expected to grow quickly such as development and refurbishment situations. It gets its name because it is the middle layer of debt, falling between the secured 'senior' debt of a conventional lender, and the equity of the project owner. A mezzanine lender will usually have the right to convert the debt to an ownership or equity interest in the project if the loan is not paid back in time and in full. Mezzanine finance is usually 'subordinated' to the lending provided by the senior lender, and secured by a second ranking mortgage.

Mezzanine finance is often provided quickly, with relatively little due diligence on the part of the lender. This, and the fact that it is subordinated to the senior debt, means that it is usually higher risk lending, and therefore relatively expensive finance for a borrower.

For a valuer, it is important to understand that:

- a mezzanine lender is usually the first lender to be exposed in the event that a project fails or a borrower defaults and
- a mezzanine lender lends against the security of the highest tranche of equity in the property that forms the security.

These factors mean that the liability risk for a valuer in advising mezzanine lenders about the value of a property is high. Members should ensure that their fee and liability cap reflect this level of risk. A default in the mezzanine debt tranche could increase the risk to the senior tranche for the valuer as there can be a greater potential for distress throughout the debt stack once one tranche is in default.

C5 CMBS (Securitisation)

Securitisation (or commercial mortgage-backed security (CMBS)) is the process in which multiple loans are pooled by the originating lender so that they can be repackaged into interest-bearing securities.

Lenders use securitisation to transfer the credit risk of the assets they originate from their own balance sheets to those of other financial institutions, such as other banks, insurance companies, investment funds, and hedge funds. The interest and principal payments from the assets are passed through to the purchasers of the securities.

CMBS essentially takes two forms, of which the most common is 'conduit CMBS', addressed here. The other is 'agented CMBS', which is similar but is not specifically addressed here.

There is also a practical distinction between CMBS in which the securities are sold on a restricted, private basis, and those where the securities are sold publicly, in the capital markets.

Typically, a bank will make a number of loans over a period of time, then sell those loans to a 'special purpose vehicle' (SPV) issuing entity. The SPV will raise money to buy the loans by issuing tradable, interest-bearing securities (usually bonds) that are sold to investors. The security issue is supported by the security for the original loans (i.e. the mortgages given by the borrowers). The transfer of the loans typically takes place by way of 'novation' from the original lender to the issuing SPV. The SPV then becomes the lender under the loan agreement.

As the SPV has no employees and no real existence other than acting as a flow-through vehicle, it has to delegate all of its functions to third-party service providers. It, therefore, typically appoints a servicer to manage the loan on its behalf (although sometimes the original lender will also retain the servicing role). The investors receive fixed or floating rate payments from a trustee account funded by the cashflows generated by the underlying loans.

The property valuation will typically be referred to in the 'offering circular' for the CMBS, which is the document sent to prospective buyers of the bonds to advertise the investment. The arranging bank may also seek to make the valuation available on a data website for investors.

In English law, a valuation cannot be referred to in an offering circular without the permission of the valuer. This means that the initiating lender will need to obtain the valuer's permission before carrying out the CMBS transaction. That may present the valuer with an opportunity to ensure that the firm's fee – and, where appropriate, the liability cap – are commensurate with the risk to the firm.

The risks for valuers in a public CMBS are greater than they are in a private CMBS. This is essentially for two reasons:

1. In a private offering, the valuer will have a better awareness of which investors are involved and will probably have an opportunity of agreeing contractual terms with all of them (including, where it can be negotiated, a liability cap).
2. In a public offering, the valuer will not have knowledge of who the investors may be, will not be able to agree contractual terms with all of them, and there may be regulatory restrictions on the terms that can be included in the engagement (including as to liability cap).

Please see the guidance in section C6 concerning liability caps in the context of public offerings generally, that apply equally in the specific context of CMBS transactions.

Unless members have competent in-house expertise and capability, members should not provide valuations for CMBS transactions without taking specialist legal advice.

C6 Crowdfunding and peer to peer lending

As of the date of publication of this guidance note, the use of valuations in crowdfunding and peer-to-peer lending is undeveloped. However, the preliminary view of RICS is that the risks can be similar to the risks entailed in public offerings, because the valuer may not know who the investors are who wish to rely on the valuation, and is unlikely to be able to agree contractual terms with each of them. The arranger of the crowdfunding or peer-to-peer lending may be content for the valuation report to be provided to potential investors for their information only, on a 'non-reliance' basis, which will reduce the risk for the valuer.

If so, members should ensure that both their engagement letters and valuation reports make this basis clear, and should ask the arranger also to include a note on any website to which the valuation report is uploaded, expressly recording this basis for the valuation. Until the principles affecting the use of valuations in these situations become clear, members should take specialist legal advice if asked to provide a valuation for use in crowdfunding or peer-to-peer lending.

C7 Restricting third-party reliance

Section 2.1 explains that a claim for breach of contract can only be brought by a party to the contract, i.e. the client, but that a valuer can be sued in negligence by those who are not party to the valuation contract (i.e. third parties) to whom the valuer expressly accepts a 'duty of care', or those to whom the court says the valuer has assumed a 'duty of care'. That will usually include any third parties who the valuer has permitted to rely on the valuation.

Valuers, therefore, need to ensure there is appropriate language in both the instructions they accept and also their reports that suitably restricts the ability of third parties to rely on the report and valuation. In practical terms, the reader of the report should be put on notice by its terms or by the correspondence under which it is distributed as to who may rely on the report and who may not.

In general terms, the addressees of the report (sometime called the beneficiaries) will be able to rely on the report. Members' engagement letters and reports should state that any party entitled to rely on the report will be deemed to accept the whole terms of the instruction including the cap on liability.

As mentioned above, valuers should also prohibit assignment of their engagement contracts to third parties, unless they understand the risks of permitting assignment, and decide it is appropriate to take those risks in the context of any particular engagement.

If consenting to a report being seen by a third party, it is important to specify in the engagement letter and in the report itself whether the third party is also permitted to rely on it, or it is provided for information only on a 'non-reliance' basis. A reliance letter or a non-reliance letter is a useful tool in this respect.

Parties who often ask to be permitted to rely on loan security valuations include:

- arranger
- agent for lenders or investors (if dealing with agents for lenders, including a lead lender acting as agent, a member should seek confirmation that they are authorised on behalf of other lenders)
- lenders under the original loan documentation (other finance parties).

Parties who it may be appropriate to exclude from reliance on loan security valuations include:

- borrower or sponsor
- loan servicer
- receiver
- transferees, successors or assignees of the loan
- other potential lenders, if the original lender decides to syndicate the loan
- lenders' other advisers
- bond holders (where the bonds are a private issuance – see section C5)
- hedging and swap counterparties
- lenders for other loans on the property (e.g. mezzanine lenders when valuing for the senior lender) and
- trustees.

C8 Invoicing parties other than the client

Care needs to be taken if the commercial valuer is asked to invoice a party who is not the client. The following issues could arise:

- By issuing an invoice to a non-client, members could inadvertently permit the party to whom the invoice has been issued to rely on the valuation. Therefore, members should issue a clear statement alongside the invoice to the effect that by invoicing the requested party, they are not permitting reliance on the valuation.
- Without a direct contract or fee agreement, it may not be possible to pursue the invoiced party for non-payment. Members should consider raising this risk with the client.
- Members should ensure that they are not inadvertently becoming involved in VAT or other tax evasion, and if unsure of the position, take specialist tax advice.

RICS recognises that lenders sometimes ask their borrower customers to pay the costs of valuations provided to the lender. Although not always possible, the safest way for a valuer to deal with this in order to avoid the risks described is to issue the invoice to the lender client and ask the lender client to reclaim the cost from the borrower. If doing this, members need to ensure that they are not inadvertently becoming involved in VAT evasion, and if unsure of the position, should take specialist tax advice.

C9 Vacant possession valuations

It is common for clients, especially lenders, to instruct valuers to provide a vacant possession value (VPV) for investment properties. This should be instructed as a special assumption valuation, see Red Book Global Standards VPS 1, paragraph 3.1 (i), VPS 3(i) VPS4 (3) for guidance.

As there is no specific definition or guidance on the basis of VPVs in Red Book Global Standards, there is, therefore, a heightened risk of misunderstanding. For investment properties, it is recommended that the valuer is either instructed on the following points by the client, or that the valuer clearly states their approach, for example:

Assumed physical state:

- Is it assumed that the property is in the same state as it currently exists or that the occupier has complied with their repairing and reinstatement obligations?
- Has vacant possession been achieved by a managed exit or by way of a default?
- Is any dilapidations money assumed available that can be applied to any refurbishment or repair costs?

Property use:

- Is the VPV considered only for the current use or are alternative uses to be reflected included redevelopment?
- What assumptions and investigations are to be made into planning?

Market context:

- Is it assumed that the present occupier is/is not 'in the market' in the event of the hypothetical vacancy, either to buy or lease the property?

The list above is not exhaustive and may vary depending on the circumstances.

C10 Reinstatement cost

It is common for clients, especially lenders, to instruct valuers to provide a reinstatement cost (RC). It is important to understand if this will be used as the basis for insuring the property or as a guide that the current/proposed insurance is broadly appropriate.

If the client wishes to be entitled to place reliance on the RC for making commercial decisions, it should be undertaken by an appropriate and experienced qualified person, such as a building surveyor. More commonly, lenders only require RC for guidance and formal reliance is not required. In these circumstances, and subject to appropriate guidance, the RC can be undertaken by valuers. In this case the following must be made clear in the letter of engagement and the report:

- The RC is provided as a guide only and without liability, and any decisions taken on the basis of it are entirely at the user's risk.
- The RC has been undertaken by a valuer and is provided in the context of a valuation instruction.
- A clear statement of what has been reflected in the RC, which may include: demolition costs; fees (including project management); external works (e.g. car parking and landscaping). The treatment VAT, which is generally not included, should be clear.
- Assumptions on planning and building regulations, particularly for older buildings.
- If the property is in a conservation area, is a listed building or an unusual construction, the valuer may wish to either decline to provide an RC, or state that there is a risk of much higher variation on the cost.

Note: If the valuer is adjusting floor areas to a different basis for the reinstatement cost calculation, e.g. from NIA to GIA or from IPMS 3 to IPMS 2, the adjustment factors should be stated.

C11 Summary: key questions

When agreeing a commercial lending valuation instruction, address the following questions:

- Who can rely on the valuation, and for what purpose? For example, senior debt provider or mezzanine lender, etc.
- Should the engagement contract with the client include a clause preventing the client from assigning the benefit of the contract to third parties?
- Is the purpose of the report clear and specific? For example, in connection with new lending, loan monitoring, default, CMBS, etc.?
- In defining the purpose, members should try to be as specific as possible about the lending transaction for which they are permitting the valuation to be used. Members should consider making it clear – preferably in both the engagement letter and the valuation report – that the valuation may not be relied on for different, or subsequent, lending decisions.
- Are both the engagement letter and the valuation report clear about who the report is to be addressed to, and whether third-party reliance is permitted?
- Is it necessary/appropriate to deal expressly with reliance by specific third parties such as receivers, rating agencies, and other advisers?
- What liability cap is agreed?
- Consider the basis of the liability cap. For example, a cap for each party or claim, or a total cap for the entire instruction (see section 3).

- Particular care should be taken where accepting instructions from a mortgage broker, i.e. where the valuer may be at 'arm's length' from the lender client, in order to ensure that the issues raised in this guidance note are properly considered.

Appendix D: Valuations for investment funds and public offerings

D1 Public offerings including IPOs

As well as CMBS, there are other transactions in which finance will be raised in capital markets against the security of property. The most obvious example is an operating company whose property assets form a significant part of its balance sheet value, which either floats on the stock exchange for the first time (an initial public offering (IPO)), or is already listed and seeks to raise more finance through the stock exchange. In a London Stock Exchange public offering, and in the case of most comparable jurisdictions, including Ireland and the United States, the prospectus or equivalent document must refer to a valuation from an independent valuer. That can only be done with the consent of the valuer.

If asked to consent to a valuation being referred to in this context, members should take specialist advice, because the risks associated with the valuation being relied on by investors – including potential investors in other jurisdictions – are significant. For example, it is not usually legally permissible to agree a liability cap in this context.

Where the valuation is referred to in a public offering document, members should consider taking specialist legal advice about limiting liability. However, in broad terms, it is not permitted for a valuer to impose a liability cap on the purchasers of the investment instruments issued, but:

- it should be possible to limit liability to the lender and other professional parties and
- where there is a private offering to a finite number of investors on a limited number of loans (such as in a private CMBS), it may be possible to agree with those investors a cap on the valuer's liability.

It is important to note that the valuer should only approve references to their own valuation, and not inadvertently approve the whole prospectus or circular, as this significantly increases the valuer's responsibility and liability.

Appendix E: Dispute resolution

If the contract between a firm of valuers and their client is silent as to how disputes are to be resolved, the default position will be litigation, i.e. formal proceedings in the court.

The parties can choose not to go to court. The principal alternatives are explained in this appendix. These alternative choices can be made after a dispute has arisen, but by that stage, one party may already have resolved to go to court, so if a firm prefers one of these alternative routes for resolving disputes with clients, it would be better to agree that 'up front' in the engagement letter or standard terms and conditions.

RICS requires all RICS-regulated firms to have a complaints-handling process in place. This document must also include an ADR provision as a part of RICS' commitment to promoting ADR as a means of resolving disputes. In addition to the alternatives to litigation described in this appendix, RICS' **Dispute Resolution Service** (DRS) has been providing ADR services for over 40 years and has developed a new form of ADR designed specifically for the resolution of claims relating to residential valuations.

E1 Court proceedings/litigation

The court process is usually the most reliable and thorough way to resolve a dispute, but unfortunately it can also be slow and expensive and is public. Over the past decade, the English courts have taken steps to address this, first, by requiring more active 'case management' by the courts, and secondly, by implementing the Pre-Action Protocols.

There is a specific Pre-Action Protocol for professional negligence claims, which includes claims against valuers. The purpose of the Protocol is to require the parties to exchange correspondence and documents and investigate the dispute fully and to consider ADR before commencing court proceedings.

A claimant is supposed to start proceedings only if the Protocol has been complied with and it has not brought the matter to an end.

It is important to understand the costs consequences of court proceedings. The basic rule is that the loser pays the other side's costs as well as their own costs (although in fact the other side's costs are generally reduced by approximately 10–40% depending on the nature of the costs order made, or even more in Scotland).

The courts are taking an ever more proactive role in managing legal costs. Since April 2013, parties to most types of UK litigation have been obliged to prepare detailed costs summaries, which must either be agreed or approved by the court, and which then set the maximum limit of recoverable costs. Litigants, therefore, need to manage their legal costs carefully, or risk facing a substantial exposure to costs even if they win the case. It should also be noted that the basic 'loser pays' rule can be displaced – or watered down – if the court is informed at the costs stage that the winning party refused unreasonably to participate in a mediation at an earlier stage.

E2 Arbitration

Arbitration can be similar to litigation, but the parties appoint their own judge (arbitrator) when the dispute arises. The most important difference from court proceedings is that the arbitration process is private; the judgement (called the award in an arbitration) is confidential to the parties. It can be quicker and less expensive than court proceedings, but that is not always the case. As in court proceedings, the arbitrator will make a decision about the costs of the process after deciding the substantive dispute, and just as in court proceedings, the default position is that the loser pays both parties' costs. An arbitration award can sometimes be appealed to the courts, but only in limited circumstances.

E3 Expert determination

Expert determination is similar to arbitration, but it is less formal. Arbitration is an 'adversarial' process, like litigation, where each party presents its case and the judge/arbitrator makes a decision. By contrast, expert determination is essentially an 'inquisitorial' process, whereby the expert conducts inquiries with the parties' assistance before making a decision, but the process can include elements of the adversarial process. Expert determination is usually less expensive and quicker than court proceedings, but because the process for expert determination and arbitration is more flexible, it is not possible to say which will be quicker and less expensive in any given case as between expert determination and arbitration. The process is best suited to resolving disputes over specific technical issues. It is often used in valuation disputes, but it must be understood that it can also be less thorough than court proceedings or arbitration. The expert is usually not bound to apply legal principles, and the decision can only be challenged in extremely limited circumstances.

E4 Mediation

Mediation is a negotiation, facilitated by a mediator. The mediator does not have to be a lawyer, and in many valuation disputes, it is a chartered surveyor.

Mediation will only resolve the dispute if both parties agree to the outcome. The mediator does not make a decision, or even (unless specifically asked to by both parties) express a view on the merits of the dispute. Because it is consensual, it works best against the backdrop or pressure of one of the more formal processes outlined above. Often, contractual parties, including valuers and their clients, agree at the outset of an engagement that, if a dispute arises, they will at least try mediation before resorting to more formal processes.

E5 Ombudsman

The Financial Services Ombudsman has jurisdiction to hear complaints and to award financial redress of up to:

- £150,000 for complaints referred before 1 April 2019
- £160,000 for complaints concerning acts/omissions before 1 April 2019
- £350,000 for complaints referred between 1 April 2019 and 31 March 2020 and concerning acts/omissions after 1 April 2019
- £355,000 for complaints referred after 1 April 2020 and concerning acts/omissions on or after 1 April 2019

if a firm is carrying on regulated activities, or is providing ancillary services, including providing valuation advice, in connection with regulated activities. The Ombudsman may become involved if a valuer's services are provided as part of a mortgage application.

In addition to the Financial Services Ombudsman, there are currently two government-approved providers of Ombudsman services for property agents:

- Property Redress Scheme and
- The Property Ombudsman (TPO).

RICS also approves Centre for Dispute Resolution (CEDR) as an alternative dispute resolution provider for RICS-regulated firms. These providers offer consumer redress for firms involved in the property sector, including estate agents and valuers, without charging the consumer for the use of the service.

Delivering confidence

We are RICS. Everything we do is designed to effect positive change in the built and natural environments. Through our respected global standards, leading professional progression and our trusted data and insight, we promote and enforce the highest professional standards in the development and management of land, real estate, construction and infrastructure. Our work with others provides a foundation for confident markets, pioneers better places to live and work and is a force for positive social impact.

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