

# Appraisal Management Company Liability Issues

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# AMC Liability Issues

## Update on Significant Case Developments Affecting AMCs

- USA (Whistleblower) v. Lender and AMC
- NY Attorney General v. National AMC
- FDIC v. National AMC, FDIC v. National AMC #2
- ING v. Regional AMC

## AMC “Reps and Warrants”

- Common Reps and Warrants
- Appraisal Warranties
- Relation to Professional Liability Insurance
- “Insured Warranties”



# General Appraisal Liability News

- **Most of the worst news about appraisal liability does not relate to AMCs**
  - Individual appraisers continue to face high volumes of claims relating to appraisals delivered 2003-2008.
  - Most of these claims relate to appraisals ordered by mortgage brokers and uniformly allege appraisal inflation.
  - Most of the AMC side of the appraisal industry is fortunate to have entered or grown at a time of very tight lending standards and low defaults on post-2009 mortgages.



# General Appraisal Liability News

- The three biggest appraisal liability cases against appraisal industry defendants relate to commercial appraisals:
  - \$8 billion alleged damages in federal case in Idaho.
  - \$2 billion alleged damages in federal case in Colorado.
  - >\$250 million alleged damages in Texas state court.



# General Appraisal Liability News

## ■ An Epidemic of Buyer's – or Lender's – Re

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6 TYP, LLC, CHESLEY B. SULLENBERGER III, and  
LORRAINE SULLENBERGER

7  
8 SUPERIOR COURT OF CALIFORNIA - COUNTY OF BUTTE

9  
10 **BY FAX**  
C 10-01879

11 TYP, LLC, CHESLEY B. SULLENBERGER III, and LORRAINE SULLENBERGER,  
12 Plaintiffs,  
13  
14 v.  
15 [REDACTED] SAVINGS BANK as  
16 successor in interest by merger to [REDACTED]  
17 NATIONAL BANK, [REDACTED], and  
DOES 1 through 10, inclusive,  
18 Defendants.

FILED Superior Court of California  
County of Butte  
APR 23 2010  
Kimberly Jones, Clerk  
Deputy

1. DECLARATORY AND INJUNCTIVE RELIEF;  
2. FRAUD AND DECEIT;  
3. FRAUD AND NEGLIGENT MISREPRESENTATION;  
4. CONSTRUCTIVE FRAUD;  
5. BREACH OF FIDUCIARY DUTY;  
6. BREACH OF COVENENT OF GOOD FAITH AND FAIR DEALING;  
7. UNJUST ENRICHMENT;  
8. NEGLIGENCE;



# General Appraisal Liability News

- However, the biggest actual award or proposed settlement so far in 2012 does relate to appraisals delivered through an AMC.
  - It's a whistleblower, federal False Claims Act case.
  - Part of a trend, spreading to appraisal world.



IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,  
*et al.*,

Plaintiffs,

)  
)  
)  
)  
)  
)

# The New Trend: Whistleblower Claims

deposits conform with the Miscellaneous Receipts Act and other law.

- ii. The Federal Payment Settlement Amount includes resolution of the following qui tam actions: (i) \$75,000,000 from the claims in United States ex rel. [REDACTED], et al., Civil Action No. CV-09-2040 (E.D.N.Y.); (ii) \$45,000,000 from those

claims in [REDACTED]  
al., No. 2:

(D. Mass). Following payment of any amounts owed as a result of resolutions pursuant to 31 U.S.C. § 3730(d), and subject to 28 U.S.C. § 527 (Note), these amounts shall be deposited into FHA's Capital Reserve Account and the Veterans Housing Benefit Program Fund (pursuant to 38 U.S.C. § 3722(c)(3), as being incident to housing loan operations) or as otherwise directed by the Department of Veterans Affairs, in

# The New Trend: Whistleblower Claims

- **Copycat whistleblower cases already filed**
  - False claims act “bounty” cases
  - Employment cases
- **Some law firms specifically are seeking appraiser whistleblowers for new cases**
  - The lure of a 10-30% bounty:

**Awards Paid to Whistleblowers Exceed  
\$2.8 Billion**

**ARE YOU A WHISTLEBLOWER?**

A whistleblower is an individual who discloses original information about fraudulent or unethical activities in an effort to bring them to the light of





## Update: NY Attorney General v. National AMC

- On 11/22/11, NY's highest appellate court upheld denial of the AMC's motion to dismiss argued based on federal preemption of appraisal functions performed for or within federally regulated lenders.

No. 184  
The People &c., by Andrew M. Cuomo, Attorney General of the State of New York,  
Respondent,  
v.  
[REDACTED], et al.,  
Appellants.

Business Law § 349) as well as the common law. The primary issue we are called upon to determine is whether federal law preempts these claims alleging fraud and violations of real estate appraisal independence rules. We conclude that federal law does not preclude the Attorney General from pursuing these claims against defendants.

# Update: NY Attorney General v. National AMC

Aside from the AMC defending itself in that case, why would federal preemption issues generally matter to other AMCs and lenders?

If (a) the federal Interagency Appraisal and Evaluation Guidelines permit a lender to use “evaluations” in certain circumstances, as they do . . .

exemption, the institution should seek guidance from its primary federal regulator. For those transactions qualifying for the appraisal threshold, existing extensions of credit, or the business loan exemptions, an institution is exempted from the appraisal requirement, but still must, at a minimum, obtain an evaluation consistent with these Guidelines.<sup>39</sup>

but (b) a state says non-appraisers can't perform valuations for lending purposes, you have a possible conflict and a *possible* preemption issue.

# Update: NY Attorney General v. National AMC

So, what was the NY court's ruling again? That federal law in the form of FIRREA does *not* preempt the NY attorney general's attempt to enforce claims under state law for federally related lending by WaMu.

Some AMCs and lenders have been scared by this decision – and scared away from non-appraiser evaluations in residential and commercial lending, and non-appraiser review type products.

But the decision is being taken out of context and the “correct” answer is likely different . . . see, e.g., Fidelity National and Market Intelligence v. Sinclair (E.D. Penn. 2004) (deciding evaluations used under threshold exemption permissible).

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# FDIC v. Two National AMCs

- Still just the two WaMu-related cases -- \$154 million and \$129 million. (Others might thank those AMCs.)
- All claims in the cases now contractual.
- One AMC lost on limitation of liability, for now.
- One AMC plans to take depositions of all appraisers.
- Other FDIC news -- filing MBS cases based on AVMs



IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF DELAWARE

ING BANK, fsb  
One South Orange Street  
Wilmington, DE 19801

Plaintiff,

vs.

DANA PALMER/  
TEAM ONE APPRAISALS  
479 Island Boulevard  
Fox Island, WA 98333, and

AMERICAN REPORTING  
COMPANY, LLC  
4020 LK Washington Blvd  
Suite 205  
Kirkland, WA 98033

CA NO. 09-

JURY TRIAL DEMANDED

## Typical Lender Lawsuit Against AMC: Vicarious Liability and Breach of Contract Claims

### PARTIES

3. Plaintiff, ING Bank, fsb (hereinafter referred to as "Plaintiff" or "ING"), is a federally chartered savings bank located at One South Orange Street, Wilmington, Delaware, in the City of Wilmington, in the State of Delaware 19801.

4. Dana Palmer (hereinafter referred to as "Palmer") is an individual who, based upon information and belief, resides at 479 Island Boulevard, in the City of Fox Island, in the State of Washington 98333.

## Typical Lender v. AMC Case

6. Defendant, American Reporting Company, LLC (hereinafter referred to as “ARC”) is a business located at 4020 LK Washington Boulevard, Suite 205, in the City of Kirkland, in the State of Washington, 98033.

7. On or about September 19, 2005, [REDACTED], Vice President of Business Operations of ARC, entered into a Service Agreement (hereinafter referred to as “Service Agreement”) with ING for the performance of appraisal services. Attached hereto as Exhibit “A”, a true and correct copy of the Service Agreement.



# Typical Lender v. AMC Case

9. The appraisal services were to conform to the customary standard of skilled professional appraisers in the industry following the applicable guidelines established by the Uniform Standards of Professional Appraisal Practice (herein after referred to as “USPAP”). See Exhibit “A” at ANNEX 2: Service Level Requirements at section 2(i)(a).

10. Per the Service Agreement, all appraiser reports submitted to ING were to be in compliance with the then-current version of the USPAP. See Exhibit “A” at ANNEX 2: Service Level Requirements at section 2(i)(a).

13. Palmer valued the property at \$2,300,000.00 on February 5, 2008 in her appraisal (hereinafter referred to as the “Original Appraisal”). Attached hereto as Exhibit “B”, a true and correct copy of the Original Appraisal.



# Typical Lender v. AMC Case

19. The Walker Review of the Original Appraisal detailed numerous mistakes and miscalculations in the Original Appraisal. See Exhibit “D” at page 1 of “Addendum” and pages 1 through 5 of the “Uniform Residential Appraisal Report.”

20. As a direct result of the actions of the Defendants, ING, suffered significant financial losses based on the current unpaid principal loan balance of \$1,610,000.00, in an amount to be determined at trial.



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# Typical Lender v. AMC Case

**ING sues:**

- The appraiser for negligence – and the appraiser settles.
- The AMC for breach of the warranties in the service agreement and for negligence based on alleged vicarious liability for the appraiser/subcontractor.



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# Typical Lender v. AMC Case Recent Court Decision in Case

ARC argues that it cannot be held vicariously liable for the tortious actions of Palmer since Palmer was an independent contractor.<sup>6</sup> (D.I. 66 at 6-7) According to ARC, there is no dispute that Palmer was an independent contractor since: 1) Palmer entered into a “Independent Contract Appraiser” Service Agreement with ARC; and 2) Palmer testified to being an “independent contractor” of ARC. (D.I. 66 at 6) (citing D.I. 67 at 86; 156)



type of relationship that existed). This case is no different. While ARC and Palmer indicated that they believed Palmer to be an independent contractor, other facts of record suggest that this relationship is more appropriately characterized a master/servant type relationship. (D.I. 73 at 9-10) (noting that ARC required Palmer to perform the appraisal in a specific fashion, ARC worked with Palmer from 2007 until 2009, and ARC was in the business of performing appraisals) Accordingly, any servant/independent contractor determination will be made by a jury at trial.

Furthermore, the court notes that, even if Palmer is determined to be an independent contractor, that does not necessarily resolve the issue of liability. In Delaware, exceptions exist to the general rule that owners and contractees cannot be held liable for torts committed by independent contractors. *Fisher*, 695 A.2d at 60. For example, "if an owner or contractee's control dominates the manner or means of the work performed" by the independent contractor, the owner or contractee can be held vicariously liable. *Id.* at 61.

# AMC Contractual Obligations for Appraisal Quality

- Loosely referred to as “reps and warrants” (but AMCs may represent and warrant matters beyond appraisal quality).
- Steadily growing list of contractual promises by AMCs such as:
  - Panel appraisers will meet defined qualifications.
  - Reports will be delivered within a certain timeframe.
  - Appraisal will fulfill all lender and GSE requirements.
  - Appraisal will meet certain accuracy standards (e.g., appraisal will be within 10% of “true” market value).
  - AMC will reimburse lender for any repurchases due to appraisal deficiencies.

# AMC Contractual Obligations for Appraisal Quality

- Present clearest liability risks for AMCs.
  - The obligations greatly expand an AMC's potential liability.
  - Breaches of the obligations easier to prove than negligence.
  - Most such *contractual* obligations are beyond the coverage of an AMC's professional liability insurance or other forms of regular insurance, such as general liability or fidelity.



# “Insured Warranties”

- Insurance products do exist that will cover some of the obligations.
- “Collateral Insurance” or “Insured Warranted Appraisals.”
- Overview:
  - The AMC enters into a service agreement with its lender client.
  - The service agreement contains certain warranties and representations regarding appraisal accuracy and quality standards (the “warranty”).
  - The warranty is backed by a liability insurance policy. Unlike a regular E&O policy, however, the lender basically can make a direct claim.
  - The coverage of the policy remains in place for 5 years from the date of the appraisal, unlike regular professional liability insurance which is “claims made.”
  - The premium for coverage of an appraisal is paid one-time.



# “Insured Warranties” -- Example Language

Simplistically, the policy covers a lender’s “actual financial loss” as the result of an “incident” relating to an appraisal with an insured warranty.

“Actual financial loss” means:

- (a) The unpaid principal balance, interest, foreclosure costs, etc., minus
- (b) The amount subsequently collected as a result of final resale of the secured property.

“Incident” means “any error, omission, action, failure to act, breach of contract or breach of duty by the Insured in the rendering or failure to render their Professional Services resulting in the stated value of the secured property as stated on a retrospective appraisal report being less than 90% of the stated value of the original insured warranted appraisal report.”



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# “Insured Warranties” -- Simple Claim Example

## With 0% deductible and 10% variance:

1. Appraised value (by AMC’s appraiser): \$200,000  
Value per retrospective appraisal: \$190,000  
Application of 10% variance: \$10,000 error is within 10%  
Result: no covered loss
2. Appraised value (by AMC’s appraiser): \$200,000  
Value per retrospective appraisal: \$155,000  
Application of 10% variance: \$45,000 error is outside 10%  
Result: \$45,000 covered loss (\$45,000 less 0% deductible)





# “Insured Warranties” -- Actual AMC Uses

- A few lenders are requiring the insurance as a condition to doing business.
- Some AMCs are using the product to market themselves.
- Some AMCs are using the product to limit their liability by getting lenders to agree that the AMC’s liability is limited to the warranty for which they have insurance.
- Issues for the future (price, expectations).

