11-2011

Re-Appraising the Appraisers: Expanding Liability to Buyers and Borrowers in the Story of the 2008 Financing Industry Crisis

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By Shelby D. Green

The disturbing story of the 2008 financial industry crisis, though told and retold numerous times, could begin with some reference to the times—the "best" and the "worst." The most recent retelling was by the National Commission on the Causes of the Financial and Economic Crisis in the United States (Crisis Commission), appointed by Congress under the Fraud Enforcement & Recovery Act of 2009, Pub. L. No. 111-21, 123 Stat. 1617. Most remarkable in the report was the conclusion that the crisis was entirely avoidable, that all the omens—soaring mortgage debt, the proliferation of risky mortgage products, the unsustainable rise in housing prices, and frenzied mortgage securitization—were ignored.

Among the main protagonists identified were property appraisers and the ratings agencies (Moody's, Standard & Poor's, and Fitch). According to the Crisis Commission, lenders routinely pressured appraisers to place artificially high prices on properties and blacklisted honest appraisers, assigning business only to appraisers who would come up with the desired price target amounts. Financial Crisis Inquiry Commission Report (Report), at 18, 22, 91, available at http://fcic.law.stanford.edu/report; see also *Capital West Appraisals, LLC v. Countrywide Fin. Corp.*, 759 F. Supp. 2d 1267 (W.D. Wash. 2010) (dismissing complaint alleging that appraisers were blacklisted by mortgage broker). For the lender, an inflated value could make the difference between closing and losing the deal. Appraisers, in their self-interest, succumbed to the pressure and inflated the value of homes. Remarkably, however, this pressure to write up the value of properties came not only from mortgage brokers, lenders, and real estate agents, but also in many cases from the borrowers themselves, who were anxious for their deals to go through. Report, at 91.

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An inflated appraisal would seem to defy economic wisdom because the lender's ability to recoup the amount of the loan on foreclosure is determined by the value of the property. If the lender intends to sell the mortgage immediately on the secondary market rather than holding onto it, however, then a high appraised value does benefit the lender economically. That is exactly what occurred in the market bubble before the 2008 crisis. Most home loans entered the securitization pipeline almost immediately after the parties left the closing table, packaged as residential mortgage-backed securities and blessed with triple-A ratings from the credit rating agencies. The ratings were derived not from an evaluation of the quality of the underlying mortgages, a great many of which were subprime and unmoored from sound underwriting criteria, but from a mathematical model developed by the agencies. See Report, at xix, xxv, 121. These heavy houses soon collapsed on these very shaky foundations. Recent reports show that nearly a quarter of all mortgages are now underwater. See First American CoreLogic, *Negative Equity Report* (June 2011), available at www.corelogic.com/about-us/news/new-corelogic-data-shows-slight-decrease-in-negative-equity.aspx.

By and large, these players have escaped liability to the economic losers that relied on their work—the ratings agencies more so than the appraisers because ratings have been categorized as opinions rather than factual statements subject to fraud or misrepresentation law. See *Wyo. State Treasurer v. Moody's Investors Serv. Inc. (In re Lehman Bros. Mortgage-Backed Sec. Litig.)*, 2011 U.S. App. LEXIS 9567 at *42 (2d Cir. May 11, 2011) (rejecting liability under securities acts). But see *Abu Dhabi Commercial Bank v. Morgan Stanley & Co., Inc.*, 651 F. Supp. 2d 155, 176 (S.D.N.Y. 2009) (ratings made without genuine or reasonable belief in accuracy with a basis in fact were not mere opinions and could be actionable misrepresentations); Jeanne Eaglesham & Jeannette Neumann, *Raters Drawing SEC Scrutiny*, Wall St. J., June 17, 2011, at C1 (the Securities and Exchange Commission announcing an investigation into the practices by these ratings agencies).

Appraisers who knowingly prepared inflated appraisals as part of a property "flipping" scheme, *Hoffman v. Stamper*, 867 A.2d 276, 290–92 (Md. 2005), or who have been shown to have deliberately prepared a false appraisal as part of a conspiracy to defraud or wrongfully obtain government benefits (such as FHA insurance), *Barkley v. Olympia Mortg. Co.*, Nos. 04-CV-875 (RJD) (KAM) et al., 2007 WL 2437810 at *21 (E.D.N.Y Aug. 22, 2007); *Edalatdju v. Guaranteed Rate, Inc.*, 748 F. Supp. 2d 860 (N.D. Ill. 2010), have been held liable to buyer-borrowers, when it was clear that the inflated appraisal was the linchpin of the alleged fraud and conspiracy. See also *United States v. Gee*, No. 3:07cr211, 2009 U.S. Dist. LEXIS 55278 (W.D.N.C. Feb. 18, 2009) (criminal charges against appraiser).

A successful liability claim based on these theories is not at all guaranteed, however, because of the practical difficulties of amassing the evidence to sustain the claims. Fraud requires a showing not only that the appraisal value was incorrect but also that it was knowingly false and made with the intent to deceive. *American Gen. Home Equity v. Gjura*, No. 102365/09, 2010 N.Y. Misc. LEXIS 3951 (N.Y. Sup. Ct. July 16, 2010). When the buyer-borrower cannot plead facts supporting assertions of fraud with particularity (that is, specific fraudulent information, who misrepresented and concealed it—the "who, what, when, where, and why"), the complaint is met with dismissal. *First Place Bank v. Skyline Funding, Inc.*, No. 10-CV-2044, 2011 U.S. Dist. LEXIS 22349 (N.D. Ill. Mar. 4, 2011); *Martell v. Turcheck*, No. 2:07-cv-14068, 2008 WL 2714210 (E.D. Mich. July 7, 2008).

Similarly, buyer-borrowers often fail in their claims of civil conspiracy because of the inability to find the facts necessary to establish that two or more persons acted in concert to accomplish an unlawful purpose. See, e.g., *Croye v. GreenPoint Mortg. Funding, Inc.*, 740 F. Supp. 2d 788 (S.D. W.Va. 2010). Pleading a conspiracy under the Racketeer Influenced and Corrupt Organizations

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Act (RICO), 18 U.S.C. § 1962, though apparently easier, presents the same obstacles as a civil conspiracy claim under common law. The RICO conspiracy statute makes it unlawful for persons to conspire to engage in a criminal enterprise through patterns of racketeering activities. That act is more comprehensive than the common law conspiracy offense because all that is required is a showing that one *knowingly* agrees to *facilitate* a scheme that includes the operation or management of a RICO enterprise. *Smith v. Berg,* 247 F.3d 532, 537 (3d Cir. 2001). It is not necessary to have engaged in a specific act; the defendant's knowledge of the racketeering activity and agreement to facilitate the scheme is enough. *Salinas v. United States,* 522 U.S. 52, 64 (1997). As with fraud, however, the plaintiff must do more than attempt to construct a conspiracy from otherwise discrete acts. *Hearns v. Parisi,* 548 F. Supp. 2d 132 (M.D. Pa. 2008); *Martell v. Turcheck,* No. 2:07-CV-14068, 2008 WL 2714210 (E.D. Mich. July 7, 2008).

On the surface, suing in negligence seems the most promising avenue for recovery against appraisers, because liability depends on an examination of defendant's conduct alone and does not require an examination of defendant's mental state to show intent or agreement. But historically insuperable hurdles have operated to prevent recovery under this seemingly simple cause of action. One hurdle is lack of privity. The appraiser's legal relationship is with the hiring party—the lender—to assess the risks of the loan transaction and not with the purchaser, who may rely on the appraisal in making the decision to purchase. Because of the lack of privity with the buyer-borrowers, the appraisers had no duty and hence no liability to them, even when the property appraisal was critical in the loan transaction. Moreover, even if the facts showed that the appraiser was somehow negligent and that injury to the buyer-borrower was foreseeable, appraisers have asserted the economic loss rule, which operates to preclude recovery in a tort action for purely economic losses, unaccompanied by physical injury or property damage.

These defenses might have seemed reasonable or appropriate in a time when there were isolated errors in appraisal reports, but in the world described by the Crisis Commission, fraught with sharp practices and dishonesty, a new regime seems in order. In the last few years, some courts, perceiving the disconnect between the formal rules governing the conduct of appraisers and the ends sought to be achieved by those rules, are making rulings aimed at some harmony and coherence for a sensible imposition of liability for appraisers' wrongful conduct. The limitations of the negligence claim and the need for a new regime are discussed in further detail below.

Appraisers Are Licensed Professionals

The work of real estate appraisers is regulated by state law. Based on their training and experience, appraisers must be certified, licensed, or registered. Their work is governed by rules and regulations issued by various legislatively created boards or agencies. They can be disciplined or have their certification, license, or registration denied, suspended, or revoked for misconduct; certain types of misconduct also may subject offenders to criminal penalties. *Zumbach v. Bd. of Real Estate Appraisers,* 15 A.3d 741, 744 & n.3 (Me. 2011).

Many states (for example, Idaho, Colorado, West Virginia, Utah) have adopted the Uniform Standards of Professional Appraisal Practice (2011) (USPAP), prescribed by the Appraisal Standards Board of the Appraisal Foundation, to govern the work of local appraisers and the communication of reports. The preamble to USPAP states that the purpose of the standards

> is to promote and maintain a high level of public trust in appraisal practice by establishing requirements for appraisers. It is essential that appraisers develop and communicate their analyses, opinions, and conclusions to intended users of their services in a manner that is meaningful and not misleading.

Id. Among other things, an appraiser must correctly complete research and analyses necessary to produce a credible appraisal (USPAP Standard 1), be aware of, understand, and correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal (USPAP Standards R. 1-1(a)), not commit a substantial error of omission or commission that significantly affects an appraisal (USPAP Standards R. 1-1(b)), not render appraisal services in a careless or negligent manner (USPAP Standards R. 1-1(c)), and act with honesty, impartiality, and professional competence (USPAP Ethics Rule). To ensure that reports are meaningful and

reliable, the USPAP requires that an appraisal report include a summary of the information and data evaluated, the appraisal methods and techniques employed, the reasoning that supports the analyses, opinions, and conclusions, and a statement of all extraordinary assumptions and hypothetical conditions. USPAP Standards R. 2-1, 2-2. The appraiser must certify that to the best of his knowledge and belief, the report is honest, impartial, does not reflect a predetermined value, and is not dependent on any compensation. USPAP Standards R. 3-6.

This comprehensive legislative and regulatory structure suggests that real estate appraisers practice a profession involving knowledge or skill and that their conduct should be judged according to the tenets of their field. Therefore, a buyer's negligence claim against an appraiser involves professional negligence. See *Brown v. Interbay Funding, LLC*, 417 F. Supp. 2d 573, 579 (D. Del. 2006) ("By asserting that [the defendants] deviated from the applicable standard of care required for real estate appraisers, a claim for professional negligence is implicated"), aff'd, 198 F. App'x 223 (3d Cir. 2006).

Privity of Contract as the Source of Duty

The requirements for a cause of action for negligence are so well written in the law that they hardly need citation. A plaintiff must establish that the defendant owed the plaintiff a duty, the defendant breached that duty, the plaintiff was injured, and the breach of the duty caused the plaintiff's injury. Although the basic elements are plain, some embellishments attach in the case of professional negligence; that is, the plaintiff must show that the professional's conduct fell below the standard of care associated with that profession. *Hice v. Lott*, 223 P.3d 139, 145 (Colo. Ct. App. 2009). The USPAP standards can be used as evidence of the standard of care for appraisers but are not conclusive proof of the standard. *Kelley v. Carbone*, 837 N.E.2d 438, 443 (Ill. App. Ct. 2005). Surely, actions and lapses such as not visiting the property, not employing accepted valuation techniques, making irrational assumptions, and accepting payment for a false appraisal easily establish a breach of the standard of care.

Establishing a breach of the standard of care is perhaps the least of a plaintiff's burden, however; an unbridgeable chasm may lie ahead—a plaintiff must establish that the duty that was breached was owed to him. Whether a duty exists is a legal question. *Hice*, 223 P.3d at 143. Ordinarily, a duty to use care will arise from a contractual relationship between the parties. This requirement is immediately troublesome for the buyer-borrower who enters into a loan transaction based on a value assigned to the property by an appraiser because the usual conception of the relationship is that the appraiser owes a duty to the party hiring the report—typically the lender.

In some states, courts have held as a matter of law that a real estate appraiser owes no duty of care to a buyer-borrower, but only to the lender, even when the borrower must pay the appraisal fee as a part of the closing costs. These courts take this view on the basis that the purpose of the appraisal is to protect the lender from lending a sum of money that exceeds the value of the property to be used as a security for the loan. See *Decatur Ventures, LLC v. Daniel*, 485 F.3d 387, 390 (7th Cir. 2007) ("appraisers expect lenders to use their opinions to protect themselves *from* borrowers"); *D.H.G. Props, LLC v. Ginn Cos., LLC*, No. 3:09-cv-735-J-34JRK, 2010 U.S. Dist. LEXIS 140208, at *46 (M.D. Fla. Sept. 28, 2010) (because appraisal is conducted for lender's own benefit and not for benefit of borrower, no duty to borrower arises). The mere fact that the lender requires the borrower to pay for the appraisal as a part of the cost of the extension of the loan does not impose a duty on the appraiser with respect to the borrower. Thus, when the appraiser has no agreement with the borrower or the borrower's real estate broker for the appraisal, there is no duty to the borrower that could be the basis of a negligence action. See *Webb v. LeClair*, 933 A.2d 177 (Vt. 2007); *Tracht v. American Property Analysts, Inc.*, No. E-07-024, 2008 Ohio App. LEXIS 222 (Ohio Ct. App. Jan. 25, 2008); *Martell v. Turcheck*, No. 2:07-cv-14068, 2008 WL 2714210 (E.D. Mich. July 7, 2008). Indeed, in Connecticut, absent privity of contract, an appraiser has no liability to those who rely on the appraisal except in case of intentional misrepresentation. Conn. Gen. Stat. § 36a-755(d); *Loud v. Cimmino*, No. CV095011214S, 2010 Conn. Super. LEXIS 517 (Conn. Super. Ct. Feb. 22, 2010). This lack of liability exists even when the statute requires lenders to make available a copy of the report to borrowers.

Although the buyer-borrower may be able to establish a contractual relationship with the appraiser and the lender under the third-party beneficiary theory, *Vogan v. Hayes Appraisal Assocs.*, 588 N.W.2d 420, 423–24 (Iowa 1999), the burden of doing so is not an easy one. The putative third-party beneficiary must show that the primary parties intended to confer the benefits of their agreement and enforcement rights on the third party. That intent is determined from the terms of the contract read in the light of the circumstances, including the motives and purposes of the parties. Although express language to this effect is not essential, the evidence must nonetheless show that the parties intended this result. Unfortunately, most appraisal agreements do not contain such language but almost always expressly state that the report is being prepared for the client (the lender) and no other. See USPAP Statement 9; *Partout v. Harper*, 183 P.3d 771 (Idaho 2008) (no third-party beneficiary status established when no intent to benefit could be gleaned from the contract, even though letter requesting appraisal required that it be completed according to Department of Veterans Affairs instructions and conform to USPAP).

Foreseeability and Reliance as Substitutes for Privity

The status of appraisers as professionals might well call for dispensing with privity of contract. A host of sound policy reasons can be articulated for holding professionals accountable to persons that reasonably rely on the services offered, even if they are not formally clients. This suggestion stems

from the reasons for licensing professionals in the first place. Their work involves a high degree of training, and they hold themselves out to the public as having particular skills and knowledge. Extension of liability to nonclients is further supported by several other factors, such as a basic assessment of the relative positions of the parties in the transactions in which the appraiser performs, the need to prevent unjust enrichment and to neutralize the danger of unprovable fraud, and the importance of providing an incentive for honest and competent appraisals through imposition of liability (on the party best able to ensure that the report is meaningful and useful for its intended purposes). Even so, equally compelling notions of fairness and justice call for some delineation of the occasions for extending an appraiser's duties to, and liability with respect to, nonclients.

These challenges arise rather frequently in the attorney context. Courts have held that a member of the bar owes a fiduciary duty to persons, though not strictly clients, that the lawyer knows or should know rely on the lawyer in his or her professional capacity. *Petrillo v. Bachenberg*, 655 A.2d 1354 (N.J. 1995); *Prudential Ins. Co. of America v. Dewey, Ballantine, Bushby, Palmer & Wood*, 605 N.E.2d 318 (N.Y. 1992). Consequently, foreseeability has come to replace privity as a means of delineating a professional's duty to a nonclient in the legal context and the same standard has recently been applied in the context of determining an appraiser's liability to a buyer-borrower. *Zanaty Realty, Inc. v. Williams*, 935 So. 2d 1163, 1167 (Ala. 2006) (applying theory but finding that buyer's reliance on the appraisal report was not foreseeable). The foreseeability of reliance by a borrower has been found when an appraisal report stated that the lender (the client) could disclose or distribute the appraisal report to the borrower without having to obtain the appraiser's consent. See *Mustafa v. Anderson Appraisal Svcs.*, 2009 Cal. App. Unpub. LEXIS 514 (Ct. App. 2009).

In recent times courts have extended the liability of professionals to nonclients in the fields of accounting, auditing, and financial advising. This movement has occurred in an era of increasing financial regulation of businesses aimed at facilitating informed decision-making and oversight by investors. See, e.g., *Federated Mgmt. Co. v. Coopers & Lybrand*, 738 N.E.2d 842 (Ohio Ct. App. 2000) (accountants); *Caprer v. Nussbaum*, 825 N.Y.S.2d 55 (N.Y. App. Div. 2006) (accountants); *Murphy v. BDO Seidman, LLP*, 6 Cal. Rptr. 3d 770 (Ct. App. 2003) (company auditor); *Baker v. Goldman Sachs & Co.*, 656 F. Supp. 2d 226 (D. Mass. 2009) (financial advisor). The movement to extend liability in the case of attorneys was not caused by any large scale or recurrent phenomena—just a perception of a need for a new assessment in light of evolving norms of fairness and responsible conduct. As the movement relates to property appraisals, the Crisis Commission and others that have studied the crisis have found that appraisals play an integral role in most real property transactions and that false or inflated appraisals were among the principal drivers of the eventual collapse of the industry.

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Liability to Third Parties Under Restatement (Second) of Torts

Buyer-borrowers may be able to establish a claim against an appraiser for negligent misrepresentation under the Restatement (Second) of Torts § 552, "Information Negligently Supplied for the Guidance of Others." Under this section, a person in a business that involves supplying information can be held liable for supplying false information and failing to exercise reasonable care or competence in obtaining or communicating the information to (1) the persons for whose benefit and guidance he or she intends to supply the information and (2) others, if he or she knows that the contracting recipient intends to supply it to such other persons and they justifiably rely on the information in the transaction that such information was intended to influence. Surprisingly, both buyer-borrowers and appraisers have cited this section for their respective positions: the former as an exception to the privity requirement, *Caruso v. Nat'l City Mortg. Co.*, 931 N.E.2d 1167 (Ohio Ct. App. 2010), and the latter to limit the class of those entitled to rely on the appraisal. *Schaaf v. Highfield*, 896 P.2d 665 (Wash. 1995).

Although there are competing views on whether it must be shown that the actor "knows" that the recipient will pass the information on to others or whether it is sufficient that the event was foreseeable, recent cases have taken the latter position. In *Young v. Bourland*, 2010 Cal. App. Unpub. LEXIS 3 (Ct. App. Jan. 4, 2010), the court read the Restatement section to mean that an appraiser is deemed to have intended to influence its client's transaction with a third party whenever the appraiser knows with substantial certainty that the third party, or the particular class of persons to which the third party belongs (for example, borrowers), will rely on the representation in the course of the transaction. In *Sage v. Blagg Appraisal Co.*, 209 P.3d 169 (Ariz. Ct. App. 2009), the court read the Restatement as not requiring that the professional know for a certainty that the statement will be furnished to a third party, but only that the professional know that the contracting recipient (typically the lender) *intends* to furnish the statement to another. When the appraiser knows that a lender must furnish the appraisal to a buyer-borrower if asked, he knows the lender *intends* to furnish it to the buyer, within the meaning of the Restatement. Id. at 174.

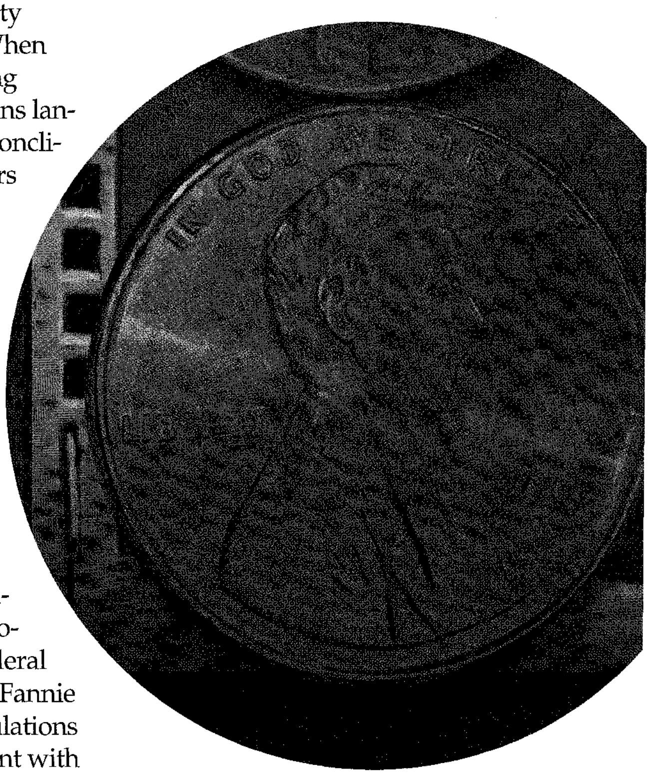
In finding that an appraiser could be liable to a buyer-borrower under the circumstances in question, the court departed from the categorical relationships (landowner-invitee; tavern owner-patron) from which duties have historically arisen. Instead, it found a sufficient basis for imposing a duty in public policy as evidenced in the Restatement and the realities of the loan/purchase transaction, as well as the emerging industry guidelines recognizing that the buyer-borrower normally relies on the appraiser.
Id.; see also *Withrow v. First Tennessee Bank Nat'l Ass'n*, No. 3:04-cv-546, 2006 WL 2981295 (E.D. Tenn. Oct. 16, 2006) (reasonably foreseeable that the purchaser would rely on the appraisal and that the misrepresentations were not made directly to the plaintiffs was not defeating); *Zimmerman v. Logeman*, No. 09-cv-210-slc, 2009 U.S. Dist. LEXIS 111411 (W.D. Wis. Nov. 30, 2009) ("it does not matter whether [appraiser] made a false statement *to* plaintiffs; it only matters whether plaintiffs *relied* on a statement that [appraiser] made to someone else").

Intended Users and Disclaimers Under USPAP

Appraisers attempt to blunt the effect of Restatement § 552 through express language in the appraisal report—identifying intended users and disclaiming any intent to benefit those that are not intended users. USPAP defines "intended user" to mean "the client and any other party as identified, by name or type, as users of the appraisal . . . by the appraiser on the basis of communication with the client at the time of the assignment." USPAP Statement 9. It lists as intended users lenders, government agencies, partners of a client, and a client's attorney and accountant. Id. USPAP further provides that a party that receives an appraisal report from an appraiser's client does not "become a party to the appraiser-client relationship." Such parties do not by any disclosure requirement "become intended users of the report unless they were specifically identified by the appraiser at the time of the assignment." Id.

Although such language carries a plain import, not all courts accept it at face value. In *Davis v. McGuigan*, 325 S.W.3d 149, 159–60 (Tenn. 2010), the disclaimer in the report stated that it was prepared for the "sole and exclusive use of the lender . . . to assist with the mortgage lending decision" and was "not to be relied upon by third parties for any purposes whatsoever." Nevertheless, the Tennessee Supreme Court found that the buyer was entitled to rely on the conclusions in the report because a reasonable person could have taken the report as a statement of a disinterested expert about the value of the property. The report certified that it was unbiased and true and correct. Given the appraiser's admission that buyers of property are interested in and could learn of the value at which the appraiser appraised that property from the report, it was not unreasonable for the appraiser to expect that the lender would communicate the substance of the appraisal report to the borrower and that the result might influence the borrower's conduct. The Sixth Circuit, however, in *Willecke v. Kozel*, 395 F. App'x 160 (6th Cir. 2010), applying Michigan law, found that language stating expressly that the appraisal was intended for the lender and that prohibited its use by others and for any other purpose, precluded finding a duty of care owing to the borrower. When an appraisal report has conflicting language—for example, it contains language both disclaiming use by nonclients and also language that others may rely on the appraisal report as part of any mortgage finance transaction that involves any one or more of these parties—a fact- finder could conclude that the document invited reliance by a buyer-borrower. See *Desimone v. Quicken Loans, Inc.*, No. 1:09-cv-01421-WTL-MJD, 2011 U.S. Dist. LEXIS 26772 (S.D. Ind. Mar. 15, 2011).

Borrowers whose loans were eventually purchased by the Federal Home Loan Mortgage Corporation (Freddie Mac) and the Federal National Mortgage Association (Fannie Mae) may be able to rely on regulations revised in 2005. Though consistent with USPAP (providing that "[t]he intended use of the appraisal report is for the lender-client to evaluate the property that is the subject of this appraisal for a mortgage finance transaction"), these regulations also required appraisers to certify their understanding that "[t]he borrower, another lender at the request of the borrower, the mortgagee or its successors and assigns, mortgage insurers, government sponsored enterprises, and other secondary market participants may rely on this appraisal report as part of any mortgage finance transaction that involves any one or more of these parties." See Freddie Mac & Fannie Mae, *Uniform Residential Appraisal Report*, Appraiser's Certification no. 23, www.efanniemae.com/sf/formsdocs/forms/pdf/sellingtrans/1004.pdf (Certification 23). Explaining the purpose of this certification, Fannie Mae states that the acknowledgment of other parties that often rely on the appraisal report "is not meant to expand the list of intended users," but only "to clarify that others, although not intended users, often rely on the appraisal report as part of a mortgage finance transaction." Fannie Mae, *Guidance for Lenders and Appraisers*, www.efanniemae.com/sf/guides/ssg/relatedsellinginfo/appcode/pdf/appraisalguidance.pdf,



at 8. Indeed, notwithstanding Certification 23, when appraisers believe that the lender-client is the only intended user, Fannie Mae has stated that it will accept an additional notice that "[t]he intended user of this appraisal report is the lender/client. The intended use is to evaluate the property that is the subject of this appraisal for a mortgage finance transaction . . . . No additional intended users are identified by the appraiser." Fannie Mae, *Selling Guide*, www.efanniemae.com/sf/guides/ssg/sg/pdf/sel052411.pdf, at 513.

Although the certification that others may rely on the report may provide the predicate for an action against an appraiser by the relying party, Fannie Mae's clarification that the certification does not enlarge the class of intended users may negate this advantage, leaving it to the courts to determine, nonetheless, whether a borrower who is not an intended user has a cause of action against the appraiser. In any event, none of the courts that have purported to extend the class of those entitled to rely on an appraisal report have expressed any qualms about doing so, and, if they did, misgivings could be resolved on the basis that no new burdens would befall the appraisers. As professionals, appraisers are already under an obligation to act in a nonnegligent fashion and, even as they should expect some amount of reliance by buyer-borrowers, the same standard of care would apply. The class of those to whom the appraiser will owe this duty would not be extended to indeterminate levels but would be limited to those involved in the transaction that triggered the appraisal report. Importantly, extending accountability will likely foster greater adherence to the existing standards of conduct.

Reliance for the Purchase vs. the Loan Transaction

In sorting out the chronology of events for a coherent narrative, some courts have distinguished the purchase transaction from the loan transaction, finding no reliance or liability if the facts show that the buyer-borrower had already entered into a contract for the purchase of the property before the appraisal was conducted. When a purchaser has signed a contract to purchase the subject property before the appraisal report was prepared and does not request or obtain a copy of the report before closing, "he will be hard pressed to demonstrate that he relied in any manner on the appraisal." *Caruso v. Nat'l City Mortg. Co.*, 931 N.E.2d 1167, 1171 (Ohio Ct. App. 2010). The fundamental flaw in this distinction is

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revealed in the reasoning of the cases. A distinction on the basis of two discrete transactions does not reflect the realities of real estate purchase transactions, most of which depend on obtaining financing from a lender. Indeed, the appraisal is often the most fundamental predicate for the transaction, as most contracts for purchase are made contingent on obtaining financing, which in turn depends on a satisfactory appraisal. For purposes of determining the appraiser's liability, the purchase transaction cannot sensibly be separated from the loan transaction. See *Edalatdju v. Guaranteed Rate, Inc.*, 748 F. Supp. 2d 860, 864–66 (N.D. Ill. 2010) (because plaintiffs were able to obtain financing only because of the appraisal, the purchase agreement would not have been consummated had it not been for the false statement of value); *Borish v. Russell*, 230 P.3d 646 (Wash. Ct. App. 2010) (finding sufficient reliance on an appraisal when the buyer-borrower retained a contract rescission right that the buyer-borrower could exercise only if the appraised value was for less than the purchase price and the buyer-borrower omitted to cancel based on a false appraisal report).

In *Sage v. Blagg Appraisal Co.*, 209 P.3d at 174, the Arizona Court of Appeals recognized the purchase-loan distinction as a false one, pointing out that the appraisal the lender orders typically is the foundation of the home purchase transaction. Even though ostensibly the appraiser serves only the mortgage transaction and not the separate purchase transaction, the distinction is meaningless because a lender will not finance the buyer's purchase if its appraiser concludes the home is not worth the financed amount. Because in many cases the residential purchase contract form gives the buyer the right to cancel the contract if the appraisal falls short, the court "would blink at reality to conclude otherwise." Id. The dual purposes of an appraisal—informing the buyer about the fairness of the purchase price and affordability of the anticipated loan and assessing the sufficiency of the collateral—surely are so apparent that they must determine rights and responsibilities.

Economic Loss Rule

The narrative of a tort claim would hardly be complete without discussing the part in which the economic loss rule rises as a monolith against the injured plaintiff to preclude recovery. The rule prevents a party from claiming economic damages in a negligence claim absent physical property damage or bodily injury, other than the defective product or property. Economic damages are damages for inadequate value, costs of repair and replacement of the defective product, or consequent loss of profits—without any claim of personal injury or damage to other property. Economic loss seems to describe the majority of claims against appraisers—that is, the only loss is the reduced value of the property and higher mortgage payments based on an inflated price.

The general idea behind the doctrine is to prevent dissatisfied buyers from using tort law to recover for potentially indeterminate losses that were or should have been protected against under the contract. *Digicorp, Inc. v. Ameritech Corp.*, 662 N.W.2d 652, 659 (Wis. 2003). Tort law aims to redress physical injury whereas contract law protects

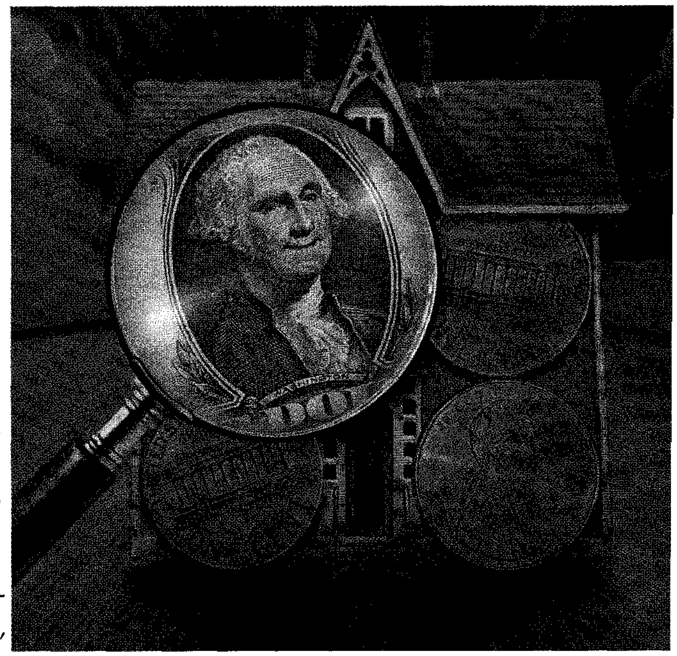
the parties' expectation interests. *Borish v. Russell*, 230 P.3d at 650. This doctrine means that even if a court were to find a contractual relationship between the buyer-borrower and the appraiser, if the claimed loss is an economic loss and no exception to the economic loss rule applies, then the buyer-borrower will be limited to contractual remedies, which may mean recovery for only the cost of the appraisal.

Although the economic loss doctrine is indeed monolithic for claims squarely within its coverage—simple negligence—a buyer-borrower may be able to maneuver around the bar to recovery by recasting the cause of action as involving additional or intentional wrongful conduct, such as business disparagement and intentional interference with contract, fraud, or fraudulent inducement, *Zimmerman v. Logeman*, 2009 U.S. Dist. LEXIS 111411 (W.D. Wis. Dec. 1, 2009), or by establishing an independent duty. In *West v. Inter-Financial, Inc.*, 139 P.3d 1059 (Utah 2006), the Utah Supreme Court ruled that real estate appraisers, who are licensed professionals, owe duties to third parties in the performance of their work and therefore may be liable to third parties for economic damages as a matter of law. They have a "statutory duty to the public" and are expected to be "honest, ethical, and competent." Id. at 1065. As such licensed professionals, they can be held liable for all losses occasioned by their wrongful conduct, even absent a formal contractual relationship. Courts have taken varying views on whether a claim under Restatement (Second) of Torts § 552 operates as an exception to the economic loss rule. Compare *Caruso v. National City Mortg. Co.*, 187 Ohio App. 3d 329, 334 (2010) (economic damages recoverable), with *Vesta Constr. & Design, LLC v. Lotspeich & Assoc.*, 974 So. 2d 1176 (Fla. Dist. Ct. App. 2008) (Restatement § 552 is not an exception to economic loss rule).

A New Regime: From Tragedy to Morality Play

The 2008 financial industry crisis seemed a redux of the savings and loan debacle of the 1980s, when faulty and fraudulent appraisals played a large part in the collapse of many savings and loan institutions. Then, like now, Congress enacted legislation aimed at setting standards for competent and ethical behavior by participants in loan transactions. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989, 12 U.S.C. §§ 3331–3355, established requirements for real estate appraisals in federally related transactions. Those standards existed in the USPAP, but vigorous enforcement was lacking.

To avert a new tragedy, oversight of opportunistic players must come from all fronts. To implement the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, the Federal Reserve Board has adopted a rule that prohibits coercion by lenders that might compromise the independent judgment of appraisers. 12 C.F.R. § 226.42(c). The rule also prevents appraisers and appraisal management companies from having financial or other interests in the properties or the credit transactions and makes unlawful the extension of credit with knowledge of appraiser coercion. Id. § 226.42(d), (e). Fannie Mae and Freddie Mac have recently published *Appraiser Independence Requirements*, www.efanniemae.com/sf/guides/ssg/relatedsellinginfo/appcode/pdf/air.pdf, with the same objectives.



Almost two dozen states have enacted legislation based on the Appraisal Management Company Registration and Regulation Model Act, created by The Appraisal Institute (www.appraisalinstitute.org). See, e.g., Mo. Rev. Stat. §§ 339.1100–333-1240; Tenn. Code Ann. §§ 62-39-401–62-39-426; Okla. Stat. §§ 858-801–858-829. The model act aims to regulate the conduct of appraisal management companies. An appraisal management company is defined as a person who administers appraisers to fulfill requests for appraisal services. See www.appraisalinstitute.org/newsadvocacy/downloads/modelprovisionsamc.pdf. Such companies must register with the board and otherwise comply with its rules. The act imposes stringent requirements on companies to reduce fraud in the appraisal process by ensuring the independent and honest preparation of appraisal reports. And, beginning in October 2011, the Federal Housing Administration will reduce the maximum value of the homes it will insure to $625,500 from $729,750. U.S. Dep't Housing & Urban Dev., *Potential Changes to FHA Single Family Loan Limits Beginning Oct. 1, 2011*, http://portal.hud.gov/hudportal/documents/huddoc?id=FHA_Loan_Limits_HERA.pdf. The former ceiling (adopted in 2008—just as the crisis was taking shape) for homes in high-priced areas of the country, surely acted as an incentive toward higher appraisals.

Conclusion

Inflated real estate appraisals played a critical role in the market bubble that led to the 2008 financial crisis, but the appraisers have escaped liability to consumers in many cases because of limitations in existing law. What is left to do now is a reappraisal, not of the standards for appraiser performance, but of the standards for holding appraisers to account to those hapless economic losers caught in the whirlwinds of the saga—a recasting from tragedy to morality play. ■