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FDIC News: FDIC Sues CoreLogic (eAppraiseIT) and Lender Processing Services (LSI Appraisal) over WaMu Appraisals

By Peter C

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| 13 | Attorneys for Plaintiff | |
| 14 | FEDERAL DEPOSIT INSURANCE CORPORATION | |
| 15 | as Receiver of Washington Mutual Bank | |
| 16 | IN THE UNITED STATES DISTRICT COURT | |
| 17 | FOR THE CENTRAL DISTRICT OF CALIFORNIA | |
| 18 | FEDERAL DEPOSIT INSURANCE CORPORATION, as Receiver of Washington Mutual Bank, | Case No. SACV11-764 DOC(ANx) |
| 19 | Plaintiff, | |
| 20 | v. | COMPLAINT FOR: |
| 21 | | (1) GROSS NEGLIGENCE (Against All Defendants); |
| 22 | | (2) BREACH OF CONTRACT (Against EA); |
| 23 | CORELOGIC VALUATION SERVICES, LLC, f/k/a eAppraiseIT, LLC; | (3) BREACH OF CONTRACT (Against First American Solutions); |
| 24 | CORELOGIC, INC., f/k/a The First American Corporation; THE FIRST AMERICAN FINANCIAL CORPORATION; CORELOGIC REAL ESTATE SOLUTIONS, LLC, f/k/a First American Real Estate Solutions, LLC; and CORELOGIC REAL ESTATE | (4) ALTER EGO, SINGLE BUSINESS ENTERPRISE, JOINT VENTURE (Against CoreLogic, First American Information Services, and First American Solutions) |
| 25 | | |
| 26 | | |
| 27 | | |
| 28 | | |
| | | COMPLAINT |

(See updates [here](#) and [here](#).)

In December, we offered 11 predictions for AMC liability risks in 2011. Three of the predictions were: #1 -- several AMCs would be sued by the FDIC, #5 -- some AMCs would see their "reps and warrants" come back to bite them, and #11 -- the FDIC would continue to be the single biggest source of appraisal-related claims. See [11 Predictions for AMC Liability Risks in 2011](#). These came true in the last two weeks.

The lawsuits described below against CoreLogic and LSI Appraisal will likely also lead #3 to occur: a few AMCs will endure liability aftershocks relating to litigation by the purchasers of mortgage backed securities. Purchasers of WaMu packaged mortgage securities -- and likely MBS from other sources -- will almost certainly pursue their own claims against these AMCs. We may also see consumer class actions attempting to emulate the FDIC actions.

The FDIC's Lawsuit against CoreLogic and eAppraiseIT

On May 9, 2011, the FDIC filed a lawsuit in U.S. District Court (C.D. Cal.) against CoreLogic and various affiliated companies including CoreLogic Valuation Services, LLC, f/k/a eAppraiseIT, LLC ("eAppraiseIT"). In its complaint, the FDIC alleges that eAppraiseIT supplied potentially thousands of improper appraisals and that eAppraiseIT was grossly negligent in the provision of appraisal services in 2006 and 2007. According to the complaint, the FDIC has sampled 259 appraisals out of the thousands at issue and alleges that 194 (or 75%) of them "contain multiple egregious violations of USPAP." Keep in mind that many so-called "forensic reviews" obtained by entities making appraisal liability claims, including the FDIC, are often pieces of advocacy, riddled with their own problems and supplied by other AMCs. Nevertheless, just based on those 194 allegedly flawed appraisals, the FDIC says that eAppraiseIT is responsible for more than \$129 million in losses that WaMu allegedly suffered -- presumably, the damages sought by the FDIC could be much higher when the FDIC reviews more appraisals. A few sample allegations from the FDIC's complaint are attached to the right.

6 27. During all relevant times and with regard to the original appraisals provided
7 by EA, WaMu would request the appraisal from EA electronically. EA would then select
8 one of its individual licensed appraisers located in the vicinity of the subject property to
9 perform the appraisal. Time was always of the essence, and WaMu required that the
10 appraisal be completed in a timely manner -- usually just a matter of days after the order
11 was placed. When EA's appraiser completed the appraisal, he or she would send it
12 electronically to EA. EA would then send the appraisal electronically to Bangalore, India,
13 for what EA called an "administrative review."
14 28. The EA employees in Bangalore, India, conducting the administrative
15 reviews were not appraisers, and they were not familiar with residential real estate in the
16 United States. EA employees in Bangalore would merely compare the appraisal against a
17 pre-prepared checklist of administrative requirements. If the appraisal appeared to
18 comply with all administrative requirements it was sent to WaMu with the express
19 understanding that WaMu would rely on that appraisal in processing a mortgage loan on
20 the subject property.

The FDIC's allegations appear closely related to the issues in the 2007 case filed in New York state court by then-NY Attorney General Cuomo against eAppraiseIT. That case is still being litigated -- most recently, the New York court denied a motion for summary judgment by eAppraiseIT as discussed in this prior post [here](#).

5 31. To date, the FDIC and its experts have reviewed in depth only 259 of the
6 many thousands of appraisals provided or approved by EA. Based on expert analysis of
7 these appraisals, only 7 of the 259 appraisals, which is less than 3 percent of the appraisals
8 reviewed, were found to be fully compliant with the applicable professional standards.
9 On the other hand, 194 of the 259 appraisals, more than 75 percent of the appraisals
0 reviewed, provided or approved by EA were found to contain multiple egregious
1 violations of USPAP and applicable industry standards. Those violations constitute a
2 degree of carelessness that rises to the level of gross negligence. EA's grossly negligent
3 performance or approval of these 194 appraisals proximately and directly caused losses to
4 WaMu of at least \$129,102,303.77. WaMu relied on these appraisal services in making
5 residential loans to its borrowers, and the Defendants knew that WaMu was relying on
6 EA's appraisals in making the residential mortgage loans. WaMu would not have made
7 these residential loans but for the inflated appraisals provided or approved by EA. The
8 remaining 58 appraisal services were found to contain violations of USPAP, but not to the
9 same degree as the grossly negligent appraisals.

How is it that the FDIC can be suing about appraisals delivered 5 or more years ago? First, when the FDIC sells off the assets of a failed lender for which it has been appointed receiver, the FDIC typically retains for itself the right to claims against parties like professionals and officers and directors whom it can blame for losses of the failed lender. The standard language included in FDIC asset sale agreements is shown to the right. Second, under its interpretation of the Federal Deposit Insurance Act, the FDIC receives an extension of any state statutes of limitations -- an additional three years for tort claims (e.g., negligence) and six years for breach of contract claims, running from the date of the FDIC's appointment as receiver.

3.5 Assets Not Purchased by Assuming Bank. The Assuming Bank does not purchase, acquire or assume, or (except as otherwise expressly provided in this Agreement) obtain an option to purchase, acquire or assume under this Agreement:

(a) any financial institution bonds, banker's blanket bonds, or public liability, fire, or extended coverage insurance policy or any other insurance policy of the Failed Bank, or premium refund, unearned premium derived from cancellation, or any proceeds payable with respect to any of the foregoing;

(b) any interest, right, action, claim, or judgment against (i) any officer, director, employee, accountant, attorney, or any other Person employed or retained by the Failed Bank or any Subsidiary of the Failed Bank on or prior to Bank Closing arising out of any act or omission of such Person in such capacity, (ii) any underwriter of financial institution bonds, banker's blanket bonds or any other insurance policy of the Failed Bank, (iii) any shareholder or holding company of the Failed Bank, or (iv) any other Person whose action or inaction may be related to any loss (exclusive of any loss resulting from such Person's failure to pay on a Loan made by the Failed Bank) incurred by the Failed Bank; provided, that for the purposes hereof, the acts,

The FDIC's Lawsuit against LSI Appraisal and Lender Processing Services

The FDIC also sued LSI Appraisal, its parent corporation Lender Processing Services and various of their affiliates yesterday in the same U.S. District Court. This lawsuit also concerns appraisals delivered to or managed for WaMu during the same period. In this lawsuit, the FDIC seeks approximately \$154 million in damages, but these alleged damages only relate to 220 specific appraisals or review appraisals supplied by LSI between June 2006 and May 2008 -- the FDIC says it has only sampled 292 so far (of course, the ones sampled would only be for loans that have defaulted). The FDIC suggests in its complaint that there could be thousands more appraisals at issue. Indeed, the FDIC alleges that LSI supplied or managed more than 386,000 appraisals for WaMu during the relevant time period.

4 variations, and/or tying compensation or employment to appraisal results. LSI
5 represented and agreed that it would review each and every appraisal that it provided to
6 WaMu to ensure that the appraisals complied with the federal and state statutes and
7 guidelines and the industry standards, including USPAP. Instead, LSI merely "rubber
8 stamped" the appraisals, doing little more than checking required boxes and obtaining
9 necessary signatures on review forms and providing no substantive assurance that any of
0 the appraisers it provide complied with USPAP or other guidelines. In addition, LSI's
1 process made it nearly impossible for LSI to act as a "gatekeeper" between loan staff and
2 appraisers as it had promised. The automated order, mostly automated assignment, meant
3 that LSI did not review information sent by the loan officer to the appraisers.

A sample of the FDIC's allegations in the complaint against LSI Appraisals is attached above. The full text of the complaint is available [here](http://appraiserlaw.com) on appraiserlaw.com.

AMC Reps, Warrants and Indemnification

In our prior predictions for AMC liability risks, we also advised that the representations and warranties so freely made by AMCs to secure lender business would also present a problem in 2011. These "reps and warrants" and the related indemnification clauses will make the FDIC's case against both AMCs much easier to pursue. A

25. Finally, under section 7.1(j) of the LSI Agreement, LSI agreed to indemnify and hold harmless WaMu for loss, damage, claim, or expense arising out of or relating to any claim "by WaMu relating to any breach of the representations and warranties regarding the Services provided by [LSI] pursuant to this Agreement." See LSI Agreement at section 7.1(j) and Exhibit A.

sample of the indemnification given by LSI, as alleged by the FDIC in its complaint, is included here. Appraisers and AMCs alike need to pay attention to what they are signing away.

The FDIC also Filed Lawsuits against an Insurance Carrier and Another Individual Appraiser in the Same Court

The FDIC undoubtedly continues to be the biggest source of appraisal-related liability claims. In addition to the two cases above, in [another lawsuit](#) filed April 29, 2011 in the same federal court, the FDIC sued insurer General Star National Insurance Company for denying coverage for a claim made by the FDIC against an appraiser insured by the carrier. In that complaint, the FDIC seeks approximately \$525,000 in compensatory damages against the insurance company and an unspecified amount of punitive damages. The FDIC earlier obtained a default judgment for \$459,000 against the appraiser in a separate lawsuit. After reading the court documents in both cases, I believe that the insurance carrier's denial of the claim was likely appropriate under the policy it issued and that the case typifies FDIC bully tactics. In state insurance filings, GenStar has now indicated that future E&O policies effective after 6/1/2011 for appraisers needing insurance for work before August 2008 will contain an exclusion for damages alleged by the FDIC. Most insurers are making this move because of the FDIC's hyper-aggressive litigation tactics against individual appraisers -- insurance premiums that most appraisers can afford are just not enough to cover the FDIC's view that appraisals are a form of mortgage insurance. The case is a good lesson for appraisers, and AMCs too, about the critical importance of coverage for "prior acts" since the reason for the claim not being covered was that the appraiser did not have coverage for her prior acts.

The FDIC also filed another lawsuit against an individual appraiser in the same Santa Ana federal courthouse on May 2, 2011 -- showing that while the FDIC has moved up the chain-of-command in the appraisal industry by suing two of the largest AMCs and insurance carriers, it will continue to sue the little guy as well.

General Remarks about Claims against AMCs and Appraisers

As noted elsewhere on this blog, while we report on lawsuits affecting appraisers and AMCs, I don't think that anyone in the appraisal industry should relish in the liability of other parties, even large AMCs. This litigation will likely hurt all appraisers. The lawsuit may unfortunately further diminish the perceived value of appraiser-performed valuations in general and subject unrelated appraisers to even more litigation by other parties (even if the appraisers had nothing to do with these AMCs). In addition, no one -- whether it's a full-fee independent appraiser, an AMC panel appraiser or an AMC itself -- is paid an appraisal fee high enough to justify the treatment of any opinion of value as a guarantee of value or as alternative mortgage insurance. The quality standards during the mortgage boom years were set by the lenders and their regulators -- lenders got the quality they ordered under the supervision of their regulators, including the OTS and FDIC. Yet, now, these same lenders and the FDIC are looking at those appraisals as a way to recoup their losses resulting from bad lending and falling real estate prices.