

**Recent Cases Affecting
Licensed Real Estate
Appraisers and Lessons
Learned Therefrom**

ITKOWITZ PLLC

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***Itkowitz PLLC Continuing Education Course Prepared for the Columbia Society of
Real Estate Appraisers – Recent Cases Affecting Licensed Real Estate Appraisers and
Lessons Learned Therefrom – January 2015***

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I. Introduction (10 Minutes)

A. This is a survey of recent cases affecting real estate appraisers.

During this evening’s presentation, I could stand up in front of the room and recite rules and laws to you. That would be boring for me, and more boring for you.

Instead, I am going to discuss with you various legal cases having to do with appraisers and appraisals. I am going to tell you the story of each case – the facts, the players. I am going to describe the dispute that arose. I will tell you each side’s legal argument, what the court’s decision was, and why. Finally, we will discuss what the “take away” is for real estate appraisers in New York today. In some cases I include a little extra information that I think you might like to have.

In this way, you can see the law in action, and how it applies to what you do every day.

Tonight’s class needs to be interactive and collaborative. I am NOT an appraiser. I work with appraisers and appraisals in my capacity as a real estate litigator. I know many appraisers. I read cases and laws on appraisers and appraisals. BUT YOU ARE ON THE FRONT LINES. You in the audience should raise your hands and make whatever comments you have.

The Columbia Society of Real Estate Appraisers is at the forefront of appraiser education, and it recognizes that one of its best resources is its membership. Therefore, your comments about real life appraisal situations is of tremendous value to the group.

If you ask me a question and I am not able to answer it, I will take note of it, research it after the class, consult with Mr. Neglia, and email you the answer and/or post it somewhere on the Columbia site.

Tonight’s presentation is being video recorded so that it can, hopefully, become a resource for use at some other time. If you make a comment or ask a question the camera is not going to turn on to you.

B. A brief word on the New York State Court System.

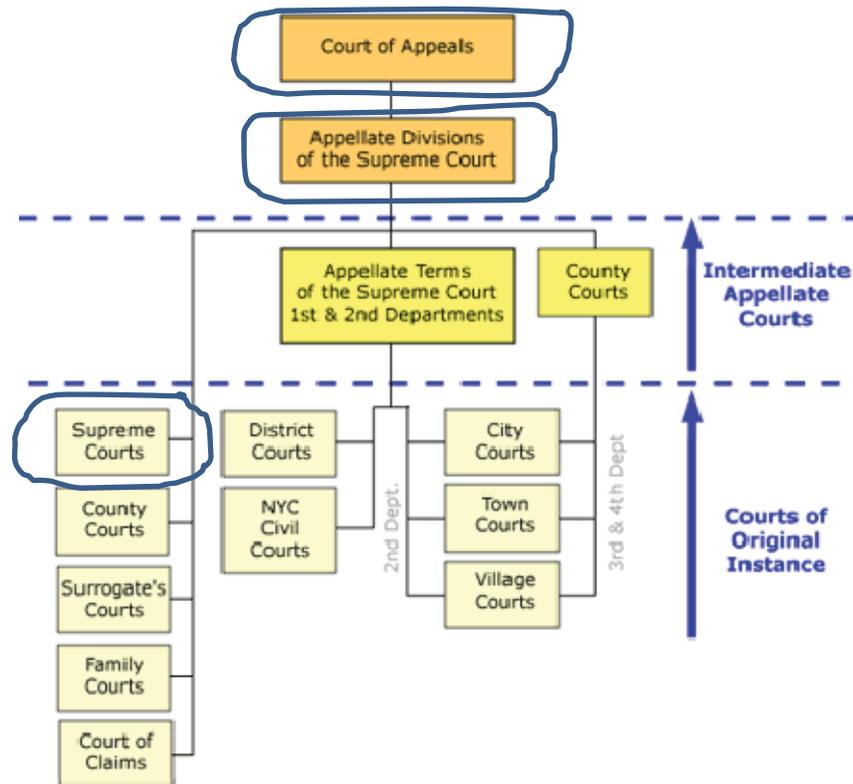
The lowest court in New York State is the Supreme Court, the court of original jurisdiction, the place where a case would first be brought. There is one in each county. The name of the court sometimes confuses people because on the Federal level the “Supreme” Court is the highest court, not the lowest.

If a party in a Supreme Court case does not like the outcome of that case, it would appeal to the Appellate Division of the Supreme Court. There are four of those. The First Department covers Manhattan. The Second Department covers Brooklyn and Long Island. The Third and Fourth Departments are upstate.

You are not allowed to appeal every decision from the Appellate Division. But if you have the right to appeal, you appeal to the highest court in the State – the Court of Appeals in Albany.

Here is a chart:

CIVIL COURT STRUCTURE



Tonight, I will be pointing out which court a case comes from. In general, the higher the court, the more “persuasive” its rulings are. Cases from the Court of Appeals are the most important cases. All the other courts have to follow what the Court of Appeals decides, unless the legislature makes a law that says otherwise.

C. A Brief word on USPAP, because it comes up a lot.

Uniform Standards of Professional Appraisal Practice (“USPAP”) is a set of quality control standards applicable for real property, personal property, intangibles, and business valuation appraisal analysis and reports. USPAP was first developed in the 1980s by a joint committee representing the major U.S. and Canadian appraisal organizations after the big savings and loan crisis. The Appraisal Foundation (TAF), a non-profit organization established in 1987, administers the USPAP. Since 2006, USPAP has been updated in two year cycles, which begins on January 1 of even numbered years. The current version of USPAP is available at

www.appraisalfoundation.org and has an effective date of January 1, 2014. New York has also incorporated USPAP rules into state law (*see* 19 NYCRR 1106.1).

II. *Kosterich v. Ciotta*, 63298/2012, NYLJ 1202675952250 at 1 (Supreme Court, Westchester County, August 8, 2014) (13 Minutes)

Facts:

Appraisal performed by homeowners who were trying to refinance their home. Before the bank would make the loan, the bank required the homeowner to get an appraisal from Defendant-Appraisers.

In determining the value of the property, Appraisers used three sales of comparable properties which took place within the last six months to a year that were located within a half mile of the premises.

Homeowner alleged Defendant-Appraisers were negligent in their appraisal of the premises and committed professional malpractice. Homeowner alleged:

- That Appraisers breached duty to Homeowner by failing to exercise reasonable care, skill, and diligence in performing their appraisal report as an ordinarily prudent appraiser and appraisal company would use under similar circumstances.
- That Appraisers did not use appropriate or accurate comparables in valuing the premises and failed to provide support for their final valuation of the premises.
- That the appraisal didn't comply with Uniform Standards of Professional Appraisal Practice.
- That due to negligent preparation, the premises was valued 200k lower than actual value.

Legal Arguments:

Appraiser argued that there was no privity with Homeowner and thus Appraisers owed no duty.

Outcome and Court's Reasoning:

Court finds there is no privity and that the intended user of the appraisal was the Lender and not plaintiff.

Extra Info:

Let us explain the concept of “privity of contract”. Black’s Law Dictionary defined “Privity of Contract” as:

The relationship between the parties to a contract, allowing them to sue each other but preventing a third party from doing so.

The underlying concept is that a person cannot be made the debtor of another against his will. Contractual rights and duties only affect the parties to a contract. This principle is the distinguishing feature between the law of contract and the law of property. True property rights are ‘binding on the world’ in the lawyer's traditional phrase. Contractual rights, on the other hand, are only binding on, and enforceable by, the immediate parties to the contract.

What this Means for Appraisers:

Homeowners trying to refinance that do not like your appraisal cannot sue you.

III. **Sutton v. Hafner Valuation Group Inc., 2004 N.Y. Slip. Op. 01492 (App. Div. 3rd Dept. 2014) (13 Minutes)**

This case is sort of funny and tells us a little something about appraisers as expert witnesses.

Facts:

The Plaintiff was a litigant in a partnership and corporate dissolution dispute. The Defendant was an appraiser who was going to testify on behalf of the litigant in a legal case.

Appraiser had a strong *curriculum vitae*:

“...certified general real estate appraiser, had received a Juris Doctor degree in 1981, had “[l]itigation [c]onsultation [d]eveloped” in 15 listed contexts and was “[q]ualified as [e]xpert [w]itness” in Supreme Court and the Public Service Commission.”

Shortly before appraiser was to testify as an expert witness at plaintiff's trial, he met with plaintiff's counsel and, upon questioning, disclosed that he was previously licensed to practice law but had been disbarred. Plaintiff decided not to utilize defendant's services for trial, retained another appraiser and requested that defendant refund the money she had paid them.

Legal Arguments:

Plaintiff sued real estate appraiser for tortious interference, fraud, breach of contract, and negligence. Lower court granted appraiser's motion to dismiss/summary judgment.

Outcome and Court's Reasoning:

Appellate Division held that Plaintiff failed to state cause of action for tortious interference; appraiser was not liable for fraud; and appraiser did not breach contract. Appraiser did not breach contract requiring him to appraise property and provide reports that would be ready for court use in prior proceeding, where appraiser provided the requested reports, his status as disbarred attorney did not render his reports inadmissible; he could've testified.

What this Means for Appraisers:

Be honest with your clients about the things in your background that will come out on the stand if you have to testify as a witness.

IV. ***Knobel v. Perales, 2014 Slip. Op. 50202(U) (Supreme Court, NY County 2014) (13 minutes)***

Facts:

Appraisers appealed an Article 78 hearing where the Department of State ruled to yank their licenses. A former employee of the Appraisers signed off on appraisals done by other employees. In 2009, she discovered her name and signature had been placed without her knowledge and permission on appraisals that she had not seen or approved. She brought a claim against the Appraisers. Administrative Law Judge revoked the Appraiser's licenses.

Outcome and Court's Reasoning:

The Court held that the notice of violation issued against the Appraisers was deficient in failing to warn the appraisers that their licenses were at risk. Moreover, the Court held that there was no sufficient proof of an alleged fraud.

Extra Information / Comment:

This was a technical knockout. The Appraisers won on a technicality regarding notice. The decision was without prejudice to the Attorney General issuing new charges against the Appraisers. I cannot tell from online what else ever happened with this matter, there is nothing else reported.

What this Means for Appraisers:

You have procedural rights if your license is being threatened and the Court will uphold them.

V. ***People of the State of New York v. First American Corp., 18 N.Y.3d 173 (Court of Appeals, 2011) (13 minutes)***

This is that big eAppraiseIT / WaMu case.

Facts:

First American provided real estate appraisal services to lending institutions, including savings and loan associations and banks. It supplies these services through its wholly owned subsidiary, eAppraiseIT, an appraisal management company that conducts business in New York. eAppraiseIT publicly advertised that its appraisals conform with USPAP and that they are “audited for compliance.” USPAP, incorporated into both federal and New York law (*see* 12 CFR 34.44; 19 NYCRR 1106.1), requires appraisers to “perform assignments with impartiality, objectivity, and independence, and without accommodation of personal interests”.

The case started in 2007, when the Attorney General initiated an action against defendants, pursuant to its authority under Executive Law § 63 (12) and General Business Law § 349, asserting claims that defendants engaged in repeated fraudulent and deceptive acts in the conduct of its business to the detriment of consumers and the public. The Attorney General also alleged that defendants “unjustly enriched themselves by receiving payment for independent, accurate, and legal appraisals, but failing to provide such appraisals” in violation of the common law.

Specifically – in the course of the eAppraiseIT’s relationship with Washington Mutual, Inc. (“WaMu”) (then the largest nationwide savings and loan institution), eAppraiseIT permitted their appraisers to be pressured into changing appraisal values that were too low in order to allow certain loans to proceed to closing.

In the spring of 2006, nonparty WaMu, retained eAppraiseIT to perform independent appraisals on WaMu loan applications. WaMu soon became eAppraiseIT’s largest client, providing close to 30% of its business in New York. The complaint alleges that, in response to stricter federal appraisal regulations, WaMu hired eAppraiseIT in order to create “a structural buffer between the banks and the appraisers that eliminates potential pressure or conflicts of interest.”

Nevertheless, the Attorney General asserted that WaMu, throughout the course of its relationship with aAppraiseIT, cajoled eAppraiseIT employees to augment the appraised values assigned to certain homes in order to allow the loans associated with those homes to proceed to closing.

Legal Arguments:

Here is what the AG’s complaint against eAppraiseIT alleged:

Shortly after WaMu hired eAppraiseIT, WaMu's loan production personnel complained that “eAppraiseIT's staff and fee appraisers were not ‘hitting value,’ that is, were appraising homes at a value too low to permit loans to close.”

Initially, eAppraiseIT management attempted to thwart the coercion exerted by WaMu. During the latter part of 2006, however, WaMu allegedly continued to express its dissatisfaction with the appraisal reports issued by eAppraiseIT. It purportedly indicated to First American that any future business with WaMu would be “expressly conditioned” on eAppraiseIT's ability to furnish appraisals with “high enough values.”

In February 2007, WaMu allegedly directed eAppraiseIT's to cease utilizing its panel of fee appraisers and instead employ appraisers from a panel previously selected by WaMu's loan origination staff who inflate the values of homes “in a greater majority of the time.”

As a result of this mounting pressure, eAppraiseIT eventually capitulated to WaMu's demands. According to the Attorney General, by April 2007, “WaMu had complete control over eAppraiseIT's appraiser panel” and defendants knew that their compliance with WaMu “violated appraiser independence regulations” under USPAP.

eAppraiseIT contended that the Home Owners' Loan Act (HOLA) and the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) and their regulations **preempt** the Attorney General from raising these claims.

Preemption analysis begins, as always, with reference to the well-familiar Supremacy Clause of the United States Constitution, which provides that federal laws “shall be the supreme Law of the Land; and the Judges in every state shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding” (US Const, art VI, cl 2). Indeed, the Supremacy Clause “vests in Congress the power to supersede not only State statutory or regulatory law but common law as well” (*Guice v Charles Schwab & Co.*, 89 NY2d 31, 39 [1996], *cert denied* 520 US 1118 [1997]).

In determining whether federal law preempts state law, the United States Supreme Court has instructed that a court's "sole task is to ascertain the intent of Congress" (*California Fed. Sav. & Loan Assn. v Guerra*, 479 US 272, 280 [1987]; see also *Medtronic, Inc. v Lohr*, 518 US 470, 485 [1996]).

Of course, "[p]reemption can arise by:

- (i) express statutory provision,
- (ii) implication, or
- (iii) an irreconcilable conflict between federal and state law"

This appeal required the court to focus its analysis solely on implied preemption or field preemption, which occurs when:

"[t]he scheme of federal regulation [is] so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it . . . [o]r the Act of Congress may touch a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject" (*Rice v Santa Fe Elevator Corp.*, 331 US 218, 230 [1947]).

In that regard, eAppraiseIT insisted that "HOLA and FIRREA so occupy the field that these two statutes preempt any and all state laws speaking to the manner in which appraisal management companies provide real estate appraisal services" (*First Am. Corp.*, 76 AD3d at 73). But the Court of Appeals disagreed.

The Court's Holding and Reasoning:

The Court reviewed the history of HOLA from the Great Depression of the 1930s, and FIRREA from the savings and loan crisis of the mid-1980's.

FIRREA mandates that the Office of Thrift Supervision "prescribe appropriate standards for the performance of real estate appraisals." The statute "require[s], at a minimum . . . that real estate appraisals be performed in accordance with generally accepted appraisal standards as evidenced by the appraisal standards promulgated by the Appraisal Standards Board of the Appraisal Foundation" – i.e. the USPAP. New York has also incorporated USPAP rules into state law (see 19 NYCRR 1106.1).

But that did not mean that the Federal Government was going to make all the laws and regulations relevant to appraisers in each State.

FIRREA sanctions the establishment and use of state agencies dedicated to certifying and licensing appraisers. Under FIRREA, Congress created the Appraisal Subcommittee, charged with “monitor[ing] State appraiser certifying licensing agencies for the purpose of determining whether a State agency's policies, practices, and procedures are consistent with this chapter”. According to the Appraisal Subcommittee, FIRREA “recognize[s] that the States [are] in the best administrative position to certify and license real estate appraisers and to supervise their appraisal-related activities” and permits the States to impose stricter appraisal standards as necessary. The case gives a lot more examples of how FIRREA is set up for the Federal and State Governments to work in partnership. Thus, the Court of Appeals denied eAppraiseIT’s motion to dismissed based on preemption grounds.

What This Means to Appraisers:

New York State still has a lot of power when it comes to regulating and prosecuting appraisers under State law.

VI. FDIC v. Hoyle, 2012 WL 4049808 (United States District Court for the Eastern District of New York, 2012) (13 Minutes)

Facts:

The plaintiff FDIC asserted claims for breach of contract, negligence, and negligent misrepresentation in connection with the defendants’ appraisal of real property.

The Appraiser defaulted (did not show up for court), so the Court had to consider the Appraiser’s liability in his absence.

The complaint alleged that the defendants prepared the Appraisal Report in a manner that violated the Uniform Standards of Professional Appraisal Practice (“USPAP”) and inflated the value of the Subject Property by \$177,500. Had the subject property been appraised

correctly, its value would have been \$372,500. Based on this violation of professional standards, the complaint asserts three claims against the defendants: (1) negligence; (2) negligent misrepresentation; and (3) breach of contract. The court finds that the allegations of the complaint sufficiently established the defendants' liability on all three claims.

Extra Info:

“Cause of action” = A legal theory of a lawsuit. Blacks Law Dictionary.

The same set of facts may give rise to multiple causes of action, and care must be taken to charge the jury on each cause of action supported by the evidence. N.Y. Pattern Jury Instr.--Civil 3:6.

Legal Arguments:

I included this case because it gives us a good discussion of what the elements are of these common causes of action against appraisers.

Breach of Contract:

The elements of a breach of contract action are “(1) the existence of an agreement, (2) adequate performance of the contract by the plaintiff, (3) breach of contract by the defendant, and (4) damages.” The court notes that a contract between an appraiser and a bank can be oral as well as written.

How is “breach” measured? Under New York law, a professional performing work under a contract impliedly agrees to exercise reasonable care and skill in the completion of his contractual duties. Compliance with USPAP and the use of appropriate comparables form part of the ordinary professional obligations of an appraiser.

Here, the complaint alleges that the defendants selected comparable sales that were locationally, physically and functionally not the most similar to the Subject Property. Moreover, one of the comparables was a new two-family home, even though the Subject Property was a single-family home. The Appraisal Report further failed to note prior transfer history of some of the comparables used. By failing to comply with USPAP, the defendants breached their agreement with Lender.

How are “damages” proven? NetBank made a loan that it otherwise would not have approved, leading to financial loss when the loan defaulted and the proceeds from the sale of the foreclosed property were insufficient to repay the loan. The financial loss is the amount of damages.

Negligence:

The elements of a cause of action in negligence are (1) a duty on the part of the defendant as to the plaintiff; (2) a breach of this duty; and (3) injury to the plaintiff (4) as a result of the breach.

The element of duty is established because appraisers, as professionals, have a legal duty to perform their work competently. In other words, a real estate appraiser assumes a duty of care to the financing party if it was known that a financing party would rely on its appraisal.

Compliance with USPAP forms a part of an appraiser’s ordinary professional obligations to prepare credible and reliable appraisals. “The court in this case stated:

The defendants’ duty of care extended specifically to the plaintiff because the defendants knew ... that the Appraisal ... would be used by Lender for the ... purpose of the Loan. The defendants’ failure to comply with USPAP constitutes a breach of a duty to the plaintiff. The defendants in this case prepared an appraisal that inflated the property’s value by \$177,500. The inflated figure resulted from the defendants’ failure to choose appropriate comparables and failure to disclose the comparables’ past transfer histories. Both actions were violations of USPAP. As a result, Lender approved a loan transaction it would not have otherwise approved, causing it damages in the value of the loan.

Negligent Misrepresentation:

A claim for negligent misrepresentation resulting only in economic injury “requires that the underlying relationship between the parties be one of contract or the bond between them so close as to be the functional equivalent of contractual privity.”

The remaining elements for negligent misrepresentation are (1) awareness by a declarant that a statement is to be used for a particular purpose, (2) reliance by a known party on the statement in furtherance of that purpose, and (3) some conduct by the declarant linking it to the relying party and evincing its understanding of that reliance.

Here, “the allegations establish the defendants’ awareness of the particular purpose of the appraisal based on portions of the Appraisal Report that state that the ‘intended use’ of the report is a mortgage finance transaction. Furthermore, Lender was a party known to the defendants because the Appraisal Report states that the ‘intended user’ is the ‘lender/client.’”

“The third element of the claim is met because the defendants prepared and presented the appraisal to Lender’s agent. The Appraisal Report also specifically states on its face that it was prepared for ‘Lorenzo Mortgage Company and its successors and its assigns.’”

What this Means to Appraisers:

Do not default when you are sued!

VII. Jones v. Bank of Am. Nat. Ass’n, 97 A.D.3d 639 (2nd Dept. 2012) (13 Minutes)

Facts:

Predatory lending scheme case. Homeowner brought suit alleging that the Appraisers overvalued their property in order to enable homeowners to obtain grossly unaffordable mortgage loans in order to purchase the property.

Legal Arguments:

General Business Law § 349

Plaintiffs alleged a cause of action against the appellants to recover damages for violations of General Business Law § 349.

General Business Law § 349 provides that “[d]eceptive acts or practices in the conduct of any business, trade or commerce or in the furnishing of any service in this state are hereby declared unlawful” (General Business Law § 349 [a]). A private right of action to recover damages for violations of General Business Law § 349 has been provided to “any person who has been injured by reason of any violation of” the statute (General Business Law § 349 [h]). Under General Business Law § 349 (h), a prima facie case requires a showing that the defendant engaged in a consumer-oriented act or practice that was “ ‘deceptive or misleading in a material way and that [the] plaintiff has been injured by reason thereof’ ”

Fraud

Plaintiffs also alleged fraud. To establish a prima facie case of fraud, a plaintiff must present proof that the plaintiff relied upon the defendant’s misrepresentation.

The Court’s Holding and Reasoning:

The plaintiffs failed to allege that the appellants’ alleged acts and practices misled them in a material way – so no GBL § 349.

The plaintiffs also failed to allege a cognizable cause of action against Horowitz to recover damages for fraud – so no fraud.

Appraisers moved to dismiss the complaint for failure to state a cause of action. The Supreme Court denied their motion and the Appraisers appealed. The Appellate Division held for Appraisers!

What this Means to Appraisers:

Of all the things appraiser have to worry about -- General Business Law § 349 (Deceptive Business Practices) and fraud – are typically not among them. Standards for these causes of action are very high. But skip to *Flandera* and *Allstate* below and see a different result!

Also this case relies upon the next case, *Rodin*.

VIII. **Rodin Properties–Shore Mall, N.V. v. Ullman, 264 A.D.2d 367, (1st dept. 1999) (13 Minutes)**

You might ask – Hey, this case is not “recent”, why is it in here? It is just a very important appraiser case. Many other cases cite it. It’s worth a look.

Facts:

Plaintiff Lender/Investors loaned \$49,125,000.00 to Shore Mall Associates (“SMA”) to refinance a New Jersey Shopping center. The loan was expressly conditioned on the borrowers’ obtaining an appraisal showing the shopping center had a value of at least \$60,000,000.

SMA hired the Defendant–Appraisers. The letter agreement between SMA and the Appraisers contained an express acknowledgment that the appraisal report was intended to assist SMA in obtaining financing and that the report could be shared with prospective lenders.

The Appraisers valued the shopping center at \$65,000,000.00.

Legal Arguments:

Plaintiff claimed the appraisal was inflated and brought suit under contract, negligence, and fraud theories against Appraisers. The Supreme Court granted Appraisers motion to dismiss finding that the same facts were raised in Plaintiff’s complaint *for both its contractual and tort claims*.

Extra Info: What is a Tort?

A tort is a civil wrong, other than breach of contract, for which a remedy may be obtained, usually in the form of damages; a breach of a duty that the law imposes on persons who stand in a particular relation to one another. Black’s Law Dictionary.

Back to Legal Arguments:

The Appellate Division reversed, holding that as professional appraisers, Defendant owed a duty to Plaintiff independent of any contractual obligation; “Professionals, common carriers and bailees, for example, may be subject to tort liability for failure to exercise reasonable care, irrespective of their contractual duties. In these instances, it is policy, not the parties’ contract that gives rise to a duty of care.” It does not matter that the same facts serve as the basis of both tort and contract claims.

The Court’s Holding and Reasoning:

The Court concluded: “When a professional, such as Defendant, has a specific awareness that a third party will rely on his or her advice or opinion . . . tort liability will ensue if the professional report of opinion is negligently or fraudulently prepared.” Appraisers lose.

What this Means to Appraisers:

The same facts may be used to bring claims of contract and tort against an Appraiser. Appraisers, as professionals, owe duties of care to third-parties whom they know will rely on their appraisal report.

IX. Flandera v. AFA Am., Inc., 78 A.D.3d 1639, 913 (4th Dept. 2010) (13 Minutes)

Here is a case where the a cause of action for fraud against appraisers was allowed to proceed. This case addresses a very interesting issue. How can appraisers get into so much trouble over an OPINION? After all, an appraisal, by its very nature, is an opinion. An appraisal is not solidly objective. Shouldn’t that give an appraiser a defense to suit?

Facts and Legal Argument:

First-time homebuyers brought action against appraisers, claiming that the appraisal for the subject property had several misrepresentations concerning the condition and qualities of the home. Plaintiffs claimed, for example, that the appraisal misrepresented who owned

the property, whether the property had municipal water, the type of basement, the status of repairs on the property, etc. Homebuyers sued appraisers for fraud.

The Court’s Holding and Reasoning:

The Appellate Division held that Plaintiffs had sufficiently plead the elements of fraud including material representation of fact, scienter (intent to misrepresent), justifiable reliance, and damages. The Court stated that:

“although appraisals or other assessments of market value ‘are akin to statements of opinion, which generally are not actionable,’ an assessment of market value that is based upon misrepresentations concerning existing facts may support a cause of action for fraud.”

An assessment of market value based upon misrepresentations concerning existing facts of a property may support a cause of action for fraud. Appraisers lose.

What this Means to Appraisers:

An appraisal may ultimately be an opinion. But the appraisal is based upon facts, and the facts relied upon are recited in the appraisal. Those facts can objectively be misrepresented. If they are, it could give rise to a cause of action for fraud.

X. Allstate v. Credit Suisse, 42 Misc.3d 1220(A), (Supreme Court, NY Cty, 2014) (13 Minutes)

We thought the program needed at least one Residential–Mortgage–Backed–Securities (“RMBS”) case!

Facts:

Fraud action. Allstate purchased \$231M of RMBS from Credit Suisse – interests in a pool of mortgage loans, sold as securities to investors. The loans had a high default rate, nearly 1/3 were written off. This complaint alleges fraud, fraudulent inducement, and negligent

misrepresentation. One of the things allegedly misrepresented was loan-to-value ratios – and these were arrived at by using appraisals that were not created using sound data, and in derogation of correct appraising practice.

The Court's Holding and Reasoning:

The Court:

As to loan-to-value ratios (i.e., the ratio of a mortgage loan's principal balance to the value of the mortgaged property), the complaint alleges that the offering materials misrepresented these ratios and misrepresented that the ratios were calculated using data based on sound appraisal practices. The complaint further alleges that defendants knew that the appraisal process was manipulated, and sets forth specific allegations about the appraisal practices of the originators of some of the mortgages underlying the offerings at issue.

Fraud claims based on appraisals have been dismissed on the ground that an appraisal is a subjective opinion and is not actionable absent an allegation that the appraiser did not believe the appraisal at the time it was issued. (*See e.g. Tsereteli*, 692 F. Supp 2d at 393; *IndyMac Mtge.-Backed Secs. Litig.*, 718 F. Supp 2d at 511.) Fraud claims involving appraisals have also been dismissed where the complaint pleaded only general allegations that the appraisers were subject to pressure from the banking industry to inflate their appraisals, and not that the appraisers of the loans at issue succumbed to such pressure. (*See e.g. Plumbers' Union Local No. 12 [Nomura]*, 632 F3d at 774.)

However, fraud claims based on allegations similar to those here have repeatedly been upheld where the complaint pleaded allegations about the appraisal practices of the originators at issue. (*Capital Ventures [J.P. Morgan]*, 2013 WL 535320, at * 4–5; *Morgan Stanley Mtge. Pass-Through Certificates Litig.*, 810 F. Supp 2d at 672–673 [holding that claim was stated where complaint made detailed allegations as to systematic disregard of appraisal standards by originators at issue]; *Allstate Ins. Co. v. Countrywide Fin. Corp.*, 824 F. Supp 2d 1164, 1185–1186 [CD Cal 2011] [noting that appraisals are generally inactionable opinions, but upholding fraud claim

based on appraisals where complaint pleaded facts calling into question the factual bases for the appraisals].)

Here, similarly, the specific allegations of the complaint regarding the originators' deviations from appraisal standards, with resulting impact on the calculation of the loan-to-value ratios, are sufficient to support the fraud cause of action.

What this Means to Appraisers:

Here fraud gets sustained because the deviations from standard appraisal practice were so gross and they were systematic. In other words, this was not the situation where an appraiser made a mistake or just wasn't that good (for that see the *Ramapo* case below).

XI. *Clement v. United Homes LLC*, 914 F. Supp. 2d 362 (United States District Court for the Eastern District of New York 2012) (13 Minutes)

Facts:

Predatory property flipping scheme case.

Legal Arguments:

Homeowner brought action against appraisers, alleging that appraisers took part in a conspiracy to defraud her and other minority home buyers through a predatory property flipping scheme, by providing appraisals that intentionally overstated the value of their homes. Plaintiff asserted claims for violations of the Fair Housing Act, the Civil Rights Act, civil rights statutes, the Truth in Lending Act, and city, and state law. Appraisers moved to dismiss the claims.

The Court’s Holding and Reasoning:

The United States District Court held that Plaintiff’s claims for violations of the FHA and civil right statutes were barred by reason of statute of limitations – that is, **two years from the date of injury**.

The Court further held that the continuing violation doctrine did not apply and that judicial economy, convenience, and fairness would not be served if the Court exercised supplemental jurisdiction over Plaintiff’s state law claims.

Court says:

Where there are continuing violations that give rise to a claim of a discriminatory policy, the statute of limitations period does not begin to run until the end of the “last asserted occurrence” of a discriminatory policy. *see also Patterson v. Cnty. of Oneida*, 375 F.3d 206, 220 (2d Cir. 2004) (“To bring a claim within the continuing violation exception, a plaintiff must at the very least allege that one act of discrimination in furtherance of the ongoing policy occurred within the limitations period.”).

However, plaintiff does not allege a discriminatory practice that extends into the limitations period. Her complaint does not adequately allege any actions on the part of any defendants after 2005, let alone actions supporting an ongoing discriminatory policy.

Plaintiff does not allege any violations *following* her closing on August 5, 2005.

Plaintiff’s cause of action was barred by the statute of limitation and the continuing violation doctrine did not apply. Appraisers win.

What This Means to Appraisers:

Statutes of limitation can be a powerful defense in a lawsuit. It is always the first thing your defense counsel will look at.

XII. Estrada v. Metropolitan Prop. Group, Inc., 110 AD3d 497 (Appellate Division, 1st Dept. 2013) (13 Minutes)

Facts:

Purchaser of residential cooperative apartment unit brought action against broker, bank, and appraiser, alleging, among other things, fraud and deceptive business practices having to do with alleged deceptions over square footage. The Supreme Court, New York County, dismissed the purchaser's case, and purchaser appealed.

Holding and Reasoning of the Court:

The Appellate Division upheld the dismissal of the case against the appraiser. Why? Because the purchaser could not have relied upon the appraiser's report, inasmuch as he entered into a contract to purchase the apartment four months BEFORE the appraisal was prepared!

What This Means to Appraisers:

Some people will sue you for anything! Don't confuse them with the facts!

XIII. Ramapo v. 1236 Rogers Avenue LLC, 46 Misc.3d 1201(A) (Supreme Court, Kings Cty.) (13 Minutes)

"Competing Appraiser" Case.

Facts:

Foreclosure of a four family building in Brooklyn – Rogers Avenue. Building sold at auction in 2010. Bank did not get all its money back, so it moved for a deficiency judgment of over \$1M. Court needed to know the fair market value price of the property in order to properly calculate the amount of the deficiency.

Real Property Actions and Proceedings Law § 1371(2) permits the mortgagee (bank) in a mortgage foreclosure action to recover a deficiency judgment for the difference between the amount of the judgment and EITHER the auction price at the foreclosure sale or the fair market value of the property, whichever is higher.

Interesting case because the purchaser at auction bought the property for \$255k in April 2012, and flipped it in June 2013 for \$690k. This raised an issue of fact as to the proper valuation at time of auction in 2010.

So, this became a “competing appraiser” case. The appraiser for the buyer said the property was worth \$400k, and the appraiser for the defendants said the property was worth \$600k. The appraiser for the defendants carried the day. Why?

Holding and Reasoning of the Court:

The Court said:

It is a matter of the diligence Mr. Winner Appraiser [NAME REDACTED] displayed in describing how he came to his findings in comparison with the guesswork and estimates upon which Mr. Loser Appraiser [NAME REDACTED] based his appraisal.

Mr. Winner established that he did research on market trends and comparable sales. He also researched the property’s Building Code violations and building permits. Further, in choosing his comparables, Mr. Winner used a more concentrated geographic area than that chosen by Mr. Loser and he documented his efforts as regards his chosen comparables, by calling brokers and using the records of the Multiple Listing Service.

Further, Mr. Winner’s conclusions concerning the condition of the property was in relative accord with that of [another guy], the only witness who had any knowledge of the building who was not paid by one of the parties, or is a principal of a party. Like Mr. Winner, Mr. [other guy] stated that the property was in “fair” condition.

By contrast, Mr. Loser first relied upon purchaser’s instruction that he was to presume the property was to be gutted. Then, in his 2012 inspection, he visited the building in the midst of demolition and drew conclusions about the building’s structure even though he is not trained as an architect or engineer or contractor and did not know if the items being torn out of the building were still operable before they were removed.

Additionally, Mr. Winner based the adjustments he made to the building’s value on the basis of renovations using actual (sworn to) cost estimates for the property in the Building Department’s records, as opposed to Mr. Loser’s use of a formula presented without any foundation. In addition, Mr. Winner recognized that while the cost of renovations affects the value upwards, how much the renovations affect value depends upon market conditions, and noted that not every cent spent on renovations is necessarily a cent of added value. Mr. Loser’s testimony and report display no such understanding of this crucial fact. In fact, Mr. Loser admitted that he reduced the value of a comparable to account for presumed renovation costs, without knowing himself whether the comparable he chose actually was renovated.

The Court thus rejects plaintiff’s appraisal of fair market value, which is within the court’s discretion to do. The Court is entitled to reject the opinion of the plaintiff’s appraiser as being without probative value in light of his insufficient evidentiary foundation.

What This Means to Appraisers:

Do your appraisals like Mr. Winner did!

XIV. Board of Managers of French Oaks v. Town of Amhearst, 989 NY2d 642 (Court of Appeals, 2014) (13 Minutes)

This is a tax certiorari case.

Facts:

Condo challenging a town's real estate tax assessment.

Legal Arguments:

According to the Real Property Tax law a rebuttable presumption of validity attaches to the valuation of property made by the taxing authority. Thus, the taxpayer challenging the authority of the assessment bears the initial burden of coming forward with substantial evidence that the property was overvalued.

A taxpayer will most often attempt to meet the substantial evidence requirement by offering a “detailed, competent appraisal based on standard, accepted appraisal techniques and prepared by a qualified appraiser” (*Matter of Niagara Mohawk Power Corp. v. Assessor of Town of Geddes*, 92 N.Y.2d 192, 196, 677 N.Y.S.2d 275, 699 N.E.2d 899 [1998]).

The Uniform Rules for the New York State Trial Courts prescribe the basic requirements for written appraisals at 22 NYCRR 202.59[g][2] states:

The appraisal reports shall contain a statement of the method of appraisal relied on and the conclusions as to value reached by the expert, together with the facts, figures and calculations by which the conclusions were reached. If sales, leases or other transactions involving comparable properties are to be relied on, they shall be set forth with sufficient particularity as to permit the transaction to be readily identified, and the report shall contain a clear and concise statement of every fact that a party will seek to prove in relation to those comparable properties. The appraisal reports also may contain photographs of the property under review and of any comparable property that specifically is relied upon by the appraiser, unless the court otherwise directs”.

Holding and Reasoning of the Court:

The Court found the condo’s appraiser made two mistakes:

- (1) The appraisal identified four comparable apartment complexes used to calculate the capitalization rate, setting forth the sale price, gross income, expenses and net operating income for each of the rental properties. Since net operating income is one-half of the equation in determining the capitalization rate (net operating income divided by sales price), an accurate calculation is of paramount importance. But other than referencing “forecast financials,” the appraiser did not provide the sources of the income or expense figures related to each comparable.

- (2) The hearing testimony of the condo’s appraiser revealed that he had little to no confirmable data to support the income and expense numbers he employed to derive the capitalization rate. During his direct examination, the appraiser asserted that he relied on “very good” and “very strong” data that came from “certified sources.” On cross-examination, however, he conceded that he had no certified expense or income information and instead had relied on “forecasted economic indicators” with respect to the apartment buildings. In fact, he could identify only two documents in the record that provided any “limited historic operating expenses,” and this information was for only two comparables and did not correlate to the numbers used in the appraisal report. He admitted that he had no documents supporting his analysis as to the other two comparable properties. When pressed, he proffered that the relevant figures were based on his “personal exposure” to the complexes, i.e., his own unverifiable knowledge. But as the Appellate Division dissenters aptly recognized, “[a]n appraiser cannot simply list financial figures of comparable properties in his or her appraisal report that are derived from alleged personal knowledge; he or she must subsequently ‘prove’ those figures to be. Simply put, the record affords no basis to check or test whether the net operating incomes for these four properties—and the capitalization rates adduced from them—were valid, or even in the ballpark.

Thus, the condo in this case failed to meet this threshold because its appraiser did not support the proposed capitalization rate with objective data necessary to substantiate the component calculations.

What This Means to Appraisers:

You need to be basing an appraisal on objective data and document what that data is and where it came from.

XV. Bonus Material – The “Accidental Defendant” By Peter Christiansen (12 Minutes)

This is a very good article I came across on appraisalinstitute.org by their general counsel. It's dated 2014. Copy enclosed.

A guy with a small appraising business found himself a defendant in a serious professional liability case filed by the FDIC over an appraisal he never worked on or signed. It resulted in the guy dishing out \$90,000.00 – for an appraisal he never worked on! The guy's mistake had nothing to do with his appraisals – it had to do with a business mistake.

For two years the guy (let's call him “A”) had an informal arrangement with another appraiser (let's call him “B”). A rented B a desk and let B have an email address with A's domain name. B also had access to A's software and data services. A's firm billed B's client's for B's work. When payments were received, A's firm kept a percentage of the payment as payment for the services A was providing to B.

You can guess what happened next. B messed up an appraisal. The FDIC concluded that A and B were partners, or joint venturers, and thus A was liable for B's mess. What was worse was that the insurance company would not defend A because he had an “individual” policy that did not cover him for the work of other appraisers.

What could A have done differently? He could have formed a limited liability company. And/or, he could have gotten insurance to cover appraisers working with him.

XVI. Conclusion (5 Minutes)

Appraisers are tremendously powerful people, and therefore have a lot of responsibility. The community depends on them for so many things.

Consider the range of cases we saw today. Appraisers were players in so many human dramas, including:

- Real estate deals as small as a first time home purchase and as big as huge commercial deals involving shopping malls
- Litigations
- Predatory lending and flipping schemes
- Residential Mortgage Backed Securities cases
- Foreclosures
- Tax Certiorari Proceedings

There were issues concerning 50 square feet in a cooperative apartment to \$231M in bad securities. These dramas played out from the lowest courts to the State's highest court to the Federal Courts.

You guys (and ladies) are everywhere. The world depends on you doing what you do ethically and correctly.

APPENDIX

Kosterich v Frank Ciotta & Assoc., 45 Misc.3d 838 (2014)

995 N.Y.S.2d 439, 2014 N.Y. Slip Op. 24279

45 Misc.3d 838, 995 N.Y.S.2d 439, 2014 N.Y. Slip
Op. 24279

Diana L. Kosterich, Plaintiff

v

Frank Ciotta & Associates et al., Defendants.

Supreme Court, Westchester County
August 8, 2014

CITE TITLE AS: Kosterich v Frank Ciotta & Assoc.

APPEARANCES OF COUNSEL

Jeffrey A. Kosterich, LLC, Tuckahoe (*Jeffrey A. Kosterich* of counsel), for plaintiff.

L'Abbate, Balkan, Colavita & Contini, L.L.P., Garden City (*Scott E. Kossove* of counsel), for defendants.

*839 OPINION OF THE COURT

Paul I. Marx, J.

It is ordered that (1) plaintiff's motion (a) to remove defendant Alan Hindesman from the caption,¹ and (b) for summary judgment are denied; and (2) defendants' motion for summary judgment is granted.²

This action arises out of an appraisal performed by defendants, Frank Ciotta & Associates, Inc. and Alan Hindesman, of real property owned by plaintiff, Diana L. Kosterich. In June 2013, plaintiff sought to refinance an existing home equity loan on her home at 10 Sturbridge Place, Scarsdale, New York 10538. To refinance her home equity loan, plaintiff attempted to secure a \$600,000 loan from Fairway Independent Mortgage Corporation (Fairway) using the premises as collateral. Before approving plaintiff's loan application, Fairway required that plaintiff obtain an appraisal of the premises from defendants. Plaintiff paid defendants \$700 to perform the appraisal. **2

On or about July 1, 2013, defendants completed a Uniform Residential Appraisal Report on the premises indicating the value of the premises to be \$720,000. In determining the value of the property, defendants used three sales of comparable properties which took place within the last six months to a year that were located within a half mile of the premises.

Plaintiff alleges that defendants were negligent in their appraisal of the premises and committed professional malpractice. Plaintiff asserts that defendants breached their duty to her by failing to exercise the reasonable care, skill, and diligence in performing their appraisal report as an ordinarily prudent appraiser and appraisal company would use under similar circumstances. Specifically, plaintiff alleges that defendants failed to use appropriate or accurate comparables in valuing the premises *840 and failed to provide support for their final valuation of the premises. Plaintiff also alleges that defendants failed to comply with the Uniform Standards of Professional Appraisal Practice in preparing the appraisal.

Plaintiff asserts that, due to defendants' negligent preparation of the appraisal at issue, the premises were valued approximately \$200,000 lower than their actual value. Plaintiff alleges that but for the low appraisal value of the premises ascribed to it by defendants, Fairway would have approved plaintiff's \$600,000 loan. Plaintiff asserts that she suffered damages of over \$2,000,000 as a result of defendants' negligence. In support of her claim for damages, plaintiff states that "Defendant's [sic] action resulted in Plaintiff's inability to refinance a loan at historical [sic] favorable rates."³

Plaintiff moves for summary judgment based on what she characterizes as her presentation of prima facie evidence of defendants' professional malpractice. In opposition, defendants argue that plaintiff was not in privity with them and therefore they owed her no duty. Defendants also contend that plaintiff has not established that their purported malpractice was the proximate cause of her damages and she failed to provide sufficient evidence supporting her assertion that their appraisal was inaccurate.

Defendants move for summary judgment based on the same grounds regarding lack of privity that they asserted in opposition to plaintiff's motion. In opposition, plaintiff asserts that defendants owed her a duty under the "near privity" doctrine. She also claims that her damages are "easily quantifiable" because she did not receive a refinanced loan at "historical [sic] favorable rates" and that defendants' appraisal was inaccurate because it did not use correct comparables.

CPLR 3212 (b) states in pertinent part that a motion for summary judgment "shall be granted if, upon all the papers and proof submitted, the cause of action or defense shall be established sufficiently to warrant the court as a matter of law in directing judgment in favor of any party."

APPENDIX

Kosterich v Frank Ciotta & Assoc., 45 Misc.3d 838 (2014)

995 N.Y.S.2d 439, 2014 N.Y. Slip Op. 24279

“[A] viable cause of action for professional malpractice or negligence ‘requires that the underlying relationship between the parties be one of contract or of the bond between them so close as to be the functional equivalent of contractual privity.’ ” (*Bullmore v Ernst & Young Cayman Is.*, 45 AD3d 461, 464 [1st Dept 2007], quoting *841 *Ossining Union Free School Dist. v Anderson LaRocca Anderson*, 73 NY2d 417, 419 [1989]; see also *Mannix Indus. v Antonucci*, 191 AD2d 482 [2d Dept 1993].)

Defendants allege that there is no privity between the parties as defendants were hired by, and acted on behalf of, Fairway, not plaintiff. Plaintiff does not dispute that there is no contract **3 between the parties but asserts that there is near privity. She argues that she paid defendants to perform the appraisal on which Fairway relied and that such reliance established a relationship of “near privity” between plaintiff and defendants. Defendants counter by stating that to give rise to a relationship of near privity, plaintiff, not Fairway, must have relied on defendants’ appraisal.

Plaintiff relies on *Fortress Credit Corp. v Dechert LLP* (89 AD3d 615 [1st Dept 2011]), which she asserts has identical facts to this case, to support her claim that a relationship of near privity existed between the parties. In *Fortress Credit Corp.*, a lender brought suit against a law firm for professional malpractice and negligent misrepresentation. (*Id.* at 616.) The defendant law firm had written a legal opinion for its client, a borrower, on whether relevant loan documents had been carried out with the formalities necessary to make them binding. (*Id.*) In its written legal opinion letter, the law firm determined that the relevant loan documents had been duly executed and delivered. (*Id.*) The lender alleged that it sustained damages by relying on the law firm’s faulty written opinion. (*Id.*) The Court found that the lender had sufficiently alleged a relationship of “near privity” between itself and the law firm because the lender alleged

“that the particular purpose of the opinion letter was to aid [the lender] in deciding whether to enter into the loan transaction, that [the law firm] was aware that [the lender was] relying on the opinion in making that decision, and that [the law firm] evinced its understanding of that reliance by addressing the legal opinion to [the lender].” (*Fortress Credit Corp.* at 616-617.)

Plaintiff’s reliance on *Fortress Credit Corp.* is misplaced. The facts in that case are far from analogous to the instant case. Indeed, the appraisal itself negates any reasonable reliance by plaintiff, for it states:

“the Intended User of this appraisal report is the

Lender/Client. The Intended Use is to evaluate the *842 property that is the subject of this appraisal for a mortgage finance transaction, subject to the stated Scope of Work, purpose of the appraisal, reporting requirements of this appraisal report form, and Definition of Market Value. No additional Intended Users are identified by the appraiser . . . A borrower or third party may receive a copy of the appraisal, however, it does not mean that the borrower or third party is an intended user.”⁴

It is clear from the language of the appraisal that plaintiff could not reasonably rely on the appraisal. The appraisal specifically states that “[a] borrower or third party may receive a copy of the appraisal, however, it does not mean that the borrower or third party is an intended user.” The stated purpose of the appraisal was solely to aid Fairway in performing its assessment of plaintiff’s loan application. Further, plaintiff did not rely on defendants’ appraisal. In fact, she rejected the results of the appraisal as inaccurate from the outset. (See *Parrott v Coopers & Lybrand*, 95 NY2d 479, 484 [2000].) Upon receipt of a copy of the appraisal, plaintiff contacted Fairway to contest its results and seek a modification. Plaintiff also contacted another real estate appraiser in an effort to obtain more favorable comparables than those used by defendants in their report. Plaintiff does not even allege that she relied on defendants’ appraisal.

To establish a relationship so close as to approach that of privity, the following criteria must be met:

“(1) an awareness by the maker of the statement that it is to be used for a particular purpose, (2) reliance by a known party on the statement in furtherance of that purpose, and (3) some conduct by the maker of the statement linking it to the relying party and evincing its understanding of that **4 reliance.” (*Vineyards Hills Devs., Inc. v Dewkett Eng’g, P.C.*, 56 AD3d 763, 763 [2d Dept 2008], citing *Credit Alliance Corp. v Arthur Andersen & Co.*, 65 NY2d 536, 551 [1985].)

Here, defendants’ appraisal indicates that it would be used by Fairway for the particular purpose of determining whether to issue a loan to plaintiff secured by the premises. Plaintiff submits no evidence indicating that defendants were aware that the appraisal would be used by her in any manner. Instead, plaintiff attempts to piggy back on Fairway’s reliance on the appraisal *843 because it was made in connection with her loan application.

Plaintiff claims that she paid \$700 to defendants for the appraisal. Plaintiff attaches an invoice from defendants

APPENDIX

Kosterich v Frank Ciotta & Assoc., 45 Misc.3d 838 (2014)

995 N.Y.S.2d 439, 2014 N.Y. Slip Op. 24279

which is addressed to Fairway and states that the \$700 fee was “[p]aid in full via check.”⁵ The invoice does not identify who paid the \$700 fee. Although plaintiff may have ultimately paid for the appraisal, she offers no evidence that she made direct payment to defendants. In any event, merely arranging for services and paying for those services is not enough to create privity. (See *Conti v Polizzotto*, 243 AD2d 672, 673 [2d Dept 1997].)

Defendants have made a prima facie case that no relationship existed between plaintiff and themselves that gave rise to privity or near privity. Plaintiff has not raised any genuine issue of material fact. Therefore, defendants are entitled to summary judgment. Plaintiff has failed to allege facts sufficient to establish that a “near privity” relationship existed between her and defendants. Thus, plaintiff cannot maintain her causes of action against them.

Footnotes

- ¹ Plaintiff filed her motion to remove Alan Hinesman from the caption and for summary judgment on February 21, 2014, and set the return date of the motion for March 19, 2014. On March 12, 2014, the parties stipulated to adjourn the motion to April 16, 2014. The court administratively adjourned the motion to the following Monday, April 21, 2014. Defendants filed their motion for summary judgment on April 17, 2014 and set the return date of the motion for May 19, 2014. On July 25, 2014, these motions were reassigned to the undersigned for decision. The motions are consolidated for disposition.
- ² The court received correspondence from the parties disputing whether defendants’ opposition was timely filed. The New York State Courts E-Filing system indicates that defendants’ opposition was filed on April 14, 2014. Therefore, defendants’ opposition papers were timely and will be considered by the court.
- ³ Affirmation in opposition of Jeffrey A. Kosterich, Esq. ¶ 10.
- ⁴ Plaintiff’s notice of motion, exhibit A at 4.
- ⁵ Plaintiff’s notice of motion, exhibit C.

Accordingly, it is ordered that defendants’ motion for summary judgment is granted. It is further ordered that plaintiff’s motion for summary judgment is denied. It is further ordered that plaintiff’s motion to remove defendant Alan Hinesman from the caption is denied as moot. All other arguments advanced and requests for relief not specifically addressed herein have been considered and are denied.

FOOTNOTES

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APPENDIX

Sutton v Hafner Valuation Group, Inc., 115 A.D.3d 1039 (2014)

982 N.Y.S.2d 185, 2014 N.Y. Slip Op. 01492

115 A.D.3d 1039, 982 N.Y.S.2d 185, 2014 N.Y. Slip
Op. 01492

Valerie M. Sutton, Appellant

v

Hafner Valuation Group, Inc., et al., Respondents.

Supreme Court, Appellate Division, Third
Department, New York
March 6, 2014

CITE TITLE AS: Sutton v Hafner Valuation Group,
Inc.

*1040 HEADNOTES

Valerie M. Sutton, Hoosick Falls, appellant pro se.
Thorn Gershon Tymann & Bonanni, LLP, Albany (Erin
Mead of counsel), for respondents.

McCarthy, J. Appeal from an order of the Supreme Court
(McGrath, J.), entered January 28, 2013 in Rensselaer
County, which, among other things, granted defendants'
motion to dismiss the complaint and/or for summary
judgment dismissing the complaint.

In connection with a partnership and corporate dissolution
action, plaintiff retained defendant Hafner Valuation
Group, Inc. to appraise real property and provide "court
ready appraisal reports." Defendant James M. O'Neill,* an
appraiser employed by Hafner Valuation, prepared two
appraisal reports for plaintiff and attached his curriculum
vitae (hereinafter CV) to each. The CV stated, among
other information, that O'Neill was a certified general real
estate appraiser, had received a Juris Doctor degree in
1981, had "[l]itigation [c]onsultation [d]eveloped" in 15
listed contexts and was "[q]ualified as [e]xpert [w]itness"
in Supreme Court and the Public Service Commission.
Shortly before O'Neill was to testify as an expert witness
at plaintiff's trial, he met with plaintiff's counsel and,
upon questioning, disclosed that he was previously
licensed to practice law but had been disbarred (*see*
Matter of O'Neill, 287 AD2d 199 [2001]). Plaintiff
decided not to utilize defendants' services for trial,
retained another appraiser **2 and requested that
defendants refund the money she had paid them.

After they refused, plaintiff commenced this action
alleging tortious interference, fraud, breach of contract
and negligence. Defendants answered, apparently one day
late, prompting plaintiff to move for a default judgment.
Supreme Court denied the motion and deemed the answer
timely served nunc pro tunc. Approximately 10 months
after the answer was served, defendants moved to dismiss
the complaint and for summary judgment dismissing the
complaint. Plaintiff cross-moved for summary judgment.
Supreme Court denied plaintiff's cross motion and
granted defendants' motion, dismissing the complaint
against O'Neill for lack of personal jurisdiction,
dismissing the tortious interference claim for failure to
state a cause of action and dismissing the remaining
causes of action on summary judgment grounds. Plaintiff
appeals. *1041

Supreme Court erred in dismissing the complaint against
O'Neill on personal jurisdiction grounds. Plaintiff did not
effectuate proper substituted service on O'Neill because
she failed to mail a copy of the pleadings to O'Neill after
the process server left a copy with the president of Hafner
Valuation at O'Neill's place of business (*see CPLR 308*
[2]). Despite the error in service and defendants having
raised it in their answer, O'Neill waived his objection on
this ground by failing to move for judgment on that basis
within 60 days of serving the answer (*see CPLR 3211* [e];
State Farm Fire & Cas. Co. v Firmstone, 18 AD3d 900,
901-902 [2005]). Thus, he was not entitled to dismissal on
that ground.

The complaint fails to allege all of the elements of
tortious interference with contract or tortious interference
with prospective business relations. Plaintiff did not
allege that she had a contract with any third party that
defendants knew about and interfered with, nor that
defendants used any wrongful means to secure a
competitive advantage over or inflict harm upon plaintiff
(*see Carvel Corp. v Noonan*, 3 NY3d 182, 189-191
[2004]; *NBT Bancorp v Fleet/Norstar Fin. Group*, 87
NY2d 614, 621-622 [1996]; *Dune Deck Owners Corp. v*
Liggett, 85 AD3d 1093, 1095 [2011]). Accordingly,
Supreme Court properly dismissed the tortious
interference claim.

Supreme Court properly granted summary judgment to
defendants on plaintiff's fraud cause of action. "The
elements of fraud include a misrepresentation that is false
and that the defendant knows is false, made to induce the
other party to rely on it, justifiable reliance on the
misrepresentation by the other party, and injury"
(*DerOhannesian v City of Albany*, 110 AD3d 1288, 1292
[2013], *lv denied* 22 NY3d 862 [2014]; *see Mandarin*

APPENDIX

Sutton v Hafner Valuation Group, Inc., 115 A.D.3d 1039 (2014)

982 N.Y.S.2d 185, 2014 N.Y. Slip Op. 01492

Trading Ltd. v Wildenstein, 16 NY3d 173, 178 [2011]). Contrary to plaintiff's allegations, defendants never represented that O'Neill was a licensed attorney. O'Neill's CV states that he has a Juris Doctor degree, which is a true statement. The Court of Appeals has held that a person who is not licensed to practice law may identify himself or herself "by use of the letters J.D. following his [or her] name . . . [because] [t]he letters identifi[y] him [or her] as one who ha[s] successfully completed a law school curriculum, not as a member of the Bar licensed to practice law" (*Matter of Rowe*, 80 NY2d 336, 342-343 [1992], *cert denied* 508 US 928 [1993]). Plaintiff does not allege any other active misrepresentations. An omission or concealment can constitute fraud, but only where the defendant had a duty to disclose the material fact alleged to be omitted or concealed (see *1042 *Mandarin Trading Ltd. v Wildenstein*, 16 NY3d at 179). The record does not disclose any fiduciary duty that would require defendants to inform plaintiff that O'Neill—who was hired as a real estate appraiser and litigation consultant, not as an attorney—had been disbarred. Accordingly, no triable issues of fact exist on the fraud cause of action. **3

Supreme Court properly dismissed the breach of contract cause of action. Initially, plaintiff failed to specify the provisions of the contract that were allegedly breached (see *Trump on the Ocean, LLC v State of New York*, 79 AD3d 1325, 1326 [2010], *lv dismissed and denied* 17 NY3d 770 [2011]; *Woodhill Elec. v Jeffrey Beamish, Inc.*, 73 AD3d 1421, 1422 [2010]). The cause of action could be dismissed based on that error alone (see *Woodhill Elec. v Jeffrey Beamish, Inc.*, 73 AD3d at 1422). Even if we liberally view the complaint as alleging a breach, the only contract here required defendants to appraise the property and provide reports that would be ready for court use.

Footnotes

* In the complaint, plaintiff misspelled O'Neill's name as James M. O'Neil.

Plaintiff does not dispute that O'Neill provided the requested reports. Instead, plaintiff asserts that the appraisal reports were nullified based on O'Neill's status as a disbarred attorney. The disbarment would be fodder for cross-examination if he testified, but it does not render his reports inadmissible. O'Neill could have testified, and he informed plaintiff that he was willing and able to do so. Alternatively, plaintiff could have requested that another appraiser employed by Hafner Valuation testify. While plaintiff made a strategic choice to seek an appraiser from another company, defendants established that they did not breach the contract and plaintiff failed to raise an issue of fact regarding any alleged breach. Thus, the court properly dismissed that cause of action.

The negligence or negligent misrepresentation claim could not survive as it is based on the same alleged wrongful conduct as the breach of contract claim, rendering it duplicative, and defendants have no special relationship or legal duty to plaintiff other than their contractual relationship (see *Torok v Moore's Flatwork & Founds, LLC*, 106 AD3d 1421, 1422 [2013]; *Fleet Bank v Pine Knoll Corp.*, 290 AD2d 792, 795 [2002]).

Lahtinen, J.P., Garry and Rose, JJ., concur. Ordered that the order is affirmed, without costs.

FOOTNOTES

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APPENDIX

Knobel v. Perales, 42 Misc.3d 1226(A) (2014)

992 N.Y.S.2d 158, 2014 N.Y. Slip Op. 50202(U)

Unreported Disposition

42 Misc.3d 1226(A), 992 N.Y.S.2d 158 (Table), 2014 WL 642832 (N.Y.Sup.), 2014 N.Y. Slip Op. 50202(U)

This opinion is uncorrected and will not be published in the printed Official Reports.

In the Matter of the Application of STEVEN M. KNOBEL and JEFFREY JACKSON, Petitioners,
v.

Cesar A. Perales as SECRETARY OF THE STATE OF NEW YORK, Respondent.

100753/13

Supreme Court, New York County
Decided on January 31, 2014

CITE TITLE AS: Matter of Knobel v Perales

ABSTRACT

Knobel, Matter of, v Perales, 2014 NY Slip Op 50202(U). Administrative Law—Hearing—Adequacy of Notice of Charges—Due Process. Executive Law—§ 160-u (State certified and licensed real estate appraisers; disciplinary proceedings). (Sup Ct, NY County, Jan. 31, 2014, Schlesinger, J.)

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OPINION OF THE COURT

Alice Schlesinger, J.

In this Article 78 proceeding, petitioners Steven M. Knobel and Jeffrey Jackson, Certified Real Estate Appraisers, are asking the Court to review and annul the Decision and Order of the Secretary of State dated May 10, 2013 (Petition, Exh A). This decision essentially adopted the December 27, 2012 Decision and Order of the Administrative Law Judge (Exh B), although broadened its rationale. In both decisions the penalty was the revocation of petitioners' licenses. Petitioners claim the decision was in violation of law, was arbitrary and capricious, and directed a penalty that was shocking in its harshness. Most significantly, they urge that the decision was lacking in due process and deprived them of the right to a fair hearing and prejudiced their ability to offer a meaningful defense. They base this assertion on the failure of respondent to give them proper notice of the *2 charges against them.

The petitioners were directed to mail in their licenses on or before May 24, 2013. Their counsel then brought an Emergency Petition asking that this direction be stayed. On May 22, 2013, after hearing oral argument, I did grant a temporary stay of that direction. I then scheduled further argument for July 10, 2013, after reading the papers. At that time, I continued the stay. Finally, on October 11, 2013, a letter was sent to counsel from my Chambers, asking them to answer two questions relating to due process issues raised by petitioners and not really addressed by respondent.

Now, after reviewing those additional arguments and reading the cited cases, I am convinced that the temporary stays I had ordered were appropriate and I am relieved that the petitioners did not have to experience the loss of their licenses and possibly their livelihood as well. I say this because I find that the petitioners are right when they argue that they were denied due process for inadequate notice of the charges against them.

The substance of the allegations against Messrs. Knobel and Jackson and the corporation they ran, Mitchell, Maxwell & Jackson, Inc. ("MMJ") involved a former employee, Marianne Mueller.¹ Ms. Mueller was with MMJ from 2003 to 2010. She clearly was good at her work, as shown by her advancement from Apprentice Appraiser to Appraiser and finally to Supervisory Appraiser. She served in this capacity with the title Executive Vice President of Legal Services and Private Claims.

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Ms. Mueller, in this supervisory role, was to sign off on appraisals done by other MMJ employees. In 2009, Ms. Mueller said she discovered that her name and electronic signature had been placed without her knowledge and permission on appraisals that she had neither seen nor approved. She identified fourteen such documents. Subsequently, she brought a claim to this effect. Administrative Law Judge Roger Schneier presided at a hearing held on four non-consecutive days. The addresses of the properties involved in the appraisals were all located in New York City, except for one in Harrison, New York.

On the first day of the hearing, January 31, 2012, petitioners (respondents then) were represented by counsel, Eric S. Wei. However, after that day, they represented themselves. They are now, once again, represented by counsel.

In an extremely abbreviated decision, less than three pages, wherein the Findings of Fact take up about half of the three pages and are very general, the ALJ, in two paragraphs stated his findings. He found first that Ms. Mueller, the complainant, had the burden to prove her claim by substantial evidence, and second, that she had succeeded in doing that. She seems to have satisfied her burden solely on the strength of her testimony, which the ALJ found “convincing” and which the numerous witnesses and large number of documentary exhibits produced by respondents “did not refute”. No details were given.

The final paragraph in the “Opinions and Conclusions of Law” section is one very long sentence, which states the following:

By participating in a scheme in which the electronic signature of an appraiser was affixed to appraisals to falsely indicate that she had reviewed those appraisals where without such a signature the appraisals would not have been accepted by their client and, therefore, *3 MMJ obviously would not be paid, the respondents engaged in acts involving dishonesty and misrepresentation with the intent to substantially benefit themselves in violation of [Executive Law §160-u\[1\]\[e\]](#).

Judge Schneier then determined in the final paragraph of his decision that all three respondents, Knobel, Jackson and MMJ, had violated [Executive Law §160-u\(1\)\(e\)](#) and “accordingly, pursuant to [Executive Law §160-u\[1\]](#),” Knobel & Jackson’s licenses as Certified Residential Real Estate Appraisers were revoked. They were then directed to surrender their license certificates and pocket cards.

Rather than doing that, petitioners, on January 22, 2013, appealed the decision to the Secretary of State. That appeal was heard by First Deputy Secretary of State, Daniel E. Shapiro. Appellants sought a *de novo* review of the ALJ’s decision, claiming the decision had multiple “errors of law and fact”. They also asked for a stay of the penalty, which the Appellee, the Division of Licensing Services, opposed. Despite this opposition, a stay was granted pending a final determination on appeal.

Deputy Secretary Shapiro reached his decision on May 10, 2013. Even though it was considerably longer than the one preceding it (it was thirteen plus pages), the Findings of Fact were announced in one sentence; that is, “Upon review of the full record on appeal, the Findings of Fact, as stated in the ALJ’s decision ... are hereby adopted and incorporated by reference.” Later on in the decision, the Deputy Secretary stated that the ALJ as the trier of fact had determined the credibility of each witness and by having “personally observed the testimony of the witnesses, the ALJ is in the best position to judge a witness’ veracity and credibility...”. (p. 5, citations omitted).

What Deputy Secretary Shapiro did next is interesting and certainly raised a question in my mind as to its propriety. I asked counsel to discuss this issue after reviewing their submissions and hearing oral argument. What he did was reference a number of the appraisal reports and point out that they contained “peculiarities in the Supervisory Appraiser’s signature block of the reports’ certifications” (p. 6). He then specifically noted certain e-mail addresses “that appear to be unconnected to Ms. Mueller” (p. 6). Several pages later, he made a connection between these peculiar addresses and the “Personal Liability of Appellants Knobel and Jackson” (p. 9).

He began this discussion with the conclusory statement that “Evidence in the record strongly suggests that Appellants Knobel and Jackson either directed the affixing of Ms. Mueller’s electronic signature to the subject appraisal reports without her authorization, or knew that it was done”(p. 9). He elaborated no further on what this evidence is. He then pointed to two e-mail addresses that appear in the area of the Supervisory Appraiser’s signatures, “SKNOBEL@MMJA.COM” and “SK@MMJA.COM”, along with State Certification numbers that match Knobel’s. Finally, he noted that the one report appraised by Appellant Jackson contained the e-mail address “mmjjeff@aol.com”. He then made the finding, one never reached or even considered before, relevant to these items on page 10 that:

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the presence of Appellants' e-mail addresses or state certification number beneath Ms. Mueller's signature constitutes substantial evidence that they personally knew of or authorized the affixing of Ms. Mueller's electronic signature without her permission, at least in connection with five of the summary appraisal reports offered by Appellee at the hearing. *4 Accordingly, the ALJ's conclusion that Appellants Knobel and Jackson violated [Executive Law §160-u\(1\)\(e\)](#) will not be disturbed.

Finally, Deputy Secretary Shapiro found the penalty appropriate because "as discussed above [appellants] committed multiple fraudulent acts intended to benefit themselves that also constituted separate violations of USPAP" (p. 12).

Before this Court begins its discussion as to whether the determination here "was made in violation of lawful procedure, was affected by an error of law or was arbitrary and capricious or an abuse of discretion, including abuse of discretion as to the measure or mode of penalty or discipline imposed" in accordance with [§7803\(3\) of the CPLR](#), it is important to review the complaint that initiated the inquiry and contains the actual charges. I say this because the petitioners urge that lawful procedures were in fact not followed and that their rights to due process of law were violated.

Specifically, counsel argues that the complaint was materially defective because it never informed petitioners that they were charged with having engaged in acts of dishonesty or misrepresentation with an intent to substantially benefit themselves. Such a charge forms the substance of [Executive Law 160-u\(1\)\(e\)](#), which they were found guilty of by both the ALJ and the reviewing Deputy Secretary, but petitioners argue that it was something they were never charged with. And it is clear they were not. Petitioners also claim that the above failure was a clear violation of [State Administrative Procedure Act \(SAPA\) §301\(2\)\(c\)](#), which requires the Notice of Violation to include "a reference to the particular sections of the statutes and rules involved, where possible".

Petitioners also claim that the decisions here were arbitrary and capricious and not supported by substantial evidence. Respondents dispute this claim and essentially argue two things; one, that the decision by the Secretary of State was supported by substantial evidence, and two, since the Petition raises that issue, the controversy must be transferred to the Appellate Division pursuant to [§7803\(4\)](#) and [§7804\(g\) of the CPLR](#).

The Notice of Hearing, which contained the complaint, is dated December 21, 2011 (Exh J). It was signed by ALJ

Roger Schneier. In the complaint's Preliminary Statement, which gives the basis for the enforcement proceeding, the following is stated as Respondent's alleged actions:

By directly or indirectly, negligently and/or fraudulently, preparing and communicating one or more real estate appraisal reports which contained errors and omissions, and evidenced violations of the Uniform Standards of Professional Appraisal Practice (USPAP) and/or NYS Executive Law Article 6-E and 19 NYCRR, Parts 1101 and 1106, et. seq., thereby violating provisions of all of the foregoing, and violating the standards for the development or communication of real estate appraisals provided in Article 6-E of the Executive Law in violation of [Executive Law §160-u](#).

Parenthetically, counsel points out here that [Executive Law 160-u\(1\)](#) contains 12 subsections, all affording different grounds for the discipline of appraisers.

The statement then sets out five specific categories of failures, presumably in an effort to elaborate on the charges. But vis-a-vis any statutes or rules that were violated, only [Executive Law §160-u](#) is referenced.

The General Allegations proceed to discuss how Marianne Mueller submitted a *5 written complaint which alleged that MMJ, her former employer, had "improperly affixed her electronic signature on appraisal reports, without her approval" (¶5 under this heading). These allegations contain 20 paragraphs which discuss "errors and misstatements" and state that the "Department's investigation confirmed that there was a failure by the Respondents to implement satisfactory security measures ..." to make sure the appraisals were "properly prepared and reviewed" (¶18-19).

The complaint concludes that "By Reason of the Foregoing, the Respondents are charged with engaging in the following acts of professional misconduct." What follows is a restatement of the earlier allegations with no further specification. Significantly, there are, at most, two assertions of dishonesty or fraud which appear in the first sentence of the first charge and the fourth charge. The first reads as follows: "By directly or indirectly, negligently and/or fraudulently, preparing and communicating one or more real estate appraisal reports which contained errors and omissions ..." respondents violated various provisions of law. As stated earlier, the statutory references regarding the charged misconduct are to USPAP and Article 6-E of the [Executive Law, Section 160-u](#).²

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Contrary to the position urged by counsel for respondent here, I do not agree that this controversy exclusively involves a question of substantial evidence. That is why I am not transferring it to the Appellate Division. Rather, as suggested by the above, I find that the matter can and should be resolved pursuant to [CPLR §7803\(3\)](#) because I find that there was a failure to give proper notice of the charges and that such a failure compromised the entire process and clearly prejudiced the petitioner's right to prepare and prove a defense to [Executive Law §160-u\(1\)\(e\)](#), the section they were found guilty of violating but never charged with. I also find that the Deputy Secretary's use and analysis of evidence never before dealt with by the ALJ exacerbated the lack of proper notice and the prejudice that resulted. Under circumstances such as these, where issues exist that could terminate the proceeding, transfer to the Appellate Division on substantial evidence grounds is premature. *See, e.g., Nabors v Town of Somers*, 54 AD3d 833 (2nd Dep't 2008).

Here it should be noted that while Ms. Mueller testified that the electronic signatures were not placed by her, nor did she review the fourteen appraisals, there was no testimony identifying the person or persons who did place her signature. Nor was there any testimony that petitioners Knobel and Jackson had specific knowledge of this act. Rather, the defense testimony from all six of the appraisers who had prepared the 14 reports in the first instance was that, in fact, the reports were shown to Ms. Mueller and signed by her. But the ALJ made no mention of these witnesses in his one sentence finding.

I raise the above evidence not to counter my earlier finding that this case is not so much a substantial evidence one as a due process error of law one. Rather, I raise it because there was a complete paucity of proof here that Knobel and Jackson individually or jointly were behind this so-called nefarious scheme and/or that they reaped large benefits from it. They were never informed that such a possibility was being considered by the ALJ hearing the evidence. Further, there was no way they could have reasonably *6 predicted it because again they were never given notice that such were the allegations that could lead to such a finding against them.

In respondent's Supplemental Memorandum of Law requested by this Court, counsel points to an exchange that occurred on the first day of the hearing between attorney Wei, who for that one day represented Knobel and Jackson, and Mr. Kenny, counsel for the complainant. Wei wanted to have Counts 2,3 and 4 dismissed because he said "if I understand Mr. Kenny correctly, he is saying they [Knobel and Jackson] committed blatant fraud". The

Counts he wanted dismissed concerned negligence and failure to implement proper security measures. But Kenny backed away from this suggestion, saying: "I don't think I ever said blatant fraud'. We will be presenting evidence that hopefully shows she did not give her consent to have her signature placed on the appraisals. It is up to the court to decide the facts and circumstances of the evidence as to whether these violations exist, like in any other case."

However, as counsel for petitioners argued in their Reply here, the State when given an opportunity to acknowledge that fraud was what they did intend to prove, did not take it. Rather, all counsel for the complainant said was that the evidence would show Ms. Mueller had not given her consent and the court could take it from there. At the very least, this exchange shows confusion as to the true gravamen of the offense charged.

Individuals facing charges, such as these turned out to be, should not have any confusion as to what the State is attempting to prove. They are entitled to know with precision that they could be found guilty of intentionally committing a fraud, a fraud in which they intended to substantially benefit. That charge was never communicated. And, as evident by the above exchange, nor was it even suggested.

The cases cited by moving counsel amply illustrate why this decision must be annulled. In an early Court of Appeals decision, *Matter of Murray v Murphy*, 24 NY2d 150 (1969), two police detectives were dismissed by the Police Commissioner of the City of New York because he found that they had acted with a corrupt motive in effectuating a coercive settlement between individuals under investigation. His findings were at sharp variance with the trial commissioner's findings; he had recommended a far lesser penalty. The court said that the question to be resolved was whether petitioners had received a fair hearing in light of their argument that they had been found guilty of a specification never charged (p155). Further, the court said that it appeared that the attorney representing the petitioners at the hearing had made clear his belief that corruption was not being charged. No one, including the trial judge, had disabused him of that notion.

In beginning the discussion that followed, the court stated: "The first fundamental of due process is notice of the charges made. This principle equally applies to an administrative proceeding for even in that forum no person may lose substantial rights because of wrongdoing shown by the evidence, but not charged." 24 NY2d at 157. The court even went so far as to say that: "Where we are involved with such a fundamental constitutional right

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as the right to be put on notice of the charges made, prejudice will be presumed” (*Id.*, citations omitted).

However, here the petitioners do succeed in showing that while prejudice might be presumed, in actuality, they were prejudiced. There was prejudice in how they approached the hearing and prepared their defense. Examples of this are given. First, counsel states that petitioners would have presented evidence that they lacked knowledge of the use of *7 Mueller’s unauthorized signature. Then, they would have submitted evidence of their good character. They also would have submitted evidence that they neither intended to benefit from the unauthorized signature, nor did they in actuality benefit, certainly not in a substantial way. This is a factor that must be proved pursuant to [Executive Law §160-u\(1\)\(e\)](#). Finally, Knobel would have testified that the e-mail addresses found so significant by Deputy Secretary Shapiro were not in fact his.

In a more recent Court of Appeals decision [Block v Ambach, 73 NY2d 323 \(1989\)](#), the court in considering the issue of what satisfies the notice requirement of due process, found that in light of all the other solid evidence in the case, the absence of the specific dates of misconduct, which were not alleged there, was not fatal.

Two proceedings were involved in *Block*, both concerning doctors and charges of misconduct involving sexual activity with their patients. Both doctors were found guilty and had their licenses revoked. But both argued that the failure to specify specific dates of the misconduct violated their due process rights. These claims were rejected. The court distinguished between the specificity required for a hearing pursuant to the State Administrative Procedure Act and one required under the Criminal Procedure Law. The latter, involving a loss of freedom, naturally requires much more specification. Here, the court found that petitioners had received reasonable notice of the charges, which enabled them to prepare and present adequate defenses.

But in two recent Appellate Division, First Department, cases, closer to the circumstances here, the court found otherwise. In [Mayo v Personnel Review Bd. of Health & Hosps. Corp., 65 AD3d 470 \(2009\)](#), the court held that petitioner’s due process rights had been violated because the termination of Mayo’s employment had been based on uncharged misconduct. He had been charged with initiating an assault with one of his subordinates, but he was found guilty of failing to report the incident, an offense he was never charged with.

The court there citing to *Murray (supra)* stated that the

“Petitioner and his attorney were entitled to assume that the hearing would be limited to the charges as made. By switching the basis of the charges after the hearing ..., the PRB violated petitioner’s right to be treated with elemental fairness ...” [65 AD3d at 473](#).

In [Wolfe v Kelly, 79 AD3d 406 \(2010\)](#), a police officer with consistently positive evaluations was accused of having stopped unidentified individuals in unspecified locations and confiscating narcotics and money. These events had allegedly occurred six to eight years earlier and at four times on unspecified dates in a two-year period. Wolfe asserted that he had been denied due process of law because of this lack of specificity, which prevented him from preparing any type of defense other than a general denial. The court agreed.

Respondent cites to cases, all of which are easily distinguishable from the circumstances here. In [Matter of Mangini v Christopher, 290 AD2d 740 \(3rd Dep’t 2002\)](#), petitioners were denied assistance from the County’s Department of Social Services after a fair hearing. They claimed that the notice to them was defective as not clearly informing them of the basis for the denial. But the court found this claim unavailing and pointed out that the notice did adequately detail the reasons for the proposed termination. Further, the petitioners had failed to demonstrate any prejudice as a result of any inadequacies in the *8 notice.

A case much closer to this one as regards the facts and the ultimate conclusion is [Whitehead-Nolan, Inc., et al., v Shaffer, as Secretary of State, 183 AD2d 610 \(1st Dep’t 1992\)](#). This case involved real estate brokers whose licenses had been revoked pursuant to a finding of incompetency. This determination was annulled by the court. Because of financial difficulties, petitioners had been in the habit of writing or post-dating checks without sufficient funds. But a settlement had been reached wherein they promised not to issue post-dated checks. However, after the settlement, petitioner’s counsel, who had complained about not being paid, was given a post-dated check that was dishonored. Charges were then brought by the State for violating the terms of the settlement.

After a hearing, the judge found petitioners guilty and revoked their licenses based on improper checks given to Stolz, a former employee of petitioner and to other employees as well. But the problem was that the notice to petitioners before the hearing only referenced the one post-dated check given to the lawyer. This was not part of the evidence at the hearing.

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The court said that notice was inadequate as the checks to employees including Stolz had never been mentioned prior to the hearing. The court found also that petitioners had no way of knowing in advance that the Hearing Judge might predicate his determination on the Stolz checks and therefore had no reason to object to this testimony. The court said in conclusion (at 612) that: "In fact, prejudice was created by the mere fact that if petitioners had known that the Stolz checks would be so crucial to the Administrative Judge's decision, they might have approached the hearing differently."

A similar comment can and should be made here. As pointed out earlier, if petitioners had been informed of the actual section they were accused of violating, [Executive Law §160-u\(1\)\(e\)](#), or if it had been made clear that they were being charged with intentional acts sounding in fraud, their defense could have and would have been very different. Therefore, even though courts do find that prejudice may be presumed in administrative proceedings where inadequate notice has been provided, here petitioners succeed in showing that they did suffer prejudice both real and substantial.

In conclusion, I am annulling the determination of Deputy Secretary Shapiro in all respects. This decision relied on the ALJ's findings, which of course are also annulled. Before individuals can be deprived of their professional licenses, they must first be told what they are claimed to have done and further how that activity specifically

violated some rule or statute. It is clear to me that that was not done here. No specific statute was alleged to have been violated and, as important, no assertions were ever communicated to them making it clear that they were facing claims of intentional fraudulent conduct.

Accordingly, it is hereby

ADJUDGED that this Article 78 petition is granted and the May 10, 2013 determination revoking petitioners' licenses is annulled based on inadequate notice of the predicate charges. However, this dismissal is without prejudice to any further action the respondent may have the right to take.

Dated: January 31, 2014

J.S.C.

FOOTNOTES

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Footnotes

- ¹ Knobel is President of the corporation and Jackson is chairman.
- ² The fourth paragraph alleges the failure to implement satisfactory security measures. By this failure "Respondents demonstrated negligence, untrustworthiness and/or incompetency."

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18 N.Y.3d 173, 960 N.E.2d 927, 937 N.Y.S.2d 136,
2011 N.Y. Slip Op. 08450

The People of the State of New York, by Andrew
M. Cuomo, Attorney General of the State of New
York, Respondent

v

First American Corporation et al., Appellants.

Court of Appeals of New York
Argued October 11, 2011
Decided November 22, 2011

CITE TITLE AS: People v First Am. Corp.

SUMMARY

Appeal, by permission of the Appellate Division of the Supreme Court in the First Judicial Department, from an order of that Court, entered June 8, 2010. The Appellate Division affirmed so much of an order of the Supreme Court, New York County (Charles E. Ramos, J.; op 24 Misc 3d 672), as had denied defendants' motion to dismiss the complaint on the ground of federal preemption. The following question was certified by the Appellate Division: "Was the order of the Supreme Court, as affirmed by this Court, properly made?"

People v First Am. Corp., 76 AD3d 68, affirmed.

OPINION OF THE COURT

Ciparick, J.

This appeal arises out of an action commenced by the New York State Attorney General against defendants The First American Corporation (First American) and eAppraiseIT, LLC (eAppraiseIT) seeking injunctive and monetary relief as well as *176 civil penalties for violations **2 of New York's Executive Law and Consumer Protection Act (see Executive Law § 63 [12]; General 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.

I.

First American provides real estate appraisal services to lending institutions, including savings and loan associations and banks. It supplies these services through its wholly owned subsidiary, eAppraiseIT, an appraisal management company that conducts business in New York. eAppraiseIT publicly advertises that its appraisals conform with the Uniform Standards of Professional Appraisal Practice (USPAP) and that they are "audited for compliance." USPAP, incorporated into both federal and New York law (see 12 CFR 34.44; 19 NYCRR 1106.1), requires appraisers to "perform assignments with impartiality, objectivity, and independence, and without accommodation of personal interests" (Advisory Standards Board, USPAP, Ethics Rule [2010-2011 ed], available at http://www.uspap.org/USPAP/frwr/ETHICS_RULE.htm).

In a complaint filed in November 2007, the Attorney General initiated this action against defendants, pursuant to its authority under Executive Law § 63 (12) and General Business Law § 349, asserting claims that defendants engaged in repeated fraudulent and deceptive acts in the conduct of its business to the detriment of consumers and the public. The Attorney General also alleges that defendants "unjustly enriched themselves by receiving payment for independent, accurate, and legal appraisals, but failing to provide such appraisals" in violation of the common law.

According to the complaint, in the spring of 2006, nonparty Washington Mutual, Inc. (WaMu), then the largest nationwide savings and loan institution, retained eAppraiseIT and another company to perform independent appraisals on WaMu loan applications. WaMu soon became eAppraiseIT's largest client, providing close to 30% of its business in New York. The complaint alleges that, in response to stricter federal appraisal regulations, WaMu hired eAppraiseIT in order to create "a structural buffer between the banks and the appraisers that eliminates potential pressure or conflicts of interest."

*177 Nevertheless, the Attorney General asserts that WaMu, throughout the course of its relationship with defendants, cajoled eAppraiseIT employees to augment the appraised values assigned to certain homes in order to allow the loans associated with those homes to proceed to closing. The complaint highlights that, shortly after WaMu hired eAppraiseIT, WaMu's loan production personnel complained that "eAppraiseIT's staff and fee appraisers were not 'hitting value,' that is, were appraising homes at a value too low to permit loans to close." On August 15, 2006, eAppraiseIT's executive vice-president advised the company's president that

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WaMu loan officers' unsubstantiated requests for appraisal adjustments amounted to "direct pressure on the appraiser[s] for a higher value without" justification. **3

Initially, eAppraiseIT management attempted to thwart the coercion exerted by WaMu. During the latter part of 2006, however, WaMu allegedly continued to express its dissatisfaction with the appraisal reports issued by eAppraiseIT. It purportedly indicated to First American that any future business with WaMu would be "expressly conditioned" on eAppraiseIT's ability to furnish appraisals with "high enough values." Furthermore, in February 2007, WaMu allegedly directed eAppraiseIT's to cease utilizing its panel of fee appraisers and instead employ appraisers from a panel previously selected by WaMu's loan origination staff who inflate the values of homes "in a greater majority of the time."

As a result of this mounting pressure, the complaint asserts that eAppraiseIT eventually capitulated to WaMu's demands. According to the Attorney General, by April 2007, "WaMu had complete control over eAppraiseIT's appraiser panel" and defendants knew that their compliance with WaMu "violated appraiser independence regulations" under USPAP.

The Attorney General filed the complaint in Supreme Court and defendants removed the action to the United States District Court for the Southern District of New York, asserting that District Court had federal question jurisdiction of the action (*see* 28 USC § 1331). Defendants also sought dismissal of the complaint in federal court. The Attorney General, in response, moved to remand the case back to Supreme Court. District Court granted the Attorney General's motion, and, in so doing, did not address defendant's motion to dismiss (*see People of New York ex rel. Cuomo v First Am. Corp.*, 2008 WL 2676618, 2008 US Dist LEXIS 51790 [SD NY 2008]).

*178 Back in Supreme Court, defendants moved to dismiss the complaint pursuant to CPLR 3211. Defendants contended that the Home Owners' Loan Act (HOLA) (12 USC § 1461 *et seq.*) and the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) (Pub L 101-73, 103 US Stat 183) and their concomitant regulations preempt the Attorney General from raising these claims. Defendants premised their preemption arguments on two theories: they maintained that the relevant federal statutory and regulatory scheme occupied the entire field of real estate appraisals. Alternatively, defendants posited that New York's attempt to regulate eAppraiseIT conflicted with federal law in that it obstructed WaMu's ability to finance real estate transactions. Lastly, defendants asserted that the complaint failed to state a cause of action under General Business Law § 349.

Supreme Court denied the motion. Addressing the

preemption arguments, Supreme Court first concluded that "federal regulation does not occupy the entire field with respect to real estate appraisal regulation" (*People v First Am. Corp.*, 24 Misc 3d 672, 680-681 [Sup Ct, NY County 2009]). The court reasoned that "[i]n the area of real estate appraisals, Congress expressly envisioned a unique regulatory system overseen and enforced by both the federal government and the states" (*id.* at 679). Supreme Court likewise concluded that defendants failed to "articulate[] how the enforcement of USPAP standards under New York law or the application of General Business Law § 349 conflicts with federal law, or otherwise interferes with a bank's nationwide operations or ability to lend" (*id.* at 682). Finally, the court **4 opined that the Attorney General adequately pleaded a cause of action under General Business Law § 349.

The Appellate Division affirmed the order of Supreme Court. Before the Appellate Division, defendants abandoned their conflict preemption arguments (*see People v First Am. Corp.*, 76 AD3d 68, 72 [1st Dept 2010]) but still maintained that, given the comprehensive nature of HOLA and FIRREA, it is clear that Congress intended to occupy the entire home lending field. The Appellate Division disagreed and concluded, like Supreme Court, that Congress did not intend to occupy the entire field with respect to appraisal management companies (*see id.* at 73-76). The court also determined that the Attorney General articulated a cause of action under General Business Law § 349 and had standing to do so, reasoning that the complaint "references misrepresentations and other deceptive conduct allegedly *179 perpetrated on the consuming public within the State of New York" (*id.* at 83).

The same panel of the Appellate Division granted defendants leave to appeal to this Court and certified a question inquiring whether its order, which affirmed the order of Supreme Court, was "properly made" (2010 NY Slip Op 84106[U] [2010]). We now affirm and answer the certified question in the affirmative.

II.

Preemption analysis begins, as always, with reference to the well-familiar Supremacy Clause of the United States Constitution, which provides that federal laws "shall be the supreme Law of the Land; and the Judges in every state shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding" (US Const, art VI, cl 2). Indeed, the Supremacy Clause "vests in Congress the power to supersede not only State statutory or regulatory law but common law as well" (*Guice v Charles Schwab & Co.*, 89 NY2d 31, 39 [1996], *cert denied* 520 US 1118 [1997]). In determining whether federal law preempts state law, the United States Supreme Court has instructed that a court's

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“sole task is to ascertain the intent of Congress” (*California Fed. Sav. & Loan Assn. v Guerra*, 479 US 272, 280 [1987]; see also *Medtronic, Inc. v Lohr*, 518 US 470, 485 [1996] [“(T)he purpose of Congress is the ultimate touchstone in every pre-emption case”] [internal quotation marks omitted]; *Matter of People v Applied Card Sys., Inc.*, 11 NY3d 105, 113 [2008]).

Of course, “[p]reemption can arise by: (i) express statutory provision, (ii) implication, or (iii) an irreconcilable conflict between federal and state law” (*Applied Card Sys.*, 11 NY3d at 113, citing *Balbuena v IDR Realty LLC*, 6 NY3d 338, 356 [2006]). This appeal requires us to focus our analysis solely on implied preemption or field preemption, which occurs when:

“[t]he scheme of federal regulation [is] so pervasive as to make reasonable the inference that Congress left no room for the **5** States to supplement it . . . [o]r the Act of Congress may touch a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject” (*Rice v Santa Fe Elevator Corp.*, 331 US 218, 230 [1947]).

***180** In that regard, defendants insist that “HOLA and FIRREA so occupy the field that these two statutes preempt any and all state laws speaking to the manner in which appraisal management companies provide real estate appraisal services” (*First Am. Corp.*, 76 AD3d at 73). We disagree.

The Great Depression of the 1930s and the financial devastation that ensued triggered Congress to enact HOLA. HOLA created “a system of federal savings and loan associations, which would be regulated by the [Federal Home Loan Bank] Board” (FHLBB) (*Fidelity Fed. Sav. & Loan Assn. v De la Cuesta*, 458 US 141, 160 [1982]). The purpose of this comprehensive legislation was “to provide emergency relief with respect to home mortgage indebtedness at a time when as many as half of all home loans in the country were in default” (*id.* at 159 [internal quotation marks and citations omitted]). HOLA gave the FHLBB “plenary authority” to “promulgate[] regulations governing the powers and operations of every Federal savings and loan association from its cradle to its corporate grave” (*id.* at 144-145 [internal quotation marks and citation omitted]).

During the mid-1980s, the federal savings and loan crisis erupted, prompting Congress in 1989 to pass FIRREA. In enacting FIRREA, Congress restructured the regulation of federal savings and loan associations by disbanding the FHLBB and replacing it with the Office of Thrift Supervision (OTS) (see FIRREA, Pub L 101-73, tit III, § 301, 103 US Stat 183, 277, amending 12 USC § 1461 *et seq.* [establishing the OTS]; Pub L 101-73, tit IV, § 401, 103 US Stat 183, 354, repealing 12 USC § 1437 [see 12

USCA § 1437, Historical and Statutory Notes (disbanding the FHLBB))). As relevant here, FIRREA’s legislative history reveals that Congress designed the statute, in part, “to thwart real estate appraisal abuses . . . [by] establish[ing] a system of uniform national real estate appraisal standards” (HR Rep 101-54[I], 101st Cong, 1st Sess, at 311, reprinted in 1989 US Code Cong & Admin News, at 107; see also 12 USC § 3331 [“real estate appraisals utilized in connection with federally related transactions are performed . . . in accordance with uniform standards”]).

To effectuate this stated goal, Congress enacted 12 USC § 3339 as part of FIRREA, which mandates that the OTS “prescribe appropriate standards for the performance of real estate appraisals.” The statute “require[s], at a minimum . . . that real estate appraisals be performed in accordance with generally accepted appraisal standards as evidenced by the appraisal standards promulgated by the Appraisal Standards Board of the ***181** Appraisal Foundation” (12 USC § 3339 [1]). In 1987, prior to the FIRREA legislation, the United States appraisal profession formed The Appraisal Foundation, a private “not-for-profit organization dedicated to the advancement of professional valuation” (The Appraisal Foundation, <http://appraisalfoundation.org> [accessed Nov. 14, 2011]). The Appraisal Foundation established USPAP and the Appraisal Standards Board, appointed by The Appraisal Foundation and referenced by FIRREA, “develops, interprets and amends” USPAP (*id.*). As noted earlier, New York has also incorporated USPAP rules into state law (see 19 NYCRR 1106.1).

In aiming to prevent further real estate appraisal abuse, Congress envisaged a robust partnership with the states. To that end, FIRREA sanctions the establishment and use of state agencies dedicated to certifying and licensing appraisers¹ and delineates requirements for using these appraisers in federally related transactions (see 12 USC §§ 3331, 3336; 12 CFR 34.44, 564.3).² Furthermore, under FIRREA, Congress created the Appraisal Subcommittee, charged with “monitor[ing] State appraiser certifying licensing agencies for the purpose of determining whether a State agency’s policies, practices, and procedures are consistent with this chapter” (12 USC § 3347 [a]; see also 12 USC § 3348 [c]). According to the Appraisal Subcommittee, FIRREA “recognize[s] that the States [are] in the best administrative position to certify and license real estate appraisers and to supervise their appraisal-related activities” and permits the States to impose stricter appraisal standards as necessary (Appraisal Subcommittee, <https://www.asc.gov/Legal-Framework/TitleXI.aspx> [accessed Nov. 14, 2011]). Thus, this subcommittee has observed that FIRREA “created a unique, complementary relationship between the States, the private sector, and the Federal government” (*id.*).

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Consistent with this understanding of FIRREA, OTS itself stated that a financial “institution should file a complaint with the appropriate state appraiser regulatory officials when it suspects that a state certified or licensed appraiser failed to comply with USPAP, applicable state laws, or engaged in other ***182** unethical or unprofessional conduct” (OTS, Mem for Chief Executive Officers, *Final Interagency Appraisal and Evaluation Guidelines*, CEO Ltr 371, at 23 [Dec. 2, 2010], http://www.ots.treas.gov/_files/25371.pdf [accessed Nov. 14, 2011]).³ ****6** Similarly, the United States Government Accountability Office, an independent, nonpartisan agency that works for Congress, has observed that FIRREA “relies on the states to . . . monitor and supervise compliance with appraisal standards and requirements” (Government Accountability Office, Report to Congressional Requesters, *Regulatory Programs: Opportunities to Enhance Oversight of the Real Estate Appraisal Industry*, at 3 [GAO-03-404, May 2003], available at <http://www.gao.gov/new.items/d03404.pdf> [accessed Nov. 14, 2011]).

Despite FIRREA’s clear mandate to induce states to regulate real estate appraisers in partnership with federal agencies,⁴ defendants ask us to find that 12 CFR 560.2, a subsequent regulation promulgated by the OTS pursuant to its authority under HOLA, nonetheless, supports preemption. 12 CFR 560.2 (a) states that “OTS is authorized to promulgate regulations that preempt state laws affecting the operations of federal savings associations.” The regulation further provides that “[t]o enhance safety and soundness and to enable federal savings associations to conduct their operations in accordance with best practices (by efficiently delivering low-cost credit to the public ***183** free from undue regulatory duplication and burden), OTS hereby occupies the entire field of lending regulation for federal savings associations.”

Paragraph (b) of 12 CFR 560.2 lists illustrative examples of the categories of state laws, such as mortgage processing and origination, preempted under paragraph (a). 12 CFR 560.2 (c), however, states that certain types of state laws, such as contract and commercial law and tort law, are not preempted “to the extent that they only incidentally affect the lending operations of Federal savings associations.” According to the OTS, in analyzing whether 12 CFR 560.2 preempts a state law, “the first step [is] to determine whether the type of law in ****7** question is listed in paragraph (b). If so, the analysis will end there; the law is preempted” (61 Fed Reg 50951, 50966-50967 [1996]). Applying this first step, we note the examples recorded in paragraph (b) do not mention real estate appraisals. We also conclude, in accord with the Appellate Division, that the Attorney General’s challenge to defendants’ alleged misconduct under state law does not correspond with any of the categories of law

preempted by paragraph (b).

The OTS further instructs that, “[i]f the law is not covered by paragraph (b), the next question is whether the law affects lending. If it does . . . the presumption arises that the law is preempted” (*id.*; see also 12 CFR 560.2 [c]). Here, the crux of the Attorney General’s complaint is that defendants engaged in unlawful and deceptive business practices in that they failed to adhere to the requirements of USPAP. We conclude the Attorney General’s authority to prosecute First American and its subsidiary eAppraiseIT—an independent appraisal management company—for such faulty practices under Executive Law § 63 (12) and General Business Law § 349 is not preempted because, at most, it would incidentally affect the lending operations of a federal savings association (*accord* 1996 Ops Chief Counsel OTS, *RE: Preemption of State Laws Applicable to Credit Card Transactions*, at 10 [Dec. 24, 1996], available at 1996 WL 767462 and http://www.ots.treas.gov/_files/56615.pdf [concluding that impact on lending of an Indiana statute outlawing deceptive acts and practices was “only incidental to the primary purpose of the statute—the regulation of the ethical practices of all businesses ***184** engaged in commerce”]; see also *In re Ocwen Loan Servicing, LLC Mtge. Servicing Litig.*, 491 F3d 638, 643 [7th Cir 2007]).⁵

(^[1]), (^[2]) In conclusion, we hold that FIRREA governs the regulation of appraisal management companies and explicitly envisioned a cooperative effort between federal and state ****8** authorities to ensure that real estate appraisal reports comport with USPAP. We perceive no basis to conclude that HOLA itself or federal regulations promulgated under HOLA preempt the Attorney General from asserting both common law and statutory state law claims against defendants pursuant to its authority under Executive Law § 63 (12) and General Business Law § 349. Thus, defendants’ motion to dismiss on the grounds of federal preemption was properly denied. We also agree with the Appellate Division that the Attorney General has adequately pleaded a cause of action under General Business Law § 349 and that the statute provides him with standing.

Accordingly, the order of the Appellate Division should be affirmed, with costs, and the certified question answered in the affirmative.

Read, J. (dissenting). The Depression-era Home Owners Loan Act (HOLA) (12 USC § 1462 *et seq.*), until recently amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) (Pub L 111-203, 124 US Stat 1376 [2010]), occupied the field of the regulation of federal savings associations (FSAs) and was implemented by the Office of Thrift ***185** Supervision (OTS).¹ Further, HOLA’s broad language “expresse[d] no limits on the [OTS’s] authority to regulate the lending practices of [FSAs],” such that “[i]t

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would have been difficult for Congress to give the [OTS] a broader mandate” (*Fidelity Fed. Sav. & Loan Assn. v De la Cuesta*, 458 US 141, 161 [1982] [internal quotation marks omitted] [discussing the power of the Federal Home Loan Bank Board, OTS’s predecessor]). The issue here is whether the real estate appraisal activities that are the subject of this lawsuit fall within the field occupied by OTS in the exercise of its **9 broad regulatory authority over FSAs, thus preempting this action for injunctive and monetary relief (i.e., disgorgement of profits, including appraisal fees paid by borrowers, restitution and damages) for alleged violations of Executive Law § 63 (12) (fraudulent or illegal business practices), General Business Law § 349 (deceptive acts or practices) and unjust enrichment. The federal courts that have considered the comparable question (in particular, the United States District Court for the Southern District of New York) have answered in the affirmative (see *Cedeno v IndyMac Bancorp., Inc.*, 2008 WL 3992304, 2008 US Dist LEXIS 65337 [SD NY 2008]; *Spears v Washington Mut., Inc.*, 2009 WL 605835, 2009 US Dist LEXIS 21646 [ND Cal 2009]). Since I would not second-guess how the federal courts have reasonably interpreted the preemptive effect of a federal statute, I respectfully dissent.

I.

Federal Preemption under HOLA

To carry out its “broad[] mandate” under HOLA with respect to the lending practices of FSAs, OTS “promulgated *186 regulations governing the powers and operations of every Federal savings and loan association from its cradle to its corporate grave,” and “regulate[d] comprehensively the operations of these associations, including their lending practices and, specifically, the terms of loan instruments” (*De la Cuesta*, 458 US at 145, 161, 167 [internal quotation marks omitted]).

In 12 CFR 560.2 (a), entitled “Occupation of field,” OTS expressed its preemptive intent in the clearest possible terms:

“OTS is authorized to promulgate regulations that preempt state laws affecting the operations of [FSAs] OTS hereby occupies the entire field of lending regulation for [FSAs]. OTS intends to give [FSAs] maximum flexibility to exercise their lending powers in accordance with a uniform federal scheme of regulation. Accordingly, [FSAs] may extend credit as authorized under federal law, including this part, without regard to state laws purporting to regulate or otherwise affect their credit activities, except to the extent provided in paragraph (c) of this section For purposes of this section, ‘state law’ includes any state statute, regulation, ruling, order or judicial decision” (12 CFR 560.2 [a]).

OTS then sets out 13 “[i]llustrative examples” of the “types of state laws preempted by [12 CFR 560.2 (a)], without limitation.” As relevant to this discussion, these examples include

“state laws purporting to impose requirements regarding: **10

“(5) Loan-related fees

“(9) Disclosure and advertising . . . [and]

“(10) Processing, origination, servicing . . . [of] mortgages” (12 CFR 560.2 [b]).

Immediately following the nonexclusive list of types of preempted laws, the regulation identifies types of state laws that “are not preempted to the extent that they only incidentally affect the lending operations of [FSAs] or are otherwise consistent with the purposes of paragraph (a) of this section” (12 CFR 560.2 [c]). These laws include

“(1) Contract and commercial law; (2) Real property law; (3) Homestead laws specified in *187 12 U.S.C. 1462a(f); (4) Tort law; (5) Criminal law; and (6) Any other law that OTS, upon review, finds: (i) Furthers a vital state interest; and (ii) Either has only an incidental effect on lending operations or is not otherwise contrary to the purposes expressed in paragraph (a) of this section” (12 CFR 560.2 [c]).

OTS adopted 12 CFR 560.2 in 1996 to express its “longstanding position . . . on the federal preemption of state laws affecting the lending activities of federal savings associations,” meant to “confirm and carry forward its existing preemption position” (OTS, Final Rule, 61 Fed Reg 50951, 50965 [1996]). Stated another way, OTS explained that

“[b]ecause lending lies at the heart of the business of a federal thrift, OTS and its predecessor . . . have long taken the position that the federal lending laws and regulations occupy the entire field of lending regulation for [FSAs], leaving no room for state regulation. For these purposes, the field of lending regulation has been defined to encompass *all laws affecting lending by federal thrifts, except certain specified areas such as basic real property, contract, commercial, tort, and criminal law*” (*id.* [emphasis added]).

OTS then provided the courts with an interpretive framework for 12 CFR 560.2, as follows:

“When confronted with interpretive questions under § 560.2, we anticipate that courts will, in accordance with well established principles of regulatory construction, look to the regulatory history of § 560.2 for guidance. In this regard, OTS wishes to make clear that the purpose of paragraph (c) is to preserve the traditional

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infrastructure of basic state laws that undergird commercial transactions, not to open the door to state regulation of lending by [FSAs]. When analyzing the status of state laws under § 560.2, the first step will be to determine whether the type of law in question is listed in paragraph (b). If ****11** so, the analysis will end there; the law is preempted. If the law is not covered by paragraph (b), the next question is whether the law affects lending. If it does, then, in accordance with paragraph (a), the presumption arises that the law is preempted. This presumption can be reversed ***188** only if the law can clearly be shown to fit within the confines of paragraph (c). For these purposes, *paragraph (c) is intended to be interpreted narrowly. Any doubt should be resolved in favor of preemption*” (*id.* at 50966-50967 [emphasis added]).

II.

Cedeno

Cedeno was a purported class action brought on behalf of the plaintiff and a similarly situated class of residential home mortgage borrowers against defendant IndyMac, an FSA, and its receiver, the Federal Deposit Insurance Corporation (FDIC). The plaintiff alleged violations of two federal statutes, California’s deceptive practice law and [New York’s General Business Law § 349](#), and claimed breach of contract and unjust enrichment.

IndyMac moved to dismiss all claims, and asserted federal preemption as the basis for dismissing the plaintiff’s state law claims. In deciding the motion, the judge accepted as true the plaintiff’s allegations that IndyMac did not “disclose to the plaintiff that it selected appraisers, appraisal companies and/or appraisal management firms who performed faulty and defective appraisal services which inflated the value of residential properties in order to allow [IndyMac] to complete more real estate transactions and obtain greater profits”; neglected “to provide the necessary insulation and separation between its own internal production or sales personnel responsible for providing the mortgage services . . . and the credit or valuation personnel who were responsible for overseeing and verifying the accuracy of the appraisal services,” which led to “pressure” for “approv[al of] inflated appraisals so that loans and profits could be increased”; failed “to ensure that the appraisals were accurate and allowed its own quality control staff to approve inflated and defective appraisals”; “communicated” to appraisers “that there was a certain ‘target value’ or ‘qualifying value’ necessary to close the loan” so that they “understood that if they met the targeted value, they would be selected for future referral of business from IndyMac”; and “hired appraisal management firms or appraisers whose prior performance repeatedly returned the values needed to match the

qualifying loan values” (2008 WL 3992304, *1, *2, 2008 US Dist LEXIS 65337, *2, *5-6).

189** With respect to IndyMac’s preemption defense, the court first noted that HOLA vested OTS with the “principal responsibility for regulating federally chartered savings associations”; that in 12 CFR 560.2, OTS had stated “its intention to occupy the entire field of the lending regulation for FSAs” and that “[p]ursuant to the plenary authority granted under HOLA to regulate the operations of FSAs,” OTS had issued “extensive regulations governing [their] *12** operations” (2008 WL 3992304, *5, 2008 US Dist LEXIS 65337, *17-18). The judge then turned to 12 CFR 560.2 (b) and (c), observing that included among the “illustrative examples of the types of state laws preempted by OTS regulation” were “state laws purporting to impose requirements regarding loan-related fees (§ 560.2[(b) (5)]), disclosure and advertising (§ 560.2[(b) (9)]), and processing or origination of mortgages (§ 560.2[(b) (10)])”; and that 12 CFR 560.2 (c) “identif[ie]d certain types of state laws, such as state contract, tort, and commercial law, that [were] not preempted to the extent that they only incidentally affect[ed]” a thrift’s “lending operations” (2008 WL 3992304, *5, 2008 US Dist LEXIS 65337, *18-19 [internal quotation marks omitted]).

IndyMac argued that “the plaintiff’s state law claims [were] specifically directed at loan-related fees as contemplated by Section 560.2(b)(5) and directly challenge[d] both IndyMac’s disclosure and advertising and the processing or origination of mortgages as described in Sections 560.2(b)(9) and 560.2(b)(10),” such that “the Court should not even reach the ‘incidental effect’ analysis contained in section (c)” (2008 WL 3992304, *6, 2008 US Dist LEXIS 65337, *19 [internal quotation marks omitted]). To evaluate IndyMac’s argument, the court turned to OTS’s 1996 regulation because “[w]hen considering, as here, *laws that do not on their face purport to impose regulations on the areas listed in paragraph (b)*, it is necessary to determine whether the law, as applied to the claims raised, is the type of law listed in paragraph (b)” (2008 WL 3992304, *6, 2008 US Dist LEXIS 65337, *20 [emphases added]); see also two cases discussed by the court as examples of the foregoing proposition: *Silvas v E*Trade Mtge. Corp.*, 514 F3d 1001 [9th Cir 2008] [holding claims under the California deceptive practice statute for allegedly faulty disclosure and an allegedly improper lock-in fee preempted under 12 CFR 560.2 (b) (9) and (b) (5), respectively] and *In re Ocwen Loan Servicing, LLC Mtge. Servicing Litig.*, 491 F3d 638 [7th Cir 2007] [concluding that some of the claims asserted under the California deceptive ***190** practice statute would be preempted and others would not]). Of course, the plaintiff countered that “her state law claims challenging IndyMac’s appraisal practices [were] state contract and commercial challenges that [fell] within the exceptions outlined in paragraph

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(c),” while IndyMac insisted that she was “merely trying to circumvent HOLA preemption by pleading plainly preempted claims as violations of state contract law and consumer protection statutes” (2008 WL 3992304, *7, 2008 US Dist LEXIS 65337, *22-23).

The judge summed up the issue that he was required to decide as follows:

“The question before the Court is whether the plaintiff’s claims under state contract law and California and New York state deceptive practice statutes are brought in an effort to regulate IndyMac’s appraisal practices *in a way that interferes with an area defined in paragraph (b) or more than incidentally affects IndyMac’s federally regulated thrift operations for purposes of paragraph (c)*” (2008 WL 3992304, *7, 2008 US Dist LEXIS 65337, *23 [emphasis added]).

Evaluating this question first in the context of the California deceptive practice statute, the judge concluded that the plaintiff did, indeed, attempt to apply this statute to “impose requirements in **13 areas explicitly preempted by federal law” because the challenged appraisal practices “appear [ed] to relate directly to the processing or origination of mortgages” and thus fell within 12 CFR 560.2 (b) (10); and “relate[d] directly to the appraisal fee . . . charged in connection with the mortgage,” and thus sought to regulate loan-related fees within the meaning of 12 CFR 560.2 (b) (5) (2008 WL 3992304, *8, 2008 US Dist LEXIS 65337, *25). Further, by challenging the disclosure made to her, the plaintiff also attempted to use the deceptive practices statute “to regulate the disclosures made in connection with the mortgage,” as encompassed by 12 CFR 560.2 (b) (9). The judge therefore opined that “as applied to the plaintiff’s allegations,” the California statute was preempted under 12 CFR 560.2 (b) (*id.*).

Given his disposition of the case, the judge did not need to analyze whether the plaintiff’s claim under the California deceptive practice statute “more than incidentally affect[ed]” lending within the meaning of 12 CFR 560.2 (c). He nonetheless added that the statute also ran afoul of this provision because “[t]he *191 practices the plaintiff [sought] to regulate relate[d] directly to the valuation of the collateral security for loans”; and “[t]he relief the plaintiff [sought] would plainly set particular requirements on IndyMac’s lending operations” (2008 WL 3992304, *8, 2008 US Dist LEXIS 65337, *26).

Applying the same analysis, the court held that the plaintiff’s claim under New York’s General Business Law § 349 was likewise preempted because “[a]s applied to the allegations in this case, [she was] relying on a state law to regulate a loan-related fee, disclosure of information relating to the fee, and the processing and origination of a mortgage,” which were preempted under

12 CFR 560.2 (b) (5), (9) and (10), respectively. Moreover, although it was therefore again unnecessary to analyze the statute’s application under 12 CFR 560.2 (c), the judge concluded that “the New York statute as applied in this case more than incidentally affect[ed] federal thrift lending operations” (2008 WL 3992304, *9, 2008 US Dist LEXIS 65337, *27, *28).

Next, the court addressed the plaintiff’s contract claim and her claim for unjust enrichment. As to the former, the judge first observed that plaintiff did not allege that IndyMac had breached any specific provision of any contract that she had entered into with the thrift; rather, “the gist” of her claim, as was the case with her state statutory claims, was that she was provided with an inaccurate appraisal, thereby breaching the covenant of good faith and fair dealing. The court decided that the plaintiff’s state law claim for breach of contract was foreclosed by 12 CFR 560.2 (10) because “like the claims under California and New York deceptive practice statutes, . . . it relies on state law purporting to impose a requirement on the processing and origination of the mortgage” (2008 WL 3992304, *10, 2008 US Dist LEXIS 65337, *31). And as he had before, the judge also evaluated the claim under 12 CFR 560.2 (c), concluding that the regulation sought by the plaintiff would more than incidentally affect IndyMac’s lending operations. As he explained,

“[t]he contract claim is simply another means to attempt to regulate the method used by IndyMac to assess the value of collateral in securing its loans. Granting the plaintiff the relief she seeks would have the same effect as a direct regulation of appraisal practices—causing IndyMac to alter the *192 methods it uses to evaluate **14 loans and more than incidentally affecting lending operations of federally chartered savings associations” (2008 WL 3992304, *10, 2008 US Dist LEXIS 65337, *32).

Finally, the judge declared that the plaintiff’s unjust enrichment claim failed to state a cause of action “because it [was] a quasi contractual claim and the relationship between the plaintiff and IndyMac [was] regulated by contract”; and “[w]hile there [might] be a dispute as to the scope of the contract, there [was] no dispute as to the existence of the contract between the plaintiff and IndyMac” (*id.*). As a result, any potentially valid claim for unjust enrichment would be preempted for the same reasons stated with respect to the plaintiff’s contract claim.²

Spears

The plaintiffs brought this class action against defendants Washington Mutual Bank FA (WaMu), an FSA, First American eAppraiseIT (a defendant in this case) and

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Lender's Service, Inc. (LSI), claiming that they "participated in a scheme to provide home-loan mortgage borrowers with inflated appraisals of the property they sought to purchase" (2009 WL 605835, *1, 2009 US Dist LEXIS 21646, *2). Specifically, the complaint alleged that WaMu retained First American eAppraiseIT and LSI to run its appraisal program; that subsequently, First American eAppraiseIT and LSI performed virtually all of WaMu's appraisals, and, as a result, WaMu's borrowers became these firms' largest source of business; that WaMu's loan origination staff created a list of "preferred appraisers" to perform appraisals for WaMu borrowers; that WaMu maintained the contractual right with these "preferred appraisers" to challenge an appraisal by requesting reconsideration; that WaMu would use such a request to coerce First American eAppraiseIT and LSI to increase the appraised value of property; and that WaMu asked First American eAppraiseIT and LSI to hire business managers to be given authority to override the values determined by third-party appraisers.

The plaintiffs asserted that this alleged scheme violated a federal law and four provisions of California consumer protection statutes, and constituted a breach of contract and unjust enrichment. After the complaint was filed, the FDIC was *193 substituted as receiver for WaMu, and the plaintiffs stipulated to dismiss all claims against WaMu/the FDIC. First American eAppraiseIT and LSI moved to dismiss all claims.

The defendants argued that the plaintiffs' state statutory claims were preempted by HOLA. The judge followed the analysis employed by the *Cedeno* court under OTS's 1996 regulations—i.e., he first looked at whether, *as applied*, the four state statutory provisions were the type of state law contemplated under 12 CFR 560.2 (b). The plaintiffs based one cause of **15 action on First American eAppraiseIT's alleged unlawful conduct in contravention of the Uniform Standards of Professional Appraisal Practice (USPAP); specifically, the plaintiffs asserted that the appraisal management firm violated USPAP's requirement that "an appraisal be performed with impartiality, objectivity, and independence" (2009 WL 605835, *5, 2009 US Dist LEXIS 21646, *16). They based two other causes of action on the same conduct, asserting that "the impartiality of the offered appraisals constituted unfair and fraudulent business practices" (*id.*) Finally, the plaintiffs alleged in a fourth cause of action that First American eAppraiseIT "represented that their home appraisal services were of a standard or quality that they were not" in violation of state statute (2009 WL 605835, *5, 2009 US Dist LEXIS 21646, *16-17).

The judge concluded that

[e]ach of these claims relate directly to the processing and origination of mortgages. Appraisals are required for many real-estate transactions. 12 C.F.R. 34.43

(requiring a certified or licensed appraisal for all real-estate financial transactions except those falling within enumerated exceptions). And those appraisals must be performed according to certain standards in order to protect the public and federal financial interests. 12 C.F.R. 34.41(b). *Indeed, plaintiffs' theory of the case, that lenders and appraisers conspired to inflate appraisals in order to increase mortgage resale prices, demonstrates the importance and interrelationship of impartial appraisals to mortgage origination and servicing*" (2009 WL 605835, *6, 2009 US Dist LEXIS 21646, *17 [emphases added]).

Citing *Cedeno*, the court held that these state statutory claims, "as applied, relate[d] to the processing and origination of, and *194 participation in, mortgages, and [were] thus preempted under § 560.2(b)(10)" (*id.*).³

III.

Analysis

This complaint and the complaints in *Cedeno* and *Spears* present the same basic storyline: the FSAs (IndyMac in *Cedeno*; WaMu in this case and *Spears*) shifted from a business model where they held real estate mortgages until the underlying loans were repaid by the borrowers to one where they sold security interests in aggregated mortgages in the financial markets; and in order to maximize their profits from this endeavor, the FSAs coerced or conspired with the appraisal management firms to which they outsourced their real estate appraisal work (unidentified appraisal management firms and appraisers in *Cedeno*; First American eAppraiseIT in this case and *Spears*) to inflate the appraised value of the real property backing the home loans that they made. As the majority put it, "the crux of the Attorney General's complaint is that defendants [thereby] engaged in unlawful and deceptive business practices in that they failed to adhere to the requirements of USPAP," as required by 12 CFR 564.4 (majority op at 183).

As an initial matter, there can be no doubt that real estate appraisals affect the lending operations of an FSA. This is why Congress amended HOLA in 1989 by adopting the Financial *195 Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) (Pub L 101-73, 103 US Stat 183). FIRREA expanded federal oversight of FSAs explicitly to include review and regulation of their real estate appraisal practices (12 USC § 3331 *et seq.*). In general, Congress sought thereby to improve lending by requiring real estate appraisals used in connection with federally-related transactions to be performed in writing, in accordance with uniform standards (i.e., USPAP) by competent and independent appraisers (*see* 12 CFR part 564). As the House Report recommending passage of FIRREA pointed out, "[a]ppraisal deficiencies go

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hand-in-hand with poor underwriting and administration standards” (HR Rep 101-54 [I], 101st Cong, 1st Sess, reprinted in 1989 US Code Cong & Admin News, at 96). “Given the crucial role appraisals play in the safety and soundness of the underwriting of real estate related loans and investments,” Congress envisaged that FIRREA would “protect Federal financial and public policy interests in real estate related financial transactions requiring the services of an appraiser” (*id.* at 274).

This suit is preempted because, in substance, and particularly on the allegations before us, it challenges a thrift’s lending practices. The complaint details alleged collusion **16 between thrift managers and appraisers, the precise activity that Congress found would undermine sound real estate loans. Even if it were theoretically possible for a lawsuit in this vein not to be preempted, it cannot be the case here, where the sole relevance of the alleged misrepresentations is how they affected loans and lending. That is, while the State claims that First American eAppraiseIT’s misrepresentations to the public are an independent harm, they are only harmful to the extent they affect *lending practices*; put another way, the only reason the appraisers’ alleged misrepresentations matter is because of the way in which they affected the thrift’s underwriting. Since those matters are properly matters of federal law, this suit should not proceed. For the same reasons, the *Cedeno* and *Spears* courts both determined that allegedly fraudulent real estate appraisal practices concerned mortgages, and that suits seeking to impose liability for these practices were preempted as attempts to impose substantive requirements in an area regulated by OTS (*Cedeno*, 2008 WL 3992304, *8, 2008 US Dist LEXIS 65337, *25; *Spears*, 2009 WL 605835, *6, 2009 US Dist LEXIS 21646 at *17).

The bulk of the complaint in this case alleges, in effect, a failure to disclose, an area that is expressly preempted (*196 12 CFR 560.2 [b] [9]); the Attorney General seeks to recoup the appraisal fees paid to the thrift by borrowers, and laws that affect loan-related fees are also expressly preempted (*id.* 560.2 [b] [5]). More broadly, appraisal is so important to mortgage underwriting that it cannot be separated from the processing or origination of mortgages (*id.* 560.2 [b] [10]), as the courts concluded in *Cedeno* and *Spears*. Even if the Attorney General’s claims arguably do not fall within paragraph (b), they affect lending; therefore, they are presumptively preempted and this presumption “can be reversed only if the law can clearly be shown to fit within the confines of paragraph (c)” (61 Fed Reg at 50966). But the Congressional findings in support of FIRREA make clear that a thrift’s appraisal practices do not merely “incidentally affect” lending within the meaning of paragraph (c); they are, in fact, critical to the making of safe and sound real estate loans. As a result, the Attorney General seeks to regulate practices directly related to the valuation of the collateral security for such home loans

(*see Cedeno*, 2008 WL 3992304, *8, 2008 US Dist LEXIS 65337, *26-27).

The majority bases its conclusion that the Attorney General’s claims are *not* preempted principally on the notion that FIRREA “governs the regulation of appraisal management companies and explicitly envisioned a cooperative effort between federal and state authorities to ensure that real estate appraisal reports comport with USPAP” (majority op at 184).⁴ FIRREA establishes a role for the states, but that role is confined to its traditional one of **17 certifying and licensing individual appraisers (*see* 12 USC §§ 3346-3348).⁵ Notably, FIRREA did not purport to amend HOLA preemption so as to allow the states to regulate *197 a thrift’s real estate appraisal practices. As the Dodd-Frank Act shows, Congress certainly knows how to draft provisions that expressly disclaim any intent to preempt nonconflicting state statutes falling within the same subject area as federal law. And since real estate appraisal activities clearly fall within the subject area pervasively regulated and occupied by HOLA—a thrift’s lending operations—Congress would have to have *expressly* narrowed HOLA preemption by carving out an exception for real estate appraisal practices: by definition, there can be no such thing as an implied exception from field preemption.

Finally, the Attorney General attempts to get around *Cedeno* and *Spears* the only way he can—by characterizing these decisions as “wrongly decided.” He faults both judges for “overlook[ing] the impact of FIRREA on the field-preemption analysis.” This of course assumes that FIRREA altered HOLA preemption with respect to the real estate appraisal activities that are the subject of this lawsuit, a proposition for which—as already explained—there is simply no support. He also notes that the lawsuit in *Cedeno* was brought against the FSA, although the defendant in *Spears* was concededly the appraisal management company—indeed, it was First American eAppraiseIT. The fact is, if the Attorney General’s preemption analysis is correct, it should make no difference whether the appraisal practices addressed in this lawsuit were carried out by the thrift’s in-house appraisers (called “staff appraisers” in the regulations; *see* 12 CFR 564.5 [a]) or outside appraisal firms to which the thrift outsourced its real estate appraisal work (called “fee appraisers” in the regulations; *see id.* 564.5 [b]). OTS’s regulations governing real estate appraisals apply equally to the staff and fee appraisers. As First American eAppraiseIT notes, the Attorney General is merely seeking by this lawsuit to regulate a thrift’s lending **18 activities indirectly by suing the appraisal management company to which the thrift lawfully assigned its authorized banking activities.

In sum, I believe that *Cedeno* and *Spears* were correctly decided. In any event, we should, in my view, adopt the

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federal courts' interpretation of a federal statute unless that interpretation appears to be plainly wrong. And even if one disagrees with the decisions in *Cedeno* and *Spears*, they are certainly reasonable applications of HOLA preemption in the context of real *198 estate appraisal practices relating to the underwriting of home loans made by thrifts. Applying the analysis of those cases to the nearly identical facts here, I conclude that this lawsuit is preempted by HOLA.

Order affirmed, etc.

FOOTNOTES

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Chief Judge Lippman and Judges Graffeo, Smith, Pigott and Jones concur with Judge Ciparick; Judge Read dissents and votes to reverse in a separate opinion.

Footnotes

- ¹ Contrary to defendants' assertion, for purposes of FIRREA, we see no distinction between an individual appraiser and an appraisal management company. FIRREA reaches both.
- ² As relevant here, a "federally related transaction" means "any real estate-related financial transaction which . . . requires the services of an appraiser" (12 USC § 3350 [4] [B]).
- ³ OTS's interpretation of FIRREA remains unchanged. In its 1994 *Interagency Appraisal and Evaluation Guidelines*, rescinded after the release of the 2010 addition, OTS likewise called upon financial institutions "to make referrals directly to state appraiser regulatory authorities when a State licensed or certified appraiser violates USPAP . . . Examiners finding evidence of unethical or unprofessional conduct by appraisers will forward their findings and recommendations to their supervisory officers for appropriate disposition and referral to the state, as necessary" (OTS, Thrift Bulletin, *Interagency Appraisal and Evaluation Guidelines*, at 10 [Nov. 4, 1994], http://www.ots.treas.gov/_files/84042.pdf; see also *First Am. Corp.*, 76 AD3d at 75-76).
- ⁴ We observe that the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (see Pub L 111-203, 124 US Stat 1376), enacted by Congress after the commencement of this lawsuit, confirms this understanding. For example, 12 USC § 3353 (a) (1) requires appraisal management companies to comply with USPAP and "register with and be subject to supervision by a State appraiser certifying and licensing agency in each State in which such company operates." Significantly, that statute states that "[n]othing in this section shall be construed to prevent States from establishing requirements in addition to any rules promulgated" herein (12 USC § 3353 [b]; see also 12 USC § 1465 [b] [observing that HOLA "does not occupy the entire field in any area of State law" unless such state law conflicts with federal law]).
- ⁵ In concluding that HOLA preempts this lawsuit, our dissenting colleague principally relies on the analysis of two federal district court cases, *Cedeno v IndyMac Bancorp, Inc.* (2008 WL 3992304, 2008 US Dist LEXIS 65337 [SD NY 2008]) and *Spears v Washington Mut., Inc.* (2009 WL 605835, 2009 US Dist LEXIS 21646 [ND Cal 2009]). According to the dissent, this Court should "adopt the federal courts' interpretation of a federal statute unless that interpretation appears to be plainly wrong" (dissenting op at 197). We observe, however, that other federal district courts, consistent with our analysis, have concluded that HOLA does not preempt claims related to real estate appraisals (see e.g. *Bolden v KB Home*, 618 F Supp 2d 1196, 1205 [CD Cal 2008] [finding that OTS regulations under HOLA do not preempt plaintiffs' claims since those "claims relate to real estate appraisal standards, whereas . . . HOLA was concerned with the credit activities of federal savings associations"]; *Fidelity Natl. Info. Solutions, Inc. v Sinclair*, 2004 WL 764834, 2004 US Dist LEXIS 6687 [ED PA 2004] [concluding that state laws regulating real estate appraisals do not target federal savings associations or national bank operations]).
- ¹ The Dodd-Frank Act brought about a sea change in HOLA preemption: the Act provides that HOLA does *not* occupy the field in any area of law, and conforms the preemption standard applicable to FSAs to the conflict preemption standard for national banks delineated by the United States Supreme Court in *Barnett Bank of Marion Cty., N. A. v Nelson* (517 US 25, 31 [1996] [state laws may be preempted where they are in "irreconcilable conflict" with federal statutes, which may occur where compliance with both laws is impossible, or where the state law is "an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" (citations omitted)]; see 12 USC § 1465 [a], [b]). Defendants First American Corporation and First American eAppraiseIT readily acknowledge that the Attorney General's lawsuit would *not* be preempted under the Dodd-Frank Act's conflict preemption standard. The new standard for FSAs is not retroactive, however, and only became effective on July 21, 2011, the date when OTS was transferred to the Office of the Comptroller of the Currency (OCC) (see Pub L 111-203, tit X, §§ 1046, 1047 [b]; § 1048, 124 US Stat 1376, 2017). On October 19, 2011, 90 days after this transfer, OTS ceased to exist (see 12 USC § 5413).
- ² The court also determined that the plaintiff failed to state a claim under either of the federal laws asserted, and so dismissed the complaint.

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- ³ In addition to dismissing the four state statutory claims on the basis of HOLA preemption, the court also granted LSI's motion to dismiss on the basis of lack of standing; denied First American eAppraiseIT's motion to dismiss one of the two claims asserted under federal law, and granted its motion to dismiss the other one; granted its motion to dismiss the breach of contract claim; and granted the plaintiffs 20 days' leave to amend. Although the judge concluded that the plaintiffs failed to plead an action for breach of contract, he advised them that in the event they chose to amend their breach of contract claim, he would revisit the issue of preemption with respect to it. He also decided that the unjust enrichment claim was subject to dismissal under California law because it had the same basis as the single federal law claim remaining in the action, which furnished an adequate alternative form of relief. Finally, the judge agreed with First American eAppraiseIT that, even if the state law claims had not been preempted, the plaintiffs failed to state a claim because there was no showing of actual damages, as required by the statutes; i.e., "[b]ecause plaintiffs would have had to pay for the appraisal in order to take out the loan, they would have paid an appraisal fee whether the appraisal provided was defective or not. That is, had the appraisal been performed lawfully and in good faith, plaintiffs provide[d] no basis on which to conclude that they would have been better off" (2009 WL 605835, *1, 2009 US Dist LEXIS 21646,*19).
- ⁴ The majority asserts that two federal district courts' opinions are "consistent with [its] analysis" (majority op at 184 n 5). Unlike *Cedeno* and *Spears*, the facts and legal issues in those cases do not correspond with the facts and legal issues here. For example, in *Bolden v KB Home* (618 F Supp 2d 1196, 1201 [CD Cal 2008]), the issue was whether FIRREA or the OTS regulation created "complete preemption," a concept distinct from field preemption—and not an issue in this case—which pertains to whether a federal statute so displaces a state cause of action that, even if pleaded under state law, it actually arises under federal law and creates removal jurisdiction (see e.g. *Beneficial Nat. Bank v Anderson*, 539 US 1, 6-8 [2003]). *Fidelity Natl. Info. Solution, Inc. v Sinclair* (2004 WL 764834, *1-3, 2004 US Dist LEXIS 6687, *1-8 [ED Pa 2004]) directly concerned a state's authority to require those performing appraisals to be licensed, not whether appraisals affected FSAs' lending operations.
- ⁵ Even there, OTS cautioned that it might "from time to time, impose additional qualification criteria for certified appraisers performing appraisals in connection with federally related transactions within its jurisdiction" (see 12 CFR 564.2 [j]).

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Only the Westlaw citation is currently available.
United States District Court,
E.D. New York.

FEDERAL DEPOSIT INSURANCE
CORPORATION, in its Capacity as Receiver for
Netbank, FSB Plaintiff,

v.

Sidney HOYLE and Sidney Hoyle DBA Sidney
Hoyle Appraisers, Defendants.

No. 10–CV–4245 (JG)(VVP). | Aug. 2, 2012.

Attorneys and Law Firms

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Neufeld & O’Leary, New York, NY, for Plaintiff.

REPORT AND RECOMMENDATION

POHORELSKY, United States Magistrate Judge.

*1 This matter was referred by the Honorable John Gleeson to the undersigned to issue a Report and Recommendation concerning the plaintiff’s motion for a default judgment against the defendants Sidney Hoyle and Sidney Hoyle d/b/a Sidney Hoyle Appraisers (“Hoyle” or “defendants”). The plaintiff’s claims stem from the defendants’ alleged negligence in performing an appraisal of real property for a mortgage loan transaction. The plaintiff seeks \$355,365.22 in damages based on the defendants’ default.¹As discussed below, the court concludes that liability is established by the defendants’ default and that judgment should be entered awarding damages in the amount of \$265,000 plus prejudgment interest.

I. ENTRY OF DEFAULT JUDGMENT

The plaintiff Federal Deposit Insurance Corporation (“FDIC”) is a corporation and instrumentality of the United States, organized and existing pursuant to 12 U.S.C. § 1811 *et seq.* The defendants are Sidney Hoyle and the company through which he conducts his appraisal business, Sidney Hoyle Appraisers. The plaintiff FDIC

brings this case in its capacity as the receiver of NetBank, a failed national bank previously operating in Alpharetta, Georgia. Following NetBank’s failure, its bank charter was revoked, and its assets were placed in a FDIC receivership. Complaint ¶ 13. As receiver, the FDIC operates as NetBank’s successor in interest. Complaint ¶ 14. Jurisdiction in this court is based on 28 U.S.C. § 1345 and 12 U.S.C. § 1819(b)(2)(A), which provides that “all suits of a civil nature at common law or in equity to which the [FDIC], in any capacity, is a party shall be deemed to arise under the laws of the United States.”Accordingly, the FDIC may bring suit on behalf of NetBank, as it has done here.

“It is well established that a party is not entitled to a default judgment as a matter of right; rather the entry of a default judgment is entrusted to the sound judicial discretion of the court.”*Cablevision of S. Conn. v. Smith*, 141 F.Supp.2d 277, 281 (D.Conn.2001) (quoting *Shah v. N.Y. State Dep’t of Civil Servs.*, 168 F.3d 610, 615 (2d Cir.1999) (internal quotation marks omitted)). When deciding whether to enter default, the court considers various factors, including, (1) the amount of money involved; (2) whether issues of fact or of substantial public importance are at stake; (3) whether the default is largely technical; (4) whether the plaintiff has been substantially prejudiced by the delay; (5) whether the grounds for default are clearly established; (6) whether the default was caused by a good-faith mistake or excusable neglect; (7) how harsh an effect default would have; and (8) whether the court believes it later would be obligated to set aside the default on defendant’s motion. *Cablevision of S. Conn.*, 141 F.Supp.2d at 281 (citing 10 Moore’s Federal Practice § 55.20(2)(b) (3d ed.1999)). In civil actions, when a party fails to appear after being given notice, the court normally has justification for entering default. *Bermudez v. Reid*, 733 F.2d 18, 21 (2d Cir.1984).

*2 The plaintiff FDIC asserts claims for breach of contract, negligence, and negligent misrepresentation in connection with the defendants’ appraisal of real property. The plaintiff has filed the affidavit of a process server attesting to service of the summons, complaint, civil cover sheet, and individual practices of Judge Gleeson upon the defendants. *See* Affidavit of Service by Nelson Carvajal [DE 9]. After four attempts to serve the defendants in person, the process server completed service of process by affixing the papers on a front gate at Hoyle’s address and mailing the papers to the same address. *Id.* Such method of service is authorized by Section 308 of the New York Civil Practice Laws and Rules and Rule 4(e) of the Federal Rules of Civil Procedure. The defendants

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have failed to answer or otherwise defend this action. Plaintiff's Mem. at 1. Nor have the defendants responded to the plaintiff's application for default. The plaintiff moved for a default judgment, and on January 9, 2012, the Clerk of Court entered a default against the defendants pursuant to [Federal Rule of Civil Procedure 55](#). Clerk's Entry of Default as to Sidney Hoyle and Sidney Hoyle d/b/a/ Sidney Hoyle Appraisers, 1/09/2012 [DE 18].

The grounds for default are therefore clearly established, and there are no grounds for believing the default is based on a good-faith mistake or technicality. *See Cablevision Systems N.Y.C. Corp. v. Leath*, No. 01-CV-9515, 2002 WL 1751343, at *2 (S.D.N.Y. July 26, 2002) (default willful where defendant never responded to complaint, appeared or explained default). Based on the defendants' inaction, it is unlikely that the court will be compelled at some future date to enter an order vacating the default judgment. Judgment by default should therefore be granted so long as liability and damages are appropriately established.

II. LIABILITY

Given the default, the well-pleaded allegations of the complaint are deemed admitted, except as to the amount of damages. *See, e.g., Greyhound Exhibitgroup, Inc. v. E.L. U.L. Realty Corp.*, 973 F.2d 155, 158 (2d Cir.1992); *Au Bon Pain Corp. v. Arctect, Inc.*, 653 F.2d 61, 65 (2d Cir.1981). The plaintiff is entitled to all reasonable inferences in its favor. *Finkel v. Romanowicz*, 577 F.3d 79, 84 (2d Cir.2009) (citing *Au Bon Pain Corp.*, 653 F.2d at 65). In a motion for a default judgment, the court considers the complaint in its entirety, as well as documents incorporated into the complaint by reference. *Mayflower Transit, LLC v. Colvin*, No. 11-CV-663, 2011 WL 4975793, at *2 (E.D.N.Y. Sept. 20, 2011), *report and recommendation adopted by* 2011 WL 5024291 (E.D.N.Y. Oct 19, 2011). Liability does not automatically attach from the well-pleaded allegations of the complaint, however, as it remains the court's responsibility to ensure that the factual allegations, accepted as true, provide a proper basis for liability and relief. *See Au Bon Pain Corp.*, 653 F.2d at 65.

*3 The well-pleaded allegations of the complaint establish the following facts. Meritage Mortgage Corporation ("Lender"), through its agent Lorenzo Mortgage Company ("Lorenzo Mortgage") hired the defendants to perform an appraisal of real property in connection with a mortgage financing transaction between Lender and Mohammed A. Mamun ("Borrower").² Complaint ¶¶ 6, 28. The purpose of the appraisal was to determine the value of the property in order to decide whether or not to

make a loan to Borrower, and if so, in what amount. *See id.* ¶ 23. For this transaction, Lender had set the loan-to-value ratio ("LTV") at 100%. *Id.* ¶ 24. This meant that in order for Lender to finance a loan in the amount for which Borrower applied (\$525,000), the property appraisal had to equal or exceed \$525,000. *Id.* ¶ 24.

The Appraisal Report prepared by Hoyle, dated December 7, 2005, valued the subject property ("Subject Property") at \$550,000.³*Id.* ¶ 32. As a result of the information in the Appraisal, Lender approved the loan as it met the LTV of 100%. *Id.* ¶ 33. Borrower, however, defaulted before making his first payment. *Id.* ¶ 20. On September 25, 2007, NetBank sold the Subject Property for \$260,000. *Id.* ¶ 22.

The complaint alleges that the defendants prepared the Appraisal Report in a manner that violated the Uniform Standards of Professional Appraisal Practice ("USPAP") and inflated the value of the Subject Property by \$177,500. *Id.* ¶¶ 34, 37-40. Had the Subject Property been appraised correctly, its value would have been \$372,500 as of December 7, 2005. *Id.* ¶ 41. Based on this violation of professional standards, the complaint asserts three claims against the defendants: (1) negligence; (2) negligent misrepresentation; and (3) breach of contract. As discussed below, the court finds that the allegations of the complaint sufficiently establish the defendants' liability on all three claims.

A. Breach of Contract

As an initial matter, the court finds that the plaintiff FDIC has standing to pursue the claims in the complaint based on the transaction the defendants entered into with Lorenzo Mortgage. The complaint alleges that there is an agency relationship between Lorenzo Mortgage and Lender. Complaint ¶ 78. A contract made on behalf of a principal by its agent is a contract of the principal. *See, e.g., Parola v. Lido Beach Hotel, Inc.*, 99 A.D.2d 465, 470 N.Y.S.2d 44 (2d Dep't 1984). Agency is "a fiduciary relationship which results from the manifestation of consent of one person to allow another to act on his or her behalf and subject to his or her control, and consent by the other so to act."*Maurillo v. Park Slope U-Haul*, 194 A.D.2d 142, 146, 606 N.Y.S.2d 243, 246 (2d Dep't 1993) (citations omitted); *see, e.g., Time Warner City Cable v. Adelphi Univ.*, 27 A.D.3d 551, 552, 813 N.Y.S.2d 114, 116 (2d Dep't 2006). Here, the complaint alleges that Lender employed the defendants through Lorenzo Mortgage for the express purpose of an appraisal on the Subject Property. Complaint ¶ 28. The complaint also alleges that Lender paid Hoyle through Lorenzo Mortgage. *Id.* ¶ 81, 813 N.Y.S.2d 114. These allegations

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are sufficient to establish an agency relationship between Lender and the defendants. The complaint further alleges that Lender transferred all of its interests in the loan to NetBank. *Id.* ¶ 9, 813 N.Y.S.2d 114. Viewing the allegations in the complaint in the light most favorable to the plaintiff, the court takes this statement to mean that the interests transferred included the right to sue Hoyle for harm resulting from the Appraisal Report. Finally, as receiver of NetBank, the plaintiff FDIC may bring all actions on behalf of NetBank. The link between the defendants and the plaintiff has thus been adequately pleaded, and there is no issue as to the plaintiff FDIC's standing to bring this suit.

*4 The plaintiff also pleads sufficient facts to maintain a claim for breach of contract. The elements of a breach of contract action are "(1) the existence of an agreement, (2) adequate performance of the contract by the plaintiff, (3) breach of contract by the defendant, and (4) damages." *Eternity Global Master Fund Ltd. v. Morgan Guar. Trust Co. of N.Y.*, 375 F.3d 168, 177 (2d Cir.2004) (quoting *Harsco Corporation v. Segui*, 91 F.3d 337, 348 (2d Cir.1996)). The complaint alleges that Lender retained the defendants for the express purpose of appraising the Subject Property "per the Financial Industry Reform, Recovery and Enforcement Act of 1989 ... and the Uniform Standards of Professional Appraisal Practice...." Complaint ¶ 28. The allegations are silent as to whether the agreement was oral or in writing. "[M]anifestation of mutual assent," however, need only be "sufficiently definite to assure that the parties are truly in agreement with respect to all material terms." *See Express Indus. & Terminal Corp. v. N.Y. State Dep't of Transp.*, 93 N.Y.2d 584, 589, 693 N.Y.S.2d 857, 715 N.E.2d 1050 (1999) (citing *Martin Delicatessen v. Schumacher*, 52 N.Y.2d 105, 109, 436 N.Y.S.2d 247, 417 N.E.2d 541); *see also Maffea v. Ippolito*, 247 A.D.2d 366, 367, 668 N.Y.S.2d 653, 654 (2d Dep't 1998). Furthermore, oral agreements can be binding and enforceable absent a clear expression of intent to be bound only by a writing. *See, e.g., Wisdom Import Sales Co. v. Labatt Brewing Co.*, 339 F.3d 101, 109 (2d Cir.2003) (citing *R.G. Group, Inc. v. Horn & Hardart Co.*, 751 F.2d 69, 74-75 (2d Cir.1984)). The complaint does not indicate any intent by the parties to be bound only by a writing. Thus, Lender's employment of Hoyle, whether agreed upon orally or in writing, created an agreement sufficient to satisfy the first element of the plaintiff's claim. The complaint further alleges that Lender paid Hoyle for his services through Lorenzo Mortgage (Complaint ¶ 81), establishing performance on the part of the plaintiff to meet the second element of the claim.

The third element, breach, is met based on the plaintiff's allegations that the defendants prepared their appraisal in a negligent manner. Under New York law, a professional performing work under a contract impliedly agrees to exercise reasonable care and skill in the completion of his contractual duties. *See Vitol Trading S.A., Inc. v. SGS Control Servs., Inc.*, 680 F.Supp. 559, 567 (S.D.N.Y.1987) *rev'd on other grounds*, 874 F.2d 76 (2d Cir.1989) (reversing the district court's award of damages, but affirming its finding of breach of contract based on the defendant's failure to perform in a workman-like manner). The complaint alleges that compliance with USPAP and the use of appropriate comparables form part of the ordinary professional obligations of an appraiser. *See* Complaint ¶¶ 48-50. The defendants have also certified their compliance with USPAP and the selection of accurate comparable sales, indicating that the defendants understood these obligations to be part of their contractual duties. *See* Appraisal Report at 7. Thus, as imposed by law and evinced by the Appraisal Report, compliance with USPAP and the selection of appropriate comparables constituted implied terms of the agreement between the defendants and Lender. Here, the complaint alleges that the defendants selected comparable sales that were locationally, physically and functionally not the most similar to the Subject Property. Complaint ¶ 38. Moreover, comparable # 2 was a new twofamily home, even though the Subject Property was a single-family home. *Id.* The Appraisal Report further failed to note prior transfer history of comparables # 1 and # 3. *Id.* ¶ 39. The defendants' failure to skillfully select and accurately represent the comparables was a violation of USPAP. *Id.* ¶ 51. By failing to comply with USPAP, the defendants breached their agreement with Lender.

*5 Lastly, the plaintiff alleges that it suffered direct damages as a result of the defendants' breach. NetBank made a loan that it otherwise would not have approved, *id.* ¶¶ 56, 73, 86, leading to financial loss when the loan defaulted and the proceeds from the sale of the foreclosed property were insufficient to repay the loan. *Id.* ¶¶ 20, 22. For these reasons, the elements of the plaintiff's breach of contract claim have been sufficiently established for the purposes of a default judgment.

B. Negligence

In the alternative, and should its contract claim fail, the FDIC asserts a claim for "negligence" in its second cause of action. The court finds that the complaint has adequately alleged a claim for negligence by the defendants.⁵ The elements of a cause of action in negligence are (1) a duty on the part of the defendant as to

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the plaintiff; (2) a breach of this duty; and (3) injury to the plaintiff as a result. See *Akins v. Glens Falls City Sch. Dist.*, 53 N.Y.2d 325, 333, 441 N.Y.S.2d 644, 424 N.E.2d 531 (1981) (citations omitted); *Greenberg, Trager & Herbst, LLP v. HSBC Bank USA*, 17 N.Y.3d 565, 576, 934 N.Y.S.2d 43, 958 N.E.2d 77 (2011).

The element of duty is established because appraisers, as professionals, have a legal duty to perform their work competently. See *Oestreicher v. Simpson*, 243 N.Y. 635, 154 N.E. 636 (1926); see also *Chemical Bank v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 74 A.D.2d 786, 787, 425 N.Y.S.2d 818, 819 (1st Dep't 1980) (holding that a real estate appraiser assumes a duty of care to the financing party if it was known that a financing party would rely on its appraisal); *Navarre Hotel & Importation Co. v. American Appraisal Co.*, 156 A.D. 795, 797-98, 142 N.Y.S. 89, 91-92 (1st Dep't 1913) (holding that an appraisal company may be held liable to an undisclosed principal for negligent appraisal of property). Compliance with USPAP forms a part of an appraiser's ordinary professional obligations to prepare credible and reliable appraisals. Complaint ¶ 48; see also *Albert Aff.* ¶¶ 11-12. The defendants' duty of care extended specifically to the plaintiff because the defendants "knew ... that the Appraisal ... would be used by Lender for the ... purpose of the Loan...." Complaint ¶ 53.

The defendants' failure to comply with USPAP constitutes a breach of a duty to the plaintiff. Complaint ¶¶ 48, 51. In *Oestreicher*, the Court of Appeals upheld a claim for negligence against an appraisal company whom the plaintiff hired to appraise jewelry and who fixed the value at twice its actual worth. 243 N.Y. at 635. The defendants in this case likewise prepared an appraisal that inflated the property's value by \$177,500. The inflated figure resulted from the defendants' failure to choose appropriate comparables and failure to disclose the comparables' past transfer histories. Complaint ¶¶ 38-40. Both actions were violations of USPAP. *Id.* ¶ 51. As a result, Lender approved a loan transaction it would not have otherwise approved, causing it damages in the value of the loan. *Id.* ¶¶ 56-59. The foregoing allegations in the complaint, admitted to be true by the defendants' default, are sufficient to establish liability on a claim of negligence.

C. Negligent Misrepresentation

*6 The facts as alleged in the complaint are also sufficient to establish a claim of negligent misrepresentation. A claim for negligent misrepresentation resulting only in economic injury "requires that the underlying relationship between the parties be one of contract or the bond

between them so close as to be the functional equivalent of contractual privity." *Ossining Union Free Sch. Dist. v. Anderson LaRocca Anderson*, 73 N.Y.2d 417, 419, 541 N.Y.S.2d 335, 539 N.E.2d 91 (1989); see also *Parrott v. Coopers & Lybrand, L.L.P.*, 95 N.Y.2d 479, 483, 718 N.Y.S.2d 709, 741 N.E.2d 506 (2000) (citations omitted). As discussed above, Lender, through Lorenzo Mortgage, contracted directly with Hoyle. The relationship between the plaintiff and the defendants as alleged is thus one of contractual privity.

The complaint's allegations also meet the remaining elements for negligent misrepresentation. They are (1) awareness by a declarant that a statement is to be used for a particular purpose, (2) reliance by a known party on the statement in furtherance of that purpose, and (3) some conduct by the declarant linking it to the relying party and evincing its understanding of that reliance. See *Credit Alliance Corp. v. Arthur Andersen & Co.*, 65 N.Y.2d 536, 551, 493 N.Y.S.2d 435, 483 N.E.2d 110 (1985). The allegations establish the defendants' awareness of the particular purpose of the appraisal based on portions of the Appraisal Report that state that the "intended use" of the report is a mortgage finance transaction. Complaint ¶¶ 30, 70; see also Appraisal Report at 6. Relying on the appraised value of the Subject Property, and in furtherance of the mortgage finance transaction, Lender approved Borrower's loan. Complaint ¶ 71. Furthermore, Lender was a party known to the defendants because the Appraisal Report states that the "intended user" is the "lender/client." *Id.* ¶¶ 30, 72, 493 N.Y.S.2d 435, 483 N.E.2d 110; see also Appraisal Report at 6. The third element of the claim is met because the defendants prepared and presented the appraisal to Lorenzo Mortgage, Lender's agent. Complaint ¶ 68. The Appraisal Report also specifically states on its face that it was prepared for "Lorenzo Mortgage Company and it's [sic] successors and it's [sic] assigns." See *id.* ¶ 30, 493 N.Y.S.2d 435, 483 N.E.2d 110; see also Appraisal Report at 1. The complaint's allegations are therefore sufficient to support a claim of negligent misrepresentation.

III. STATUTE OF LIMITATIONS

The plaintiff FDIC brought this suit in a timely manner. Determining the timeliness of an action brought by the FDIC as receiver involves a two-part analysis. *FDIC v. Abel*, No. 92-CV9175, 1995 WL 716729, at *10 (S.D.N.Y. Dec.6, 1995). First, the Financial Institutions Reform Recovery and Enforcement Act of 1989 ("FIRREA"), provides the FDIC with a six-year statute of limitations for contract claims and a three-year limit for tort claims, starting from the date the FDIC assumed its receivership. See 12 U.S.C.A. § 1821(d)(14); see also

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F.D.I.C. v. Pelletreau & Pelletreau, 965 F.Supp. 381, 385 (E.D.N.Y.1997); *FDIC v. Abel*, 1995 WL 716729, at *10. Second, the FIRREA limitations period only applies if the FDIC's claim was viable under state law on the date the FDIC assumed its receivership. *FDIC v. Abel*, 1995 WL 716729, at *10 (“FIRREA does not revive stale claims.”(citing *FDIC v. Henderson*, 61 F.3d 421, 423 (5th Cir.1995))). As to the first question of the timeliness of the FDIC's filing, here, the FDIC accepted its appointment as receiver of NetBank on September 28, 2007. The FDIC filed its complaint with this court on September, 17, 2010, which was less than three years after its appointment. Complaint ¶ 13. The plaintiff's contract and tort claims are thus timely under FIRREA's limitations period.

*7 The next question as to whether the plaintiff's claims were viable at the time of the FDIC's appointment requires the court to determine the relevant statute of limitations and date of accrual for each of the plaintiff's claims under state law. Turning first to the statute of limitations, although the plaintiff's causes of action are titled as breach of contract, negligence, and negligent misrepresentation, its allegations of breach of professional standards of care evoke the New York claim for professional malpractice, which carries its own statute of limitations under N.Y. C.P.L.R. 214(6). See Complaint ¶¶ 47, 64 (“Appraiser and Appraisal Company, in their professional capacity, owed Lender a duty to conform to a certain standard of conduct...”). N.Y. C.P.L.R. 214(6) provides for a three-year statute of limitations for “action[s] to recover damages for malpractice, other than medical, dental or podiatric malpractice.” See N.Y. C.P.L.R. 214(6). New York state courts define malpractice as “negligence of a member of a profession in his relations with his client or patient.” *Cubito v. Kreisberg*, 69 A.D.2d 738, 742, 419 N.Y.S.2d 578, 580 (2d Dep't 1979), *aff'd*, 51 N.Y.2d 900, 434 N.Y.S.2d 991, 415 N.E.2d 979 (1980); see also *Chase Scientific Research, Inc. v. NIA Group, Inc.*, 96 N.Y.2d 20, 23, 725 N.Y.S.2d 592, 749 N.E.2d 161 (2001) (defining malpractice as “professional misfeasance toward one's client”). The term “professionals,” in the context of N.Y. C.P.L.R. 214(6), refers generally to those professions that require “extensive formal learning and training,” “licensure and regulation,” “a code of conduct,” and “a system of discipline.” *Chase Scientific Research, Inc.*, 96 N.Y.2d at 29, 725 N.Y.S.2d 592, 749 N.E.2d 161 (citations omitted).⁶ Real estate appraisers have been considered professionals by New York courts. See *Early v. Rossback*, 262 A.D.2d 601, 692 N.Y.S.2d 465 (2d Dep't 1999), *rev'd on other grounds sub nom. Brothers v. Florence*, 95 N.Y.2d 290, 716 N.Y.S.2d 367, 739 N.E.2d 733 (2000).

N.Y. C.P.L.R. 214(6), furthermore, applies to all of the claims pursued by the plaintiff here, notwithstanding the fact that the plaintiff has brought one claim based in contract and two claims based in tort. Prior to the 1996 amendment to N.Y. C.P.L.R. 214(6), “case law provided that the applicable Statute of Limitations for an appraiser malpractice claim turned on the remedy sought. If a tort remedy was sought, the applicable Statute of Limitations was three years, whereas if a contract remedy was sought, the applicable Statute of Limitations was six years.” *Early*, 262 A.D.2d at 602, 692 N.Y.S.2d at 466 (internal citations omitted), *rev'd on other grounds sub nom. Brothers v. Florence*, 95 N.Y.2d 290, 716 N.Y.S.2d 367, 739 N.E.2d 733 (2000). The amendment effectively eliminated that distinction. See N.Y. C.P.L.R. 214(6) (“an action to recover damages for malpractice ... regardless of whether the underlying theory is based in contract or tort”); see, e.g., *Morson v. Kreindler & Kreindler, LLP*, 814 F.Supp.2d 220, 227 (E.D.N.Y.2011) (holding that N.Y. C.P.L.R. 214(6) applied to breach of contract and breach of fiduciary duty claims against defendant attorneys because the claims were based on the same alleged conduct that formed plaintiff's legal malpractice claim). All three of the plaintiff's claims here are brought on the basis of professional negligence, as evidenced by the complaint's allegations regarding a professional duty of care for appraisers and the defendants' failure to conform to that duty. See Complaint ¶¶ 47–51, 64–68, 82–84. Accordingly, the three-year statute of limitations under C.P.L.R. 214(6) applies to each of the plaintiff's claims.

*8 For the date of accrual, the court also looks to the standard applicable to malpractice claims. See *Morson*, 814 F.Supp.2d at 227. Under New York law, “[a]n action for malpractice accrues at the date of the malpractice complained of.” *Glamm v. Allen*, 57 N.Y.2d 87, 93, 453 N.Y.S.2d 674, 439 N.E.2d 390 (1982) (citation omitted); see also *Williamson ex rel. Lipper Convertibles, L.P. v. PricewaterhouseCoopers LLP*, 9 N.Y.3d 1, 7–8, 840 N.Y.S.2d 730, 872 N.E.2d 842 (2007) (“A claim accrues when the malpractice is committed, not when the client discovers it.”) (citations omitted). For appraiser malpractice actions, the date of malpractice is the date on which the appraisal was completed. See *Early*, 262 A.D.2d at 601–02, 692 N.Y.S.2d at 466 (holding that appraiser malpractice claims were timebarred based on the date of the last appraisal performed by the defendants), *rev'd on other grounds sub nom. Bros. v. Florence*, 95 N.Y.2d 290, 716 N.Y.S.2d 367, 739 N.E.2d 733 (2000); cf. *Ackerman v. Price Waterhouse*, 84 N.Y.2d 535, 541, 620 N.Y.S.2d 318, 644 N.E.2d 1009 (1994) (holding that in the context of a malpractice action against

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an accountant, the plaintiff's claim accrued upon receipt of the accountant's work product because this is the point at which a client reasonably relies on the accountant's advice and can become liable for tax deficiencies). Thus, the earliest date of accrual here is December 7, 2005, the date on which the defendants completed and drafted their Appraisal Report. Complaint ¶ 29. Applying the three-year statute of limitations under N.Y. C.P.L.R. 214(6) to this date, the court finds that the plaintiff's claims were viable on September 28, 2007, the date on which the FDIC assumed its receivership position. As such, the plaintiff's claims are timely.

IV. DAMAGES

The plaintiff has requested damages of \$265,000 as its "principal loss," plus prejudgment interest of \$90,365.22. Plaintiff's Mem. at 8–9, 11–12. The plaintiff derives this "principal loss" figure from the difference between the amount of the loan (\$525,000) and the price at which Lender sold the subject property upon foreclosure (\$260,000). The prejudgment interest represents the interest accrued from June 25, 2007, the date of the foreclosure sale, to April 8, 2011, at the New York statutory rate of 9%. In support, the plaintiff has included the affidavit of Karen Freeborn setting forth the foreclosure sale price of \$260,000, which is corroborated by a Real Property Transfer Report. See Freeborn Aff. [DE 16–8]; New York Real Property Transfer Report [DE 16–7].⁷ As discussed below, the court finds that the plaintiff is entitled to the compensatory damages amount requested, as well as the prejudgment interest accrued until the date of judgment.

A. Standard

Federal Rule 55(b) requires the court to make an independent assessment of damages when deciding a motion for default judgment. See *SEC v. Mgmt. Dynamics, Inc.*, 515 F.2d 801, 814 (2d Cir.1975). Damages are proven through an evidentiary hearing or through affidavits and other documentary submissions that provide a factual basis for determining the amount of damages to be awarded. See *Greyhound Exhibitgroup v. E.L. U.L. Realty Corp.*, 973 F.2d 155, 158 (2d Cir.1992); *Transatlantic Marine Claims Agency, Inc. v. Ace Shipping Corp.*, 109 F.3d 105, 111 (2d Cir.1997). Having provided notice to the defaulting defendant, the court is able to receive documentary evidence in lieu of holding an evidentiary hearing on damages. See, e.g., *Transatlantic Marine*, 109 F.3d at 111 ("We have held that, under Rule 55(b)(2), 'it [is] not necessary for the District Court to hold a hearing, as long as it ensured that there was a basis

for the damages specified in the default judgment." (quoting *Fustok v. ContiCommodity Servs. Inc.*, 873 F.2d 38, 40 (2d Cir.1989)) (citation omitted)). Here, the court has not held a hearing but is in receipt of the affidavits and other documents provided by the plaintiff to support its damages claims.

B. Analysis

*9 "It is well settled that in breach of contract actions 'the nonbreaching party may recover general damages which are the natural and probable consequence of the breach.'" *Bi-Econ. Mkt., Inc. v. Harleysville Ins. Co. of N.Y.*, 10 N.Y.3d 187, 192, 856 N.Y.S.2d 505, 886 N.E.2d 127 (2008) (quoting *Kenford Co. v. Cnty. of Erie*, 73 N.Y.2d 312, 319, 540 N.Y.S.2d 1, 537 N.E.2d 176 (1989)). "[D]amages for breach of contract should put the plaintiff in the same economic position he would have been in had the defendant fulfilled the contract." *Lucente v. Int'l Bus. Machs. Corp.*, 310 F.3d 243, 262 (2d Cir.2002) (citing *Indu Craft, Inc. v. Bank of Baroda*, 47 F.3d 490, 495 (2d Cir.1995)). Likewise for tort actions, "a plaintiff must prove that a defendant's breach directly and proximately caused his or her damages." *Nat'l Mkt. Share, Inc. v. Sterling Nat. Bank*, 392 F.3d 520, 525 (2d Cir.2004) (emphasis omitted) (citations omitted). Additionally, "[t]he proper measure of damages for breach of contract is determined by the loss sustained or gain prevented at the time and place of breach." *Oscar Gruss & Son, Inc. v. Hollander*, 337 F.3d 186, 197 (2d Cir.2003) (quoting *Simon v. Electrospace Corp.*, 28 N.Y.2d 136, 145, 320 N.Y.S.2d 225, 269 N.E.2d 21 (1971)); *Sharma v. Skaarup Ship Mgmt. Corp.*, 916 F.2d 820, 825 (2d Cir.1990) ("It is a fundamental proposition of contract law, including that of New York, that the loss caused by a breach is determined as of the time of breach.") (citing *Simon*, 28 N.Y.2d at 145, 320 N.Y.S.2d 225, 269 N.E.2d 21 (internal footnote omitted)).

Here, the plaintiff has proven that it suffered injury as a natural and probable consequence of the defendants' inflated appraisal. The complaint and supporting documents establish that Lender relied on the defendants' appraisal for the purpose of assessing the viability of Borrower's loan application. See *Sharma*, 916 F.2d at 826 ("The principal of the loan is determined by the market value of the collateral..."). Indeed, the main purpose of the appraisal, of which the defendants were aware, was to aid the Lender in determining whether or not to make the loan. See Complaint ¶ 53; Appraisal Report at 6.

Thus, when Borrower defaulted and NetBank foreclosed upon the property, NetBank should have been left with property that was worth \$550,000 at the time of appraisal.

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Instead, NetBank was left with property that was worth \$372,500 at the time of the appraisal, and following the foreclosure sale, suffered a loss of \$265,000 in principal. Had the value of the property been appraised for its true value, Lender “would not have approved or funded the [loan]” and in fact “would have required a viable secondary source of repayment to liquidate....” Complaint ¶¶ 73, 74. Thus, if not for the negligent appraisal, Lender would not have suffered a loss in principal because it would not have issued the loan at all. Placing the plaintiff in the position it would have been in had the defendants fulfilled the contract requires the court to award the plaintiff damages in the amount of its loss of principal, \$265,000.⁸

*10 The court notes that even though it was the Borrower’s default, and not the defendants’ conduct alone, that led to the plaintiff’s loss of \$265,000, that does not change the court’s analysis because the prospect of the Borrower’s default was in the reasonable contemplation of the parties. In New York, “[s]pecial, or consequential damages, which ‘do not so directly flow from the breach,’ are recoverable in limited circumstances.” *Bi-Econ. Mkt., Inc.*, 10 N.Y.3d at 192, 856 N.Y.S.2d 505, 886 N.E.2d 127 (quoting *American List Corp. v. U.S. News & World Report*, 75 N.Y.2d 38, 43, 550 N.Y.S.2d 590, 549 N.E.2d 1161 (1989)). Consequential damages are awarded only when the loss from such a breach was “reasonably contemplated” by the parties. *See id.* at 193, 856 N.Y.S.2d 505, 886 N.E.2d 127. “It is not necessary for the breaching party to have foreseen the breach itself or the particular way the loss occurred, rather, ‘it is only necessary that loss from a breach is foreseeable and probable.’” *Id.* (quoting *Ashland Mgt. v. Janien*, 82 N.Y.2d 395, 403, 604 N.Y.S.2d 912, 624 N.E.2d 1007 (1993)) (citations omitted). Thus, although the Borrower’s default on the loan and the foreclosure sale of the property at issue were not directly caused by the inflated appraisal, they are the types of events that can be reasonably contemplated in any real estate transaction. Professional appraisers like the defendants, who are aware that the property is being appraised for the purpose of a mortgage loan for real property, would reasonably foresee that the borrower could default on that loan and the bank would be forced to sell the property to mitigate its loss. For these reasons, the plaintiff is entitled to a damages award of \$265,000.

C. Prejudgment Interest

The plaintiff FDIC is also entitled to prejudgment interest on its damages award. The FDIC requests \$90,365.22 in prejudgment interest, based on the state statutory rate of 9% and calculated from June 25, 2007, the date on which

NetBank sold the foreclosed property, to April 8, 2011.⁹ Under New York law, prejudgment interest is calculated at a rate of 9% per annum. N.Y. C.P.L.R. § 5004. Furthermore, “New York law requires a district court to grant prejudgment interest when a party is entitled to such interest as a matter of right.” *Matsumura v. Benihana Nat’l Corp.*, 465 F. App’x 23, 30 (2d Cir.2012) (citing *New England Ins. Co. v. Healthcare Underwriters Mut. Ins. Co.*, 352 F.3d 599, 602–03 (2d Cir.2003)). “A prevailing party is entitled to prejudgment interest as a matter of right ‘upon a sum awarded because of a breach of performance of a contract, or because of an act or omission depriving or otherwise interfering with title to, or possession or enjoyment of, property.’” *Id.* (quoting N.Y. C.P.L.R. § 5001(a)); *see also Graham v. James*, 144 F.3d 229, 239 (2d Cir.1998) (“Under New York law, ‘prejudgment interest is normally recoverable as a matter of right in an action at law for breach of contract.’” (quoting *Adams v. Lindblad Travel, Inc.*, 730 F.2d 89, 93 (2d Cir.1984))). As discussed above, the plaintiff is entitled to damages based on the defendants’ breach of contract. Thus, the plaintiff is also entitled to prejudgment interest on that amount.

*11 Calculated at the statutory rate of 9%, interest on the plaintiff’s damages of \$265,000 from June 25, 2007, the date of the foreclosure sale, to August 1, 2012 amounts to \$121,733.02.¹⁰ Following August 1, 2012, interest will continue to accrue at the rate of \$65.34 per day until the date that judgment is entered.¹¹

CONCLUSION

In accordance with the above considerations, the undersigned hereby recommends that the motion for default judgment be granted, and that the plaintiff be awarded damages in the amount of \$265,000, and prejudgment interest in the amount of \$121,733.02 plus \$65.34 per day from August 1, 2012 to the date of judgment.

Any objections to the Report and Recommendation above must be filed with the Clerk of the Court within 14 days of receipt of this report. Failure to file objections within the specified time waives the right to appeal any judgment or order entered by the District Court in reliance on this Report and Recommendation. 28 U.S.C. § 636(b)(1); Fed.R.Civ.P. 72(b); *see, e.g., Thomas v. Arn*, 474 U.S. 140, 155, 106 S.Ct. 466, 88 L.Ed.2d 435 (1985); *IUE AFL-CIO Pension Fund v. Herrmann*, 9 F.3d 1049, 1054 (2d Cir.1993); *Frank v. Johnson*, 968 F.2d 298, 299 (2d Cir.1992); *Small v. Sec’y of Health and Human Servs.*,

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892 F.2d 15, 16 (2d Cir.1989) (per curiam).

record.

Counsel for the plaintiff shall serve a copy of this Report and Recommendation on the defendants by regular mail and file proof of such service in the

Footnotes

- 1 In support of the motion for a default judgment, the plaintiff has submitted a Memorandum of Law [DE 16–2] (“Plaintiff’s Mem.”), a copy of the appraisal report prepared by the defendants [DE 16–3] (“Appraisal Report”), the Affidavit of Steven Albert, an individual retained to retroactively appraise the property with an accompanying reappraisal report [DE 16–4, 16–5, 16–6] (“Albert Aff.” and “Reappraisal Report,” respectively), a copy of the “Real Property Transfer Report” reflecting the re-sale of the property at issue here by the plaintiff [DE 16–7], and the Affidavit of Karen Freeborn regarding damages [DE 16–8] (“Freeborn Aff.”).
- 2 Lender is a wholly-owned subsidiary of NetBank in the business of making mortgage loans. Complaint ¶¶ 7, 8. The plaintiff FDIC has substantial legal interests in the transaction between Borrower and Lender because Lender transferred all of its interests in the loan to NetBank. *See id.* ¶ 9. When the FDIC became receiver for NetBank, NetBank’s interests were transferred to the FDIC. *Id.* ¶ 14.
- 3 The Appraisal Report is referred to and quoted throughout the complaint and is therefore incorporated into the complaint by reference.
- 4 In its discussion of the breach of contract claim, the plaintiff alleges that the Appraisal Report “constitutes the formation of the contract between the Lender ... and Defendants.” Complaint ¶ 78. The court has not been presented with and is unaware of any authority to support the conclusion that an appraisal report constitutes a contract, nor does the report on its face appear to constitute an agreement. Rather, it evidences a prior agreement to perform services. The complaint’s allegations of Lender’s employment of Hoyle, however, do establish the existence of an agreement. The court thus does not need to resolve whether or not the report itself is a contract.
- 5 The FDIC’s tort cause of action may stand alternative to, but not in addition to its action in contract. New York courts have long grappled with whether a party may assert causes of action in both contract and tort “where the parties’ relationship initially is formed by contract, but there is a claim that the contract was performed negligently.” *Sommer v. Federal Signal Corp.*, 79 N.Y.2d 540, 551, 583 N.Y.S.2d 957, 593 N.E.2d 1365 (1992). “A tort may arise from the breach of a legal duty independent of the contract, but merely alleging that the breach of a contract duty arose from a lack of due care will not transform a simple breach of contract into a tort.” *Id.* (citing *Clark–Fitzpatrick, Inc. v. Long Island R.R. Co.*, 70 N.Y.2d 382, 389, 521 N.Y.S.2d 653, 516 N.E.2d 190 (1987); *Rich v. N.Y. Cent. & Hudson Riv. R.R. Co.*, 87 N.Y. 382, 398 (1882)). Here, the plaintiff supports both claims with the same allegations regarding the circumstances and the harm sustained. The plaintiff also bases its breach of contract claim on the existence of a professional duty of care on the part of the defendants. Therefore, no duty independent of the contract exists in this case. *Cf. Tsafatinos v. Lee David Auerbach, P.C.*, 80 A.D.3d 749, 750, 915 N.Y.S.2d 500, 500 (2d Dep’t 2011) (finding that the plaintiffs’ breach of contract and breach of fiduciary duty causes of action were duplicative of their legal malpractice cause of action because the two former claims were based on the same facts underlying the latter claim and the plaintiffs did not allege distinct damages). Nonetheless, a plaintiff may assert alternative legal theories on the same allegations in support of recovery. *See, e.g., Auguston v. Spry*, 282 A.D.2d 489, 491, 723 N.Y.S.2d 103, 106 (2d Dep’t 2001) (citations omitted).
- 6 Based on these criteria, New York courts have accepted and rejected the applicability of C.P.L.R. 214(6) to several professions. *See Chase Scientific Research, Inc.*, 96 N.Y.2d at 28, 725 N.Y.S.2d 592, 749 N.E.2d 161 (affirming that architects, engineers, lawyers, and accountants are “professionals,” but holding that insurance brokers are not); *In re R.M. Kliment & Frances Halsband, Architects*, 3 N.Y.3d 538, 543, 788 N.Y.S.2d 648, 821 N.E.2d 952 (2004) (applying C.P.L.R. 214(6) to a professional negligence claim against an architect); *Castle Oil Corp. v. Thompson Pension Emp. Plans, Inc.*, 299 A.D.2d 513, 514, 750 N.Y.S.2d 629, 631 (2d Dep’t 2002) (holding that actuaries are not “professionals” within the meaning of C.P.L.R. 214(6)).
- 7 Ms. Freeborn was retained as “Investigations Lead Contractor” by the plaintiff to investigate matters pertaining to the mortgage loan in this litigation, including the amount of the loan and the amount for which the Subject Property sold upon foreclosure. *See Freeborn Aff.* ¶ 6–8.
- 8 The plaintiff would also likely be entitled to return of the fee it paid the appraiser as direct damages, *see Vitol Trading S.A., Inc.*, 874 F.2d at 79–80, but since the plaintiff has neither alleged the amount of the fee nor sought its recovery, the court has no basis for awarding it as damages.

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- 9 The awarding of prejudgment interest is a question of substantive law. *Schwimmer v. Allstate Ins. Co.*, 176 F.3d 648, 650 (2d Cir.1999) (citing *Marfia v. T.C. Ziraat Bankasi*, 147 F.3d 83, 90 (2d Cir.1998)). Thus, “where prejudgment interest can only be awarded on the basis of what is solely a state claim, it is appropriate to use the state interest rate.” *Thomas v. iStar Fin., Inc.*, 652 F.3d 141, 150 n. 7 (2d Cir.2011); *see also Marfia*, 147 F.3d at 90.
- 10 According to N.Y. C.P.L.R. 5001(b), prejudgment interest is to be “computed from the earliest ascertainable date the cause of action existed...” While an argument can be made that the plaintiffs are entitled to prejudgment interest from the date of the appraisal, the plaintiff offers the later date of the foreclosure sale as the date on which the court should begin to calculate prejudgment interest without explanation or citation to authority. Since the plaintiff’s choice of accrual date results in a smaller prejudgment interest award, the court declines to reassess whether the plaintiff is entitled to a longer prejudgment interest period.
- 11 The *per diem* interest is calculated by multiplying the principal amount owed (\$265,000) by the yearly statutory rate (.09) and dividing this amount by 365 (the number of days in a year) to arrive at \$65.34.

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97 A.D.3d 639, 949 N.Y.S.2d 76, 2012 N.Y. Slip Op.
05500

Angil Jones et al., Respondents

v

Bank of America National Association et al.,
Defendants, and NH Appraisal Associates, Inc., et
al., Appellants.

Supreme Court, Appellate Division, Second
Department, New York
July 11, 2012

CITE TITLE AS: Jones v Bank of Am. N.A.

HEADNOTE

Consumer Protection
Deceptive Acts and Practices

Private Right of Action—Lack of Material Deceptive Act

L'Abbate, Balkan, Colavita & Contini, LLP, Garden City, N.Y. (Diane P. Whitfield and Scott E. Kossove of counsel), for appellants.

Vernon & Ginsburg, LLP, New York, N.Y. (Darryl M. Vernon and Djinsad Desir of counsel), for respondents.

In an action, inter alia, to recover damages for violations of [General Business Law § 349](#), fraud, and negligence in the performance of a real estate appraisal, the defendants NH Appraisal Associates, Inc., and Naftali Horowitz appeal from an order of the Supreme Court, Kings County (Schmidt, J.), dated September 7, 2011, which denied their motion pursuant to [CPLR 3211 \(a\) \(7\)](#) to dismiss the second amended complaint and all cross claims insofar as asserted against them.

Ordered that the order is modified, on the law, (1) by deleting the provision thereof denying that branch of the motion of the defendants NH Appraisal Associates, Inc., and Naftali Horowitz which was pursuant to [CPLR 3211 \(a\) \(7\)](#) to dismiss the first cause of action, which alleged violations of [General Business Law § 349](#), insofar as asserted against them, and substituting therefor a provision granting that branch of the motion, (2) by deleting the provision thereof denying that branch of the motion of the defendants NH Appraisal Associates, Inc.,

and Naftali Horowitz which was pursuant to [CPLR 3211 \(a\) \(7\)](#) to dismiss the second cause of action, which alleged fraud, insofar as asserted against the defendant Naftali Horowitz, and substituting therefor a provision granting that branch of the motion, and (3) by deleting the provision thereof denying that branch of the motion of the defendants NH Appraisal Associates, Inc., and Naftali Horowitz which was pursuant to [CPLR 3211 \(a\) \(7\)](#) to dismiss the sixth cause of action, which alleged negligence in the performance of a real estate appraisal, asserted against the defendant Naftali Horowitz, and substituting therefor a provision granting that branch of the motion; as so modified, the order is affirmed, with costs payable by the plaintiffs to the defendants NH Appraisal Associates, Inc., and Naftali Horowitz. *640

The plaintiffs commenced this action against, among others, the defendant NH Appraisal Associates, Inc., and its principal, the defendant Naftali Horowitz (hereinafter together the appellants). The plaintiffs alleged, inter alia, that as part of a predatory lending scheme, Horowitz, in preparing an appraisal report with respect to certain real property, overvalued that property in ****2** order to enable the plaintiffs to obtain a grossly unaffordable mortgage loan to purchase that property.

On a motion to dismiss a complaint pursuant to [CPLR 3211 \(a\) \(7\)](#) for failure to state a cause of action, the court must accept the facts alleged as true, accord the plaintiff the benefit of every possible inference, and determine only whether the facts as alleged fit within any cognizable legal theory (see *Leon v Martinez*, 84 NY2d 83, 87-88 [1994]).

Applying these principles to the allegations in the second amended complaint, the plaintiffs failed to allege a cognizable cause of action against the appellants to recover damages for violations of [General Business Law § 349](#). [General Business Law § 349](#) provides that “[d]eceptive acts or practices in the conduct of any business, trade or commerce or in the furnishing of any service in this state are hereby declared unlawful” ([General Business Law § 349 \[a\]](#)). A private right of action to recover damages for violations of [General Business Law § 349](#) has been provided to “any person who has been injured by reason of any violation of” the statute ([General Business Law § 349 \[h\]](#)). Under [General Business Law § 349 \(h\)](#), a prima facie case requires a showing that the defendant engaged in a consumer-oriented act or practice that was “‘deceptive or misleading in a material way and that [the] plaintiff has been injured by reason thereof’ ” (*Goshen v Mutual Life Ins. Co. of N.Y.*, 98 NY2d 314, 324 [2002], quoting

APPENDIX

Jones v Bank of Am. N.A., 97 A.D.3d 639 (2012)

949 N.Y.S.2d 76, 2012 N.Y. Slip Op. 05500

Oswego Laborers' Local 214 Pension Fund v Marine Midland Bank, 85 NY2d 20, 25 [1995]). However, the plaintiffs failed to allege that the appellants' alleged acts and practices misled them in a material way (cf. *Ladino v Bank of Am.*, 52 AD3d 571, 574 [2008]).

The plaintiffs also failed to allege a cognizable cause of action against Horowitz to recover damages for fraud. To establish a prima facie case of fraud, a plaintiff must present proof, inter alia, that the plaintiff relied upon the defendant's misrepresentation (see *Smith v Ameriquest Mtge. Co.*, 60 AD3d 1037, 1039 [2009]; *Cohen v Houseconnect Realty Corp.*, 289 AD2d 277, 278 [2001]). However, the plaintiffs failed to allege that they relied upon any alleged misrepresentation by Horowitz (cf. *Stuart v Tomasino*, 148 AD2d 370, 372 [1989]).

The plaintiffs failed to allege a cognizable cause of action *641 against Horowitz to recover damages for negligence in the performance of a real estate appraisal. The plaintiffs failed to allege facts that would support a determination that Horowitz owed them a duty to exercise care in performing the appraisal (cf. *Rodin Props.-Shore Mall v Ullman*, 264 AD2d 367, 368-369 [1999]).

The appellants' remaining contentions are without merit. Skelos, J.P., Dillon, Leventhal and Sgroi, JJ., concur.

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APPENDIX

Rodin Props.-Shore Mall v Ullman, 264 A.D.2d 367 (1999)

694 N.Y.S.2d 374, 1999 N.Y. Slip Op. 07250

264 A.D.2d 367, 694 N.Y.S.2d 374, 1999 N.Y. Slip
Op. 07250

Rodin Properties-Shore Mall N. V., Appellant,
v.
Leo Ullman et al., Defendants, and Cushman &
Wakefield of Pennsylvania, Inc., et al.,
Respondents.

Supreme Court, Appellate Division, First
Department, New York
(August 26, 1999)

CITE TITLE AS: Rodin Props.-Shore Mall v
Ullman

Order, Supreme Court, New York County (Beatrice Shainswit, J.), entered on or about January 8, 1999, granting defendants Cushman & Wakefield of Pennsylvania, Inc. and Cushman & Wakefield, Inc.'s motion for summary judgment dismissing the second, third, fourth and fifth causes of action in the amended complaint, unanimously reversed, on the law, with costs and disbursements, the motion denied, and said causes of action reinstated.

Plaintiff, a consortium of investors, loaned Shore Mall Associates, L.P. (SMA) \$49,125,000 to refinance a New Jersey shopping center known as Shore Mall. The loan was expressly conditioned on the borrowers obtaining an appraisal showing Shore Mall as having a value of at least \$60,000,000. SMA selected Cushman & Wakefield, for a fee of \$18,000, to appraise the property. The letter agreement between SMA and Cushman & Wakefield contains an express acknowledgment that the appraisal report was intended to assist SMA in obtaining financing and that the report could be submitted to prospective lenders, including several affiliated with plaintiff.

Cushman & Wakefield appraised Shore Mall at \$65,500,000, which, according to plaintiff, is grossly inflated. Plaintiff alleges that the appraisal also contained material misrepresentations, *368 the foremost of which was the representation that the mall was "the principal, fully integrated shopping complex in its primary trade area" and that the only other major regional mall serving the area, Hamilton Mall, was 20 miles away. In point of fact, Hamilton Mall was the dominant retail center in the region and was only 5.6 miles away. In addition, the report failed to mention that Shore Mall had competition just across the street from Hamilton Mall. Furthermore,

Cushman & Wakefield's projection of South Mall's cash flow was substantially exaggerated. In its amended complaint, plaintiff asserted causes of action against Cushman & Wakefield for fraud (second), negligence (third), negligent misrepresentation (fourth), gross negligence (fifth), breach of third-party beneficiary contract (sixth) and onrechtmatige daad (thirteenth), a Dutch tort.* The IAS Court, finding that the same facts were asserted for both the contract and tort claims, granted Cushman & Wakefield's motion for summary judgment dismissing the tort claims on the ground that they were duplicative of the contract claims. We reverse.

As a professional appraiser, Cushman & Wakefield owed a duty to plaintiff independent of any contractual obligation. "Professionals, common carriers and bailees, for example, may be subject to tort liability for failure to exercise reasonable care, irrespective of their contractual duties In these instances, it is policy, not the parties' contract, that gives rise to a duty of due care." (*Sommer v Federal Signal Corp.*, 79 NY2d 540, 551-552 [citations omitted].) In such circumstances, contrary to the IAS Court's holding, the fact that the same facts serve as the basis of both the tort and contract claims is of no moment. "[L]iability in tort may arise from and be inextricably intertwined with that conduct which also constitutes a breach of contractual obligations." (*Apple Records v Capitol Records*, 137 AD2d 50, 55.) Here, the record shows that Cushman & Wakefield knew that plaintiff would be relying on its appraisal. Thus, it had a duty to plaintiff, independent of its contract with SMA. Although the legal duty for tort liability must spring from facts extraneous to and not constituting elements of the contract, it "may be connected with and dependent upon the contract." (*Clark-Fitzpatrick, Inc. v Long Is. R. R. Co.*, 70 NY2d 382, 389.) When a professional, such as Cushman & Wakefield, has a specific awareness that a third party will rely on his or her advice or opinion, the furnishing of which is for that very purpose, and there is reliance thereon, tort liability will ensue if the professional report or opinion is negligently or fraudulently *369 prepared. (*Prudential Ins. Co. v Dewey, Ballantine, Bushby, Palmer & Wood*, 80 NY2d 377, 384.) Thus, notwithstanding the assertion of breach of a third-party beneficiary contract claim, the tort allegations of fraud, gross negligence, negligence and negligent misrepresentation are properly pleaded.

Concur--Sullivan, J. P., Williams, Wallach, Lerner and Friedman, JJ.

APPENDIX

Flandera v AFA Am., Inc., 78 A.D.3d 1639 (2010)

913 N.Y.S.2d 441, 2010 N.Y. Slip Op. 08466

78 A.D.3d 1639, 913 N.Y.S.2d 441, 2010 N.Y. Slip
Op. 08466

Elaine Flandera et al., Respondents-Appellants
v
AFA America, Inc., et al., Defendants, and Steven
Essig et al., Appellants-Respondents.

Supreme Court, Appellate Division, Fourth
Department, New York
November 19, 2010

CITE TITLE AS: Flandera v AFA Am., Inc.

Court erred in granting defendants' motion seeking dismissal of cause of action alleging violation of General Business Law § 349; plaintiffs alleged sufficient facts establishing that defendants engaged in consumer-oriented conduct directed against general public that was deceptive or misleading in material way and that plaintiffs were injured thereby.

Hiscock & Barclay, LLP, Syracuse (Matthew J. Larkin of counsel), for defendants-appellants-respondents.
Gary J. Pieples, Syracuse, for plaintiffs-respondents-appellants.

Appeal and cross appeal from an order of the Supreme Court, Onondaga County (Donald A. Greenwood, J.), entered September 9, 2009. The order denied in part the motion of defendants Steven Essig and Essig Appraisal Associates to dismiss the complaint against them.

It is hereby ordered that the order so appealed from is unanimously modified on the law by granting that part of the motion seeking dismissal of the first cause of action in its entirety with respect to plaintiff Chastity Kinahan and dismissing that cause of action in its entirety with respect to her and by denying that part of the motion seeking dismissal of the third cause of action and reinstating that cause of action and as modified the order is affirmed without costs.

Memorandum: Plaintiffs commenced this action seeking damages allegedly resulting from, inter alia, fraud, civil conspiracy, and deceptive business practices with respect to plaintiffs' purchases of properties as first-time home

buyers with poor credit. Supreme Court previously granted the motion of Steven *1640 Essig and Essig Appraisal Associates (hereafter, defendants) to dismiss plaintiffs' complaint in a prior action. After plaintiffs commenced the instant action, defendants moved to dismiss the complaint on various grounds, and the court granted the motion in part. This appeal by defendants and cross appeal by plaintiffs ensued.

With respect to defendants' appeal, we conclude that the court properly denied the motion insofar as it sought to dismiss the complaint in its entirety pursuant to CPLR 3211 (a) (5), based on the doctrine of res judicata. The complaint filed in this action corrected some of the deficiencies in the complaint in the prior action that warranted the court's dismissal thereof, i.e., the failure to allege facts with the requisite specificity (*see 175 E. 74th Corp. v Hartford Acc. & Indem. Co.*, 51 NY2d 585, 590 n 1 [1980]; *Allston v Incorporated Vil. of Rockville Centre*, 25 AD2d 545 [1966]; *cf. Marine Midland Bank-Western v Movable Homes*, 61 AD2d 1139 [1978]).

Also contrary to the contention of defendants on their appeal, the court properly denied that part of their motion seeking dismissal of the first cause of action with respect to plaintiff **2 Elaine Flandera for failure to state a cause of action insofar as it alleges fraud. "In determining whether a complaint fails to state a cause of action, a court is required to 'accept the facts as alleged in the complaint as true, accord plaintiff[] the benefit of every possible favorable inference, and determine only whether the facts as alleged fit within any cognizable legal theory'" (*Daley v County of Erie*, 59 AD3d 1087, 1087 [2009], quoting *Leon v Martinez*, 84 NY2d 83, 87-88 [1994]; *see generally CPLR 3211 [a] [7]*). Although appraisals or other assessments of market value "are akin to statements of opinion[,] which generally are not actionable" (*Stuart v Tomasino*, 148 AD2d 370, 372 [1989]), an assessment of market value that is based upon misrepresentations concerning existing facts may support a cause of action for fraud (*see Rodin Props.-Shore Mall v Ullman*, 264 AD2d 367, 368-369 [1999]; *see also Cristallina v Christie, Manson & Woods Intl.*, 117 AD2d 284, 294-295 [1986]).

Here, plaintiffs alleged with the requisite specificity that defendants' appraisal of the property purchased by Flandera contained "several misrepresentations concerning the condition and qualities of the home, including, but not limited to: who owned the property, whether the property had municipal water, the type of basement and the status of repairs on the home" (*see generally CPLR 3016 [b]*). We thus conclude that

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Flandera v AFA Am., Inc., 78 A.D.3d 1639 (2010)

913 N.Y.S.2d 441, 2010 N.Y. Slip Op. 08466

plaintiffs stated a claim for fraud with respect to Flandera, inasmuch as they sufficiently pleaded the elements of a material misrepresentation of fact, scienter, justifiable reliance, and damages to support such a claim (see *Simmons v Washing Equip. Tech.*, 51 AD3d 1390, 1391-1392 [2008]).

We agree with defendants, however, that the complaint fails to state a cause of action for fraud against them with respect to plaintiff Chastity Kinahan, and we therefore modify the order accordingly. The complaint fails to allege any material misrepresentations of fact upon which defendants' allegedly overvalued appraisal was based and is thus insufficient to state a cause of action by Kinahan for fraud (see *id.*). We have reviewed defendants' remaining contentions and conclude that they are without merit.

With respect to plaintiffs' cross appeal, we agree with plaintiffs that the court erred in granting that part of defendants' motion seeking dismissal of the third cause of

action, alleging the violation of [General Business Law § 349](#). We therefore further modify the order accordingly. Plaintiffs alleged sufficient facts establishing that defendants engaged in consumer-oriented conduct directed against the general public that was deceptive or misleading in a material way and that plaintiffs were injured thereby (see *Oswego Laborers' Local 214 Pension Fund v Marine Midland Bank*, 85 NY2d 20, 24-26 [1995]; *Latiuk v Faber Constr. Co.*, 269 AD2d 820 [2000]). We thus conclude that, "[a]t this early pre-discovery phase, [plaintiffs'] allegations sufficiently plead [the] violation[] of [General Business Law § 349](#)" (*Skibinsky v State Farm Fire & Cas. Co.*, 6 AD3d 975, 976 [2004]). Present—Smith, J.P., Peradotto, Lindley, Sconiers and Pine, JJ.

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APPENDIX

Allstate Ins. Co. v. Credit Suisse Securities (USA) LLC, 42 Misc.3d 1220(A) (2014)

986 N.Y.S.2d 864, 2014 N.Y. Slip Op. 50106(U)

Unreported Disposition

42 Misc.3d 1220(A), 986 N.Y.S.2d 864 (Table), 2014 WL 432458 (N.Y.Sup.), 2014 N.Y. Slip Op. 50106(U)

This opinion is uncorrected and will not be published in the printed Official Reports.

Allstate Insurance Company, ALLSTATE LIFE INSURANCE COMPANY, ALLSTATE BANK (F/K/A ALLSTATE FEDERAL SAVINGS BANK), AND KENNETT CAPITAL, INC., Plaintiffs,

v.

Credit Suisse Securities (USA) LLC, CREDIT SUISSE FIRST BOSTON MORTGAGE SECURITIES CORPORATION, CREDIT SUISSE FINANCIAL CORPORATION, ASSET BACKED SECURITIES CORPORATION, AND DLJ MORTGAGE CAPITAL, INC., Defendants.

650547/2011

Supreme Court, New York County

Decided on January 24, 2014

CITE TITLE AS: Allstate Ins. Co. v Credit Suisse Sec. (USA) LLC

ABSTRACT

APPEARANCES OF COUNSEL

Counsel for the plaintiff is A. William Urquhart, Esq., Quinn Emanuel Urquhart & Sullivan, LLP, 51 Madison Avenue, New York, New York. Counsel for the defendant is Richard W. Clary, Esq., Cravath, Swaine & Moore LLP, 825 Eighth Avenue, New York, New York.

OPINION OF THE COURT

Marcy S. Friedman, J.

This fraud action arises out of the Allstate plaintiffs' purchase of residential mortgage backed securities (RMBS) Certificates from the Credit Suisse defendants.¹ Defendants move to dismiss the Amended Complaint, pursuant to CPLR 3211 (a) (5) and (7), on the grounds that it is barred by the statute of limitations and fails to state a cause of action.

BACKGROUND / THE AMENDED COMPLAINT

Plaintiffs Allstate Insurance Company (Allstate Insurance) and Allstate Life Insurance Company (Allstate Life) are insurance companies domiciled in, and with their principal places of business in, Illinois. Allstate Life is a wholly-owned subsidiary of Allstate Insurance, which is the successor-in-interest to Allstate Bank. Plaintiff Kennett Capital, Inc. is a Delaware *2 corporation and, along with Allstate Insurance and Allstate Life, an indirect, wholly-owned subsidiary of non-party The Allstate Corporation. (Am. Compl., ¶¶ 14-17). Between December 2005 and November 2007, plaintiffs purchased \$231,999,837 in RMBS Certificates from Credit Suisse First Boston Corporation, the predecessor to defendant Credit Suisse Securities (USA) LLC, in eleven offerings.²

The RMBS Certificates are mortgage pass-through securities which represent interests in a pool of mortgage loans. The cash flows from the borrowers who make interest and principal payments on the individual mortgages comprising the mortgage pool are "passed through" to the certificate holders. (Am. Compl., ¶ 33.)

The securities are created in a multi-step process which, according to the complaint, was entirely controlled by defendants. (*Id.*, ¶ 18.)³ More particularly, a "sponsor" or "seller" *3 originates the loans or acquires the loans from third-party lenders. (*Id.*, ¶ 34.) Here, defendant DLJ Mortgage Capital, Inc. acted as the sponsor or seller (or both) for all of the securitizations at issue. It also originated and/or acquired some of the mortgage loans underlying ARMT 2005-6A, ARMT 2007-1, CSMC 2006-8, CSMC 2007-3 and CSMC 2007-5. (*Id.*, ¶¶ 19, 61, 65.) Defendant Credit Suisse Financial Corporation originated a significant portion of the loans securitized in ARMT 2007-1, CSMC 2007-3, CSMC 2007-5, and HEMT 2006-2. (*Id.*, ¶¶ 21, 61.) The remaining loans were originated by third-party mortgage lenders that received substantial "warehouse" lines of credit from defendants to do so. These lenders included Countrywide Home Loans Inc. ("Countrywide"), Option One Mortgage Corp. ("Option One"), and Taylor, Bean and Whitaker Mortgage Corp. ("TBW"). (*Id.*, ¶ 62.) Countrywide originated a significant percentage of loans underlying the ARMT 2007-1, CSMC 2006-8, CSMC 2007-3 and CSMC 2007-5 offerings (*id.*, ¶ 165); Option One originated 100% of the mortgage loans underlying the ABSC 2006-HE5 offering (*id.*, ¶ 180); and TBW originated 100% of the loans underlying the TBW 2006-4 offering. (*Id.*, ¶ 189.)

After the loans are pooled, the sponsor transfers them to the "depositor," which is typically a special-purpose

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affiliate of the sponsor. (*Id.*, ¶ 35.) Here, the depositors for all of the securitizations were defendants Credit Suisse First Boston Mortgage Securities Corp. and Asset Backed Securities Corporation. (*Id.*, ¶¶ 35, 67.)

The depositor transfers the acquired loan pool to an “issuing trust.” The depositor then securitizes the loan pool in the issuing trust. (*Id.*, 36.) The issuing trust passes the securities back to the depositor, which becomes the issuer of the RMBS. (*Id.*, 37.) The depositor then passes the RMBS to the underwriter, which offers and sells the securities to investors. Here, the underwriter was defendant Credit Suisse Securities (USA) LLC, formerly known as Credit Suisse First Boston Corp. (*Id.*, ¶¶ 20, 37-38, 69.)

As alleged in the complaint, the loans underlying plaintiffs’ Certificates experienced high default rates. By February 2011, when the complaint was filed, nearly one-third of the loans in the collateral pools for ARMT 2007-1, HEMT 2005-5, and HEMT 2006-2 had already been written off for a loss. (*Id.*, ¶ 118.) The delinquency rates for loans remaining in the loan pools at the time of filing of the complaint were as follows: ARMT 2005-6A (41.20%); ARMT 2007-1 (43.03%); CSMC 2006-8 (18.45%); CSMC 2007-3 (29.92%); CSMC 2007-5 (24.14%); HEMT 2005-5 (19.31%); HEMT 2006-2 (17.84%); and TBW 2006-4 (47.79%). (*Id.*, ¶ 119.) The credit ratings for the Certificates also deteriorated, with all but one of them dropping to non-investment grade by at least two of the three ratings agencies which originally provided their ratings, and all of them fell to “junk-bond” status according to at least one rating agency. (*Id.*, ¶ 121.)

As discussed more fully below, the complaint alleges that defendants made false representations that the mortgage loans were originated in accordance with sound underwriting guidelines. (*Id.*, 76-85.) It further alleges that defendants misrepresented specific “risk *4 metrics” that were material to assessing the riskiness of the mortgage loans, including metrics regarding owner-occupancy levels, loan-to-value ratios, sufficiency of the borrowers’ income, credit ratings, and credit enhancements relating to the Certificates. (*Id.*, 89-116.) Based on the alleged misrepresentations and omissions, the complaint pleads causes of action for common law fraud (*id.*, ¶¶ 307-313), fraudulent inducement (*id.*, ¶¶ 314-320), and negligent misrepresentation (*id.*, ¶¶ 321-331).

DISCUSSION

Statute of Limitations

Defendants argue that the complaint is barred by the Illinois statute of limitations. The parties agree that under New York’s borrowing statute, CPLR 202, the cause of action must be timely under the limitations period of both New York and the jurisdiction where the cause of action accrued. (*See Global Fin. Corp. v Triarc Corp.*, 93 NY2d 525, 528 [1999].) They further agree that in view of the Allstate plaintiffs’ residence, their claims must satisfy the limitations provided by both New York and Illinois law. As all of the Certificates were purchased in and after December 2005, and the complaint was filed on February 28, 2011, plaintiffs’ claims would be timely under the six-year New York statute of limitations for fraud. (CPLR 213.) The critical question is therefore whether the claims are barred by Illinois’ shorter statute of limitations.

The parties dispute whether the applicable Illinois statute of limitations is the five year statute of limitations for common law fraud (Illinois Code of Civil Procedure, 735 ILCS 5/13-205) or that provided by the Illinois Securities Law of 1953 (815 ILCS 5/13 [D]). The latter statute requires an action to be commenced within three years of the date of sale of the security. Its tolling provision provides, however, that the three year period shall run from the earlier of the date on which the plaintiff had actual notice of the violation of the statute, or the date on which the plaintiff in the exercise of reasonable diligence had knowledge of facts that would lead to knowledge of the violation. The version of the Illinois Securities Law in effect at the time of the sale of the Certificates at issue also provided that an action could not in any event be brought more than five years after the sale of the securities.⁴ *5

The parties agree that this court must borrow Illinois’ rules for tolling in applying the Illinois statute of limitations. (*See Antone v General Motors Corp.*, 64 NY2d 20, 31 [1984].) However, defendants contend, and plaintiffs dispute, that information in the public domain was sufficient to afford plaintiffs actual or constructive knowledge of their claims by February 2008, and that all of plaintiffs’ claims are therefore time-barred. (Ds.’ Memo. In Support at 12.)

These very issues were decided by this Court (Bransten, J.) in determining motions to dismiss substantially similar actions filed by Allstate against other financial institutions that offered RMBS Certificates. (*Allstate Ins. v Ace Secs. Corp.*, 2013 NY Slip Op 31844 [U], 2013 WL 1103159 [Sup Ct, NY County Mar. 14, 2013] [*Ace*]; *Allstate Ins. Co. v Merrill Lynch & Co.*, 2013 NY Slip Op 31845[U], 2013 WL 4046711 [Sup Ct, NY County Mar. 14, 2013] [*Merrill Lynch*]; *Allstate Ins. Co. v Morgan Stanley*, 2013 NY Slip Op 31130 [U], 2013 WL 2369953 [Sup Ct, NY

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County Mar. 14, 2013][*Morgan Stanley*].) In each case, the Court declined to dismiss any of the state law claims on statute of limitations grounds, with the exception in *Ace* of claims relating to two certificates. The arguments and case law proffered by the parties on the prior motions were essentially identical to those presented here. The factual differences, relating primarily to the particular certificates purchased and the identity of the third party loan originators, are not material. The court concurs with the analysis of the three decisions on the statute of limitations issues and adopts it here.⁵

In brief, as held by the *Ace* Court, the statute of limitations in the Illinois Securities Law applies not merely to statutory securities claims but also to common law fraud and negligent misrepresentation claims arising from the purchase of a security. (*Ace*, 2013 WL 1103159, at *5, citing *Trogenza v Lehman Bros., Inc.*, 287 Ill App3d 108 [Ill App 1st Dist 1997], *lv denied* 174 Ill 2d 595.) Thus, absent tolling, all of plaintiffs' claims arising out of RMBS purchases prior to February 28, 2008 would be time-barred under the statute's base three-year limitations period accruing from the "date of sale." Moreover, recovery relating to any RMBS purchases prior to February 28, 2006 is barred regardless of tolling, under the ultimate five-year deadline imposed by the Illinois Securities Law. (815 ILCS 5/13 [D][2].) Plaintiffs thus concede that claims under the two HEMT 2005-5, A1A Certificates are untimely under the Illinois Securities Law statute of limitations. (Ps.' Memo. In Opp. at 10, 11 n 23.)

As to tolling, the court rejects defendants' contention that the documentary evidence demonstrates as a matter of law that Allstate was put on notice of its claims by information that was publicly available prior to February 2008. In support of this contention, defendants cite statements in offering documents from 2007, which warn of weakness in the residential mortgage market, increasing delinquencies, and potential problems with the performance of loans originated by bankrupt originator New Century. (Ds.' Memo. In Support at 12.) Defendants also cite newspaper articles from 2007, which generally discuss a loosening of underwriting standards by investment banks, problems with sponsor due diligence, and pressures on appraisers to inflate appraisals. (Ds.' Reply Memo. at 3-4, n 5.) *6

As the *Ace* Court reasoned, defendants must demonstrate not merely that plaintiffs could have known that certain statements in the offering materials were false, but also that plaintiffs could have known that defendants were aware of the misrepresentations and thus acted with intent to deceive. (*Ace*, 2013 WL 1103159, at *8 [citing *Baron v Chrans*, 2008 WL 2796948 [CD Ill 2008]; *Merck & Co. v*

Reynolds, 559 US 633, 648 [2010]]; *Phoenix Light SF Ltd. v Ace Secs. Corp.*, 2013 NY Slip Op 50653[U], 2013 WL 1788007, *5 [Sup Ct, NY County 2013, Kornreich, J.] [same].) The underwriter defendants in *Ace* sought to demonstrate that Allstate was on notice of its claims by virtue of information that was publicly available prior to 2008. The *Ace* Court rejected this contention, notwithstanding the defendants' citation of more extensive public information than that cited by defendants here, including information about class actions brought in 2006 and 2007 against the originator of certain of the offerings, alleging misrepresentations regarding appraisals and underwriting standards; newspaper reports in 2007 about the bankruptcies or closings of several of the originators; an announcement by Allstate's counsel that it was conducting an investigation into the conduct of numerous subprime lenders; and Standard & Poor's placement of certain offerings on a credit watch for possible downgrade in November 2007 and January 2008. The Court held that "[n]one of the allegations or facts which defendants contend should impute notice to plaintiffs directly implicate misrepresentation or scienter on the part of defendants. The collapse of the various loan originators, or even plaintiffs' counsel's accusations of wrongdoing against one of them, would not necessarily apprise plaintiffs that defendants were complicit in their wrongdoing. . . ." (*Ace*, 2013 WL 1103159, at * 9.)

In declining to hold as a matter of law that the publicly available information was sufficient to afford plaintiffs notice, the *Ace* Court also reasoned that general allegations of misconduct in the subprime industry were insufficient to show knowledge or misconduct by the defendants with respect to the particular loan pools at issue. (*Id.*)

The *Ace* decision is consistent with the decisions of numerous other Courts in RMBS cases which have denied motions to dismiss based on claims that the plaintiffs were put on notice, or their duty of inquiry was triggered, by information, including newspaper reports, available prior to 2008. As one Court noted, "courts have been reluctant to conclude that purchasers of mortgage-backed securities were on inquiry notice of similar claims as late as mid-- 2008, let alone as early as 2007." (*Massachusetts Mut. Life Ins. Co. v Residential Funding Co., LLC*, 843 F Supp 2d 191, 208-09 [D Mass 2012] [holding that information from newspaper articles, industry publications and government reports that was publicly available before 2007 was insufficient to establish inquiry notice "because it did not directly relate to the misrepresentations and omissions alleged in the complaints," and "did not alert Plaintiff to potential fraud in any specific securitization it had purchased"]; *Matter of*

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Countrywide Fin. Corp. Mtge.-Backed Secs. Litig., 2012 WL 1322884, *4 [CD Cal 2012] [holding, in case under state Blue Sky law, that “2007 was a turbulent time during which the causes, consequences, and interrelated natures of the housing downturn and subprime crisis were still being worked out,” and that Court could not, based solely on the complaint and judicially noticeable documents, conclude that a reasonably diligent investor by August 2007 would have linked reports of increased delinquencies in loan pools with the delinquencies in the loan pools at issue]; *Capital Ventures Intl. v J.P. Morgan Mtge. Acquisition Corp.*, 2013 WL 535320, *7 [D Mass 2013] *7 [holding that plaintiff was not put on notice of its claims by newspaper articles, government publications, and media reports, available before October 2007, which noted the widespread erosion of underwriting guidelines in the mortgage market, pressure on appraisers to generate inflated property values, and pervasive misrepresentation of owner occupancy, and which associated the erosion of underwriting guidelines and increased default rates with the primary originators whose loans backed plaintiffs’ certificates]; *Phoenix Light SF Ltd.*, 2013 WL 1788007, at *5 [holding that “information reported in newspapers about the possible falsity of loan data is insufficient to put plaintiffs on notice of a defendant’s intent to defraud”].)

This court concludes, similarly, that defendants fail to demonstrate as a matter of law that Allstate was put on notice of facts, prior to February 28, 2008, which in the exercise of reasonable diligence would have led to knowledge of its claims that defendants were aware of misrepresentations as to the underwriting standards and the quality of the mortgage loans underlying the offerings at issue, or as to scienter on defendants’ part. The bankruptcy of New Century was of limited significance, as New Century was responsible for originating only 10% of one of the ten mortgage groups in the offerings. Plaintiffs were not required to conclude, from New Century’s problems, that all of the Certificates were affected by fraud and that defendants were or might be complicit in the wrongdoing. Nor did general reports of misconduct in the subprime industry put plaintiffs on notice that defendants had engaged in misconduct or had knowledge of the misconduct of others involved in the securitization process. Defendants’ further contention that the loan level analysis made by plaintiffs in 2010 could have been made based on information available prior to 2008 (*see* Oral Argument Transcript at 11) at most raises a triable issue of fact.

On the record on this motion to dismiss, the court must also credit plaintiffs’ allegation that the necessary information giving rise to a duty to inquire only emerged after February 28, 2008. In this connection, plaintiffs note

that the first non-investment-grade credit rating downgrade to any of the Certificates occurred in March 2008, with downgrades to other Certificates occurring later in 2008 and throughout 2009. (Am. Compl., ¶¶ 12, 303-05.) Plaintiffs allege that other necessary information regarding defendants’ and the originators’ specific practices only became available between late 2008 and 2011 by virtue of reports by the Office of the Comptroller of the Currency, the Financial Crisis Inquiry Commission, and the United States Senate Permanent Subcommittee on Investigations (*id.*, ¶¶ 49-52, 231-35); investigations and lawsuits by the Securities and Exchange Commission, the Massachusetts Attorney General, and private litigants with access to the loan files (*id.*, ¶¶ 8, 10, 171-75, 182-84, 201-227); the release of a “trending” report by due diligence firm Clayton (*id.*, ¶ 157); and plaintiffs’ own development of complex methodologies which enabled them to conduct a loan-level analysis. (*Id.*, ¶ 302).

The *Ace*, *Merrill Lynch*, and *Morgan Stanley* actions were all filed between February 17, 2011 and July 11, 2011, in close proximity to or later than the date of tolling of the statute of limitations in this case. As in those cases, the issue of timeliness cannot be resolved on this motion except as to the claims arising out of the HEMT 2005-5, A1A Certificates. The motion to dismiss on statute of limitations grounds will therefore be denied except as to those purchases.

Failure to State a Claim

Defendants contend that the complaint fails to state causes of action for fraud or *8 fraudulent inducement. To plead fraud, the plaintiff must allege the following elements: “a material misrepresentation of a fact, knowledge of its falsity, an intent to induce reliance, justifiable reliance by the plaintiff, and damages.” (*Eurycleia Partners, LP v Seward & Kissel, LLP*, 12 NY3d 553, 559 [2009].) The elements of a fraudulent inducement claim are substantially the same. (*See Perrotti v Becker, Glynn, Melamed & Muffly LLP*, 82 AD3d 495 [1st Dept 2011].) A fraud claim must be pleaded with particularity, pursuant to CPLR 3016 (b). (*Eurycleia*, 12 NY3d at 559.) However, this statute “should not be so strictly interpreted as to prevent an otherwise valid cause of action in situations where it may be impossible to state in detail the circumstances constituting a fraud.” (*Id.*, quoting *Pludeman v Northern Leasing Sys., Inc.*, 10 NY3d 486, 491[2008].) CPLR 3016 (b) is satisfied when the alleged facts “suffice to permit a reasonable inference’ of the alleged misconduct.” (*Id.*, quoting *Pludeman*, 10 NY3d at 492.)

This Court and Courts in other jurisdictions have

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repeatedly considered the sufficiency of pleadings of fraud claims in RMBS cases. This court's task in determining Credit Suisse's motion to dismiss is therefore the case-specific one of applying a well-developed body of law to the particular allegations of the complaint at issue.

Misrepresentations

As noted above, the complaint alleges that Credit Suisse falsely represented in the offering materials (principally prospectuses and prospectus supplements) that loans were originated in accordance with sound underwriting guidelines. (Am. Compl., ¶ 76.) The complaint sets forth specific allegations in this regard, including that the offering materials represented that the lenders or underwriters employed underwriting standards to evaluate the mortgage loans and the borrowers' credit standing and repayment ability (*id.*, ¶ 77); that the offering materials represented that loans "were originated or acquired generally in accordance with" described underwriting guidelines (*id.*, ¶ 78); that in acquiring the loans, defendants conducted diligence on the operations of the originators (*id.*, ¶ 81); and that "exceptions" to underwriting standards were made on a case-by-case basis only when the borrower was able to demonstrate the existence of "compensating factors." (*Id.*, ¶ 82.)⁶

The complaint alleges in summary: "[A]t the time Defendants made these representations, they knew the Mortgage Loans were not being generated in accordance with the underwriting guidelines they described to investors. At the time of these Offerings, Defendants had, in fact, abandoned sound underwriting practices and knew the companies from which they were acquiring the Mortgage Loans had similarly abandoned sound loan-origination practices. Defendants' abandonment of sound underwriting practices was systematic and significant and pervaded Defendants' RMBS offerings during this period."

(*Id.*, 5.) In addition, the complaint charges that defendants ignored their own due diligence and *9 that of Clayton, a third-party firm they hired. (*Id.*, ¶¶ 240-246.) Defendants also allegedly took "affirmative measures to profit from" their packaging of loans that they knew to be defective. (*Id.*, ¶ 10.) After the securities were sold, Credit Suisse would allegedly "issue repurchase demands" to originators Credit Suisse would then *keep the money* it recovered from the originators, rather than pass the proceeds to the securitization trusts that own the loans for the benefit of investors, *while leaving the defective loans in the pools.*" (*Id.*, ¶¶ 10, 260-264 [emphasis in Complaint].) In support of these allegations, the

complaint pleads that defendants' deviations from underwriting standards are confirmed by Allstate's loan-level analysis of the specific loans at issue, the collateral pools' "dismal performance," independent forensic review of thousands of defendants' loan files by their own insurers and other entities, internal e-mails, and documents reflecting defendants' discovery of borrower misrepresentations and underwriting defects. (*Id.*, ¶ 85.)

Defendants counter that the offering materials fully disclosed the risks of the mortgage loans underlying the Certificates. They cite the following disclosures and qualifications: The offering materials "did not make definitive representations about the underwriting standards used to originate the mortgage loans" but, rather, "reported that the mortgage loans . . . were originated *generally* in accordance with the underwriting criteria described herein." (Ds.' Memo. In Support at 4 [defendants' emphasis].) The offering materials disclosed that the underwriting standards for a substantial number of the mortgage loans would be "*generally less stringent*" than the standards for Fannie Mae or Freddie Mac. (*Id.* [defendants' emphasis].) They also disclosed that certain exceptions to the underwriting standards would be made, with no representations as to the frequency of such exceptions. (*Id.* at 4-5.) The offering materials acknowledged that some loans might not conform even to these less stringent standards, in which case there were specific procedures for replacing or repurchasing mortgages that were discovered to depart from the representations and warranties of the seller. (*Id.* at 5.) In addition, the offering materials disclosed that defendants did not verify the information about the loans, that "many loans" were underwritten using reduced and other limited-documentation programs, and that loans originated under such programs "may experience higher rates of default than other types of loans." (*Id.* at 5-6.)

Defendants also point to the following specific disclosures in the offering materials regarding data material to the quality of the underlying loans: With respect to owner occupancy, the offering materials explicitly stated that owner occupancy information was based solely on the borrower's representation in the loan application and was not independently verified by defendants. (*Id.* at 6.) With respect to the loan-to-value and combined loan-to-value ratios of the mortgages, the offering materials disclosed that these ratios were based on appraisers' valuations that were not necessarily current and were not independently verified by defendants. (*Id.*) The offering materials also expressly warned that there were no assurances that a property's value would remain at the appraised price and, if residential real estate values declined, the ratios might not reliably predict

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delinquencies, foreclosures and losses that might occur on the mortgage loans. (*Id.* at 7.) With respect to credit ratings, the offering materials warned that the performance of the mortgage loans could vary from the rating agencies' assumptions, and that the ratings might be subject to revision or withdrawal at any time by the rating agencies. (*Id.*) With respect to credit enhancements, the offering materials warned that the enhancements available to *10 certain classes of certificates were not insurance against all losses and that, once exhausted, the classes would bear the losses. (*Id.* at 8.)

According to defendants, the offering materials also generally warned that economic conditions affect loan repayment and delinquency rates, and that the secondary market for the Certificates could become illiquid. (*Id.*) The Certificates purchased in 2007 warned that the residential mortgage market had experienced difficulties that may adversely affect the performance or market value of the securities. (*Id.* at 9.)

Courts considering RMBS claims have overwhelmingly held that such disclosures or warnings do not give notice to investors of the defendant's "wholesale abandonment of underwriting standards." (*Plumbers' Union Local No. 12 Pension Fund v Nomura Asset Acceptance Corp.*, 632 F3d 762, 773 [1st Cir. 2011] [denying motion to dismiss based on disclosures in offering materials, like those at issue here, that underwriting standards were generally less stringent than those for Fannie Mae and Freddie Mac; that certain exceptions to underwriting standards were made in the event compensating factors were demonstrated for a prospective borrower; and that defendant bank originated or purchased loans that may have been originated under limited documentation programs]; *see also Matter of Morgan Stanley Mtge. Pass-Through Certificates Litig.*, 810 F Supp 2d 650, 672 [SD NY 2011] [holding that "boilerplate disclaimers and disclosures in the relevant offering documents," including disclosures that borrower information was not always obtained or verified, and that appraisals might not be independent, did not "disclose the risk of a systematic disregard for underwriting standards or an effort to maximize loan originations without regard to loan quality"]; *New Jersey Carpenters Vacation Fund v Royal Bank of Scotland Group, PLC*, 720 F Supp 2d 254, 270 [SD NY 2010], *mod on other grounds* 2013 WL 1809767 [SD NY 2013, No. 08-CV-5093] ["Disclosures that described lenient, but nonetheless existing guidelines about risky loan collateral, would not lead a reasonable investor to conclude that the mortgage originators could entirely disregard or ignore those loan guidelines"]; *Public Empls.'Ret. Sys. of Mississippi v Merrill Lynch & Co. Inc.*, 714 F Supp 2d 475, 483 [SD NY 2010] ["[T]he alleged repeated deviation from established underwriting

standards is enough to render misleading the assertion in the registration statements that underwriting guidelines were generally followed"]; *Matter of IndyMac Mtge.--Backed Secs. Litig.*, 718 F Supp 2d 495, 509 [SD NY 2010] [holding that warnings that loans could have been issued under reduced or no documentation programs or pursuant to exceptions to underwriting guidelines "do not adequately warn of the risk the standards will be ignored"]; *see Ace*, 2013 WL 1103159, at *12 [holding that disclosure that "originators could make a substantial number of exceptions to the underwriting guidelines," and warnings of possibly high delinquency, foreclosure and bankruptcy rates, and other risks, were insufficient to disclose the risk of "systematic disregard for underwriting standards"]; *Stichting Pensioenfonds ABP v Credit Suisse Group AG*, 2012 NY Slip Op 52433 [U], 2012 WL 6929336, *8 [Sup Ct, NY County 2012, Schweitzer, J.] [holding that disclosure that loans would be originated "generally in accordance" with described underwriting standards and that "exceptions" to such standards would be made based on "compensating factors," without any statements as to the frequency of such exceptions or factors that would be considered, were insufficient to immunize defendant from claim that underwriting standards "were in fact ignored"].)

This court holds, on this persuasive authority, that the cited disclosures in the offering *11 materials do not, as a matter of law, bar Allstate's claim that the offering materials made actionable misrepresentations that the underlying mortgage loans were made in compliance with sound underwriting standards. Put another way, the allegations of the complaint regarding defendants' repeated deviations from underwriting standards are actionable, notwithstanding that the offering materials disclosed that exceptions to the underwriting standards might be made in issuing the loans.

Defendants further argue, based on the inclusion in the offering materials of a "repurchase or substitute" provision, under which defendants agreed to repurchase or substitute nonconforming loans, that the offering materials made clear that there was a possibility that nonconforming loans would be included in the pools backing the offerings. They assert that the repurchase provision thus "changed the nature of the representations in the Offering Documents regarding the characteristics of the underlying loans, rendering Allstate's alleged misstatements non-actionable." (Ds.' Reply Memo. at 9; Ds.' Memo. In Support at 24-25.) This argument is based on *Lone Star Fund V (U.S.), L.P. v Barclays Bank PLC* (594 F3d 383 [5th Cir 2010]), in which the plaintiff's fraud claim was predicated entirely upon the defendant's representation in the offering materials that there were no

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delinquent loans underlying the certificates. (*Id.* at 388.) The Court reasoned that this representation must be read in the context of the offering materials as a whole, and that because they contained a repurchase or substitute provision, which contemplated that the mortgage pools might contain delinquent mortgages, the defendant “made no actionable misrepresentations.” (*Id.* at 389.) *Lone Star* has repeatedly been distinguished as inapplicable where, as here, plaintiffs based their claims “not on the mere presence of specific mortgages which do not meet the standards described in the Offering Documents, but instead on the systematic abandonment of [defendants’] purported underwriting standards.” (*Stichting*, 2012 WL 6929336, at *7; see also *Plumbers’ & Pipefitters’ Local No. 562 Supplemental Plan & Trust v J.P. Morgan Acceptance Corp. I*, 2012 WL 601448, *18--19 [ED NY 2012, No. 08-CV-1713]; *Employees’ Retirement Sys. of the Govt. of the Virgin Islands v J.P. Morgan Chase & Co.*, 804 F Supp 2d 141, 155 [SD NY 2011].) This court agrees that the existence of the repurchase or cure provision “does not change the nature of [defendants’] representations about their process.” (*Stichting*, 2012 WL 6929336, at *7.)

Defendants further argue that the pleadings lack particularity because plaintiffs have not tied their allegations of misconduct to the particular Certificates purchased, or to the groups of loans within each offering that back their purchases. (See Ds.’ Memo. In Support at 17-19.) Again, however, the courts have repeatedly rejected similar allegations. (*Tsereteli v Residential Asset Securitization Trust 2006--A8*, 692 F Supp 2d 387, 392 [SD NY 2010] [holding that where complaint alleged that there was “widespread abandonment of underwriting guidelines at IndyMac Bank during the period of time at issue and that the percentage of defaulting’ loans rose dramatically shortly after the Certificates were issued,” complaint pleaded a “sufficient nexus between the alleged underwriting standard abandonment and the loans underlying the Certificates”]; *Plumbers & Pipefitters’ Local No. 562*, 2012 WL 601448, at *18 [following *Tsereteli* in rejecting claim that complaint should be dismissed based on failure of complaint to identify any specific nonconforming loans underlying the certificates]; *Employees’ Ret. Sys. of the Govt. of the Virgin Islands*, 804 F Supp 2d at 152 [quoting *Tsereteli* for the proposition that “[a] plaintiff need not allege that any particular loan or loans were issued in deviation from the *12 underwriting standards, so long as the complaint alleges widespread abandonment of underwriting guidelines”]; *Morgan Stanley Mtge. Pass-Through Certificates Litig.*, 810 F Supp 2d at 672 [same]; *IndyMac Mtge.-Backed Secs. Litig.*, 718 F Supp 2d at 509-510 [same].) Recently, the Second Circuit approved this line

of cases. (*New Jersey Carpenters Health Fund v Royal Bank of Scotland Group, PLC*, 709 F3d 109, 122-123 [2013], revg *New Jersey Carpenters Health Fund v Novastar Mtge., Inc.*, 2012 WL 1076143, * 5, 6 [SD NY 2012, No. 08-CV-5310].) There are cases that have dismissed complaints for failure to plead a sufficient nexus between deviations from underwriting standards and specific loans. (See e.g. *Footbridge Ltd. Trust v Countrywide Home Loans, Inc.*, 2010 WL 3790810 [SD NY 2010, No. 09-CV-4050] [finding nexus between general allegations and specific securities insufficient in case involving fixed-rate loans secured by second liens on residential properties -- securities that were concededly known by plaintiffs to be risky]; *City of Ann Arbor Empls.’ Retirement Sys. v Citigroup Mtge. Loan Trust Inc.*, 2010 WL 6617866, ** 4, 6 [ED NY 2010, No. 08-CV-1418] [after initially dismissing complaint without prejudice [703 F Supp 2d 253], holding that plaintiffs complied with “court’s directive to tie the allegedly misleading statements to their particular investments,” but accepting allegations as to specific loans representing only a “tiny fraction” of the mortgages underlying the securities at issue].)

However, as this Court has noted, “the weight of the authority indicates that . . . allegations of systematic underwriting failure are sufficient to state a claim and do not need to be accompanied by reference to specific loans in the securitization pools of the Certificates.” (*Stichting*, 2012 WL 6929336, at *8.) The court adopts this reasoning and holds that plaintiffs’ allegations regarding the poor performance of their particular Certificates, coupled with their allegations of defendants’ systemic abandonment of underwriting standards, are sufficient to state a claim for misrepresentation.⁷

The court further finds that the allegations of the complaint regarding specific misrepresentations as to loan-to-value ratios, owner occupancy, and credit ratings are sufficient to support the fraud causes of action. Misrepresentations of such data have repeatedly been held actionable. (*Ace*, 2013 WL 1103159, at *13 [and authorities cited therein].)

As to loan-to-value ratios (i.e., the ratio of a mortgage loan’s principal balance to the value of the mortgaged property), the complaint alleges that the offering materials misrepresented these ratios (Am. Compl., ¶¶ 95-97), and misrepresented that the ratios were calculated using data based on sound appraisal practices (*id.*, ¶ 98). The complaint further alleges that defendants knew that the appraisal process was manipulated (*id.*, ¶¶ 101, 273-276), and sets forth specific allegations about the appraisal practices of the originators of some of the mortgages

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underlying the offerings at issue (*id.*, ¶¶ 176-179 [Countrywide], 181-183 [Option One], 198 [TBW]). *13

Fraud claims based on appraisals have been dismissed on the ground that an appraisal is a subjective opinion and is not actionable absent an allegation that the appraiser did not believe the appraisal at the time it was issued. (See *e.g. Tsereteli*, 692 F Supp 2d at 393; *IndyMac Mtge.-Backed Secs. Litig.*, 718 F Supp 2d at 511.) Fraud claims involving appraisals have also been dismissed where the complaint pleaded only general allegations that the appraisers were subject to pressure from the banking industry to inflate their appraisals, and not that the appraisers of the loans at issue succumbed to such pressure. (See *e.g. Plumbers' Union Local No. 12 [Nomura]*, 632 F3d at 774.) However, fraud claims based on allegations similar to those here have repeatedly been upheld where the complaint pleaded allegations about the appraisal practices of the originators at issue. (*Capital Ventures [J.P. Morgan]*, 2013 WL 535320, at * 4-5; *Morgan Stanley Mtge. Pass-Through Certificates Litig.*, 810 F Supp 2d at 672-673 [holding that claim was stated where complaint made detailed allegations as to systematic disregard of appraisal standards by originators at issue]; see also *Matter of Bear Stearns Mtge. Pass-Through Secs. Litig.*, 851 F Supp 2d 746, 769 [SD NY 2012]] [declining to dismiss appraisal allegations based on subjective opinion rule]; *Matter of Wachovia Equity Secs. Litig.*, 753 F Supp 2d 326, 378 n 48 [SD NY 2011] [same]; *Allstate Ins. Co. v Countrywide Fin. Corp.*, 824 F Supp 2d 1164, 1185-1186 [CD Cal 2011] [noting that appraisals are generally inactionable opinions, but upholding fraud claim based on appraisals where complaint pleaded facts calling into question the factual bases for the appraisals].) Here, similarly, the specific allegations of the complaint regarding the originators' deviations from appraisal standards, with resulting impact on the calculation of the loan-to-value ratios, are sufficient to support the fraud cause of action.

As to owner occupancy, the complaint alleges that the offering materials made specific representations that falsely overstated the percentage of the loans in the loan pools that were owner occupied (Am. Compl., ¶¶ 91-94), and that defendants knew that occupancy data was being manipulated in order to facilitate the securitization process. (*Id.*) Defendants argue that the offering materials were not misleading because they disclosed that the owner occupancy data was based on the borrowers' representations, without independent verification. (Ds.' Memo. In Support at 19.) However, as this Court previously held on similar allegations, "if defendants knew that they and their originators had systematically abandoned the underwriting guidelines and were

permitting or encouraging borrowers to falsify information, they cannot hide behind the borrowers' representations to immunize their conduct." (*Merrill Lynch*, 2013 WL 4046711, at *12; *Capital Ventures [J.P. Morgan]*, 2013 WL 535320, at *5.)

As to credit ratings, the complaint alleges that defendants "affirmatively manipulated the ratings process to secure ratings they knew were not an accurate reflection of the credit risk of the offerings. Defendants also fed the ratings agencies baseless and false statistics regarding the loans . . ." (Am. Compl., ¶¶ 112, 229-236, 281.) Claims based on credit ratings have been dismissed as inactionable absent an allegation that the rating agency did not believe that the ratings it assigned were supported by the factors considered. (*Tsereteli*, 692 F Supp 2d at 394-395; *Plumbers' Union Local No. 12 [Nomura]*, 632 F3d at 775-776 [holding that ratings are "inherently opinions" and that fraud claim was not maintainable "so long as the ratings were honestly made, had some basis, and did not omit critical information. That a high rating may be mistaken, a rater negligent in the model employed or the rating company interested in securing more business may be true, but it does not make the report of the rating false or misleading"]; *14 *IndyMac Mtge.-Backed Secs. Litig.*, 718 F Supp 2d at 511-512.) Allegations based on credit ratings have been upheld, however, where the complaint focused not on the subjective belief of the ratings agency but on the knowledge of the defendants as to the support for the ratings. (*Capital Ventures [J.P. Morgan]*, 2013 WL 535320, at *6 [upholding claim based on ratings where plaintiff claimed "defendants knew that the underlying data was faulty and so that there was no real basis for the credit ratings," court reasoning that "defendants cannot simply repeat opinions they know are inaccurate or baseless and then disclaim liability"]; *Bear Stearns Mtge. Pass-Through Secs. Litig.*, 851 F Supp 2d at 772 ["If Bear Stearns knowingly fed incomplete or inaccurate information to the Rating Agencies . . . the ratings' unqualified reproduction in the Offering Documents would constitute an actionable misrepresentation and omission"].) Here, the allegations of the complaint are sufficient, under this persuasive latter authority, to support the fraud claim.⁸

Remaining Elements of Fraud Claim

Defendants contend that the allegations of the complaint are insufficient to plead scienter. (Ds.' Memo. In Support at 26-29.) The scienter element, like the other elements of a fraud claim, must be pleaded with particularity. (CPLR 3016 [b].) This requirement is satisfied where the "complaint contains some rational basis for inferring that the alleged misrepresentation was knowingly made."

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(*Houbigant, Inc. v Deloitte & Touche LLP*, 303 AD2d 92, 93 [1st Dept 2003]; accord *Seaview Mezzanine Fund, LP v Ramson*, 77 AD3d 567, 568 [1st Dept 2010].)

This Court has rejected challenges to the pleading of the scienter element in RMBS cases brought on substantially similar complaints. (*Stichting*, 2012 WL 6929336, at *10 [holding that scienter was adequately pleaded where complaint alleged that Credit Suisse defendants “were involved in every step of the complex process that eventually resulted in the Certificates, including making the mortgage loans, selecting the loans for securitization, commissioning diligence reviews of the loans, servicing the loans, monitoring loan performance, bundling the loans into RMBS, and selling the RMBS Certificates to investors,” and where complaint alleged that defendants’ knowledge of poor quality of the loans could be inferred from their “repricing program,” which involved demanding extra compensation from third-party originators for poor quality loans]; *Ace*, 2013 WL 1103159, at * 10 [upholding scienter pleading where complaint alleged that “defendants knew about and ignored deficiencies in the loan pools, deliberately manipulated the due diligence process and ratings procedures to conceal the deficiencies, participated in a variety of other questionable practices to procure a high volume of loans, and used its knowledge to negotiate cheaper prices for loans”].) Consistent with this authority, the court holds that the scienter element is sufficiently pleaded on the substantially similar allegations at issue.

Defendants also challenge the sufficiency of the pleading of the justifiable reliance *15 element of the fraud claim, primarily on the ground that the offering materials made disclosures about the quality of the underlying loans, including the lack of verification of borrower information, and the risks in investing in RMBS Certificates in a weakening residential market. (Ds.’ Memo. In Support at 29-31.)

The complaint alleges that plaintiffs did not have access to the underlying loan files in determining whether to invest in the Certificates and therefore depended on defendants to present accurate information about the underlying loans. (Am. Compl., ¶ 4.) Defendants do not dispute that plaintiffs did not have access to the loan files. As held by this Court in prior RMBS cases, plaintiffs’ allegation as to this lack of access supports the justifiable reliance element of the fraud claim at the pleading stage. (*Ace*, 2013 WL 1103159, at * 14; *Stichting*, 2012 WL 6929336, at *10; see *CIFG Assur. N. Am., Inc. v Goldman, Sachs & Co.*, 106 AD3d 437, 437-438 [1st Dept 2013] [holding, in RMBS case in which plaintiff conducted its own due diligence, that there was a question

of fact as to whether plaintiff reasonably relied on defendants’ representations, and that plaintiff “was not required, as a matter of law, to audit or sample the underlying loan files”].)The court notes, however, that “the reasonableness of [an investor’s] reliance generally implicates factual issues whose resolution would be inappropriate” on a motion to dismiss. (*Knight Secs., L.P. v Fiduciary Trust Co.*, 5 AD3d 172, 173 [1st Dept 2004] [brackets omitted].) There is an extensive body of case law, which continues to develop, on the extent to which a sophisticated investor may justifiably rely on the representations of the seller regarding the risks of the transaction or, put another way, on the circumstances in which an investor must conduct its own due diligence. (See e.g. *DDJ Mgmt., LLC v Rhone Group L.L.C.*, 15 NY3d 147 [2010]; *ACA Fin. Guar. Corp. v Goldman, Sachs & Co.*, 106 AD3d 494 [1st Dept 2013]; *HSB Nordbank AG v UBS AG*, 95 AD3d 185, 188-189 [1st Dept 2012].) While the instant case is not one in which “the allegations of the . . . complaint itself establish that [plaintiffs] could have uncovered any misrepresentation of the risk of the transaction through the exercise of reasonable due diligence within the means of a financial institution of its size and sophistication” (compare *HSB Nordbank*, 95 AD3d at 188-189), neither is it one in which the pleadings demonstrate as a matter of law that plaintiffs’ reliance on defendants’ representations was justifiable. Rather, a significant issue of fact exists as to the reasonableness of plaintiffs’ investigation in light of the information available to them.

Defendants also assert that plaintiffs cannot establish loss causation -- i.e., that the decline in the value of the RMBS Certificates was proximately caused by defendants’ alleged misrepresentations. In particular, defendants contend that plaintiffs have impermissibly ignored non-fraudulent explanations for their losses, such as whether the economic downturn was an intervening cause. (Ds.’ Memo. In Support at 32-33.) This claim has been rejected by this Department. (*MBIA Ins. Corp.*, 87 AD3d at 296 [holding that “[i]t cannot be said, on this pre-answer motion to dismiss, that MBIA’s losses were caused, as a matter of law, by the 2007 housing and credit crisis”].)

For the above reasons, defendants’ motion to dismiss the fraud claims will be denied.

Negligent Misrepresentation

Negligent misrepresentation claims based on allegations substantially similar to those here have repeatedly been dismissed. (E.g. *MBIA Ins. Corp.*, 87 AD3d at 296-297; *Ace*, 2013 WL 1103159, at * 15-16; *Stichting*, 2012 WL

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6929336, at *13.) Here, as well, the negligent *16 misrepresentation claim will be dismissed as a result of plaintiffs' failure to allege the existence of the necessary special or privity-like relationship.

It is accordingly hereby ORDERED that defendants' motion to dismiss is granted only to the extent of dismissing the cause of action for negligent misrepresentation and the fraud causes of action arising out of the purchases of the HEMT 2005-5, A1A Certificates.

Dated: New York, New York

January 24, 2014

MARCY S. FRIEDMAN, J.S.C.

FOOTNOTES

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Footnotes

¹ Plaintiffs and defendants will collectively be referred to as Allstate and Credit Suisse, respectively, except where the entities must be distinguished. The roles of the various defendants in the process by which the securities were created are discussed below.

² The offerings were as follows:

<i>Offering</i>	<i>Purchaser</i>	<i>Purchase Price</i>	<i>Date</i>
HEMT 2005-5, A1A	Allstate Life	\$35,460,000	38707
	Allstate Insurance	\$10,000,000	38707
ARMT 2005-6A, A22	Allstate Insurance	\$3,526,279	38790
HEMT 2006-2, 2A1	Allstate Insurance	\$10,000,000	38809
	Allstate Life	\$15,000,000	38809
CSMC 2006-8, 3A1	Allstate Life	\$19,902,325	5/06/[06]
TBW 2006-4, A4	Allstate Insurance	\$30,113,015	38951
ABSC 2006-HE5, A1	Allstate Life	\$5,539,343	39006
	Allstate Insurance	\$5,538,448	39006
CSMC 2007-3, 4A6	Allstate Bank	\$13,000,000	39154
	Allstate Insurance	\$14,166,666	39154
HEMT 2005-5, A1F2	Allstate Insurance	\$17,641,262	39329
HEMT 2006-2, 1A1	Allstate Insurance	\$24,992,167	8/28/07
ARMT 2007-1, 5A4	Kennett Capital	\$19,935,897	39356
CSMC 2007-5, 1A10	Allstate Insurance	\$7,184,435	39415

(Am. Compl., ¶ 11 and Am. Compl., Exh. B).

³ The process by which residential mortgages are securitized was summarized by the Appellate Division as follows: "Securitization involves packaging numerous mortgage loans into a trust, issuing debt securities in the trust and selling those notes, known as residential mortgage-backed securities, to investors. The securities are backed by the mortgages, and the borrowers'

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Allstate Ins. Co. v. Credit Suisse Securities (USA) LLC, 42 Misc.3d 1220(A) (2014)

986 N.Y.S.2d 864, 2014 N.Y. Slip Op. 50106(U)

payments of principal and interest on their mortgage loans are used to pay the investors who purchased the securities.”
(*MBIA Ins. Corp. v Countrywide Home Loans, Inc.*, 87 AD3d 287, 290 [1st Dept 2011].)

4 Illinois Securities Law (815 ILCS 5/13 [D]), at the time of the sale of the securities at issue, provided:“D. No action shall be brought for relief under this Section or upon or because of any of the matters for which relief is granted by this Section after 3 years from the date of sale; provided, that if the party bringing the action neither knew nor in the exercise of reasonable diligence should have known of any alleged violation of . . . this Act which is the basis for the action, the 3 year period provided herein shall begin to run upon the earlier of:

(1) the date upon which the party bringing the action has actual knowledge of the alleged violation of this Act; or

(2) the date upon which the party bringing the action has notice of facts which in the exercise of reasonable diligence would lead to actual knowledge of the alleged violation of this Act; but in no event shall the period of limitation so extended be more than 2 years beyond the expiration of the 3 year period otherwise applicable.”

An amendment, effective August 5, 2013, deleted from the end of D (2): “but in no event shall the period of limitation so extended be more than 2 years beyond the expiration of the 3 year period otherwise applicable.” Plaintiff has not notified this court, since the submission of the instant motion, of any claim that the amendment is retroactive.

5 The reasoning of the Court in the three decisions was virtually identical. For purposes of convenience, citations are therefore only to the *Ace* decision.

6 While plaintiffs cite examples of representations made in offering materials for specified Certificates (Am. Compl., ¶¶ 76-83), they represent that the offering materials for each Certificate contain substantially similar or identical statements of fact concerning the underwriting standards. (*Id.*, ¶ 84.) Defendants do not deny that the pleaded allegations are representative.

7 To the extent that defendants argue that the complaint is not pleaded with particularity because the factual allegations as to the deviations from underwriting standards are insufficiently specific, plaintiffs cite independent loan level analyses and internal emails regarding defendants’ discovery of deviations. (Am. Compl., ¶¶ 273-275.) Such pleaded factual bases for general allegations as to deviations from underwriting standards have been characterized by the Courts as “substantial sources,” and cited in upholding the complaints. (*Plumbers’ Union Local No. 12 Pension Fund [Nomura]*, 632 F3d at 773; *Capital Ventures [J.P. Morgan J]*, 2013 WL 535320, at *3.)

8 Defendants seek dismissal of the claims based on allegedly false representations as to credit enhancements, on the ground that they are derivative of the claims regarding misrepresentations as to deviations from underwriting standards, owner occupancy status, and loan-to-value ratios. (Ds.’ Memo. In Support at 23-24.) As those allegations have been held sufficient to withstand the motion to dismiss, the allegations as to credit enhancements are also sufficient.

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APPENDIX

914 F.Supp.2d 362
United States District Court,
E.D. New York.

Ruthleona CLEMENT, Plaintiff,

v.

UNITED HOMES, LLC, United Property Group,
LLC, Yaron Herscho, Galit Network, LLC, [First
United Mortgage Banking Corporation](#), Albert
Benshabat, Maya Benshabat, [American Servicing
Corporation](#), Ocwen Loan Servicing, LLC,
Defendant.

No. 10–CV–2122 (RRM)(RLM). | Dec. 27, 2012.

Attorneys and Law Firms

***364** Ruthleona Clement, Far Rockaway, NY, pro se.

***365** [Jason P. Sultzer](#), Littleton Joyce Ughetta Park & Kelly LLP, Purchase, NY, [Robert P. Johnson](#), Naidich Wurman Birnbaum & Maday LLP, Great Neck, NY, [Jeffrey Fleischmann](#), [Allison J. Schoenthal](#), [Andrew Jaan Sein](#), [Christian Adrian Fletcher](#), Hogan Lovells US LLP, New York, NY, for Defendants.

MEMORANDUM AND ORDER

[ROSLYNN R. MAUSKOPF](#), District Judge.

Plaintiff *pro se* brings this action for monetary and equitable relief against three affiliated real estate entities, United Homes, LLC (“United Homes”), United Property Group, LLC, and Galit Network, LLC; the principal and officer of those entities, Yaron Herscho; First United Mortgage Banking Corporation (“First United”), a mortgage lender; real estate appraisers Maya and Albert Benshabat (the “Benshabats”); and two mortgage servicing companies, American Servicing Corporation and Ocwen Loan Servicing, LLC (“Ocwen”). Plaintiff’s claims—arising out of the financing and purchase of her home in 2005—sound in fraud under the Fair Housing Act, 42 U.S.C. §§ 3604, 3605, the Civil Rights Act, 42 U.S.C. §§ 1981, 1982, 1985, and the Truth in Lending Act, 15 U.S.C. § 1601 *et seq.*, as well as city and state law. (Compl. (Doc. No. 1) ¶ 3.)

Presently before the Court is the Benshabats’ motion to

dismiss all claims against them for failure to state a claim pursuant to [Rule 12\(b\)\(6\) of the Federal Rules of Civil Procedure](#). For the reasons set forth below, the Benshabats’ motion is GRANTED in part and DENIED in part.

BACKGROUND¹

I. Facts

Plaintiff is a 31-year-old African-American woman who at all relevant times lived in Far Rockaway, Queens, and worked for a pharmaceutical company where she earned approximately \$3,000 per month. (*Id.* at ¶¶ 110, 114.) During the summer of 2005, plaintiff became interested in buying her first house. (*Id.* at ¶¶ 110–11.) Plaintiff noticed an advertisement for United Homes, a realty company, on the number 2 subway line. (*Id.* at ¶ 111.) She called the phone number on the advertisement and made an appointment to tour homes that were for sale. (*Id.*) The United Homes representative on the phone instructed plaintiff to come to the United Homes office for a meeting. (*Id.*) Several days later, plaintiff attended a meeting at the Brooklyn office of United Homes, where she was assured by a sales representative that United Homes would take care of every aspect of the home-buying process. (*Id.* at ¶ 112.) The sales representative then took plaintiff to see two homes in a predominantly minority neighborhood in Queens. (*Id.* at ¶ 113.) Plaintiff was interested in one property at 2920 Lewmay Road. (*Id.*) The sales representative assured her that the new construction was high quality, and that the structure and roof were guaranteed up to 20 years. (*Id.* at ¶ 113.) The representative also assured plaintiff that she would be able to afford the house, in part through renting out the top two floors for \$1,800. (*Id.* at ¶ 114.)

“A couple of days later,” plaintiff attended another appointment at the United Homes’ office, where she met with a mortgage banker named David Unger (“Unger”) ***366** from First United. (*Id.* at ¶ 115.) During the meeting, plaintiff filled out loan application forms, and Unger then told her she qualified for a loan for an amount up to the selling price of the home at \$614,000. (*Id.* at ¶ 116.) He also told her that she would be able to rent out the two upstairs units for \$1,800, as well as refinance the mortgage in five years to a lower, fixed rate. (*Id.* at ¶ 117.)

On the following Monday, plaintiff received a call from the United Homes sales representatives informing her that the closing for the house was scheduled for the following

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day. (*Id.* at ¶ 118.) Later that day, plaintiff contacted United Homes to ask for a later closing date, to allow her to obtain a lawyer and an appraisal report. (*Id.* at ¶ 121.) The United Homes representative told plaintiff that an appraisal report had already been prepared, and it would be delivered at the closing. (*Id.* at ¶ 122.) The representative also said that if plaintiff was unable to find a lawyer, one would be provided for her by United Homes at the closing, at no cost to plaintiff. (*Id.*) When plaintiff reminded the representative that she had not received a copy of either the mortgage note or the sales agreement to show to a lawyer, the United Homes representative convinced her that given the short amount of time, it would be best to review the documents with the lawyer to be provided by United Homes at the closing. (*Id.* at ¶ 57123–24.)

At the closing on August 5, 2005, plaintiff was provided with a lawyer, Jay Sanchez (“Sanchez”). (*Id.* at ¶ 126.) She was then given a number of documents to sign. (*Id.* at ¶ 127.) Although she expected Sanchez to review and interpret the legal language for her, Sanchez asked plaintiff to first review the documents, and then she could ask him any questions she may have. (*Id.* at ¶ 128.) As plaintiff began to ask questions, everyone present pressured her to sign the documents, as it was “getting late” and there was another party who needed to use the office for a closing. (*Id.* at ¶ 129.)

Plaintiff ended up signing two mortgages. (*Id.* at ¶ 130.) Although she was told that the first mortgage was going to have a monthly payment of \$2,558.35, it instead required a monthly payment of \$3,590.32. (*Id.*) As this was over \$1,000 more than the monthly payment she anticipated, plaintiff assumed that the two mortgages had been combined into one. (*Id.*) The mortgage was for \$491,200 with an adjustable interest rate up to 11.25%. After signing the first note, she was presented with the second mortgage note with a monthly payment of \$944.23. (*Id.* at ¶ 131.) The second mortgage was for \$122,800.00, at a fixed 9.04% interest rate with payments over 180 months, with an unspecified “balloon payment” at the end of the 15–year loan period. (*Id.* at ¶ 131.) The monthly payments (\$4,824.23) on plaintiff’s two mortgages were 160% of her approximately \$3,000 monthly salary. (*Id.* at ¶ 133.) Also, despite the earlier claims made by United Homes and Unger, insisting that plaintiff would be able to rent part of the house for \$1,800 a month, she alleged that she has only been able to find a tenant willing to pay \$1,300 a month. (*Id.* at ¶ 145.)

Upon moving into the house, plaintiff noticed a number of problems, including leaks in the roof and skylight, as well as water damage to the lower floor of the house. (*Id.* at ¶

143.) Plaintiff complained to United Homes on a number of occasions about the defects in the house. (*Id.* at ¶ 144.) Although United Homes sent contractors to work on the house, plaintiff was forced to hire additional contractors to fix the incomplete and shoddy work. (*Id.*) As a result of the problems with her house, plaintiff has organized with other homeowners on her block facing similar issues. *367 (*Id.* at ¶ 46.) She has also contacted elected officials, attorneys, and organizations, including the Congress of Racial Equality (CORE). (*Id.*)

Plaintiff also became suspicious that her house had been improperly appraised, and that she had paid more for the house than it was worth. (*Id.* at ¶ 47.) She hired an independent appraiser to review the appraisal given by United Homes, the review of which was pending at the time the complaint was filed. (*Id.*)

II. Procedural Background

On May 10, 2010, plaintiff filed a complaint against United Homes and related people and companies, First United, and Maya and Albert Benshabat (“the Benshabats”), who were responsible for the appraisal of plaintiff’s home. (*Id.* at ¶¶ 2, 8.) In her complaint, plaintiff alleges numerous violations of federal, state, and local laws.² (*Id.* at ¶ 3.) Plaintiff argues that defendants engaged in a conspiracy to defraud minority home-buyers, including herself, through a predatory “property flipping” scheme, whereby United Homes bought houses and—in collusion with appraisers, mortgage brokers, and lawyers—sold the houses at artificially high prices to unwitting minority buyers, a process known as “reverse redlining.” (*Id.* at ¶¶ 1–2, 36); see *Barkley v. Olympia Mortg. Co.*, No. 04–CV–875 (RJD)(KAM), 2007 WL 2437810, at *1–8 (E.D.N.Y. Aug. 22, 2007) (outlining a similar alleged scheme).

On September 3, 2010, plaintiff filed a motion for default judgment as to many of defendants. (Doc. No. 15.) This Court referred that motion to Magistrate Judge Mann, who, due to concerns as to actual notice, granted defendants additional time to enter appearances and respond to the complaint. (Memorandum & Order (Doc. No. 16).) Defendants United Homes, United Property Group, Hershco, and Galit Network filed an answer to the complaint alleging counter-claims against all other defendants. (Doc. No. 17.) The Benshabats filed a motion to dismiss. (Doc. No. 25.) Thereafter, Judge Mann issued an order on plaintiff’s original motion for default, denying the motion with respect to all defendants except for First United, who had yet to appear. (Doc. No. 30.) Judge Mann found that plaintiff would be entitled to an entry of default against First United, that First United had waived

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any timeliness defense by failing to appear and raise the defense, and that First United had admitted all well-pleaded allegations as to liability. (*Id.* at 2–3.) However, Judge Mann deferred an inquest on damages until after disposition of the claims against the other defendants. (*Id.* at 4.) The Clerk of Court never made an entry of default, and this Court has not adopted Judge Mann’s order as to default. Plaintiff also ultimately withdrew the action as against defendant Ocwen Loan Servicing, LLC. (Stip. Of Dismissal (Doc. No. 36).)

Turning to the defendants bringing the present motion, plaintiff accuses the Benschabats of providing a “made-to-order” appraisal that intentionally overstated the value of her home. (*Id.* at ¶ 2.) The Benschabats allegedly arrived at the inflated appraisal figure by only including sales made by United Homes (not the value of all surrounding neighborhood homes) without including the sales history. (*Id.* at ¶ 73–74.) The Benschabats also allegedly *368 included the value of anticipated construction and new features, without devaluing the property for existing problems. (*Id.* at ¶ 5.) The appraisal, in turn, furthered United Home’s ability to charge higher prices for faulty houses, and enabled First United to provide large, unfavorable mortgages to minority homebuyers. (*Id.* at ¶ 2.)

On November 12, 2010, the Benschabats filed a motion to dismiss. (Doc. No. 25.) The Benschabats argue, among other things, that according to 12(b)(6) of the Federal Rules of Civil Procedure, many of plaintiff’s claims against the Benschabats failed to state a claim for which relief could be granted, as the claims are time-barred by the relevant statutes of limitations. Plaintiff failed to file any opposition the present motion to dismiss. (*See* Ltr. from Counsel for Moving Defs. (Doc. No. 26).) Discovery has been ongoing, and the Benschabats, in addition to all other remaining defendants, recently filed a request for a pre-motion conference in order to seek leave to file a summary judgment motion on grounds including the statute of limitations. (Doc. Nos. 74–77.)

STANDARD OF REVIEW

A motion to dismiss for failure to state a claim pursuant to Federal Rule of Civil Procedure 12(b)(6) requires the court to examine the legal, rather than factual, sufficiency of a complaint. *Harris v. Mills*, 572 F.3d 66, 71 (2d Cir.2009). As required by Rule 8(a)(2), a pleading must contain a “short and plain statement of the claim showing that the pleader is entitled to relief.” To withstand a motion to dismiss, “a complaint must contain sufficient

factual matter, accepted as true, to ‘state a claim to relief that is plausible on its face.’ ” *Ashcroft v. Iqbal*, 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007)).

A court considering a 12(b)(6) motion must “take[] factual allegations [in the complaint] to be true and draw[] all reasonable inferences in the plaintiff’s favor.” *Harris*, 572 F.3d at 71 (citation omitted). A complaint need not contain “ ‘detailed factual allegations,’ ” but it must contain “more than an unadorned, the-defendant-unlawfully-harmed-me accusation.” *Iqbal*, 556 U.S. at 678, 129 S.Ct. 1937 (quoting *Twombly*, 550 U.S. at 555, 127 S.Ct. 1955). In other words, “[t]hreadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice.” *Id.* (citing *Twombly*, 550 U.S. at 555, 127 S.Ct. 1955). Rather, the plaintiffs’ complaint must include “enough facts to state a claim to relief that is plausible on its face.” *Twombly*, 550 U.S. at 570, 127 S.Ct. 1955. “A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.” *Iqbal*, 556 U.S. at 678, 129 S.Ct. 1937 (citing *Twombly*, 550 U.S. at 556, 127 S.Ct. 1955). The determination of whether “a complaint states a plausible claim for relief will ... be a context-specific task that requires the reviewing court to draw on its judicial experience and common sense.” *Id.* at 679, 129 S.Ct. 1937 (citing *Iqbal v. Hasty*, 490 F.3d 143, 157–58 (2d Cir.2007)).

In considering a motion to dismiss for failure to state a claim pursuant to Rule 12(b)(6), a district court must limit itself to the facts stated in the complaint, documents attached to the complaint as exhibits, and documents incorporated by reference in the complaint. *Hayden v. Cnty. of Nassau*, 180 F.3d 42, 54 (2d Cir.1999).

While *pro se* plaintiffs must satisfy these pleading requirements, federal courts are “obligated to construe a *pro se* complaint liberally.” *See Harris*, 572 F.3d at 71–72 (2d Cir.2009) (citations omitted). In other *369 words, trial courts hold *pro se* complaints to a less exacting standard than they apply to complaints drafted by attorneys. *Haines v. Kerner*, 404 U.S. 519, 520–21, 92 S.Ct. 594, 30 L.Ed.2d 652 (1972); *Boykin v. KeyCorp*, 521 F.3d 202, 213–14 (2d Cir.2008). Since *pro se* litigants “are entitled to a liberal construction of their pleadings, [their complaints] should be read to raise the strongest arguments that they suggest.” *Green v. United States*, 260 F.3d 78, 83 (2d Cir.2001) (citation and internal quotation marks omitted). When a *pro se* plaintiff has altogether failed to satisfy a pleading requirement,

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however, the court should not hesitate to dismiss his claim. See *Rodriguez v. Weprin*, 116 F.3d 62, 65 (2d Cir.1997); see also *Johnson v. City of New York*, 669 F.Supp.2d 444, 448 (S.D.N.Y.2009) (“[T]o survive a motion to dismiss, even a *pro se* plaintiff must plead enough facts to state a claim to relief that is plausible on its face.” (citation and internal quotation marks omitted)).

DISCUSSION

The Benshabats’ motion to dismiss raises multiple grounds for dismissal, including a challenge to the timeliness of the complaint. As the Court finds that the movants’ timeliness arguments have merit, only those grounds are discussed below.

I. Claims Barred by Reason of Statute of Limitations

Pursuant to Federal Rule of Civil Procedure 8(c)(1), “[t]he lapse of a limitations period is an affirmative defense that a defendant must plead and prove.” *Staehr v. Hartford Fin. Servs. Grp., Inc.*, 547 F.3d 406, 425 (2d Cir.2008). However, a defendant may raise a pre-answer statute of limitations defense during a Rule 12(b)(6) motion to dismiss “[w]here the dates in a complaint show that an action is barred by a statute of limitations.” *Ghartey v. St. John’s Queens Hosp.*, 869 F.2d 160, 162 (2d Cir.1989). On a motion to dismiss, the Court must “accept all of the factual allegations [in the complaint] as true, and draw all reasonable inferences in the plaintiff’s favor.” *Ofori-Tenkorang v. Am. Int’l Grp., Inc.*, 460 F.3d 296, 298 (2d Cir.2006). “ ‘While a statute-of-limitations defense may be raised in a motion to dismiss under [Rule] 12(b)(6), such a motion should not be granted unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim that would entitle him to relief.’ ” *Ortiz v. Cornetta*, 867 F.2d 146, 148 (2d Cir.1989) (citation omitted). Therefore, the Court can only grant a motion to dismiss based on statute of limitations grounds if there is no factual question as to whether the alleged violations occurred within the statutory period. See *Old Republic Ins. Co. v. Hansa World Cargo Serv., Inc.*, 51 F.Supp.2d 457, 468 (S.D.N.Y.1999).

A. Applicable Statutes of Limitations³

As explained below, plaintiff’s FHA claims are governed by a two-year limitations period, and her fraud claim has at least a six-year limitations period. All other claims are

governed by three-year limitations periods.

*370 1. Fair Housing Act Claims pursuant to 42 U.S.C. §§ 3604, 3605

To bring a claim under either 42 U.S.C. § 3604 or § 3605 of the Fair Housing Act (“FHA”), “[a]n aggrieved person may commence a civil action in an appropriate United States district court or State court not later than 2 years after the occurrence or the termination of an alleged discriminatory housing practice.” 42 U.S.C. § 3613(a)(1)(A); *Adams v. Han*, 478 Fed.Appx. 686, 687–88 (2d Cir.2012).

2. Civil Rights Claims pursuant to 42 U.S.C. §§ 1981, 1982, and 1985

[1] [2] “As there is no federal statute of limitations governing the Reconstruction-era civil rights statutes ... ‘federal courts should select the most appropriate or analogous state statute of limitations’ to determine the proper limitations period.” *Bacon v. Suffolk Legislature*, No. 05–CV–4307 (JFB)(ETB), 2007 WL 2288044, at *4–5 (E.D.N.Y. Aug. 8, 2007) (quoting *Goodman v. Lukens Steel Co.*, 482 U.S. 656, 660, 107 S.Ct. 2617, 96 L.Ed.2d 572 (1987)). For §§ 1982 and 1985 actions, federal courts in New York follow the three-year limitations period set by New York Civil Practice Law and Rules (“NYCPLR”) § 214(5). See *id.* (§ 1985); see also *Paige v. Police Dep’t*, 264 F.3d 197, 199 n. 2 (2d Cir.2001) (§ 1985); *Barkley*, 2007 WL 2437810 at *22 (§ 1982); see also *Bacon*, 2007 WL 2288044 at *5 (noting that neither the Supreme Court nor the Second Circuit have ruled as to § 1982).

[3] The applicable statute of limitations for plaintiff’s § 1981 claim turns on whether plaintiff states a claim under the statute as it was originally passed, or under its 1991 Amendments. See *Jones v. R.R. Donnelley & Sons Co.*, 541 U.S. 369, 382, 124 S.Ct. 1836, 158 L.Ed.2d 645 (2004). In 1991, Congress amended § 1981, expanding the scope of the phrase to “make and enforce contracts” to include “making, performance, modification, and termination of contracts, and the enjoyment of all benefits, privileges, terms, and conditions of the contractual relationship,” thereby adding new causes of action. *Id.* at 383, 124 S.Ct. 1836. Where a plaintiff brings claims under the new causes of action created by the 1991 Amendments, the statute of limitations is governed by 28

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U.S.C. § 1658, which applies a four-year limitations period for civil actions “arising under an Act of Congress enacted after the date of [its] enactment” in 1990. *Id.* However, where a plaintiff brings a claim established by the original § 1981, that claim is subject to the “‘borrowed’ limitations periods” from state law.” *Id.* at 382, 124 S.Ct. 1836. Here, plaintiff claims that she was targeted based on her race to be fraudulently induced to enter into a contract. “Plainly, this claim addresses plaintiff’s rights to make contracts and therefore arises under the original statute. Accordingly, plaintiff’s first cause of action is subject to a three-year statute of limitations.” *Mahmud v. Kaufmann*, 496 F.Supp.2d 266 (S.D.N.Y.2007) (citing *Jones*, 541 U.S. at 382, 124 S.Ct. 1836); see *Barkley*, 2007 WL 2437810 at *14 (holding that the three-year statute of limitations applied to a “reverse redlining” § 1981 claim in a nearly identical case).

3. Claims pursuant to State and City Law

^[4] New York State Human Rights Law (“NYSHRL”) § 296(5) and New York General Business Law § 349 are governed by the three-year limitations period set by § 214 of the NYCPLR for “an action to recover upon a liability, penalty or forfeiture created or imposed by statute.” *Kassner v. 2nd Avenue Delicatessen Inc.*, 496 F.3d 229, 238 (2d Cir.2007) (§ 296(5)); *Barkley*, 2007 WL 2437810 at *22; *371 *Caldwell v. Gutman, Mintz, Baker & Sonnenfeldt, P.C.*, No. 08–CV–4207 (JFB)(WDW), 2012 WL 1038804, at *9 (E.D.N.Y. Mar. 28, 2012) (§ 349).

Plaintiff also alleges unlawful discriminatory practices in violation of Title 8 of the New York City Administrative Code (“NYC Admin Code”), including §§ 8–107.5 and 8–107.6. (Compl.¶ 251.) “A civil action commenced under [Title 8] must be commenced within three years after the alleged unlawful discriminatory practice....” NYC Admin. Code § 8–502(d); *Bermudez*, 783 F.Supp.2d at 574.

Plaintiff also alleges common law negligence, which is “an action to recover damages for a personal injury.” *Id.* § 214(5). The claim is therefore governed by § 214 of the New York Civil Practice Law and Rules, which sets a three-year limitations period for the commencement of an action. See, e.g., *Barkley*, 2007 WL 2437810 at *22; *Syracuse v. Loomis Armored US, LLC*, No. 11–CV–00744 (MAD/GHL), 2012 WL 88332, at *4 (N.D.N.Y. Jan. 11, 2012) (negligence).

Under New York law, plaintiff’s cause of action in fraud

must be commenced within two years from the time the fraud was discovered, or with the exercise of due diligence, should have been discovered, or six years from the date the alleged fraud was committed, whichever is longer. N.Y. C.P.L.R. §§ 213(8), 203(g); *Cappelli v. Berkshire Life Ins. Co.*, 276 A.D.2d 458, 713 N.Y.S.2d 756, 757 (N.Y.App.Div.2000).

B. Application of Statute of Limitations to Plaintiff’s Claims

In her complaint, plaintiff presents a “review” of “60 properties sold by the United Homes entities” “during 2002 and 2003.” (Compl. ¶ 37.) Regarding her own experience, plaintiff alleges that her interaction with defendants generally began in “summer of 2005.” (*Id.* at ¶ 111.) She further alleges that defendants Benshabats conducted the appraisal on her home “from June to August 2005,” (*id.* at ¶ 76), and that the transaction closed on August 5, 2005, (*id.* at ¶ 126). Plaintiff filed her complaint on May 10, 2010, (see Doc. No. 1), almost five years after the most recent alleged conduct. Because plaintiff’s claims, save for common law fraud, are subject to statutes of limitations of three-years or less, all such claims are time-barred unless the Court finds that the accrual of such claims was delayed or equitable tolling is warranted.

C. Issues Related to When Plaintiff’s Claims Accrued

There are two doctrines that could delay the commencement of the statutory period, so as to make some of plaintiff’s claims timely. The diligence-discovery rule could delay the accrual of plaintiff’s claims until she discovered her injury. Or the continuing violation theory could extend the injury itself, thereby also delaying the accrual of the cause of action. However, as discussed below, neither doctrine sufficiently delays the claims in plaintiff’s complaint as it is written.

1. Discovery Rule of Accrual

^[5] ^[6] “[F]ederal rules of accrual apply even when we “borrow” an analogous state statute of limitations.” *Corcoran v. New York Power Auth.*, 202 F.3d 530, 544 (2d Cir.1999). Under federal law, an action normally accrues at the time of injury. See, e.g., *Kronisch v. U.S.*, 150 F.3d 112, 121 (2d Cir.1998). However, “where plaintiff would reasonably have had difficulty discerning the fact or cause of injury at the time it was inflicted, the

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so-called ‘diligence-discovery rule of accrual’ applies.” *Id.* Under this rule, “accrual may be postponed until the plaintiff has or with reasonable diligence should have discovered the critical facts of both his injury and its cause.” *Corcoran*, 202 F.3d at 544.

Claims under the FHA, as well as under §§ 1981, 1982 and 1985, are subject to the *372 discovery rule and thus accrue when a “plaintiff knows or has reason to know of the injury that serves as the basis for the action.” *Dombrowski v. City of New York*, 116 F.3d 465, *1 (2d Cir.1997) (§ 1981); see *Jaghory v. New York State Dep’t of Educ.*, 131 F.3d 326, 331 (2d Cir.1997) (§ 1985); *Ungar v. New York City Housing Auth.*, No. 06–CV–1968, 2009 WL 125236, at *14 (S.D.N.Y. Jan. 14, 2009) (suggesting that FHA claims accrue when “plaintiff knows or has reason to know of the injury which is the basis of his action”); see also *Singleton v. City of New York*, 632 F.2d 185, 191–93 (2d Cir.1980) (“[For federal claims,] [t]he crucial time for accrual purposes is when the plaintiff becomes aware that he is suffering from a wrong for which damages may be recovered in a civil action.... Where no single act is sufficiently decisive to enable a person to realize that he has suffered a compensable injury, the cause of action may not accrue until the wrong becomes apparent.”); but see *Rodriguez v. Village of Island Park, Inc.*, No. 89–CV–2676, 1991 WL 128568, at *7 (E.D.N.Y. July 2, 1991) (“No cases in this circuit have specifically decided whether a discovery standard applies for claims under § 1982 or the Fair Housing Act....”)

^[7] ^[8] Discovery of the “critical facts” of injury and causation “requires only knowledge of, or knowledge that could lead to, the basic facts of the injury, i.e., knowledge of the injury’s existence and knowledge of its cause or of the person or entity that inflicted it.... [A] plaintiff need not know each and every relevant fact of his injury or even that the injury implicates a cognizable legal claim. Rather, a claim will accrue when the plaintiff knows, or should know, enough of the critical facts of injury and causation to protect himself by seeking legal advice.” *Corcoran*, 202 F.3d at 544 (internal quotations omitted). This reasoning has been applied to the context of employment discrimination, where a plaintiff’s claim begins to run when he learns of the discriminatory conduct, e.g. the unlawful termination, not when the plaintiff has reason to know of a possibly discriminatory motive for that conduct. See *Morris v. Broadridge Financial Services, Inc.*, No. 10–CV–1707 (JS) (AKT), 2010 WL 5187669, at *3 (E.D.N.Y. Dec. 14, 2010) (collecting cases).

^[9] The allegedly discriminatory, deceptive, and negligent

practices in plaintiff’s complaint occurred in “summer 2005” up to the closing date August 5, 2005. (Compl. ¶¶ 76, 111, 126.) It is at this time that plaintiff suffered injury. However, plaintiff allegedly did not know of her injuries at that time. She does not specify when she moved into her home, but alleges that “many warranty problems came to her attention within months.” (*Id.* at ¶ 143.) Plaintiff alleges that she contacted defendants directly to discuss the problems, and she “organized with the other homeowners on her block facing similar issues and contacted various elected officials, attorneys, [and] help organizations.” (*Id.* at ¶ 146.) She “became increasingly suspicious that she had paid more for the house than it was actually worth” “in the years after the closing.” (*Id.* at ¶ 147.) In 2010, she allegedly hired an appraiser to review the appraisal performed by defendants. (*Id.*)

Even if she did not know of its legal significance at the time, plaintiff learned of her injury “within months” of moving into her new home, when the “warranty problems came to her attention.” While plaintiff does specify the exact date she learned of these problems, if it was “within months” of the closing on August 5, 2005, it is still well outside the three-year statutory period, as plaintiff did not file her complaint until five years later. The fact that plaintiff only became “increasingly suspicious” in the years that followed does *373 not prevent accrual, as plaintiff had “reason to know” of the injury.

2. Continuing Violation Theory

Many of plaintiff’s claims concern discrete violations of laws that prohibit finite conduct, which, aside from the discovery rule discussed above, accrue on the date of the injury. See, e.g., *Gould v. Berk & Michaels, P.C.*, No. 89–CV–5036 (SWK), 1991 WL 152613, at *5 (S.D.N.Y. July 29, 1991) (actions for professional negligence accrue on the date the injury is suffered); *Radin v. Albert Einstein Col. of Med. of Yeshiva Univ.*, No. 04–CV–704 (RPP), 2005 WL 1214281, at *16 (S.D.N.Y. May 20, 2005) (actions under Business Law § 349 accrue when plaintiff has been injured by the deceptive act or practice).

^[10] However, some of plaintiff’s claims concern unlawful “practices,” which can occur over a period of time, thereby constituting a “continuing violation.” The statute of limitations for certain discrimination claims, including the FHA, can be effectively extended under the “continuing violation” theory, whereby the plaintiff claims, not just an isolated violation, but an ongoing policy of discrimination which extend into the limitations

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period. See *Havens Realty Corp. v. Coleman*, 455 U.S. 363, 381, 102 S.Ct. 1114, 71 L.Ed.2d 214 (1982); *Grimes v. Fremont General Corp.*, 785 F.Supp.2d 269, 291–92 (S.D.N.Y.2011). In addition to her FHA claims, the continuing violation theory can be applied to plaintiff's federal and state civil rights claims, as well as the City Administrative Code violations. See e.g., *Cornwell v. Robinson*, 23 F.3d 694, 703–04 (2d Cir.1994) (§ 1985); *Bermudez v. City of New York*, 783 F.Supp.2d 560, 574 (S.D.N.Y.2011) (§ 1981); *Thompson v. Metropolitan Life Ins. Co.*, 149 F.Supp.2d 38, 54–55 (S.D.N.Y.2001) (§ 1982); *Bermudez*, 783 F.Supp.2d at 574 (N.Y.SHRL and NYC Admin Code).

^[11] Where there are continuing violations that give rise to a claim of a discriminatory policy, the statute of limitations period does not begin to run until the end of the “last asserted occurrence” of a discriminatory policy. *Havens Realty Corp.*, 455 U.S. at 363, 102 S.Ct. 1114; see also *Patterson v. Cnty. of Oneida*, 375 F.3d 206, 220 (2d Cir.2004) (“To bring a claim within the continuing violation exception, a plaintiff must at the very least allege that one act of discrimination in furtherance of the ongoing policy occurred within the limitations period.”); but see *National R.R. Passenger Corp. v. Morgan*, 536 U.S. 101, 114–15, 122 S.Ct. 2061, 153 L.Ed.2d 106 (2002) (holding that a “continuing violation” must involve a discriminatory practice, not serial discrete acts); but see also *Patterson*, 375 F.3d at 220 (no recovery for discrete acts outside the statutory time period).

^[12] However, plaintiff does not allege a discriminatory practice that extends into the limitations period. Her complaint does not adequately allege any actions on the part of any defendants after 2005, let alone actions supporting an ongoing discriminatory policy. Plaintiff does, however, allege additional acts of discrimination by defendants, pursuant to an alleged discriminatory policy, directed toward *other* victims. *Barkley v. Olympia Mortgage Co.*, a case substantially similar to this one, recognized that violations subsequent to those directed at the plaintiffs in that case could be used to support their allegation of an unlawful policy. *Id.* The *Barkley* court reviewed alleged sales of property by United Homes, also a defendant in this case, in minority neighborhoods during the statutory period, and reasoned that plaintiffs had sufficiently alleged a policy of FHA violations, even though the violations were not directed at any of the plaintiffs in the case. *Id.* Despite that the *Barkley* plaintiffs' individual claims fell outside of the *374 two-year statutory period, the court allowed the claims to stand under the continuation violation theory. See *Barkley*, 2007 WL 2437810, at *16.

Here, however, the continuing violation doctrine does not apply. Plaintiff does not allege any violations *following* her closing on August 5, 2005. The “review” of sales in plaintiff's complaint references only sales taking place *before* her own, and thus even farther outside the statutory period. (*Id.* at ¶ 37.) Because plaintiff only makes generalized allegations about a continuing policy that could even possibly extend into the statutory period, the continuing violation theory cannot be applied to render her claims timely. See, e.g., *Grimes*, 785 F.Supp.2d at 292 (finding that continuing violation doctrine did not apply where plaintiff made only general assertions about defendants' conduct within the limitations period, distinguishing *Barkley*, wherein plaintiffs made concrete allegations regarding sales during the statutory period); see also, e.g., *Shelter Inc. Realty v. City of New York*, No. 01–CV–7015, 2007 WL 29380, at *12 (E.D.N.Y. Jan. 4, 2007).

D. Equitable Tolling

^[13] Because plaintiff's claims are not timely, her complaint must be dismissed unless the Court will toll the limitations period. For plaintiff's federal claims, “[w]here the federal statute does not provide a statute of limitations and a federal court ‘borrows’ a state statute of limitations, the court also ‘borrows’ the applicable state law tolling rules unless those rules are inconsistent with, or would frustrate the purposes of, the federal law.” *Corcoran*, 202 F.3d at 543; *M.D. v. Southington Bd. of Educ.*, 334 F.3d 217, 223 (2d Cir.2003) (citation omitted).

^[14] ^[15] ^[16] ^[17] The court may “equitably toll” the statute of limitations where a litigant can show that she “has been pursuing h[er] rights diligently” and that “some extraordinary circumstance stood in h[er] way.” *Torres v. Barnhart*, 417 F.3d 276 (2d Cir.2005) (citing *Pace v. DiGuglielmo*, 544 U.S. 408, 125 S.Ct. 1807, 161 L.Ed.2d 669 (2005)).⁴ “Under the doctrine of “fraudulent concealment,” the statute of limitations will be equitably tolled if a plaintiff establishes the following:

- (1) the defendant concealed from her the existence of her cause of action during the statutory period, (2) she commenced the action within the statutory period from the time that she became aware of her claim, and (3) her continuing ignorance was not attributable to lack of diligence on her part.

Council v. Better Homes Depot, Inc., 2006 WL 2376381, *8–11 (E.D.N.Y. Aug. 16, 2006) (quoting *New York v. Hendrickson Bros., Inc.*, 840 F.2d 1065, 1083 (2d Cir.1988)). Furthermore, the elements of fraudulent concealment must be pled with specificity

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pursuant to Federal Rule of Civil Procedure 9(b). *Grimes*, 785 F.Supp.2d at 291; *375 *Barkley*, 2007 WL 2437810, *16 (citing *Armstrong v. McAlpin*, 699 F.2d 79, 90 (2d Cir.1983)).

[18] To allege the first prong, concealment, “a plaintiff must either plausibly allege that the defendant took affirmative steps to prevent the plaintiff’s discovery of his claim or injury or that the wrong itself was of such a nature as to be self-concealing.” *Singh v. Wells*, 445 Fed.Appx. 373, 378 (2d Cir.2011) (quoting *Hendrickson*, 840 F.2d at 1083) (internal quotation marks omitted). Here, plaintiff alleges that defendants scheduled her closing so as to make it difficult for her to have an attorney review her documentation, actively discouraged her from bringing an attorney to her closing, and provided an attorney for her at the closing with the allegedly false implication that he would advise her according to her interests. “The act of employing ostensibly independent legal counsel as part of a predatory lending scam has been held to satisfy the concealment element by several district courts in this circuit.” *Barkley*, 2007 WL 2437810 at *17 (citing cases).

[19] As for the third prong, at least one court in this circuit found that plaintiffs satisfied the due diligence requirement, since, despite the defective condition of their homes, they would not have known they were the victims of a discriminatory practice “[w]ithout meeting other United Homes clients or explaining their circumstances to an attorney who responsibly represented their interests.” *Id.* Here, however, plaintiff does not specify when she met with other member of the community. She fails to meet the second prong for the same reason—she has failed to specify a date within the statute of limitations on which she learned of her cause of action. *Id.* at *17; see also *Council*, 2006 WL 2376381, at *8–9, 2006 U.S. Dist. LEXIS 57851, at *27–28. Therefore, on the current complaint, plaintiff does not sufficiently allege fraudulent concealment.⁵

Therefore, all of plaintiff’s claims, aside from common law fraud, are untimely, and the current complaint should be dismissed. As discussed below, plaintiff shall be given an opportunity to respond to the Court with any additional facts that she believes can be plead in good faith, either as to unlawful conduct within the statutory period, or as to conduct justifying equitable tolling.

E. Sua Sponte Dismissal of Claims Against Other Defendants

[20] “Where one defendant has successfully raised a statute of limitations defense with respect to a particular claim, a court may also dismiss the claim *sua sponte* as to

similarly situated defendants.” *Coakley v. Jaffe*, 49 F.Supp.2d 615, 623 (S.D.N.Y.1999); see *Leonhard v. United States*, 633 F.2d 599, 609 n. 11 (2d Cir.1980). Here, the analysis above applies to the nonmoving defendants as much as the moving defendants. Aside from common law fraud, plaintiff has not alleged any timely claims against any defendants within the statutory period. Therefore all such claims should be dismissed as against all defendants.

*376 The Second Circuit has cautioned against *sua sponte* dismissal on untimeliness grounds without giving the litigant notice and an opportunity to be heard. *Abbas v. Dixon*, 480 F.3d 636, 640 (2d Cir.2007) (“The pleading requirements in the Federal Rules of Civil Procedure, however, do not compel a litigant to anticipate potential affirmative defenses, such as the statute of limitations, and to affirmatively plead facts in avoidance of such defenses.”) (citations omitted). Here, plaintiff has been given notice and an opportunity to be heard as to timeliness, an opportunity she declined to pursue.⁶ However, as the present motion was brought by only some of defendants in this case, and out of an abundance of caution, the Court will give plaintiff an opportunity to be heard as to timeliness with respect to the claims against the other defendants.⁷

The Court finds that *sua sponte* dismissal is warranted as to First United as well, notwithstanding its failure to appear. In her order, Judge Mann specifically declined to take up the issue of the timeliness of plaintiff’s complaint, as First United had arguably waived such a defense by failing to appear. Although Judge Mann’s analysis is sound, given that the Court has now taken up the timeliness issue *sua sponte* as to the remaining defendants, there is no apparent reason why the Court should decline to do so with respect to First United as well. Cf. *Eppendorf-Netheler-Hinz GmbH v. Enterton Co.*, 89 F.Supp.2d 483, 488 (S.D.N.Y.2000), *aff’d* 14 Fed.Appx. 102, 104 (2d Cir.2011) (affirming summary judgment on grounds of laches as well as *sua sponte* vacatur of a default judgment against a non-appearing defendant and dismissal as to that defendant on the same grounds).

The Court hereby gives notice to plaintiff that her complaint is subject to dismissal on the basis of untimeliness unless she can allege plausible facts going to the discovery of her injury, further conduct by defendants, or entitlement to tolling of the statute of limitations, with respect to all claims save for state law fraud, against all remaining defendants, including First United.

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II. Plaintiff's State Law Fraud Claim and Supplemental Jurisdiction

^[21] ^[22] Pursuant to 28 U.S.C. § 1367(c)(3), a district court has the discretion to decline to exercise supplemental jurisdiction over state claims after the dismissal of all claims over which it had original jurisdiction or over claims raising “a novel or complex issue of State law.” 28 U.S.C. § 1367(c). “In the usual case in which all federal-law claims are eliminated before trial, the balance of factors to be considered under the [supplemental] jurisdiction doctrine—judicial economy, convenience, fairness, and comity—will point toward declining to exercise jurisdiction over the remaining state-law claims.” *Carnegie–Mellon Univ. v. Cohill*, 484 U.S. 343, 350 n. 7, 108 S.Ct. 614, 98 L.Ed.2d 720 (1988). Justification for exercising supplemental jurisdiction “lies in considerations of judicial economy, convenience and fairness to litigants; if these are not present a federal court should hesitate to exercise jurisdiction over state claims.” *United Mine Workers v. Gibbs*, 383 U.S. 715, 726, 86 S.Ct. 1130, 16 L.Ed.2d 218 (1966).

*377 ^[23] Here, plaintiff's state law fraud claim is timely. However, the Court has currently dismissed all of plaintiff's federal claims against the moving defendants. Because the Court is ordering plaintiff to show cause why the claims against the other defendants should not also be dismissed, and because the Court is allowing plaintiff leave to amend some of the allegations related to her federal claims, the Court finds that judicial economy, convenience, and fairness would not be served by exercising supplemental jurisdiction. If plaintiff amends to successfully allege a timely federal cause of action, the

Court will entertain plaintiff's state law fraud claim at that time; conversely, if plaintiff fails to state a timely federal claim, the Court will decline to exercise supplemental jurisdiction over the state law fraud claim. Accordingly, the moving defendants' motion to dismiss plaintiff's state law fraud claim is denied without prejudice and may be renewed if plaintiff amends to adequately plead a timely federal cause of action.

CONCLUSION

For the reasons stated above, the Benshabats' motion to dismiss plaintiff's state law fraud claim, is DENIED without prejudice, and their motion to dismiss all other claims is GRANTED. Plaintiff is ORDERED TO SHOW CAUSE on or before January 21, 2013 why the Court should not dismiss all claims, except for the state law fraud claim, against the remaining non-moving defendants on statute of limitations grounds for the reasons above. If plaintiff does not comply with this Order, all claims against all defendants will be dismissed with prejudice, and that the Court will decline to exercise its supplemental jurisdiction with respect to her state law fraud claim.

The Clerk of Court shall mail a copy of this Memorandum and Order to plaintiff.

SO ORDERED.

Footnotes

- ¹ The following facts are taken from plaintiff's complaint. However, it should be noted that, to a large extent, the complaint reproduces facts from, and brings the same claims as, the complaint filed in *Barkley v. Olympia Mortgage Co.*, 2007 WL 2437810 (E.D.N.Y.2007). (See 1: 104–cv–00875; Amd. Comp. (Doc. No. 78).)
- ² Plaintiff alleges that one or all of the defendants violated the following laws: New York State General Business Law § 349; fraud; civil conspiracy to defraud; Fair Housing Act, 42 U.S.C. §§ 3604, and 3605; Civil Rights Act, 42 U.S.C. §§ 1981, 1982, and 1985; New York State Human Rights Law, Executive Law § 296(5); Title 8 of the New York City Administrative Code; negligence; Truth in Lending Act, 15 U.S.C. § 1601 *et seq.*
- ³ Plaintiff's complaint also includes a claim under the Truth in Lending Act, 15 U.S.C. § 1601, which must be brought within one year from “the date of the occurrence of the violation.” 15 U.S.C. § 1640(e). “In cases involving ‘closed-end credit’ transactions, such as mortgages, the ‘occurrence of the violation’ typically refers to the date on which a plaintiff enters into a loan agreement.” *Barkley*, 2007 WL 2437810 at *17. Plaintiff does not name the Bashabats in its TILA allegations. (See ¶ 302 (naming only First United).) However, as plaintiff alleged that she entered into the mortgage in or around August 2005, any TILA claim is time-barred.
- ⁴ The state standard for equitable tolling is substantially similar to the federal standard. “Under New York law, the doctrines of equitable tolling or equitable estoppel may be invoked to defeat a statute of limitations defense when the plaintiff was induced by fraud, misrepresentations or deception to refrain from filing a timely action.” *Abbas v. Dixon*, 480 F.3d 636, 642 (2d Cir.2007) (internal quotation marks omitted). Equitable tolling is applicable where: (1) the defendant has wrongfully deceived or misled the

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Clement v. United Homes, LLC, 914 F.Supp.2d 362 (2012)

plaintiff in order to conceal a cause of action, and (2) the plaintiff's failure to commence the action within the statutory period is not due to lack of diligence on her part. *Council v. Better Homes Depot, Inc.*, 2006 WL 2376381, *11–12 (citing *Gleason v. Spota*, 194 A.D.2d 764, 599 N.Y.S.2d 297 (N.Y.App.Div.1993); *Ramsay v. Imogene Bassett Hosp.*, 113 A.D.2d 149, 495 N.Y.S.2d 282 (N.Y.App.Div.1985)).

- 5 Defendants argue that the filing of a lawsuit by private parties puts plaintiffs with identical claims on notice of their potential claims. See *Korwek v. Hunt*, 646 F.Supp. 953, 958 (S.D.N.Y.1986), *aff'd*, 827 F.2d 874 (2d Cir.1987) (citing *Berry Petroleum Co. v. Adams & Peck*, 518 F.2d 402, 410 (2d Cir.1975)); *Weiss v. La Suisse, Societe D'Assurances Sur La Vie*, 381 F.Supp.2d 334, 339 (S.D.N.Y.2005). However, the lawsuits in the cited cases involved widely publicized suits based on the exact same conduct, which is not the case here. Furthermore, the *Barkley* case, which lodged the same claims against many of the defendants in this case, was filed before plaintiff even closed on her house, rendering the legal fiction of notice actually impossible in this case.
- 6 Plaintiff failed to file any opposition to the present motion to dismiss. (See Ltr. from Counsel for Moving Defs. (Doc. No. 26).)
- 7 Notably, all other remaining defendants raised a statute of limitations defense in their answers, and all have recently sought leave to file for summary judgment on grounds including the statute of limitations. (Answers (Doc. Nos. 6, 17); Premotion Conference Requests (Doc. Nos. 74–77).)

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APPENDIX

Estrada v Metropolitan Prop. Group, Inc., 110 A.D.3d 497 (2013)

973 N.Y.S.2d 147, 2013 N.Y. Slip Op. 06639

110 A.D.3d 497, 973 N.Y.S.2d 147, 2013 N.Y. Slip Op.
06639

Brian Estrada, Appellant
v
Metropolitan Property Group, Inc., et al.,
Respondents.

Supreme Court, Appellate Division, First
Department, New York
October 15, 2013

CITE TITLE AS: Estrada v Metropolitan Prop.
Group, Inc.

HEADNOTE

Cohen, Frankel & Ruggiero, LLP, New York (Mina Kennedy of counsel), for appellant.

Pick & Zabicki, LLP, New York (Eric C. Zabicki of counsel), for Metropolitan Property Group, Inc., respondent.

Hogan Lovells US LLP, New York (Leah Rabinowitz of counsel), for Wells Fargo Bank, N.A., respondent.

Sahn Ward Coschignano & Baker, PLLC, Uniondale (Michele A. Pincus of counsel), for Victoria Hughes, respondent.

Order, Supreme Court, New York County (Donna M. Mills, J.), entered August 10, 2012, which, upon reargument of defendant Wells Fargo Bank, N.A.'s motion to dismiss, granted the motion and dismissed the complaint as against it, granted defendant Victoria Hughes's motion for summary judgment dismissing the complaint as against her, and granted defendant

Metropolitan Property Group, Inc.'s (the broker) cross motion for summary judgment dismissing the complaint as against it, unanimously affirmed, without costs.

Plaintiff could not have reasonably relied on alleged misstatements about a cooperative apartment's square footage in deciding to purchase the apartment. The advertisements for the apartment by the broker described the apartment as "550 s.f." and as "approximately 500 s.f." The discrepancy in the square footage in the various advertisements should have alerted plaintiff to the possibility that advertisements were not accurate with respect to square footage but mere sales puffery. Under these circumstances, plaintiff should have taken the opportunity to inspect the apartment before he contracted to buy it. Moreover, with respect to the appraiser and the bank, plaintiff could not have relied on the appraiser's report inasmuch as he entered into a contract to purchase the apartment four months before the appraisal was prepared. Accordingly, the court properly dismissed the fraud claims against defendants (*see Stuart Silver Assoc. v Baco Dev. Corp.*, 245 AD2d 96, 98-99 [1st Dept 1997]).

The court properly dismissed the breach of fiduciary duty claim against the broker. Given that the fraud claim was deficient, the only branch of the fiduciary duty claim that could have remained was one for "injury to property." However, that claim is time-barred by the three-year statute of limitations (*see CPLR 214 [4]; *2 Yatter v Morris Agency*, 256 AD2d 260, 261 [1st Dept 1998]), as the alleged injury occurred more than three years before the filing of this action. Concur—Andrias, J.P., Sweeny, Acosta, Saxe and Clark, JJ. [**Prior Case History: 2012 NY Slip Op 32131(U).**]

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APPENDIX

Unreported Disposition
Slip Copy, 46 Misc.3d 1201(A), 2014 WL 7177426
(Table), 2014 N.Y. Slip Op. 51758(U)

This opinion is uncorrected and will not be published
in the printed Official Reports.

Ramapo Realty LLC, Plaintiff,
v.
1236 Rogers Avenue, LLC, RAHIM
SIUNYKALIMI, et al, Defendants.

15083/08
Supreme Court, Kings County
Decided on December 12, 2014

CITE TITLE AS: Ramapo Realty LLC v 1236
Rogers Ave., LLC

ABSTRACT

OPINION OF THE COURT

Debra Silber, J.

Recitation, as required by CPLR 2219(a), of the papers
considered in the review of plaintiff's motion to confirm
the corrected Referee's report of sale and for leave to
enter a deficiency judgment, and defendants 1236 Rogers
Avenue, LLC and Rahim Siunykalmi's cross-motion to
reject the Referee's report of sale, and for an order
directing that no deficiency may be claimed by plaintiff.

PapersNumbered

Notice of Motion, Affirmation and
Exhibits..... 1-4d

Notice of Cross-Motion, Affirmation in Support and
Exhibits.....5-9o

Affidavit in Further Support of Motion and in Opposition
to

Cross-Motion and
Exhibits.....10-12p

Affirmation in Support of Cross-Motion and in Reply to

Plaintiff's Opposition and Exhibits13-14o

Other: Defendants' Memo of
Law.....15

*2 Upon the foregoing cited papers, and following a
hearing, the Decision/Order on this application is as
follows:

Plaintiff moves to confirm the corrected Referee's report
of sale and for leave to enter a deficiency judgment, and
defendants 1236 Rogers Avenue, LLC (the debtor) and
Rahim Siunykalmi (the guarantor) cross-move to reject
the Referee's report of sale, and for an order directing
that no deficiency may be claimed by plaintiff. The motion
and cross-motion are both granted in part and denied in
part as detailed below.

Procedural History

This foreclosure action concerns a property which is a
four-family house at 222 East 39th Street, Brooklyn, New
York, and was commenced on May 22, 2008. No answer
was submitted on behalf of the defendant borrower and a
Judgment of Foreclosure and Sale was issued on default
on June 17, 2010. Following issuance of the judgment, an
auction sale was held on August 19, 2010, at which an
upset price of \$880,258.42 was announced to prospective
bidders. Plaintiff was the high bidder, with a bid of
\$1,000, and plaintiff took title by deed dated April 18,
2012, almost two years after the auction.

Thereafter, plaintiff timely moved for a deficiency
judgment. Defendants 1236 Rogers Avenue, LLC and
Rahim Siunykalmi (as guarantor) were personally served
with plaintiff's notice of motion to confirm the report of
sale and for leave to enter a deficiency judgment. The
motion was granted on default, by order dated September
20, 2012. The deficiency in the Referee's report, before
deducting the value of the property, was \$1,057,548.36.

The defendants subsequently moved to vacate the
deficiency judgment, on the grounds that theReferee's
Report overstated the interest due by nearly \$185,000.
Plaintiff conceded the deficiency amount was not
calculated correctly with respect to the accrued interest
and taxes, due to the two years' delay in closing title. The
court granted that branch of defendants' motion which
sought to correct the calculation of the deficiency, and
directed that the Referee correct the report of sale, by
order dated February 7, 2014. The Referee subsequently

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Ramapo Realty LLC v 1236 Rogers Ave., LLC, Slip Copy (2014)

46 Misc.3d 1201(A), 2014 N.Y. Slip Op. 51758(U)

issued a Corrected Report of Sale, which was filed with the County Clerk on March 10, 2014. In the corrected report, the deficiency, before deducting the value of the property, is \$867,707.76

Plaintiff then moved to confirm the Corrected Referee's Report of Sale and for leave to enter a deficiency judgment. Defendants cross-moved, pursuant to [RPAPL §1355](#) and [§1371](#), for an order rejecting the Corrected Report of Sale and directing that no deficiency may be claimed by plaintiff, as plaintiff's announced upset price at the auction sale was in excess of the amount owing on the judgment of foreclosure and sale. In the event such relief was denied, defendants requested that the matter be set down for a hearing to determine the fair market value of the real property at the time of auction and the appropriate deficiency amount.

The defendants established that a hearing was necessary as to the fair and reasonable market value of the property, with one appraisal submitted on behalf of plaintiff in the amount of \$365,000 for the property's value on April 23, 2012, and another submitted on behalf of the defendants in the amount of \$600,000 for the property's value on August 19, 2010.

On July 28, 2014, the court issued a decision and order rejecting defendants' argument concerning the upset price, but directing that, in light of the conflicting appraisals submitted by the parties, an evidentiary hearing be held as to the fair market value of the subject property and *3 the proper amount of the deficiency. See [TPZ Corp. v Block 7589 Corp.](#), 233 AD2d 496 [2d Dept 1996]. It is noted that Jericho sold the property on June 21, 2013 to Rickey Marks for \$690,000, according to ACRIS, after purchasing it from plaintiff for \$255,000 on April 18, 2012, the same day plaintiff closed with the Referee. This latest sale clearly raised an issue of fact as to the proper valuation.

The Hearing

The hearing took place on September 8, 2014. Three witnesses testified for the plaintiff and one for the defendants. The plaintiff introduced three exhibits into evidence; they are Mr. Cheng's three appraisal reports. Defendant introduced one, Mr. Neglia's appraisal.

At the conclusion of the hearing, the court reserved decision.

Plaintiff's Witnesses

Raymond Mordekhai

Raymond Mordekhai testified that he does home purchasing for Jericho Homes. He's done it for ten years. As part of his work, he looks for foreclosure listings.

Jericho purchased the subject property from the plaintiff for \$255,000. The contract was signed in August of 2010 and the closing took place in April of 2012.

Mr. Mordekhai visited the property before the auction. It is a two story brick building. After the closing, he went inside and saw it was in fair condition, but required some work. He did not testify that it required a complete renovation, or that it couldn't be occupied as it was. Jericho wanted to "flip" the property, so they renovated it. He acted as the broker to sell it and he showed it in late 2012 or early 2013. The listing price was \$695,000. When he went back to show the property, it had been totally renovated. There were four new kitchens and four new bathrooms, new windows and a new front door. He did not know how much was spent by his client on the renovation.

Mr. Mordekhai stated that he went to the auction in 2010 and had authority and instructions to bid when he went to the auction. He did not bid because the upset price (of \$880,000) was too high.

Edmund Chang

Edmund Chang testified that he has been a real estate appraiser since 2002; he started his own company in 2004.

Mr. Chang stated that in November of 2009, James Orford of plaintiff Ramapo asked him to do a fair market value appraisal of the property, but without access to the interior. He was told by Mr. Orford to assume the property would require a "gut" renovation. Mr. Chang selected comparable properties and determined that the property at issue was worth \$400,000.

In April of 2012, Mr. Chang was asked by Rob Margolin of plaintiff Ramapo to do another appraisal. This time, he had interior access from Mr. Dilmanian, a principal of Jericho, the new owner. He did a walk through of the property. It consists of a basement and two floors. The lot was 30 feet by 100 feet. The building was 22 feet by 80 feet (which presumably means there was a driveway and two apartment per floor). There was demolition going on inside the building. It did not seem structurally sound to him. He saw old tile, old fixtures, worn joists and studs, the floor was soft and there was old paint. He took pictures and did the appraisal. He *4 admitted that he did

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not know if the items torn out of the house were operable before they were removed. He estimated the property to be worth \$365,000 as of April 23, 2012, which was less than the value he included in his earlier appraisal report with a valuation date of November 2, 2009.

In August of 2014, Mr. Chang was retained to do another appraisal of the the property, valued as of August 19, 2010, the date of the auction. This was after the court scheduled the hearing to determine the value. He visited the outside of the house on September 2, 2014; he did not go inside. He never saw the interior after Jericho finished its renovations. He picked the comparables. He concluded that the value was \$385,000 as of August 2010. He guessed/estimated that the value of the renovation was \$195,000. He calculated the cost of renovating the 3,520 square feet at \$55 per square foot to obtain this figure. He did not see the interior of the house before the demolition nor did he see the renovation after Jericho took title. He has no training in architecture or engineering. He does not know if what was torn out was operable. He estimated the renovation he never saw as “low level, cheap work.” He testified that the property was worth \$565,000 renovated.

Mr. Chang then testified that there were not many four-family properties in the area, so the comparables he used in 2014 are not really comparable. He explained that comparable No.3, a four-family, was sold for \$620,000, and he took \$7,500 off because it was a little larger and most significantly, he took \$200,000 off for the renovations needed to the subject property, even though he had no idea whether the comparable property was recently renovated or was, as was the subject property, in “fair condition.” Mr. Chang also opined that, for these comparables, at the time he prepared his second appraisal, the market was in decline, and values had gone down 4% to 6% in the prior six months. As a result, the actual sales price listed for these comparables were 4% to 6% higher than if they went to contract on the valuation date utilized in his appraisal.

Mr. Chang testified that all three appraisals were conducted in accordance with all guidelines and regulations for New York State appraisers. He noted that appraisers are not required to go inside of the homes they use as comparables.

Robert Margolin

Robert Margolin testified he is the managing member of Ramapo Realty LLC. The company makes six-to-12 month loans to real estate professionals. In the instant matter, the loan to defendant resulted from a referral by a Queens-based mortgage broker.

Mr. Margolin stated that he never personally visited the subject property. The loan in question had a six-month maturation and was never paid. They did not have an appraiser when they made the loan, but they considered the high bid at the auction in the prior foreclosure sale, \$525,000. They bailed defendant out of the prior foreclosure by lending him \$482,000. This was before the 2008 “crash.”

Mr. Margolin said that he met Mr. Dilmanian of Jericho at the auction and discussed a sale to Jericho with him. To convey the property, he had to get approval from an entity called Leaf Funding and it took 20 months to do so. They re-sold the property mostly “as is,” as soon as they could, with a \$5,000 cap for violations. It was a negotiated sale.

Defendants’ Witness

Dominick Neglia

Dominick Neglia testified he has been a real estate appraiser since 1985. He is licensed by *5 New York State to appraise both commercial and residential real estate. He has published articles in the field and has taught courses about both residential and commercial appraisals and has received awards. He’s testified as an expert 18 to 20 times before. He’s done appraisals for the public administrator. He’s on the court’s Part 36 list for court appointments as an appraiser.

Mr. Neglia stated that he did his appraisal by valuing the property as of August 19, 2010, the auction date. He did research on market trends and comparable sales. He saw the exterior of the property only. He estimated the value of the property as \$600,000.

Mr. Neglia testified that he read the Chang appraisal (2012) and it doesn’t explain the discrepancies with the contract price. He disputed the appraisal point by point. He said Chang’s neighborhood boundaries for his comparables are too large and that they are wrong. For his appraisal report, he called brokers or used Multiple Listing Service records to find his comparables.

Mr. Neglia opined that Mr. Chang had adjusted the appraisal by \$200,000 for “gut renovations” without any evidence of the basis for this figure. He noted that, in 2012, there were building permits filed with the NYC Department of Buildings by the buyer (Jericho) with a cost estimate of \$80,000. In his opinion, the buyer (Jericho) took a \$600,000 property, made \$80,000 in upgrades and sold it for \$690,000. He said the cost of renovations affects the value upwards, but how much the

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renovations affect the value depends upon market conditions, not just the amount expended.

Mr. Neglia acknowledged that he never went inside the property. He described the property as structurally sound, in average condition and said it was properly maintained. He assumed the property was livable and habitable, with older systems (boiler, plumbing, etc.).

Discussion

RPAPL 1371(2) permits the mortgagee in a mortgage foreclosure action to recover a deficiency judgment for the difference between the amount of the judgment and either the auction price at the foreclosure sale or the fair market value of the property, whichever is higher. See, *BTC Mortg. Investors Trust 1997-SI v. Altamont Farms, Inc.*, 284 AD2d 849 [3rd Dept 2001]; *Columbus Realty Inv. Corp. v Gray*, 240 AD2d 529, 530 [2nd Dept 1997]; *Marine Midland Bank v Harrigan Enters.*, 118 AD2d 1035, 1037 [3rd Dept 1986]. The statute says, in relevant part:

§ 1371. Deficiency judgment 1. If a person who is liable to the plaintiff for the payment of the debt secured by the mortgage is made a defendant in the action, and has appeared or has been personally served with the summons, the final judgment may award payment by him of the whole residue, or so much thereof as the court may determine to be just and equitable, of the debt remaining unsatisfied, after a sale of the mortgaged property and the application of the proceeds, pursuant to the directions contained in such judgment, the amount thereof to be determined by the court as herein provided. 2. Simultaneously with the making of a motion for an order confirming the sale, provided such motion is made within ninety days after the date of the consummation of the sale by the delivery *6 of the proper deed of conveyance to the purchaser, the party to whom such residue shall be owing may make a motion in the action for leave to enter a deficiency judgment upon notice to the party against whom such judgment is sought or the attorney who shall have appeared for such party in such action. Such notice shall be served personally or in such other manner as the court may direct. Upon such motion the court, whether or not the respondent appears, shall determine, upon affidavit or otherwise as it shall direct, the fair and reasonable market value of the mortgaged premises as of the date such premises were bid in at auction or such nearest earlier date as there shall have been any market value thereof and shall make an order directing the entry of a deficiency judgment. Such deficiency judgment shall be for an amount equal to the sum of the amount owing by the party liable as determined by the judgment with

interest, plus the amount owing on all prior liens and encumbrances with interest, plus costs and disbursements of the action including the referee's fee and disbursements, less the market value as determined by the court or the sale price of the property whichever shall be the higher.

The trial court enjoys broad discretion in that it can reject expert testimony and arrive at a determination of value that is either supported by expert testimony or supported by other evidence so long as adequately explained by the court. *BTC Mortg. Investors Trust 1997-SI v Altamont Farms, Inc.*, 284 AD2d 849; *ARC Machining & Plating v Dimmick*, 238 AD2d 849, 850 [3rd Dept 1997]. Generally, a court must determine the fair and reasonable market value of the mortgaged premises as of the date such premises were bid in at auction. RPAPL 1371 [2]; *Columbus Realty Inv. Corp. v Gray*, 240 AD2d 529 [2nd Dept 1997]; *Farmers Natl. Bank v Tulloch*, 55 AD2d 773 [3rd Dept 1976]; *Crossland Mtge. Corp. v Frankel*, 192 AD2d 571 [2nd Dept 1993].

In making its determination herein, the court found Mr. Margolin (Ramapo) and Mr. Mordekhai (Jericho) to be credible fact witnesses, but the crucial determination is with regard to the credibility of the competing appraisers. In this, the court found Mr. Neglia far more credible than Mr. Chang.

This conclusion is not merely a matter of Mr. Neglia's more impressive credentials, including his work doing appraisals for the Courts and the Public Administrator. It is a matter of the diligence Mr. Neglia displayed in describing how he came to his findings in comparison with the guesswork and estimates upon which Mr. Chang based his appraisal.

Mr. Neglia established that he did research on market trends and comparable sales. He also researched the property's Building Code violations and building permits. Further, in choosing his comparables, Mr. Neglia used a more concentrated geographic area than that chosen by Mr. Chang and he documented his efforts as regards his chosen comparables, by calling brokers and using the records of the Multiple Listing Service.

Further, Mr. Neglia's conclusions concerning the condition of the property was in relative accord with that of Mr. Mordekhai, the only witness who had any knowledge of the building who was not paid by one of the parties, or is a principal of a party. Like Mr. Neglia, Mr. Mordekhai stated that the property was in "fair" condition.

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By contrast, Mr. Chang first relied upon Mr. Orford's instruction that he was to presume the property was to be gutted. Then, in his 2012 inspection, he visited the building in the midst of demolition and drew conclusions about the building's structure even though he is not trained as *7 an architect or engineer or contractor and did not know if the items being torn out of the building were still operable before they were removed.

Additionally, Mr. Neglia based the adjustments he made to the building's value on the basis of renovations using actual (sworn to) cost estimates for the property in the Building Department's records, as opposed to Mr. Chang's use of a formula presented without any foundation. In addition, Mr. Neglia recognized that while the cost of renovations affects the value upwards, how much the renovations affect value depends upon market conditions, and noted that not every cent spent on renovations is necessarily a cent of added value. Mr. Chang's testimony and report display no such understanding of this crucial fact. In fact, Mr. Chang admitted that he reduced the value of a comparable to account for presumed renovation costs, without knowing himself whether the comparable he chose actually was renovated.

The Court thus rejects plaintiff's appraisal of fair market value, which is within the court's discretion to do. See, *BTC Mortg. Investors Trust 1997-SI v Altamont Farms, Inc.*, 284 AD2d 849; *Adirondack Trust Co. v Farone*, 282 AD2d 910 [3rd Dept 2001]. The Court is entitled to reject the opinion of the plaintiff's appraiser as being without probative value in light of his insufficient evidentiary foundation. See, *Diaz v New York Downtown Hosp.*, 99 NY2d 542, 544, [2002]; *Flushing Sav. Bank, FSB v Bitar*, 106 AD3d 690; *BTC Mtge. Invs. Trust 1997-SI v Altamont Farms*, 284 AD2d 849, 850; *Adirondack Trust Co. v Farone*, 282 AD2d 910, 912-913 [2001]. As such, the court necessarily determines that the fair market value

has been established by defendants' appraiser, the only other evidence of auction date fair market value provided at the hearing. *BTC Mortg. Investors Trust 1997-SI v Altamont Farms, Inc.*, 284 AD2d 849; *Adirondack Trust Co. v Farone*, 282 AD2d 910.

The court accepts the appraisal done by Mr. Neglia, which reports that the fair and reasonable value of the premises on the date of the auction was \$600,000. The referee's computation of the deficiency deducts the purchase money (\$1,000.00), and the deficiency, as set forth in the referee's corrected report, is the sum of \$867,707.76. After deducting the appraised value of the property of \$600,000, instead of the \$1,000, the deficiency, pursuant to the terms of RPAPL § 1371, is \$267,707.76. It is assumed that the corrected real estate taxes indicated in the Referee's corrected report, in the sum \$39,966.05 were due and owing on September 18, 2010, as they were reduced as requested by defendant's counsel.

Plaintiff may enter a deficiency judgment for \$267,707.76, plus interest at the statutory rate from September 18, 2010.

This is the decision and order of the court. Settle judgment on notice.

Dated: December 12, 2014

Debra Silber, A.J.S.C.

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APPENDIX

Matter of Board of Mgrs. of French Oaks Condominium v..., 23 N.Y.3d 168 (2014)

12 N.E.3d 1072, 989 N.Y.S.2d 642, 2014 N.Y. Slip Op. 02971

23 N.Y.3d 168, 12 N.E.3d 1072, 989 N.Y.S.2d 642,
2014 N.Y. Slip Op. 02971

In the Matter of the Board of Managers of French
Oaks Condominium, Respondent

v

Town of Amherst et al., Appellants, and
Williamsville Central School District,
Intervenor-Respondent.

Court of Appeals of New York
Argued March 24, 2014
Decided May 1, 2014

CITE TITLE AS: Matter of Board of Mgrs. of
French Oaks Condominium v Town of Amherst

OPINION OF THE COURT

Graffeo, J.

In this tax certiorari proceeding, the issue is whether petitioner rebutted the **2 presumption of validity that attached to *171 the tax assessment of its real property. Because petitioner's proof failed to provide the factual and statistical information needed to substantiate its calculations, we conclude that the presumption was not overcome. The order of the Appellate Division should therefore be reversed and the petition dismissed.

Petitioner is the board of managers of the French Oaks Condominium (the Board), a residential complex located in the Town of Amherst, New York. The development consists of 39 individual units of varying sizes and layouts, each built between 2003 and 2005. Respondent Town of Amherst assessed the aggregate property at \$5,176,000 for the 2009-2010 tax year. In July 2009, the Board commenced this Real Property Tax Law (RPTL) article 7 proceeding against the Town, the Town's assessor and the Town's Board of Assessment Review (collectively, the Town) challenging the tax assessment as excessive.¹

In support of its petition, the Board submitted an appraisal report that set the valuation of the property at \$4,265,000—nearly one million dollars less than the assessment roll figure. In reaching this conclusion, the Board's appraiser applied an income capitalization method to establish the market value of the complex, treating each condominium unit as if it were an

income-producing rental. Under the direct capitalization methodology, the first step required determination of the net operating income of the condominiums. The appraiser computed the net operating income by comparing the 39 units to similar apartments to estimate the market rental value of the condominiums, and then subtracted the expenses incurred in managing the condominiums. After making some upward and downward adjustments to account for the differences between the various units and the comparable apartments, the appraiser calculated the total annual net operating income at \$541,754.

The next step in the capitalization of income formula is to determine the appropriate capitalization rate. This can be accomplished by taking the annual net operating income of a comparable and dividing that figure by its sale price (*see* Appraisal Institute, *The Appraisal of Real Estate* at 514 [11th ed 1996]). To make this computation, the Board's appraiser identified four purportedly comparable apartment complexes—all constructed *172 between 1959 and 1978—in the vicinity of the French Oaks development. To compute the net operating income for the four comparables, the appraiser had to ascertain their gross incomes and expenses. Although the appraiser offered specific figures for these items in his report, he indicated that they were derived from what he referred to as "forecast financials." The report did not explain how the appraiser arrived at these income and expense figures and did not otherwise identify the **3 sources for this component. The results reached after dividing the estimated net operating income of each comparable property by its sale price were four capitalization rates that ranged from 8.59% to 10.36%. The appraiser settled on a median capitalization rate of 9.5% and added a "tax factor" of 3.27% to the capitalization rate for a final capitalization rate of 12.7%.²

The last step in the income capitalization methodology required dividing the property's net operating income by the final capitalization rate. Once the proffered net operating income of \$541,754 was divided by the final capitalization rate of 12.7%, the appraisal report set forth the conclusion that the 39-unit complex should have been assessed at approximately \$4,265,000 for the 2009-2010 tax year.

The Town offered an appraisal that also utilized the income capitalization method but reached a different valuation for assessment purposes. Unlike the Board's appraiser, the Town's expert inspected the interior of each of the 39 condominium units and included detailed photographs and information in the report. He estimated the net operating income at \$535,423 and computed an

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initial capitalization rate of 7.6%, to which he added a tax factor of 2.84% for a final capitalization rate of 10.44%. After dividing the net operating income by the capitalization rate, which resulted in an estimated value of \$5,128,573, the expert deducted \$49,725 in personal property items for an appraised market value of \$5,080,000 (this valuation presented by the Town's expert differed only slightly from the assessed value assigned by the Town's assessor for the tax roll).³

A two-day hearing was conducted before a referee. Following the testimony of the Board's appraiser, which largely tracked *173 his appraisal report, the Town moved to dismiss the petition on the basis that the Board had failed to meet its initial burden of adducing substantial evidence to rebut the presumption that the Town's tax assessment was valid. The referee reserved decision and the Town presented its case through the testimony of its expert.

After the hearing, the referee denied the Town's dismissal motion, holding that the Board's proof rebutted the presumption of validity. Weighing the evidence presented by both **4 parties, the referee concluded that the Board had established by a preponderance of the evidence that its property was overassessed. In reaching this determination, the referee adopted the Town's net operating income of \$535,423 and its tax factor of 2.84%, but accepted the Board's initial capitalization rate of 9.5% (for a final capitalization rate of 12.3%). Dividing the net operating income of \$535,423 by the final capitalization rate of 12.3%, the referee held that the complex should have been assessed at \$4,353,030, significantly less than the \$5,176,000 value listed on the 2009-2010 tax roll. Supreme Court thereafter directed the Town to amend its tax roll to reflect the referee's decision and remit any tax overpayments to the Board.

The Town appealed and the Appellate Division, with two Justices dissenting, affirmed (103 AD3d 1102 [4th Dept 2013]). The majority found that the taxpayer had rebutted the presumption; that its appraisal adequately complied with 22 NYCRR 202.59 (g) (2) (the applicable regulation containing the requirements for appraisal reports); and that the referee did not err in accepting the initial capitalization rate of the Board's appraiser—the only item from the Board's appraisal the referee relied upon. The dissenters would have adopted the Town's proposed value in its entirety, reasoning that the capitalization rate analysis conveyed in the Board's appraisal was entitled to no weight because its appraiser “failed to offer any factual support for the great majority of his figures” (*id.* at 1110 [Peradotto and Carni, JJ., dissenting]). In particular, the dissent concluded that the analysis of the Board's

appraiser was deficient since he relied only on his “personal exposure” to at least three of the four comparable properties he used to calculate the capitalization rate (*id.* at 1109). Hence, “[i]n the absence of any documentary *174 or tangible evidence, respondents' counsel could not determine whether petitioner's appraiser accurately reported the financial figures of the allegedly comparable properties, nor can we make such a determination” (*id.* at 1110).

The Town appealed as of right under CPLR 5601 (a) based on the two-Justice dissent. We subsequently denied the Board's motion to dismiss the appeal predicated on its claim that the double dissent was not on a question of law (21 NY3d 956 [2013]).

Before us, the Town maintains that the Board failed to rebut the presumption that the tax assessment was accurate and the petition should have been dismissed. The Town asserts that the Board's appraisal should have been disregarded because it did not substantially comport with the dictates of 22 NYCRR 202.59 (g) (2) in that it failed to adequately disclose the factual underpinnings and sources that justified the appraiser's calculations. The Town contends that the Board did not furnish essential information pertaining to each of the 39 units, as well as the comparable apartments, so that the adjustments made to estimate the complex's market rental value under step one of the direct capitalization methodology were inadequate for review. Likewise, the Town urges that the Board's appraiser did not include sufficient documentary proof or data supporting the figures related to the four comparable properties from which the appraiser derived his capitalization rate under step two of the formula. In response, the Board asks us to **5 affirm the reduction of its tax assessment, contending that the Appellate Division majority correctly concluded that its appraiser supplied sufficient facts regarding the condominium units and the comparable rental properties relevant to the first step and an adequate explanation for the computation of the capitalization rate under the second step.⁴

In an RPTL article 7 tax certiorari proceeding, “a rebuttable presumption of validity attaches to the valuation of property made by the taxing authority” (*Matter of Roth v City of Syracuse*, 21 NY3d 411, 417 [2013]). Consequently, a taxpayer *175 challenging the accuracy of an assessment bears the initial burden of coming forward with substantial evidence that the property was overvalued by the assessor. In the context of tax assessment cases, we have explained that the substantial evidence standard requires the taxpayer to “demonstrate the existence of a valid and credible dispute regarding valuation” (*Matter of FMC Corp. [Peroxygen*

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Chems. Div.] v Unmack, 92 NY2d 179, 188 [1998]). If the taxpayer satisfies this threshold burden, the presumption disappears and the court “must weigh the entire record, including evidence of claimed deficiencies in the assessment, to determine whether petitioner has established by a preponderance of the evidence that its property has been overvalued” (*id.*). But where a taxpayer fails to rebut the presumption, the municipality’s assessor has no obligation to go “forward with proof of the correctness of [its] valuation,” and the petition is to be dismissed (*id.* at 187 [internal quotation marks and citation omitted]).

A taxpayer will most often attempt to meet the substantial evidence requirement by offering a “detailed, competent appraisal based on standard, accepted appraisal techniques and prepared by a qualified appraiser” (*Matter of Niagara Mohawk Power Corp. v Assessor of Town of Geddes*, 92 NY2d 192, 196 [1998]). The Uniform Rules for the New York State Trial Courts prescribe the basic requirements for written appraisals:

“The appraisal reports shall contain a statement of the method of appraisal relied on and the conclusions as to value reached by the expert, together with the facts, figures and calculations by which the conclusions were reached. If sales, leases or other transactions involving comparable properties are to be relied on, they shall be set forth with sufficient particularity as to permit the transaction to **6 be readily identified, and the report shall contain a clear and concise statement of every fact that a party will seek to prove in relation to those comparable properties. The appraisal reports also may contain photographs of the property under review and of any comparable property that specifically is *176 relied upon by the appraiser, unless the court otherwise directs” (22 NYCRR 202.59 [g] [2]).⁵

Although we have not previously had occasion to analyze this regulation, Appellate Division case law is instructive. Courts construing this provision have held that an appraisal should be disregarded when a party violates section 202.59 (g) (2) by failing to adequately “set forth the facts, figures and calculations supporting the appraiser’s conclusions” (*Pritchard v Ontario County Indus. Dev. Agency*, 248 AD2d 974, 974 [4th Dept 1998]; see also *Matter of Thomas v Davis*, 96 AD3d 1412, 1414 [4th Dept 2012]; *Matter of Johnson v Kelly*, 45 AD3d 687, 687 [2d Dept 2007]; *Matter of State of New York v Town of Thurman*, 183 AD2d 264, 268-269 [3d Dept 1992]). The reasonableness of this rule is obvious since noncompliance with 22 NYCRR 202.59 (g) (2) frustrates the primary objectives of these requirements—to afford “opposing counsel the opportunity to effectively prepare for cross-examination” (*Matter of Gullo v Semon*, 265

AD2d 656, 657 [3d Dept 1999]) and to enable the courts to undertake meaningful review of appraisals. With these principles in mind, we examine the adequacy of the Board’s proof at the hearing.

Putting aside the other claimed inadequacies identified by the Town, we focus on the step-two capitalization rate analysis provided by the Board’s appraiser, which was critical to the outcome of this case and the only figure submitted by the taxpayer that was adopted by the referee. The appraisal identified four comparable apartment complexes used to calculate the capitalization rate, setting forth the sale price, gross income, expenses and net operating income for each of the rental properties (*see Appraisal Institute, The Appraisal of Real Estate* at 514 [11th ed] [“Deriving capitalization rates from comparable sales is the preferred technique when sufficient data on sales of similar, competitive properties are available”]). Since net operating **7 income is one half of the equation in determining the capitalization rate (net operating income divided by sales price), an accurate calculation is of paramount importance. But other *177 than referencing “forecast financials,” the appraiser did not provide the sources of the income or expense figures related to each comparable (*see id.* [“Data on each property’s sale price, income, expenses, financing terms, and market conditions at the time of sale are needed”]).

More importantly, the hearing testimony of the Board’s appraiser revealed that he had little to no confirmable data to support the income and expense numbers he employed to derive the capitalization rate. During his direct examination, the appraiser asserted that he relied on “very good” and “very strong” data that came from “certified sources.” On cross-examination, however, he conceded that he had no certified expense or income information and instead had relied on “forecasted economic indicators” with respect to the apartment buildings. In fact, he could identify only two documents in the record that provided any “limited historic operating expenses,” and this information was for only two comparables and did not correlate to the numbers used in the appraisal report. He admitted that he had no documents supporting his analysis as to the other two comparable properties. When pressed, he proffered that the relevant figures were based on his “personal exposure” to the complexes, i.e., his own unverifiable knowledge.⁶ But as the Appellate Division dissenters aptly recognized, “[a]n appraiser cannot simply list financial figures of comparable properties in his or her appraisal report that are derived from alleged personal knowledge; he or she must subsequently ‘prove’ those figures to be facts at trial” (103 AD3d at 1110 [Peradotto and Carni, JJ., dissenting]). Simply put, the record before us affords no basis to check

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or test whether the net operating incomes for these four properties—and the capitalization rates adduced from them—were valid, or even in the ballpark.

In sum, although the substantial evidence standard is not a heavy one, “the documentary and testimonial evidence proffered by petitioner [must be] based on sound theory and objective data” (*Matter of FMC Corp.*, 92 NY2d at 188 [internal quotation marks and citation omitted]). The Board in this case failed to meet this threshold because its appraiser did not support the proposed capitalization rate with objective data necessary to substantiate the component calculations. As a result of *178 this deficiency in proof, the Board did not rebut the presumption that the tax assessment of \$5,176,000 was valid.

Accordingly, the order of the Appellate Division should be reversed, with costs, and the petition dismissed.

Chief Judge Lippman and Judges Read, Smith, Rivera and Abdus-Salaam concur; Judge Pigott taking no part.

Order reversed, with costs, and petition dismissed.

FOOTNOTES

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Footnotes

- ¹ The Board later brought a second RPTL article 7 proceeding seeking review of the tax assessment for the 2010-2011 tax year. The parties stipulated that a referee would resolve the first proceeding and that decision would apply to the second proceeding.
- ² When assessed real estate taxes are presumed to be incorrect, appraisers may add a tax factor rather than deducting the assessed taxes as expenses. Here, the Board’s appraiser calculated the tax factor by dividing the Town’s overall tax rate (\$32.68 per thousand) by 1,000.
- ³ Because the net operating incomes offered by the Board’s appraisal (\$541,754) and the Town’s report (\$535,423) were quite close, the disparity in their ultimate valuations is explained by the difference in their respective capitalization rates. Hence, the merit of the Board’s argument was based in large part on the persuasiveness of the capitalization rate proposed by its appraiser.
- ⁴ The Board further suggests that we cannot review the threshold issue of whether it rebutted the presumption through substantial evidence because the two-Justice dissent at the Appellate Division was not predicated on this issue. It is well settled, however, that once an appeal lies as of right under CPLR 5601 (a), an appellant may, on the ensuing appeal, seek review of all questions properly raised below (*see Matter of Duchnowski*, 31 NY2d 991 [1973]). The issue is therefore properly before us.
- ⁵ 22 NYCRR 202.59 applies to tax assessment review proceedings outside the City of New York. 22 NYCRR 202.60, applicable to tax certiorari proceedings brought in the counties within the City of New York, contains a provision with similar operative language (*see* 22 NYCRR 202.60 [g] [3]). The only distinction is that 22 NYCRR 202.60 (g) (3) generally requires appraisal reports to include photographs of the assessed property and any comparable properties, whereas 22 NYCRR 202.59 (g) (2) merely permits such photographs.
- ⁶ The Board’s appraiser also acknowledged that there were more recent sales of three of the four comparable properties that he did not consider in his analysis.

ABOUT THE AUTHOR

Michelle Maratto Itkowitz practices real estate litigation. She has over twenty years of experience, and is best known for her work in the area of commercial and complex-residential landlord and tenant law in the City of New York. She also is very experienced in general commercial litigation and all manner of real estate transactions

Michelle publishes and speaks frequently on legal issues in real estate. The groups that Michelle has written for and/or presented to include:



- Lawline.com
- The Columbia Society of Real Estate Appraisers
- LandlordsNY
- Lorman Education Services
- The Association of the Bar of the City of New York
- The New York State Bar Association, Real Property Section, Commercial Leasing Committee
- Thompson Reuters
- The Cooperator
- The New York State Bar Association CLE Publications
- The TerraCRG Brooklyn Real Estate Summits
- The Association of the Bar of the City of New York
- BisNow

Michelle regularly creates and shares original and useful content on real estate and law (all accessible via www.itkowitz.com) for the real estate and legal communities, including booklets, videos, podcasts, and articles. She is frequently quoted in the press on a variety of real estate and legal issues. As the “Legal Expert” for LandlordsNY, the first social networking platform exclusively for landlords and property managers, Michelle answers member's questions, guest blogs, and teaches. Michelle recently developed a six-part, seven-hour continuing legal education curriculum for Lawline.com entitled "New York Landlord and Tenant Litigation". Over 16,000 lawyers have purchased Michelle's earlier CLE classes from Lawline, and the programs have met with the highest reviews. Michelle is currently co-authoring a chapter on lease remedy clauses for the New York State Bar Association, Real Property Section, Commercial Leasing Committee.

Michelle is admitted to practice in New York State and the United States District Court for the Southern District of New York. She received a Bachelor of Arts in Political Science in 1989 from Union College, and a Juris Doctor in 1992 from Brooklyn Law School. She began her legal career at Cullen & Dykman.

Michelle is a pioneer of Legal Project Management, a unique and better way for lawyers and clients to work together. Michelle writes and speaks extensively about Legal Project Management. Ask Michelle about our alternative legal fee options! (This is her favorite topic.)

There are many ways to keep up with Michelle. When Michelle tweets (@m_maratto), which is not an obnoxious amount, she does so in an easy to understand manner about useful stuff regarding real estate, business, the legal industry, and organic herb gardening. Feel free to contact Michelle; she would be happy to speak to you.