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Bagelmann v. First National Bank

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Bagelmann v. First National Bank, 2012 WL 5642039 (Iowa Supreme Court, November 16, 2012)

SYNOPSIS: The Iowa Supreme Court holds that a mortgagor cannot use the National Flood Insurance Act as the basis for a state law negligence claim against a lender and servicer for an incorrect flood determination, but remands the case for further proceedings to determine whether the servicer may be held liable in negligence for failing to disclose the correct information to the mortgagor after discovering it.

FACTS: In 2001, the Bagelmanns were negotiating to purchase a home along the Cedar River in Waverly, Iowa. They sought mortgage financing from First National Bank of Waverly (FNB). FNB arranged for a flood determination from LandAmerica, which erroneously concluded that the home was not in a flood zone and that flood insurance was not needed. After receiving this determination (and making their own further investigation), the Bagelmanns contracted to purchase (and ultimately did purchase) the home for $238,500.

In 2003, the Bagelmanns received the same erroneous information when they refinanced their loan to pay for remodeling. Following the refinancing, FNB assigned the refinanced mortgage note to Iowa Banker's Mortgage Co. (IBMC), which in turn assigned the note to Fannie Mae, with IBMC retaining the servicing of the note.

When FEMA issued new flood maps in the spring of 2008, LandAmerica advised IBMC that the property actually was in a special flood hazard area. [The status of the home had not actually changed; LandAmerica simply read the map correctly this time.] IBMC did not pass this information to the Bagelmanns until after their home had flooded on June 10, 2008, severely damaging their home and some of their personal property. By then, of course, it was too late to buy flood insurance.

Despite the fact that the property lacked flood insurance, FEMA paid the Bagelmanns the pre-flood appraised value of $415,000 for their property, plus a $10,850 moving/relocation allowance. After netting the mortgage payoff to Fannie Mae, the Bagelmanns received $190,647.33 for their home, but still claimed more than $418,000 in monetary damages that they claim could have been avoided if FNB and IBMC had informed them of the correct flood hazard determination.

On September 29, 2010, the Bagelmanns brought an action against FNB and IBMC asserting, inter alia, claims for (1) negligence and breach of contract against FNB for the initial incorrect

flood hazard determinations; (2) negligence and breach of contract against both FNB and IBMC for failing to notify the Bagelmanns of the correct determination before the June 10, 2008 flooding occurred; (3) negligent misrepresentation against FNB for the initial erroneous flood determination; and (4) breach of contract against FNB and IBMC based on the theory that the Bagelmanns were third-party beneficiaries of the loan assignment agreement between FNB and IBMC. [No action was filed against LandAmerica, which was by this time in bankruptcy.]

FNB and IBMC moved for summary judgment, denying that they had ever contracted with the Bagelmanns to provide them with accurate flood hazard determinations or that the assignment of the mortgage from FNB to IBMC covered this subject. Each denied that it had any legal duty to provide accurate flood hazard determinations, denied any negligence, and asserted that any negligence was attributable to LandAmerica. In addition, they argued that recognizing a negligence cause of action would be inconsistent with the absence of a federal cause of action under the National Flood Insurance Act (NFIA) for erroneous flood hazard determinations. The district court granted summary judgment to the defendants on all counts, and the Bagelmanns appealed to the Iowa Supreme Court.

ANALYSIS: Except as to one potential claim, the Iowa Supreme Court affirmed the district court's grant of summary judgment. It agreed that the Bagelmanns could not use the requirements of the NFIA as the basis for a state-law claim. The court noted that prior 8th Circuit precedent established the lack of an implied right of action under the NFIA, and that allowing the Bagelmanns to assert a state-law claim would undermine the purposes of the NFIA:

The circumstance [the Baglemenns] present is not one where a legal duty … would otherwise exist under state law, and where federal law is only being invoked as a standard of conduct. Rather, the alleged duty to advise customers about flood insurance in these cases arose only because of federal law.

In the absence of a statute, banks normally would not have an underlying obligation to tell customers whether they need flood insurance or not. We therefore agree it would be inconsistent with the lack of a private right of action under the NFIA to authorize a negligence action based upon a duty that exists only because of the NFIA….

The NFIA protects borrowers to a certain degree, but its main focus is on protecting regulated lenders and the federal government. This is evident in the actual requirements the Act imposes. The insurance only needs to be sufficient to cover the outstanding principal balance of the loan…. Moreover, if the law were designed to offer broad protection to homeowners in flood zones, it would not have limited the insurance requirement only to those homes financed by federally regulated lenders. More specifically, the Act's scope suggests that disclosure to borrowers was not a principal goal. There is no requirement that lenders provide any detail regarding flood risks, beyond a notification that a property is in a flood zone and requires insurance.

The court then addressed whether there could be an independent state-law basis for a negligence claim. The Baglemanns argued that FNB and IBMC should be held liable under the "assumed duty" principle in Restatement (Second) of Torts § 323, but the court rejected this argument, noting that liability under § 323 was possible only where the defendant intends to render services to another that are necessary for the other's protection:

Here FNB, and later IBMC, were not trying to render a service to the Bagelmanns for the Bagelmanns' protection. They were complying with a federal law that required them to determine whether the property was in a special flood zone and, if so, give notice and make certain that the property was covered by flood insurance.

A lender "undertakes" to notify a borrower regarding the need for flood insurance because federal law requires it to do so. Hence, the Bagelmanns' section 323 argument becomes essentially another way to try to convert the statutory requirements of the NFIA into a state common law duty.

The Bagelmanns also argued that because IBMC knew several weeks before the 2008 flood that the property was in a flood zone and the prior determinations were incorrect, it had a duty to disclose this information to the Bagelmanns under Restatement (Second) of Torts § 551(2) ("One party to a business transaction is under a duty to exercise reasonable care to disclose to the other before the transaction is consummated … subsequently acquired information that he knows will make untrue or misleading a previous representation that when made was true or believed to be so...."). The court concluded that this duty could not have extended to FNB, which by 2008 had assigned the note, but concluded that it was at least plausible that such a duty could have extended to IBMC. The court thus ordered a remand to the district court to determine (among other issues) whether there was a transaction involving the Bagelmanns and IBMC that was yet to be consummated.

The court also affirmed the district court's grant of summary judgment for FNB on the Bagelmanns' negligent misrepresentation claim. The Bagelmanns analogized the case to Larsen v. United Federal Savings & Loan Ass'n, 300 N.W.2d 281 (Iowa 1981), in which the court upheld a jury verdict against a lender whose employee had negligently prepared an inflated appraisal. In Larsen, the court had noted that:

Even though the appraisal might be made primarily for the benefit of the lending institution, the appraiser should also reasonably expect the home purchaser, who pays for the appraisal and to whom the results are reported (and who has access to the written report on request), will rely on the appraisal to reaffirm his or her belief the home is worth the price he or she offered for it. The purchaser of the home should be among those entitled to rely on the accuracy of the report and therefore should be entitled to sue for damages resulting from a negligent appraisal.

The Bagelmanns argued that while the flood hazard determination was prepared principally for the lender, they had to pay for it and should be able to bring a negligent misrepresentation claim if it is inaccurate due to the fault of the lender. The court concluded,

however, that the record contained no evidence of that FNB acted negligently in retaining LandAmerica, nor that FNB should have realized that the information in LandAmerica's report was incorrect.

Finally, the court also affirmed summary judgment in favor of FNB and IBMC on the Bagelmann's breach of contract claims. The court noted that if FNB or IBMC had entered into a contract to provide the Bagelmanns with accurate flood hazard determinations, "this could result in the creation of an independent legal duty, notwithstanding the absence of a private right of action under the NFIA." However, the court noted that (1) both the 2001 and 2003 flood determinations stated that they were prepared by LandAmerica, (2) the Baglemanns had been advised that FNB was ordering the statements from a third party, (3) the Baglemanns presented no evidence that FNB had guaranteed or warranted the accuracy of LandAmerica's determination, and (4) the determination explicitly stated that it was provided solely for the benefit of FNB and could not be relied upon by any other entity or individual. Likewise, the court rejected that view that the Bagelmanns were third-party beneficiaries of the assignment agreement between IMBC and FNB.

COMMENT 1: The Court's rejection of the Bagelmanns' negligence and breach of contract claims against FNB is consistent with the overwhelming weight of judicial authority. It will be interesting to see, however, what the court does on remand with the issue of whether the Bagelmanns had a valid claim under Restatement § 551(2) based on IBMC's failure to timely disclose the correct flood determination. At the time, there was no pending application to refinance the Bagelmann's loan; thus, the only apparent "transaction" could have been (a) the original loan or (b) the servicing of that loan. If the "transaction" was the original loan, wouldn't it have been "consummated" at the time of closing? If the "transaction" is the servicing of the loan, when is servicing of a loan "consummated"?

COMMENT 2: The opinion does not make clear exactly what the "property" was for which the Bagelmanns received payment from FEMA. It seems possible that some portion of the Bagelmanns' claim for damages may have been based upon the value of damaged personal property. If FEMA essentially paid the Bagelmanns despite their failure to carry flood insurance --- which presumably would have covered possessions, at least to the extent of the policy limit --- why should the Bagelmanns be able to assert this claim? Why shouldn't FEMA be subrogated to their position (whatever that position might be)?