

IN THE SUPREME COURT  
STATE OF SOUTH DAKOTA

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No. 27130

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WELLS FARGO BANK, N.A.,

Plaintiff and Appellee,

vs.

MATTHEW R. FONDER, CARALYNN C. FONDER, and any person in possession,

Defendants, Third-Party Plaintiffs and Appellants,

vs.

WELLS FARGO INSURANCE, INC. FLOOD SERVICES,

Third-Party Defendant and Appellee.

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APPEAL FROM THE CIRCUIT COURT  
SIXTH JUDICIAL CIRCUIT  
STANLEY COUNTY, SOUTH DAKOTA

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HONORABLE JOHN L. BROWN  
Circuit Court Judge

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APPELLANT'S BRIEF

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## **PRELIMINARY STATEMENT**

Throughout this brief, Defendants, Third Party Plaintiffs, and Appellants Matthew R. Fonder and his wife Caralynn, are referred to as the Plaintiffs, and as the “Fonders.” The Third Party Defendant and Appellee, Wells Fargo Insurance, Inc. Flood Services is referred to as the Defendant, and as “WFFS.”

References to the transcript of the hearing held on WFFS’s motion to dismiss are designated by “HT” followed by the page number. References to materials in the Appendix will be designated by “APPX” followed by the page number.

## **JURISDICTIONAL STATEMENT**

At the conclusion of the hearing held on December 11, 2013, the trial court granted Defendant WFFS’s motion to dismiss Plaintiffs’ Complaint under SDCL § 15-6-12(b)(5). HT 20-22. An order granting Defendant’s motion to dismiss was filed with the clerk on December 27, 2013. APPX 3. Notice of Entry of the Order was served on January 10, 2014. APPX 1-2. The remaining claim plead by Wells Fargo Bank, N.A. was dismissed by stipulation of the parties. The Order of Dismissal was signed on May 20, 2014 and Notice of Entry of the Order of Dismissal was served on June 10, 2014. Appellants filed and served their Notice of Appeal from the order granting Defendant’s motion to dismiss and Docketing Statement on June 26, 2014.

## **STATEMENT OF THE ISSUES**

- A. WHETHER THE CIRCUIT COURT ERRED IN DISMISSING THE CASE UNDER SDCL § 15-6-12(b)(5), CONCLUDING THAT THE PLAINTIFFS HAVE FAILED TO STATE A CLAIM UPON WHICH RELIEF CAN BE GRANTED.**
- B. WHETHER THE CIRCUIT COURT ERRED IN DENYING THE FONDERS’ MOTION TO AMEND THEIR THIRD PARTY COMPLAINT.**

In the motion hearing on December 11, 2013, the trial court dismissed the matter under SDCL § 15-6-12(b)(5), concluding that the Fonders have failed to state a claim upon which relief can be granted. HT 20-22; APPX 3. The trial court also denied the Fonders' motion to amend their Third Party Complaint. *Id.*

The most relevant cases cited in Appellants' Brief are as follows:

*Elkjer v. City of Rapid City*, 2005 SD 45, 695 N.W.2d 235

*Mid-Western Electric, Incorporated, v. DeWild Grant Reckert & Associates, Co.*, 500 N.W.2d 250 (SD 1993)

*Klecan v. Countrywide Home Loans, Inc.*, 951 N.E.2d 1212 (Ill. App.Ct. 2011)

*Paul v. Landsafe Flood Determination, Inc.*, 550 F.3d 511 (5<sup>th</sup> Cir. 2008)

The most relevant statutory and constitutional provisions are as follows:

SDCL § 20-9-1

SDCL § 15-6-12(b)(5)

SDCL § 15-6-15(a)

SD Const. art. 6, § 20

## **STATEMENT OF THE CASE**

On February 3, 2012, Wells Fargo Bank, NA filed a complaint against the Fonders, seeking to foreclose on the home that they had purchased on Frontier Road, north of Fort Pierre, South Dakota. Through that foreclosure action, and by stipulation of the parties, on May 20, 2013, the Fonders initiated suit against WFFS seeking recovery of damages sustained as a result of their reliance on WFFS's erroneous flood determination. HT 3-4. On July 16, 2013, WFFS responded to the suit by filing a motion to dismiss, pursuant to SDCL § 15-6-12(b)(5). The trial court granted WFFS's motion at the conclusion of a hearing held on December 11, 2013. HT 20-22; APPX 3.

## STATEMENT OF THE FACTS

On May 12, 2011, the Fonders purchased their dream home located on Frontier Road, which is situated on the Missouri River north of Fort Pierre, South Dakota. HT 3; APPX 4. Prior to purchasing the home, on April 12, 2011, WFFS conducted a flood hazard determination on the property and determined that the Fonders' new home was not located in a flood zone (Special Flood Hazard Area ("SFHA")). APPX 8. Because of WFFS's determination, the lender did not require the Fonders to obtain flood insurance at the time of closing. Also, relying solely on WFFS's erroneous determination, the Fonders decided not to purchase flood insurance on their own at the time of closing on their new property. On or about June 1, 2011, just a few weeks after the Fonders and their 16-month old daughter moved into their new home, they were forced to move out due to the rapidly rising floodwaters on the Missouri River. APPX 5.

For the next few months, the Fonders' new home had three to five feet of standing water on the main living level while they bounced from house to house waiting for the floodwaters to recede. At the request of the Fonders through their own insurance company, on or about July 8, 2011, Factual Data Flood conducted a flood determination on the Fonders' property, and determined that the home was in fact located in a SFHA. APPX 9. With two conflicting flood determinations in hand, the Fonders decided that they needed to verify which flood determination was correct. The Fonders requested that the Federal Emergency Management Agency ("FEMA") determine if their new home was located in a SFHA. On or about October 18, 2011, FEMA confirmed that the Fonders' home was in fact located in a SFHA. APPX 10. The flood destroyed the Fonders' new home. To their detriment, the Fonders relied on WFFS's erroneous

representation that their new home was not located in a flood zone, and because of their reliance on the erroneous flood determination, they did not have flood insurance to cover their damages. The Fonder family was devastated. The Fonders brought this negligence action against WFFS to recover damages because “but for” WFFS’s professional negligence, the Fonders would have had flood insurance to help cover their losses, and would not have had a foreclosure action brought against them. APPX 6-7.

### STANDARD OF REVIEW

“A motion to dismiss under Rule 12(b)(5) tests the law of a plaintiff’s claim. A court must deny the motion unless it appears beyond doubt that the plaintiff cannot recover under any facts provable in support of the claim.” *Elkjer v. City of Rapid City*, 2005 SD 45 ¶ 6, 695 N.W.2d 235, 238 (citations omitted). On appeal, this Court examines the trial court’s determination on a motion to dismiss for failure to state a claim de novo, giving no deference to the trial court’s decision. *Id.* Motions to dismiss under Rule 12(b)(5) are viewed with disfavor, and are rarely granted. *Id.* “Pleadings should not be dismissed merely because the court entertains doubts as to whether the pleader will prevail in the action... The rules of procedure favor the resolution of cases upon the merits by trial or summary judgment rather than on failed or inartful accusations.” *Thompson v. Summers*, 1997 SD 103 ¶ 7, 567 N.W.2d 387, 390. “The clearance of dockets and calendars is of secondary concern in the administration of justice.” *Chicago & North Western Ry. Co. v. Bradbury*, 129 N.W.2d 540, 542 (SD 1964). “In evaluating a complaint, the court must accept the material allegations as true and construe them in a light most favorable to the pleader and determine whether the allegations allow relief on

‘any possible theory.’” *Fenske Media Corporation v. Banta Corporation*, 2004 SD 23 ¶ 7, 676 N.W.2d 390, 392-393.

## ARGUMENT

### A. THE CIRCUIT COURT ERRED IN DISMISSING THE CASE UNDER SDCL § 15-6-12(b)(5), CONCLUDING THAT THE PLAINTIFFS HAVE FAILED TO STATE A CLAIM UPON WHICH RELIEF CAN BE GRANTED.

#### 1. The Fonders’ case is a case of first impression in South Dakota.

WFFS’s argument hinges on one South Dakota case which is both factually and legally distinguishable from the Fonders’ case. The case that WFFS relies on is *Highmark Federal Credit Union v. Hunter*, 2012 SD 37, 814 N.W.2d 413. Both the facts and the legal question raised in the Fonders’ case are completely different from the facts and the legal question presented in the *Highmark* case. Based on those two points alone, it is clear that the Fonders’ case is a case of first impression in South Dakota, and the trial court should not have granted WFFS’s motion to dismiss.

The facts in the Fonders’ case are distinguishable from the facts in the *Highmark* case. In *Highmark*, both the homebuyer (Ms. Hunter) and the lender were notified that the home that Ms. Hunter was purchasing was located in a SFHA. *Id* at ¶ 2. What happened to the Fonders was the exact opposite. The Fonders were notified that the home that they were purchasing was not located in a SFHA. APPX 5 and 8. In *Highmark*, Ms. Hunter made a counterclaim against Highmark for negligence, and Highmark was the lender in the transaction. *Highmark* at ¶’s 2 and 4. The Fonders have brought this action against WFFS, an independent third-party flood determination company. The Fonders did not bring an action against their lender in the transaction. HT



3; APPX 4-7. If the Fonders only cause of action had been against the lender, they would not be before this Court today as the law is well settled in that area.

The legal question presented by the Fonders' case is also distinguishable from the legal question answered by this Court in the *Highmark* case. The legal question in the *Highmark* case was whether the lender had a duty to ensure that there was flood insurance on the property when it was aware that the property was located in a SFHA. *Highmark* at ¶ 1. The legal question in the Fonders' case is whether a negligence action against an independent third-party flood determination company can arise under South Dakota common-law when it was reasonably foreseeable that the Fonders would rely on WFFS's flood determination when deciding whether or not to purchase flood insurance on their new property. In *Highmark*, this Court did not determine whether or not, under South Dakota law, a cause of action could be maintained against a third-party flood determination provider who made an erroneous flood determination, when that professional opinion was relied upon by a reasonably foreseeable plaintiff to their detriment.

The Fonders believe that WFFS may have contracted their flood determination work out to another third-party. However, without the opportunity to conduct discovery in this matter, the Fonders were unable to verify if WFFS actually performed the flood determination, or if they contracted the work out to another company. If in fact WFFS contracted with another independent third-party to conduct the flood determination on its behalf, the legal question of whether a sub-contractor of an independent third-party flood determination company hired by a lender could be held liable for its negligence would

not only be a case of first impression in South Dakota, it appears that it would also be a case of first impression in the United States.

The facts and the legal questions presented by the *Highmark* case are distinguishable from the facts and legal questions raised in the Fonders' case, the trial court should not have granted WFFS's motion to dismiss for failure to state a claim.

**2. The law is not well settled in this area.**

It is well-settled both across the country and in South Dakota that a negligence action cannot be maintained against a lender who failed to ensure that flood insurance was in place on a property when the lender knew it was located in a SFHA. The question raised in the Fonders' case is whether a negligence action can be maintained against an independent third-party flood determination company when it was reasonably foreseeable that the Plaintiffs would rely on the Defendant's erroneous flood determination is a case of first impression in South Dakota, and is not well-settled across the country. The recent trend in cases across the country involving this issue have found or inferred that a cause of action can be maintained against an independent third-party flood determination company under state common law.

In *Klecan v. Countrywide Home Loans, Inc.*, the Third District Appellate Court of Illinois found that the National Flood Insurance Act ("NFIA") did not preclude a homeowner from pursuing a state common-law claim against the independent third-party flood determination provider hired by the lender. *Klecan v. Countrywide Home Loans, Inc.*, 951 N.E.2d 1212, 1215-1216 (Ill. App.Ct. 2011). The *Klecan* Court based its finding upon the grounds that the homeowner was a foreseeable beneficiary of the flood determination provider's findings, as it impacted their determination to purchase. *Id.* In

*Paul v. Landsafe Flood Determination, Inc.*, the United States Court of Appeals for the Fifth Circuit recognized that under Mississippi state law, the homeowner's reliance on a flood service provider's determination was reasonably foreseeable, and a state law negligence action was allowed to proceed against the independent third-party flood determination company. *Paul v. Landsafe Flood Determination, Inc.*, 550 F.3d 511, 518 (5<sup>th</sup> Cir. 2008). As set forth later in this brief, like Illinois and Mississippi, South Dakota also follows the same "reasonably foreseeable" standard in professional negligence actions.

In addition to *Klecan* and *Paul*, other courts have recently held or inferred that a state law claim may exist against an independent third party flood determination provider, and is not precluded by the NFIA. *Williams v. Standard Fire Insurance Company*, 892 F.Supp.2d 608 (MD Pa. 2012) (holding that NFIA did not preclude homeowner's Pennsylvania state law claims against an independent third-party flood determination provider); *Bagelmann v. First National Bank*, 823 N.W.2d 18 (Iowa 2012) (Iowa Supreme Court found that a negligent misrepresentation claim may exist against an independent third-party flood determination provider under Iowa law, and reversed and remanded for further proceedings).

The question raised in the Fonders case is a case of first impression in South Dakota, and is not well-settled across the country. Based upon these arguments alone, the trial court erred in dismissing the matter under SDCL § 15-6-12(b)(5).

**3. Both South Dakota common-law and caselaw create a duty, and allow for a negligence action against a third-party flood determination company.**

To recover against WFFS in a negligence action under South Dakota law, the Fonders would need to prove five things: 1) a duty (created by South Dakota common-

law, and the “reasonably foreseeable” standard adopted by this Court), 2) breach of that duty (failure of WFFS to use reasonable care when preparing the flood determination), 3) factual causation (“but for” WFFS’s erroneous determination, the Fonders would have obtained flood insurance when purchasing their new property), 4) proximate causation (it was foreseeable that the Fonders would rely on the professional opinion rendered by WFFS), and 5) damages (that the Fonders were damaged because of their reliance on WFFS’s erroneous determination). *Lien v. McGladrey & Pullen*, 509 N.W.2d 421, 423 (SD 1994).

SDCL § 20-9-1 provides in part: “Every person is responsible for injury to the person, property, or rights of another caused by his willful acts or caused by his want of ordinary care or skill....” This statute clearly provides that there is a statutory duty in South Dakota for all professionals, who hold themselves out as professionals in their respective areas, to exercise due care when rendering a professional opinion that others may rely on.

This Court has held that the legal concept of foreseeability is to be used when determining whether or not a duty exists in a professional negligence action. *Mid-Western Electric, Incorporated, v. DeWild Grant Reckert & Associates, Co.*, 500 N.W.2d 250, 254 (SD 1993). In the *Mid-Western Electric* case, this Court stated “[t]o deny a plaintiff his day in court would, in effect, be condoning a professional’s right to do his or her job negligently with impunity as far as innocent parties who suffer economic loss... We therefore recognize that in South Dakota a cause of action exists for economic damage for professional negligence beyond the strictures of privity of contract.” *Id.* This Court has also stated that “it is *foreseeability* of injury to another, not a *relationship* with

another, which is a prerequisite to establishing a duty necessary to sustain a negligence cause of action.” *Thompson v. Summers*, 1997 SD 103 ¶ 13, 567 N.W.2d 387, 392 (emphasis original). When rendering a professional opinion, this Court has held that a veterinarian has a legal duty not only to the owner of cattle, but also to the future buyer of those cattle when the buyer relies on the opinion of the veterinarian in deciding whether or not to purchase the cattle. *Limpert v. Bail*, 447 N.W.2d 48, 51 (SD 1989). Based on these cases and SDCL § 20-9-1, it would naturally follow that a flood-zone determination company who renders a professional opinion would have a legal duty in South Dakota to a reasonably foreseeable party that would rely on that professional opinion.

As set forth earlier in the brief, at the request of the Fonders, Factual Data Flood conducted a second flood determination on their property, and determined that the home was in fact located in a SFHA. APPX 9. While this flood determination was set forth on a similar form to the one that was completed by WFFS, the determination conducted by Factual Data Flood was not related to a mortgage. If the Fonders had purchased their home with cash and hired a professional flood determination provider like Factual Data Flood or WFFS to conduct a flood determination for them, based on South Dakota statutes and caselaw, the Fonders believe that they would have been able to bring a professional negligence action against the flood determination provider if they reasonably relied on the erroneous determination to their detriment. The result should not be any different here, and the Fonders should be able to maintain a professional negligence action against WFFS.

Based upon the South Dakota statute and caselaw set forth above, it is clear that a flood determination company owes a duty to a reasonably foreseeable person (the

Fonders) who may be injured by their professional negligence in the State of South Dakota.

**4. Dismissing the matter without the opportunity for a trial on the merits is bad public policy.**

To not allow the Fonders their day in court on this issue would be bad public policy. The framers of our constitution clearly envisioned that people in a situation like the Fonders would be afforded an opportunity to conduct discovery, present their case, and have it decided on the merits. Article VI § 20 of the South Dakota Constitution states: “All courts shall be open, and every man for an injury done him in his property, person or reputation, shall have remedy by due course of law, and right and justice, administered without denial or delay.”

The Fonders are innocent, blameless people in this matter. To their detriment, they relied on an erroneous flood determination that was prepared by a company that holds itself out to be an expert in that area. It was reasonably foreseeable, and WFFS knew or should have known that the Fonders would rely on this erroneous flood determination as Mr. Fonder’s name was clearly set forth at the top of the erroneous document. APPX 8. “Where one undertakes by contract to perform a certain service and is chargeable with the duty of performing the work in a reasonably proper and efficient manner, and injury occurs to a blameless person, the injured person has a right of action directly against the offending contractor which is not based on any contractual obligation but rather on the failure of such contractor to exercise due care in the performance of his assumed obligation.” *Limpert*, 447 N.W.2d at 51.

Based on the arguments set forth above, the Fonders have shown that they are entitled to relief under many possible theories, and the trial court erred in granting WFFS's motion to dismiss for failure to state a claim upon which relief can be granted.

**C. THE CIRCUIT COURT ERRED IN DENYING THE FONDERS' MOTION TO AMEND THEIR THIRD PARTY COMPLAINT.**

In the same Order that dismissed the Fonders' case, the trial court denied the Fonders' motion to amend their Third Party Complaint. APPX 3. As acknowledged by the trial court, the Fonders' motion to amend was denied simply because their overall case was dismissed. HT 21-22; APPX 3. If the trial court is reversed on the first issue and the matter remanded for a trial on the merits, the Fonders would like the opportunity to amend their Third Party Complaint to add a cause of action for Negligent Misrepresentation.

SDCL § 15-6-15(a) states in relevant part that "a party may amend his pleading only by leave of court or by written consent of the adverse party; and leave shall be freely given...." This Court has noted that "[o]ther courts have held that once a judgment is entered, amending the pleadings cannot be allowed until the judgment is set aside or vacated." *McDowell v. Citicorp, Inc.*, 2008 SD 50 at ¶ 13, 752 N.W.2d 209, 213. Because the trial court erred in dismissing the Fonders' case for failure to state a claim, the court also erred in denying the Fonders the opportunity to amend their complaint.

**CONCLUSION**

To overcome WFFS's motion to dismiss, the Fonders only need to show that they may be entitled to relief under 'any possible theory.' *Fenske*, 2004 SD 23 ¶ 7, 676 N.W.2d at 392-393. at ¶ 7. The Fonders have clearly outlined a professional negligence

claim against WFFS under South Dakota common-law that is supported by South Dakota caselaw that has been consistently handed down by this Court. The Fonders' case is a case of first impression in South Dakota, and the legal question presented by their case is not well-settled in other jurisdictions.

Both South Dakota common-law and caselaw create a legal duty in this matter, and allow for a professional negligence action against WFFS. Dismissing their case without the opportunity to conduct discovery, present their case, and have it decided on the merits would be bad public policy as the Fonders are innocent, blameless people in this matter. The trial court erred in determining that WFFS is immune from this negligence suit under South Dakota law, and that the Fonders have failed to state a claim upon which relief can be granted. The trial court also erred in denying the Fonders' motion to amend their third party complaint in this matter.

Based on the arguments and authorities set forth above, the Fonders respectfully request that this court reverse the trial court's decision and remand the matter for a trial on the merits.


#### **APPELLANT'S REQUEST ORAL ARGUMENTS**

#### **CERTIFICATE OF COMPLIANCE**

In accordance with SDCL 15-26A-66(b)(4), I certify that this brief complies from the Argument and Authorities section through the date and signature line. This brief contains 3,769 words and 22,316 characters including spaces. I have relied on the work and character count of the word processing system used to prepare this brief.



Dated this 8th day of August, 2014.

  
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### CERTIFICATE OF SERVICE


The undersigned hereby certifies that Appellant's Brief was served by electronic filing and by depositing the same in the United States Post Office in Sioux Falls, South Dakota, with first-class postage thereon fully prepaid upon the following addresses:

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THE HONORABLE JOHN L. BROWN  
Circuit Court Judge

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### **PRELIMINARY STATEMENT**

Throughout this Brief, reference will be made to Appellants, Matthew R. Fonder and Caralynn C. Fonder as “the Fonders” and to Appellee, Wells Fargo Insurance, Inc. Flood Services as “Wells Fargo Flood.” Reference will also be made to Appellee, Wells Fargo Bank, N.A., as “Wells Fargo.”

Reference to exhibits from Appellants’ Brief will be referred to as “AA” followed by specific Appendix Page(s). Reference to the motion to dismiss hearing transcript will be referred to as “HT” followed by the specific page(s).

### **JURISDICTIONAL STATEMENT**

The Fonders initiated this appeal after the Circuit Court (i) granted Wells Fargo Flood’s motion to dismiss the Fonders’ Complaint pursuant to SDCL § 15-6-12(b)(5) for failure to state a claim upon which relief may be granted and (ii) denied the Fonders’ motion to amend their Third-Party Complaint. Judge Brown’s Order was signed and filed on December 27, 2013. (AA 3). Notice of Entry of Order was served on January 10, 2014. (AA 1-2).

Though the Order provided for the dismissal of Wells Fargo Flood, the Court did not direct the entry of a final judgment pursuant to SDCL § 15-6-54(b). The Fonders appealed the Circuit Court’s Order, but this Honorable Court, by Order of February 7, 2014, entered an order to show cause, on the grounds that the order from which appeal was sought was not a final order appealable of right pursuant to SDCL § 15-26A-3. On April 4, 2014, the Honorable David Gilbertson, Chief Justice of this Court, entered an order dismissing the Fonders’ appeal without prejudice.



Since that time, the remaining claim pled by Wells Fargo was dismissed by stipulation of the parties. The Order of Dismissal was signed on May 20, 2014, and Notice of Entry of the Order of Dismissal was served on June 10, 2014.

The Fonders filed and served their Notice of Appeal from the Order granting Wells Fargo Flood's motion to dismiss and Docketing Statement on June 26, 2014. This Court has jurisdiction in this case by virtue of the Fonders' timely-filed Notice of Appeal. This case is proper before the Court under the authority of SDCL-15-26A-3(2).

### **STATEMENT OF LEGAL ISSUES**

**Issue:**            **Whether a state law cause of action can arise out of an erroneous flood zone determination conducted pursuant to the Flood Disaster Protection Act of 1973.**

*The Circuit Court held in the negative.*

### **Most Relevant Cases:**

Highmark Federal Credit Union v. Hunter, 2012 SD 37, 814 N.W.2d 413

Hofbauer v. Northwestern National Bank of Rochester, 700 F.2d 1197 (8th Cir. 1983)

### **STATEMENT OF THE CASE**

On February 3, 2013, Wells Fargo filed a Complaint against the Fonders seeking to foreclose on the Fonders' home. On May 29, 2013, the Fonders filed a Third-Party Complaint against Wells Fargo Flood arising out of an allegedly erroneous flood zone determination performed by Wells Fargo Flood for Wells Fargo pursuant to the Flood Disaster Protection Act of 1973. On July 16, 2013, Wells Fargo Flood moved to dismiss the Fonders' Third-Party Complaint, and a hearing was held on December 11, 2013, before the Honorable John L. Brown, Circuit Court Judge. At the conclusion of the hearing, Judge Brown granted Wells Fargo Flood's Motion to Dismiss and denied the

Fonders' motion to amend their Third-Party Complaint, finding that the Supreme Court of South Dakota had determined in Highmark Federal Credit Union v. Hunter, 2012 SD 37, 814 N.W.2d 413, that (i) state law causes of action, whether against the lender or a flood-zone determination company, could not arise out of violations of the Flood Disaster Protection Act of 1973; (ii) the federal act did not create any private right of action; and (iii) no duty was owed to the Fonders, who are not members of the class intended to be protected by the federal act. (HT 20-21).

### STATEMENT OF THE FACTS

This case arises out of the Fonders' purchase of the real property and home located at 3702 North Frontier Rd., Fort Pierre, South Dakota ("The Property"). (AA 4, ¶ 4). The Fonders allege that in connection with the purchase, the lender required a standard flood hazard determination to comply with federal regulations. (AA 5, ¶ 7). The Fonders allege that the flood determination (the "Flood Determination") was performed by Wells Fargo Flood and was erroneous because it failed to note that the Property was located within a special flood hazard area. (AA 5, ¶¶ 8-11). The Flood Determination provides in bold text as follows:

**This flood determination is provided solely for the use and benefit of the entity named in Section 1, Box 1 [Wells Fargo] in order to comply with the 1994 Reform Act and may not be used or relied upon by any other entity or individual for any purpose, including, but not limited to deciding whether to purchase a property or determining the value of a property.**

(AA 8).

The Property flooded subsequent to the May 12, 2011 closing, and the Fonders filed their Third-Party Complaint against Wells Fargo Flood asserting state law claims of

negligence, breach of fiduciary duty and negligent infliction of emotional distress. (AA 5, ¶ 9, AA 6 ¶¶ 12-22, AA 7, ¶ 23).

### STANDARD OF REVIEW

A motion to dismiss under SDCL 15-6-12(b) tests the legal sufficiency of the pleading, not the facts which support it. Guthmiller v. Deloitte & Touche, LLP, 2005 S.D. 77 ¶ 4, 699 N.W.2d 493, 496. For purposes of the pleading, the court must treat as true all facts properly pled in the complaint and resolve all doubts in favor of the pleader. Id. In reviewing a trial court’s grant or denial of a motion to dismiss, the Supreme Court of South Dakota determines whether a party is entitled to judgment as a matter of law. Id. Thus, all reasonable inferences of fact must be drawn in favor of the non-moving party. Id. An appeal of a motion to dismiss presents a question of law and plenary, or *de novo*, review is employed by this Court with no deference given to the trial court’s legal conclusions. Wojewski v. Rapid City Reg’l Hosp., Inc., 2007 S.D. 33 ¶ 11, 730 N.W.2d 626, 631 (internal citations omitted).

### ARGUMENT

#### **I. The Fonders Have Failed To State A Cognizable Claim Against Wells Fargo Flood**

The Flood Disaster Protection Act of 1973 (the “Act”) provides the legal backdrop for the Fonders’ claims. The Act requires flood insurance for loans secured by improved real estate situated within a federally recognized Special Flood Hazard Area (“SFHA”) and mandates that federally regulated lending institutions bear the responsibility of determining whether flood insurance is required and ensuring that it is appropriately obtained. See 42 U.S.C. §§ 4104a, 4012a(b)(1) (2008); see also 42 U.S.C. §§ 4001-4129 (2008).

Significantly, courts throughout the country, including the Supreme Court of South Dakota in Highmark Federal Credit Union v. Hunter, 2012 SD 37, 814 N.W.2d 413, and the United States Court of Appeals for the 8<sup>th</sup> Circuit in Hofbauer v. Northwestern Nat'l Bank of Rochester, MN., 700 F.2d 1197 (8<sup>th</sup> Cir. 1983), have held that there is no express or implied right of borrowers to sue lenders under the Act. This protection necessarily extends to flood determination companies who act at the behest of these lenders.

Consistent with the majority of the Courts in the United States, the Highmark Court declined to allow a state law theory of liability to be asserted by a borrower against a lender due to an alleged failure of the lender to take action required by the Act. In Highmark, the home of Rachelle Hunter (“Hunter”), a borrower, flooded without any flood insurance. 814 N.W.2d at 414. Though Hunter’s home was located in a flood area, the mortgagor erroneously failed to warn Hunter to purchase flood insurance and also failed to purchase flood insurance for Hunter at her own expense. Id. In a foreclosure claim brought by the mortgagor, Hunter asserted a counterclaim against the mortgagor, alleging state common law theories of negligence and breach of duty in failing to warn her to purchase flood insurance and in failing to purchase the insurance at her expense. Id. at 414-15. The Supreme Court of South Dakota, however, deferred to principals of federalism, noting that the Act creates neither a private cause of action for borrowers nor any duty under state common law toward borrowers Id. at 417-18. In other words, the Act is designed to protect lenders and the federal treasury, and borrowers cannot bootstrap a state law claim based on a federal statute that was not enacted to protect them. Id.

Here, because the state law claims alleged by the Fonders are necessarily derivative of and dependent upon the Act, and because Wells Fargo Flood owes no duty to the Fonders as expressly stated in bold text in the Flood Determination – and as so held in Highmark – there are no facts upon which the Fonders could state a claim for relief.

**A. The History and Purpose of the Act**

Congress passed the Act as an amendment to the National Flood Insurance Act of 1968 (“NFIA”), which authorized the federal government to establish the National Flood Insurance Program (the “NFIP”). Under the NFIP, property owners could voluntarily purchase flood insurance protection from the federal government in light of the private industry’s inability to offer reasonably-priced flood insurance on a national level. In 1973, Congress amended the NFIA and enacted the Flood Disaster Protection Act (previously identified above as the “Act”). The Act prohibits regulated lenders from making, increasing, extending or renewing any loan secured by improved real estate located in a SFHA unless the secured property and any personal property securing the loan is covered for the life of the loan by flood insurance. See 42 U.S.C. § 4012a(b)(1). In that event, lenders are only mandated to require flood insurance for the amount of the outstanding loan balance. See 42 U.S.C. § 4012a(b), 42 U.S.C. § 4012a. Congress subsequently enacted the National Flood Insurance Reform Act of 1994 (“Reform Act”). The Reform Act amended 42 U.S.C. § 4001 et seq. by imposing new obligations on both mortgage originators and servicers.

Flood zone determination companies like Wells Fargo Flood provide standard flood determinations for regulated lenders such as Wells Fargo pursuant to the Act, specifically 42 U.S.C. §§ 4104a and 4012a(b), to ensure a lender’s compliance with the Act. Those companies have no relationship with or duty to borrowers such as the

Fonders, either contractual or otherwise, and do not perform the flood determinations for their benefit. On the contrary, in this case the Flood Determination was performed solely to ensure Wells Fargo's compliance with the Act.

**B. There Is No Express or Implied Private Right of Action Under the Act**

The Act does not recognize a private cause of action by borrowers against lenders or companies that perform flood determinations for action or inaction under the procedures specified by the Act. Highmark, 2012 SD 37, 417 N.W.2d 413; see also Hofbauer v. Northwestern Nat'l Bank of Rochester, MN., 700 F.2d 1197 (8<sup>th</sup> Cir. 1983); Lukosus v. First Tenn. Bank N.A., 2003 WL 21658263, at \*4 (W. D. Va. July 9, 2003), aff'd., 89 Fed. Appx. 412 (4<sup>th</sup> Cir. 2004); Nicholson v. Countrywide Home Loans, 2008 WL 731032, at \*3 (N.D. Oh. 2008) ("Courts have unanimously held that NFIA does not create a private cause of action for borrowers.") (citing Wentwood Woodside I, LP v. GMAC Commercial Mortg. Corp., 419 F.3d 310, 323 (5<sup>th</sup> Cir. 2005)); see also Arvai v. First Fed. Sav. & Loan Ass'n., 698 F.2d 683, 684 (4<sup>th</sup> Cir. 1983) (holding that the Act does not recognize a private cause of action for borrowers and affirming the district court's dismissal of claim made by borrowers for failure to state a claim upon which relief can be granted); Till v. Unifirst Federal Sav. and Loan Ass'n., 653 F.2d 152, 156 (5<sup>th</sup> Cir. 1981); Ellis v. Countrywide Home Loans, Inc., 541 F. Supp. 2d 833, 836 (S.D. Miss. 2008) ("[t]he law is clear that no private right of action exists under the NFIA against a Regulated Lender for failure to make an accurate flood zone determination"); Ford v. First American Flood Data Services, 2006 WL 2921432, at \*7-8 (M.D.N.C. Oct. 11, 2006) (dismissing claim against flood zone determination company and holding that there is no private right of action by a borrower as a result of a flood determination company's allegedly incorrect flood zone determination); R.B.J. Apartments, Inc. v. Gate

City Sav. & Loan Ass'n, 315 N.W.2d 284, 290 (N.D. 1982) (refusing to recognize state law cause of action and stating “[i]t is not within the competence of the judiciary to amend these comprehensive enforcement schemes by adding to them another private remedy not authorized by Congress”).

Though it is clear that the Act does not expressly provide for a private cause of action, courts have considered whether the Act created an implied private right of action and have concluded that it does not. See Arvai, 698 F.2d at 684. In determining whether an implied private right of action exists under a statute, the courts rely on the United States Supreme Court’s decision in Cort v. Ash, 422 U.S. 66, 95 S.Ct. 2080 (1975). In Arvai, the Court specifically analyzed whether an implied right of action existed under the Act. Applying the Cort factors,<sup>1</sup> the Fourth Circuit upheld the district court’s decision that borrowers who borrow money from a federally regulated lender “were not in a class for whose special benefit the Act was passed.” Arvai, 698 F.2d at 684. The Arvai court found no specific congressional intent indicating a right of action for damages and concluded that no such right of action existed under the Act. Id. Likewise, in Dollar v. NationsBank of Georgia, N.A., 534 S.E.2d 851, 853 (Ga. App. 2000), the court stated that the bank’s “determination as to whether or not Dollar’s [*i.e.*, the borrower’s]

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<sup>1</sup> The Supreme Court, in Cort, enumerated a list of factors to be considered in determining whether a statute creates a private right of action. First, is the plaintiff one of the class for whose especial benefit the statute was enacted, that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the states, so that it would be inappropriate to infer a cause of action based solely on federal law? Cort, 422 U.S. at 76, 95 S.Ct. at 2087-88 (internal citations and quotations omitted).

residence was in a flood zone was made, not for Dollar's benefit, but for the purpose of protecting the bank's interest in its collateral." (citations omitted) (emphasis added). See also R.B.J., 315 N.W.2d at 290 ("the statute evinces a greater concern for the lender than for the borrower"). Indeed, as noted by the Supreme Court of South Dakota, "courts have consistently held that in adopting the NFIA, Congress meant to protect lenders and the federal treasury." Highmark, 814 N.W.2d at 417. As such, the Act was not created for the benefit of a borrower, and thus, no implied private right of action by a borrower exists.

Further, in Ford, the Court specifically extended the finding that there is no implied right of action for borrowers under the Act to claims asserted against a third-party flood hazard determination company. 2006 WL 2921432, at \*9. In Ford, the borrowers alleged state law negligence and breach of contract claims against a lender and First American Flood Data Services ("First American"), a company that provided flood zone determinations for lenders. Id. at \*2. The claim against First American arose out of its purported failure to correctly ascertain that the property purchased by plaintiff was located in a SFHA. Id. First American sought to dismiss the borrower's claims and argued that even if the allegations regarding the accuracy of the flood zone determination were true, a borrower has no legal right to bring a private action against a lender or flood company either under the Act or any common law theory. Id. The court found that the overwhelming majority of both federal and state courts refuse to allow either private federal or common law claims arising out of violations of the Act. Id. at \*3. Accordingly, the court granted First American's motion to dismiss.



C. The State Law Claims Against Wells Fargo Flood Fail Because They Are Derivative of the Act and Wells Fargo Flood Owes No Duty to the Fonders

The Supreme Court of South Dakota, consistent with the majority rule in the United States, has made clear that a borrower may not bring a state common law claim against a lender as a result of a failure to discharge obligations under the Act. Highmark, 814 N.W.2d at 417-18. In so holding, the Highmark Court relied on case law from other jurisdictions, and noted three primary reasons for refusing to allow state common law claims to be asserted against the lender who allegedly violated the NFIA: (i) in adopting the NFIA, Congress “meant to protect lenders and the federal treasury,” (ii) the “NFIA does not create a private right of action,” and (iii) a “common-law right of action for violation of the statute was not intended.” Id.

This holding was in accord with a clear majority rule that has developed in the United States to preclude such claims based on federalism concerns:

[I]t would implicate serious federalism concerns to allow [private-action NFIA] claims to stand, and, consequently, most states dealing with this issue have held that these federalism concerns preclude any state common law action based on a violation of the NFIA . . . [thus] it would defy logic to permit the NFIA – which does not provide borrowers with a direct cause of action – to be used indirectly for the purpose of creating a standard of conduct in the context of a common law negligence claim.

\* \* \*

Plaintiff's claims arose out of First American's failure to correctly determine that the Property was located in a Special Flood Zone Hazard Area. [NFIA] provides for and regulates third-party flood zone determinations to ensure that lenders comply with its flood insurance provisions. Therefore, any duty First American owed to Plaintiff, either from the contract between First American and [the lender] or from an ordinary negligence standard, would have arisen from the [NFIA], a breach of which would

violate the [NFIA]. For this reason, Plaintiff's claims are based directly on alleged violations of the [NFIA].”

Callahan v. Countrywide Home Loans, 2006 WL 2993178, at \*1–2 (N.D. Fla. Oct. 20, 2006) (emphasis in original) (quoting Harris v. Nationwide Mutual Fire Ins. Co., 2011 WL 6056459, at \*4 (M.D. Tenn. Dec. 5, 2011)). See also Ellis, 541 F. Supp. 2d at 838 (S.D. Miss. 2008) (citations omitted) (“most states dealing with this issue have held that . . . federalism concerns preclude any state common law action based on a violation of the NFIA.”); Ford, 2006 WL 2921432, at \*4 (“[w]hen state courts have addressed the issue, they have almost uniformly decided not to allow private causes of action by borrowers based on violations of the Act, usually reasoning that legislative intent and principles of federalism and separation of powers caution against it”); Lukosus, 2003 WL 21658263, at \*1 (“those state courts that have considered the issue have rejected any such common law cause of action, based in part on principles of federalism”).

Further, other courts, just as the Court in Highmark, have ruled that even absent the federalism concerns, negligence claims fail against flood determination companies because they do not owe a duty to borrowers:

While the incorrect flood zone determination of which Plaintiffs complain may serve as evidence of conduct falling below the applicable standard of care, it does not establish that Defendants owed Plaintiffs some duty in relation to that determination. Indeed, Defendants owed no such duty: the determination was undertaken for the benefit of the lender, and by extension, the federal treasury.

Weise v. CoreLogic Flood Services, Inc. 2012 WL 8134588, at \*5 (E.D. Tenn. Mar. 2, 2012); see also Audler v. CBC Innovis Inc., 519 F.3d 239, 251 (5th Cir. 2008) (“a flood determination company retained by lender to perform flood zone determination on a borrower’s property does not owe a duty to the borrower”); Nicholson, 2008 WL 731032,

at \*3 (holding that a borrower could not assert a common law negligence claim based upon NFIA).

Here, the Fonders' claims are barred as a matter of established South Dakota law, which is in accord with the majority rule throughout the United States. The Fonders' claims arise out of alleged violations of the NFIA. Because the NFIA was not enacted for their benefit, however, Wells Fargo Flood owed them no duty, and any violation of the NFIA by Wells Fargo Flood is simply not actionable by the Fonders. The Fonders' claims should therefore be dismissed.

**D. The Fonders Fail to Cite Any South Dakota Precedent Sufficient to Overcome Wells Fargo Flood's Motion to Dismiss**

The Fonders suggest throughout their brief that the instant case is an issue of first impression before this Court. On the contrary, Highmark specifically addressed the issue of whether a South Dakota tort claim can arise out of an erroneous flood determination conducted pursuant the Act. The South Dakota Supreme Court announced a bright line rule that such a claim cannot be made because the Act was not meant to protect borrowers, the Act does not create a private right of action, and a common-law right of action for violation of the statute was not intended. Highmark, 814 N.W.2d at 417-18. The Supreme Court's decision in Highmark is in accord with the majority rule that has developed in the United States that state law causes of action cannot arise out of statutory violations under the Act. In their brief, the Fonders cite to no South Dakota authority that distinguishes, disagrees with, or in any way calls into question the holding in Highmark. Instead, the Fonders feebly attempt to distinguish Highmark on its facts and otherwise rely upon out-of-state authority articulating a minority rule that the South Dakota Supreme Court has considered and rejected.

1. The Fonders' Effort to Distinguish *Highmark* Fails

Because Highmark is fatal to the Fonders' claims, they unpersuasively suggest that the Highmark decision can be distinguished and disregarded because the defendant in that case was a lender as opposed to a flood determination company. However, the central question under Highmark was not who violated the Act, but rather whether a violation of the Act can give rise to a state law duty to a borrower in tort. Highmark, 814 N.W.2d at 416 (“[w]hether federal statutes establish a standard of care, *i.e.*, duty, in state-based claims is a matter of state law.”). Thus, Highmark conclusively established that the Act does not give rise to a state law duty, and there is therefore no basis to distinguish between a lender who allegedly violates the Act, and a flood determination company – acting at the behest of a lender – who allegedly violates the Act. Highmark, 814 N.W.2d at 417-18.

When a federally backed loan is made in connection with the financing of an improved parcel of real estate, the Act requires that a lender condition the loan on the borrower obtaining flood insurance coverage over any “improved real estate or mobile home” located in a SFHA. See 42 U.S.C.A 4012a(b)(1)(A). To discharge its duty to the federal treasury, the lender must determine whether the building or mobile home is located in a SFHA. The determination is documented on the Standard Flood Hazard Determination Form promulgated by the FEMA pursuant to the Act. See 44 C.F.R. § 65.16. The lender typically discharges its statutory and regulatory duty by hiring a flood determination company to conduct the flood determination pursuant to the Act. Like the lender, the flood determination company is acting pursuant to the Act, and any violation of the Act by the flood determination company (such as an erroneous flood determination), cannot give rise to a state law duty. See, e.g., Highmark, 814 N.W.2d at

417-18 (“[t]he next reason that the NFIA does not establish a duty in a negligence case is that the [Act] does not create a private right of action. . . . [i]f the [Act] does not create a private right of action, then it follows that an individual cannot use the [Act] to establish a duty in an individual civil claim”).<sup>2</sup>

Indeed, other states that have adopted the majority rule have considered whether a distinction should be drawn between lenders acting pursuant to the Act and flood determination companies acting pursuant to the Act and concluded that no such distinction should be made. See, e.g., Ford, 2006 WL 2921432, at \*9 (rejecting any distinction between lenders and flood determination companies and dismissing the plaintiff’s state law claims against the third-party flood determination company); Callahan, 2006 WL 2993178, at \*2 (N.D. Fla. Oct. 20, 2006) (finding Ford to be both “on-point” and “persuasive”); see also Weise, 2012 WL 8134588 (E.D. Tenn. Mar. 2, 2012) (holding that a third-party flood determination company did not owe borrowers any duty and dismissing borrower’s claims against the flood determination company); Harris v. Nationwide Mut. Fire Ins. Co., 2011 WL 6056459 (M.D. Tenn. Dec. 5, 2011) (determining that plaintiff’s claims were based on the Act and dismissing the complaint against third-party flood determination companies); Cruey v. First Am. Flood Data Servs., Inc., 174 F. Supp.2d 525 (E.D. Ky. 2001) (holding that borrower had no implied right of action against the third-party determination company under the Act). These

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<sup>2</sup> The Fonders also claim that Highmark is distinguishable because the borrowers in that case were aware that the property at issue was in a SFHA. However, under Highmark, knowledge or lack thereof of the violation of the Act was not a component of the Court’s analysis of whether a state law duty could exist for violation of the federal Act. To the contrary, the Court announced a bright-line rule that precluded state law causes of action that were derivative of violations of the Act.

courts have considered – and rejected – the very distinction offered by the Fonders in the instant case.

For the above reasons, Highmark requires dismissal of the Fonders' Complaint, which is necessarily derivative of and reliant upon alleged violations of the Act that the South Dakota Supreme Court has announced cannot give rise to a state law tort claim.

2. **The Out-of-State Minority Rule Cases Cited by the Fonders Are Inapposite, Because the Supreme Court of South Dakota Has Rejected the Minority Rule Regarding Violations of the Act**

The Fonders essentially ask the Court to reject Highmark together with the numerous other decisions throughout the country articulating the majority rule on the subject of whether a state law cause of action sounding in tort can be asserted for alleged violations of the Act. Instead they ask the Court to rely on two Fifth Circuit cases applying Mississippi law, Paul v. Landsafe Flood Determination, 550 F. 3d 511 (5th Cir. 2008) and Till v. Unifirst Fed. Sav. & Loan Assn., 653 F.2d 152, 161 (5<sup>th</sup> Cir. 1981), an Illinois state court opinion, Klecan v. Countrywide Home Loans, 951 N.E.2d 1212 (Ill. App. Ct. 2011), and Williams v. The Standard Fire Insurance Company, 892 F. Supp.2d (M.D. Pa. 2012) (applying Pennsylvania law) from the Middle District of Pennsylvania. Of course, this Court is bound by the precedent of the Supreme Court of South Dakota in Highmark and not the nonbinding authority cited by the Fonders. See State v. Means, 268 N.W.2d 802, 811 (S.D. 1978) (“when the court has laid down a principle of law as applicable to a certain state of facts, it will adhere to that principle, and apply it to all further cases where the facts are substantially the same”) (citing Printup v. Kenner, 43 S.D. 473, 476, 180 N.W. 512, 513 (1920)). Even so, the cases cited by the Fonders are distinguishable and should not be persuasive.

First, the Paul case cited by the Fonders (which relied, in part, on the Till case) articulates a minority rule adopted by only a handful of courts in the country that an erroneous flood-zone determination is the kind of professional opinion in which justifiable detrimental reliance by a reasonably foreseeable person can be made. Paul, 550 F.3d at 518. However, both Paul and Till apply Mississippi law and Paul notes that Mississippi's broad approach to negligent misrepresentation is "almost unique" to that state based on a foreseeability approach followed by few other jurisdictions, including South Dakota. Id. This Court, however, is bound by the Supreme Court of South Dakota's bright line rule announced in Highmark and not the "almost unique" minority rule articulated in Paul.

Next, the Williams case from the United States District Court for the Middle District of Pennsylvania, applying Pennsylvania law, was resolved prior to trial and is otherwise distinguishable on its facts. Williams involved a structure that was allegedly uninsurable from inception of the loan at issue due to it being built entirely above water. The standard National Flood Insurance Program flood insurance policy at issue contained a specific exclusion for structures built entirely over water, which was applicable regardless of the accuracy of the flood zone determination made in connection with the loan. These unique facts make Williams an unreliable predictor of Pennsylvania law, let alone South Dakota law, where the Supreme Court has announced a bright line rule in Highmark.

The Fonders also rely on a single state court opinion issued by the Illinois court in Klecan. There is no question, however, that Klecan posits the minority view and that its holding is an anomaly when considered against the cases nationally which have

considered this issue. In fact, Klecan has not been followed since it was decided over three years ago in June 2011.

In sum, the Supreme Court of South Dakota has rejected the minority view relied upon in the cases cited by the Fonders and instead adopted the majority rule that the Act cannot give rise to a state common law duty.

**II. For The Same Reasons, The Fonders' Motion to Amend the Third-Party Complaint Is Futile and Should Be Denied**

On the same facts already pled, the Fonders seek to add a claim for negligent misrepresentation in their proposed amended complaint. Presumably, the Fonders believe the Paul case provides the basis for that claim. However, for the reasons already briefed, state law duties cannot be derived from the Act, and the Fonders' claim for negligent misrepresentation necessarily arises out of an allegedly incorrect flood zone determination made pursuant to the Act.

Although SDCL § 15-6-15(a) provides in relevant part that “[I]eave [to amend] shall be freely given when justice so requires,” it would be unjust for the Court to grant leave to amend the complaint, because the Fonders will still be unable to state a claim upon which relief can be granted. In Prairie Lakes Health Care Sys., Inc. v. Wookey, 1998 SD 99, ¶ 29, 583 N.W.2d 405, 417, the Supreme Court of South Dakota noted, “A plaintiff typically will not be precluded from amending a . . . complaint in order to state a claim on which relief can be granted . . . .” (citing 6 C. Wright & A. Miller, Federal Practice and Procedure § 1487 (1990)). Here, however, for all the reasons already briefed, any amendment to the complaint will not state a claim upon which relief can be granted. Thus, the Fonders' motion to amend their Third-Party Complaint must be denied as futile.



CONCLUSION

For the foregoing reasons, Appellee Wells Fargo Insurance, Inc. Flood Services respectfully requests that this Court affirm the Circuit Court's dismissal of the Third-Party Complaint filed by Appellants Matthew R. Fonder and Caralynn C. Fonder.

Dated this 2 day of October, 2014.

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**APPELLEE RESPECTFULLY REQUESTS  
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**CERTIFICATE OF COMPLIANCE**

This Brief complies with the type-volume limitation of SDCL § 15-26A-66(b)(4) because this Brief contains 6,492 words, excluding the parts of the Brief exempted by SDCL § 15-26A-66(b)(3).

This Brief complies with the typeface requirements of SDCL § 15-26A-66(b)(1) because this Brief has been prepared in a proportionally spaced typeface using Microsoft Word 2010 in Times New Roman, size 12.

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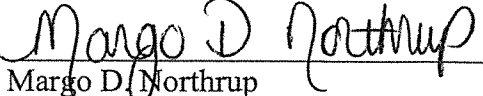
**CERTIFICATE OF SERVICE**

The undersigned hereby certifies that Appellee's Brief was served by electronic filing and by First Class mail, postage prepaid to:

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IN THE SUPREME COURT  
STATE OF SOUTH DAKOTA

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No. 27130

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WELLS FARGO BANK, N.A.,

Plaintiff and Appellee,

vs.

MATTHEW R. FONDER, CARALYNN C. FONDER, and any person in possession,

Defendants, Third-Party Plaintiffs and Appellants,

vs.

WELLS FARGO INSURANCE, INC. FLOOD SERVICES,

Third-Party Defendant and Appellee.

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APPEAL FROM THE CIRCUIT COURT  
SIXTH JUDICIAL CIRCUIT  
STANLEY COUNTY, SOUTH DAKOTA

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HONORABLE JOHN L. BROWN  
Circuit Court Judge

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APPELLANTS' REPLY BRIEF

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NOTICE OF APPEAL FILED JUNE 26, 2014

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## PRELIMINARY STATEMENT

Throughout this reply brief, the Appellants Matthew R. Fonder and Caralynn C. Fonder will be referred to the Appellants or the “Fonders.” The Third Party Defendant and Appellee Wells Fargo Insurance, Inc. Flood Services will be referred to as the Appellee or “WFFS.” Appellee’s brief will be referred to as “Appellee’s Brief” with the corresponding page number(s).

## ARGUMENT

### **I. THE CIRCUIT COURT ERRED IN DISMISSING THE CASE UNDER SDCL § 15-6-12(b)(5), CONCLUDING THAT THE PLAINTIFFS HAVE FAILED TO STATE A CLAIM UPON WHICH RELIEF CAN BE GRANTED.**

The main issue before the Court in this matter is whether the circuit court erred in dismissing the Fonders’ case under SDCL § 15-6-12(b)(5) for failure to state a claim upon which relief can be granted. In its brief, the Appellee in this matter misstates the issue before the Court. Appellee’s Brief at 2. WFFS claims that the issue before this court is something other than the circuit court’s Rule 12(b)(5) dismissal, arguing against the merits of the Fonders’ case which was never heard by the circuit court. With the circuit court’s dismissal, the Fonders did not have the opportunity to argue the merits of their case before any court.<sup>1</sup> The Fonders also did not have the opportunity to depose the individual who conducted the flood determination, or discover any emails, correspondence, training materials, desk manuals, or other documentation related to their case.

It is within the realm of possibility that there was an intentional misrepresentation, as opposed to a negligent misrepresentation, on the erroneous flood determination

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<sup>1</sup>WFFS has taken the opportunity in its brief to primarily argue the merits of its case, and argue against the merits of the Fonders’ case.



conducted by WFFS to ensure that the Fonders' loan would get approved. However, without the opportunity to conduct discovery, the Fonders would be unable to determine whether or not there was an intentional misrepresentation on the flood determination that was conducted on their new property.

This Court should not focus on the National Flood Insurance Act (NFIA), as the "duty" and the cause of action both arise under South Dakota statutes and case law, not the NFIA. Furthermore, the bold text contained in the standard flood determination does not protect WFFS from a common-law negligence claim. A party cannot shield itself from tort liability with a simple statement on a document. This Court has held that "[o]ne-sided agreements whereby one party is left without remedy for another party's breach are oppressive and should be declared unconstitutional." *Durham v. Ciba-Geigy Corp.*, 315 N.W.2d 696, 700 (S.D. 1982).

Flood zone determination companies, like WFFS, provide flood determinations for, and have relationships with, people like the Fonders. This is evidenced by the flood determination conducted by the third-party flood determination company, Factual Data Flood, which provided a correct flood zone determination for the Fonders, and determined that their home was in fact located in a special flood hazard area (SFHA). See Appellants Brief - APPX 9. While this flood determination was set forth on a similar form to the one that was completed by WFFS, the determination conducted by Factual Data Flood was not related to a mortgage and no regulated lender was involved. WFFS's statement that flood zone determination companies only have relationships with regulated lenders is wrong.

Flood insurance is available to any homeowner who is interested in purchasing it; flood insurance availability is not limited to transactions where a regulated lender is involved. If the Fonders had purchased their home with cash and hired a professional flood determination provider like Factual Data Flood or WFFS to conduct a flood determination for them, based on South Dakota statutes and case law, a professional negligence action could be brought against the flood determination provider if the Fonders reasonably relied on an erroneous determination to their detriment. See *Lien v. McGladrey & Pullen*, 509 N.W.2d 421, 423 (SD 1994); *Mid-Western Electric, Incorporated, v. DeWild Grant Reckert & Associates, Co.*, 500 N.W.2d 250, 254 (SD 1993); *Thompson v. Summers*, 1997 SD 103 ¶ 13, 567 N.W.2d 387, 392; and *Limpert v. Bail*, 447 N.W.2d 48, 51 (SD 1989). The result should not be any different here, and the Fonders should be able to maintain a professional negligence action against WFFS.

This Court did not hold in *Highmark Federal Credit Union v. Hunter*, 2012 SD 37, 814 N.W.2d 413, that “negligence claims fail against flood determination companies because they owe no duty to borrowers.” See Appellee Brief at 11. Instead, this Court held that a lender did not owe a duty to a mortgagee to force-place flood insurance on a mortgaged property when the lender knew that the property was located in a SFHA.

*Highmark Federal Credit Union*, 2012 SD 37, ¶ 20, 814 N.W.2d at 418.

The Fonders’ claim is not against the lender in the transaction. The Fonders’ claim is against the third-party flood determination company WFFS. Other courts have recognized the potential for a claim against a third-party flood determination company.<sup>2</sup> The better reasoned analysis of those courts weighs in favor of this Court holding that a

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<sup>2</sup> *Williams v. Standard Fire Insurance Company*, 892 F.Supp.2d 608 (MD Pa. 2012); *Paul v. Landsafe Flood Determination, Inc.*, 550 F.3d 511, 518 (5<sup>th</sup> Cir. 2008); *Klecan v. Countrywide Home Loans, Inc.*, 951 N.E.2d 1212 (Ill.App.Ct. 2011); *Bagelmann v. First National Bank*, 823 N.W.2d 18 (Iowa 2012).

negligence claim against a third-party flood determination company is distinguishable from claims against the lender in the transaction, and allowing the Fonders' claim to be heard.

In *Klecan v. Countrywide Home Loans, Inc.*, 951 N.E.2d 1212 (Ill.App.Ct. 2011), the Third District Appellate Court of Illinois recognized the distinction between a claim against a lender versus a claim against a third-party flood determination company. That court held: “[a]lthough other Illinois courts have held that a borrower’s common-law negligence claim against a lender was barred by the Flood Act, we note that an Illinois court has yet to address a borrower’s common law negligence claim against a flood determiner.” See *Id.* at 1214 (citations omitted).

Similarly, the Supreme Court of Iowa recently recognized the distinction between a claim against a lender, versus a claim against a third-party flood determination company. *Bagelmann v. First National Bank*, 823 N.W.2d 18 (Iowa 2012). In *Bagelmann*, the Supreme Court of Iowa determined that, as this Court determined in *Highmark*, a borrower cannot sue a lender under state common law for failing to discharge a duty created by the NFIA. See *id.* at 25. The *Bagelman* court however, went on to state that “[n]one of this, however, forecloses the possibility that an *independent* state law duty could exist based upon something other than a violation of the NFIA” inferring that a state law cause of action may exist against the third-party flood determination company. *Id.* at 28 (citations omitted) (emphasis original). These courts have recognized the potential for a claim against a third-party flood determination company, and distinguished those cases from claims against the lender in the transaction.

The Fonders are asking this Court to similarly recognize the distinctions between those types of cases.

South Dakota has long recognized the reasonably foreseeable standard. See *Lien v. McGladrey & Pullen*, 509 N.W.2d 421, 423 (SD 1994); *Mid-Western Electric, Incorporated, v. DeWild Grant Reckert & Associates, Co.*, 500 N.W.2d 250, 254 (SD 1993); *Thompson v. Summers*, 1997 SD 103 ¶ 13, 567 N.W.2d 387, 392; and *Limpert v. Bail*, 447 N.W.2d 48, 51 (SD 1989). The similarity between the case law and its “reasonably foreseeable” standard as used in other jurisdictions supports South Dakota extending its “reasonably foreseeable” standard to negligence cases against third-party flood determination companies.

The *Klecan* case is not “... an anomaly when considered against the cases nationally which have considered this issue.” See Appellee Brief at 16-17. The Appellee has misidentified the issue in this case. This is not a case of the borrower stating a claim against a lender as the Appellee argues. This is a case of the borrower stating a claim against an independent, third-party service provider. As argued above, the states that follow the same “reasonably foreseeable” standard that is well established in South Dakota, have found that state common-law actions may be maintained against third-party flood determination companies based on that standard. There is no reason for South Dakota to reject the minority position embraced by like-minded states merely because it is the minority position.

This Court is *not* “bound” by its decision in the *Highmark* case and the Court’s hands are *not* tied. See Appellee Brief at 16. Because the Fonders’ case is clearly distinguishable from the *Highmark* case, this Court can easily distinguish the two types of

cases just as the *Klecan* and *Bagelman* courts did. The Fonders are not asking this Court to abandon its decision in *Highmark*. The Fonders are simply asking the Court to recognize that their case is distinguishable from *Highmark*, and their case should not have been dismissed under Rule 12(b)(5) without the opportunity to conduct discovery and argue the case on its merits.


To overcome a motion to dismiss, the Fonders only need to show that they may be entitled to relief under “any possible theory”. The Fonders have outlined a professional negligence claim against WFFS under South Dakota common-law, supported by South Dakota case law that has been consistently handed down by this Court. The Fonders’ case is a case of first impression in South Dakota, and the legal question presented by their case is not well-settled in other jurisdictions.

Both South Dakota common-law and case law create a legal duty in this matter, and allow for a professional negligence action against WFFS. The trial court erred in determining that WFFS is immune from this negligence suit under South Dakota law, and that the Fonders have failed to state a claim upon which relief can be granted.

### **CONCLUSION**

For these reasons, and all the other reasons contained in Appellant’s Brief, the Fonders respectfully request that this Court reverse the decision of the circuit court in dismissing this matter under SDCL §15-6-12(b)(5).

Dated this 17<sup>th</sup> day of October, 2014.



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**APPELLANT REQUESTS ORAL ARGUMENT**

## CERTIFICATE OF COMPLIANCE

In accordance with SDCL 15-26A-66(b)(4), I certify that this brief complies with the type volume limitation. This brief contains 1,679 words and 10,575 characters including spaces. I have relied on the word and character count of the word processing system used to prepare this brief.

Dated this 17<sup>th</sup> day of October 2014.



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