SUPREME COURT OF CALIFORNIA
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Supreme Court of California
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S258019
Case No. _________

In the Supreme Court
of the
State of California

KWANG K. SHEEN,
Plaintiff and Appellant
v.
WELLS FARGO BANK, N.A., et al.
Defendant and Respondent

AFTER A DECISION BY THE COURT OF APPEAL
SECOND APPELLATE DISTRICT, DIVISION EIGHT, CASE NO. B289003
SUPERIOR COURT OF CALIFORNIA, COUNTY OF LOS ANGELES
CASE NO. BC631510
THE HONORABLE JUDGE ROBERT L. HESS

Petition for Review

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I. ISSUE PRESENTED FOR REVIEW

Does a mortgage servicer owe a borrower a duty of care to refrain from making material misrepresentations about the status of a foreclosure sale following the borrower's submission of, and the servicer's agreement to review, an application to modify a mortgage loan?

II. WHY REVIEW SHOULD BE GRANTED

Since at least 2014, the law in California has been clear that a mortgage lender and servicer owe a borrower a common law duty to review an application for modification of a mortgage loan with ordinary care. *Alvarez v. BAC Home Loans Servicing, L.P.* (2014) 228 Cal.App.4th 941, 944–48; *Daniels v. Select Portfolio Servicing, Inc.* (2016) 246 Cal.App.4th 1150, 1158 ("[W]e hold, among other conclusions, that: . . . a loan servicer may owe a duty of care to a borrower . . . even though its involvement in the loan does not exceed its conventional role."). In *Alvarez v. BAC Home Loan Servicing, L.P.*, the Court of Appeal for the First Appellate District held that "a lender does owe a duty to a borrower to not make material misrepresentations about the status of an application for a loan modification or about the date, time, or status of a foreclosure sale." *Id.* at 946–47 (quoting *Lueras v. BAC Home Loans Servicing, LP* (2013) 221 Cal.App.4th 49, 68). Two years later, the Court of Appeal for the Sixth Appellate District in *Daniels v. Select Portfolio Servicing, Inc.* agreed with *Alvarez* that "a loan servicer may owe a duty of care to a borrower . . . even though its involvement in the loan does

not exceed its conventional role." *Daniels,* 246 Cal.App.4th at 1158.

In this case, the Court of Appeal for the Second Appellate District, Division Eight, has explicitly disagreed with *Alvarez* and *Daniels* in a decision certified for publication and has thereby created a conflict of law among three separate Courts of Appeal that should be resolved by the Supreme Court.

III. STATEMENT OF THE CASE

Plaintiff alleges in his Second Amended Complaint ("SAC") that he is a borrower who lost his home to foreclosure in October 2014. (3 Clerk's Transcript ("CT") 496 ¶ 49.) The home was located at 5224 Cheryl Ave., La Crescenta, California 91214 (the "Property"). (3 CT 487 ¶ 6.) In November 2005, Plaintiff obtained second- and third-lien residential mortgage loans (the "Second Loan" and "Third Loan", respectively) from Defendant Wells Fargo Bank, N.A. ("Wells Fargo"). (3 CT 487 ¶¶ 7–8.) These loans were secured by the Property. (3 CT 487-488 ¶¶ 7–8.)

Plaintiff experienced tremendous financial difficulty in late 2008 and, in around 2009, missed a number of payments due on the Second and Third Loans. (3 CT 488 ¶ 9.) Wells Fargo caused to be recorded a Notice of Default and Election to Sell Under Deed of Trust (the "Notice of Default") on or about September 10, 2009, ostensibly in connection with the Second Loan. (3 CT 488 ¶ 9.)

On December 14, 2009, Wells Fargo caused to be recorded a Notice of Trustee's Sale, again ostensibly in connection with the Second Loan. (3 CT 488 ¶ 10.) The Notice of Trustee's Sale stated

that the Property would be sold at auction on January 4, 2010. (3 CT 488 ¶ 10.) In or about the last week of December 2009, Wells Fargo caused the January 4, 2010 foreclosure sale of the Property to be postponed to February 3, 2010. (3 CT 488 ¶ 10.)

In late January 2010, Plaintiff and his legal representatives at the Asian Pacific American Legal Center of Southern California ("APALC") contacted Wells Fargo by email regarding the possibility of cancelling the foreclosure sale scheduled for February 3, 2010 so that Plaintiff could apply and be considered for modifications of the Second and Third Loans. (3 CT 488 ¶ 11.) A Wells Fargo representative replied to Plaintiff's legal representative on January 28, 2010, stating that Wells Fargo's Loss Mitigation department "is currently working on this matter." (3 CT 488 ¶ 11.) At the same time, Plaintiff submitted applications for modification of the Second and Third Loans. (3 CT 488 ¶ 12.) In or about the first week of February 2010, Wells Fargo cancelled all foreclosure proceedings that had previously been initiated in connection with the Second Loan. (3 CT 488 ¶ 13.)

On or about March 17, 2010, Wells Fargo sent Plaintiff two separate letters in connection with the Second and Third Loans, respectively. (3 CT 488 ¶ 15.) The first letter stated that it was being sent in reference to an account ending in the numbers "4658", which were the second-to-last four numbers of the Second Loan. (*Id.*) It addressed Plaintiff as follows, in part:

> Due to the severe delinquency of your account, it has been charged off and the entire balance has

> been accelerated. Accordingly, your entire balance is now due and owing. In addition, we have reported your account as charged off to the credit reporting agencies to which we report. As a result of your account's charged off status, we will proceed with whatever action is deemed necessary to protect our interests. This may include, if applicable, placing your account with an outside collection agency or referring your account to an Attorney with instructions to take whatever action is necessary to collect this account. Please be advised that if Wells Fargo elects to pursue a legal judgment against you and is successful, the amount of the judgment may be further increased by court costs and attorney fees.

The letter stated that the date of the "charge-off" was February 25, 2010. (3 CT 488 ¶ 15.)

The second letter was almost identical to the first. The only difference was that the second letter stated that it was being sent in reference to an account ending in "6485", which were the second-to-last four numbers of the Third Loan, with a balance of $87,396.86. (3 CT 488 ¶ 16.)

Plaintiff speaks almost no English. (3 CT 488 ¶ 17.) His primary language is Korean. (3 CT 488 ¶ 17.)

Plaintiff received the March 17, 2010 letters less than two months after he had submitted applications for modification of the Second and Third Loans, and while he was still waiting for a response to those applications. (3 CT 488 ¶ 18.) Plaintiff therefore believed that Wells Fargo sent the March 17, 2010 letters in response to his pending applications for mortgage modification. (3 CT 488 ¶ 19.) He believed that the letters meant that the Second

and Third Loans had been modified such that they were unsecured loans, that Wells Fargo had cancelled the February 3, 2010 foreclosure sale as a result of its plan to modify the Second and Third Loans, and that the Property would never be sold at a foreclosure auction as a result of these modifications. (3 CT 488 ¶ 19.)

Plaintiff believed that the March 17, 2010 letters reflected such a modification of the Second and Third Loans because of the statement in the letters that Wells Fargo might "refer[] your account to an Attorney" and that it might "pursue a legal judgment against you." (3 CT 488 ¶ 20.) Plaintiff believed that, pursuant to the modifications he thought he had received, Wells Fargo's remedy to collect the outstanding debt Plaintiff owed in connection with the Second and Third Loans was limited to pursuing a money judgment against Plaintiff in court, rather than selling Plaintiff's home at foreclosure. (3 CT 488 ¶ 20.)

Wells Fargo did not provide Plaintiff with a response to the January 2010 applications for modification of the Second and Third Loans following the March 17, 2010 letters. (3 CT 488 ¶ 21.) The March 17, 2010 letters were the only identifiable pieces of correspondence Plaintiff received from Wells Fargo in response to the applications. (3 CT 488 ¶ 21.)

In or about March 2010, Wells Fargo also contacted Plaintiff by phone. (3 CT 488 ¶ 22.) Plaintiff's wife Jong-Sin Sheen answered the call. During the call, a Wells Fargo representative told Ms. Sheen that there would be no more foreclosure sale of Plaintiff's home. (3 CT 488 ¶ 22.)

About a month later, Plaintiff received a letter from Wells Fargo dated April 23, 2010. (3 CT 488 ¶ 23.) The letter referred to the Second Loan and to a "Date of Charge-Off" of February 24, 2010 in the subject line above the body of the letter. (3 CT 488 ¶ 23.) The letter then stated:

> In an effort to resolve your charged-off account, Wells Fargo recently attempted to contact you to discuss the repayment of your debt with one of our multiple payment options. Unfortunately, we have been either unable to reach you or unable to obtain an acceptable payment arrangement on your account.
>
> . . .
>
> Unless we receive a phone call from you within 15 days of this offer, we may take advantage of all remedies available to us to recover our balance in full, which may include outsourcing your account to a collection agency or referring your account to an attorney with instructions to take whatever action deemed necessary to collect this account.

(3 CT 488 ¶ 23.)

The April 23, 2010 letter further confirmed Plaintiff's understanding that the Second Loan had been modified such that it was now unsecured. (3 CT 488 ¶ 24.) Plaintiff interpreted the letter as a standard collections letter a consumer would receive in connection with an unsecured, unpaid debt, in particular because the letter made no direct mention of a possible foreclosure sale and instead referred directly to the intervention of a collection agency in connection with the Second Loan. (3 CT 488 ¶ 24.)

On November 22, 2010, Wells Fargo assigned the servicing rights to the Second Loan to Dove Creek. (3 CT 488 ¶ 28.) On

November 24, 2010, Wells Fargo also assigned its beneficial interest under the deed of trust securing the Second Loan to Dove Creek. (3 CT 488 ¶ 28.)

After a series of subsequent assignments, the beneficial interest in the Second Loan was assigned to Defendant Mirabella Investments Group, LLC ("Mirabella"). (3 CT 488 ¶¶ 29-31.) In April 2014, Mirabella recorded a Notice of Default stating that the Second Loan was in default. (3 CT 488 ¶ 31.) Next, in July 2014, Mirabella recorded a Notice of Trustee's Sale stating that the Property would be sold at a public auction on August 22, 2014. (3 CT 488 ¶ 32.) Also in or about July 2014, Plaintiff received a letter from Mirabella stating that the Second Loan was in default. (3 CT 488 ¶ 33.)

On October 29, 2014, Plaintiff's home was sold at a trustee's sale. (3 CT 488 ¶ 49.)

The trial court sustained Wells Fargo's demurrer to the Second Amended Complaint, holding both that Wells Fargo did not owe Plaintiff a duty of care and that Wells Fargo had not breached any duty of care. (4 CT 893-894; RT 20:15-26.)

In an opinion certified for publication, the Court of Appeal affirmed the trial court's ruling. (Attach. A hereto.) The Court explicitly disagreed with prior precedent and held that a mortgage servicer does not owe a duty to a borrower to process a loan modification application with ordinary care.

No party filed a petition for rehearing following the decision by the Court of Appeal.

IV. ARGUMENT

A. Summary of Argument

The Court of Appeal in this case created a conflict among the California Courts of Appeal regarding whether a mortgage servicer owes a borrower a duty to process a loan modification application with ordinary care. The Supreme Court should resolve the split, in light of the confusion that will result if the conflict is permitted to stand and especially in light of the frequency with which negligence claims against mortgage servicers are litigated in the lower courts.

B. Review Should Be Granted to Resolve a Conflict Among the Courts of Appeal Regarding Whether Loan Servicers Owe Borrowers a Common Law Duty of Care.

1. *The general rule in California is that all persons are required to use ordinary care to prevent harm to others, and may be held liable for injuries resulting from a failure to use ordinary care absent a public policy weighing against the imposition of liability.*

The basic principle of tort liability is that a person is responsible for injuries as a result of his lack of care. The California Supreme Court states that "[w]hile the question whether one owes a duty to another must be decided on a case-by-case basis, every case is governed by the rule of general

application that all persons are required to use ordinary care to prevent others from being injured as the result of their conduct."[1] *Weirum v. RKO General, Inc.* (1975) 15 Cal. 3d 40, 46 This holding is consistent with section 1714 of the Civil Code, which provides: "[e]very one is responsible, not only for the result of his willful acts, but also for an injury occasioned to another by his want of ordinary care or skill in the management of his property or person. . . ." Civ. Code § 1714. Section 1714 "does not distinguish among injuries to one's person, one's property or one's financial interests." *J'Aire Corp. v. Gregory* (1979) 24 Cal. 3d 799, 806.

Further, "[a]lthough it is true that some exceptions have been made to the general principle that a person is liable for injuries caused by his failure to exercise reasonable care in the circumstances, it is clear that in the absence of a statutory provision declaring an exception to the fundamental principle enunciated by section 1714 of the Civil Code, no such exception should be made unless clearly supported by public policy." *Rowland v. Christian* (1968) 69 Cal. 2d 108, 112; *see also Christensen v. Sup. Ct.* (1991) 54 Cal. 3d 868, 885 ("In determining liability for negligence, we begin always with the command of Civil Code section 1714"; exceptions "are recognized only when clearly supported by public policy.").

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[1] Petitioner addresses the Supreme Court's recent holding in the *Gas Leak Cases* on this issue in Section IV.B.4, *infra.*

The California Supreme Court held that courts must decide on a case-by-case basis whether an exception from the general rule provides grounds to depart from the basic principle of a duty of ordinary care. To make such a determination in cases involving a financial institution, courts weigh six factors: "[1] the extent to which the transaction was intended to affect the plaintiff, [2] the foreseeability of harm to him, [3] the degree of certainty that the plaintiff suffered injury, [4] the closeness of the connection between the defendant's conduct and the injury suffered, [5] the moral blame attached to the defendant's conduct, and [6] the policy of preventing future harm." *Connor v. Great Western Sav. & Loan Ass'n* (1968) 69 Cal. 2d 850, 865 (quoting *Biakanja v. Irving* (1958) 49 Cal. 2d 647, 650) (the "*Biakanja*" factors); *see also Jolley v. Chase Home Finance, LLC* (2013) 213 Cal. App. 4th 872, 899.

The California Supreme Court recently reconfirmed that determining whether a duty of care exists requires balancing a number of factors, *see Beacon Residential Cmty. Assn. v. Skidmore, Owings & Merrill LLP* (2014) 59 Cal. 4th 568, 581, and rejected invitations to ignore them. *See, e.g., Stewart v. Cox* (1961) 55 Cal. 2d 857, 863 ("The liability of a contractor or subcontractor must be determined by applying this general test rather than by arbitrarily placing them in a separate category subject to a special rule.").

2. *The decision by the Court of Appeal in this case conflicts with prior law, establishes a split in authority over the imposition of negligence liability in*

the mortgage modification context and will result in confusion and inconsistent rulings if the Supreme Court does not resolve the conflict.

Prior to the decision by the Court of Appeal in this case, it was also well-established in California that a mortgage loan servicer owes a borrower a common law duty of care. In *Alvarez*, the Court of Appeal for the First Appellate District held that "a lender does owe a duty to a borrower to not make material misrepresentations about the status of an application for a loan modification or about the date, time, or status of a foreclosure sale." *Alvarez*, 228 Cal.App.4th at 946–47 (quoting *Lueras*, 221 Cal.App.4th at 68). The plaintiffs in *Alvarez* had alleged negligence against their mortgage servicer following the servicer's negligent review of the plaintiffs' applications for loan modification. *Id.* at 943. The servicer "allegedly agreed to consider modification of the plaintiffs' loans" before reneging on its agreement. *Id.* at 948. The *Alvarez* plaintiffs alleged "that the mishandling of their applications 'caus[ed] them to lose title to their home, deterrence from seeking other remedies to address their default and/or unaffordable mortgage payments, damage to their credit, additional income tax liability, costs and expenses incurred to prevent or fight foreclosure, and other damages.'" *Id.* at 948–49.

The Court in *Alvarez* held that the plaintiffs' allegations supported a finding that the servicer owed the plaintiffs a duty of care, and that the servicer had breached its duty by failing to consider a modification of the plaintiffs' loans as promised. *Id.* at

946-49. The Court noted that "[i]t is foreseeable that a borrower might be harmed by an inaccurate or untimely communication about a foreclosure sale or about the status of a loan modification application, and the connection between the misrepresentation and the injury suffered could be very close." *Id.* at 947 (quoting *Lueras*, 221 Cal. App. 4th at 68–69).

Next, the court in *Alvarez* cited approvingly to a federal district court from the Northern District of California, which held that the factors identified in *Biakanja v. Irving* (1958) 49 Cal.2d 647, as relevant to determining whether a defendant is liable to a plaintiff for breach of a common law duty "weigh in favor of imposing a duty of care on a lender that undertakes to review a loan for potential modification." *Id.* at 948. The *Alvarez* Court held that, "because defendants allegedly agreed to consider modification of the plaintiffs' loans, the *Biakanja* factors clearly weigh in favor of a duty." *Alvarez*, 228 Cal. App. 4th at 948.

Additional Court of Appeal decisions also follow the well-worn principle of applying the *Biakanja* factors on a case-by-case basis, rather than relying on a general rule departing from the duty imposed under Civil Code § 1714. These factors remain the touchstone for ascertaining whether a duty of care is owed. *See, e.g., Beacon Residential Cmty. Ass'n*, 59 Cal. 4th at 574, 578, 585-86.

Indeed, California law was well-settled prior to the Court of Appeal's decision in this case against blind reliance on the general rule to reject negligence claims in the mortgage servicing context, particularly in light of the changing relationship between

modern mortgage servicers and their customers. See *Jolley*, 213 Cal. App. 4th at 903. *Jolley* cautioned that "courts should not rely mechanically on the 'general rule' that lenders owe no duty of care to their borrowers." *Id.* at 901 ("*Nymark* [*v. Heart Federal Savings & Loan Association* (1991) 231 Cal.App.3d 1089] does not support the sweeping conclusion that a lender never owes a duty of care to a borrower. Rather, the *Nymark* court explained that the question of whether a lender owes such a duty requires 'the balancing of [the "*Biakanja* factors"].'")

Even *Nymark v. Heart Federal Savings & Loan Association*, the case on which mortgage servicers often rely to argue that they owe no common law duty of care when processing applications for mortgage modification, does not establish the absence of a duty in all circumstances. Instead, *Nymark*'s holding is limited to the loan origination context, "when the institution's involvement in the loan transaction does not exceed the scope of its conventional role as a mere lender of money." *Nymark*, 231 Cal. App. 3d at 1096. It does not provide a new test departing from the fundamental principles described by California Supreme Court precedent.

In *Nymark*, the Court of Appeal first identifies the specific factual circumstances addressed in that case: "[t]he parties have not identified, nor have we found, any California case specifically addressing whether a lender has a duty of care to a borrower in appraising the borrower's collateral to determine if it is adequate security for a loan." *Nymark*, 231 Cal. App. 3d at 1095-96. Nymark then acknowledges that a financial institution owes no

duty of care when it does not exceed the scope of its conventional role as a mere lender of money. *Id.* at 1096. In holding that the defendant owed the plaintiff no duty of care, the court reasoned that "defendant performed the appraisal of plaintiff's property in the usual course and scope of its loan processing procedures to protect defendant's interest by satisfying it that the property provided adequate security for the loan." *Id.* Defendant did not conduct the appraisal to induce plaintiff to enter into the loan transaction; rather, defendant was simply "acting in its conventional role as a lender of money to ascertain the sufficiency of the collateral as security for the loan." *Id.* at 1096–97.

The *Nymark* court evaluated the *Biakanja* factors and found no duty should be imposed under the specific facts of the case. Providing particular emphasis on the public policy prong, the *Nymark* court stated:

> [C]reation of such a duty would adversely affect consumers, particularly those seeking to acquire affordable housing. A lender which currently obtains a cursory appraisal at minimal cost to the borrower in order to satisfy itself that the collateral provides adequate security for the loan would be compelled by the threat of negligent appraisal liability to undertake a comprehensive examination of the collateral. The added cost of such a detailed appraisal undoubtedly would be passed on to the borrower. For housing loans, this consequence would be contrary to the public interest in reducing the cost of acquiring housing.

Id. at 1100.

In sum, *Nymark* faithfully followed California Supreme Court precedent to find no duty of care under the specific facts before it. But the *Nymark* court's analysis of the *Biakanja* factors concerns loan origination, not loan servicing. Loan servicing, particularly in its modern form, differs greatly from money lending, involving different actors, different rules, different incentives and different problems. As such, *Nymark* is not on point in this case. The better, and more complete, analysis of the issue as it related to the facts here appears in *Alvarez*, *Jolley*, and *Daniels*.

The Court of Appeal in this case sought support for its decision from *Lueras v. BAC Home Loans Servicing*, LP (*Lueras*). The Court construed *Alvarez* and *Lueras* as standing in conflict over whether application of the *Biakanja* factors to a mortgage servicer's review of a loan modification application weighs in favor of imposing a duty on the servicer to review the application with ordinary care. (Opn. at 8-9.)

However, a careful reading of *Lueras* and *Alvarez* reveals that there is no conflict between the two. Negligence analysis should begin by identifying the allegedly negligent conduct claimed in the specific action before the court. *Alvarez*, 228 Cal. App. 4th at 948-49 (2014) (*Alvarez*). In *Lueras*, the plaintiff claimed that the mortgage servicer had a duty to offer and approve a loan modification. *Lueras*, 221 Cal. App. 4th at 62. The *Lueras* court then correctly found that there is no duty to "offer, consider, or approve a loan modification." *Id.* at 67.

In contrast, *Alvarez* held that the mortgage servicer only had a duty after the mortgage servicer agreed to review plaintiff for loan modification. *Alvarez*, 228 Cal. App. 4th at 944. The *Alvarez* opinion ultimately finds that a servicer owes a duty to exercise reasonable care in the processing of a loan modification once a servicer agrees to consider a modification of an applicant's loan. *Id.* at 948.

This distinction is important. Indeed, "there is no express duty on a lender's part to grant [or consider, or approve] a modification under state or federal loan modification statutes." *Lueras*, 221Cal. App. 4th at 67. However, Sheen does not allege that the servicer owed him a duty to grant a loan modification. Rather, Sheen alleged the servicer misled him about the status of his application for a loan modification and about the possibility that his home might one day be sold at foreclosure. (3 CT 496-497 ¶ 55.) Sheen does not seek to hold Wells Fargo liable for failing to provide him with a sought-after loan modification. Instead, Sheen claims that Wells Fargo misled him about the results of his application.

Substantial confusion, even among the Courts of Appeal, therefore appears to exist regarding the correct interpretation and the scope of *Lueras*, as well as over the central question in this case: whether mortgage servicers have a duty to process loan modification applications with ordinary care. The Supreme Court should resolve this confusion.

3. *Resolution of the conflict in authority is especially important in light of recent legislative and regulatory*

> *responses to servicer abuses, which express a strong policy of avoiding foreclosure and underscore that this area of the law is vitally important to the public interest.*

In an attempt to address the modern mortgage servicing industry's widespread, well-documented, and ongoing failures, legislators and other regulators have responded with increasingly specific rules governing loan servicing and loss mitigation. These responses have sought to identify and prohibit the most harmful servicer conduct, and to create procedures that counterbalance the skewed incentives described above, in keeping with the strong public policy of avoiding foreclosure where possible. It would be perverse to find that these rules were intended to insulate servicers from a duty of ordinary care, or to preclude traditional remedies when homeowners are foreseeably harmed by wrongful conduct.

The California Homeowner Bill of Rights ("HBOR") sets out stringent procedural protections for borrowers seeking modifications or other loss mitigation options. Civil Code § 2923.6 prohibits "dual tracking" – the servicer practice of proceeding to foreclosure even while the borrower is still being considered for loss mitigation options, and Civil Code section 2924.12 provides a private right of action and damages for dual tracking violations. The Legislature found it necessary to ensure that, "as part of the nonjudicial foreclosure process, borrowers are considered for, and have a meaningful opportunity to obtain,

available loss mitigation options, if any, offered by or through the borrower's mortgage servicer, such as loan modifications or other alternatives to foreclosure." Civ. Code § 2923.4.

On the federal level, the federal Consumer Financial Protection Bureau has explicitly recognized servicer failures and abuses as a driver in the foreclosure crisis. Notice of proposed amendments to regulations under the federal Real Estate Settlement and Procedures and Truth in Lending Acts and requests for public comment, for example, observed:

> The recent financial crisis exposed pervasive consumer protection problems across major segments of the mortgage servicing industry. As millions of borrowers fell behind on their loans, many servicers failed to provide the level of service necessary to serve the needs of those borrowers. Many servicers simply had not made the investments in resources and infrastructure necessary to service large numbers of delinquent loans.

2012 Real Estate Settlement Procedures Act (Regulation X) Mortgage Servicing Proposal, 77 Fed. Reg. 57200, 57200 (Sept. 17, 2012).

The problems stemmed not just from poor practices, but from the market failures discussed above:

> Several aspects of the mortgage servicing business make it uniquely challenging for consumer protection purposes. Given the nature of their activities, servicers can have a direct and profound impact on borrowers. However, industry compensation practices and the structure of the mortgage servicing industry create wide variations in servicers' incentives to provide effective customer service to borrowers. Also, because borrowers cannot choose their own

> servicers, it is particularly difficult for them to protect themselves from shoddy service or harmful practices.
> . . .
>
> Additionally, servicers may have financial incentives to foreclose rather than engage in loss mitigation.

Id. at 57203; *see also* 2012 Truth in Lending Act (Regulation Z) Mortgage Servicing; Proposed Rule, 77 Fed. Reg. 57318 (Sept. 17, 2012).

None of these efforts to curb servicer abuses was intended to displace state common law remedies. HBOR's specific protections and pointed remedies create and enforce primarily procedural rights against servicers. They are not exclusive.

HAMP itself does not give homeowners a way to enforce its rules when servicers break them. *See* Treasury's Servicer Participation Agreement template for servicers participating in HAMP, ¶ 5(b), at B-3 ("Servicer . . . covenants that all Services will be performed in compliance with, all applicable Federal, state, and local laws").[2]

Rather than create a private right of action, Congress intended that HAMP rules (promulgated by the Treasury Department) would be enforced under state common law and general consumer protection statutes as an industry-wide standard of care: 15 U.S.C. § 1639a(c), provided that "[t]he

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[2] *Available* at https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/servicerparticipationagreement.pdf.

qualified loss mitigation plan guidelines issued by the Secretary of the Treasury . . . shall constitute standard industry practice for purposes of all Federal and State laws."

The degree to which the mortgage servicing industry should be regulated is therefore an important question of law that implicates substantial public policy considerations. The Supreme Court should review the decision by the Court of Appeal to determine whether the common law doctrine of negligence should also apply to regulate the industry.

4. *The Supreme Court should also settle whether its recent decision in the* Gas Leak Cases *foreclosed the application of common law negligence to cases involving pure economic loss in the mortgage-servicing context, and clarify whether a case-by-case analysis is still appropriate to determine the existence of a duty of care in negligence cases involving pure economic loss.*

The Court of Appeal in this case also relied substantially on the Supreme Court's recent decision in *Southern California Gas Company v. Superior Court* (2019) 7 Cal.5th 391 (*Gas Leak Cases*) to support its findings. The Court of Appeal read the *Gas Leak Cases* to hold that, absent certain exceptions enumerated in the Restatement of Torts, a defendant cannot be held liable in tort for negligence where a plaintiff suffers purely economic loss. (Opn. at 13-15.)

This reading substantially ignores, however, that even under the *Gas Leak Cases*, the Supreme Court recognized that

negligence cases brought for pure economic loss are evaluated in the same way as all negligence cases in California:

> Our subsequent decision in *Bily* [*v. Arthur Young & Co.* (1992) 3 Cal. 4th 370] however, underscored for negligence cases involving purely economic losses what is true of all negligence cases. Deciding whether to impose a duty of care turns on a careful consideration of the " 'the sum total' " of the policy considerations at play, not a mere tallying of some finite, one-size-fits-all set of factors.

Gas Leak Cases, 7 Cal. 5th at 401.

The Supreme Court also analogized the facts in the *Gas Leak Cases* to a hypothetical scenario it had imagined in *Bily*:

> We nonetheless acknowledged in *Bily* the "need to limit liability for [purely] economic loss[es]" even in the absence of those additional considerations. In doing so, we pointed to a hypothetical scenario similar in many ways to the case now before us. We considered a situation where "a defendant negligently causes an automobile accident that blocks a major traffic artery such as a bridge or tunnel." That defendant would of course be liable for "personal injuries and property damage suffered in such an accident." But would "any court," we continued, "allow recovery by the myriad [other] third parties who might claim [purely] economic losses because the bridge or tunnel" was blocked? Based on concerns about limitless liability and unending litigation, as well as on long-standing legal consensus, we considered that prospect "doubtful."

Id. at 402-403 (internal citations omitted).

Finally, the *Gas Leak Cases* involved plaintiffs whose "only relevant ties to SoCalGas [were] having the misfortune of operating near the Aliso Facility." *Id.* at 408. There was no relationship between the parties in that case, and no additional circumstances or policy considerations, that weighed sufficiently

against the Supreme Court's concerns that imposing liability in the *Gas Leak Cases* would have risked "liability in an indeterminate amount for an indeterminate time to an indeterminate class." *Id.* at 414.

The Supreme Court should therefore take this opportunity to clarify the scope of its recent holding in the *Gas Leak Cases*. This case provides a good opportunity to do so, as the Court of Appeal engaged in little of the case- and context-specific analysis in which the courts in *Alvarez* and *Daniels* engaged when they found that a mortgage servicer has a duty to process a mortgage loan with ordinary care. The Supreme Court can use this case to clarify whether its recent holding was intended to be read as broadly as the Court of Appeal suggested here, or whether courts should still engage in case-specific analysis to determine whether a duty of care exists, even in cases involving pure economic loss.

Indeed, although the Court of Appeal here implied that *Alvarez* may have come out differently if it had been decided following the Supreme Court's ruling in the *Gas Leak Cases*, (Opn. at 14-15), the *Alvarez* court would likely disagree. In determining that a duty of care exists in the processing of loan modifications, the *Alvarez* court considered the differences between modern mortgage servicing from tradition loan origination. *Alvarez*, 228 Cal. App. 4th at 949. These differences weigh heavily in favor of imposing tort duties on servicers, even in the wake of the *Gas Leak Cases*. Traditional mortgage lending involved a bank evaluating a borrower and her security, and issuing a loan with terms reflecting the perceived risk that the

borrower would default. The same bank would then: (i) retain the loan, making its profit on interest the borrower paid; and (ii) service the loan by maintaining direct contact with the borrower, collecting her payments and negotiating any changes to the loan. *See* Eamonn K. Moran, Wall Street Meets Main Street: Understanding the Financial Crisis, 13 N.C. Banking Inst. 5, 32 (2009) ("Traditionally, banks managed loans 'from cradle to grave' as they made mortgage loans and retained the risk of default, called credit risk, and profited as they were paid back.") (citation omitted).

In the modern mortgage servicing context, however, these tasks have been dispersed among different actors, changing the relationships between the borrower, the loan originator, the ultimate holder of the loan, and the servicer of the loan. First, borrowers are captive, with no choice of servicer, little information, and virtually no bargaining power. Servicing rights are bought and sold without borrower input or approval. Borrowers cannot pick their servicers, or fire them for poor performance. In the absence of any constraint, servicers may actually have incentives to misinform and under-inform borrowers. Providing limited and low-quality information not only allows servicers to save money but increases the chances they will collect late fees and other penalties from confused borrowers. *See* Kurt Eggert, Limiting Abuse and Opportunism by Mortgage Servicers, 15 Hous. Pol'y Debate 753, 769-70 (2004) ("Unlike the traditional banking system, servicers operate in a transactional milieu that has been almost completely

depersonalized."); *see also* Adam J. Levitin & Tara Twomey, Mortgage Servicing, 28 Yale J. on Reg. 1, 25-29 (2011) (discussing why servicers prefer highly automated default management); *cf. Burch v. Sup. Ct.* (2014) 223 Cal. App. 4th 1411, 1421 (fact that the injured plaintiff has no ability to "control and adjust the risks by contract" weighs in favor of duty).

Servicers' dramatic failure to invest in personnel, infrastructure, and technology has led to a focus on problems of "dual-tracking" and "single point of contact." *See, e.g.*, 2012 Real Estate Settlement Procedures Act (Regulation X) Mortgage Servicing Proposal, 77 Fed. Reg. 57,200, 57,200 (Sept. 17, 2012) ("As millions of borrowers fell behind on their loans . . . [m]any servicers simply had not made the investments in resources and infrastructure necessary to service large numbers of delinquent loans."); Civ. Code § 2923.6 (prohibiting "dual-tracking").

Borrowers experience this failure to invest as an inability to talk to anyone at their (unchosen) servicer, constant, repeated requests for the same documents "lost" by servicers, improper denial of loan modifications, and foreclosures despite pending loan modification applications. *See* Paul Kiel, Homeowners Say Banks Not Following Rules for Loan Modifications, ProPublica, Jan. 14, 2010, 9:00am ("Like many borrowers in the program, [Reynolds] says he was asked over and over to send the same documents and later, updated versions of those documents. Finally, in late November, he received an answer: He was denied a permanent loan modification."). At best, borrowers are discouraged by these time and energy-wasting problems. At

worst, borrowers are denied help or misled about the status of a foreclosure sale, and can unnecessarily lose their homes.

Moreover, homeowners facing foreclosure and applying for modification or other loss mitigation alternatives (like short sale) are absolutely dependent upon their mortgage servicers to process their requests in a timely, accurate fashion. Information asymmetry can be profound: during the modification process, the homeowner has to rely entirely on information from the servicer – both about whether the loan is likely to be modified, and on the status of the modification – to make life-changing decisions such as whether to file for bankruptcy, sell the home, or give up the home through foreclosure or deed in lieu of foreclosure. But servicers often fail to provide such necessary information. *See* Lydia Nussbaum, ADR's Place in Foreclosure: Remedying the Flaws of a Securitized Housing Market, 34 Cardozo L. Rev. 1889, 1901 (2013) (stating that the servicing industry is "notorious for its lack of customer service"); Christopher L. Peterson, Predatory Structured Finance, 28 Cardozo L. Rev. 2185, 2265 (2007) ("Phone calls to the loan's servicer are frequently ignored, subject to excruciating delays, and typically can only reach unknowledgeable staff who themselves lack information on the larger business relationships.").

The potential harm to the homeowner flowing from this disparity in bargaining power is greatest in the loan modification process, where a servicer's improper or erroneous denial of loan modification can end in unnecessary foreclosure. Even delay can be harmful; over the course of the modification process, which can

take months or even years, the homeowner may be falling further and further behind on the mortgage (or, alternately, using up savings on a home that is no longer affordable).

Second, because modern mortgage servicing is divorced from loan ownership, servicers have incentives to charge borrowers unnecessary fees and to extend default. These incentives shifted in part as a result of mortgage loan securitization, which increasingly unmoored banks from the fate of the mortgages they created, invested in, and serviced. Susan E. Hauser, Predatory Lending, Passive Judicial Activism, and the Duty to Decide, 86 N.C. L. Rev. 1501, 1517 (2008) ("Today, there is no longer one 'lender' who faces the full panoply of risks associated with the making of a mortgage loan."). After origination, the servicer only has a financial incentive to collect its servicing fee. This servicing fee does not depend on loan performance, nor on maximizing net present value through a modification. *See* Steven L. Schwarcz, The Future of Securitization, 41 Conn. L. Rev 1313, 1322-23 (2009); Diane Thompson, Foreclosing Modifications: How Servicer Incentives Discourage Loan Modifications, 86 Wash. L. Rev. 755, 767-68 (2011) (explaining servicer fee structure). Thus, loan servicing looks even less like traditional lending activity than originating-to-securitize loans.

The modern servicing structure has made it more profitable for large loan servicers to foreclose on the loans they service than to negotiate loan modifications, even where the modifications would be more profitable for the investors who own the loans. *See*

Schwarcz, The Future of Securitization, 41 Conn. L. Rev at 1322; Alan M. White, Deleveraging the American Homeowner: The Failure of 2008 Voluntary Mortgage Contract Modifications, 41 Conn. L. Rev. 1107, 1127 (2009) (stating that "the investor losses may be very large, but the servicer will almost always benefit by completing a foreclosure sale"); Steve Ruterman, "Servicers Behaving Badly: An Insider's Perspective on the Root Cause of This Recurring Problem" (2012)[3] (discussing incentives to extend default and information asymmetry between investor and servicer); *see also* Diane Thompson, Foreclosing Modifications: How Servicer Incentives Discourage Loan Modifications 86 Wash. L. Rev. 755, 767-68 (2011) ("The conflict between servicers' compensation and the interests of investors, the beneficial owners of loans, depresses the number of loan modifications made, and increases the number of foreclosures."). Moreover, servicers can bill investors for services of third parties during the foreclosure process. Servicers often own shares in companies which provide these ancillary services, and charge above market rates on these services. *See* National Mortgage Servicing Standards and Conflicts of Interest, Hearings Before Sen. Com. on Banking, Hous. & Urban Affairs, 112th Cong., 1st Sess., pp. 122-128 (2011) (statement of Laurie F. Goodman, Senior

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[3] Available at http://www.subprimeshakeout.com/2012/03/servicers-behaving-badly-an-insiders-perspective-on-the-root-cause-of-this-recurring-problem.html.

Managing Dir., Amherst Securities).

The Court of Appeal in this case took a wide view of the *Gas Leak Cases*. In so doing, it veered away from engaging in case- and -context-specific analysis when evaluating the application of common law negligence to circumstances involving pure economic loss, and instead appears to have "tall[ied] . . . some finite, one-size-fits-all set of factors" to reach its decision. *Gas Leak Cases*, 7 Cal. 5th at 401. This wide view could be adopted by lower courts across the state to effectively eliminate case-specific analysis in negligence cases brought solely for economic loss. The Supreme Court should clarify whether this wide view was appropriate in light of its recent holding.

V. CONCLUSION

The Court should grant review to resolve an explicit split among the Courts of Appeal over whether mortgage servicers owe a duty to borrowers to process loan modification applications with ordinary care. The Court of Appeal's decision in this case disagrees with the previously published authority on the issue, and relies on a particularly wide view of the Supreme Court's recent holding in the *Gas Leak Cases* to support its decision. Uncertainty and confusion will abound in the lower courts until the Supreme Court takes a side on this issue.

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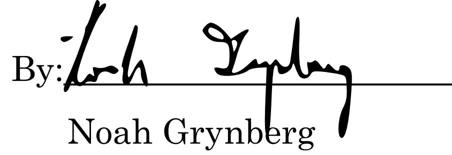
Respectfully submitted,

LOS ANGELES CENTER FOR
COMMUNITY LAW AND ACTION

Dated: September 16, 2019 By: 

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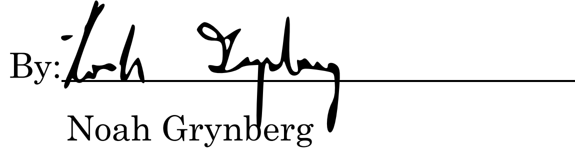
CERTIFICATE OF WORD COUNT

Pursuant to Rule 8.204(c) of the California Rules of Court, I hereby certify that this brief contains 7,005 words, including footnotes and excluding the caption page, table of contents, table of authorities, signature blocks, and certificates. In making this certification, I have relied on the word count of the computer program used to prepare the brief.

Dated this 16th day of September, 2019.

LOS ANGELES CENTER FOR COMMUNITY LAW AND ACTION

By: 

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CERTIFICATE OF INTERESTED ENTITIES OR PERSONS

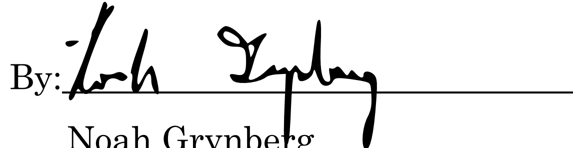
Counsel for Plaintiff and Appellant lists the following entities that may qualify as interested entities or persons pursuant to California Rules of Court, Rule 8.208(e)(2):

1. FCI Lender Services, Inc.
2. Mirabella Investments Group, LLC

I certify and declare under the laws of the State of California that the foregoing is true and correct.

Dated this 16th day of September, 2019.

LOS ANGELES CENTER FOR
COMMUNITY LAW AND ACTION

By: 

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Attachment A

Filed 8/5/19

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION EIGHT

COURT OF APPEAL – SECOND DIST.
FILED
Aug 05, 2019
DANIEL P. POTTER, Clerk
S. Lui Deputy Clerk

KWANG K. SHEEN, Plaintiff and Appellant, v. WELLS FARGO BANK, N.A. Defendant and Respondent.	B289003 (Los Angeles County Super. Ct. No. BC631510)

APPEAL from a judgment of the Superior Court of Los Angeles County, Robert L. Hess, Judge. Affirmed.

Los Angeles Center for Community Law and Action, Noah Grynberg for Plaintiff and Appellant.

Kutak Rock, Jeffrey S. Gerardo, and Steven M. Dailey for Defendant and Respondent.

Homeowners in mortgage trouble may try to negotiate a better deal. If mortgage modification negotiations fail and the borrower falls behind, the lender may foreclose, sell the house, and evict the homeowner. In a nutshell, this happened to borrower Kwang Sheen with his lender Wells Fargo Bank, N.A. (Wells). Sheen sued Wells in *tort* for negligent mortgage modification and other claims. The trial court sustained Wells's demurrer, partly because Wells did not owe Sheen a duty in *tort* during *contract* negotiation.

The issue of whether a tort duty exists for mortgage modification has divided California courts for years. The California Supreme Court has yet to resolve this division. We must take sides.

We join with the old rule: no tort duty during contract negotiations. Our small contribution to this extensive debate is to use the general approach of the recent Supreme Court decision in *Southern California Gas Leak Cases* (2019) 7 Cal.5th 391 (*Gas Leak Cases*). The *Gas Leak Cases* decision was not about mortgage modifications, but it gives us guiding sources of law about whether to extend tort duties when, as here, there is no personal injury or property damage. Seeking wisdom, the Supreme Court considered decisions from other states as well as the Restatement of Torts. We do likewise.

These sources of law decisively weigh against extending tort duties into mortgage modification negotiations. The majority of other states are against it, and the most recent Restatement counsels against this extension because other bodies of law—breach of contract, negligent misrepresentation, promissory estoppel, fraud, and so forth—are better suited to handle contract negotiation issues. We therefore affirm.

I

We recount Sheen's allegations from the operative pleading: his second amended complaint, which was skillfully drafted and is 26 pages long. Sheen attached no documents to this unverified complaint. In the trial court, able counsel represented Sheen. The same counsel appeared for oral argument in this court.

Sheen's complaint tells of a homeowner who borrowed money on his house three times, defaulted on all three loans after the subprime meltdown, sought loan modifications, declared bankruptcy, and emerged from bankruptcy. In the end, Sheen lost his house to foreclosure.

The complaint begins with Sheen's home purchase in 1998. Sheen got a $500,000 loan secured by a deed of trust. This first loan is not at issue here.

In 2005, Sheen obtained two junior loans from Wells, in the amounts of $167,820 and $82,037. Sheen had financial troubles during the 2008 financial crisis and missed payments on the second and third loans. In September 2009, Wells recorded a notice of default on the second loan. The beneficiary of the first loan recorded a notice of default a few months later.

Sheen sought to modify all his home loans. Sheen's previous representative contacted Wells in January 2010 seeking forbearance and modifications to the second and third loans. Sheen himself submitted loan modification requests about both loans on January 29, 2010.

Wells sent Sheen two letters on March 17, 2010. One letter concerned the second loan. It stated Wells was accelerating Sheen's payments due under the second loan. Sheen alleges this letter led him to believe his mortgages were converted into unsecured loans because the letter stated Wells may "plac[e] your account with an outside collection agency." Around this time, a Wells representative

called Sheen's wife and told her there would be no foreclosure sale. Instead, the representative allegedly explained, Wells was simply trying to recover money through standard collections practices.

Sheen received an additional letter from Wells on April 23, 2010 concerning the second loan in which Wells offered to charge off 50% of the balance if Sheen and Wells could come to a satisfactory arrangement. This letter reinforced Sheen's belief Wells had converted his mortgage into an unsecured loan because the letter did not explicitly mention a possible foreclosure sale.

In November 2010, Wells sold Sheen's defaulted second loan in the secondary market for distressed mortgage debt. After the second loan passed through two investment entities, Mirabella Investments Group, LLC (Mirabella) ultimately bought it in November 2013.

Meanwhile, Argent Mortgage Company, LLC, the holder of the first loan, recorded a notice of trustee sale in April 2012. Sheen succeeded in modifying this loan and Argent rescinded its notice of default in August 2013.

Wells ultimately cancelled the third loan in March 2014.

Mirabella moved forward on the second loan and recorded a notice of default in April 2014. Sheen began making modification requests to Mirabella in August 2014, but Mirabella did not tell Sheen whether it would modify this loan. Instead Mirabella wrote Sheen in August 2014 stating it sold its servicing rights for the second loan to FCI Lender Services, LLC (FCI).

Sheen made another modification request directly to FCI that month, but it rejected the application because Sheen had too little income. Ten days later Sheen filed for Chapter 7 bankruptcy relief. Sheen made two more requests for modification while his bankruptcy was pending. FCI rejected each of these applications, again citing Sheen's low income.

Sheen made a third modification request in October 2014 with the assistance of a legal aid society representative. FCI allegedly informed this representative it considered Sheen's second loan to no longer be in "active foreclosure." Sheen also contacted Mirabella directly. Mirabella allegedly told Sheen and his wife it would consider modification in lieu of foreclosure.

The bankruptcy court dismissed Sheen's bankruptcy case on October 24 and vacated the bankruptcy stay. Sheen got a phone call five days later that his home would be sold that day. Surprised, Sheen immediately followed up with FCI, which confirmed the news.

Mirabella bought Sheen's home at the auction later that day. Mirabella then sold the home to Equity Investments Group, Inc. and Compass Alternative Investments, LLC. Sheen then lost an unlawful detainer action.

II

We describe this case's procedural posture.

Sheen sued Wells and others in 2016. Sheen's first count was for negligence. He alleged Wells owed him a duty of care to process, review, and respond carefully and completely to the loan modification applications he submitted to Wells. Additionally, Wells allegedly owed him a duty to refrain from engaging in unfair and offensive business practices that confused Sheen and prevented him from pursuing all options to avoid foreclosure. Sheen alleged Wells breached its duty by failing to respond to his applications, by sending two letters suggesting loans had been modified and his house would not be sold, by phoning his wife to say there would be no foreclosure sale of his home, by confirming Sheen's interpretation of these letters with a further letter that read like it was sent in connection with an unsecured debt rather than a

secured mortgage loan, and by assigning a loan without notifying the assignor that Sheen's modification application was pending.

Sheen also sued Wells for intentional infliction of emotional distress, alleging Wells knew he was in a state of financial difficulty. Yet Wells failed to respond to his modification application, sent him misleading letters, and suggested to Sheen's wife the house would not be sold in foreclosure. Wells further confirmed Sheen's understanding of the letter with a further letter that made no mention of a foreclosure sale. These alleged actions, Sheen claimed, stated a claim for intentional infliction of emotional distress.

Sheen's final claim against Wells was for violating the unfair competition law, Business & Professions Code section 17200 et seq. (section 17200). Sheen alleged that, under section 17200, Wells's acts violated the laws against negligence and intentional infliction of emotional distress. Sheen claimed Wells's conduct had been unfair because it was immoral, unethical, and unscrupulous. Finally, Sheen alleged Wells's conduct was fraudulent because it was likely to have deceived members of the public.

Wells demurred to Sheen's second amended complaint.

Sheen's counsel stressed to the trial court that "we are not alleging fraud, and we are not alleging breach of contract . . . ." Rather, Sheen limited his claims against Wells to three counts described above: negligence, intentional infliction of emotional distress, and violations of section 17200.

The trial court sustained Wells's demurrer against Sheen's three causes of action without leave to amend. The court dismissed the negligence cause of action because Sheen had not pleaded facts supporting a tort duty of care by Wells to Sheen regarding loan modification. The court dismissed the intentional infliction of emotional distress claim for failure to plead outrageous conduct.

And the court dismissed Sheen's section 17200 claim for want of an underlying claim. The court entered judgment for Wells.

Wells's successful demurrer did not affect Sheen's suit against other defendants, which proceeded. Sheen appealed the trial court's judgment for Wells. Wells is the lone defendant in this court, and Sheen is the lone plaintiff.

III

The trial court was right to sustain the demurrer.

We independently review an order dismissing a complaint. (*Lazar v. Hertz Corp.* (1999) 69 Cal.App.4th 1494, 1500–1501.)

We begin by noting the claims Sheen did *not* bring. Sheen did not sue Wells for common law:

1. Breach of contract,
2. Negligent misrepresentation,
3. Promissory estoppel, or
4. Fraud.

Neither did Sheen claim a statutory breach of the following:

1. California Foreclosure Prevention Act (Civ. Code, § 2924 et seq.),
2. California Homeowner Bill of Rights (Civ. Code, § 2920 et seq.),
3. Perata Mortgage Relief Act (Civ. Code, § 2923.5),
4. Real Estate Settlement Procedures Act (12 U.S.C. § 2601 et seq.),
5. Home Affordable Modification Program (12 U.S.C. § 5201 et seq.), or
6. Truth in Lending Act (15 U.S.C. § 1601 et seq.).

These omissions were well counseled and not inadvertent. During oral argument on the demurrer, Sheen's counsel—an expert in this field of law—stressed to the trial court the suit's limited and precisely targeted nature. The implication is Sheen did not attempt

these other theories because, in his attorney's estimation, they did not or could not offer him the type of relief he wanted. So Sheen turned to common law negligence to fill the gap.

Sheen told the trial court he was bringing his negligence claim on an *Alvarez* and *Daniels* theory. (See *Alvarez v. BAC Home Loans Servicing, L.P.* (2014) 228 Cal.App.4th 941 (*Alvarez*); *Daniels v. Select Portfolio Servicing, Inc.* (2016) 246 Cal.App.4th 1150 (*Daniels*).)

We respectfully disagree with *Alvarez* and *Daniels*. In our view, the trial court correctly sustained Wells's demurrer because a lender does not owe a borrower a tort duty of care during a loan modification negotiation.

The 2014 *Alvarez* decision sharpened a conflict in California's state courts. *Alvarez* ruled lenders *do* owe borrowers a duty of care in tort during mortgage modification negotiations. The *Alvarez* opinion rejected the 2013 decision in *Lueras v. BAC Home Loans Servicing, LP* (2013) 221 Cal.App.4th 49, 67 (*Lueras*), which held a lender does *not* owe a borrower a common law duty "to offer, consider, or approve" a loan modification. (See also *Nymark v. Heart Fed. Savings & Loan Assn.* (1991) 231 Cal.App.3d 1089, 1096 ["Liability to a borrower for negligence arises only when the lender 'actively participates' in the financed enterprise 'beyond the domain of the usual money lender.'"].)

The *Alvarez* opinion stressed that "the bank holds 'all the cards'" and that borrowers are captive, with virtually no bargaining power. (*Alvarez*, *supra*, 228 Cal.App.4th at p. 949.) The opinion noted the "moral imperative that those with the controlling hand be required to exercise reasonable care in their dealings with borrowers seeking a loan modification." (*Ibid.*) The decision reasoned recent legislation demonstrated "'a rising trend to require lenders to deal reasonably with borrowers in default to try to

effectuate a workable loan modification.'" (*Id*. at p. 950.) In careful detail, *Alvarez* explained why it took a view conflicting with *Lueras*. (*Id*. at pp. 947–951.)

This conflict persists. The *Daniels* court followed *Alvarez*, while other courts have aligned with *Lueras*. The unpublished Fourth Appellate District decision in *Lacken v. Select Portfolio Servicing, Inc*. (Feb. 20, 2018 G053997) 2018 Cal.App.Unpub. Lexis 1163, pp. *18–*22, 2018 WL 948198, pp. *6–*8, reviewed the debate and continued the rift, as do numerous federal decisions. (See *Anderson v. Deutsche Bank Nat. Trust Co. Americas* (9th Cir. 2016) 649 Fed.Appx. 550, 552; *Deschaine v. IndyMac Mortgage Services* (9th Cir. 2015) 617 Fed.Appx. 690, 693; *Hackett v. Wells Fargo Bank* (C.D. Cal. Mar. 5, 2018, 2:17-CV-7354) 2018 U.S.Dist. Lexis 38412, pp. *22–*26, 2018 WL 1224410, pp. *8–*9; *Cruz v. Freedom Mortgage Corporation* (C.D.Cal. May 3, 2018, CV 18-1438) 2018 WL 6118532, pp. *5–*6.)

Our list of cases in conflict is hardly exhaustive but the extent and duration of this conflict shows the governing test does not yield predictable and uniform results.

That governing test stems from *Biakanja v. Irving* (1958) 49 Cal.2d 647 (*Biakanja*). How one views this test apparently depends on the beholder. (Compare *Alvarez*, *supra*, 228 Cal.App.4th at pp. 948–951 [*Biakanja* dictates duty] with *Lueras, supra*, 221 Cal.App.4th at p. 67 [*Biakanja* dictates no duty].) Our view is that *Lueras* and allied opinions correctly analyzed the *Biakanja* factors.

Rather than rely on this debatable test alone, we seek added certainty by turning to the latest word from the California Supreme Court in its *Gas Leak Cases* opinion. This case concerned the issue of tort duty, albeit not in the mortgage modification context. Rather, *Gas Leak Cases* arose when a utility accidentally let methane escape, which caused nearby businesses to lose money.

Like Sheen, these businesses suffered neither personal injury nor property damage. Their losses were purely economic. The question in *Gas Leak Cases* was whether the utility owed these businesses a tort duty of care. The High Court said no. The economic loss rule means there is no such tort duty.

The *Gas Leak Cases* quoted a legal test called the "*Rowland* factors" that derived from and is nearly identical to the *Biakanja* test. (See *Gas Leak Cases, supra,* 7 Cal.5th at p. 398 [citing *Rowland v. Christian* (1968) 69 Cal.2d 108, 113, which in turn cited *Biakanja*]; *id.* at p. 400 [analyzing and applying *Biakanja*]; *id*. at p. 401 [the *Biakanja* test involved "a subset of the *Rowland* factors"].) But the High Court eschewed "rote application of these separate so-called *Rowland* factors" and instead took a comprehensive look at the total considerations at play. (*Id.* at p. 399.)

One fundamental consideration was that economic losses flowing from "a financial transaction gone awry" are "'primarily the domain of contract and warranty law or the law of fraud, rather than of negligence.'" (*Gas Leak Cases*, *supra*, 7 Cal.5th at p. 402.) Here we have a financial transaction gone awry and nothing more: Sheen suffered neither personal injury nor property damage.

The *Gas Leak Cases* decision also considered the views of other jurisdictions and of the Restatement of Torts. (*Gas Leak Cases*, *supra*, 7 Cal.5th at pp. 403–407.) We follow this lead.

Decisions from other jurisdiction form a consensus that "cuts sharply against imposing a duty of care to avoid causing purely economic losses in negligence cases like this one . . . ." (*Gas Leak Cases*, *supra*, 7 Cal.5th at p. 403.)

Courts in at least 23 states have refused to impose tort duties on lenders about loan modifications. (See *Prickett v. BAC Home Loans* (N.D.Ala. 2013) 946 F.Supp.2d 1236, 1244–1245 [applying Alabama law]; *Miller v. Bank of New York Mellon* (Colo.Ct.App.

2016) 379 P.3d 342, 345–348; *Burdick v. Bank of America, N.A.* (S.D.Fla. 2015) 99 F.Supp.3d 1372, 1377–1378 [applying Florida law]; *Chung v. JPMorgan Chase Bank, N.A.* (N.D.Ga. 2013) 975 F.Supp.2d 1333, 1344–1346 [applying Georgia law]; *Wigod v. Wells Fargo Bank, N.A.* (7th Cir. 2012) 673 F.3d 547, 567–568 [applying Illinois law]; *Jaffri v. JPMorgan Chase Bank, N.A.* (Ind.Ct.App. 2015) 26 N.E.3d 635, 638; *Legore v. OneWest Bank, FSB* (D.Md. 2012) 898 F.Supp.2d 912, 918–919 [applying Maryland law]; *Afridi v. Residential Credit Solutions, Inc.* (D.Mass. 2016) 189 F.Supp.3d 193, 199 [applying Massachusetts law]; *Polidori v. Bank of America, N.A.* (E.D.Mich. 2013) 977 F.Supp.2d 754, 763–764 [applying Michigan law]; *Wivell v. Wells Fargo Bank, N.A.* (8th Cir. 2014) 773 F.3d 887, 900 [applying Missouri law]; *Anderson v. ReconTrust Company, N.A.* (Mont. 2017) 390 Mont. 12, 20; *McGee v. CitiMortgage* (D.Nev. May 31, 2013, 2:12-CV-2025) 2013 U.S.Dist. Lexis 76675, pp. *16–*17, 2013 WL 2405301, p. *6 [applying Nevada law]; *Schaefer v. Indymac Mortgage Services* (1st Cir. 2013) 731 F.3d 98, 103–107 [applying New Hampshire law]; *Patetta v. Wells Fargo Bank, N.A.* (D.N.J. Sep. 10, 2009, 3:09–CV–2848) 2009 U.S.Dist. Lexis 82338, pp. *30–*32, 2009 WL 2905450, p. *8 [holding no fiduciary duty exists between borrowers and lenders that would support non-contractual liability under New Jersey law]; *Dooley v. Wells Fargo Bank, Nat. Ass'n* (S.D.Ohio 2013) 941 F.Supp.2d 862, 866–867 [applying Ohio law]; *Medici v. JP Morgan Chase Bank, N.A.* (D.Or. Jan. 15, 2014, 3:11–CV–00959) 2014 U.S.Dist. Lexis 4928, pp. *9–*10, 2014 WL 199232, pp. *3–*4; *Bordoni v. Chase Home Finance LLC* (E.D.Pa. 2019) 374 F.Supp.3d 378, 384–386 [applying Pennsylvania law]; *Henderson v. Wells Fargo Bank, N.A.* (N.D.Tex. 2013) 974 F.Supp.2d 993, 1010–1012 [applying Texas law]; *Needham v. Fannie Mae* (D.Utah 2012) 854 F.Supp.2d 1145, 1153 [applying Utah law]; *Parks v. BAC Home*

Loan Servicing, LP (E.D.Va. 2011) 825 F.Supp.2d 713, 716 [applying Virginia law]; *Srok v. Bank of Am.* (E.D.Wis. Nov. 6, 2015, 15-CV-239) 2015 U.S.Dist. Lexis 151025, pp. *17–*21, 2015 WL 6828078, pp. *7–*8 [applying Wisconsin law]; *McNeely v. Wells Fargo Bank, N.A.* (S.D.W.Va. Dec. 10, 2014, 2:13-CV-25114) 2014 U.S.Dist. Lexis 170784, pp. *12–*20, 2014 WL 7005598, pp. *5–*7; *Powell v. Ocwen Loan Servicing, LLC* (D.Wyo. Aug. 7, 2014, 14-CV-113) 2014 U.S.Dist. Lexis 187163, pp. *12–*16, 2014 WL 11498232, pp. *5–*6 [applying Wyoming law].)

This 23-state bloc is the dominant position, but there may be a contrary minority view. An unpublished 2014 federal district court opinion reported two dissenting cases: one unpublished decision from Arizona and another from Mississippi. (See *Powell v. Ocwen Loan Servicing, LLC*, *supra*, 2014 U.S.Dist. Lexis 187163, p. *13, 2014 WL 11498232, pp. *5–*6 [citing *McIntosh v. IndyMac Bank, FSB* (D.Ariz. Jan. 10, 2013, CV-11-1805) 2013 U.S.Dist. Lexis 3959, pp. *6–*7, 2013 WL 135315, p. *2; *Montgomery v. CitiMortgage, Inc.* (S.D.Miss. 2013) 955 F.Supp.2d 640, 649–650 (*Montgomery*)].)

So perhaps Arizona and Mississippi support *Alvarez*. We are unsure.

The pertinent law in Arizona appears to be a bit of a mixed bag. (Compare *Snyder v. HSBC Bank, USA, N.A.* (D.Ariz. 2012) 913 F.Supp.2d 755, 775–776 [noting relevant Arizona law "is not well-settled"] with *id.* at p. 776 [concluding bank owed no duty to borrower] and *Zazueta v. Nationstar Mortg., LLC* (D.Ariz. Apr. 1, 2014, (CV-13-1415), 2014 U.S.Dist. Lexis 189627, pp. *16–18, 2014 WL 12527708, pp. *6–*7 [apparently holding no tort duty exists between a financial institution and a borrower].)

We have similar uncertainty about the law of Mississippi. (Compare *Poppelreiter v. GMAC Mortg., LLC* (N.D.Miss. Dec. 7,

2011, 1:11CV008) 2011 U.S.Dist. Lexis 140957, pp. *8–*9, 2011 WL 6100440, p. *3 [relationship between a mortgagor and mortgagee is not a fiduciary one but rather an arms-length business transaction involving a normal debtor-creditor relationship] with *Montgomery*, *supra*, 955 F. Supp.2d at 649 [under Mississippi law a negligence claim may be founded on the breach of a legal duty arising from a contract between parties].)

Our uncertainty about Arizona and Mississippi does not matter. Whether the tally is 23 to zero or 23 to two, the overwhelming supermajority of states disagree with *Alvarez*.

The dominant position is there is no tort duty during mortgage modification negotiations. This consensus is "a striking degree of unanimity." (*Gas Leak Cases*, *supra*, 7 Cal.5th at p. 407.) It weighs against *Alvarez*.

Turning next to the Restatement of Torts, it supports *Lueras* and opposes *Alvarez*, as we explain.

There is "[l]ittle wonder" the Restatement "takes the dominant view. Although acknowledging that '[d]uties to avoid the unintentional infliction of economic loss' exist in certain recognized circumstances, the latest Restatement provides that there is 'no general duty to avoid the unintentional infliction of economic loss on another.' (Rest.3d, Torts, Liability for Economic Harm (Tent. Draft. No. 1, Apr. 4, 2012) § 1 (Restatement T.D. 1).)" (*Gas Leak Cases*, *supra*, 7 Cal.5th at p. 407.)

Specifically, the most recent Restatement explains there can be no liability in tort for economic loss caused by negligence in the performance or *negotiation* of a contract between its parties. (Rest.3d Torts, Liability for Economic Harm (Tent. Draft No. 1, Apr. 4, 2012) § 3.) Certain exceptions exist but do not apply here.

The Restatement gives its rationale. "When a party's negligence in performing or negotiating a contract causes economic

loss to the counterparty, remedies are determined by other bodies of law: principally the law of contract, though sometimes also the law of restitution or relevant statutes. The law of contract and the law of restitution have been developed for the specific purpose of allocating economic losses that result from the negotiation and performance of contracts. They provide a more extensive and finely tuned apparatus for the purpose than the law of torts, which has developed primarily to address injuries that occur outside contractual relationships. [¶] [This approach] serves several purposes. When a dispute arises, the rule protects the bargain the parties have made against disruption by a tort suit. Seen from an earlier point in the life of a transaction, the rule allows parties to make dependable allocations of financial risk without fear that tort law will be used to undo them later. Viewed in the long run, the rule prevents the erosion of contract doctrines by the use of tort law to work around them. The rule also reduces the confusion that can result when a party brings suit on the same facts under contract and tort theories that are largely redundant in practical effect." (Rest.3d Torts, Liability for Economic Harm (Tent. Draft No. 1, Apr. 4, 2012) § 3, com. b., p. 22.)

The Restatement rebuts factors that may have contributed to *Alvarez's* result. "Pressure to find a tort claim arises because the stakes are high and the plaintiff's position is sympathetic . . . . But if denying relief to the plaintiff seems to produce an injustice on those grounds, a better response is to reconsider the application of . . . the other doctrines of contract law that are responsible for the result. Using tort law to bypass those doctrines weakens them and retards their development. It also interferes with the ability of others to make reliable agreements in the future. In the alternative, a result unappealing on its equities may call for a statutory solution. Statutes can impose responsibility on sellers for

certain risks without distorting widely applicable legal principles to reach the desired outcome. . . . When two parties negotiate over a contract, the amount of care they are expected to show for each other's interests will often be unclear or significantly less than the care expected in a situation involving strangers or the risk of physical injury. That is among the reasons why the duties of care between parties who negotiate contracts are not governed by the law of tort." (Rest.3d Torts, Liability for Economic Harm (Tent. Draft No. 1, Apr. 4, 2012) § 3, com. d., pp. 27–28.)

The Restatement is definitive: it "eliminates tort claims based on a defendant's negligent statements of intent to make a contract, predictions about the likelihood of a contract, or mistaken suggestions that a contract has been formed." (Rest.3d Torts, Liability for Economic Harm (Tent. Draft No. 1, Apr. 4, 2012) § 3, com. e., p. 29.)

"Detailed doctrines in the law of contract, of restitution, and of estoppel have developed to provide relief in such cases where necessary. If those bodies of law fall short, the appropriate response again is to reform them, not to use the law of tort to supply their deficiencies." (Rest.3d Torts, Liability for Economic Harm (Tent. Draft No. 1, Apr. 4, 2012) § 3, com. e., p. 29.)

In sum, the consensus of other jurisdictions and of the Restatement cuts against *Alvarez* and similar decisions.

Logic points to the same conclusion: "it is strange to impose a negligence duty on lenders to carefully review modification applications when there is no such tort duty to *approve* applications as a result of that review." (*Carbajal v. Wells Fargo Bank, N.A.* (C.D.Cal. Apr. 10, 2015, CV 14-7851) 2015 U.S.Dist. Lexis 47918, p. *15, 2015 WL 2454054, p. *6, affd. (9th Cir. 2017) 697 Fed.Appx. 555, original italics.)

Finally, the *Gas Leak Cases* opinion noted the ability of legislatures to craft remedies beyond the ken of courts. Legislatures, both state and federal, have responded to problems in the mortgage modification field. "[T]hrough the democratic process, the Legislature can bring to bear a mix of expertise while considering competing concerns to craft a solution in tune with public demands." (*Gas Leak Cases*, *supra*, 7 Cal.5th at p. 413.)

In the mortgage modification field, legislatures have been active, and their results have been designedly limited in time and scope. Neither legislators nor borrowers (nor others) want to increase mortgage costs or to limit the availability of mortgages and mortgage modifications. (Cf. *Daniels*, *supra*, 246 Cal.App.4th at p. 1183 [absent a duty in the first place to modify a loan or even to evaluate such an application, imposing negligence liability for the mishandling of loan modification applications could discourage lenders from offering modification].)

After fair notice, legislators can hear from disinterested experts and from all affected sectors before acting. After hearings and reports, legislatures can craft broadly acceptable compromises and can enact limited and experimental pilot programs. Legislatures can adjust policy swiftly in the face of change and experience.

Courts can do none of these things well. The complexity and importance of financial markets gives special force to the law of unintended consequences.

We conclude we should follow *Lueras*, not *Alvarez*. Under this view, the trial court properly dismissed Sheen's negligence count because a lender does not owe a borrower a common law duty to offer, consider, or approve a loan modification.

Sheen's other claims are meritless. We agree with the trial court the intentional infliction of emotional distress claim is

frivolous. Wells's alleged responses to Sheen's loan modification requests may have been confusing, confused, tardy, or flat wrong, but this alleged conduct was not so extreme as to exceed all bounds of what a civilized society usually tolerates. (*Vasquez v. Franklin Management Real Estate Fund, Inc.* (2013) 222 Cal.App.4th 819, 832.)

The trial court also was right to dismiss Sheen's section 17200 claim. (See, e.g., *AMN Healthcare, Inc. v. Aya Healthcare Services, Inc.* (2018) 28 Cal.App.5th 923, 950.)

DISPOSITION

The judgment is affirmed. Wells is entitled to its costs on appeal.

WILEY, J.

WE CONCUR:

BIGELOW, P. J.

STRATTON, J.

PROOF OF SERVICE

I, the undersigned, declare that I am over the age of 18 and am not a party to this action. I am employed in the City of Los Angeles, California; my business address is 1137 N. Westmoreland Ave., #16, Los Angeles, CA 90029.

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Petition for Review

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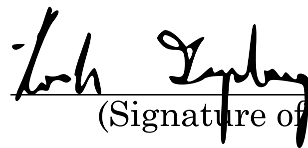
Noah L. Grynberg
(Type or Print Name)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