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Supreme Court of California
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Case No. S258019

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

KWANG K. SHEEN,

Plaintiff and Appellant,

v.

WELLS FARGO BANK, N.A.,

Defendant and Respondent.

California Court of Appeal,
Second District, Division Eight, No. B289003

Los Angeles Superior Court, No. BC631510 The Honorable Robert L. Hess, Judge

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APPLICATION FOR LEAVE TO FILE AMICUS BRIEF AND AMICUS BRIEF IN SUPPORT OF RESPONDENT

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APPLICATION OF THE CALIFORNIA MORTGAGE ASSOCIATION, CALIFORNIA MORTGAGE BANKERS ASSOCIATION, MORTGAGE BANKERS ASSOCIATION, and UNITED TRUSTEES ASSOCIATION FOR LEAVE TO FILE AMICUS BRIEF IN SUPPORT OF RESPONDENT:

Pursuant to California Rule of Court Rule 8.520(f), the California Mortgage Association ("CMA"), the California Mortgage Bankers Association ("CMBA"), the Mortgage Bankers Association ("MBA"), and the United Trustees Association ("UTA") hereby request leave of this Court to file the following amicus brief in support of the position of Respondent Wells Fargo Bank, N.A. ("Respondent"). This amicus brief will assert that:

(1) Absent fraudulent representations, personal injury and/or property damages, a borrower is properly limited to contract remedies against the borrower's lender and servicer in connection with their servicing of the borrower's loan, including with respect to collections, charge-offs, loan modifications and foreclosure proceedings.
(2) Imposing a negligence duty and standard of care on loan servicing would have a chilling effect on the availability and terms of forbearances and loan modifications that would be offered to borrowers.
(3) Any extension of the duties of lenders or servicers in connection with collections, charge-offs, loan modifications, and/or foreclosures should be left to the Legislature, which has enacted a comprehensive scheme for regulating the conduct of non-judicial foreclosures.

The issues raised by this appeal therefore directly concerns the rights and duties of lenders, servicers, foreclosure trustees, and borrowers with respect to the servicing and enforcement of real estate secured loans throughout California.

The purpose of this amicus brief is to assist the Court in determining that the applicable law and public policy with respect to these issues warrants affirmance. The amici also seeks to provide the Court with insight on the unique roles of the loan servicer and the foreclosure trustee under California and Federal law, and industry practice, and to explain to the Court the potential ramifications, if the lower court's decision were reversed, on important public policies, including the negative impact on lenders, servicers, foreclosure trustees, *and* borrowers.

As set forth in the following Statement of Interest, the CMA, CMBA, MBA, and the UTA have specialized knowledge regarding the intent and operation of California's laws and statutes governing the servicing of real estate secured loans, including compliance with the applicable state and federal laws governing collection activities, forbearances, loan modifications, and foreclosures, as well as a significant interest in the outcome of this matter as it relates to the rights and duties of their lender, loan servicer, and foreclosure trustee members.

No party or counsel for a party in this case has authored this brief in whole or in part, nor made any monetary contribution to fund the preparation or submission of this brief, except to the limited extent a party might be a dues paying member of one or more of the amici. Nobody has made any monetary contribution to fund the preparation or submission of this brief, other than the amici, their members, and counsel in this appeal.

Accordingly, the CMA, CMBA, MBA, and the UTA respectfully request the Court to grant their Motion and allow their amicus brief to be filed and considered on this appeal. Pursuant to California Rules of Court Rule 8.520(f)(2) this application has been timely filed as the last Appellants' reply was filed on July 20, 2020.

An amicus brief in the State of California is typically allowed to be as long as the principal briefs [California Rules of Court Rule 8.520(c)], at least absent Court order. The proposed amicus brief is 13,223 words, excluding the cover information, tables, this application and Statement of Interest, certificates, and signature blocks.

Respectfully submitted,

DATED: September 18, 2020

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STATEMENT OF INTEREST:

The CMA, CMBA, MBA, and the UTA hereby submit this Amicus Brief in support of an order affirming the lower court's ruling in favor of Respondent Wells Fargo Bank, N.A. ("Respondent") as to Petitioner Kwang K. Sheen's ("Petitioner") claim that he was entitled to maintain a negligence claim against Respondent based on its servicing of a real estate-secured loan, in particular on its communications to him concerning his loan modification application and the charge-off of that loan, in light of a subsequent foreclosure several years later by a successor owner of the loan following Petitioner's failure to cure his admitted default on the Loan. Petitioner argues Respondent should have informed him that foreclosure remained a possibility if he did not reinstate his Loan.

A. The California Mortgage Association:

The CMA is a non-profit trade association of private lenders and brokers. Its members include individuals as well as entities that make, arrange, sell, or service loans secured by deeds of trust on real property in California. Most CMA members are licensed as real estate brokers under the California Bureau of Real Estate or as California Finance Lenders under the California Department of Business Oversight. CMA also represents affiliate members which include attorneys, escrows, accountants, software companies, and others interested in mortgage lending and in loan servicing. CMA members either directly service mortgage loans they make or arrange

or they have other licensees (CMA members) specializing in mortgage loan servicing, service their loan portfolios. The duties and liabilities of loan servicers and lenders of loans secured by deeds of trust on real property are a matter of great concern to CMA members.

For over 60 years, CMA, and its predecessors, has been actively involved in the California legislative process through its legislative advocates. CMA has previously filed amicus curiae briefs before various courts in Federal Court in *Ho v. Recontrust Co.* No. 10-56884; the State of California including the California Court of Appeal in *Kachlon v. Markowitz* (2008) 168 Cal. App.4th 316; in *Mabry v. Super. Ct. of Orange County,* (2010) 185 Cal.App.4th 208; in *Paveco Construction Inc. v. East West Bank,* (2011) Appeal # B223912 (Second Dist. Div. 2) unpublished; and in *Davidson v. Seterus, Inc.,* (2018) 21 Cal.App.5th 283.

The CMA's goal is to provide a clear understanding of the Legislation and case law that impacts the private mortgage lending and loan servicing communities, including important issues relating to lending, funding, servicing and foreclosure of loans secured by deeds of trust.

B. <u>The California Mortgage Bankers Association</u>:

The CMBA is a non-profit association that, for over 60 years, has been actively engaged in representing the residential and commercial real estate finance industry before the California Legislature, the Governor, the Courts, and all regulatory agencies and departments of the State of

California, and is dedicated to promoting fair and ethical lending practices through high membership standards, robust training, educational, and leadership development programs, and the publication of scholarly journals and periodic newsletters on topics of importance to industry members and consumers.

The CMBA's membership consists of approximately three hundred (300) companies representing a full spectrum of both residential and commercial lenders, servicers, brokers, and mortgage loan originators, as well as a broad range of service providers to those industry participants. According to statistics maintained by the Mortgage Bankers Association of America, the estimated dollar volume of residential purchase and refinance loan originations in the United States during 2016 was approximately $1.89 Trillion Dollars. Based on historical data, approximately 19 percent (19%) of those loans (over $350 billion), were originated in California. Of these, a substantial percentage---if not the overwhelming majority---were originated and serviced by CMBA members.

The CMBA is advised by its Board of Directors consisting of senior executives from prominent residential and commercial mortgage banking firms and professional service providers, as well as a Legal Services Committee consisting of California attorneys experienced in the real estate finance industry, including the Association's general counsel, who consulted on this brief. Together they monitor litigation of concern to

residential and commercial real estate finance industry members, including borrowers, and have a dedicated and unique focus on the effect of judicial decisions at both the state and federal levels that are likely to have a significant impact on real estate lending and servicing in the State of California.

C. The Mortgage Bankers Association:

The Mortgage Bankers Association (MBA) is a national association representing over 2,200 members of the real estate finance industry. Its membership spans real estate finance companies, mortgage companies, mortgage brokers, commercial banks, thrifts, life insurance companies, and others in the mortgage lending field. MBA seeks to strengthen the nation's residential and commercial real estate markets, to support sustainable homeownership, and to extend access to affordable housing to all Americans. MBA therefore has a strong interest in maintaining the stability of the mortgage and real estate markets. Among other recent amicus briefs, MBA has submitted amici briefs in the U.S. Supreme Court cases of *Seila v. Consumer Financial Protection Bureau* (2020), *Rotiske v. Klemm* (2019), and *Obduskey v. McCarthy Holthus LLP* (2019).

D. The United Trustees Association:

The UTA is a national organization that, since 1968, has been the source for information, expertise, continuing education and opinion on trustee issues and practices for its members. UTA membership is

comprised of those acting as trustees under real property deeds of trust, including employees of title companies, financial institutions, and independent companies. UTA members also work in allied and support organizations, including posting and publishing companies and computer service firms. Hundreds of UTA members, including foreclosure trustees, transact business in California and will be directly and substantially affected by the Court's resolution of this appeal.

The UTA has been actively involved in the legislative process of various states for over 25 years. The UTA has previously filed amicus curiae briefs before, among others, the California Supreme Court, the California Courts of Appeal, the Federal Ninth Circuit Court of Appeals, and the United States Supreme Court in the cases of: *BFP v. Resolution Trust Corporation* (1994) 511 U.S. 531; *Obduskey v McCarthy & Holthus L.L.P,* (2019) 139 S. Ct. 1029; *I.E. Associates v. Safeco Title Ins. Co.* (1985) 39 Cal.3d 281,; *Trustors Security Service v. Title Recon Tracking Service* (1996) 49 Cal.App.4th 592; *Prudential Home Mortgage Company, Inc. v. Superior Court* (1998) 66 Cal.App.4th 1236; *Nguyen v. Calhoun* (2003) 105 Cal.App.4th 428; *Kachlon v. Markowitz* (2008) 168 Cal.App.4th 316; *Banc of America Leasing & Caital, LLC v. 3 Arch Trustee Services, Inc.,* (2009) 180 Cal.App.4th 1090; *Mabry v. Orange County Superior Court*, (2010) 185 Cal.App.4th 208; *Biancalana v. T.D.*

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Respectfully submitted,

DATED: September 18, 2020

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WITH PERMISSION

AMICUS BRIEF

I. FACTS/PROCEDURAL HISTORY:

To the extent relevant, the CMA, CMBA, MBA and the UTA adopt the facts and procedural history as set forth in the Answering Brief on the Merits filed by Respondent Wells Fargo Bank, N.A. ("Respondent") on May 15, 2020. However, it is worth highlighting that the only conduct of Respondent complains of consists of the following:

(a) "Initially" not responding to Petitioner's January, 2010 loan modification applications on two loans;

(b) two March 17, 2010 letters from Respondent advising Petitioner that his two loans had been "charged off," that "the entire balance has been accelerated" and was now "due and payable," and that Respondent would "proceed with whatever action is deemed necessary to protect our interests." [Clerk's Transcript ("CT") p. 488 at ¶¶15-16] The letters instructed Petitioner to contact Respondent if he had any questions. [*Id.*];

(c) a March, 2010 telephone call in which Petitioner's wife was supposedly told by Respondent that "there would be no more foreclosure sale of their home." [*Id.* at ¶ 22];

(d) an April 23, 2010 letter from Respondent referencing the charge-off and warning Petitioner that, unless he addressed the delinquent loan, Respondent could "take advantage of all

remedies available to [it} to recover [the loan] balance in full….” [*Id.* at ¶ 23]; and

(e) not notifying the assignee of the loans that Petitioner had submitted a loan modification application. [AOB at 25]

Notably, none of these communications include any mention of any modification of a loan, nor of the release of any security interest, and only the telephone call referenced any foreclosure. Moreover, Petitioner concedes that he understood that he was still liable to repay the Loan. [AOB at 23] Nonetheless, Petitioner is essentially urging that Respondent had a duty of care to make sure he understood that the charging off of his Loan, and the notification that Respondent would not be proceeding with a previously scheduled foreclosure, did not mean that there could never be a foreclosure in the event of an uncured default.

There is no allegation that Petitioner received or executed any written modification agreement, let alone what its terms might have been, nor does he allege that he actually performed under such an agreement, or even followed up with Respondent to ask about its status or terms. Indeed, the written correspondence referenced above reflects that the loans were, and remained, in default at all times. Instead, Petitioner merely refers to his *assumption* as to what the communications meant, even though he never sought any clarification from Respondent.

The sole issue here is whether Respondent can be held liable for negligence based on these communications or lack of communications.

II. ISSUES:

For the purposes of this amicus brief, the two primary issues of concern to the CMA, CMBA, MBA, and UTA are:

1. Whether, absent any actual misrepresentation or physical injury or property damage, a borrower is properly limited to contract remedies in connection with a dispute over communications concerning the servicing of his loan; and

2. Whether the Court should unilaterally extend the existing duties of lenders and servicers in connection with their handling of loan modifications and foreclosures by finding a negligence duty and standard of care apply or rather should properly defer any such determination to the Legislature.

III. STANDARD OF REVIEW:

The sole focus of Appellant's Petition is the question of whether Respondent owed him a negligence duty of care in connections with its communications to him concerning his loan modification application and the charge off of his loan. As such, the proper standard of review is *de novo* as this is purely a question of law. *Quelimane Co. v. Stewart Title Guaranty Co.* (1998) 19 Cal.4th 26, 57; *Bily v. Arthur Young & Co.* (1992) 3 Cal.4th 370, 397; *Nymark v. Heart Fed. Savings & Loan Assn.* (1991) 231 Cal.App.3d 1089, 1095.

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IV. **ANALYSIS AND ARGUMENT**:

A. **The General Rule in California is that a Lender Owes No Duty to a Borrower When Acting in the Normal Scope of the Relationship**:

The elements of a cause of action for negligence are: (1) a legal duty of care, (2) breach of that duty, and (3) proximately caused damages.[1] *Merrill v. Navegar, Inc.* (2001) 26 Cal.4th 465, 477. The *sine qua non* of the negligence claim, though, is the existence of a *non-contractual* duty of care to the plaintiff. *Erlich v. Menezes*, (1999) 21 Cal.4th 543, 552, 553–554. It is well-established that the relationship between a financial institution and its customer is essentially contractual in nature (albeit the relationship is also subject to the requirements of various statutes and regulations) [*Lueras v. BAC Home Loans Servicing, L.P.,* (2013) 221 Cal.App.4th 49, 68; *Chazen v. Centennial Bank,* (1998) 61 Cal.App.4th 532, 537].

Although the starting point in most discussions of whether a financial institution owes a duty of care to its customer is usually *Nymark, supra*, the concept has been recognized by the courts of this State, including this Court, long before then. *See Connor v. Great Western Sav. & Loan Assn.*, (1968) 69 Cal.2d 850, 864, finding a lender can be liable to a

[1] This case presents an unusual situation where the damages arose years after Respondent had assigned away its interest in the Loan, when the current owner of the Loan elected to foreclose as a result of Petitioner's admittedly uncured default. [AOB at 23-24]

borrower for negligence where the lender "actively participates" in the financed enterprise "beyond the domain of the usual money lender"; *accord Kinner v. World Sav. & Loan Assn.*, (1976) 57 Cal.App.3d 724, 730-34; *Wagner v. Benson,* (1980) 101 Cal.App.3d 27, 35 (lender was not liable for negligence for failing to warn borrowers that loan purpose was risky, despite allegation that lender withheld information, where lender was not actively involved in the investment). In *Nymark, supra*, at 1095-97, the court succinctly summarized the holdings of the prior cases and clearly articulated the rules derived from them: "[A] s a general rule, a financial institution owes no duty of care to a borrower when the institution's involvement in the loan transaction does not exceed the scope of its conventional role as a mere lender of money." *Id.* at 1096.

It is also well-settled in California that, "absent special circumstances[,]…a loan transaction is at arm's-length and there is no fiduciary relationship between the borrower and the lender." *Oaks Management Corp. v. Superior Court* (2006) 145 Cal.App.4th 453, 466; *see also*, *Das v. Bank of America, N.A.,* (2010) 186 Cal.App.4th 727, 740-41("Under the common law, banks ordinarily have limited duties to borrowers."); *Kim v. Sumitomo Bank of California* (1993) 17 Cal.App.4th 974, 979 (no fiduciary relationship exists between a debtor and creditor); *Nymark, supra*, at 1093 fn.1, *citing Price v. Wells Fargo Bank* (1989) 213 Cal.App.3d 465, 476–478 ("[t]he relationship between a lending institution

and its borrower-client is not fiduciary in nature.”). A commercial lender is entitled to pursue its own economic interests in a loan transaction and this “right is inconsistent with the obligations of a fiduciary which require that the fiduciary knowingly agree to subordinate its interests to act on behalf of and for the benefit of another.” *Nymark, supra*, *citing Committee on Children's Television, Inc. v. General Foods Corp.* (1983) 35 Cal.3d 197, 221.

Similarly, a loan servicer does not owe a borrower a fiduciary duty “when its involvement in the transaction does not exceed the scope of its conventional role as a loan servicer.” *Williamson v. Sacramento Mortg., Inc.* (E.D. Cal. Sept. 30, 2011) 2011 WL 4591098, *9, *citing Huerta v. Ocwen Loan Servicing, Inc.* (N.D. Cal. Mar. 1, 2010) 2010 WL 728223, *4. *See also Lueras, supra*, 62-69 extensively discussing the limits on negligence claims arising out of the traditional lender role.

B. Loan Charge Offs and Foreclosures Fall Within the Conventional Scope of a Lender and Loan Servicer’s Business:

Having established the general rule that a financial institution, acting within the normal course, or conventional role, of its business as a lender of money, owes no negligence or fiduciary duty of care to its borrower, the question becomes whether the conduct alleged here—the sending of the three charge off letters and the telephone call purportedly informing

Sheen's wife that the previously scheduled foreclosure sale would not go forward—was within the normal course and scope of that role.

As held by the court in *Sierra–Bay Fed. Land Bank Assn. v. Superior Court,* (1991) 227 Cal.App.3d 318, 334: "A commercial lender is not to be regarded as the guarantor of a borrower's success and is not liable for the hardships which may befall a borrower. [citation omitted] It is simply not tortious for a commercial lender to lend money, take collateral, or to foreclose on collateral when a debt is not paid."

In *Ragland v. U.S. Bank, N.A.,,* (2012) 209 Cal.App.4th 182, 206-08, the court specifically found that a lender who allegedly told a borrower not to make a loan payment in order to be considered for a loan modification could not be held negligent because no duty was owed to the borrower as that advice fell within its "conventional role as a lender of money." *Id.* at 207.

As mentioned above, the court in *Lueras, supra*, at 62-69 provided an extensive overview of the law of negligence as it applied to lenders, concluding, at 68, that:

> [A] loan modification is the renegotiation of loan terms, *which falls squarely within the scope of a lending institution's conventional role as a lender of money*. A lender's obligations to offer, consider, or approve loan modifications and to explore foreclosure alternatives are created solely by the loan documents, statutes, regulations, and relevant directives and announcements from the United States Department of the Treasury, Fannie Mae, and other governmental or quasi-governmental agencies.

[emphasis added] *See also Scheuerman v. PHH Mortgage Corporation,* 2020 WL 1984063 at *10-11 (S.D. Cal. April 27, 2020)(and cases cited therein).

In *Lueras*, like the claims at issue here, the conduct allegedly giving rise to the negligence claim included not offering a loan modification and: "'failing to timely and accurately respond to customer requests and inquiries,' by 'failing to comply with state consumer protection laws, properly service the loan, and use consistent methods to determine modification approvals,'…." The court did note, though, there could still be potential liability for *negligent misrepresentation* since "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."

Conversely, in *Alvarez v. BAC Home Loans Servicing*, (2014) 228 Cal.App.4th 941, 945-51, the court, while paying lip service to the existence of the *Nymark* line of cases, agreed with the decision in *Jolley v. Chase Home Finance, LLC*, (2013) 213 Cal.App.4th 872, 901, that "'*Nymark* 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"' [citation omitted]." The court then held that the test of *Biakanja v. Irving* (1958) 49 Cal.2d 647 compelled a different conclusion, at least where the lender had already agreed to review a loan modification application and was accused of "failing to process the applications in a timely manner, dual tracking and losing documents." None of which is claimed to have occurred here. The impropriety of foisting a duty of care on a contractual relationship by superimposing the *Biakanja* test is discussed below.

Many decisions have recognized the "split" between the *Lueras* and *Alvarez* views as to whether a loan modification falls within the conventional role and no agreement has been reached as to how to resolve that split. *See, e.g., Sheen, supra,* at 352-53; *Boruta v. JPMorgan Chase Bank, N.A.,* 2020 WL 887784 at *10-11 (N.D. Cal. Feb. 24, 2020) (and cases cited therein). Some courts have even sought to avoid the split by denying that *Nymark* applies to loan modifications at all, indulging in the legal fiction that modifications do not fall within "the scope of [the lender or servicer's] conventional role."[2] *See, e.g., Ansanelli v. JP Morgan*

[2] Petitioner engages in a small legal fiction of his own, arguing there is no actual split between *Alvarez* and *Lueras* [AOB at 32-36]. *See Weimer v.*

Chase Bank, N.A., 2011 WL 1134451 at *7 (N.D. Cal. March 28, 2011). This approach is clearly erroneous as the whole purpose of the modification is to revise the terms *of the existing loan*. *See Lueras, supra,* at 67; *accord Badame v. J.P. Morgan Chase Bank, N.A.*, (9th Cir. 2016) 641 Fed. Appx. 707, 710 ("Chase did not owe Plaintiffs a duty of care when considering their loan modification application because a loan modification is the renegotiation of loan terms, which falls squarely within the scope of a lending institution's conventional role as a lender of money."). *See also Rockridge Trust v. Wells Fargo, N.A.,* (N.D. Cal. 2015) 985 F.Supp.2d 1110, 1160-62 (discussing the split of authority on the issue and coming down on the side that a loan modification: "'is nothing more than a renegotiation of loan terms. This renegotiation is the same activity that occurred when the loan was originated; the only difference being that the loan is already in existence.'"[3]

In this regard, the cases make clear that loan modifications are themselves contractual and must satisfy normal contract rules, including mutual agreement, consideration, and compliance with the Statute of Frauds. *See Granadino v. Wells Fargo Bank, N.A.,*

Nationstar Mortgage, LLC, (2020) 47 Cal.App.5th 341, 358-59, review granted 2020 WL 4211744 (Cal. S.Ct. July 22, 2020).

[3] *Quoting Morgan v. U.S. Bank N.A.,* 2013 WL 684932, at *3 (N.D. Cal. Feb. 25, 2013) (in turn *quoting Armstrong v. Chevy Chase Bk, FSB,* 2012 WL 4747165, at *4 (N.D. Cal. Oct. 3, 2012)).

(2015) 236 Cal.App.4th 411, 415-16; *Secrest v. Security Nat. Mortg. Loan Trust 2002–2*, (2008) 167 Cal.App.4th 544, 553 ("A modification of a contract is a change in the obligations of a party by a subsequent mutual agreement of the parties."). Sheen satisfied none of these criteria and does not mention any applicable exception to the Statute of Frauds.

While no California case could be found expressly holding that a charge-off is within the scope of a financial institution's conventional role as lender, the point is nonetheless obvious since the charge-off is an accounting tool for the benefit of the lender and does not alter or amend the borrower's liability on the loan or the lender's right to enforce that loan. *Cavalry SPV I, LLC v. Watkins*, (2019) 36 Cal. App. 5th 1070, 1075, fn.1 (*citing to Frost v. Resurgent Capital Servs., L.P.*, 2016 WL 3479087, at *1 (N.D. Cal., June 27, 2016). *See also Gonzales v. Specialized Loan Servicing, L.P.,* 2020 WL 2992175 at *6 (E.D. Cal. June 4, 2020), where the court rejected plaintiff's negligence claim that a servicer breached "a duty of care to exercise reasonable skill and servicing the…Loan and ensuring that she would not be subject to wrongful foreclosure" by seeking to foreclose on a charged-off loan. The court held: "even accepting this duty, there is no plausible claim alleged. As discussed above, the fact that the…Loan may have been

'charged off' does not make it unenforceable or no longer legally binding. [citation omitted] That is, a loan that is 'charged off' may still be legally collected upon." Notably, Petitioner concedes his Loan remained collectible despite the charge off—he just *assumed* it "somehow" also meant his Loan was now unsecured and there could be no foreclosure, even though no such representation was made in any of the correspondence. [AOB at 21-23] In any event, Respondent was not the entity who foreclosed here nor is it claimed to have participated in that foreclosure, or to have made any representation as to what a future assignee of the Loan might do.

C. <u>Contract Issues Should Not Give Rise to Tort Claims</u>:

It bears repeating that the relationship at issue here is a contractual one and the conduct complained of, concerning an application for a loan modification, a charge-off, and a foreclosure, arises entirely out of that contractual relationship. None of the cases cited by Petitioner hold that parties negotiating an original loan contract owe a negligence duty of care in conducting those negotiations and, as noted by the Court of Appeal in *Sheen v. Wells Fargo Bank, N.A.,* (2019) 38 Cal.App.5th 346, 356-57, "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.)." [emphasis added] The only

distinction to be found as to a modification is that the parties are already in the contractual relationship and are governed by its terms.

It is this distinction that cases following *Alvarez* rather than *Lueras* tend to tout, claiming that: "The borrower's lack of bargaining power, coupled with conflicts of interest that exist in the modern loan servicing industry, provide a moral imperative that those with the controlling hand be required to exercise reasonable care in their dealings with borrowers seeking a loan modification." *Alvarez, supra,* at 949. However, this reasoning ignores the reality that loan servicing is heavily regulated to minimize that risk and that there are no actual conflicts created by the servicer's role in the negotiation—the parties all know that the servicer represents the interests of the owner of the loan, not those of the borrower. The argument that a servicer has a negative incentive as it might make more by shoddy performance of its duties [*Id.*] is one that is not only entirely speculative but, again, ignores the heavily regulated nature of the industry, as well as the fact that servicers must follow any guidelines or contractual obligations imposed by the owner of the loan--and routinely negligent or incompetent servicers would not tend to be hired as they would increase the risk to the owner, while intentional misconduct by the servicer would be actionable by the borrower under existing law as violating an independent duty. Conversely, imposing such a vague "duty of care" on the standard relationship between a borrower and a lender or servicer just provides more

incentive for defaulting borrowers to try to game the system by tying up enforcement of the loan through expensive and time-consuming litigation.

In *Applied Equipment Corporation v. Litton Sandi Arabia Limited*, (1994) 7 Cal. 4th 503, 514, this Court recognized that: "Contract and tort are different branches of law. Contract law exists to enforce legally binding agreements between parties; tort law is designed to vindicate social policy." The Court then went on to note that: "Conduct amounting to a breach of contract becomes tortious only when it also violates an independent duty arising from principles of tort law." *Id.* at 515. Although the Court was specifically addressing the issue of whether a party to a contract could be held liable for conspiracy to interfere with its own contract, many of the same precepts apply to the negligence claim at issue here as well. "Within the different spheres of contract and tort, motivations for conduct are also treated differently. In an intentional tort action, motives amounting to malice, oppression, or fraud may justify punitive damages. (Civ.Code, § 3294.) But the law generally does not distinguish between good and bad motives for breaching a contract." *Id.* at 516. "The imposition of tort liability in these circumstances also thwarts legal rules and policies limiting contract damages to those sums reasonably foreseeable to the contracting parties." *Id.* at 517. "A breaching party already has a legal incentive to perform—the likely prospect of liability for breach of contract. We perceive no additional value, and significant additional uncertainty, from the

imposition of tort damages on a contracting party in this instance." *Id.* at 520.

Petitioner, of course, will point to his argument that he did not claim Respondent breached its contract or violated any contractual duty [AOB at 52; Reply at 12] but that ignores the reality that the conduct upon which he seeks to rely is inherently contractual in nature, whether it be a modification of the terms of the existing Loan or a charge-off of that loan when it becomes non-performing, or a foreclosure based on that default. It is irrelevant to the question of whether his remedy lies in tort or contract whether he could prevail on a breach of contract claim under the specific facts of this case. *See Lueras, supra,* at 68:

> Lueras's allegations that Bank of America and ReconTrust owed him duties to "follow through on their own agreements," to comply with consumer protection laws, and to stop foreclosure sales that were unlawful fail to state a cause of action for negligence because such duties, if any, are imposed by the loan documents and the Forbearance Agreement, statutes, or regulations. If Bank of America and ReconTrust failed to "follow through" on those agreements, then **Lueras's remedy lies in breach of contract, not negligence.**[4]

[emphasis added] Nonetheless, Petitioner urges [Reply at 12]:

"Even though Sheen is in privity with Wells, he has no contract remedy **because Wells' conduct didn't violate their loan contract**.

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[4] The court noted defendants would be liable in tort for any misrepresentations. *Id.*

So unless Sheen can sue in tort, he won't have any remedy at all." [emphasis added] This presumes that there was in fact a wrong committed here but, also, ignores the possibility of other available claims which would not be precluded by the parties' contractual relationship *if the facts existed to support them*, *e.g.* estoppel and misrepresentation.

Petitioner concedes the facts of his case do not support these other potential claims [Reply at 31-33]; however, that does not warrant shoe-horning his facts into another cause of action or creating a remedy where none exists—especially where, as here, extensive statutory and regulatory schemes exist governing loan servicing in general and the loan modification and foreclosure processes in particular.[5] In *Kajima/Ray Wilson v. Los Angeles County Metropolitan Transp. Authority,* (2000) 23 Cal.4th 305, 317, this Court cautioned: "prudence is warranted whenever courts fashion damages remedies in an area of law governed by an extensive statutory scheme." Or, as Justice Arabian memorably stated in his concurrence in *Moore v. Regents,* (1990) 51 Cal.3d 120, 150: "Courts cannot and should not seek to fashion a remedy for

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[5] In addition to the California Homeowners' Bill of Rights (which was enacted after Respondent assigned its interest in the Loan), an extensive body of federal regulations applies, including those crafted by the CFPB under the Dodd-Frank Act.

every ‘heartache and the thousand natural shocks that flesh is heir to.’ Sometimes, the discretion of forbearance is the better part of responsive valor.”

Perhaps with the precept in mind, this Court held in *Erlich. supra*, at 552: “‘[C]ourts will generally enforce the breach of a contractual promise through contract law, except when the actions that constitute the breach violate a social policy that merits the imposition of tort remedies.’” The Court went on to explain, at 553–54:

> Our previous decisions detail the reasons for denying tort recovery in contract breach cases: the different objectives underlying tort and contract breach; the importance of predictability in assuring commercial stability in contractual dealings; the potential for converting every contract breach into a tort, with accompanying punitive damage recovery, and the preference for legislative action in affording appropriate remedies. [citations omitted] The same concerns support a cautious approach here. Restrictions on contract remedies serve to protect the “ ‘freedom to bargain over special risks and [to] promote contract formation by limiting liability to the value of the promise.’ ” [citations omitted]
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> Generally, outside the insurance context, “a tortious breach of contract ... may be found when (1) the breach is accompanied by a traditional common law tort, such as fraud or conversion; (2) the means used to breach *554 the contract are tortious, involving deceit or undue coercion or; (3) one party intentionally breaches the contract intending or knowing that such a breach will cause severe, unmitigable harm in the form of mental anguish, personal hardship, or substantial consequential damages.” [citation omitted] Focusing on intentional conduct gives substance to the proposition that a breach of contract is tortious only when some independent duty arising from tort law is violated. [citation omitted] **If every negligent breach of a contract gives rise to tort damages the limitation would be meaningless, as would**

the statutory distinction between tort and contract remedies.

[emphasis added] *Accord Robinson Helicopter Co. v. Dana Corp.,* (2004) 34 Cal.4th 979, 989-92; *Rufini v. CitiMortgage, Inc.,* (2014) 227 Cal.App.4th 299, 311. The *Erlich* opinion specifically stated, at 554, that: "[I]t is sufficient to note that more than mere negligence has been involved in each case where tort damages have been permitted."

Petitioner seeks to subvert that holding by arguing mere negligence is enough but no violation of any existing social policy exists to warrant imposing a negligence duty for the ordinary servicing of a loan, particularly where, as here, it is based on the claimed withholding of additional information that the borrower never requested and that the lender/servicer had no contractual or statutory obligation to disclose in the type of communications at issue. Petitioner already knew from the terms of the Deed of Trust he signed that foreclosure was one of the remedies Respondent could pursue in the event of an uncured default. His complaint is that it should have reminded him of that possibility in sending the charge-off letters to him and in informing his wife that the existing foreclosure would not proceed.

Although, here, Respondent was both the lender and servicer, the expansion of tort liability poses an even greater concern where the entity against whom negligence is sought to be raised is just a third party servicer.

As this Court recently held in *Goonewardene v. ADP, LLC,* (2019) 6 Cal.5th 817, 839-41 (rejecting, at 821, the imposition of tort liability on a payroll company accused of not paying compensation due to a client's employee as "neither necessary nor appropriate."): (1) the plaintiff in that action was already adequately protected by existing statutory remedies, (2) tort liability was not needed to deter negligent conduct by defendant, (3) there was no special relationship between plaintiff and defendant, (4) imposition of tort liability "may improperly distort [defendant's] performance of its contractual obligations…in at least some circumstance", and (5) imposition of a tort duty of care "is likely to add an unnecessary and potentially burdensome complication to California's increasing volume of…litigation [in this area]." Most, if not all, of these considerations are present here as well: (1) There is already a well-spring of State and Federal regulations governing loan servicing, (2) the addition of a negligence claim would not further deter negligent conduct by a lender/servicer or foreclosure trustee above existing remedies (indeed, an independent servicer or trustee who fails to properly perform its duties would be subject to regulatory penalties, investor indemnifications and would soon find it difficult to obtain new work), (3) as noted above, the cases make clear there is no "special relationship" between a borrower and

its lender/servicer[6], (4) the imposition of a tort duty of case would potentially distort the economic relationship between the independent servicer or trustee and the lender, and (5) the Court hardly needs to be reminded of the existing glut of borrower-lender/servicer litigation.

Moreover, as this Court also observed in *Foley v. Interactive Data Corp.,* (1988) 47 Cal.3d 654, 694 (in declining to expand tort liability to encompass breaches of the implied covenant of good faith and fair dealing):

> The issue is how far courts can or should go in responding to these concerns regarding the sufficiency of compensation by departing from long established principles of contract law. Significant policy judgments affecting social policies and commercial relationships are implicated in the resolution of this question in the employment termination context. Such a determination, which has the potential to alter profoundly the nature of employment, the cost of products and services, and the availability of jobs, arguably is better suited for legislative decisionmaking.

See Southern California Gas Leak Cases, (2019) 7 Cal.5th 391, 413 (“*Gas Leak Cases”*): "[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." In other words, the Legislature, not the courts, is in the best position to decide on whether to expand tort liability for matters that are properly governed by the parties’

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[6] Even more so, there is no special relationship between the foreclosure trustee and the borrower; rather it is entirely governed by contract and statute. *Hatch v. Collins,* (1990) 225Cal.App.3d 1104, 1111-12; *Stephens, Partain & Cunningham v. Hollis*, (1987) 196 Cal.App.3d 948, 955.

contract, particularly where, as here, the determination "has the potential to alter profoundly the nature of" the borrower-lender relationship, the costs—and risks—of lending, and the availability of loans and loan modifications.

D. **The *Biakanja* Test is Inapplicable to Parties in Privity of Contract:**

It is too frequently forgotten, in applying the *Biakanja* test, that the genesis and crux of that ruling is: "The determination whether in a specific case the defendant will be held liable *to a third person not in privity*" [emphasis added] which this Court found to be "a matter of policy…[involving] the balancing of various factors, among which are the extent to which the transaction was intended to affect the plaintiff, the foreseeability of harm to him, the degree of certainty that the plaintiff suffered injury, the closeness of the connection between the defendant's conduct and the injury suffered, the moral blame attached to the defendant's conduct, and the policy of preventing future harm." *Biakanja, supra,* at 630; *accord Goonewardens, supra,* at 838. In other words, the test is used to provide a potential means of recovery for defects in the performance of a contract where there is no contractual relationship between the plaintiff and defendant. *See Tobon v. Nationstar Mortgage LLC,* 2017 WL 8114978 at *4, n.3 (C.D. Cal. April 4, 2017)("[The *Biakanja*] test was not meant to be used as a means of creating tort liability between two parties in contractual privity; its application makes no sense

under such circumstances.); *Neuda v. Wells Fargo Bank, N.A.*. 2016 WL 10987366 at *6 (C.D. Cal. Nov. 18, 2016). The reality is that there is no need to find a "special relationship" using the *Biakanja* factors where the parties already have a *contractual* relationship.[7]

Unfortunately, some courts have ignored that purpose and treated the *Biakanja* factors as being applicable even to cases where there was privity between the parties. *See, e.g., Ott v. Alfa-Laval Agri, Inc.*, (1995) 31 Cal.App.4th 1439, 1450, 1454; *accord North American Chemical Co. v. Superior Court,* (1997) 59 Cal.App.4th 764, 783. However, those cases build upon a series of faulty assumptions. Thus, in *Ott, supra,* at 1448, the court purported to rely on this Court's holding in *J'Aire Corp. v. Gregory*, (1979) 24 Cal.3d 799, 809 but conceded that *J'Aire* did not involve parties in privity before nonetheless concluding *without analysis* that the reasoning of *J'Aire* was "wholly incompatible" with a limitation to parties not in privity. As support for this leap, *Ott* relied on the holding in *Pisano v. American Leasing,* (1983) 146 Cal.App.3d 194, 196, a case where the parties were in privity; however, the *Pisano* opinion makes no reference to the concept of privity, nor does it apply the *Biakanja* factors. *North American Chemical,* in turn, just relied on the flawed analysis of *Ott* and

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[7] *Connor, supra,* at 865, involved an unusual situation where there was a contractual relationship between defendant and some plaintiffs but the negligence claim at issue did not arise out of that contract.

the assumptions *Ott* made about *J'Aire* and *Pisano.* Like a child's game of "telephone," the original message of *J'Aire* got more garbled with each retelling. Notably, *Ott* did *not* itself involve parties in privity of contract. 31 Cal.App.4th at 1444. *See R Power Biofuels, LLC v. Chemex LLC,* 2016 WL 6663002 at *6-7 (N.D. Cal. Nov. 11, 2016)(distinguishing *Ott* and *Pisano*). No cogent rationale for extending *J'Aire* to cases where the parties are in privity of contract is provided by these cases.

Although, in *Aas v. Superior Court,* (2000) 24 Cal.4th 627, 645, this Court noted that the lower courts in the foregoing cases had expanded the reach of *J'Aire* to situations where the parties were in privity, it neither approved nor disapproved of that expansion. Instead, the Court declined to extend *J'Aire* to claims for construction defects that had not caused any property damages, stating, at 653: "the facts of this case do not present a sufficiently compelling reason to preempt the legislative process with a judicially created rule of tort liability." Indeed, that legislative process is precisely what happened in response to *Aas. See Gas Leak Cases, supra*, at 402, citing to *Rosen v. State Farm General Ins. Co.,* (2003) 30 Cal.4th 1070, 1079-1080.

Neither *Alvarez, supra*, at 945-50 nor *Jolley, supra*, at 899-901 support the expansion of *Biakanja* to cases where the parties are in privity of contract. Although both cases involved parties who were in privity, neither case analyzed whether privity was a bar to the use of the *Biakanja*

factors to impose tort liability. They both just assumed they should apply the test, in part based on their rejection of any assertion that *Nymark* stood for the proposition that a lender *never* owes a duty of care to a borrower. While it is true that *Nymark, supra*, at 1098-1100, also applied the *Biakanja* factors to the conduct at issue there, *Nymark* also failed to consider whether the test was even applicable to parties in privity. Moreover, the court there seems to have applied the test as a "belt and suspenders" backing for its holding that there was no duty of care owed as the conduct complained of did not exceed the scope of its conventional role as lender rather than a necessary prerequisite to that determination. *Id.* at 1099: "Application of these factors to the circumstances here supports our conclusion that defendant did not owe a duty of care to plaintiff." [emphasis added]

Even conceding that *Nymark* and its progeny [*See Das, supra,* and cases cited therein] merely establishes a "general rule" of non-liability for negligence, routinely requiring the application of the *Biakanja* factors to every transactional dispute between a financial institution and its customer risks having the exception swallow the rule and involving the courts in a detailed analysis of those transactions, requiring it to make numerous subjective judgments.[8] As the court of appeal held in the recent case of

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[8] By the same "logic," if Petitioner's position were accepted as the law, the *Biakanja* factors could be invoked in any other debtor-creditor

Kurtz-Ahlers, LLC v. Bank of America, N.A., (2020) 48 Cal.App.5th 952, 961: "We decline Kurtz-Ahlers's invitation to engage in a careful weighing of "the *Biakanja/Rowland* factors" ….In other words, we see no need to engage in a point by point consideration of those factors to arrive at the conclusion public policy does not weigh in favor of recognizing the new bank duty Kurtz-Ahlers urges us to adopt."

E. <u>Under the Economic Loss Rule, Tort Claims are Unavailable Here</u>:

In the *Gas Leak Cases, supra,* at 407, this Court cited with approval the analysis of the current Restatement of Torts concerning, stating:

> 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).)
>
> In justifying that position, the Restatement echoes widespread judicial concern that purely economic losses "proliferate more easily than losses of other kinds" and "are not self-limiting" in the same way. (Restatement T.D. 1, § 1, com. c.) Those characteristics, the Restatement explains, threaten "liabilities that are indeterminate and out of proportion to [a defendant's] culpability," and with them "exaggerated pressure to avoid an activity altogether." (Restatement T.D. 1, § 1, com. c.) ….
>
> **Only when the foregoing considerations are "weak or absent" — such as in *Biakanja* and *J'Aire*, but not in *Bily* — does a duty to guard against purely economic losses**

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arrangement, including landlord-tenant matters, where the debtor or tenant was seeking to modify the terms of their existing agreement.

> **exist under the Restatement approach to negligence claims.** (See Restatement T.D. 1, supra, § 1, com. d; see also Restatement T.D. 2, supra, § 7, com. A….)

> More specifically, in *Aas, supra,* at 636, this Court observed:

> For defective products *and negligent services* that have caused neither property damage nor personal injury, however, tort remedies have been uncertain. Any construction defect can diminish the value of a house. But the difference between price paid and value received, and deviations from standards of quality that have not resulted in property damage or personal injury, are primarily the domain of contract and warranty law or the law of fraud, rather than of negligence. In actions for negligence, a manufacturer's liability is limited to damages for physical injuries; no recovery is allowed for economic loss alone. [citation omitted] This general principle, the so-called economic loss rule, is the primary obstacle to plaintiffs' claim.

[emphases added] This Court then went on to reject the petitioner's argument that the "negligent breach of contractual duties owed directly to plaintiffs to deliver homes in compliance with the applicable building codes is a tort, for which plaintiffs may recover…." *Id.,* at 643, declaring: "The argument is not persuasive. A person may not ordinarily recover in tort for the breach of duties that merely restate contractual obligations. Instead, '"[c]ourts will generally enforce the breach of a contractual promise through contract law, except when the actions that constitute the breach violate a social policy that merits the imposition of tort remedies."' (*Erlich v. Menezes, supra*, 21 Cal.4th 543, 552…." *Id.* This Court then summed up the effect on the Economic Loss Rule as follows: "As we have explained, whether the economic loss rule applies depends on whether

property damage has occurred rather than on the possible gravity of damages that have not yet occurred." *Id.* at 650. *See also Robinson Helicopter, supra,* at 988, where this Court asserted: "The economic loss rule requires a purchaser to recover in contract for purely economic loss due to disappointed expectations, unless he can demonstrate harm above and beyond a broken contractual promise. [Citation.] Quite simply, the economic loss rule 'prevent[s] the law of contract and the law of tort from dissolving one into the other.' [Citation.]"; *accord Food Safety Net Services v. Eco Safe Systems USA, Inc.,* (2012) 209 Cal.App.4th 1118, 1130 (applying the Rule to a services contract). Petitioner misinterpret *Robinson Helicopter*, *supra*, at 988, as supporting his argument that ordinary negligence is a viable claim even where the parties are in privity of contract [Reply Brief at 7, 22, and 25]; however, a review of this Court's opinion makes clear the finding the Economic Loss Rule did not apply was limited to *intentional* torts that violated an independent duty. *Robinson Helicopter*, *supra*, at 991-92.

In *Sheen* neither property damage nor personal injury resulted from Respondent's conduct and no intentional tort is alleged so there is no basis for abrogating the Rule.

As the Court of Appeals noted in its opinion: "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*, at 402.) Here we have a financial transaction gone awry and nothing more: Sheen suffered neither personal injury nor property damage." *Sheen, supra*, at 354.[9] *See also Food Safety Net Services, supra,* applying the Economic Loss Rule to bar claims for fraud in connection with a services contract. This amicus brief also adopts and incorporates by reference the Court of Appeals thorough analysis of the issues in *Sheen, supra,* at 352-58.

There are cases, though, that have sought to carve out an exception to the Economic Loss Rule where the transaction involves the provision of services rather than the sale of goods. *See, e.g., North American Chemical Co., supra,* at 783-85 (which, as discussed above, relies on the flawed statements in *Ott* and *Pisano*), stating, at 785:

> A contract for the performance of services, as we have already discussed, necessarily carries with it both the reasonable expectation and implied at law promise that it will

[9] The court in *Weimer, supra*, at 364-65 rejected the analysis of *Sheen,* in part on the basis that it supposedly ignored the "special relationship" exception discussed in the *Gas Leak Cases*; however, for the reasons discussed above, the "special relationship" exception should have no application to parties in privity. However, *Weimer* has also been accepted for review by this Court and is being held pending resolution of *Sheen.* Moreover, unlike cases involving insurance or professional services, there is no "special relationship" inherent in the dealings between a borrower and lender (nor a servicer nor trustee). It is only by applying the *Biakanja* factors as a matter of course and/or indulging in the fiction that a modification is not part of the lender's conventional role that cases have found any "special relationship" exists.

> be performed with reasonable care. Thus, in negligent performance cases, the reasoning of *J'Aire* and the six criteria on which it relies will determine the existence of the necessary special relationship and it does not matter whether the plaintiff and defendant are in privity or not. In addition, if those six criteria are satisfied the plaintiff will be entitled to recover economic loss damages without the need to allege and prove personal injury or property damage.

However, this distinction between goods and services contracts makes no logical sense—a contract for goods also generally contains a "reasonable expectation and implied at law promise that it will be performed with reasonable care," at least as to the goods being delivered on time and in good condition, suitable for the purpose for which they were sold. *See, e.g., Aced v. Hobbs-Sesack Plumbing Co.,* (1961) 55 Cal.2d 573, 582 (discussing implied warranties); *Gutierrez v. Carmax Auto Superstores California,* (2018) 19 Cal.App.5th 1234, 1246-48 (implied warranties under the Song-Beverly Act).

As to the notion that *J'Aire* should be applied as a matter of course, as mentioned previously, where, as here, the parties are already in a relationship and there is also no need to determine whether a "special relationship" exists so as to provide "standing" for the supposedly injured party to sue. Further, such an arbitrary division runs afoul of the reasoning of this Court's cases concerning the propriety of invoking tort claims for contractual disputes and/or purely economic damages. This Court explained why this must be so in the *Gas Leak Cases, supra,* at 401-02:

> Our subsequent decision in *Bily*, 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*. (*Bily, supra*, 3 Cal.4th at p. 397….)

[emphasis added]

> In requiring more than mere foreseeability for imposing a duty of care in Bily, we appreciated the need to safeguard the efficacy of tort law by setting meaningful limits on liability. (Bily, supra, 3 Cal.4th at pp. 398-399….)….So although exposure to liability often provides an important incentive for parties to internalize the social costs of their actions, we were concerned that allowing the countless people who rely on public audit reports to recover "pure economic loss suffered" due to a shoddy audit would "raise[ ] the spectre of vast numbers of suits and limitless financial exposure." (*Bily*, at p. 400, ….) The resulting universe of potential claims would not only raise difficult line-drawing questions for courts, it might deter socially beneficial behavior.
>
> ….
>
> More fundamentally, purely economic losses flowing from a financial transaction gone awry — which were at issue in *Biakanja, J'Aire, Bily*, and our other negligence cases to date about purely economic losses — "are primarily the domain of contract and warranty law or the law of fraud, rather than of negligence." (*Aas v. Superior Court* (2000) 24 Cal.4th 627, 636….)….

See also Kurtz-Ahlers, LLC, supra, at 959-60 (holding that bank owed no duty to a customer to monitor another customer's account and warn about suspicious activity).

In *Elsayed v. Maserati North America, Inc.,* (2016) 215 F.Supp.3d 949, 963, the court provided an excellent explanation of why the economic loss rule applies to contracts involving services as well as goods:

> Plaintiff misunderstands the special relationship exception to the economic loss doctrine. The underlying purpose of the special relationship exception is to define particular "circumstances in which a party has a duty of care to avoid imposing economic losses on third parties." *Mega RV Corp. v. HWH Corp.*, 225 Cal.App.4th 1318, 1340….
>
> The Court refuses to extend the special relationship exception to encompass direct relationships. In *J'Aire Corp. v. Gregory*, 24 Cal.3d 799, 1…(1979), the California Supreme Court articulated a six factor test for the presence of a special relationship: "(1) the extent to which the transaction was intended to affect the plaintiff, (2) the foreseeability of harm to the plaintiff, (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." Id. at 804,…. Those factors make clear why extension to direct relationships is unwarranted. The first, second, and fourth J'Aire factors would almost always find a special relationship between directly-contracting parties: the transaction would always be intended to affect the plaintiff, the harm would nearly always be foreseeable, and the connection between the defendant's conduct and the injury would always be close. Such a result is directly contrary to the special relationship's status as a narrow exception to the economic loss doctrine. *See, e.g., Zamora v. Shell Oil Co*., 55 Cal.App.4th 204, 211, …(1997) ("*J'Aire* sets forth a limited exception to the general rule ...."). Furthermore, implicit in the fifth and sixth *J'Aire* factors is the test's applicability to third parties: moral blame and preventing future harm is tied to shifting harms to defenseless third parties.

Accord Body Jewelz, Inc. v. Valley Forge Ins. Co., (C.D. Cal. 2017) 241 F.Supp.3d 1084, 1092-93 (Observing also that: "Beyond these considerations, public policy also favors broad imposition of the economic loss rule. Allowing parties to essentially recover for breach of contract in

tort undermines the "predictability" that parties seek when they enter into a contract."). *See also Kurtz-Ahlers, LLC, supra,* at 959-61.

Here, too, it is of no moment whether a borrower could prevail on a contract remedy, or even on any other type of tort claim based on a misrepresentation or other wrongful conduct. The issue is whether the Economic Loss Rule should apply equally to services as it does to goods where there has been no personal injury or property damage as a result of the claimed negligent performance of the parties' contract.

F. Public Policy Considerations Caution Against Extending Tort Liability to Claims Arising Out of Mortgage Loan Servicing:

As this Court reiterated in the *Gas Leak Cases*, *supra*, at 401, quoting from its earlier holding in *Bily, supra*, at 397: "Deciding on whether to impose a duty of care turns on a careful consideration of the 'sum total' of the policy considerations at play, not a mere tallying of some finite one-size-fits all set of factors." In the present case, there are several important public policy considerations that strongly warrant *against* imposing a tort law "duty of care" in mortgage loan servicing—*including* modification negotiations:

1. Specifically tailored legislative and regulatory solutions are available that are far better suited to protect all parties in loan servicing disputes than the blunt instrument of tort law litigation.

In the *Gas Leak Cases*, *supra*, at 413, this Court concluded that, in certain circumstances, where the "ripple effects" of the problem at issue in

an "interconnected economy" defy judicial creation of more finely tuned rules, legislative remedies may provide better solutions than imposition of tort duties. In the opinion below, the Court of Appeal agreed and specifically acknowledged the value of legislative solutions in the "mortgage modification field," as follows:

> 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, 201 Cal.Rptr.3d 390 [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. (Emphasis added.)

38 Cal.App.5th at 358.

The circumstances here are exactly those where, "through 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*, at 413; *see also* Respondent's arguments at pp. 40-46 of its Answering Brief: "[b]ecause mortgage

servicing in general, and mortgage modification in particular, is intensely regulated, further obligations should come from the Legislature…."

The Answering Brief, at pp. 41-42, sets forth in some detail a list of both California state laws and federal regulatory provisions particularly applicable to the loan modification process. That list need not be repeated here (but is incorporated by reference) but provides ample evidence that existing legislative and regulatory developments have already radically transformed the "mortgage servicing landscape" from what is bleakly described in the old articles cited in Petitioner's Opening Brief---most of which were written before California's enactment its Homeowner's Bill of Rights ("HOBR") in 2013 and before the federal Consumer Financial Protection Bureau ("CFPB") promulgated its 753 page "Mortgage Servicing Rules" that took effect in 2014.[10] Thus, it is clear that the legislative and regulatory bodies can and will act to provide borrower protections where a need is perceived.

Under HOBR, there are extensive "process" protections for borrowers in loan modification negotiations including detailed requirements for: (a) servicer notification to borrowers of their foreclosure-prevention options (Civil Code §§ 2923.55 and 2924.9); (b) servicer provision of a single point of contact for borrowers (Civil Code § 2923.7);

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[10] A copy of the CFPB Mortgage Servicing Rules can be found at https://files.consumerfinance.gov/f/201301_cfpb_final-rule_servicing-respa.pdf

(c) servicer acknowledgment of borrowers' application materials and notification of any errors in same (Civil Code § 2924.10); (d) limitations on fees that can be charged for applications (Civil Code § 2924.11); (e) prohibition of "dual tracking" (Civil Code §§ 2923.6 and 2924.11); (f) continuation of borrower rights upon transfer of the loan to another servicer (Civil Code § 2924.11); (g) servicer verification of foreclosure documents and of the servicer's right to foreclose by accurate, complete and reliable evidence of the loan's status and the servicer's right to foreclose (Civil Code § 2924.17); and (h) tenant rights after foreclosure (Code of Civil Procedure § 1161(b)).

Although many of HOBR's provisions do not extend to "second loans," the legislative history indicates that this was intentional for a variety of reasons. (Answering Brief at 42.) However, when the California Legislature has determined that adjustments and/or extensions to HOBR protections are needed, it has not hesitated to act with speed and effectiveness. *See e.g.*, the recently enacted "Tenant, Homeowner, and Small Landlord Relief and Stabilization Act of 2020," extending HOBR protections to first liens on 1-4 residential dwellings, among other modifications.[11]

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[11] This was enacted on August 31, 2020. Sections 11-13 extend the protections of HOBR to first lien borrowers on mortgage loans secured by tenant-occupied 1-4 residential dwellings and make other modifications to the loss mitigation provisions of HOBR to assist borrowers and their tenants impacted by the

As noted above, at the federal level there are even more extensive protections for consumers in loan modification negotiations in the CFPB's Mortgage Servicing Rules, which cover "federally related" mortgage loans (most mortgage loans in the United States), <u>including so-called "second" loans</u> (other than home equity lines of credit; i.e. "HELOCS"), that are secured by "junior" deeds of trust.[12] These protections are extraordinarily comprehensive and have been put in place through a lengthy legislative and deliberative process. They reflect the input and analysis of hundreds, if not thousands, of industry stakeholders at every level and from every corner of the mortgage marketplace, particularly from consumer groups who presumably understand the needs of their members. They are supported by historical data, academic research and "experience on the ground," and are being continually refined and updated, with extensive commentary, to reflect changed/updated circumstances in the mortgage marketplace and the economy overall. As stated in the preface to the Mortgage Servicing Rules:

> The Bureau of Consumer Financial Protection is amending Regulation X, which implements the Real Estate Settlement Procedures Act of 1974, and implementing a commentary that sets forth an official interpretation to the regulation. The final rule implements provisions of the Dodd-Frank Wall Street

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pandemic. Significantly, even though this legislation offered a clear opportunity to extend HOBR's loss mitigation protections to "second" lien borrowers like Petitioner, the legislature again elected not to do so. This reinforces the observation at the bottom of page 42 of the Answering Brief that HOBR's "limited scope was intentional."

[12] See 12 CFR §1024.31

> Reform and Consumer Protection Act regarding mortgage loan servicing. Specifically, this final rule implements Dodd-Frank Act sections addressing servicers' obligations to correct errors asserted by mortgage loan borrowers; to provide certain information requested by such borrowers; and to provide protections to such borrowers in connection with force-placed insurance. Additionally, this final rule addresses servicers' obligations to establish reasonable policies and procedures to achieve certain delineated objectives; to provide information about mortgage loss mitigation options to delinquent borrowers; to establish policies and procedures for providing delinquent borrowers with continuity of contact with servicer personnel capable of performing certain functions; and to evaluate borrowers' applications for available loss mitigation options. Further, this final rule modifies and streamlines certain existing servicing-related provisions of Regulation X. For instance, this final rule revises provisions relating to mortgage servicers' obligation to provide disclosures to borrowers in connection with transfers of mortgage servicing, and mortgage servicers' obligation to manage escrow accounts, including restrictions on purchasing force-placed insurance for certain borrowers with escrow accounts and requirements to return amounts in an escrow account to a borrower upon payment in full of a mortgage loan. Concurrently with the issuance of this final rule, the Bureau is issuing a rule implementing amendments relating to mortgage servicing to the Truth in Lending Act in Regulation Z." (Emphasis added.) (Federal Register, February 14, 2013, p. 10696 et seq.)

Under 12 U.S.C. § 2605 there is also a private right of action under which whoever fails to comply with these provisions is liable to the borrower for each such failure. In the case of individuals, this includes "actual damages to the borrower," and in the case of a "pattern or practice" of noncompliance, any *additional* damages as the court may allow in an amount up to and including $2,000. In class actions, violators are also liable for the actual damages of each borrower in the class, plus in the case

of “pattern or practice” violations, additional damages as the court may allow up to and including $2,000 for each class member up to the lesser of $1million dollars or 1% of the servicer’s net worth. Prevailing plaintiffs may also recover costs and reasonable attorney’s fees.

2. Supervisory Enforcement by State and Federal Regulators Provides Superior Protection to Tort Law

In addition to these robust statutes and regulations, even more potent protection is available to borrowers in the form of regulatory supervision and enforcement at both the federal and state levels. As a result of the 2008 financial crisis, there have been a dramatic increases in the authority, power and aggressiveness of these governmental authorities to not only detect and redress harm to individuals but also, through licensing restrictions and supervisory examination and administrative enforcement proceedings, to punish wayward lenders and servicers (and their officers and managing agents) by curtailing or even terminating their right to do business. Through these means, individual regulatory violations are identified, and their redress tracked and mandated.

At the federal level, the CFPB was created by the “Consumer Financial Protection Act” (“CFPA”) signed into law as Title X of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) Pub.L. 111-203, 124 Stat. 1376-2223. (*See* 12 U.S.C. § 5481 et seq.). Under Dodd-Frank, the CFPB was allocated hundreds of millions of dollars annually to identify and enforce violations of the robust new

consumer protection rules discussed above.[13] Since its inception, the CFPB has come to exercise extraordinarily sweeping authority and control over all aspects of mortgage lending and servicing throughout the United States, including especially the process of borrowers' negotiations with their lenders and servicers over loan modifications. *See* CFPB website: https://www.consumerfinance.gov/policy-compliance/guidance/mortgage-resources/mortserv/ which also includes a link to the CFPB's mortgage servicing examination procedures.[14]

Under Dodd-Frank, the CFPB has the power to exercise both supervisory and enforcement authority over not just large depository institutions, but also non-depository "covered persons" of any size in any jurisdiction who are defined to include any person who "engages in offering or providing a consumer financial product or service" in any of the eleven categories found in § 5481(15), including but not limited to servicing of loans. Under that authority, CFPB has broad authority to investigate alleged violation of federal consumer protection laws, issue civil investigative demands, and enforce all of the regulations referenced above, as well as "unfair, deceptive, or abusive acts or practices" (Dodd-Frank §

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[13] According to the CFPB's annual budget report, which can be found at www.consumerfinance.gov/about-us/budget-strategy, its official budget for FY 2020 is $580.1 million, with transfers from the Federal Reserve for 2020 "capped" at $695.9 million.

[14] A copy of the pertinent portion of CFPB's "Examination Procedures" for mortgage loan servicers pertaining to "Loss Mitigation, Early Intervention, and Continuity of Contact" accompanies this brief as Appendix A.

1031), by administrative proceeding or court action and to obtain both legal and equitable relief, including:

(A) rescission or reformation of contracts;

(B) refund of moneys or return of real property;

(C) restitution;

(D) disgorgement or compensation for unjust enrichment;

(E) payment of damages or other monetary relief;

(F) public notification regarding the violation, including the costs of notification;

(G) limits on the activities or functions of the person; and

(H) civil money penalties.

See 12 U.S.C. § 6656(a).

In addition, as part of its supervisory and enforcement activities, the CFPB maintains a robust internet "complaint" portal at www.consumerfinance.gov/complaint through which individual consumers can directly elicit immediate help from the CFPB and its vast resources free of charge, as well as a separate "whistleblower tip line" portal for current or former employees to report violations by their employers. As the CFPB's website attests, complaints through these portals are acted upon quickly and the progress of their resolution tracked until resolution.

The supervisory and enforcement authority of the CFPB, as well as the "self-reporting" obligations built into its regulations, provide powerful

incentives for servicers to redress consumer complaints in real time to avoid regulatory penalties that can cripple the ability of their entire business to operate. This stands in sharp contrast to the disincentives a borrower might have to avoid prompt resolution through tort litigation, in which resolution of borrower claims can be bogged down in expensive litigation for years until a final judgment, often allowing the borrower to continue to reside in the property "free of charge."

At the state level, the California Department of Real Estate ("DRE") and Department of Business Oversight ("DBO"), through their power to conduct examinations, issue and revoke licenses, and exercise enforcement authority over mortgage loan servicers, likewise serve as effective "policemen" of alleged misconduct in the negotiation *process* for mortgage loan modifications. The DBO for example, has broad authority over its licensees to supervise and enforce not only violations of HOBR but also the same federal servicing laws and regulations as the CFPB. *See e.g*. Financial Code § 50130(g) which requires mortgage servicer licensees to comply with all applicable requirements of California and federal law, including RESPA and Financial Code § 50130(d), under which the DBO can order a licensee to cease any business conducted under authority of its license if the Commissioner finds that the conduct of that business "is in violation of any law to which that business is subject." (Emphasis added.)

In addition, under California Assembly Bill "AB 1864" ---which has now passed both houses of the legislature and is awaiting the Governor's signature---California is expanding this enforcement authority by enacting its *own* version of Dodd-Frank, the "California Consumer Financial Protection Law ("CCFPL") in which the DBO is renamed as the "Department of Financial Protection and Innovation" ("DFPI") and given even *more* supervisory and enforcement powers over consumer financial products and services, including enhanced authority to issue regulations and conduct enforcement of the CCFPL, the provisions of which make it unlawful for covered persons or "service providers" to, *inter alia*, engage in "unlawful, unfair, deceptive, or <u>abusive</u> acts or practices" with respect to consumer financial products or services, or offer or provide a consumer a financial product or service that is not in conformity with any consumer financial law. (Emphasis added.)

Under the CCFPL, § 326 of the Financial Code is amended to explicitly grant the DFPI Commissioner authority to bring a civil action or "other appropriate proceeding" to enforce the provisions of the federal Consumer Financial Protection Act (§§ 5481 et seq) "or regulations issued by the federal Consumer Financial Protection Bureau thereunder," with respect to any entity licensed, registered, or subject to oversight by the commissioner, "and to secure remedies under provisions of the Consumer Financial Protection Act of 2010." <u>In short, the DFPI will now have explicit</u>

authority to exercise all the same enforcement powers of the CFPB as to borrowers and servicers in California.

There has been an extraordinary profusion of new, robust and still-expanding consumer protection laws, regulations and enforcement authority over mortgage servicing during the last ten years, at both the state and federal levels--and particularly over the conduct of mortgage servicers in distressed loan situations. Introducing an amorphous new tort "duty of due care" in this complex area would add little in the way of substantive consumer protections but could ultimately create more harm than benefit for *all parties* and be counterproductive to the goal of consumer protection.

3. A Judicially Imposed Duty of Care Would Dramatically Increase the Volume and Complexity of Loan Servicing Disputes, Causing Increased Burdens on the Courts, Higher Costs and Delays for the Parties in Resolving Servicing Disputes, and Inconsistent Rulings as to the Proper Standards of Care.

Given the multiplicity of loan types and terms, and the unique characteristics of each borrower's financial circumstances and abilities, determination of whether "due care" has been exercised in negotiations for a loan modification can become a very complex and fact-intensive activity. Here, Petitioner attempts to disguise and artificially simplify that problem by quoting a portion of 15 U.S.C §1639a(c) out of context to imply that the "qualified loss mitigation plan guidelines issued by the Secretary of the Treasury" under the 2009 federal Home Affordable Modification Program

("HAMP") (which expired on December 31, 2016)[15] somehow constitute a set of national uniform standards for all loan modifications. (Opening Brief at 19.) But nothing could be further from the truth.[16]

HAMP was a specific, taxpayer-funded, federal government relief program designed to address the specific effects of the 2008 financial crisis and had very specific qualification criteria. It was applicable only to first lien[17] loans on properties not condemned or uninhabitable that were originated on or before January 1, 2009 for borrowers with unpaid principal loan balances not exceeding $729,750 and whose debt to income ratio under the modified loan was over 31% of gross income and, among other things, who could properly document that income, provide other proof of income such as paystubs, profit and loss statements, etc. and who signed an affidavit of financial hardship.

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[15] As noted above, the Treasury Department's website for HAMP shows the program is "closed": *See* https://www.treasury.gov/initiatives/financial-stability/TARP-Programs/housing/mha/Pages/hamp.aspx

[16] Petitioner's selective quotation from § 1639a(c) is actually a misinterpretation of the provision, which is about a "safe harbor" for *servicers* from investor litigation where the contracts required the servicers to service loans according to "industry practice." It is strange for the Petitioner to cite a provision created by Congress to *insulate* servicers from fact-specific litigation as support of creating a right to fact specific litigation! 15 U.S.C §1639a(c) actually supports Respondent's argument that what Petitioner seeks is bad for mortgage markets and bad for the cost of consumer credit.

[17] HAMP was only applicable to first lien loans, thus Petitioner's claims regarding "qualified loss mitigation plan guidelines" that "constitute standard industry practice" would not even apply to the second lien at issue.

The reality is that there is no one industry "standard" loan modification product or program and no uniform set of identifiable terms, conditions, application requirements, underwriting criteria, timing deadlines, or disclosure obligations from which "due care" negotiation standards can easily or consistently be derived. Instead, there is a wide array of loan modification options with differing underwriting criteria and application and qualification requirements, including programs offered by government sponsored entities ("GSE's") like Fannie Mae and Freddie Mac, as well as more individualized programs for so-called "portfolio lenders," and specialty government-sponsored initiatives designed to assist specifically identified groups of borrowers under particular conditions. *See e.g.*, the loan forbearance requirements under the "Coronavirus Aid, Relief, and Economic Security Act" ("CARES Act"), enacted on March 27, 2020 in response to the economic effects of the pandemic.

There is no single standard loan modification "end-product," and in lieu of bargained for negotiations between the parties, in order to determine whether the servicer exercised "due care," it will be necessary for the courts to determine at minimum (a) each loss mitigation option "available" to the borrower and (b) its terms, (c) what qualifications, (d) application forms and (e) supporting documentation were required from the borrower, (f) what were the servicer's disclosure and (g) notification obligations were, and (h) what the required timing was for each step. This needs to be done

before the court can even *begin* to evaluate whether everybody did what they were supposed to do, when they were supposed to do it.

The situation becomes even more complicated and individualized where, as is sometimes the case, there is no secondary market investor[18] with an available loan modification program but, rather, the loan is held by a "portfolio" lender[19] with its own, unique loss mitigation programs. That scenario would raise its own, unique questions, including: (a) Does the lender even have a pre-defined loan modification program? (b) What are the application requirements for the lender's program? (c) What documentation is the borrower required to submit in support of the

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[18] The secondary mortgage market is a marketplace where home loans and servicing rights are bought and sold between lenders and investors. A large percentage of newly originated mortgages are sold by lenders who issue them into this secondary market, where they are packaged into mortgage-backed securities and sold to investors such as pension funds, insurance companies, and hedge funds. The secondary mortgage market is extremely large and liquid and helps to make credit equally available to borrowers across geographical locations. Examples of secondary mortgage market investors are those who purchase mortgage-backed securities issued and guaranteed by "aggregators" like Fannie Mae and Freddie Mac whose investor securities agreements often have prescribed loss mitigation "waterfalls" accompanied by specifically defined loss mitigation program requirements.

[19] A portfolio lender is a bank or other institution that originates mortgage loans and keeps the debt in a portfolio of loans rather than selling the loans in the secondary market. Portfolio lenders also include "private money" lenders such as wealthy individuals or groups of such individuals. A portfolio lender may service the loans itself or split off the servicing rights and sell those in the secondary market, retaining beneficial ownership in the loans themselves and the rights to receive the income they generate.

application? (d) What are the terms and eligibility requirements of the program? (e) When is an application “complete”? (f) What are the criteria for determining if eligibility requirements have been met? (g) What must the lender and/or servicer do exactly to process the borrower’s application “correctly”?”

In addition, the courts will need to navigate the intricate legislative and regulatory safety net discussed above, as well as the supervision and enforcement priorities of the CFPB and state regulatory agencies specifically charged with the duty of policing the very same conduct and transactions. In that environment, exactly what is the standard of due care at each step? All of this diversity in programs and program requirements, and the factual complexity of each borrower’s individual unique circumstance, also carry with it the possibility of inconsistent rulings and increased confusion about what the actual standard of “due care” is in each situation.

The issue is not whether tort litigation can address these complex questions, but whether it is truly the best way to do so. For all the reasons listed above and many more, including the complexity of ascertaining applicable tort law damages for each individual borrower, imposition of a tort law “duty of care” on loan servicing is an open invitation to complex and lengthy litigation. Because the fact intensive nature of such litigation often defies summary resolution, such cases are likely to proliferate, with a

commensurate burden on judicial resources and court-personnel as well as the parties.[20]

4. A Judicially Imposed Duty of Care is Likely to Result in *de-facto* Destruction of the Non-Judicial Foreclosure System in California to the Detriment of California Borrowers and Communities.

The Court should not impose what would functionally become judicial oversight of the non-judicial foreclosure scheme when the state Legislature and this Court's own precedent have repeatedly shown a reluctance to needlessly complicate the foreclosure process. In *I. E. Associates v. Safeco Title Ins. Co.*, (1985) 39 Cal.3d 281, 287-89 this Court held: "The rights and powers of trustees in nonjudicial foreclosure proceedings have long been regarded as strictly limited and defined by the contract of the parties and the statutes.... [¶] ... [T]here is no authority for the proposition that a trustee under a deed of trust owes any duties with respect to exercise of the power of sale beyond those specified in the deed and the statutes." The Court then went on to acknowledge that: "There are, moreover, persuasive policy reasons which militate against a judicial expansion of those duties. **The nonjudicial foreclosure statutes -- an**

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[20] Tort liability is not a one-way street. Comparative fault is an affirmative defense under California law, favored by public policy. *See* California Judicial Counsel Jury Instruction (CACI) No. 405 "Comparative Fault of Plaintiff." the doctrine of comparative fault is likely to *further* increase the number of issues to be decided, the complexity and duration of discovery and trial, with attendant costs, and decrease the likelihood of an early resolution. This will further burden the court system and the parties.

alternative to judicial foreclosure -- reflect a carefully crafted balancing of the interests of beneficiaries, trustors, and trustees." *Id.* at 288. [emphasis added].

Imposing a judicially created tort duty of care will likely result in de-facto destruction of California's "comprehensive nonjudicial foreclosure system," the value of which this Court has repeatedly recognized. *See, e.g., Biancalana v. T.D. Service Co,.* (2013) 56 Cal.4th 807, 814. As this Court stated in *Biancalana*, *quoting* *Moeller v. Lien*, (1994) 25 Cal.App.4th 822, 830, this "comprehensive scheme" has a threefold purpose:

> "'(1) to provide the creditor/beneficiary with a quick, inexpensive and efficient remedy against a defaulting debtor/trustor; (2) to protect the debtor/trustor from wrongful loss of the property; and (3) to ensure that a properly conducted sale is final between the parties and conclusive as to a bona fide purchaser.'"

See also 6 Angels, Inc. v. Stuart-Wright Mtge., Inc., (2001) 85 Cal.App.4th 1279, 1287 ("[G]ranting relief under the circumstances present here would frustrate, rather than promote, this policy, by adding uncertainty to the finality of foreclosure sales."). Nonetheless, Petitioner seeks to have this Court impose obligations on the servicer, the loan beneficiary and the trustee beyond their existing statutory and contractual duties.

Imposition of a tort "duty of care" on loan servicing, especially on modification negotiations, would very quickly negate this legislative policy and void this precedent, turning every foreclosure into a "wrongful

foreclosure" litigation. The "comprehensive statutory nonjudicial foreclosure system" in California would become nothing but an exercise in futility while the parties prepare for the "real" battle after the foreclosure in the courts. It would disrupt the balance between efficiency and consumer protections that the Legislature has carefully drawn by requiring some of the strongest pre-foreclosure protections in the nation before a servicer can proceed to a non-judicial foreclosure. This will inevitably result in an increased cost of credit to California borrowers as secondary market investors attempt to determine their risk exposure to judicial versus non-judicial foreclosure and attendant delays on recovery of their collateral in the event of default.

Even worse, it is unlikely to stop at loan servicing; instead, the establishment of a tort duty of care will be urged by plaintiffs' counsel to extend to other contract disputes, especially those where the parties are negotiating modifications or forbearances of existing contracts (leases are just one obvious example). Indeed, counsel could even claim it should extend to *initial* contract negotiations using similar arguments.

5. A judicially imposed duty of care in mortgage loan modification negotiations might disincentivize socially beneficial behavior.

As this Court noted in the *Gas Leak Cases, supra,* at 402, one of the policy goals in deciding whether to recognize a tort duty is to make sure the result does not "deter socially beneficial behavior."

While lenders/servicers have no common law duty to modify loan contracts,[21] Civil Code §§ 2923.4 and 2923.6 make clear that California has a strong public policy of encouraging lenders to pursue workouts to avoid foreclosure. This is especially true where the "[a]nticipated recovery under the loan modification or workout plan exceeds the anticipated recovery through foreclosure on a net present value basis." Section 2923.6(a)(2). Likewise, under federal law, servicers must "[e]valuate the borrower for all loss mitigation options available to the borrower." 12 C.F.R. §1024.41(c)(1).

There is clearly a positive social benefit to encouraging lenders and servicers to have frequent and open communication with borrowers in distress and for them to offer innovative foreclosure-avoidance solutions. But imposing an affirmative tort duty of care in loan servicing would stifle open dialogue and innovative outreach and ossify communications to match court-approved scenarios. Why should a servicer risk significant extra-contractual liability to borrowers, and indemnification obligations to

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[21] *See* opinion below *citing* *Carbajal v. Wells Fargo Bank, N.A*. 2015 WL 2454054 at *6 (C.D. Cal. April 10, 2015), *affd.* (9th Cir. 2017) 697 Fed. Appx. 555. *See also Daniels v. Select Portfolio Servicing, Inc.*, (2016) 246 Cal.App.4th 1150, 1180,; *Lueras, supra*, at 64–68; *Alvarez, supra*, at 945.

secondary market investors,[22] by varying from rigid negotiation protocols approved in published court decisions?

It is also important to recognize the burden borne by communities when foreclosures linger, as they may if subject to a contested foreclosure regime. Properties that go through long delayed foreclosures are more likely to become blighted or fall into disrepair, damaging the values of surrounding homes and creating a potential nuisance.

Imposition of a tort duty of care would also create disincentives to lenders and secondary market investors to devise new loan modification programs, with innovative application and qualification requirements, out of fear they be disapproved by California courts, limiting the types of modification programs offered to California borrowers to match only those pre-approved by California courts in cases where the facts might not reflect the circumstances of other California borrowers.

6. All the above would increase costs to everyone and could decrease credit availability to California borrowers

Mortgage lending and servicing is not limited by state boundaries and it is axiomatic that mortgage capital flows to transactions offering the

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[22] *See e.g.*, Fannie Mae 2019 Servicing Guide at pp. 18-19: "…Fannie Mae may require the repurchase of a mortgage loan (or of an acquired property) or the remittance of a make whole payment for reasons including, but not limited to…an uncorrected servicing defect [defined to include "breach of any servicer requirement… related to servicing functions including, but not limited to…loss mitigation"]. (Emphasis added.)

highest return. According to the court below, twenty-three other states have already said “no” to tort liability in loan modification negotiations. Imposing a tort duty of care in negotiations increases the responsibilities and risks of separately administering California loans under standards more onerous than in other states, making it more costly and less desirable to make or service California loans.

Increased risk also equals increased cost and such costs inevitably get passed on to consumers, one way or another, as the added risks are “priced in” by the marketplace. Plaintiffs might argue “that’s a small price to pay for added protection.” But, as shown above, imposition of a tort law “duty of care” in loan modification negotiations does not necessarily provide more protection, but most certainly results in inefficiency and increased costs.

V. CONCLUSION

Accordingly, the CMA, CMBA, MBA, and the UTA respectfully submit that this Court should affirm the lower court’s rulings in favor of Respondent as existing law makes clear that, with scant exception, negligence duties should not be interposed for contract disputes, particularly in the absence of any personal injury or property damage; to the extent that there is any reason to establish further duties on lenders or servicers in conjunction with collections, charge-offs, loan modifications and foreclosure procedures, despite the existing, comprehensive statutory

schemes, the legislature, not the Court, is the appropriate authority from which to seek such relief.

Respectfully submitted,

DATED: September 18, 2020

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CERTIFICATE OF WORD COUNT

Pursuant to Rule 8.520(c) of the California Rules of Court, I hereby certify that this brief contains 13,223 words, including footnotes but excluding the accompanying Application for Leave to File and Statement of Interest as well as the matters permissibly excluded under California Rules of Court Rule 8.204(c). In making this certification, I have relied on the on the Microsoft Word 2010 word-processing program used to prepare this brief.

Respectfully submitted,

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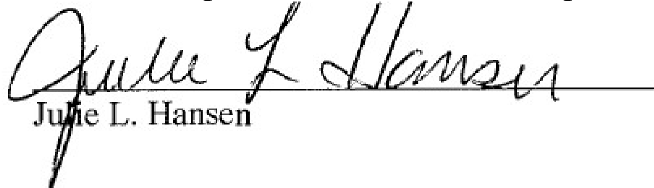

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