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Supreme Court of California
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IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

KWANG K. SHEEN, Plaintiffs and Appellants, v. **WELLS FARGO BANK, N.A., et al.,** Defendants and Respondents.	Case No. S258019

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

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

Application for Leave to File Amicus Curiae Brief and Amicus Curiae Brief of the National Housing Law Project and Eric Mercer in Support of Appellants

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APPLICATION FOR LEAVE TO FILE AMICUS BRIEF IN SUPPORT OF APPELLANTS

Pursuant to the California Rules of Court, rule 8.520(f), the parties described below respectfully request permission to file the attached brief as *amici curiae* in support of Plaintiff-Appellant.

This application is timely made pursuant to an extension granted by the Court on August 21, 2020. No party or counsel for any party in the pending appeal authored the proposed amicus brief in whole or in part, or made a monetary contribution intended to fund the preparation or submission of the brief, and no other person or entity made a monetary contribution intended to fund the preparation or submission of the brief, other than the *amici curiae*, their respective members or their respective counsel.

The **National Housing Law Project** (NHLP) is a law and advocacy center established in 1968. For over 40 years, NHLP has been dedicated to advancing housing justice by using the power of the law to increase and preserve the supply of decent affordable housing, to improve existing housing conditions, including physical conditions and management practices, to expand and enforce low-income tenants' and homeowners' rights, and to increase opportunities for racial and ethnic minorities.

NHLP provides free technical assistance, case consultations, litigation support, trainings and practice resources for legal services attorneys and other advocates representing homeowners in connection with foreclosures and loss mitigation. NHLP was a founding member of the Homeowner Bill of Rights Collaborative, which created an online resource at www.calhbor.org covering all aspects of the California Homeowner Bill of Rights and related issues. In addition, counsel for *amici curiae*, Lisa Sitkin, has represented hundreds of low- and moderate-income homeowners in connection with foreclosure, mortgage servicing, and loan modifications, participated in negotiations and hearings regarding the bill that ultimately became the California Homeowner's Bill of Rights, and is a nationally recognized expert on residential loan servicing, loan modifications and related loss mitigation issues, and California's non-judicial foreclosure process.

Eric Mercer is a member of the National Association of Consumer Advocates and currently serves as a member of the National Association of Consumer Advocates Mortgage Sub-committee and Issues Committee. He represents consumers victimized by fraudulent, abusive and predatory business practices, specializing in mortgage loan servicing abuse, deceptive mortgage origination, foreclosure rescue scams, and unfair debt collection.

The proposed *amici curiae* believe that further briefing is necessary to assist the court with respect to not fully addressed by the parties' briefs, particularly regarding: the mortgage servicing industry; the nature of the loss mitigation process; the heightened risks associated with giving servicers blanket immunity from negligence liability, particularly in view of the current economic crisis that has driven millions of borrowers into mortgage delinquency; the proper limits of the economic loss rule and the history of decisions in the Courts of Appeal regarding the duty of care owed by mortgage servicers who undertake to review borrowers for loss mitigation.

For these reasons, NHLP and Eric Mercer respectfully request permission to file the accompanying brief as *amici curiae*.

Dated: September 18, 2020 Respectfully submitted,

By /s/ Lisa Sitkin

Lisa Sitkin
Attorneys for *Amici Curiae*

FILED SEPT 25, 2020
WITH PERMISSION

AMICUS CURIAE BRIEF

I. INTRODUCTION

Critical issues of public policy give rise to a duty of care where a mortgage servicer evaluates an application for loss mitigation. Primarily, a mortgage servicer is subject to a duty of care to avoid an "unnecessary foreclosure." An unnecessary foreclosure typically occurs when a mortgage servicer proceeds with a foreclosure even though the value of the payments on the loan as modified is likely to be greater than the anticipated recovery that would result from foreclosure. That is, where all real parties in interest benefit from a loan modification instead of a foreclosure including, the investor of the loan, the borrower, and state and local economies.

Mortgage servicers have few incentives to commit resources to handling loss mitigation and foreclosure prevention accurately or fairly. Loss mitigation takes time and requires specially trained staff and substantial labor. As a result, servicers frequently fail to provide the requisite care in processing loss mitigation requests that could prevent foreclosure. Many of these errors have a direct and dispositive effect on whether a borrower receives a loan modification or loses her home to foreclosure. The primary factors include a borrower's monthly household income, the current value of the property, and the scope of an investor's restrictions on the terms of modifications for loans in a particular pool.

The economic crisis precipitated by the COVID-19 pandemic causes new concern as the crisis is putting many families at risk of foreclosure and is threatening the stability of the housing market.

Therefore, the rigid and dogmatic application of legal doctrine by the Second Circuit in the decision below should be overruled.

First, the Second Circuit below committed error to the extent it applied the "within the scope of a lending institution's conventional role as a lender of money" test to determine whether respondent, Well Fargo Bank, N.A., owes a duty to appellant, Mr. Sheen. Second, the Second Circuit below committed error when it applied the economic loss rule without consideration of whether the rule applies to mortgage servicing, whether the losses were purely economic and/or whether a mortgage servicer enters into a special relationship with a borrower once it agrees to consider an application for loss mitigation.

Mortgage servicing presents an entirely different set of facts that militate against expansion of the economic loss rule to applications for loss mitigation because the negligent handling of such applications leads to significant public harm not limited to purely economic loss. The Florida Supreme Court has cautioned against extension of the economic loss doctrine to circumstances beyond its principled origins and situation beyond its original intent.

Further, mortgage servicers enter into a special relationship with a borrower once it agrees to consider an application for loss mitigation and is uniquely positioned to avoid the harm caused by an erroneous review for loss mitigation. As such, public policy, statutory and regulatory law, a long history of California law indicate a duty arises in this context.

As such, *Amici* respectfully request that this Court overrule the Second Circuit below.

II. RELEVANT BACKGROUND INFORMATION

A. The Mortgage Servicing Industry

As described by the Consumer Financial Protection Bureau, mortgage servicing is performed by banks, thrifts, credit unions, and non-banks under a variety of business models.[1] The majority of mortgage loans originated today are sold into securitized pools of loans and serviced by a party other than the

[1] Mortgage Servicing Rules Under the Real Estate Settlement Procedures Act (Regulation X), 78 C.F.R. 10695, 10699-10701 (Feb. 14, 2013) ("CFPB 2013 Mortgage Servicing Rules").

owner of the underlying loan.[2] In some cases, loan originators (particularly non-banks) sell the ownership of the loans they originate on to other creditors but retain the mortgage servicing rights. In other cases, servicers have no role at all in origination or loan ownership, but instead purchase mortgage servicing rights on securitized loans or are hired to service loans in a lender's portfolio or to subservice loans where servicing rights are held by a party other than the lender. In a minority of cases, creditors handle the servicing for loans they either originate themselves or purchase and hold in portfolio.[3]

Under the prevalent securitization model, a lender sells the loans that it originates, retaining no interest in their revenue stream and, often, no responsibility for servicing them.[4] The mortgages are then pooled, repackaged as mortgage-backed securities, and traded so that many third-party investors come to own interests in a given mortgage.[5]

[2] Housing Finance at a Glance-A Monthly Chartbook at 8 (Urban Institute, Aug. 2020) (reporting on loan origination data from Q2 2020).

[3] *Id.*

[4] Levitin & Twomey, Mortgage Servicing (2011) 28 Yale J. on Reg. 1, 13-16.

[5] Odinet, Foreclosed: Mortgage Servicing and the Hidden

The diffusion of ownership created by mortgage securitization necessitates the involvement of third-party mortgage servicers—entities that take responsibility for collecting monthly payments and remitting them to a loan's many investors as well as communicating with borrowers.[6] Some third-party servicers are non-bank institutions, while others are subsidiaries of banks.[7]

In most cases, then, a borrower's servicer is not their original lender. Thus, although borrowers choose their lenders, they have no say in who will actually service their loans.[8] Although borrowers do not choose their loan servicers, if they encounter financial hardships and default on mortgage

Architecture of Homeownership in America (2019), p. 26; *see also* Thompson, Foreclosing Modifications: How Servicer Incentives Discourage Loan Modifications (2011) 86 Wash. L.Rev. 755, 763 ["Usually, hundreds or thousands of different individuals have at least a nominal interest in the payment stream on any given mortgage."].)

[6] McNulty, Garcia-Feijoo, & Viale, The Regulation of Mortgage Servicing: Lessons From the Financial Crisis (2019) 37 Contemp. Econ. Pol'y 170, 170.

[7] Odinet, *supra*, pp. 41-42.

[8] Odinet, *supra*, pp, 42, 109 ["Homeowners can neither make thoughtful choices about who manages their loan nor steer away from firms that engage in shoddy or harmful activities."].)

payments, they are entirely at their servicers' mercy when it comes to the loss mitigation process.

B. The Loss Mitigation Process

The process of loss mitigation is entirely different from loan origination. Loan origination is a transaction involving a potential borrower who has a choice of lenders and engages in a business deal made at least partially transparent by disclosure requirements.[9] The borrower is able to compare interest rates, origination fees and other loan terms and select the loan that is the best fit.

Loss mitigation, on the other hand, is a process in which a delinquent borrower experiencing a financial hardship seeks assistance from a mortgage servicer in the hopes of avoiding foreclosure. Typically, the process involves submission of a request for a loan modification that would allow the borrower to resolve the delinquency and resume making payments on the loan. Loss mitigation involves a lopsided relationship in which the borrower with a delinquent loan has no choice but to rely on the servicer—more often than not an entirely different party from the lender with whom the borrower has a loan agreement—to competently handle the borrower's application in line with the basic standards of the industry.

[9] *See, e.g.,* the Truth in Lending Act, 15 U.S.C. § 1601 *et seq.*

A homeowner facing foreclosure and applying for a loan modification is wholly dependent on the mortgage servicer to process the application accurately and communicate in a timely and truthful manner. Bound to a servicer selected by the lender, the homeowner does not have the option of "shopping" for loss mitigation services. Because a servicer’s mishandling of a loan modification application can end in unnecessary foreclosure, loss mitigation carries an extreme risk of irreparable harm to the homeowner not present in loan origination.

C. Loss Mitigation Does Not Typically Involve Negotiation

Although the loss mitigation process is frequently described as a "negotiation" or "renegotiation" of a loan agreement, those terms mischaracterize the nature of the process. A delinquent borrower does not approach the servicer with a proposal and then proceed to bargain over the exact terms of a final modification. Instead, in the overwhelming majority of cases, an application for a loan modification, is just that—an application. Loan modification applications typically include prescribed forms and the borrower's disclosure of sensitive financial and personal information, often on a rolling basis, in response to the servicer's instructions. A servicer reviewing a loan modification application will either approve or deny the application based on applicable internal and external guidelines[10] and on the servicer's contractual obligations to the creditor.[11] The review process and

[10] For example, servicers of loans owned or in securitized pools guaranteed by Fannie Mae must follow Fannie Mae's guidance regarding the types of loan modifications available, borrower eligibility for a loan modification and evaluation of a loan modification application. *See* Fannie Mae Workout Hierarchy, Exh. F-2-11 to the Fannie Mae Servicing Guide. Servicers who participated in the now-expired Home Affordable Modification Program (HAMP) were required to follow the rules in Chapter 2 of the Making Home Affordable Handbook regarding review and approval of loan modification applications. *See also, e.g.,* Special Inspector General for the Troubled Asset Relief Program, The Net Present Value Test's Impact on the Home Affordable Modification Program, June 18, 2012 ("SIGTARP NPV Report") at page 99 ("The actual execution of HAMP lies in large part with participating mortgage servicers, whose employees are responsible for reviewing homeowner HAMP applications and deciding whether a homeowner gets into HAMP or not. A servicer must follow the HAMP rules in making its decision, and Treasury has an oversight responsibility to ensure that servicers follow Treasury's HAMP rules."

[11] The securitized investor-servicer relationship is governed by a pooling and servicing agreement ("PSA"). These agreements typically employ a general servicing practice standard. Typical provisions require the related servicer to follow accepted servicing practices and procedures as it would employ "in its good faith business judgment" and which are "normal and usual in general mortgage servicing activities" (See "American Securitization Forum, Statement of Principles, Recommendations and Guidelines for the Modification of Securitized Subprime Residential Mortgage Loans, June 2007") ("ASF Guidance" at 2). The American Securitization Forum is a broad-based professional forum of over 350 organizations that are active participants in the U.S. securitization market. Among other roles, ASF members act as insurers, investors, financial intermediaries and professional advisers working on securitization transactions. *Id.*

the final decision do not involve any bargaining or negotiation by or with the borrower.

In the context of securitized mortgages, guidance from securitized investors provides that loan modification are preferable to foreclosure when the net present value ("NPV") of the modification would be greater than foreclosure.[12] However, this NPV model is highly dependent on the inputs a loan servicer enters into the model, most significantly the borrower's income and the value of the property.[13]

D. Loan Servicers Routinely Make Errors in the Loss Mitigation Process

Mortgage servicers have few incentives to commit resources to handling loss mitigation and foreclosure prevention accurately or fairly. Loss mitigation takes time and requires specially trained staff and substantial labor; it does not benefit from economies of scale, since each borrower's situation is unique.[14] Servicers'

See Amici Curiae's Request for Judicial Notice, Exhibit 2.

[12] "ASF Guidance" at page 4.

[13] SIGTARP NPV Report, at page 2 ("Because the NPV test is a linchpin in an otherwise eligible Homeowner's HAMP application, Treasury guidelines require that servicers maintain documentation on their NPV inputs."); *see also* SIGTARP NPV Report, page 6 ("A homeowner's fate hinges on the NPV score, so the American dream is literally at stake here.").

[14] Cordell, Dynan, Lehnert, Liang, & Mauskopf, The Incentives of Mortgage Servicers: Myths and Realities, Federal Reserve Board Working Paper No. 2008-46 (Sept. 8, 2008), pp. 15-17.

primary source of revenue is a fixed percentage fee.[15] As a result, it is more profitable for mortgage servicers "to automate as much of the servicing process as possible" than to invest in labor-intensive foreclosure prevention efforts.[16]

The structure of the mortgage servicing industry therefore discourages servicers from exercising the requisite care in processing loss mitigation requests that could prevent foreclosure. Foreclosure is the path of least resistance, since it requires less upfront investment on the servicer's part than loss mitigation does, and a servicer can be confident that investors will not challenge the decision to foreclose.

As a result, servicers make many all-too-routine types of errors in reviewing loan modification applications that are not reached directly by the procedural statutory and regulatory mandates as discussed below. Many of these errors have a direct and dispositive effect on whether a borrower receives a loan modification or loses her home to foreclosure because they involve the primary factors that decide a borrower's qualification for the

[15] Id. at p. 15.

[16] Odinet, *supra*, p. 50 ["[G]oing the loss mitigation route . . . adds costs to the servicer that are not contemplated in the fee structure with the trust."].) In fact, "investors frequently agree to reimburse foreclosure-related pass-on costs at a higher rate than they do pass-on costs related to loss mitigation," adding to the pressure on servicers to pursue foreclosure rather than loss mitigation. *Id.* at p. 54.

modification. These factors include a borrower's monthly household income,[17] the current value of the property,[18] and the scope of an investor's restrictions on the terms of modifications for loans in a particular pool.

Counsel for *amici curiae* have witnessed firsthand servicers repeatedly miscalculating borrower income despite clear documentation showing the correct figures; using inflated property valuations even after being presented with uncontroverted evidence of a property's actual market value; and misinterpreting or misapplying investor restrictions to bar a modification that was in fact permitted by the investor.

In one case, counsel for *amici curiae* represented a borrower who was told by an employee of defendants named in the complaint that his application for modification of the loan secured by his primary residence had been rejected because his monthly gross income of $2,554.75 was inadequate even though his paystubs showed that his monthly gross income was $6,075.

In another case, a borrower whose income had declined dramatically after a divorce applied for a loan modification. The servicer denied her application on the ground that the value of

[17] *See, e.g.,* Processing a Fannie Mae Flex Modification, Exh. F-1-28 of the Fannie Mae Servicing Guide (providing instructions for determining the borrower's housing expense-to-income ratio).

[18] *Id.* (providing instructions for obtaining and utilizing a property valuation).

her property was so high that the lender would recover more by foreclosing than by receiving modified loan payments. The property value the servicer relied on was premised on the existence of a second residence on the property that did not exist. Although we provided clear proof with the loan modification application and in an appeal of the initial denial that no such second residence had ever been built, the servicer repeatedly affirmed the loan modification denial based on the inflated and inaccurate market value.

Servicers also deny loan modification applications on the ground that the investor that owns the loan does not permit certain types of changes to the loan's terms. In numerous cases, we have discovered that a servicer either misinterpreted, misapplied or misrepresented such investor restrictions, with the result that a borrower who could have received a loan modification instead lost her home.

E. The COVID-19 Crisis Has Increased the Risk that Servicer Errors Will Result in Significant Numbers of Avoidable Foreclosures

The economic crisis precipitated by the COVID-19 pandemic has driven millions of homeowners into delinquency, putting families at risk of foreclosure and threatening the stability of the housing market. As of July 31, 2020, total U.S. mortgage delinquencies had risen nearly 100% year-over-year.[19] The serious delinquency rate (loans 90 days or more past due) was up by more than 1.8 million compared to pre-pandemic levels.[20] California is among the most heavily affected areas in terms of delinquency rate increases,[21] with a six-month deterioration in non-current mortgages of nearly 200%.[22]

According to the mortgage market research and data firm CoreLogic:

> Sustained unemployment has pushed many homeowners further down the delinquency funnel, culminating in the five-year high in the U.S. serious delinquency rate this June. With unemployment projected to remain elevated through the remainder of 2020, we may see further impact on late-stage delinquencies and, eventually, foreclosure.
>
> CoreLogic predicts that, barring additional government programs and support, serious delinquency rates could nearly double from the June 2020 level by early 2022. Not only could millions of families potentially lose their home, through a short sale or foreclosure, but this also could create downward pressure on home prices — and consequently home equity — as distressed sales are pushed back into the for-sale market.[23]

[19] *See* Black Knight August 21, 2020, Press Release.

[20] *Id.*

[21] *See* Black Knight July 2020 Mortgage Monitor at 7.

[22] *See* Black Knight August 21, 2020, Press Release .

[23] *See* CoreLogic Loan Performance Insights Report (analyzing data through August 30, 2020).

Analysts project that with continued high rates of unemployment and little or no additional financial assistance forthcoming from the federal government, California is among the states "projected to see the biggest jumps in foreclosure activity."[24] Even if the worst-case scenario does not occur, California could still see the number of homes in foreclosure "jump from 10,566 to 39,793, or 277 percent" over the next year.[25]

These risks are exacerbated by the enormous pressure being placed on the mortgage servicing industry as it responds to government mandates regarding COVID-19-related mortgage loan forbearance[26] and loss mitigation[27] and faces a flood of borrowers who will be seeking post-forbearance loss mitigation assistance over at least the next 18 to 24 months. As of August 2020, nearly 4 million mortgage borrowers were in temporary forbearance plans, many of which could last for up to 12

[24] "Residential Foreclosure Activity in U.S. Could Easily Double Over Coming Year" (ATTOM Data Solutions, July 31, 2020).

[25] *Id.*

[26] The federal Coronavirus Aid, Relief and Economic Security (CARES) Act requires servicers of federally backed mortgage loans to grant borrowers' requests for forbearance of up to 12 months based on a pandemic-related financial hardship. H.R. 748, 116th Cong., Sec. 4022 (2020).

[27] The Federal Housing Finance Agency, the Federal Housing Administration, the Veterans' Administration and the U.S. Department of Agriculture's Rural Housing Services have all issued guidance regarding borrowers' options for exiting a COVID-19-related forbearance. CITES

months,[28] and another 735,000 borrowers were delinquent on payments but not in a forbearance plan.[29] Moreover, as federal unemployment insurance payments established by the CARES Act neared expiration at the end of July, the share of households expressing “no confidence” in their ability to make their future mortgage payments reached almost 6 percent.[30]

Coming into this crisis, the mortgage servicing industry had significantly scaled back on personnel its default servicing operations due to extremely low delinquency rates. While we have been told by some servicers that they have made efforts to increase staffing over the past several months, advocates representing borrowers still anticipate myriad problems for borrowers seeking assistance from their servicers.

First, as amply documented by regulators and in the press, even when servicers staffed up their loss mitigation teams during the later years of the foreclosure crisis, servicers regularly failed to exercise due care. Second, clear and effective training and

[28] *See* "Forbearances Improve Slightly" (Black Knight, Aug. 28, 2020).

[29] *See* "Six Facts You Should Know about Current Mortgage Forbearances" (Urban Institute, Aug. 18, 2020). It appears that this number has increased as of September 17, 2020, with over one million borrowers delinquent on payments but not in a forbearance plan. *See* Wall Street Journal, "A Million Mortgage Borrowers Fall Through COVID-19 Safety Net", Sept. 17, 2020.

[30] "Six Facts," *supra* at n.11 (citing the Census Bureau Household Pulse Survey, week 12 (July 14-21, 2020)).

oversight of new staff may prove especially difficult while many employees continue to work remotely. Third, servicers are having to adjust procedures rapidly based on frequently updated guidance from federal agencies that affects loss mitigation protocols for borrowers exiting COVID-19-related forbearance plans. Under these circumstances, the risk that servicers will make errors that result in avoidable foreclosures is higher than it has been in several years, as is the need to ensure that servicers are on notice of their obligation to handle loss mitigation with due care.

III. ARGUMENT

A. Amici Urge the Supreme Court to Guard Against the Unwarranted Expansion of the Economic Loss Rule

1. California Supreme Court Law Imposes a Presumption of a Duty of Care Unless an Exception Is Clearly Supported by Public Policy

The basic principle of tort liability is that a person is responsible for injuries as a result of his lack of care. This Court has previously stated that "[w]hile the question whether one owes a duty to another must be decided on a case-by-case basis, every case is governed by the rule of general application that all persons are required to use ordinary care to prevent others from being injured as the result of their conduct…." *Weirum v. RKO General, Inc.*, 15 Cal. 3d 40, 46 (1975). This holding is consistent with section 1714 of the Civil Code, which provides: "[e]very one is responsible, not only for the result of his willful acts, but also for an injury occasioned to another by his want of ordinary care or skill in the management of his property or person. . . ." Civ. Code § 1714. Section 1714 "…does not distinguish among injuries to one's person, one's property or one's financial interests." *J'Aire Corp. v. Gregory*, 24 Cal. 3d 799, 806 (1979). Damages for loss of profits or earnings are recoverable where they result from an injury to one's person or property caused by another's negligence. Recovery for injury to one's economic interests, where it is the foreseeable result of another's want of ordinary care, should not be foreclosed simply because it is the only injury that occurs. *J'Aire Corp.*, 24 Cal. 3d at 806.

Further, "[a]lthough it is true that some exceptions have been made to the general principle that a person is liable for injuries caused by his failure to exercise reasonable care in the circumstances, it is clear that in the absence of statutory provision declaring an exception to the fundamental principle enunciated by section 1714 of the Civil Code, no such exception should be made unless clearly supported by public policy." *Rowland v. Christian,* 69 Cal. 2d 108, 111-13 (1968); *see also Christensen v. Superior Court,* 54 Cal. 3d 868, 885 (1991) ("In determining liability for negligence, we begin always with the command of Civil Code section 1714 …"; exceptions "are recognized only when clearly supported by public policy.").

This Court recently articulated one such exception supported by public policy in *S. Cal. Gas Leak Cases*, 7 Cal. 5th 391 (2019) ("*Gas Leak*") (where this Court determined claims for purely economic losses suffered from mere proximity to an industrial accident are disallowed because such claims create intractable line-drawing problems for courts). In *Gas Leak*, the Court's decision was based, in part, on application of the economic loss rule to the facts of that case. As discussed below, mortgage servicing presents an entirely different set of facts that militate against expansion of the economic loss rule to the mortgage servicing context.

2. An Application for Loss Mitigation to Avoid Foreclosure Is Not Limited to Purely Economic Losses

The economic loss doctrine generally provides that "[a] person may not ordinarily recover in tort for the breach of duties that merely restate contractual obligations." *Aas v. Superior Court*, 24 Cal.4th 627, 643 (2000) (superseded by statute on other grounds). It was designed to differentiate between tort claims and warranty claims in products liability cases. *Jiminez v. Superior Court*, 29 Cal.4th 473,481-484 (2002) (describing doctrine generally). The doctrine was not designed to bar recovery for economic losses entirely, only to direct which body of law should apply.

The doctrine is not a good fit when extended beyond products liability cases like *Aas*, *supra*, and purely economic losses due to proximity to an industrial accident like *Gas Leak*, *supra*. It has no application whatsoever in a mixed damages case like the vast majority of mortgage servicing cases where borrowers who face foreclosure often suffer injuries beyond mere economic loss such as frustrations, anxiety, chronic fatigue, embarrassment with family members, frustration, feelings of hopelessness, and ultimately the loss of a family home.

"Economic loss" for the purposes of the doctrine "consists of damages for inadequate value, costs of repair and replacement of the defective product or consequent loss of profits—without any claim of personal injury or damages to other property." *Robinson Helicopter Co., Inc. v. Dana Corp.*, 34 Cal. 4th 979, 988 (2004) (citation and internal quotation marks omitted); *see also S. Cal. Gas Leak Cases*, 7 Cal. 5th 391, 398 (2019). Emotional distress is a form of personal injury. *See, e.g., Ovando v. County of Los Angeles* 159 Cal.App.4th 42, 73 (2008). Such harm takes a borrower's negligence claim outside the purview of the economic loss rule.

In the context of an application for loss mitigation, the harm of a negligent review of the application often involves emotional and/or reputational injury to persons in addition to economic injury. Indeed, many courts have recognized the special harm a homeowner suffers at the loss or even prospective loss of a family home. *See Kilgore v. Wells Fargo Home Mortg.*, 2012 WL 2195656, at *1 (E.D. Cal. June 13, 2012) (*citing Park Vill. Apartment Tenants Ass'n v. Mortimer Howard Trust*, 636 F.3d 1150, 1159 (9th Cir. 2011)) ("With respect to irreparable injury, a plaintiff's loss of her residence is usually sufficient to satisfy this element."); *Wrobel v. S.L. Pope & Assocs.*, 2007 WL 2345036, at *1 (S.D. Cal. Aug. 15, 2007) ("Losing one's home through foreclosure is an irreparable injury." (citation omitted)). A number of courts have found this injury enough by itself to mandate preliminary injunctive relief. *See, e.g., Nichols v. Deutsche Bank Nat. Trust Co.*, 2007 WL 4181111, at *2 (S.D. Cal. 5 Nov. 21, 2007); *United Church of Med. Ctr. v. Med. Ctr. Comm'n*, 689 F.2d 693, 701 (7th Cir. 1982) ("A piece of property is always considered unique, and its loss is always an irreparable injury."); *Johnson v. U.S. Department of Agriculture*, 734 F.2d 774, 789 (11th Cir. 1984) ("[I]rreparable injury is suffered when one is wrongfully ejected from his home. Real property and especially a home is unique").

Since a negligently handled application for loan modification results in a unique harm beyond purely economic losses, the economic loss doctrine does not apply.

3. The Florida Supreme Court Has Cautioned Against the "Unprincipled Extension" of the Economic Loss Rule

Correcting a series of decisions that had expanded the economic loss rule beyond its logical application, the Florida Supreme Court, in *Tiara Condominium Association v. Marsh & McLennan Cos.* ("*Tiara*"), recently returned the economic loss rule to its roots by limiting it to product liability claims where there is no personal injury or damage to other property. *Tiara Condo. Ass'n Inc., v. Marsh & McLennan Cos.*, 110 So. 3d 399, 400 (Fla. 2013).

Tiara first noted that the origins of the economic loss rule in products liability cases can be traced to two cases: *Seely v. White Motor Co.*, 63 Cal. 2d 9 (Cal. 1965), and *East River Steamship Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858, 871 (1986). *Tiara Condo. Ass'n*, 110 So. 3d at 403.

In *Seely*, the California Supreme Court recognized that the rules of warranty continued to function well in a commercial setting, allowing the manufacturer to determine the quality of the product and the scope of its liability if the product failed to perform. The court reasoned that a manufacturer's liability under that theory would extend to all subsequent purchasers regardless of whether the manufacturer's promise regarding the fitness of the product was ever communicated to those purchasers. If the manufacturer were strictly liable for economic losses resulting from the failure of its product to perform as promised by the warranty, it would be liable not only to the initial purchaser, but to every consumer who subsequently obtained possession of the product. *See id*. at 150.

In *East River*, the United States Supreme Court adopted the reasoning in *Seely* when it considered the issue of economic loss resulting from defective products in the context of admiralty. According to the Supreme Court, when the damage is to the product itself, "the injury suffered—the failure of the product to function properly—is the essence of a warranty action, through which a contracting party can seek to recoup the benefit of its bargain." *Id*. at 868. The Court stated:

> Contract law, and the law of warranty in particular, is well suited to commercial controversies of the sort involved in this case because the parties may set the terms of their own agreements. The manufacturer can restrict its liability, within limits, by disclaiming warranties or limiting remedies. In exchange, the purchaser pays less for the product.

Id. at 872-73 (footnote and citation omitted). Recognizing that extending strict products liability to cover economic damage would result in "contract law . . . drown[ing] in a sea of tort," *id*. at 866, the Supreme Court held that "a manufacturer in a commercial relationship has no duty under either a negligence or strict products-liability theory to prevent a product from injuring itself." *Id*. at 871. Thus, from the outset, the focus of the economic loss rule was directed to damages resulting from defects in the product itself.

Relying on the reasoning in *Seely* and *East River*, the Florida Supreme Court adopted the products liability economic loss rule, precluding recovery of economic damages in tort where there is no property damage or personal injury. *Florida Power & Light Co. v. Westinghouse Elec. Corp.*, 510 So. 2d 899 (Fla. 1987).

However, Florida trial courts and appellate courts began to expand the application of the economic loss rule to other situations. The economic loss rule was held by Florida courts to bar tort claims for economic damages arising from a wide variety of commercial relationships, including defective products, *Fla. Power & Light Co.*, 510 So. 2d at 900 (power generating equipment); faulty business services, *AFM Corp. v. S. Bell Tel. & Tel. Co.*, 515 So. 2d 180, 180–82 (Fla. 1987) (inaccurate telephone listing); negligent construction contracting, *Sandarac Ass'n v. W.R. Frizzell Architects, Inc.*, 609 So. 2d 1349, 1350– 51 (Fla. Dist. Ct. App. 1992), and professional malpractice. *Id.* (architectural design).

The judicial expansion of the economic loss rule by lower courts and the confusion created by the doctrine's rapidly changing scope, led the Florida Supreme Court to express concern with what it "perceived as an over-expansion of the economic loss rule." *Tiara Condo. Ass'n*, 110 So. 3d at 407. In

Moransais v. Heathman, the Florida Supreme Court stated that a number of its rulings "appeared to expand the application of the [economic loss] rule beyond its principled origins and have contributed to applications of the rule by trial and appellate courts to situations well beyond our original intent." *Moransais v. Heathman*, 744 So. 2d 973, 980 (Fla. 1999). In *Tiara*, the Florida Supreme Court reversed this course by limiting application of the economic loss rule to its principled beginnings. *Tiara Condo. Ass'n*, 110 So. 3d at 407 ("…[h]aving reviewed the origin and original purpose of the economic loss rule, and what has been described as the unprincipled extension of the rule, we now take this final step and hold that the economic loss rule applies only in the products liability context.").

Amici urge this Court to also guard against unprincipled extension of the economic loss rule to situations well beyond products liability cases like *Aas*, or claims for purely economic losses suffered from mere proximity to an industrial accident, as in *Gas Leak*. Indeed, "[t]his court has repeatedly eschewed overly rigid common law formulations of duty in favor of allowing compensation for foreseeable injuries caused by a defendant's want of ordinary care." *J'Aire Corp*, 24 Cal. 3d at 805 (*internal citations omitted).*

In any event, the economic loss rule should not be extended to apply to a mortgage servicer's handling of an application for loss mitigation because in this context "…negligent interference with prospective economic advantage will be limited to instances where the risk of harm is foreseeable and is closely connected with the defendant's conduct, where damages are not wholly speculative…". *Id. at* 808.

B. Even if the Economic Loss Rule is the General Rule for Most Cases Where There Are Purely Economic Losses, California Law Recognizes a Number of Exceptions

1. A Mortgage Servicer Enters into a Special Relationship with a Borrower Once It Agrees to Consider an Application for Loss Mitigation

California courts have long held that there is an exception to the economic loss rule where a "special relationship" between the parties exists, and that the existence of such a relationship is determined by the six *Biakanja* factors. *J'Aire Corp.*, 24 Cal.3d at 803-04 (listing factors); *see also Aas v. Superior Court*, 24 Cal.4th 627, 644 (2000) (*superseded by statute on other grounds*) (*J'Aire's* "special relationship" permitting recovery of economic losses is the relationship defined by the *Biakanja* test). *J'Aire* held that "the *Biankaja* factors, in combination with 'ordinary principles of tort law such as proximate cause,' were 'fully adequate to limit recovery' of purely economic damages 'without the drastic consequence of an absolute rule which bars recovery in all such cases.'" *Aas*, 24 Cal.4th at 644, *quoting J'aire*, 24 Cal.3d at 808. All six factors must be considered by the court, and the presence or absence of one factor is not decisive. *Kalitta Air L.L.C v. Central Texas Airborne Systems, Inc.*, 315 Fed. Appx. 603, 605-606, (9th Cir. 2008).

Courts have applied the *J'Aire/Biakanja* test to determine whether a special relationship giving rise to tort liability exists both where there is no privity between the parties, and where there is a contractual relationship. In *Weimer v. Nationstar Mortg.*, LLC, 47 Cal. App. 5th 341 (2020), for example, where the plaintiff borrower alleged that a mortgage servicer negligently processed a loan modification, the Court first found a duty of care under the *Biankaja* test, *id.*, and then rejected the defendant's claim that the economic loss rule was a bar: "[h]ere, the borrower is an intended beneficiary of the modification transaction and this, along with the *Biakanja* factors, establishes a special relationship and duty. *Id.* at 365; *see also Rossetta v. CitiMortgage, Inc.*, 18 Cal. App. 5th 628 (2017) ("[w]e are convinced that a borrower and lender enter into a new phase of their relationship when they voluntarily undertake to renegotiate a loan, one in which the lender usually has greater bargaining power and fewer incentives to exercise care").

2. A Mortgage Servicer Has a Duty Arising from Statute, Contract and Otherwise to Properly Review an Application for Loss Mitigation

Wells Fargo concedes that "*Biakanja* permits a plaintiff to recover for economic losses arising from 'a contracting party's negligent performance of a contract' where policy factors dictate that 'a tort duty of care should be recognized." . . . The *Biakanja* framework thus involves two steps: [1] identifying the obligation that the defendant 'negligent[ly] perform[ed],' and [2] weighing policy factors to assess whether the defendant had a duty to the plaintiff to perform that obligation with care." *See* Answering Brief, page 54. Continuing, Wells Fargo states that: "When a defendant has already agreed to perform an obligation, the defendant is fairly on notice of its obligations and can plausibly be held liable for the economic consequences of failing to perform them with care." *See* Answering Brief, pages 56 and 57.

Indeed, a duty can be imposed "by statute, contract, or otherwise." *Temple Community Hospital v. Superior Court*, 20 Cal.4th 464, 481 (1999), *citing* 5 Witkin, Summary of Cal. Law 18 (9th Ed. 1988) Torts, § 6, p. 61). Further, "[s]tatutes may be borrowed in the negligence context for one of two purposes: (1) to establish a duty of care, or (2) to establish a standard of care." *Elsner v. Uveges*, 34 Cal.4th 915, 927-928, fn. 8 (2004); *see also* Cal. Evid. Code, § 669.

In the context of a borrower's loss mitigation application, a mortgage servicer’s duties to a borrower arise not only out of the loan contract with the lender but from a variety of sources, including, but not limited to, Cal. Civ. Code § 1714. Statutes create a duty not to misrepresent the amount owed or use unfair or harassing collection methods. *See* Rosenthal Fair Debt Collection Practices Act, Cal. Civ. Code § 1788 *et seq*. Mortgage servicers must provide clear and timely responses to applications for loss mitigation. Real Estate Settlement and Procedures Act, 12 U.S.C. § 2605, Regulation X, 12 C.F.R. § 1024.41. The California Homeowners Bill of Rights (“HBOR”) requires servicers to communicate accurately and promptly about the status of an application for loan modification, to offer a modifications where consistent with the contractual authority granted in their servicing agreements with lenders and creditors, and to implement approved loan modifications promptly. Cal. Civ. Code § 2923.6.

Perhaps the strongest source for a duty for a mortgage servicer to avoid negligent loss mitigation evaluation comes from the public policy to “… ensure that the process does not exacerbate the current crisis by adding more foreclosures to the glut of foreclosed properties already on the market if the foreclosure may be avoided through a loan modification.” Cal. Civ. Code § 2924.

All of these sources put a mortgage servicer on notice to properly perform a preexisting obligation.

However, none of these efforts to curb servicer abuses were intended to displace state common law remedies. For instance, during the last foreclosure crisis, Congress explicitly intended that loan modification rules promulgated by the U.S. Treasury Department as part of the Making Home Affordable Program would be enforced under state common law and general consumer protection statutes as an industry-wide standard of care. *See*, 10 U.S.C. § 1639a(c) (providing that its guidelines "shall constitute standard industry practice for purposes of all Federal and State laws.").

HBOR's specific protections and pointed remedies create and enforce primarily *procedural* rights against servicers. They are not exclusive. The Consumer Financial Protection Bureau also made it abundantly clear when amending Regulation X that state laws providing greater protection to consumers are not preempted, and that field preemption should not be applied to RESPA regulation. The CFPB's official interpretations state:

> State laws that give greater protection to consumers are not inconsistent with and are not preempted by RESPA or Regulation X. In addition, nothing in RESPA or Regulation X should be construed to preempt the entire field of regulation of the practices covered by RESPA or Regulation X, including the regulations in Subpart C with respect to mortgage servicers or mortgage servicing.

Official Interpretations of Reg. X, 12 C.F.R. § 1024.5(c)(1)-1.

In sum, while HBOR and Regulation X provide procedural protections which help borrowers ensure their loan modification applications are at least considered and that they are informed of missing documents and final decisions, neither addresses the kind of substantive errors made by loan servicers when processing loan modification applications.

Negligence claims can address situations where servicers procedurally comply with HBOR and Regulation X, but nonetheless still fail substantively to review an application for loan modification by, *e.g.*, miscalculating income, relying on inaccurate property valuations, and/or misinterpreting, misapplying or misrepresenting investor restrictions, as explained above. In these circumstances, a duty arises in order to effectuate the strong public policy to avoid "… additional foreclosures could further destabilize the housing market with significant, corresponding deleterious effects on the state and local economies." Cal. Civ. Code § 2924

C. The Second District Must Be Overruled to the Extent It Adopts the *Asprias-Lueras* "Within the Scope" Test

There have been seven published California Court of Appeals decisions addressing whether a duty of care exists in regards to a residential mortgage servicer's review of a borrower's loss mitigation application:

Aspiras v. Wells Fargo Bank, N.A., 219 Cal. App. 4th 948 (August 21, 2013) (review den. and opn. ordered nonpub. Jan. 15, 2014) ("*Aspiras*") (finding, **without analyzing the *Biakanja* factors**, that no duty of care exists in a review of an application for loss mitigation of a residential property because "offering loan modifications is sufficiently entwined with money lending so as to be considered within the scope of typical money lending activities").

Lueras v. BAC Home Loans Servicing, LP, 221 Cal. App. 4th 49 (October 31, 2013) ("*Lueras*") (deciding the issue without the benefit of the knowledge that the California Supreme Court would depublish *Aspiras*, expressly relying on *Aspiras* and finding, **without analyzing the *Biakanja* factors**, that there is no duty to "offer, consider, or approve a loan modification" 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").

Alvarez v. BAC Home Loans Servicing, L.P., 228 Cal. App. 4th 941 (August 7, 2014) ("Alvarez") (distinguishing *Lueras* based on the specific duty alleged and finding, after analyzing the *Biakanja* factors, that a servicer owes a duty of care once, and only after, it voluntarily undertakes to perform an evaluation of an application for loss mitigation).

Daniels v. Select Portfolio Servicing, Inc., 246 Cal. App. 4th 1150 (April 26, 2016) ("*Daniels*") (considering *Lueras* and following *Alvarez* and finding "[b]ecause four of the six [*Biakanja*] factors weigh in favor of finding a duty and the other two factors are neutral, we conclude [the loan servicer] owed appellants a duty of care with respect to the loan modification process").

Rossetta v. CitiMortgage, Inc., 18 Cal. App. 5th 628 (December 18, 2017) ("*Rossetta*") (considering *Lueras*, *Alvarez*, and *Daniels*; following *Alvarez* and finding a duty after applying the *Biakanja* factors; the Court noted, "[w]e are convinced that a borrower and lender enter into a new phase of their relationship when they voluntarily undertake to renegotiate a loan, one in which the lender usually has greater bargaining power and fewer incentives to exercise care").

Sheen v. Wells Fargo Bank, N.A., 38 Cal. App. 5th 346 (August 5, 2019) ("*Sheen*") (considering *Lueras*, *Alvarez*, and *Daniels*; following *Lueras* and finding, **without analyzing the *Biakanja* factors**, that there is no duty to "offer, consider, or approve a loan modification.").

Weimer v. Nationstar Mortg., LLC, 47 Cal. App. 5th 341 (April 2, 2020) (considering *Lueras*, *Alvarez*, *Daniels*, *Rossetta*, and *Sheen*, following *Alvarez,* carefully weighing the *Biakanja* factors and concluding that the allegations in the second amended complaint adequately allege a cause of action for negligence that is sufficient to survive demurrer).

The cases in the *Alvarez-Daniels-Rossetta-Weimer* line that found a clearly delineated duty of care did so after a careful and thorough application of the *Biakanja* factors of cases. The cases in the *Aspiras-Lueras-Sheen* line that rejected a broad duty of care either completely failed to provide any analysis of the *Biakanja* factors or, at best, made only cursory and perfunctory reference to the *Biakanja* factors.

1. The *Asprias-Lueras-Sheen* Line of Cases Fail to Properly Apply the *Biakanja* Factors, Instead Relying on an Invalid "Within the Scope" Test

In *Aspiras*, the California Court of Appeals relied on the proposition that "offering loan modifications is sufficiently entwined with money lending so as to be considered within the scope of typical money lending activities" to find no duty of care in the review of a residential application for loss mitigation. *Aspiras v. Wells Fargo Bank, N.A.,* 219 Cal. App. 4th at 964. *Aspiras* was decided on August 21, 2013. On November 18, 2013, two nonprofit entities, including *amicus curiae* the National Housing Law Project, filed a Request to Depublish *Aspiras*. *See* Amici Curiae's Request for Judicial Notice, Exhibit 1. The Request asserted that *Asprias* should be depublished because:

> …it ignored binding authority when it summarily found no duty of care. *Nymark*, the case

> that the court relied on for the proposition, itself followed established Supreme Court precedent by applying an in-depth, six-factor analysis to determine whether a duty exists. The *Aspiras* court erred by refusing to analyze whether a duty exists under the analysis required by *Nymark* and other authorities.
>
> Moreover, the *Aspiras* court's mechanical citation to *Nymark* for the proposition that a "lender" owes no duty of care to a borrower improperly extended *Nymark* far beyond the lender-borrower interaction during loan origination that the case addressed, and applied it, without justification, to the enormously different mortgage servicer-borrower relationship during the loan modification process.

Amicus Curie's Request for Judicial Notice, Exhibit 1.

On January 15, 2014 the California Supreme Court ordered *Aspiras* depublished and denied a pending Petition for Review.

In this case, the Second District below acknowledges "[t]hat [the] governing test stems from *Biakanja v. Irving* (1958) 49 Cal.2d 647 [320 P.2d 16] (*Biakanja*) and states, "[o]ur view is that *Lueras* and allied opinions correctly analyzed the *Biakanja* factors." *Sheen v. Wells Fargo Bank, N.A.*, 38 Cal. App. 5th 346, 353 (2019). In fact, the *Lueras* Court did no such thing. *Lueras* referred to the *Biakanja* factors but never performed a careful factor-by-factor analysis, instead only providing the following perfunctory analysis:

> The *Biakanja* factors do not support imposition of a common law duty to offer or approve a loan modification. If the modification was necessary due to the borrower's inability to repay the loan, the

> borrower's harm, suffered from denial of a loan modification, would not be closely connected to the lender's conduct. If the lender did not place the borrower in a position creating a need for a loan modification, then no moral blame would be attached to the lender's conduct.

Lueras, 221 Cal. App. 4th at 67. The Court merely proposed hypothetical if-then statements regarding just two of the *Biakanja* factors and failed to undertake the requisite detailed analysis of *any* of the six factors.

Instead, *Lueras* primarily relied on the "general rule" that "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." *Lueras*, 221 Cal. App. 4th at 63 *citing Nymark v. Heart Fed. Sav. & Loan Ass'n*, 231 Cal. App. 3d 1089, 1096 (1991).

However, the *Nymark* Court itself made clear that "[i]n California, the test for determining whether a financial institution owes a duty of care to a borrower-client "'involves the balancing of various factors, among which are [1] the extent to which the transaction was intended to affect the plaintiff, [2] the foreseeability of harm to him, [3] the degree of certainty that the plaintiff suffered injury, [4] the closeness of the connection between the defendant's conduct and the injury suffered, [5] the moral blame attached to the defendant's conduct, and [6] the policy of preventing future harm.'" *Id. at 1098, citing Connor v. Great Western Sav. & Loan Assn.,* 69 Cal.2d 850, 865 (1968); *see*

also Biakanja, 9 Cal.2d at 650; *Fox & Carskadon Financial Corp. v. San Francisco Fed. Sav. & Loan Assn.*, 52 Cal.App.3d 484, 488-489 (1975); *Gay v. Broder*, 109 Cal.App.3d 66, 73-74 (1980).

Nonetheless, *Lueras* eschews analysis of the proper test as stated in *Nymark* and instead relies on the application of a "within the scope" test. *See Lueras*, 221 Cal. App. 4th at 67 ("We conclude 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.")

To the extent *Sheen*, in turn, relies on the *Asprias-Lueras* "within the scope" test, it must be expressly overruled. Indeed, by granting the Request to Depublish *Aspiras*, this Court has already tacitly approved the use of the *Biakanja* factors to guide lower courts' determination of whether a financial institution owes a duty of care to a borrower in the review of an application for loan modification.

IV. CONCLUSION

Whether the economic loss rule applies in the first instance to a claim brought by a borrower after a mortgage servicer agrees to review an application for loss mitigation or whether a special relationship exists under such circumstances, courts must apply the *Biakanja* factors to determine whether a borrower may maintain such a claim. All of the cases that apply a careful and thorough analysis of the factors have found that a mortgage servicer can, and often does, owe a duty of care to a borrower to avoid an unnecessary foreclosure. *Amici* respectfully request that this Court overrule Sheen.

Dated: September 18, 2020 Respectfully submitted,

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CERTIFICATE OF COMPLIANCE
WITH WORD COUNT REQUIREMENT

Pursuant to Rule of Court 8.204(c)(1), the undersigned certifies that the computer program used to generate this brief indicates that it does not exceed 14,000 words.

Dated: September 18, 2020 Respectfully submitted,

By /s/ Lisa Sitkin

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DECLARATION OF ELECTRONIC SERVICE

I hereby declare:

1. I am, and was at the time of service, a citizen of the United States and a resident of the County of Alameda, over the age of 18 years, and not a party to this legal action. My business address is 1663 Mission Street, Suite 460, San Francisco, California, 94103.

2. On the date indicated below, I served this **Application for Leave to File Amicus Curiae Brief and Amicus Curiae Brief of the National Housing Law Project and Eric Mercer in Support of Petitioner-Appellant; Request for Judicial Notice of *Amici Curiae* the National Housing Law Project and Eric Mercer** by transmitting a true copy via this Court's TrueFiling system addressed as follows:

PLEASE ATTACHED SERVICE LIST

I declare under penalty of perjury under the laws of the State of California and the United States of America the foregoing is true and correct and that this declaration was executed on September 18, 2020, at Berkeley, California.

/s/ Lisa M. Sitkin
Lisa M. Sitkin

SERVICE LIST

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STATE OF CALIFORNIA
Supreme Court of California

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Supreme Court of California

Case Name:	**SHEEN v. WELLS FARGO BANK**
Case Number:	**S258019**
Lower Court Case Number:	**B289003**

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

9/18/2020
Date

/s/Lisa Sitkin
Signature

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