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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,

vs.

WELLS FARGO BANK, N.A.,
Defendant and Respondent.

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

AMICI CURIAE BRIEF OF THE CIVIL JUSTICE ASSOCIATION OF CALIFORNIA, THE CALIFORNIA CHAMBER OF COMMERCE, AND THE WESTERN BANKERS ASSOCIATION IN SUPPORT OF DEFENDANT AND RESPONDENT

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INTRODUCTION

A. Interest of Amici

The Civil Justice Association of California (CJAC), the California Chamber of Commerce (CalChamber), and the Western Bankers Association (WBA) welcome the opportunity to address as *amici curiae*[1] the issue this case presents:

> Does a lender or loan servicer owe a borrower in default on payments owed for a second residential mortgage a common law tort duty of care to consider or negotiate a mortgage modification agreement?

Both the trial and appellate courts answered "No": "[A] lender [or loan servicer] does not owe a borrower a common law duty to offer, consider, or approve a loan modification."

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[1] Amici obtained permission of the Court to extend the time for lodging this brief to September 8, 2020, and by separate accompanying application amici now ask the Court to accept it for filing.

Sheen v. Wells Fargo Bank, N.A. (2019) 38 Cal.App.5th 346, 358 (*Sheen*).

Petitioner's phrasing of the issue he asks this Court to decide obscures the distinction between first and second mortgages—*viz.*, "Does a mortgage servicer owe a borrower a duty of care to refrain from making material misrepresentations about the status of a foreclosure sale following the borrower's submission of, and the servicer's agreement to review, an application to modify a mortgage loan?" Petitioner's Opening Brief on the Merits, p. 11. (OBM).

But later in the same brief petitioner clarifies that what he is really asking the court to decide is if the common law extends the same rights to him (as holder of a second-lien mortgage) that statutory law confers *solely* on first-lien borrowers: "Petitioner does not have a remedy under [the state Homeowner Bill of Rights (HBOR)] because that law only grants a private right of action with regard to first-lien mortgages, and [petitioner's] mortgage from Wells was a second-lien mortgage." OBM, p. 13, fn. 1. Petitioner's default on this second-lien mortgage was the only one responsible for the foreclosure on his property.

Moreover, in his reply brief, petitioner complains that "HBOR's limited protections are insufficient to cover the myriad ways in which a servicer's negligence can injure

borrowers when it comes to loan modifications." Petitioner's Reply Brief (RB), p. 20. Thus, petitioner asks this Court to impose a tort duty on loan servicers for modification of second-lien mortgages that is not only precluded by the HBOR, but consists of broader protections than those the HBOR provides for first-lien mortgages.

Attention to the HBOR's distinction between first and second-lien mortgages that petitioner glosses over is critical here because duty analyses require courts to identify the specific action or actions a plaintiff claims the defendant has a duty to undertake. Accordingly, amici focus our analyses on why the Court should refrain from imposing a common law tort duty beyond what the Legislature has found statutorily appropriate when it comes to loan modification.

Amici have vital, complementary interests in the outcome of this case. They oppose petitioner's plea to impose a tort duty because doing so will flout legislative remedies and introduce an additional, unwarranted layer of litigation complexity into the foreclosure process. Judicial acceptance of petitioner's plea will harm both lenders and borrowers by increasing costs and decreasing lending.

CJAC is a 42-year-old nonprofit organization whose members are businesses, professional associations and

financial institutions. CJAC's principal purpose is to educate the public about ways to make laws that determine who gets paid, how much, and by whom when the conduct of some occasions harm to others, more fair, certain, and economical. Toward this end, CJAC participates as amicus curiae in select cases before the courts that implicate our purpose; the issue here being a prime example.

CalChamber is a nonprofit business association with over 13,000 members, both individual and corporate, representing virtually every economic interest in the state. For more than a century, CalChamber has been a leading voice for California business. While CalChamber represents several of the largest corporations in California, 75% of its members have 100 or fewer employees. CalChamber acts on behalf of the business community to improve the state's economic and employment climate by representing business on a broad range of legislative, regulatory, and legal issues, including as amicus curiae in cases like this one that have the potential to adversely impact businesses.

The WBA is one of the largest banking trade associations and regional educational organizations in the United States, with more than 100 years of combined experience serving banks. The California Bankers Association, a division of the WBA, is the advocate of the

western banking industry for needed legislative, regulatory and legal changes. Many of the WBA's members are mortgage lenders or servicers that depend on the nonjudicial foreclosure processes available in California and many other states to prevent serious financial losses on mortgage loans. Nonjudicial foreclosure enables them to deliver lower-cost credit to home buyers. Imposing a tort duty on these lenders and servicers to consider and negotiate loan modification for junior mortgages threatens the ability of lenders to deliver lower-cost credit to home buyers and will necessarily embroil the courts in micro-managing nonjudicial foreclosures for defaulting junior lien mortgages.

B. Importance of Issue

In its hearings on the HBOR in 2012, the Legislature found that "foreclosures blight neighborhoods, put financial pressure on families and drive down local real estate values; and consumers, made more cautious by a crippled housing market, spend less freely curbing the economy's growth."[2] That most recent foreclosure crisis begun in 2008 was estimated by 2012 to have stripped homeowners of $1.9 trillion in equity as foreclosures drained value from homes

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[2] *Assembly Floor Analysis, Proposed Conf. Rep. No. 1, SB 900*, July 2, 2012, p. 12 (hereafter *Assembly Floor Analysis of SB 900*).

located near foreclosed properties. *Id.* Even this number may understate the true costs, since it does not reflect the impact of the foreclosure epidemic on the nation's economy or the disparate impact on lower-income and minority communities. *Id.*

Both the federal and California governments responded to this past foreclosure crisis with comprehensive mortgage modification legislation designed to "provide a positive change for borrowers, communities and . . . financial markets." *Id.* at 13. In California, that legislation was substantially reenacted without opposition in 2018.

Unfortunately, a Damoclean repeat of the 2008-2012 foreclosure crisis now looms on the horizon, spurred by the coronavirus pandemic and the loss of federal aid for businesses that closed and people who lost jobs as a result of it.

> More than 20 percent of households say that they don't expect to be able to make their next monthly rent or mortgage payment, according to a Census Bureau survey. Some eviction bans have ended, and other will end soon. Americans once again are beginning to lose their homes.

Appelbaum, *The Coming Eviction Crisis: 'It's Hard to Pay the Bills on Nothing,'* THE NEW YORK TIMES, August 9, 2020.

This impending crisis may be alleviated by new legislation hammered out in numerous committees by elected representatives on the federal and state levels. But it is not something that this Court, as the "least dangerous branch"[3] of government, should wade into by imposing new tort duties upon parties to the nonjudicial foreclosure process beyond those provided by existing carefully crafted legislation.

Mortgage financing is a complex web linking numerous actors, detailed contracts, property appraisals, mathematical formulas and other factors requiring a balancing of varied and sometimes conflicting interests. This problem-solving challenge is peculiarly appropriate for legislative bodies and administrative bodies, not courts, to govern. "[T]he Legislature, with its extensive fact-finding powers, is better suited than we are to assess the financial . . . consequences of its policies. When it has made such judgments, we will not disturb them unless they are inherently improbable or

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[3] "The foremost duty of the courts in a free society is the principled declaration of public norms. The legitimacy, prestige and effectiveness of the judiciary—the "least dangerous branch"—ultimately depend on public confidence in our unwavering commitment to this ideal. Any breakdown in principled decisionmaking, any rule for which no principled basis can be found and clearly articulated, subverts and discredits the institution as a whole." *Thing v La Chusa* (1989) 48 Cal.3d 644, 675.

unreasonable." *Professional Engineers v. Dept. of Transportation* (1997) 15 Cal.4th 543, 600 (Ardaiz, J., dissenting opn.), quoting *California Housing Finance Agency v. Patitucci* (1978) 22 Cal.3d 171, 179. Not "disturbing them" means not grafting on top of existing statutory protections applicable only to first-lien mortgage modifications, broader common law tort duties owed by lenders to borrowers of statutorily excluded second-lien mortgages.

SUMMARY OF SALIENT FACTS[4]

Petitioner is a homeowner who bought his residence in 1998 with a first mortgage for $500,000 secured by a deed of trust from a lender not named in his complaint. Second Am. Compl. ¶ 6. Seven years later, he obtained two additional junior loans from Wells Fargo for approximately $250,000 also secured by the property. *Id.* at ¶¶ 7-8. He then missed a number of payments on these second and third loans due to "financial difficulty." *Id.* at ¶ 9.

In September 2009, Wells recorded a notice of default on the second loan. Petitioner, whose primary language is Korean, contacted Wells through his legal counsel in late January 2010 asking for forbearance and modifications to his

[4] These facts, taken from petitioner's unverified second amended complaint and the appellate opinion, inform and define the legal issue presented.

second and third loans. He also submitted applications to Wells for modification of these loans around the same time.

In early February 2010, Wells Fargo cancelled its previously announced February 3 foreclosure sale. Then, around mid-March, Wells sent petitioner two separate letters about the second and third loans. Aside from the different amounts of the two loans – $176,000 for the second and $87,396 for the third – both letters stated:

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

These letters reported that the date of the "charge off" was February 25, and asked petitioner to call Wells Fargo if he had any questions.

Petitioner's complaint does not state if he contacted his attorney or called Wells Fargo asking for an explanation as to

the meaning of these letters. He does, however, allege that despite speaking "almost no English," he interpreted them to mean that "the second and third loans had been modified such that they were unsecured loans, that Wells had canceled the February 3, 2010 foreclosures . . . to modify the second and third loans, and that *the property would never be sold at a foreclosure auction in connection with either the second or third loan as a result of these modifications*."[5]

Petitioner received another letter from Wells Fargo on April 23, 2010 about the second loan; it offered to reduce the remaining balance owed by 50% if he and the bank could come to a satisfactory arrangement. Because that letter did not mention specifically "foreclosure," petitioner claims it "reinforced his belief" that the loan had been converted to an unsecured loan. Again, he does not mention if he or his counsel communicated with Wells Fargo about whether his beliefs were correct or consistent with the bank's about the effects of the letter.

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[5] A quick Google search on the consequence of a "charge off" in relation to foreclosures yields the following: "The charge off does not remove the mortgage debt; it only puts it into a different classification. The *lender still retains a claim against the house, the ability to foreclose on the property* or demand payment in the case of a bankruptcy." https://www.google.com/search?source=hp&ei=bWxNX4K2Lo3K-gSCi6UI&q=%22charge+off%22+means+in+foreclosure/. (Italics added.)

Wells sold petitioner's defaulted second loan in the secondary market for distressed mortgage debt in November 2010. After that loan passed through two investment entities, Mirabella Investments Group, LLC (Mirabella) bought it in November 2013. Wells cancelled the third loan in March 2014.

Petitioner made modification requests to Mirabella in August 2014, but Mirabella promptly responded informing him it had sold its servicing rights for this second loan to FCI Lender Services, LLC. Petitioner then requested mortgage modification for that loan directly to FCI, which rejected his application because he "had too little income." Petitioner filed for Chapter 7 bankruptcy relief 10 days later.

Petitioner, with assistance of legal counsel, made a third modification request in October 2014. In response, FCI stated it no longer considered petitioner's second loan to be in "active foreclosure." Petitioner contacted Mirabella who allegedly told him and his spouse that it would "consider modification in lieu of foreclosure." The bankruptcy court vacated the bankruptcy stay on October 24; and five days later – four years after he defaulted on his second mortgage – plaintiff received a phone call informing him his home would be sold that day. Mirabella bought the property at auction and then sold it to an investment group. Petitioner was later

evicted from the property through an unlawful detainer action.

The appellate opinion summed up the preceding events this way: Petitioner "borrowed money on his house three times, defaulted on all three loans after the subprime meltdown, sought loan modifications, declared bankruptcy, and emerged from bankruptcy[, los]ing . . . his house to foreclosure." *Sheen*, *supra*, 38 Cal.App.5th at 348.

PROCEEDINGS IN THE TRIAL COURT

Petitioner sued Wells Fargo and others alleging negligence, emotional distress, and violation of the state's Unfair Competition Law. He did not, as noted in the opinion, allege fraud or breach of contract or any other of the eight independent claims he might have brought.[6]

[6] Causes of action the appellate opinion mentions the petitioner could have, but did not allege, include breach of contract, negligent misrepresentation, promissory estoppel, fraud, and several statutory claims—the California Foreclosure Prevention Act (Civ. Code § 2924 et seq.), the California Homeowner Bill of Rights (Civ. Code § 2920 et seq.), the Perata Mortgage Relief Act (Civ. Code § 2923.5),the Real Estate Settlement Procedures Act (12 U.S.C. § 2601 et seq.), the Home Affordable Modification Program (12 U.S.C. § 5201 et seq.), and the Truth in Lending Act (15 U.S.C. § 1601 et seq.). 38 Cal.App.5th at 351-352.

Wells Fargo successfully demurred to the complaint's three causes of action without leave to amend. Negligence was dismissed because plaintiff had not pleaded facts supporting a tort duty of care for loan modification. Intentional infliction of emotional distress was denied for failure to plead outrageous conduct; and the unfair competition claim was dismissed for want of a viable underlying claim.

THE APPELLATE OPINION

The court of appeal, recognizing a split amongst intermediate appellate courts on the duty issue, affirmed the trial court's judgment and held that a bank does not owe a borrower a tort duty of care to enter into loan modification or reach agreement if they considered modification. Specifically, the court disagreed with *Alvarez v. BAC Home Loans Servicing, L.P.* (2014) 228 Cal.App.4th 941 (*Alvarez*), accepting instead the reasoning and conclusion of *Lueras v. BAC Home Loans Servicing, L.P.* (2013) 221 Cal.App.4th 49 (*Lueras*) that a lender does not owe a borrower a common law duty to offer, consider, or approve a loan modification.

In following *Lueras*, the opinion also relied upon *Southern California Gas Leak Cases* (2019) 7 Cal.5th 391 holding that, absent physical injury or property damage, pure 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.” *Id.* at 402.

The appellate opinion remarked that courts in at least 23 states have refused to impose tort duties on lenders to negotiate loan modifications. In addition, the Restatement of Torts supports *Lueras* and opposes *Alvarez*, buttressing that the duties of care between parties who negotiate contracts are governed by contract, not tort law. The appellate opinion agreed that the trial court properly dismissed petitioner’s negligence claim because a lender does not, under the circumstances alleged here, owe a common law tort duty to offer, consider, or approve a loan modification. The appellate court agreed with the trial court that the intentional infliction of emotional distress claim was frivolous, and that the trial court was right to dismiss the borrower’s unfair competition claim.

SUMMARY OF ARGUMENT

Our country’s mortgage lending system—a critical element of our national and state policies to make home ownership available to as many Americans as possible—rests on the foundation of enforceable security interests in real property. By allowing lenders to take possession of collateral through foreclosure when a borrower defaults, the law reduces the risk to lenders, which in turn allows them to

make credit available to more home buyers at lower interest rates.

The entire purpose of nonjudicial foreclosure is to avoid the costs and delay of litigation that inevitably occur with judicial involvement in the foreclosure process. If the Court imposes, in addition to current statutory requirements and financial motivations, a tort duty upon lenders to consider mortgage modification for borrowers in default on their junior loan payments, increased costs and delays will ensue.

California's statutory protections in the HBOR for lenders seeking loan modification are expressly restricted to first mortgages; junior mortgages such as the second and third loans petitioner had on his property for which he defaulted, are expressly excluded. Imposition of a tort duty in these situations would essentially constitute a judicial rewriting of applicable statutes, a court command that an underinclusive legislative classification (*i.e.*, one applicable to first, but not junior mortgages) must be "repaired" under the guise of recognizing a common law tort to cover all defaulting borrowers regardless of the number of loans they have secured on the same property.

California law provides numerous avenues and protections for borrowers facing nonjudicial foreclosure. These regulatory provisions strike a balance between allowing

borrowers to obtain loan modifications and ensuring that appropriate foreclosures can proceed in a timely, efficient, and fair manner. Superimposing on this regulatory framework a state common law tort duty for second lien mortgage lenders will create considerable uncertainty for lenders and loan servicers about how to reconcile statutory requirements with this new duty. This confusion will make it more costly for lenders and servicers to do business—and thus more difficult and costly for home buyers to obtain credit.

There is nothing "special" about the relationship of respondent lender and the petitioner borrower here when it comes to the junior mortgages. Theirs is an arm's length contractual transaction. Modification of that contract is and should be governed by contract, not tort law.

The Court should repel attempts to recognize yet another "special relationship" for reasons stated in its opinions rejecting doing so for the employer-employee relationship. It should also not allow recovery for pure economic loss, which is all that is involved here, absent personal injury or property damage.

ARGUMENT

I. THE COURT SHOULD NOT IMPOSE A COMMON LAW TORT DUTY ON LENDERS TO RESIDENTIAL BORROWERS TO CONSIDER OR NEGOTIATE SECOND-LIEN MORTGAGE LOAN MODIFICATIONS.

A. When a Borrower Defaults on a Residential Mortgage Obligation, Modification of the Loan Agreement is, with the Exception of Statutory Rights and Remedies, a Matter of Contract Negotiation, not Tort Law.

A mortgage secured by a deed of trust constitutes a contractual relationship between the lender and borrower. The mortgage contract is an agreement that if the homeowner defaults on the loan, the lender may sell the property pursuant to the requisite legal procedure. *Yvanova v. New Century Mortg. Corp.* (2016) 62 Cal.4th 919. According to a long line of well-established case law, mortgage obligations are governed by two related documents: the borrower's promissory note and deed of trust, which together form the contract. See, *e.g.*, *Mitsui Manufacturers Bank v. Superior Court* (1989) 212 Cal.App.3d 726, 730-733; and *Wagner v. Benson* (1980) 101 Cal.App.3d 27, 35.

"The financing or refinancing of real property in California is generally accomplished by the use of a deed of trust." *Jenkins v. JP Morgan Chase Bank, N.A.* (2013) 216 Cal.App.4th 497, 507 (*Jenkins*). "There are three parties in

the typical deed of trust: the trustor [borrower], the beneficiary [lender], and the trustee." *Biancalana v. T.D. Service Co.* (2013) 56 Cal.4th 807, 813. In some cases the lender is also the loan servicer: it manages the loan account. Frequently, however, the lender sells the right to service the loan to another company which then administers the loan account for a fee. A loan servicer is the lender's agent, charged with collecting and applying the borrower's payments and otherwise administering performance under the note and deed of trust on the lender's behalf. See Civ. Code § 2920.5(a); *Daniels v. Select Portfolio Servicing, Inc.* (2016) 246 Cal.App.4th 1150, 1171-1172. In this case, Wells Fargo itself performed those functions.

A deed of trust *conveys title* to real property from the trustor to a third party trustee to secure the payment of a debt owed to the beneficiary under a promissory note. The customary provisions of a valid deed of trust include a power of sale clause, which empowers the beneficiary (lender) to foreclose on the real property security if the trustor fails to pay the debt owed under the promissory note. *Jenkins* at 508.

When two parties enter into a contract, including a mortgage agreement, they set forth the rules and regulations that will govern their relationship; the risks inherent in the agreement and the likelihood of its breach. As *Applied*

Equipment Corp. v. Litton Saudi Arabia Ltd. (1994) 7 Cal.4th 503, 517 explains:

> The parties to the contract in essence create a mini-universe for themselves, in which each voluntarily chooses his contracting partner, each trusts the other's willingness to keep his word and honor his commitments, and in which they define their respective obligations, rewards and risks. Under such a scenario, it is appropriate to enforce only such obligations as each party voluntarily assumed, and to give him only such benefits as he expected to receive; this is the function of contract law.

Nothing in petitioner's loan agreements and deeds of trust for any of his home mortgages mention loan modification.[7] Of course, the parties to a mortgage contract, or generally any contract, can mutually agree to modify it at any time. Unless the loan agreements or statutes expressly provide for modification, however, there is no "duty" under contracts silent on the subject that would obligate one party to negotiate with the other about whether to modify the mortgage. Any modification agreement would require the consent of both parties, which presumably would require new

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[7] "In a review of subprime securitization pooling and servicing agreements from 2006, University of California Davis Law Professor John Patrick Hunt found that 60% of loans reviewed authorized modification, while 32% were silent on modification [and] . . . only 8% expressly barred modification." *Assembly Floor Analysis of SB 900*, *supra*, p. 13.

mutually advantageous contractual terms.

Unsurprisingly, not every borrower in default is a good candidate for mortgage modification:[8]

> [B]orrowers most likely to obtain a mortgage modification are those whose monthly disposable income is *slightly* negative – i.e., monthly expenses are slightly more than their monthly income. Having a slightly negative monthly disposable income shows to the lender that a mortgage modification likely would be successful because the borrower is more likely to be able to afford the mortgage payment with all of his or her other expenses. Borrowers with severely negative monthly disposable income are not likely to obtain a mortgage modification because the lender does not see how a mortgage modification would make them able to afford to remain in their property. *The key is to show that if a modification is obtained, the borrower will be able to afford it.*

To be sure, other factors come into play that inform a lender's decision of whether to modify an existing mortgage. Even if a borrower qualifies with a slightly negative income, for instance, a modification may still be denied by a lender

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[8] Pels, *Negotiating Mortgage Modifications: Leading Lawyers on Navigating the Negotiation Process and Understanding the Impact of the Current Lending Climate on Mortgage Modifications*, *ASPATORE*, 2010 WL 895245, *2; italics added.

"based upon a net present value (NPV) test."[9]

> A NPV test is a mathematical formula [*i.e.*, an algorithm] used to determine whether the mortgage investor would make more money by approving a modification or by allowing the subject property to go into foreclosure. This NPV formula takes into account various foreclosure factors such as the current property value, foreclosure costs, and the expected resale time, and compares them with various modification factors such as the value of the modified monthly payment and the risk of a repeat default. At the end of the calculation, if the NPV result is higher for a modification than it is for a foreclosure, then the servicer must approve the qualifying mortgagor's modification as long as all other requirements are met. However, if the NPV result is higher for a foreclosure than it is for a modification, then the servicer has *full discretion* in determining whether to approve the qualifying mortgagor's modification.

Consideration of, discussions about, and negotiations over whether to modify an existing mortgage contract are sufficiently complex to obviate imposition of a common law tort duty of negligence upon lenders beyond what federal and state statutes encourage or require for first mortgages. In fact, that "complexity" is exacerbated by the presence of second mortgages secured by liens on the same property.

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[9] Chiles & Mitchell, *Federal Housing Law and Mortgage Policy* (2011) 65 *Consumer Fin. L.Q.* Rep. 194, 196; italics added.

"These liens are often held by lenders who are also servicers on the first mortgage. They [may] have little interest in . . . modification because it would harm the value of their holdings and reduce their income from fees. *A Mortgage Nightmare's Happy Ending*, *New York Times*, December 25, 2010."[10]

The complexity involved in weighing the aforementioned factors to determine whether to modify second mortgages convinced some legal commentators to conclude "the most obvious response" to mortgage modification problems stemming from multiple loans with senior and junior liens, "would be an outright ban on second mortgages," an option they dismiss as "difficult in the current political climate."[11]

While discussions with lenders about consideration of mortgage modification may occur when circumstances prompt it, the applicable mortgage contract and its remedy for nonjudicial disclosure remains in force during that time. The general tort duty under Civil Code § 1714 to not act negligently is not itself sufficient to allow recovery from one

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[10] Conf. Rep. No. 1, SB 900, California Legislature, July 2, 2012, p. 13.

[11] Been, Jackson & Willis, *Essay: Sticky Seconds–The Problems Second Liens Pose to the Resolution of Distressed Mortgages* (2012) 9 *N.Y.U. Journal of Law & Business* 71, 115-16.

contracting party against another. "[T]he breach of a tort duty apart from the general duty not to act negligently" is required. As this Court has explained, "[i]f every negligent breach of a contract gives rise to tort damages the limitation [on tort recovery in contract cases] would be meaningless, as would the statutory distinction between tort and contract remedies." *Erlich v. Menezes* (1999) 21 Cal.4th 547, 554; quoted with approval in *Robinson Helicopter Co. v. Dana Corp.* (2004) 34 Cal.4th 979, 990.

Parties to a contract have their respective duties defined in it. Failure to meet their duties is a breach. It does not matter if the breach is negligent or deliberate, it is still just a breach, not a tort. "[T]he distinction between tort and contract is well grounded in common law, and divergent objectives underlie the remedies created in the two areas. Whereas contract actions are created to enforce the intentions of the parties to the agreement, tort law is primarily designed to vindicate 'social policy.' [Citation.]" *Hunter v. Up-Right, Inc.* (1993) 6 Cal.4th 1174, 1180, quoting *Foley v. Interactive Data Corp.* (1988) 47 Cal.3d 654, 683 (*Foley*).

"While the purposes behind contract and tort law are distinct, the boundary line between them is not (*Freeman & Mills, Inc. v. Belcher Oil Co.* (1995) 11 Cal.4th 85, 106 (conc. and dis. opn. of Mosk, J.)) and the distinction between the

remedies for each is not 'found ready made.' " *Erlich, supra* at 550-551, quoting Holmes, *THE COMMON LAW* (1881) p. 13. These uncertain boundaries and the breadth of noneconomic loss redressable in tort but not contract actions – *e.g.*, emotional distress and vindication (punitive damages) – understandably create pressure to obliterate the distinction between contracts and torts. This has led to an expansion of tort law at the expense of contract principles which Grant Gilmore aptly dubbed "contorts." Gilmore, THE *DEATH OF CONTRACT* 98 (Ronald K.L. Collins ed., 2d ed. 1995). But as the concurring opinion of Chief Judge Alex Kozinski in *America, Inc. v. Microtech Intern, Inc.* (1989) 872 F.2d 312, 315 warned about this looming judicial trend:

> Not every slight, nor even every wrong, ought to have a tort remedy. The intrusion of courts into every aspect of life, and particularly into every type of business relationship, generates serious costs and uncertainties, trivializes the law, and denies individuals and businesses the autonomy of adjusting mutual rights and responsibilities through voluntary contractual agreement.

Recognizing a common law tort duty for lenders of secondary mortgage loans to "reasonably consider or negotiate" modification agreements would throw gasoline on the litigation bonfire by holding out the allure of extra-contractual damages, a carrot that entices into court parties

who might otherwise be inclined to voluntarily resolve their differences. *Id*. In addition, "[l]iability for innocent but negligent misrepresentations in a business context unjustifiably interferes with the arm's length bargaining process, thus creating unwarranted and unnecessary additional transaction costs." Comment, *The Perimeters of Liability for Negligent Misrepresentation in Maryland* (1989) 48 *MD. L. REV*. 384, 387.

B. California Statutes on the Duty of Lenders and Loan Servicers to Borrowers who Request Mortgage Modification do not apply to Borrowers who, like Petitioner, have Junior Mortgages; and the Court should not Fill this Deliberate Statutory Gap with a Common Law Tort Duty.

Assume *arguendo* that existing statutes relating to mortgage modification do not *preclude* the court from determining whether it should recognize a duty by lenders to consider or negotiate a second mortgage modification with the homeowner. Nonetheless, this court's decisions about generally applicable principles and limitations regarding a common law duty do *not* support its recognition here. See *Verdugo v. Target Corporation* (2014) 59 Cal.4th 312, 317 (*Verdugo*) (no common law duty of retail business to acquire and make available to customers on its business premises an automated external defibrillator (AED) for use in a medical emergency despite numerous statutes on the availability and

use of AEDs in various contexts).

Petitioner contends that statutes in force when his foreclosure problems arose – *e.g.*, the federal Home Affordable Modifications Program (now expired) and state HBOR – support judicial imposition of a common law tort duty for all mortgage lenders to nonnegligently process, keep borrowers informed about, and negotiate with them on mortgage modification agreements. Amici believe otherwise: past and existing statutory and judicial protections applicable to certain borrowers and lenders but not petitioner or those in his shoes (those wanting these same rights for their second mortgages) countenance the Court to reject his plea.

1. Home Affordable Modifications Program (HAMP)

HAMP was available until 2017 for loans held by government sponsored enterprise entities (GSEs), Fannie Mae and Freddie Mac and non-GSE lenders, although participation by the latter servicers was *voluntary*. To encourage participation, HAMP was funded by a $75 million commitment from the federal government under the Troubled Asset Recovery Program to be expended in the form of incentives to mortgage holders and servicers to enable them to offer modifications to homeowners in default on their mortgages. Pub. Law No. 111-22, § 202. These incentives included upfront fees payable to the servicer for each loan

modification, plus a “pay for success” fee on still-performing loans. Participating homeowners who made their payments on time were eligible to receive certain principal reduction payments, and additional one time payments to lenders, investors and servicers were available for qualifying transactions.[12]

The details of the HAMP program were revised a number of times.[13] HAMP initially applied only to certain qualifying first lien loans on one-to-four unit owner-occupied properties although some specialized programs for rental properties and second liens were later added to the program. The unpaid principal balance on a single family residence was limited to $729,750, with higher limits for some owner-occupied

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[12] See U.S. Dept. of Treasury press release, March 4, 2009 (online at http://www.ustreas.gov/press/releases/reports/guidelines_summary.pdf). Several of these fees, and the potential principal write-down, were increased and modified in the March 2010 “enhancements” to HARP. See U.S. Dept. of Treasury, Making Home Affordable Program Enhancements to Offer More Help for Homeowners (March 25, 2010) http://www.makinghomeaffordable.gov/pr_03262010.html).

[13] Program requirements for non-GSE mortgagees and servicers are summarized in the Making Home Affordable Handbook for Servicers of Non-GSE Mortgages (4.3), dated September 26, 2013 (hereinafter cited as “MHA Handbook 4.3”) available on-line at https://www.hpmpadmin.com/portal/programs/docs/hamp_servicer/mhahandbook_43.pdf.

properties with two-to-four units. The borrower could qualify whether or not he or she had defaulted on the mortgage.

The principal requirements were that the loan was originated on or before January 1, 2009, the monthly payment amount exceeded 31% of gross income, and the borrower must document income and taxes and sign an affidavit of financial hardship. Applications for a modification needed to be submitted by December 31, 2015, and the modification must have been in effect by September 30, 2016[14] A loan could only be modified once under the program. Until 2012, there was no principal reduction program under HAMP for underwater loans, and although Principal Reduction Alternative later existed, availability was limited.

If a borrower was eligible for a HAMP modification, the lender had to contact the borrower. A 30-day period must then have passed following any determination the borrower was ineligible, during which time borrower could respond to the determination. Foreclosure was delayed while the borrower's eligibility was reviewed, and the attorney or trustee conducting a sale had to certify that the borrower was not HAMP-eligible.[15] There were various provisions for temporary

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[14] MHA Handbook 4.3 at 70.

[15] See U.S. Dept. of Treasury, Making Home Affordable (continued...)

or "trial period" and permanent modifications, and other circumstances in which a servicer was required or authorized to suspend foreclosure.

Of paramount importance here, however, HAMP did *not* provide an individualized remedy that could be enforced affirmatively by homeowners whose lenders did not offer a palatable modification option; rather, the program operated by providing incentives to institutions and did not mandate legal compliance with a specific loan-by-loan standard for obligatory modifications. See *West v. JP Morgan Chase Bank, N.A.* (2013) 214 Cal.App.4th 780, 796-797. The "enforcement mechanism" for a lender's noncompliance with the modification standard is denial of the lender's right to include all or a portion of the value of the loan on its books as an asset if it does not meet the federal standard. See Final Rule, 74 Fed. Reg. 60137 (Nov. 20, 2009).

HAMP, then, is too slender a reed from which to infer and impose a common law duty for lenders to modify a second mortgage the HBOR expressly exempted from its ambit. Not only did HAMP distinguish in its application process between first and second mortgages, it was a *voluntary* program where lenders were mainly encouraged to

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[15](...continued)
Borrower Frequently Asked Questions (revised July 16, 2009).

participate in it by financial incentives to modify loans when it made economic sense to do so. For the Court to take these voluntary statutory incentives and use them as a basis to create a state common law tort obligation would likely make legislative bodies chary about enacting future incentives for voluntary action by lenders and loan servicers for mortgage modifications.

2. Homeowner Bill of Rights

All the HBOR's protections are codified in a series of statutes.[16] These provisions mandate procedures and rules designed to facilitate reliable communication between borrowers and mortgage servicers about foreclosure prevention. The HBOR holds all mortgage servicers operating in California accountable.

The HBOR's first notable protection is a ban on "dual track" foreclosures. This means that a mortgage servicer is precluded from exercising the power of sale clause in a deed of trust while a borrower is simultaneously seeking loan modification. Another HBOR protection is the requirement that mortgage servicers designate authority to someone to be

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[16] See Cal. Civ. Code §§ 2920.5, 2923.4, 2923.5, 2923.55, 2923.6, 2923.7, 2924, 2924.9, 2924.10, 2924.11, 2924.12, 2924.17, 2924.18, 2924.19 (enacted by 2012 Stat. Ch. 86, 87).

the single point of contact between borrowers and mortgage servicers. Lastly, the HBOR contains measures requiring servicers to document and verify every action in the foreclosure process with supporting evidence to eliminate practices such as "robo-signing" where mortgage servicers rubber-stamp affidavits and declarations during the foreclosure process without verifying the information.

The goal of the HBOR is to eliminate the obfuscation of information and red-tape standing between borrowers and objective information about their rights and foreclosure alternatives. Significantly, the HBOR gives "teeth" to these newly mandated protections for borrowers by creating new methods of enforcement. Koo, Comment and Note, *Saving the California Homeowner Bill of Rights from Federal Banking Preemption* (2013) 48 *U.S.F. L. Rev.* 189, 200.

Remedies for borrowers under the HBOR include injunctions and statutory damages. A borrower may enjoin a servicer who fails to comply with the HBOR any time before recordation of a deed upon sale. *Id.* note 58 at 200. Recovery of statutory damages and attorney fees is available if a foreclosure sale is completed in violation of the HBOR. *Id.*

Of primary importance here, the HBOR's protections, echoing the first iteration of HAMP, expressly do <u>not</u> apply to second mortgages: "Unless otherwise provided [these HBOR

protections] shall apply *only to first lien* mortgages or deeds of trust that are secured by owner-occupied residential real property . . . ..” Civ. Code § 2924.15; italics added. “There is . . . no more persuasive evidence of the purpose of a statute than the words by which the legislature undertook to give expression to its wishes.” *United States v. American Trucking Ass’n.* (1940) 310 U.S. 534, 542. This exclusionary language was in the original HBOR when enacted in 2012, and was reenacted verbatim when amended in 2018.

Restricting obligations under the HBOR to loan servicers for first lien mortgages was also expressly mentioned in the Committee Analyses about the bill: “‘Foreclosure prevention alternative’ means a first lien loan modification or another available loss mitigation.”[¶] “‘First lien’ means the most senior mortgage or deed of trust on the property that is the subject of the notice of default or notice of sale.” [¶] “[T]he dual track and [single point of contact provisions] apply only to first lien loan modifications.” *Senate Floor Analyses, Conference Report No. 1, SB 900*, June 27, 2012, pp. 4, 5, 26.

Petitioner complains about this express statutory exclusion denying him HBOR protections. [“Petitioner] does not have a remedy under HBOR because that law only grants a private right of action with regard to first-lien mortgages, and [petitioner’s] was a second-lien mortgage.” OBM, p. 13.

fn. 1. "Crucially, [Civil Code §] 2924.12 only creates a private right of action for first-lien mortgages, not second-lien mortgages like [petitioner's]." *Id.* at 20. He urges the Court to plug this gap by imposing a common law tort duty for him and others in default on their junior mortgages. This is significant because the "duty analysis . . . requires the court . . . to identify the *specific action or actions* the plaintiff claims the defendant ha[s] a duty to undertake." *Castaneda v. Olsher* (2007) 41 Cal.4th 1205, 1214; italics added.

There is, of course, a sound reason for Congress and the California Legislature to distinguish between senior (first lien) and junior (second and third lien) mortgages when providing statutory protections and incentivized cures for homeowners in default on their loans:[17]

> [T]he success of mortgage financing is due to a legal system that has developed a clear set of rules governing the rights and liabilities of mortgagor and mortgagee and the relative priorities among competing mortgagees all holding mortgages on the same parcel of land. *Although both senior and junior lenders held mortgages on the same property, their relative rights differed significantly by virtue of the common law rule of "first in time, first in right" and*

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[17] Berman, *"Once a Mortgage, Always a Mortgage"—the Use (And Misuse Of) Mezzanine Loans and Preferred Equity Investments* (2005) 11 *STAN. J.L. BUS. & FIN.* 76, 90.; italics added.

> *later because of the recording statutes.* In this way, the lowly mortgage proved quite flexible in providing financing, liquidity and capital for most real estate owners while at the same time protecting the collateral and security interests for mortgage lenders.

However one feels about this classificatory distinction between duties owed by lenders to senior, as opposed to junior, mortgages on the same property, the Legislature expressly recognizes it, has stuck with it for the past eight years and reenacted it in 2018. Petitioner implicitly denounces it as an underinclusive classification because he is left out of its protections. He would have the Court obliterate this legislative distinction by invoking and recognizing a common law tort duty applicable to all borrowers regardless of whether they are subject to first or junior liens on the same property. This invitation should be declined as it is a request for the court to rewrite the statute and assume responsibility by the judiciary for micro-managing mortgage foreclosures.

With respect to micro-managing nonjudicial foreclosure, one can easily imagine the future issues that would emanate from recognition of a general tort duty of care on lenders or their servicers for mortgage modification requests. Does it apply to the process employed by the lender in considering the borrower's request? Will experts be necessary to testify if the "mathematical formula" used by lenders is somehow

flawed and “unreasonably” led to a lender’s decision not to modify the mortgage? What about the appraisal value given property subject to the deed of trust or other quantitative measurements that go into the “net present value” determination? How about the determination whether the requestor’s income complies with the “slightly negative” benchmark?

If there is a tort duty for lenders not to negligently inform second-mortgage borrowers about what is happening with their request for mortgage modification, did Wells breach that duty when it sent petitioner a letter stating “we will proceed with whatever action is deemed necessary to protect our interests”? Was petitioner’s interpretation that this statement meant that no foreclosure would take place on his second mortgage mere “magical thinking,” a belief he “devoutly wished” to be true without bothering to verify the correctness of his understanding? Did petitioner’s failure to inquire of Wells about this place him at fault, and if so, does this mean comparative negligence should be injected into the nonjudicial foreclosure process? Is a trial necessary to determine if these two alternative viewpoints about “misinformation” constitute a breach of the lender’s duty?

And if the statutory duty for lenders to borrowers with first mortgages should inform and provide a similar common

law duty to borrowers with second mortgages, does this also apply to lenders with a portfolio of less than 175 loans, or to borrowers with owner-occupied real property of more than four dwelling units, which are specific, express limits in the HBOR?

To ask these questions prompts the likely ready response that they would have to be determined on a case-by-case basis, an answer indicating a plethora of future litigation to clog courts and disrupt and delay nonjudicial foreclosure to the detriment of just about everyone except defaulting, disgruntled borrowers and their counsel.

Judicially rewriting statutes to delete their explicit constraints by recognizing a common law tort duty is neither wise nor proper. Even when it comes to statutes arguably unconstitutional themselves, courts generally and wisely decline to reform or repair them in lieu of simply declaring them unconstitutional. And when courts do repair underinclusive unconstitutional statutes, they only do so when, *inter alia*, it reforms the statute "in a manner that closely effectuates policy judgments clearly articulated by the enacting body." *Kopp v. Fair Pol. Practices Com.* (1995) 11 Cal.4th 607, 615. Here, of course, there is no claim that a constitutional right is being violated by an underinclusive statutory classification leaving second mortgages exempt from

HBOR's protections. Neither can it be denied that the HBOR's express and consistent exclusion of second-lien mortgages from its protections constitutes a clear "policy judgment" of the Legislature to continue that classification.

Courts, then, have no general authority by virtue of their inherent power to rewrite a statute, even to salvage its validity. Rewriting would amount to amendment. See, *e.g.*, *Huening v. Eu* (1991) 231 Cal.App.3d 766, 777. Amendment is within the power of the legislative body. It is beyond that of the courts. "If the law is" in need of "alteration," "it ought to be changed; but the power for that is not with us." *Minor v. Happersett* (1874) 88 U.S. (21 Wall.) 178 (per Waite, C.J.). "The judges have no option in the matter. They are bound, hand and foot, by the shackles of [the] statute." Cardozo, *LAW AND LITERATURE* (1931) p. 106. Their "province" is "to expound the law, not to make it." *Luther v. Borden et al.* (1849) 48 U.S. (7 How.) 1 (per Taney, C.J.). Their authority "is only a negative—never an affirmative—force. It cannot create, it cannot initiate, it cannot put into action any governmental policy of any kind . . .. All [they] can do is to say Yes or No to a policy or program or a part of a policy or program that has been started by someone else in some other branch of government"—such as the legislative body. Rodell, *NINE MEN* (1955) p. 11. In this area, "[a]ll they can do is to approve or

disapprove—after they are asked to do so—a law passed by" that body. *Ibid.*

C. There is no "Special Relationship" between a Lender and Borrower Sufficient to Warrant Imposition of a Tort Duty upon the Lender to Pay to a Defaulting Borrower Pure Economic Damages if the Lender does not Reasonably Consider or Agree to a Modified Second Mortgage.

1. The Court should Refrain from Recognizing as "Special" the Relationship in a Second-Lien Mortgage between the Lender and Borrower.

No "special relationship" exists under the circumstances animating this case between the second mortgage lender and servicer to petitioner that warrants recognition of a common law duty in tort to him for mortgage modification. The relationship between petitioner and lender is an arm's length transaction. *Ragland v. U.S. Bank Nat. Assn.* (2012) 209 Cal.App.4th 182, 206. Petitioner borrowed money from the lender that he secured with a second deed of trust on his residence. He then breached that loan agreement by failing to make required payments under it, prompting the lender to avail itself of nonjudicial foreclosure under the deed of trust. As such, this second mortgage does not give rise to any fiduciary or quasi-fiduciary duties by the lender to petitioner that would qualify it as forming a "special relationship." *Oaks*

Management Corp. v. Superior Court (2006) 145 Cal.App.4th 453, 466.

This is not to say that a "special relationship" can never be found between borrower and lender. Where, for instance, a lender takes on more than one role, such as acting as a mortgage broker and investment advisor to the same client, it may give rise to fiduciary obligations by the lender. *Barrett v. Bank of America* (1986) 183 Cal.App.3d 1362, 1368 (bank officer had a close relationship with principal, provided investment advice, shared confidential information and otherwise created a special relationship of trust and confidence). In short, a lender who exerts egregious economic "control" over the borrower may acquire fiduciary duties. *Smith v. Home Loan Funding, Inc.* (2011) 192 Cal.App.4th 1331, 1335-1336. But those features are not present here; and as the appellate opinion emphasizes, 23 jurisdictions in the country have refused to recognize the mortgage lender-borrower relationship as "special" enough to trigger a common law tort duty to consider mortgage modification requests.

A plaintiff must do more than chant mantra-like the label "special relationship" to garner judicial recognition of that status; he must allege sufficient specific facts to show a "special relationship" of control by the lender, facts that are

absent here. A distinction between loan origination and loan servicing, with the latter activity somehow evincing a "special relationship" with the borrower, should not suffice for this purpose. See OBM, pp. 15-16. The Legislature was well aware of this particular wrinkle in the modern mortgage foreclosure process when passing the HBOR:[18]

> [T]he mortgage industry has become more complex. Rarely does a modern mortgage involve only two players, a lender and a borrower, with a common interest in avoiding default and the capacity to communicate directly. Instead, the modern mortgage industry typically involves at least four players: 1) the original lender (or originator); 2) a loan servicer (who may or may not be affiliated with the originator) who collects from the borrower and remits to the mortgage holder; 3) an investor who has purchased an interest in the mortgage (or more likely an interest in the stream of income from a pool of mortgages); and, 4) a borrower. *Under this more complex arrangement, it is the servicer – not the loan originator or the investor holding an interest in the mortgage – who collects payments and has the power to either bring a foreclosure or approve a loan modification or a short sale if the borrower fails to make timely payments.*

Despite legislative knowledge of the different roles played in today's mortgages by loan originators and loan servicers, however, the HBOR protections are expressly

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[18] *Joint Assembly and Senate Proposed Conference Report No. 1*, *SB 900*, July 2, 2012, p. 13; italics added.

exempted for second-lien mortgages. *Id.* at 2 (SB 900 “[l]imit[s] the scope of loss mitigation requirements and activities to first lien mortgages.”).

That loan servicers may have “perverse” or bad incentives (*e.g.*, their fees) not to modify mortgages is beside the point. See RB, p. 8. Contracts exist to govern the relationships between the parties to them, especially when their incentives are not aligned. Rather than excoriate foreclosure, for example, it can be reasonably argued that under certain circumstances the borrower may have “perverse incentives” not to repay the loan, and the contractual provision allowing the lender to foreclose on a property controls that incentive. The mortgage contract allocates the risks accordingly. A lender’s “incentives to work against borrower’s interests” (*id.*) may be just a lender’s incentives to work in its own interest, which is what we expect contracting parties to do.

For the Court to ignore this basic characteristic of contracts, and take a distinction the Legislature expressly found unpersuasive for application of the HBOR to second-lien mortgages and use it to impose a common law tort duty to do just that, is unsound and places courts in an awkward role vis-a-vis the other coordinate branches of government. “The relative size of a business [lender]. . ., the number of

[mortgage borrowers] the business serves, or the amount of its . . . resources" – all criteria the HBOR uses to impose statutory duties upon first but not second mortgages – "do not lend themselves to the formulation of a workable common law rule that would provide adequate guidance to businesses. Instead these factors are considerations . . . much more suitable to legislative evaluation and line-drawing." *Verdugo, supra*, 59 Cal.4th at 341. "[T]he Legislature stands in the best position to identify and weigh the competing consumer, business and public safety considerations." *California Grocers Assn. v. City of Los Angeles* (2011) 52 Cal.4th 177, 210. "The Legislature is generally in the best position to examine, evaluate and resolve the public policy considerations relevant to the duty question." *Verdugo, supra*, 59 Cal.4th at 342. In other words, what the Legislature found it should not do with respect to second mortgages, the Court should not put asunder by imposing a common law tort duty upon lenders and servicers of these mortgages.

The "special relationship" test originated from insurance cases where courts recognized a tort remedy for a breach of the implied covenant of good faith and fair dealing that exists in every contract. Existence of a tort remedy in the insurance context was recognized as appropriate because a "special relationship" existed between insurer and insured, one

characterized “by elements of public interest, adhesion and fiduciary responsibility.” *Seaman’s Direct Buying Service, Inc. v. Standard Oil Co.* (1984) 36 Cal.3d 752, 768.

Since then, however, this Court has taken a cautious approach toward expansion of new “special relationships.” *Foley, supra*, 47 Cal.3d 654 is instructive for why, having previously found the employer-employee relationship “special” enough to impose tort duties under certain circumstances, it was time to stanch the trend. A worker sought to extend tort remedies available in insurance bad faith cases to the employment context. He claimed punitive damages against his employer for firing him without cause in violation of the covenant of good faith and fair dealing implied in his employment contract. Although recognizing that traditional contract remedies may be inadequate to compensate employees for certain breaches, the Court concluded “the employment relationship is not sufficiently similar to that of insurer and insured to warrant judicial extension of the proposed additional tort remedies in view of the countervailing concerns about *economic policy and stability, and the traditional separation of tort and contract law*.” *Id.* at 693; italics added.

Foley found much to criticize about extending the “special relationship” label to the employer-employee context

that has application to the mortgage lender-borrower context. One criticism is that the special relationship test is "illusory;" it provides "a label to hang on a result but not a principled basis for decision." *Id.* at 691. Another is that while the special relationship test purports to be only a modest extension of the tort of bad faith beyond insurance and employment, it opens the way for pleading a tort cause of action in nearly every contract . . .." Third, "the role of [lender] differs from that of the 'quasi-public' insurance company with whom individuals contract specifically in order to obtain protection from potential specified harm. The [lender] does not similarly 'sell' protection to its [borrowers]." *Id.* at 692. (Of course, under both insurance and mortgage loans secured by deeds of trust, failure of the policy holder or borrower to make required payments ends, respectively, the insurer's duty to provide protection and triggers nonjudicial foreclosure right by the lender.)

Most importantly, in language pertaining to employment law that can, with the use of brackets, be appropriately adapted to nonjudicial mortgage foreclosure law, *Foley* explains that "the Legislature and Congress have recognized the importance of the [mortgage] relationship and the necessity for vindication of certain legislatively . . . established public policies in the [nonjudicial mortgage

foreclosure] context." *Id.* at 694.

Predictability of the consequences of actions related to mortgage contracts is important to commercial stability. To achieve such stability, it is important that lenders not be unduly deprived of discretion to deny mortgage modification to defaulting borrowers with second-lien loans on their property out of fear that doing so will give rise to potential tort recovery in every case.

2. *A Duty of Care by Lenders or Loan Servicers to Avoid Causing Purely Economic Losses for Negligence in Considering or Negotiating Secondary Mortgage Modifications should not be Recognized under the Authority of* Biakanja *and* J'Aire.

The appellate opinion here was right to rely upon the "approach" of *Southern California Gas Leak Cases*, *supra*, 7 Cal.5th 391 as an independent reason not to extend a tort duty when there is no personal injury or property damage, only pure economic loss. That decision relies in large part on the Restatement's finding and recommendation that there is "no general duty to avoid the unintentional infliction of economic loss on another." Rest. 3d Torts, Liability for Economic Harm, § 1. The Restatement is crystal clear about this: the economic loss rule (ELR) "eliminates tort claims based on a defendant's negligent statements of intent to make

a contract, predictions about the likelihood of a contract, or mistaken suggestions that a contract has been formed." *Id.* at § 3, com. e, p. 29.

Nonetheless, petitioner and his amici seek to evade the ELR's common-sense proscription by invoking the "special relationship" category as an exception to it. In their efforts, they place great reliance on two opinions of this Court —*Biakanja v. Irving* (1958) 49 Cal.2d 647 (*Biakanja*) and *J'Aire Corp. v. Gregory* (1979) 24 Cal.3d 799 (*J'Aire*). These two authorities, however, are misplaced when it comes to this case. Both involved third parties – intended beneficiaries of contracts made between two other parties – not as here liability of one party who is in contractual privity with the other. *Biakanja* and *J'Aire* are "third party situations" or "triangular configurations" in contrast to "two-party" or "direct party" situations. See Sebok, *The Failed Promise of a General Theory of Pure Economic Loss: An Accident of History* (2012) 61 *DEPAUL L. REV*. 615, 621.

J'Aire involved a suit between the tenant of a commercial space and a contractor who had been hired by the building's landlord to prepare a space for the tenant. The contractor failed to timely complete the work as promised and, as a result, the landlord could not deliver the space to

the tenant, who suffered a loss of expected profits. *Biakanja* involved a legatee who lost an inheritance due to the carelessness of a notary. In both opinions, as well as later ones including the *Southern California Gas Leak* opinion, the Court adopted and applied a six factor test to determine if common law tort duty applied.

But the common thread running through all of these cases that distinguish them from this one is that this six-factor test is only applied "*in the absence of privity of contract* between a plaintiff and a defendant." *Bily v. Arthur Young & Co.* (1992) 3 Cal.4th 370, 397, citing *Biakanja*; italics added. "With rare exceptions, a business entity has no duty to prevent financial loss to others with whom it deals directly." *Quelimane Co. v. Stewart Title Guaranty Co.* (1998) 19 Cal.4th 26, 59. See also *Beacon Residential Community Ass'n. v. Skidmore, Owings & Merrill LLP* (2014) 59 Cal.4th 568, 573 (deciding "whether design professionals owe a duty of care to a homeowners association and its members *in the absence of privity*," and concluding that it did because, *inter alia*, the Legislature statutorily abrogated the economic loss rule as applied by *Aas v. Superior Court* (2000) 24 Cal.4th 627) (Italics added.); *Stewart v. Cox* (1961) 55 Cal.2d 857, 861 (addressing "whether a subcontractor . . . may be liable to the owner, with

whom he was not in privity of contract." (Italics added.) Borrowers like petitioner and lenders like Wells Fargo are, however, in privity of contract; they deal directly with each other. So the *Biakanja* test is not properly employed to determine whether to impose a common law tort duty to prevent pure economic loss from one party in contractual privity with the other.

This Court uses a different analytical approach when the parties are in contractual privity. To keep from blurring the line between tort and contract law, tort recovery is disallowed for mere negligence that results in economic loss. *Erlich v. Menezes*, *supra*, 21 Cal.4th at 554. Tort liability arises in the contractual context only from a breach of duty that is "completely independent of the contract" or "from conduct which is both intentional and intended to harm." *Id.* at 552.

Even assuming that the *Biakanja* factors apply in determining whether a common law tort duty exists independent of the contractual relationship between petitioner and the lender, the factors when applied here do not weigh in favor of petitioner. First, mortgage modification is not a transaction intended solely or even primarily to affect the petitioner. We are dealing with a bilateral contract, where

any renegotiation must necessarily benefit both parties if it is to succeed, not just the borrower. And where servicing rights have been assigned to another entity, the result is the same: while a mortgage loan modification may also benefit the borrower, the loan servicer is hired by the lender to act as the lender's agent, not the borrower's. Unlike the plaintiff in *Biakanja*, the borrower is not the intended beneficiary of the lender-loan servicer agreement, but only an incidental beneficiary.

Second, while harm to a borrower like petitioner from negligent processing or consideration of a loan modification application may be foreseeable, it is far from certain. "[T]here was no guarantee the modification would be granted had the loan been properly processed." *Alvarez, supra*, 228 Cal.App.4th at 948. Foreclosure may be foreseeable in the way that "on a clear judicial day one can foresee forever," it is far from a fast or sure consequence of mishandling a modification request by a loan servicer. The borrower is not a helpless pawn in the process. He or she may appeal denial of a loan modification application. Civ. Code, § 2923.6(e). The borrower is given many months warning before a foreclosure occurs in which to reinstate the loan, refinance it, seek bankruptcy protection or take other steps to avoid foreclosure even when a loan modification is erroneously denied. And

"foreseeability alone is not sufficient to create an independent tort duty," especially between parties in privity of contract. *Erlich, supra*, 21 Cal.4th at 552.

Nor is it certain that petitioner was injured by Wells Fargo's alleged mishandling of his mortgage modification requests. He does not allege that he met the necessary qualification for a modification. And he does not mention the four years of freedom from making payments on his second mortgage while pursuing his modification applications.

Neither is there a close connection between the lender or loan servicer's allegedly negligent conduct and harm to the petitioner. Once again, petitioner cannot show that he would have been granted a modification but for Wells Fargo's alleged negligence in considering and processing his modification application. The decision to grant or deny a mortgage modification rests with the lender. It owed no contractual or other duty to grant a modification even if petitioner qualified for one.

Fifth, Wells Fargo's alleged conduct was not morally blameworthy. Sending petitioner letters that did not state, but somehow led him to believe that no one would foreclose on loans secured by his residence, does not rise to a morally offensive sin. The non-breaching lender of a second mortgage

is under no legal or moral imperative to rescue the borrower from the consequences of his or her default. "If the lender did not place the borrower in a position creating a need for a loan modification, then no moral blame [is] attached to the lender's conduct." *Lueras, supra*, 221 Cal.App.4th at p. 67. As *Daniels* held, the moral blame factor here is, at most, neutral. *Daniels v. Select Portfolio Servicing, Inc., supra*, 246 Cal.App.4th at 1183.

Sixth, and finally, imposing a duty of care on lenders and loan servicers does not necessarily prevent future harm to borrowers and may well increase it. "Imposing negligence liability for the mishandling of loan modification applications could be a disincentive to lenders from ever offering modification." *Id.* Indeed, because a loan servicer acts as the lender's agent, imposing a duty of care on the servicer would expose its principal, the lender, to vast tort liability under the doctrine of respondeat superior. Negligence actions, once one gets past the duty element, are difficult to resolve short of trial even when they are lacking in merit. Imposing a general duty on second mortgage lenders and servicers per petitioner's plea will increase the cost and delay of nonjudicial foreclosures to the detriment of the entire real estate market.

CONCLUSION

For all the aforementioned reasons, amici urge the Court to affirm the judgment below and deny recognition of a common law tort duty by a lender or loan servicer for mortgage modification to a borrower holding a second deed of trust.

Dated: September 8, 2020

/s/
Fred J. Hiestand
Counsel for *Amici Curiae*

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Dated: September 8, 2020

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