NO DUTY OF CARE OWED IN LOAN MOD NEGOTIATIONS

Disagreeing with contrary rulings from the First and Sixth Districts, the California Court of Appeal for the Second District recently affirmed a trial court's ruling that no duty of care is owed to a borrower during contract negotiations for a mortgage loan modification.

A copy of the opinion in *Sheen v. Wells Fargo Bank, N.A.* is available at: Link to Opinion.

In 1998, the plaintiff borrower obtained a $500,000 loan secured by a deed of trust (the "first loan"). The first loan is not at issue. In 2005, the borrower obtained two junior loans from the defendant bank in the amounts $167,820 (the "second loan") and $82,037 (the "third loan") (collectively, the "junior loans"). The borrower subsequently encountered financial troubles leading the bank to record a notice of default on the second loan in September 2009.

In January 2010, the borrower contacted the bank seeking to modify the junior loans and subsequently submitted loan modification requests to the bank on Jan. 29, 2010. In March 2010, the borrower received correspondence from the bank concerning the second loan, which the borrower claimed led him to believe the second loan had been converted into an unsecured loan. Around this time, the borrower separately alleged the bank contacted his wife and informed her no foreclosure sale would occur and that the bank "was simply trying to recover money through standard collection practices."

In April 2010, the borrower received a second letter from the bank where it offered to charge off 50 percent of the second loan's balance if the bank and the borrower could reach a satisfactory arrangement. The borrower claims the letter reinforced his belief that the second loan had been converted into an unsecured loan.

In November 2010, the bank sold the second loan to a different entity ("note holder") and canceled the third loan in March 2014. In August 2013, the borrower separately modified the first loan.

In April 2014, the note holder recorded a notice of default as to the second loan leading the borrower to submit several loan modification requests. The borrower asserted the note holder never responded to his modification attempts, and instead informed him in August 2014 that the second loan service transferred to another entity (the "current servicer"). Thus, the borrower submitted another loan

modification application to the current servicer who rejected it as a result of the borrower "having too little income."

The borrower subsequently filed for Chapter 7 bankruptcy relief and submitted two additional loan modification applications during the pendency of his bankruptcy. The current servicer rejected both loan modification applications again citing the borrower's low income. In 2014, the borrower, with the assistance of a legal aid representative, submitted a third loan modification application. The current servicer allegedly informed the legal aid representative that it no longer considered the second loan as being in "active foreclosure." The borrower separately contacted the note holder who informed the borrower that "it would consider a modification in lieu of foreclosure."

In October 2014, the borrower's bankruptcy was dismissed lifting the bankruptcy stay. The borrower subsequently learned that the property at issue would be sold in five days' time. The borrower immediately contacted the current servicer who confirmed the property's sale date.

The property was subsequently sold via foreclosure sale with the note holder being the highest bidder.

The borrower subsequently instituted the instant action against the bank asserting causes of action for: (1) negligence; (2) intentional infliction of emotional distress ("IIED"); and (3) violations of Business and Professions Code section 17200 ("Section 17200").

Relevant to this appeal and his negligence claim, the borrower alleged the bank owed the borrower a duty of care to: (1) "process, review, and respond carefully and completely to the loan modification applications [borrower] submitted to [bank]"; and (2) refrain from engaging in unfair and offensive business practices that confused the borrower and prevented him from pursing foreclosure prevention alternatives. The borrower further alleged the bank breached its duty of care by failing to respond to his loan modification applications and by stating it would not conduct a foreclosure, among other things.

The bank demurred to the borrower's operative complaint, which the superior court granted without leave to amend. Specifically, the trial court dismissed the borrower's negligence claim because the borrower failed to plead facts supporting a tort duty of care by [bank] to the borrower regarding the loan modification. The trial court sustained the bank's demurrer to the borrower's IIED claim for failure to

plead outrageous conduct and separately dismissed the Section 17200 "for want of an underlying claim."

The borrower appealed the lower court's order sustaining the bank's demurrer without leave to amend.

On appeal, the borrower argued the bank owed him a duty of care under the holdings of *Alvarez v. BAC Home Loans Servicing, L.P.*, (2014) 228 Cal.App.4th 941, and *Daniels v. Select Portfolio Servicing, Inc.*, (2016) 246 Cal.App.4th 1150.

As you may recall, the *Alvarez* and *Daniels* rulings held that a lender owes a borrower a duty of care in tort during mortgage modifications negotiations. However, there is a sharp conflict among California courts as to whether a lender owes a duty of care to a borrower during mortgage loan modification negotiations, and the California Supreme Court has not resolved the conflict.

The Court began its analysis by examining *Southern California Gas Leak Cases,* (2019) 7 Cal.5th 391, which recently found there is no tort duty where the damages complained of purely are economic. Specifically, the *Gas Leak Cases* held that economic losses flowing from "a financial transaction gone awry" are "primarily the domain of contract and warranty law or the law of fraud, rather than of negligence.'" (*Gas Leak Cases, supra,* 7 Cal.5th at p. 402.)

The Court further noted "a striking degree of unanimity" weighing against the *Alvarez* and *Daniels* decisions as courts in at least 23 jurisdictions refuse "to import tort duties during mortgage modifications negotiations.

The Court next examined the Restatement of Torts and found it provided that "no liability in tort for economic loss caused by negligence in the performance or negotiation of a contract between its parties." Indeed, the restatement further explained that the economic loss rule "prevents the erosion of contract doctrines by the use of tort law to work around them…[and] also reduces the confusion that can result when a party brings suit on the same facts under contract and tort theories that are largely redundant in practical effect."

The Court separately noted "the ability of legislatures to craft remedies beyond the ken of courts…[as] through the democratic process, the Legislature can bring to bear a mix of expertise while considering competing concerns to craft a solution in tune with public demands." *Gas Leak Cases, supra,* 7 Cal.5th at p. 413.

Thus, the Court held that the trial court properly dismissed the borrower's negligence claim because "a lender does not owe a borrower a common law duty to offer, consider, or approve a loan modification."

Concerning the borrower's other causes of action, the Court found his IIED claim was frivolous and that the trial court correctly dismissed the borrower's Section 17200 claim.

Accordingly, the Court affirmed the trial court's order sustaining the bank's demurrer without leave to amend.