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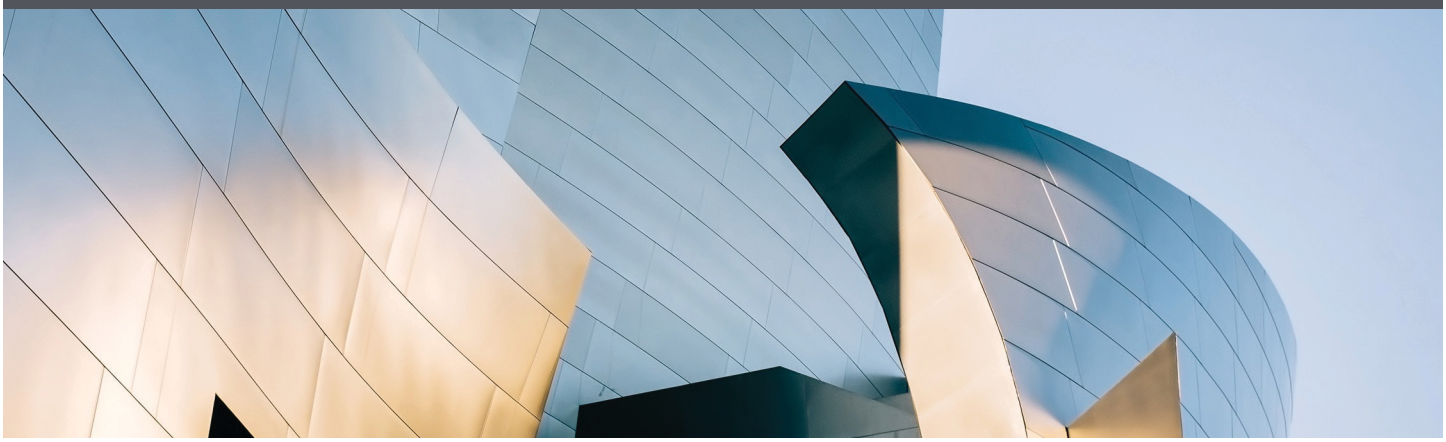

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California's Highest Court Confirms Lenders Owe No Duty to Borrowers to Process, Review, and Respond to Loan Modification Applications and Nixes Negligence Claim

Financial institutions, lenders, and servicers should take note that the California Supreme Court affirmed a Court of Appeal decision confirming there is no duty for a lender to "process, review and respond carefully and completely to" a borrower's submitted loan modification application. In doing so, California's highest court resolved a split of authority at the appellate level. However, the Court specifically disclaimed consideration of negligent misrepresentation or promissory estoppel claims, noting that nothing in the opinion "should be understood to categorically preclude those claims in the mortgage modification context."

In *Sheen v. Wells Fargo Bank, N.A.*[1] (March 7, 2022), the California Supreme Court affirmed the decision of the Court of Appeal, which upheld the trial court's decision sustaining defendant lender's demurrer to plaintiff borrower's negligence claim in a case involving a junior lien and a lender's alleged negligence in failing to respond timely to the borrower's request to modify a second position deed of trust.

BACKGROUND

Whether a duty to process, review, and respond to submitted loan modification applications exists in California has long divided the California Courts of Appeal. Typically, in defending themselves against such a claim, financial institutions, lenders, and servicers cite to *Nymark v. Heart Fed. Savings & Loan Assn.*[2] to confirm 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."[3] Even if the general rule of *Nymark* does not apply, the factors enumerated by *Biakanja v. Irving*[4] confirm that the courts should not recognize such a duty.

In *Sheen,* the borrower defaulted on junior liens sometime in 2008 or 2009. Thereafter, he contacted his lender, defendant Wells Fargo Bank, N.A. ("Wells Fargo"), regarding the possibility of canceling the foreclosure sale so that he could apply and

be considered for modification and, subsequently, submitted applications to modify his second and third position loans. Wells Fargo canceled the scheduled sale date, but had not yet responded to the borrower's application, and sold the loan. The property was ultimately foreclosed upon approximately four years later. Subsequently, the borrower brought suit, asserting a negligence claim against Wells Fargo on the grounds that it "owed Plaintiff a duty of care to process, review and respond carefully and completely to the loan modification applications Plaintiff submitted." The Court of Appeal affirmed the trial court's ruling sustaining Wells Fargo's demurrer.

CALIFORNIA SUPREME COURT'S DECISION

In affirming the Court of Appeal's decision, the California Supreme Court recognized the split of authority amongst the appellate courts and concluded that the borrower's common law negligence claim fails in light of the economic loss rule and cannot be justified by referencing the *Biakanja* factors. In a nutshell, the economic loss rule precludes recovery in tort for negligently inflicted purely economic losses in deference to a contract between litigating parties. Because the borrower's claim arises from, and is not independent of, the mortgage contract, the economic loss rule bars his negligence claim. Moreover, the California Supreme Court explained that its rejection of the borrower's arguments as incompatible with the economic loss rule also harmonizes with the well-established "general rule" of *Nymark* because the handling of a loan modification application is within the scope of Wells Fargo's role as lender. Further, the California Supreme Court confirmed that the multi-factor approach articulated in *Biakanja* does ***not*** apply in the mortgage servicing context, where the plaintiff and defendant are in contractual privity.

In addition, the California Supreme Court addressed two important policy considerations. First, in response to the borrower's argument that without the ability to bring a negligence claim, he would be left essentially remedy-less, the Court specifically noted that "there are causes of action *other* than a general claim of negligence," associated with failing to properly process, review, and respond to a loan modification application, including negligent misrepresentation and promissory estoppel. Second, in response to the borrower's argument that allowing his tort claim to go forward will prevent future harm, the Court noted that he failed to explain how imposing a duty would "encourage servicers to engage in the modification process rather than simply foreclose." Ultimately, the Court acknowledged that recognizing such a duty would impose real costs and likely involve reforms to the mortgage servicing industry, which are better left to the Legislature to tackle.

Finally, the Court expressly rejected cases balancing the *Biakanja* factors to determine whether a duty of care exists, including *Weimer v. Nationstar Mortgage, LLC*[5] (borrower sufficiently pleaded servicers had duty of care with regard to processing loan modification application after applying the *Biakanja* factors); *Rossetta v. CitiMortgage, Inc.*[6] (complaint sufficiently alleged a negligence cause of action, including a duty of care, against a loan servicer); *Daniels v. Select Portfolio Servicing, Inc.*[7] (borrower sufficiently alleged defendant breached its duty of care because four of the six *Biakanja* factors weigh in favor of finding a duty); and *Alvarez v. BAC Home Loans Servicing, L.P.*[8] (plaintiffs sufficiently alleged a breach of the duty of care by alleging improper handling of their loan modification applications, given that the *Biakanja* factors "clearly weigh" in favor of a duty), all cases frequently cited by borrowers, to the extent they are inconsistent with the Court's ruling.

CONCLUSION

Although the California Supreme Court confirmed that financial institutions, lenders, and servicers owe no separate duty to borrowers to "process, review and respond carefully and completely to" a borrower's submitted loan modification application, it

emphasized that it was only considering this narrow issue defined by the borrower.[9] Thus, while financial institutions, lenders, and servicers may see a down-tick in general negligence claims against them after this decision, they should expect to see an uptick in other causes of action associated with any failure to exercise reasonable care in processing, reviewing, and responding to loan modification applications, as the Court specifically declined to rule on negligent misrepresentation and promissory estoppel claims.

For additional information and assistance, contact Wayne Streibich, Diana M. Eng, Cheryl S. Chang, Jessica A. McElroy, or a member of Blank Rome's Financial Institutions Litigation and Regulatory Compliance ("FILARC") group.

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1. S258019 __ P.3d __ , 2022 WL 664722 (March 7, 2022)
2. 231 Cal.App.3d 1089 (1991)
3. *Id.* at 1086
4. 49 Cal.2d 647, 650 (1958)
5. 47 Cal.App.5th 341 (2020)
6. 18 Cal.App.5th 628 (2017)
7. 246 Cal.App.4th 1150 (2016)
8. 228 Cal.App.4th 941 (2014)
9. Justice Liu issued a concurring opinion to call attention to an important area that may warrant further consideration by the Legislature, citing the "frequency with which these issues are making their way through the courts." Justice Jenkins issued a concurring opinion to address his participation in *Alvarez.*