Case No. S258019

In the Supreme Court of the State of California

KWANG K. SHEEN,

Plaintiff and Petitioner

v.

WELLS FARGO BANK, N.A., et al.

Defendant and Respondent

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

Petitioner's Reply Brief

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INTRODUCTION AND SUMMARY OF ARGUMENT

Respondent Wells Fargo is advancing an extreme position in this case: it seeks total immunity for any negligent conduct it commits while servicing mortgage loans. According to Wells, once a servicer enters into a mortgage loan with a borrower, it can be as careless as it wants when servicing that loan, even if the borrower loses his home as a result of the servicer's misconduct.[1]

1. Wells first argues this result is mandated by the economic-loss rule ("ELR"), a rule designed to encourage private risk allocation between contracting parties, even though (a) Wells' loan contract with Petitioner Sheen says nothing about loan servicing (and thus does not allocate any risks regarding loan modification); and (b) Sheen has no alternative remedy.

Wells is wrong. The ELR does not bar Sheen's claim because his claim is predicated on a duty independent of the loan contract: the duty on the part of a loan servicer to exercise due care once it has agreed to review an application for a mortgage modification. (*See Robinson Helicopter Co., Inc. v. Dana Corp*. (2004) 34 Cal.4th 979, 984.) Such a duty meets all the factors set forth in in *Biakanja v. Irving* (1958) 49 Cal.2d 647, 649, for

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[1] Sheen uses the term "servicer" to refer to loan originators that service their own loans (as Wells did here) *and* independent loan servicers. The duty of care advocated here would apply to both. (For more on the distinction between loan origination and servicing, *see* Opening Brief on the Merits ("OBOM") at 14-18 and *infra* at 35.)

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deciding whether to allow a negligence claim for purely economic losses. (See ABOM at 38-50.)

This duty is warranted because, in the modern mortgage context, loan servicing is entirely distinct from loan origination, even where (as here) the servicing is done by the original lender. The rule that a lender does not have a duty of care with regard to traditional lending activities (*see*, *e.g.*, *Nymark v. Heart Fed. Savings & Loan Assn.* (1991) 231 Cal.App.3d 1089, 1095–1096), should not apply to mortgage servicing, where loans are treated as commodities and borrowers are at the mercy of loan servicers, who often have perverse incentives to work against borrowers' interests. (*See* OBOM at 14-18.)

Importantly, Wells concedes that the ELR "gives way…when a party violates a duty 'independent' of the contract." (Answer Brief on the Merits ["ABOM"] at 21 [citation omitted].) But Wells says a court may only recognize a negligence claim for economic loss under *Biakanja v. Irving* (1958) 49 Cal.2d 647, where the parties aren't in privity. In such cases, says Wells, allowing the plaintiff to sue in tort does not disturb the parties' private allocation of risk—and hence the ELR does not apply. But where the parties *are* in privity, says Wells, negligence claims are prohibited because allowing one party to sue in tort would disturb the parties' risk allocation—and hence violate the ELR.

This argument fails because the distinction between privity and non-privity is not what triggers the application *vel non* of the ELR. Rather, the relevant factor is whether the conduct giving rise to the duty is contractual or *extra*-contractual: *i.e.*, whether

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the defendant's tortious behavior also breached a contract between the parties. Where that's true, the ELR generally bars negligence claims because the plaintiff has a contractual remedy—and thus allowing the plaintiff to sue in tort would undermine the risk-allocation rationale of the ELR.

But where the tort duty is *extra-contractual*—*i.e.*, involves a duty that does *not* relate to a contractual breach—the ELR does not apply, because allowing the plaintiff to sue in tort would not disturb the tort/contract boundary line. (*See, e.g.*, *Connor v. Great W. Sav. & Loan Ass'n* (1968) 69 Cal.2d 850, 865.)

Put another way, *Biakanja*'s test for determining a duty of care is applicable (a) where the parties are not in privity (as in *Biakanja* itself) *and* (b) where the parties *are* in privity but the plaintiff lacks a contractual remedy because her injuries did not arise out of any contractual breach. Because that's true here, the ELR does not bar Sheen's negligence claim against Wells.

2. Wells also argues that, even if the ELR doesn't bar Sheen's claim, this Court should exercise "judicial restraint" in light of California's Homeowner's Bill of Rights ("HBOR"), Civ. Code section 2923.4 et seq., a statute designed to curb loan-servicing misconduct. (*See* ABOM at 44.) Because HBOR only imposes a narrow set of duties on servicers (and even as to those duties, only applies to first-lien mortgages), Wells argues it would violate the spirit of the statute for this Court to "intervene" by recognizing a common-law duty of care here.

HBOR's savings clause defeats this argument. It provides that HBOR's remedies "are in addition to and independent of any

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other rights, remedies, or procedures under any other law." (Civ. Code section 2924.12[g].) This provision shows that the Legislature was well aware that HBOR did not address all the problems of modern-mortgage servicing, and that it wanted to allow "any" other remedies under "any other law." (*Id.*)

This lawsuit asks this Court to recognize such a remedy for claims arising in negligence. "Imposing [such] a duty of care…would serve the policies underlying [HBOR's] legislative preferences…by giving lenders an incentive to handle loan modification applications in a timely and responsible manner." (*Rossetta v. CitiMortgage, Inc*. (2017) 18 Cal.App.5th 628, 642-643.)

Declining to recognize such a duty would send a signal to lenders like Wells that, so long as they comply with the limited duties prescribed by HBOR, they don't need to exercise reasonable care when servicing mortgage loans. That would not just be a terrible result for Sheen; it would be a terrible result for society. (*See Jolley v. Chase Home Finance, LLC* (2013) 213 Cal.App.4th 872, 902 & fn.18 [discussing enormous costs "borne by all of society" of home foreclosures].) The Court of Appeals' decision to the contrary should be reversed.

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ARGUMENT

I. *Biakanja* Applies Here and Weighs Heavily in Favor of Sheen.

A. *Biakanja* is Not Limited to "Stranger" Cases Where the Parties Are Not in Privity.

Wells' first argument is that *Biakanja*'s multi-factor test for deciding whether to recognize a duty of care does not apply to this case because the parties are not in privity—and thus, says Wells, the ELR prevents this Court from even considering whether there's a duty of care. This is wrong.

As a threshold matter, Wells ignores the fact that both this Court and the Courts of Appeal have consistently, for over three decades, applied *Biakanja* to determine whether lenders and mortgage servicers owe borrowers a duty of care. (*See, e.g.*, *Connor,* 69 Cal.2d at 865); *Weimer v. Nationstar Mortg., LLC* (2020) 47 Cal.App.5th 341, 360-364; *Rossetta,* 18 Cal.App.5th at 640; *Daniels v. Select Portfolio Servicing* (2016) 246 Cal.App.4th 1150, 1180-1183; *Alvarez v. BAC Home Loan Servicing* (2014) 228 Cal.App.4th 941, 948; *cf. Jolley*, 213 Cal.App.4th at 899 ["Perhaps the *Biakanja* factors must be applied here too…But even if not, they are certainly appropriate for consideration, which consideration compels a conclusion for [the borrower]."].)[2]

[2] *Weimer*, 47 Cal.App.5th 341, was issued after the Court of Appeal decided this case. *Weimer* applied *Biakanja* and *SoCalGas* to find a duty of care on the part of a servicer regarding a "modification transaction." (*Id*. at 365.)

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Despite this authority (which Wells does not acknowledge), Wells argues that *Biakanja* is inapplicable where the parties are in privity. This argument is grounded in the idea that, where there's no privity, the injured party lacks a contractual remedy—and thus it makes sense to allow that party to sue in tort. (*See* ABOM at 35 [citing *Goodman v. Kennedy* (1976) 18 Cal.3d 335, 353].) But under that reasoning, Sheen should be allowed to sue here. Even though Sheen is in privity with Wells, he has no contract remedy because Wells' conduct didn't violate their loan contract. So unless Sheen can sue in tort, he won't have any remedy at all. Thus, under Wells' own theory, the fact that Sheen's in privity with Wells shouldn't matter; the only consideration is whether the *Biakanja* factors favor a duty of care. (As explained below, they do.)

This conclusion is consistent with *Connor*, *supra*, which considered whether borrowers could bring negligence claims against a lender relating to construction defects in their homes. Applying *Biakanja*, *Connor* said they could, even though the plaintiffs were in privity with Great Western with regard to their home loans. (649 Cal.2d at 865 ["The fact that Great Western was not in privity of contract with any of the plaintiffs *except as a lender* does not absolve it of liability for its own negligence…"] [emphasis added].)

In so holding, Chief Justice Traynor recognized that, even though the borrowers were in privity with Great Western, they lacked a contract remedy because their loan agreements didn't address construction defects. Rather, their sole remedy would be

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in negligence—and the Court allowed them to sue because the *Biakanja* factors favored a duty of care. (*Id.*)

Likewise, in *Aas v. Superior Court* (2000) 24 Cal.4th 627, *superseded by statute on other grounds as stated in SoCalGas*, 7 Cal.5th at 402, this Court applied *Biakanja* to determine whether homeowners could sue a developer for potential economic losses related to construction defects, even though the homeowners were in privity with the developer. (*See id*. at 642; *see also id*. at 634.) In so doing, the Court approvingly addressed three cases that also applied *Biakanja* in instances where the parties were in privity. (*See id*. at 645.)[3]

That approach should apply here. As in *Connor*, Sheen is in privity with Wells but lacks any contract remedy because his loan contract doesn't address modification. Just as in *Connor*, then, this Court should apply *Biakanja* to determine whether he should be allowed to sue in tort.

Wells' cited cases (ABOM at 33-34 fns. 1-2) are not to the contrary. They merely establish that *Biakanja* allows recognition of a duty of care where the parties aren't in privity. That's certainly true. But *Biakanja* **also** applies where, as here, the

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[3] *Aas* ultimately found no duty of care because several of the *Biakanja* factors—in particular, the degree of certainty that the plaintiff suffered injury—were not met, partly because the construction defects had not yet caused any harm. (*Id*. at 646.) The Court also emphasized that, unlike here, the plaintiffs in privity with the defendant had alternative remedies, including for breach of contract. (*See id*. at 652-653.)

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parties *are* in privity but the plaintiff nonetheless lacks a contractual remedy. In such cases—cases like this one—allowing the plaintiff to sue in tort would not blur the tort/contract boundary line—and thus would not run afoul of the ELR.

B. *Biakanja* is Not Limited to Cases Where the Defendant Breached a "Preexisting Obligation."

Equally baseless is Wells' argument that *Biakanja* only allows recognition of a duty of care where the defendant has breached some "preexisting [contractual] obligation" or violated "a statute or some other source of law…" (*Id.*)

This argument is grounded in the notion that applying *Biakanja* absent a contractual breach would create "a general mandate to exercise care to avoid economic loss to all foreseeably affected parties, swallowing the ordinary rule." (*Id*. at 57.) But the first *Biakanja* factor takes care of that problem: it prohibits recognition of a duty unless there's an underlying transaction "intended to affect the plaintiff." (*See* 49 Cal.2d at 650.) Because a duty only extends to those the transaction was "intended to affect," there's no need to require a "preexisting violation" to prevent *Biakanja* from extending liability to "all foreseeably affected parties." (ABOM at 57.)

In this case, for example, if this Court allows borrowers to sue for negligent loan servicing, that duty will only extend to loan originators who service their own loans and independent loan servicers. Thus Wells' suggestion that applying *Biakanja* in the absence of a "preexisting violation" will extend liability to all foreseeably injured victims is simply wrong.

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C. The *Biakanja* Factors, When Properly Evaluated at a Broad Level of Generality, Weigh in Favor of a Duty of Care.

1. The Duty Question Should Be Evaluated at a Broad Level of Generality.

The only remaining duty question is whether the *Biakanja* factors weigh in favor of a negligence-based duty of care on the part of servicers. The answer should be yes. (*See* OBOM at 38-50.)

Wells tries to duck this question by arguing that this Court must apply the *Biakanja* factors to the specific facts of this case, rather than consider the *general* question of whether a servicer owes a borrower a duty to behave in a non-negligent fashion once it has accepted an application to modify a mortgage loan. (*See* ABOM at 58-59.)

In so arguing, Wells tries to conflate the questions of duty and breach, just as it tries to conflate the questions of duty and the ELR by arguing that this Court cannot even consider the *Biakanja* factors. But that's not the way duty analysis works. Rather, duty questions should be analyzed "at a relatively broad level of factual generality," leaving the issue of whether the duty was breached in a particular case to the factfinder. (OBOM at 38-39 [citing *Kesner v. Superior Court* (2015) 1 Cal.5th 1132, 1143].)

Wells argues that this "broad-generality" rule only applies to claims involving property damage or personal injury, which are subject to the presumptive duty of care set forth in Civil Code section 1714(a), whereas in the *Biakanja* context, "[t]he

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presumption is against recognizing a duty to prevent economic loss, and the question is whether to create a new duty." (ABOM at 59.)

This argument fails for two reasons. **First**, Wells' statement that "the presumption is against recognizing a duty against economic loss" (*id.*) is incorrect. As Dean Ward Farnsworth has written, "no such presumption is warranted or intended." (Ward Farnsworth, *The Economic Loss Rule* (2016) ["*Farnsworth*"], 50 Val. U. L. Rev. 545, 557.) Rather, the existence of such a duty simply "ha[s] to be established on some particular ground." (*Id.*)

Second, even if there *were* a presumption against finding a duty not to inflict economic loss, that wouldn't affect the level of generality at which a court must conduct the duty analysis. *SoCalGas* reaffirmed that, just as in cases under Section 1714(a), the "duty determination [in economic-loss cases] must ultimately "'occur[ ] at a higher level of generality'" than would a jury's analysis of fact-intensive issues like breach and causation…" (7 Cal.5th at 408 [quoting *Kesner*, 1 Cal.5th at 1144].)

Wells also errs in arguing that, unless this Court analyzes the duty question by only considering the specific facts alleged by Sheen, the "policy-bound determination of duty" would be "abdicate[d]" to juries. (ABOM at 59.) If this Court decides that servicers owe borrowers a duty of care, then the jury in this case will have to decide whether Wells violated that duty with regard to Sheen. That's not a "policy-bound determination of duty"

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(*id.*)—that's a *fact*-based determination of breach. And that's a question for a jury, not for a court.[4]

2. The *Biakanja* Factors Favor Sheen.

As previously argued (OBOM at 38-50), all the *Biakanja* factors strongly favor Sheen.

a. The first factor—"the extent to which the transaction was intended to affect the Plaintiff" (*Biakanja*, 49 Cal.2d at 650)—is clearly met here. The entire reason Sheen sought a loan modification was to stave off foreclosure and keep his home. The parties' interactions regarding the requested modification were obviously intended to affect Sheen. (*See Alvarez*, 228 Cal.App.4th at 948.) That a transaction is also intended to benefit the defendant does not affect the *Biakanja* analysis. (*See Daniels*, 246 Cal.App.4th at 1182.)

Wells' response is that the relevant "transaction" for purposes of *Biakanja* is Wells' "announcement that it intended to pursue methods of recovering Sheen's debt besides immediate foreclosure. Those communications were not intended to affect Sheen (except in the sense of exhorting him to cure his default)." (ABOM at 60.) But "curing his default" *would* have affected

[4] Even if this Court were to consider the specific facts of this case, it would be obligated to assume the truth of all material allegations in the complaint…including the allegations of negligence and cause in fact." (*J'Aire Corp. v. Gregory* (1979) 24 Cal.3d 799, 803.)

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Sheen, so even if that letter were the relevant "transaction" for purposes of *Biakanja*, the first factor would be met.

b. Wells' arguments about the second *Biakanja* factor—foreseeability—fare no better. Here again, Wells asks the Court to shift its inquiry from the general to the specific, arguing "it was not foreseeable that Wells Fargo's communications would cause Sheen harm." (ABOM at 60.)

But that's the wrong issue. The real issue is whether it's foreseeable to a servicer that misleading a borrower into thinking her loan has been modified and that she is safe from foreclosure could result in that borrower not taking actions to prevent foreclosure—and losing her home as a result. The answer to *that* question is undoubtedly yes. (*See Alvarez*, 228 Cal.App.4th at 949; *Daniels*, 246 Cal.App.4th at 1182.) Whether Wells' specific communications to Sheen actually caused his injuries is a breach question for the jury, not a duty question for the Court. (*See Kesner*, 1 Cal.5th at 1144.)

c. The same is true regarding factors three and four: certainty of injury/closeness of the connection. Wells acknowledges that Sheen lost his home to foreclosure. And its argument that Sheen's injury "was not closely connected to Wells Fargo's conduct" (ABOM at 62) goes to issues for the jury—breach and proximate causation—*not* to the question of duty, which must be analyzed by the Court at a broader level of generality.

Wells also argues that loss of opportunity to save one's home is too "speculative" to support a duty under *Biakanja*

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because it "do[es] not comfortably fit the definition of 'appreciable harm.'" (*Id.* [quoting *Aas,* 24 Cal.4th at 646 [citation omitted].) But unlike the harm at issue in *Aas* (construction defects that had not ripened into property damage), there's nothing speculative about the link between (a) a servicer's promise to a borrower that he is safe from foreclosure; (b) the borrower's resulting decision not to take steps to save his home from foreclosure; and (c) the ultimate loss of the borrower's home to foreclosure.

d. Wells' arguments as to blameworthiness suffer from the same defect: they rely on the specific facts of this case rather than the general issue of whether a servicer that negligently misleads a borrower into thinking her loan has been modified and her home is safe from foreclosure is morally blameworthy. (*See* ABOM at 62-63.)

Whether Wells' specific communications were truthful and actually caused Sheen's misunderstanding are jury questions of breach and proximate causation. The general question of whether conduct that *is* misleading and that *does* cause confusion and homelessness is morally blameworthy is a duty question for the Court—and as to that question, the answer is yes. (*See Alvarez,* 228 Cal.App.4th at 949.)

e. The final *Biakanja* factor is met because allowing negligence claims in this context would "prevent future harm to borrowers, by giving lenders an incentive to handle loan modification applications in a timely and responsible manner." (*Rossetta*, 18 Cal.App.5th at 642-643.)

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Wells counters that "[l]enders already have strong incentives and regulatory obligations to work towards reasonable modification." (ABOM at 63.) But those incentives didn't stop Wells from engaging in the type of conduct at issue here. As this case demonstrates, 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 modification. (*See also, e.g.*, *Daniels*, 246 Cal.App.4th at 1182; *infra* at 34 fn. 11.)

Equally baseless is Wells' argument that recognizing a duty of care regarding loan servicing may backfire on consumers by dissuading servicers from offering loan modifications, given the "nebulous" nature of the duty sought by Sheen. (ABOM at 64.) The Legislature did not let that concern stop it from passing HBOR; it should not stop this Court either.

And the duty advocated here is not any more "nebulous" than many other negligence claims. Medical and legal malpractice claims, for example, involve thousands of decisions for which there is no clear matrix as to what behavior the defendant should have engaged in to avoid being held liable. Yet juries have been permitted to sit in judgment of doctors and lawyers for over a century. (*See, e.g.,* 6 Witkin, *Summary 11th Torts* (2020 ed.) ("*Witkin*"), § 1066 [discussing claims against medical practitioners and explaining that juries generally measure practitioners' conduct according to the "degree of skill or care usual in the profession…"]; *Lucas v. Hamm* (1961) 56 Cal.2d 583, 591 [citing cases involving attorney malpractice].)

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Outside the professional-services context, negligence claims arise in innumerable settings, ranging from merry-go-rounds to cemeteries. (*See Witkin* § 998 [listing examples].) Juries make judgment calls in all of these areas. (*See id*. § 956 [noting that negligence "is not absolute or to be measured in all cases in accordance with some precise standard but always relates to some circumstance of time, place and person."] [citation omitted].) There is nothing about mortgage servicing that warrants a special carve-out from negligence-based duties that govern conduct in so many other settings.[5]

# # #

In short, all of the *Biakanja* factors weigh strongly in favor of recognizing a duty of care in this case. The only remaining question is whether that duty is blocked by the ELR. It is not.

II. The Economic-Loss Rule Does Not Apply Here Because Wells Violated an Independent Duty of Care.

Wells concedes that the ELR "gives way...when a party violates a duty 'independent' of the contract." (ABOM at 21 [citing *Erlich v. Menezes* (1999) 21 Cal.4th 543, 551].) Wells also concedes that its contract with Sheen does not address loan modification. That should be the end of the matter. Because the

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[5] Even if there were, this Court could look to federal and state guidelines to further define the standards that should guide servicers' conduct, as the Montana Supreme Court did in holding that a lender "owed a [fiduciary] duty to manage the modification process in a manner that would not cause the [borrower-plaintiffs] to suffer loss or injury by reason of its negligence." *Morrow v. Bank of Am., N.A.* (Mont. 2014) 324 P.3d 1167, 1178.

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contract is silent as to modification, Sheen's claim is predicated on an independent duty: the duty on the part of a servicer to behave in a non-negligent fashion after accepting an application for loan modification. The ELR does not bar that duty because it is entirely independent of Wells' contract with Sheen. (*Robinson Helicopter*, 34 Cal.4th at 988.)

A. Sheen's Claim Does Not Interfere with the Parties' Contractual Allocation of Risk.

Wells nonetheless argues that allowing Sheen to sue would "gut the [ELR]" by interfering with parties' contractual allocation of risk. (ABOM at 23.) But Sheen's contract with Wells did not allocate any risks associated with loan modification. Sheen most certainly did not agree that if Wells (1) accepted a loan-modification application; (2) cancelled foreclosure proceedings pending review of that application; (3) sent Sheen letters indicating his loan was no longer secured by a lien on the house; (4) verbally promised that Sheen's home would not be sold; and (5) transferred the loan to another servicer, who then foreclosed, then Sheen would have no remedy against Wells in either contract or tort.

Wells' argument that all these risks were anticipated by the parties and somehow accounted for in the mortgage contract—thereby rendering the independent-duty exception inapplicable to this lawsuit—cannot be reconciled with California's longstanding rule that any ambiguity created by contractual silence must be construed against the drafter—a rule that applies "with particular force" in a case involving a contract of adhesion, where

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one party has superior bargaining power. (*Sandquist v. Lebo Automotive, Inc*. (2016) 1 Cal.5th 233, 248.)

Wells' argument that "contractual 'silence may itself serve as an allocation' of risk" (ABOM at 24) is not only contrary to *Sandquist*, but it fails in the context of this case. Wells cites the *Restatement of Torts* for this proposition, but the *Restatement* goes on to say that *whether* contractual silence allocates a particular risk that lies "at the fringe of a contract's coverage" is a "question for the court to answer." (*Restatement (Third) of Torts, Liability for Economic Harm* (Tent. Draft No. 1, Apr. 4, 2012) ("*Restatement*"), § 3, com. c].) "[A]nswering that question," says the *Restatement*, "may require study of the transaction and its logic," keeping in mind that "the purpose of [the ELR] is to protect the bargain the parties made, *not to penalize the plaintiff for failing to make a broader one*." (*Id*. [emphasis added].)

What is the "logic" of the transaction here? This is where the rubber really meets the road in this case. For Wells to prevail, this Court would have to conclude that a loan contract that is silent as to modification gives the lender *carte blanche* to commit negligence while servicing that loan—including by misleading the borrower into thinking he is safe from foreclosure.

One can see why Wells might like this conclusion, but the notion that Sheen or any other borrower would silently agree to such an arrangement is fanciful. And such a conclusion would run directly contrary to the *Restatement*'s admonition that the "purpose of the ELR" is "*not* to penalize the plaintiff for failing to

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make a broader" bargain than he actually made. (*Restatement* § 3, com. c. [emphasis added].)[6]

* * *

In short, the "risk-allocation" rationale of the ELR is not even implicated by Sheen's negligence claim, let alone "gutted." (ABOM at 23.) Wells' contention to the contrary just shows how extreme its argument really is. Boiled down, Wells' position is that "contractual 'silence may itself'" block *any* tort duties of care for *any* behavior related contract's subject matter. (ABOM at 24 [quoting *Restatement* § 3].) If true, that would mean that once a lender issues a mortgage to a borrower, it can be as careless as it wants with regard to servicing that loan and not be liable for any resulting damage, so long as its behavior is related to the loan contract. That can't be the right result, particularly not where—as here—one party has all the bargaining power. (*Sandquist*, 1 Cal.5th at 248.)

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[6] The cases cited by Wells on this point (ABOM at 25-28) are just as disobliging as the *Restatement*. In *Wigod v. Wells Fargo Bank, N.A.* (7th Cir. 2012) 673 F.3d 547, 555, for example, the court held that because a servicer had *agreed* in a new Trial Period Plan ("TPP") contract to modify a borrower's loan, her negligence claim, essentially for the servicer's failure to perform under the TPP, was not independent of that new contract—and thus was barred by the ELR. (*Id.*) There was no such agreement here, and thus Sheen has no contractual remedy that displaces a tort duty of care.

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B. The Independent-Duty Rule is Not Limited to Intentional Torts and Other Areas Where This Court Has Recognized Special Relationships.

Wells also tries to circumvent the independent-duty exception by arguing that, outside the intentional-tort context (*e.g.*, *Robinson Helicopter, supra*), the exception only applies where there's some kind of "special relationship" (*not* of the *Biakanja* variety), which Wells narrowly defines as either a fiduciary duty or a contract for professional services. (*See* ABOM at 28-30.) Wells is wrong.

1. The Independent-Duty Rule Encompasses Negligence Claims.

Wells cites *Erlich v. Menezes* (1999) 21 Cal.4th 543, for the proposition that, outside the professional-services context, the ELR prohibits negligence claims between contracting parties. (ABOM at 26-27.) But *Erlich* expressly *permits* tort duties for "mere negligence" when "the conduct in question is so clear in its deviation from socially useful business practices that the effect of enforcing such tort duties will be...to aid rather than discourage commerce." (*Erlich*, 21 Cal.4th at 554 [citation omitted].)

Here, allowing borrowers to sue servicers for negligence *would* "aid rather than discourage commerce." (*Id.*) As HBOR's legislative history states, "every foreclosure imposes significant costs on local governments, including an estimated [$19,229] in local government costs." (*Jolley*, 213 Cal.App.4th at 902 fn.17 [citation omitted].) In passing HBOR, the Legislature stated that "[a]voiding foreclosure, where possible, will help stabilize the state's housing market and avoid the substantial, corresponding

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negative effects of foreclosures on families, communities, and the…economy." (*Id.*)[7]

Allowing borrowers like Sheen to sue in tort when a servicer's negligence leads to foreclosure creates an economic incentive for servicers to avoid foreclosure. It should go without saying that this would "aid" commerce—not "discourage" it. (*Erlich*, 21 Cal.4th at 554.)

And the *reason* for disfavoring economic-loss claims grounded in negligence has no application here because Sheen has no contractual remedy. In *Erlich*, this Court said that "[i]f every negligent breach of a contract gives rise to tort damages the limitation would be meaningless, as would the statutory distinction between tort and contract remedies." (*Id.* at 554.) Sheen has no quarrel with that proposition: it makes sense to preclude a negligence claim where the Plaintiff has a contractual remedy. (*Id.*)

But here Sheen has no contractual remedy, as Wells concedes. Nor can he sue for promissory estoppel, as Wells also concedes. So allowing him to sue in negligence won't blur the boundary line between tort and contract in the least.

Notably**,** Dean Farnsworth himself rejected the notion that an independent-duty exception to the ELR cannot sound in negligence. Indeed, any "statement that broad must be swiftly

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[7] HBOR's legislative history is compiled at: https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=201120120AB278.

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and extensively qualified, and so it has been." (*Farnsworth*, 50 Val. U. L. Rev. at 549.) Thus,

> [t]he rule [against allowing negligence claims for economic losses] does not apply to claims of negligent misrepresentation. The rule does not apply when the parties have a special relationship. The rule does apply to claims against professionals. The rule does not apply to claims by fishermen. The rule does not apply when a lawyer botches the drafting of a will and is sued by someone who otherwise would have inherited a bequest but did not. And so on.

(Id. [footnotes omitted].) "These exceptions," says Dean Farnsworth, "have drained the general rule of much of its clarity and utility." (*Id.*) Sheen could not agree more.[8]

To be sure, this Court *has* applied the ELR to certain claims involving negligent breach of contract. (*See Robinson Helicopter*, 34 Cal.4th at 997 [Werdeger, J., dissenting].) That makes sense in cases involving "routine breach" of contract, where allowing a contracting party to sue in tort would disrupt business relations and interfere with the contractual allocation of risk. (*Id.* at 996-998.)

But—again—this is not such a case. Not only does Sheen have no contractual remedy (because there was no contractual

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[8] This Court has "for over fifty years" allowed negligence claims in the context of professional services. (*North American Chem. Co. v. Super. Ct.* (1997) 59 Cal.App.4th 764, 774-775 [citing cases].)

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breach), but the notion that he was in a position to allocate the risk of Wells' negligent servicing is untenable.

Rather, this is a case involving parties of vastly unequal bargaining power, where the conduct at issue is independent of the underlying contract *and* "violate[s] a social policy that merits the imposition of tort remedies." (*Freeman & Mills, Inc. v. Belcher Oil Co.* (1995) 11 Cal.4th 85, 107; *cf. Barrera v. State Farm Mut. Auto. Ins. Co.* (1969) 71 Cal.2d 659, 669 [holding that, "[b]ecause of the 'quasi-public' nature of the insurance business…, the rights and obligations of [an] insurer cannot be determined solely on the basis of rules pertaining to private contracts negotiated by individual parties of relatively equal bargaining strength."].)

2. The Independent-Duty Rule is Not Limited to Cases Involving Breach of a Fiduciary Duty.

Wells also argues that the independent-duty exception to the ELR does not apply because Sheen's claim does not "remotely resemble" the independent duties previously recognized by this Court. (*See* ABOM at 28 [discussing professional service contracts with doctors, lawyers, accountants, and insurers].)

But that proposition is hardly self-evident. Loan servicing is similar to many other professional services in that the borrower and the servicer are in an "unequal relationship in which the borrower has no choice but to rely completely on the loan servicer" for activities that carry great risk for the borrower. (Andrea Bopp Stark, *A Duty to Reevaluate a Duty of Care for Mortgage Servicers* (2015) ["*A Duty to Reevaluate*"] 30 Me. B. J.

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77, 80.) That alone recommends strongly in favor of allowing negligence-based economic-loss claims against servicers. (*See Restatement* § 4 [noting that "the background rule that normally leaves contracting parties to their contracts… assumes the parties negotiated on equal footing…[T]hose assumptions and policies are weak when a client hires a professional."].)

Beyond that, the consequences to a borrower from negligent mortgage servicing can be just as serious as—and often far *more* serious than—the consequences from breach of other professional-service contracts. After all, Sheen and his wife lost their home because of Wells' negligence. And the consequences to society from loss of a home can greatly exceed (for example) the social costs of a botched lawsuit between private parties or an unsuccessful plastic surgery. (*See Jolley*, 213 Cal.App.4th at 902 & fn.18 [discussing enormous costs "borne by all of society" of home foreclosures].)

Why, then, should borrowers be singled out for uniquely disfavored treatment when it comes to recognizing a duty of care in the provision of mortgage servicing?

Wells' first answer is that "[n]o fiduciary duty exists between a borrower and lender in an arm's length transaction." (ABOM at 28 [citing *Ragland v. U.S. Bank Nat'l Ass'n* (2012) 209 Cal.App.4th 182, 206].) That is debatable, *see, e.g., Morrow,* 324 P.3d at 1177, but even if it's true, the lack of a *fiduciary* duty does not preclude recognition of a duty of reasonable care. *Connor* itself establishes that fact. (*See* 69 Cal.2d at 865.)

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And, as *Alvarez* observed, this is an area that cries out for recognition of such a duty: "[t]he borrower's lack of bargaining power, coupled with conflicts of interest that exist in the modern loan servicing industry, provide *a moral imperative* that those with the controlling hand be required to exercise reasonable care in their dealings with borrowers seeking a loan modification." (228 Cal.App.4th at 949 [emphasis added]; *see also Jolley*, 213 Cal.App.4th at 903.)

Wells' second answer is that, in all these areas, "the premise of the tort is that there is *also* a contractual breach." (ABOM at 28 [emphasis in original].) But *Connor* disproves Wells' point: there, this Court held that homeowners *could* sue a lender in tort even though there was no underlying breach of contract. (*See* 69 Cal.2d at 865.)

Wells' argument also ignores the distinction between loan origination and loan servicing. This is a crucial point. In a case like this one, a lender is wearing two separate hats: it loans a borrower money to purchase a home in its lender role, and it then *services* that loan in its role as servicer (or, in most cases, has a separate company service the loan). The fact that a lender has not breached its loan contract should not mean it has no duty of reasonable care with regard to loan servicing: the two activities are entirely distinct. (*See Rossetta,* 18 Cal.App.5th at 640 ["[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."]; Stark,

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A Duty to Reevaluate, 30 Me. B. J. at 80 [“The servicing of a loan is a very different business from the lending itself,…involving different responsibilities, incentives, and issues.”].)[9]

Here again, Wells’ argument boils down to the proposition that once a lender loans money to a borrower, it can commit negligent acts with impunity when it comes to the servicing of that loan, including misleading him into thinking his home is safe from foreclosure—and then foreclosing. That outcome flies in the face of California’s strong policy favoring loan modification to prevent home foreclosures, as embodied in HBOR. (*See Jolley*, 213 Cal.App.4th at 902-903 & fns. 17-18.)

* * *

In the final analysis, none of Wells’ attempts to avoid the independent-duty exception to the ELR withstands scrutiny. The exception clearly applies.

III. No Other Source of Law Addresses the Harm that Sheen Identifies.

Aside from its reliance on the ELR, Wells argues that this Court should not recognize a duty of care because “other sources of law address the potential harm that Plaintiff identifies.” (ABOM at 39.) This is simply untrue.

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[9] Wells’ argument makes even less sense in cases where the loan is serviced by an entity that did not originate the loan—a common occurrence in the modern era. (*See* Adam J. Levitin & Tara Twomey, *Mortgage Servicing* (2011) 28 Yale J. on Reg. 1, 5.)

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Sheen's only solid cause of action is in negligence. Sheen cannot claim breach of contract, because his loan doesn't address modification. He can't claim promissory estoppel, because Wells' misrepresentations were not sufficiently definite to sustain a quasi-contractual claim—as Wells concedes. (*See* ABOM at 52.) And negligent misrepresentation would be a long shot (at best), because it requires a showing that the plaintiff relied on a false representation that the servicer knew or "should have known" was false. (ABOM at 48 [quoting *Small v. Fritz Cos., Inc.* (2003) 30 Cal.4th 167, 173-174].)[10]

Contrary to Wells' contention (ABOM at 41-42), negligent misrepresentation is not a sufficient remedy for loan-servicing misconduct. Many (and likely most) of the injuries suffered by borrowers at the hands of servicers are the result of negligent behavior (such as delay, lost paperwork, and failure to return phone calls from borrowers), not "materially false" statements.

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[10] Two of the statements relied on by Sheen were Wells' letters implying that Sheen's loans were no longer secured by liens on his home. (*See* Clerk's Transcript ["CT"] at 489-490.) His contention is that those letters were misleading, especially in combination with Wells' failure to respond in any other way to Sheen's loan-modification application, and that Wells was negligent to send them while otherwise ignoring his application, not that they were literally false. Sheen also relies on Wells' phone call to his wife saying that his home would not be foreclosed on. (CT 491, 497-498.) Wells will likely deny having made such a call. In any event, Sheen relies on this phone call in the context of Wells' letters and Sheen's pending application, not as a stand-alone misrepresentation giving rise to liability.

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(*See* OBOM at 14-16; Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers* (2004) ("*Limiting Abuse*") 15 Hous. Policy Debate 753, 756.) A cause of action for negligent misrepresentation would not address any of these problems.

Wells therefore errs in arguing that "other sources of law" adequately address injuries like Sheen's. (ABOM at 39.) They do not. This, too, should weigh heavily in favor of recognizing a negligence duty of a care. (*See Aas,* 24 Cal.4th at 653 [holding that, in light of alternative remedies, "the facts of this case do not present a sufficiently compelling reason to preempt the legislative process]; *see also id*. at 655 [George, C.J., dissenting] ["As Chief Justice Traynor recognized in *Connor*, *supra*,…the inadequacy of contract and warranty law properly should inform our consideration of the role and use of tort law in this context."].)

IV. HBOR's Limited Scope is Not a Reason for this Court to Exercise "Judicial Restraint."

Nor is there any basis for Wells' argument that this Court should exercise "judicial restraint" because the legislature has "proven capable" of acting in this area. (ABOM at 44*; see also id*. at 43 [arguing the Court should not do "that which the Legislature has left undone"] [citation omitted].)

A. First, HBOR's limited scope defeats any notion that it would be inappropriate for this Court to recognize a duty of care with regard to mortgage servicing. (*See Consumer J. Ctr. v. Olympian Labs, Inc*. (2002) 99 Cal.App.4th 1056, 1061 [holding

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that "[o]ne can hardly 'occupy a field' while shunning vast acres of it."] [footnote omitted].)[11]

But if there were any doubt on that point, it would be defeated by HBOR's savings clause, which expressly *permits* a borrower to bring claims based on a tort duty alongside, or even in the absence of, any claims under HBOR. (*See* Civ. Code section 2924.12[g] [providing that "[t]he rights, remedies, and procedures provided by [HBOR] are in addition to and independent of any other rights, remedies, or procedures under any other law."].)

This savings clause defeats Wells' "judicial restraint" argument right out of the starting gate. (*See Rojo v. Kliger* (1990) 52 Cal.3d 65, 81-82 [holding that statutory claim did not provide exclusive remedy where law "expressly disclaims" any intent to occupy field]; *Pacific Lumber Co. v. State Water Resources Control*

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[11] For example, while a complete loan-modification application is pending, HBOR is limited to prohibiting a servicer from recording a notice of default or notice of trustee's sale and from conducting a trustee's sale. (Civ. Code section 2923.6[c].) HBOR says nothing about other kinds of servicer misconduct during the pendency of such an application that the law of negligence would regulate. (*See generally* Eggert, *Limiting Abuse*, 15 Hous. Policy Debate at 756.) Here, for example, the misconduct includes failing to respond to a loan-modification application and instead sending misleading communications while the application was pending, suggesting that Sheen's home was not at risk of foreclosure. This would not have violated HBOR even if Sheen's loan had been a first-lien mortgage, since Wells never recorded a notice of default or notice of trustee's sale after Sheen submitted his application, nor did Wells conduct a trustee's sale, but it was certainly negligent.

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Bd. (2006) 37 Cal.4th 921, 934 [holding that savings clause defeats argument that statute implicitly precludes agencies from exercising authority].)

B. Wells concedes, as it must, that HBOR's savings clause shows that HBOR does not outright preclude other remedies. (*See* ABOM at 43.) Wells nonetheless argues that this Court should not "circumvent" a legislative "gap" by recognizing a common-law duty. (ABOM at 43 [citing *U.S. v. Valdez-Pacheco* (9th Cir. 2001) 237 F.3d 1077, and *Korens v. R. W. Zukin Corp*. (1989) 212 Cal.App.3d 1054.)

But the statute in *Valdez-Pancheco* affirmatively *barred* a prisoner from collaterally attacking his sentence (*see* 237 F.3d at 1080); HBOR, in contrast, expressly *preserves* "any other rights, remedies, or procedures under any other law." (Civ. Code section 2924.12[g].) Likewise, *Korens* rejected a tenant's attempt to convince a court to order a remedy that the Legislature had "repeatedly refused" to enact. (212 Cal.App.3d at 1069.) But HBOR reflects no such "refusal"—in fact, the savings clause *allows* additional remedies. (*See* Civ. Code section 2924.12[g].)

Wells' other cases on "judicial restraint" (ABOM at 40-41) are equally off-point. Neither *Wolfe v. State Farm Fire & Cas. Ins. Co*. (2012) 46 Cal.App.4th 554, nor *Moore v. Regents of Univ. of California* (1990) 51 Cal.3d 120, involved a savings clause. In *Wolfe*, moreover, the Legislature had "not only enacted certain measures to address the problems which gave rise to appellant's complaint, it ha[d] also made clear its intent to consider other measures as well." (46 Cal.App.4th at 567.) And in *Moore*, the

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Court rejected a tort duty of care upon finding such a duty was (a) unnecessary to protect against "the very type of harm with which [the plaintiff] was threatened" (51 Cal.3d at 147) *and* (b) would actually undermine various Legislative objectives, including "punishing innocent parties [and] creating disincentives to the conduct of socially beneficial research." (*Id.* at 144.) Neither is true here.

Beyond that, "judicial abstention" is generally appropriate only where there is an alternative means of resolving the issues raised in the plaintiff's complaint…" (*Klein v. Chevron U.S.A., Inc* (2012) 202 Cal.App.4th 1342, 1169, *as modified on denial of reh'g* (Feb. 24, 2012) [distinguishing *Wolfe*].) Here, there is no such alternative remedy for Sheen. So the argument that a tort-based duty of care would somehow undermine HBOR or offend the Legislature's policy preferences is defeated by HBOR itself.

C. Wells fares no better when it argues that "even if" additional duties beyond HBOR would advance the Legislature's interest in avoiding foreclosures, that would simply be "a basis for further industry-specific legislative or regulatory action." (ABOM at 44.) Wells cites *SoCalGas* for this proposition. But *SoCalGas*'s deference to the Legislature was based on the Court's belief that its hands were tied by the ELR—a rule the Court described as often providing "unfair" and "even perverse" results, but which nonetheless proved the "least-worst" alternative under the unique circumstances of that case. (7 Cal.5th at 412.) Here, the Court's hands are *not* tied because the ELR is no barrier to a common-law remedy—and HBOR itself expressly allows one.

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Wells also argues that that HBOR's drafters must have wanted to foreclose tort remedies because HBOR's "limited scope was intentional." (ABOM at 42 [citation omitted].) But the Conference Report cited by Wells simply states that HBOR was modeled on the National Mortgage Settlement ("NMS"), which—like HBOR—only covers first-lien mortgages and prescribes a narrow set of affirmative duties. (*Id.*) There is no evidence the Legislature's decision to mirror the NMS was anything other than a practical legislative strategy. In fact, HBOR's savings clause shows the opposite.[12]

D. Wells' argument that imposing a duty here would undermine HBOR by "perversely increasing the likelihood of foreclosure, and harming rather than protecting homeowners" (ABOM at 44-45), is equally baseless. If Wells were correct, then one would expect HBOR itself to have had a chilling effect on servicers' willingness to offer loan modifications. But Wells cites no evidence to suggest that's true. Instead, it simply states that "it is entirely unclear whether imposing a general duty of care in negotiating loan modifications will improve such negotiations—or simply eliminate them altogether…" (ABOM at 44.) This type of half-baked speculation is insufficient to derail a duty of care that

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[12] The NMS was a $25 billion foreclosure settlement between five banks (including Wells Fargo), federal agencies, and state attorneys general. HBOR was designed to extend the NMS to all servicers in this state. *See* http://www.nationalmortgagesettlement.com/.

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is otherwise well-grounded in policy. (*See T.H. v. Novartis Pharm.* (2017) 4 Cal.5th 145, 173 [rejecting Novartis' argument that a tort duty of care could cause brand-name drug companies to "stifle innovation" as unsupported by "any evidence…"].)

E. Equally baseless is Wells' argument that "[t]he policy issues here pose 'empirical question[s] of fact,' which are 'better suited to legislative investigation and determination' than to judicial resolution." (ABOM at 45 [*quoting State Dep't of Health Servs. v. Superior Court* (2003) 31 Cal.4th 1026, 1048].)

Wells forgets that the recent financial crisis spurred exhaustive investigations by policymakers—investigations that gave rise to myriad legislative and regulatory solutions, including HBOR. If California's Legislature had thought HBOR sufficient to cure the myriad social ills caused by foreclosures, it could have said so. But—again—it said the opposite, by expressly preserving "any other rights, remedies, or procedures under any other law." (Civ. Code section 2924.12[g].)

Wells nonetheless insists that a "generalized" tort duty would "put every lender in a quandary" as to whether it should "[f]ollow its contract and relevant regulations" or "do something different." (ABOM at 46). But there's nothing nebulous about Sheen's claim: he is simply asking to hold Wells liable for misleading him about the status of his loan-modification request and foreclosure, thereby preventing him from taking action to prevent the loss of his home. (*See* CT 496-500 [negligence claim in Second Amended Complaint].) The notion that the "challenge" of addressing this misconduct is so nuanced that it requires

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"finely tuned rules" that "defy judicial creation" (ABOM at 46) is nothing more than smoke and mirrors.

And allowing borrowers like Sheen to sue in tort would not require servicers to choose between conflicting obligations. If Sheen had a remedy under HBOR he would be pursuing it. But he does not. Recognizing a negligence-based duty of care would not supplant or contradict existing statutory remedies; it would *complement* them. There's nothing inappropriate about that; in fact, that's exactly the role tort law is designed to play. (*See Wyeth v. Levine* (2009) 555 U.S. 555, 579 (2009) ["state [tort] law offers an additional, and important, layer of consumer protection that complements…[regulation].")

* * *

In short, the fact that HBOR does not provide Sheen a remedy is not a reason for this Court to demur. Although HBOR and other laws "provide vital protections for homeowners, none provides for complete relief to a homeowner that has faced years of abuse, misrepresentations, and runaround from a loan servicer." (Stark, *A Duty to Reevaluate,* 30 Me. B. J. at 79.)

This Court has always been at the forefront of recognizing new tort duties of care when appropriate, and has it done so in areas that are subject to "extensive specialized regulatory attention." (ABOM at 40; s*ee, e.g.*, *Kesner,* 1 Cal.5th at 1151; *Novartis*, 4 Cal.5th at 168-170.) That a particular social ill *could* be the subject of a legislative fix doesn't mean that tort law has no role to play. And it clearly has a role to play in the loan

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servicing context, where negligent misconduct has a widespread impact on individuals like Sheen and on society as a whole.

CONCLUSION

Dean Farnsworth has observed that "the economic loss rule is often intoned without reflection on its rationale, as if we all know that tort law isn't really meant to fix financial mishaps. But sometimes tort law *is* meant for that purpose..." (*Farnsworth*, 50 Val. U. L. Rev. 545, 551 [emphasis added].) This is such a case: the only way to fix Wells' "financial mishap"—its carelessness in servicing Sheen's loan contract—is to allow Sheen to sue in tort. This Court should let him.

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Respectfully submitted,

LOS ANGELES CENTER FOR
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DATED: July 20, 2020 By: /s/ Noah Grynberg

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PUBLIC JUSTICE, P.C.

DATED: July 20, 2020 By:/s/ Leslie A. Brueckner

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CERTIFICATE OF WORD COUNT

Pursuant to Rule 8.520(c)(1) of the California Rules of Court, I hereby certify that this brief contains 8,325 words, including footnotes and excluding the caption page, table of contents, table of authorities, signature blocks, and certificates. In making this certification, I have relied on the word count of the computer program used to prepare the brief.

Dated this 20th day of July, 2020.

PUBLIC JUSTICE, P.C.

By:/s/ Leslie A. Brueckner
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CERTIFICATE OF INTERESTED ENTITIES OR PERSONS

Counsel for Petitioner lists the following entities that may qualify as interested entities or persons pursuant to California Rules of Court, Rule 8.208(e)(2):

1. FCI Lender Services, Inc.
2. Mirabella Investments Group, LLC

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

Dated this 20th day of July, 2020.

By: /s/Leslie A. Brueckner
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PROOF OF SERVICE

I, the undersigned, declare that I am over the age of 18 and am not a party to this action. I am employed in City of Oakland, California; my business address is Public Justice, P.C., 475 14th St., Suite 610, Oakland, CA 94612.

On the date below, I served a copy of the foregoing document entitled **Petitioner's Reply Brief** on the interested parties in said case as follows:

X BY THE COURT'S TRUEFILING SYSTEM: Upon filing, I will cause the document to be transmitted via the Court's TrueFiling System.

SEE ATTACHED SERVICE LIST

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. This declaration is executed in Oakland, California on July 20, 2020.

Leslie A. Brueckner	/s/Leslie A. Brueckner
(Type or Print Name)	(Signature of Declarant)

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