California Supreme Court Holds No Common Law Duty to Process, Review, and Respond to Loan Modification Applications

March 30, 2022

On March 7, 2022, the California Supreme Court held in *Sheen v. Wells Fargo Bank, N.A.* that a lender owes no tort duty sounding in general negligence principles to "process, review and respond carefully and completely to" the borrower's loan modification application. This question has divided the state since the Great Recession, with *Lueras v. BAC Home Loans Servicing, LP* (2013) 221 Cal.App.4th 49, and its progeny holding that lenders did not owe a common law duty of care, and *Alvarez v. BAC Home Loans Servicing, L.P.* (2014) 228 Cal.App.4th 944, and its progeny holding a duty existed.

In *Sheen*, decided on demurrer, the borrower claimed that the lender never provided information on the status of his modification application, charged off the loan, and confirmed that it would not foreclose but would continue to collect the debt. The debtor believed that the loan was unsecured and would not be subject to foreclosure. After the loan was sold, the new owner foreclosed, and the borrowers sued.

The Court affirmed the dismissal of the negligence claim on three grounds. First, the economic loss rule bars a tort recovery for negligently inflicted purely economic losses. The Court stated that the economic loss rule harmonizes with the well-established California principle 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," and loan modifications fit within the conventional money lending role. Second, the Court found that the *Biakanja v. Irving* (1958) 49 Cal.2d 647, multifactor approach to determine whether a duty of care exists ([1] the extent to which the transaction was intended to affect the plaintiff, [2] the foreseeability of harm, [3] the degree of certainty that the plaintiff suffered injury, [4] the closeness of the connection between the defendant's conduct and the injury suffered, [5] the moral blame attached to the defendant's conduct, and [6] the policy of preventing future harm), does not arise when the parties are in privity of contract, because the contract defines the parties' responsibilities. Third, the Court rejected various policy arguments, finding that the legislature was better able to strike the correct policy balance, especially where "[t]here has been an extraordinary profusion of new, robust and still-expanding consumer laws, regulations and enforcement authority" in the mortgage service industry, especially with regard to the regulation of "the conduct of mortgage servicers in distressed loan situations."

The Court left certain issues open to future litigation. The holding did not apply to claims for negligent misrepresentation, or promissory estoppel, and noted that borrowers may assert intentional claims, such as fraud or intentional misrepresentation, if supported by facts. Borrowers and lenders should continue to process loan modification applications while complying with federal and state laws, including the California Homeowner Bill of Rights.

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