BY LORI WERDERITCH

# Navigating Lender Liability in the Wake of *Zigner*

**LAST SEPTEMBER IN ORANGE COUNTY,** Pacific Mercantile Bank was dealt a crushing blow. A jury not only found the bank liable to its customer and borrower Mark Zigner for the tort of conversion but also awarded Zigner sizable punitive damages.[1] Zigner's executed line of credit agreements with the bank authorized it, in the event of a default, to set off the outstanding debt by pulling funds from Zigner's other various accounts. Without notice, the bank exercised this remedy when Zigner could not pay down the line of credit. The loss of funds from Zigner's accounts swiftly resulted in default on many of his other financial obligations, which left Zigner with a multitude of liens and virtually no creditworthiness. Zigner responded by filing suit against the bank, alleging tortious conversion.

Zigner's line of credit with the bank had matured and, due to tough economic times, he was unable to pay. Pacific Mercantile Bank exercised its remedies in a manner consistent with the signed borrowing agreements. The story's surprise is its ending—$250,000 in compensatory damages and $1.8 million in punitives.[2]

## *Mitsui* and the Duty of Care

The case may seem startling, but a historical review makes it less so. Since a 1989 case, *Mitsui Manufacturers Bank v. Superior Court,*[3] it has been generally accepted that lending and banking institutions owe no legal duty to their borrowers and customers, severely limiting the potential for tort liability arising from such relationships. However, the judiciary has steadily eroded this principle.

*Mitsui* established the general principle that banks owe no duty of care to their borrowers or customers. The case concerns an action by Mitsui against its borrower for payment of the borrower's defaulted loan and the subsequent cross-action by the borrower against Mitsui for tortiously breaching the implied covenant of good faith and fair dealing by refusing to renew the loan in a manner consistent with some alleged oral representations. Mitsui moved for summary judgment on the action and cross-action, arguing that, as a matter of law, the relationship between a lending institution and its borrower is insufficient to support a tort claim. No breach of legal duty occurred because none is formed by a lender-borrower relationship.[4]

The appellate court agreed, reversing the denial of summary judgment and issuing a writ of mandate to enter judgment against the borrower.[5] Relying heavily on the California Supreme Court's *Foley v. Interactive Data Corporation,*[6] the *Mitsui* court concluded that the lender-borrower relationship lacked the necessary hallmarks to support a cause of action sounding in tort.[7] The majority reasoned that a lender-borrower transaction is merely an "ordinary arms-length commercial transaction between two parties of equal bargaining strength" that, when breached, are "adequately remedied by ordinary contract damages."[8] Hence, tort liability need not be extended into the realm.

*Mitsui*'s holding appears to create a general rule that characterizes the lender-borrower relationship as legally insufficient, in and of itself, to support the imposition of tort damages for breach of a legal duty. This raises a question at the heart of tort law: Can a lender-borrower relationship transform into something substantial enough to support a borrower's tort claims? While the *Mitsui* decision offers a negative answer, several post-*Mitsui* decisions have eroded that negative and established a rubric for analyzing whether and when a legal duty sufficient to support a claim in tort arises from a specific lender-borrower relationship.

Only two years after *Mitsui*, the court in *Nymark v. Heart Federal Savings and Loan Association*[9] reconciled *Mitsui*'s holding with the general principles of tort by fashioning a bright-line approach tailored to banking and lending. In *Nymark,* a borrower alleged that the lending institution was negligent in preparing an appraisal of the borrower's loan security.[10] The appraisal had been performed for the primary purpose of protecting the lender's interest in the collateral.[11] In assessing whether the borrower's negligence claim survived summary judgment, the *Nymark* court agreed that "a lender of money owes no duty of care to a borrower," but only if the "financial institution [was] acting within the scope of its conventional activities as a lender."[12]

In affirming summary judgment against the borrower, the *Nymark* court noted that the activities of the lender that were subject to the borrower's negligence claims were limited to only the processing, securing and extending of the underlying loan.[13] As these activities fulfilled the "traditional" lending role, no duty of care was further imposed. "Accordingly, in preparing the appraisal, defendant [lender] was acting in its conventional role as a lender of money to ascertain the sufficiency of the collateral as security for the loan."[14]

However, the court went on to observe that the borrower's complaint failed to allege "that the appraisal was intended to induce plaintiff [borrower] to enter into the loan transaction or to assure him that his collateral was sound." Such a statement strongly implies that, if an intent to induce is demonstrated, the lender may be subject to a legal duty of due care, notwithstanding the traditional lending routine it performed by the appraisal.[15] Accordingly, it follows that even when acting in a traditional role, depending on the alleged facts and evidence, the bank or lending institution may still be found to have owed to its borrower or customer a legal duty of care sufficient to support a tort claim.

Thus, to provide further guidance for ascertaining whether a bank has exceeded the scope of its conventional activities in the context of the alleged facts of a borrower's tort claim, the *Nymark* court affirmed the application of the general test in California for legal duty to relationships arising between banking and lending institutions and their customers.[16] The test "'involves the balancing of various factors, among which are [1] the extent to which the transaction was intended to affect the plaintiff, [2] the foreseeability of harm to him, [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.'"[17]

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Since *Nymark,* many cases have permitted banking customers and borrowers to proceed against bank or lending institutions on theories of tort, often applying the *Nymark* test to determine when the institution has acted beyond its conventional role, and in some instances expressly limiting the reach of *Mitsui.*

### *Holcomb* Limits *Mitsui*

One recent example is *Holcomb v. Wells Fargo Bank, N.A.*[18] In *Holcomb,* a bank customer brought several tort causes of action, including negligence and negligent misrepresentation, against his banking institution and one of its officers. The claims arose from statements allegedly made by the officer regarding the availability of deposited funds.[19] Purportedly, the statements induced the customer's detrimental reliance, causing the customer to write checks against deposit funds still subject to hold and not yet cleared.[20] The trial court sustained demurrers to the negligent misrepresentation and negligence causes of action because it interpreted case law to prohibit tort causes of action brought by customers against banks.[21]

In reversing the trial court, the *Holcomb* court severely narrowed the reach of *Mitsui*'s precedent by expressly stating that *Mitsui* did not stand for such a proposition. In fact, the *Holcomb* opinion goes so far as to declare *Mitsui*'s holding absolutely inapplicable to negligence claims not arising from the implied covenant of good faith and fair dealing.[22] In essence, the *Holcomb* decision virtually bulldozed the barrier imposed by *Mitsui* and opened a passage for all tort claims brought by borrowers and banking customers against their lending and banking institutions, with the single exception of tortious breach of the implied covenant of good faith and fair dealing. Ultimately, the *Holcomb* court found that the complaint at issue indeed stated a cause of action for negligent misrepresentation because it did not take issue with the bank's right to charge back the checks but rather with the statements made by the bank branch manager that allegedly induced the writing of the checks.[23] On those grounds, the complaint against the bank survived.

Later cases have similarly eroded *Mitsui*'s potential for absolute preclusion of tort liability in the lending and banking sphere by applying the *Nymark* test to dispositive motions while simultaneously and emphatically rejecting the argument that "a lender never owes a duty of care to a borrower."[24]

As the existence of legal duty is an essential element of a tort claim and a question of law to be determined by the court,[25] the course of these decisions has serious implications for dispositive motion practice in seemingly straightforward disputes between banking institutions and their customers that would appear otherwise suitable for determination on the pleadings. To illustrate, in *Sullivan v. J.P. Morgan Chase Bank, N.A.,*[26] borrowers brought an action against their lender alleging that it, in extending a loan on the borrowers' home, directed them into an unaffordable mortgage by stating it "was the best on the market" and subsequently misrepresented that permanent modifications would be made when the borrowers' requested a reduction in their monthly mortgage payment. In bringing a motion to dismiss the borrower's complaint for failure to state a claim, the bank argued that the borrowers could not prevail on their negligence cause of action because, as a matter of law, the bank did not owe its borrowers any duty of care.[27]

In applying the *Nymark* test, the *Sullivan* court outlined the specific contentions of the plaintiffs that 1) they were not qualified for the mortgage amount by prevailing industry standards, 2) the mortgage was "not in their best interests" based upon their income and the property's true market value, and 3) the mortgage contained excessive fees and monthly payments that eclipsed the ability of the plaintiffs to pay.[28] The complaint also alleged that the bank, in an effort to finalize the mortgage, appraised the property's value too highly, falsified the plaintiffs' actual income, and misinformed the plaintiffs about the loan modification process.[29] Such allegations, which reflect the common frustration of an entire population of foreclosed mortgagors, appears on its face ripe for demurrer or, depending on the forum, a motion to dismiss for failure to state a claim.

In the end, the *Sullivan* court cited a lack of authority supporting the imposition of duty of care, but only with respect to the bank's alleged misinforming the plaintiffs about the mortgage modification process.[30] Citing a very recent prior precedent,[31] the *Sullivan* court went on to find that the *Nymark* factors did in fact establish a duty of care not to overstate property value and income on a loan application that resulted in the loss of opportunity to obtain an affordable loan elsewhere. In so finding, the *Sullivan* court shifted the burden to defendant bank.[32] As the court noted, the bank "has not shown plaintiffs' allegations that it falsified their income and the subject property's value during the loan application process fall within its traditional role as a money lender."[33] On these grounds, the borrowers' negligence claims were held to have been stated by the complaint,[34] which survived the pleading stage.

*Sullivan* highlights the consequence of *Mitsui*'s weakening precedent for litigants in the banking and lending industry. Banks and lending institutions must be counseled and advised of the *Nymark* factors so that they may protect their practices and actions from the tort claims of disgruntled customers and borrowers. As demonstrated by *Zigner,* this is true even in cases in which authorization for a potentially tortious act appears to be granted by the potential future plaintiff. From the perspective of plaintiffs and their counsel, comprehensive understanding of the *Nymark* factors in artfully crafting a complaint could provide substantially stronger leverage for more favorable settlement terms. ■

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1 Zigner v. Pacific Mercantile Bank, Orange County Case No. 30-2010-00337433 (filed Jan. 21, 2010).
2 The punitive damages award was later reduced by the court to $950,000.
3 Mitsui Manufacturers Bank v. Superior Court, 212 Cal. App. 3d 726 (1989).
4 *Id.* at 729.
5 *Id.* at 733.
6 Foley v. Interactive Data Corp., 47 Cal. 3d 654 (1988) (No duty supporting tort liability exists in employment relationships.).
7 Mitsui, 212 Cal. App. 3d at 729-33.
8 *Id.* at 731.
9 Nymark v. Heart Fed. Savings & Loan Ass'n, 231 Cal. App. 3d 1089, 1092 (1991).
10 *Id.* at 1093.
11 *Id.* at 1094, 1096.
12 *Id.* at 1095-96 (citing pre-*Mitsui* decisions Wagner v. Benson, 101 Cal. App. 3d 27, 34–35 (1980); Bradler v. Craig, 274 Cal. App. 2d 466, 473 (1969); Fox & Carskadon Fin. Corp. v. San Francisco Fed. Sav. & Loan Ass'n, 52 Cal. App. 3d 484, 488 (1975).
13 *Id.* at 1096-97.
14 *Id.* at 1097.
15 *Id.* at 1096-97.
16 *Id.* at 1098-1100 (citing Biakanja v. Irving, 49 Cal. 2d 647, 650 (1958)).
17 *Id.* at 1098. (quoting Connor v. Great Western Sav. & Loan Ass'n, 69 Cal. 2d 850, 865 (1968) (quoting Biakanja v. Irving, 49 Cal. 2d 647, 650 (1958))).
18 Holcomb v. Wells Fargo Bank, N.A., 155 Cal. App. 4th 490, 496-500 (2007).
19 *Id.* at 493-95.
20 *Id.*
21 *Id.* at 496 (trial court's holding relied on *Mitsui).*
22 *Id.*
23 *Id.* at 498.
24 *See, e.g.,* Champlaie v. BAC Home Loans Servicing, LP, 706 F. Supp. 2d 1029, 1060 (E.D. Cal. 2009); Osei v. Countrywide Home Loans, 692 F. Supp. 2d 1240, 1249 (E.D. Cal. 2010); *see also* Melegrito v. CitiMortgage, Inc. 2011 WL 2197534, at *11 (N.D. Cal. June 6, 2011) (six-factor test).
25 Kentucky Fried Chicken of Cal., Inc. v. Superior Court, 14 Cal. 4th 814, 819 (1997) (The tort element of legal duty is a question of law for the court.).
26 Sullivan v. J.P. Morgan Chase Bank, N.A., 725 F. Supp. 2d 1087, 1093-94 (E.D. Cal. 2010).
27 *Id.* at 1093.
28 *Id.* at 1094.
29 *Id.*
30 *Id.*
31 Watkinson v. MortgageIT, Inc., 2010 WL 2196083, at *8-9 (E.D. Cal. Apr. 2, 2011).
32 Sullivan, 725 F. Supp. 2d 1087 at 1094.
33 *Id.*
34 *Id.*