

IMPORTANT CASE LAW SUMMARIES (NOV. 2008)

In re Schuessler, 2008 WL 174935 (Bkrtcy S.D.N.Y. April 10, 2008)

Facts:

Mortgage servicer filed a MFR based on a Chapter 7 debtor's alleged default on their mortgage. Upon discovering that the loan was not delinquent, and after several adjournments, the law firm used a non-legal entity (Pillar Processing) in an attempt to withdraw the motion. A legal assistant who was "acting on behalf of Pillar Processing, filed a letter with the Court in an attempt to withdraw the 362 motion.

The court, on its own motion, issued a show cause order and held an evidentiary hearing where the bankruptcy supervisor that signed the affidavit, and other representatives of Chase were ordered to explain why the motion incorrectly alleged default and no equity. (there was over \$100k in equity).

Holding:

Servicer was sanctioned for filing the motion for relief, which the court considered an abuse of process. However, the servicer was liable for the debtor's legal fees only—"at this time."

Discussion:

A creditor's inattentiveness can be just as abusive of process as an intentional act of misconduct.

...the actions of the Mortgage Servicer constituted an abuse of process... regardless of whether or not the abuse was the result of intentional conduct.

The Court stated that the holding was intended to serve as a warning to all creditors that, . . . , the conduct of the Mortgage Servicer (including acts that were taken and not taken by its employees, agents and attorneys) constituted an abuse of process.

"Even where creditors, such as the Mortgage Servicer, devise a system designed to insulate them from any accountability or evidence of an intentional act or misrepresentation, this does not mean that the system itself will not constitute an abuse of process; nor does it render this Court powerless to identify and correct such abuses."

Sanctions under one subsection of Rule 9011 cannot be avoided by violating another subsection of Rule 9011.

Fed. R. Bankr.P. 9011(a) requires that:

Every petition, pleading, written motion, and other paper, except a list, schedule, or statement, or amendments thereto, shall be signed by at least one attorney of record in the attorney's individual name. A party who is not represented by an attorney shall sign all papers. Each paper shall state the signer's address and telephone number, if any. An unsigned paper shall be stricken unless omission of the signature is corrected promptly after being called to the attention of the attorney or party.

The system utilized by Chase Home Finance to monitor loans in bankruptcy and to move for relief from the automatic stay was "wholly unacceptable for a national mortgage lender."

The court stated that when affidavits are submitted under penalty of perjury, it expected that the facts asserted to have been carefully researched and, to the best of the party's knowledge, not only be true, but complete enough to be an accurate characterization.

The accuracy of the affidavits submitted with a lift stay motion is particularly important because the burden of proof shifts to the debtor to prove that cause does not exist to grant relief. In short, the Court must be certain that the party requesting relief from stay is taking the matter seriously.

The court's decision was published as a warning, not just to Chase Home Finance and other mortgage servicers, but to all individuals and entities involved in the process, along the line- analysts, supervisors and other personnel employed by mortgage servicers; third-party vendors; regional law firms; and local counsel- that the conduct identified by the court, constituted an abuse of process.

In re Nosek, 2008 WL 4445707 (1st Cir. Ct. App. Oct. 2008)

The First Circuit Court of Appeals vacated the bankruptcy court, and district court, whereby damages had been awarded to a debtor for emotional distress and punitive damages.

The First Circuit concluded that the alleged failure to “account for and properly distinguish between pre-petition and post-petition payments” and its inability to “promptly credit Nosek’s account from the suspense account...” neither violated § 1322(b) nor the debtor’s confirmed plan.”

The bankruptcy court had determined that the creditor had violated “its implied covenant of good faith and fair dealing by acting contrary to the text of 11 U.S.C. § 1322(b)...” by failing to “to account for and properly distinguish between pre- petition and post-petition payments made by [Nosek], as well as ... [its] inability to promptly credit [Nosek’s] account from the suspense account.”

The First Circuit determined that § 1322(b) provided a debtor with flexibility in outlining a plan and the language of the section was permissive; not mandatory.

The bankruptcy court erred when it concluded that the creditor “defied the text of 1322(b) because it did not impose any specific duties on the creditor.

The language in the debtor’s plan did “not place any specific obligations on [the creditor], accounting or otherwise.” The debtor’s plan clearly stated that she would continue to make payments in accordance with the contract, including pre-petition arrearages. The debtor’s plan did not specify how the creditor was to account for “pre- and post-petition payments during the course of the repayment period if payments were short, late, or note made at all.”

The First Circuit vacated the lower courts’ award of \$250,000 in damages for emotional distress and \$ 500,000 in punitive damages because the debtor failed to prove that the creditor caused economic harm or had threatened her right to cure the pre-petition default.

Nosek (Bankruptcy Court)

In re Nosek, 363 B.R. 643 (Bankr.D.Mass.2007), a Massachusetts bankruptcy court sanctioned a mortgage servicer for failing to adjust its accounting procedures to reflect payments on pre-petition arrears made through a debtor’s Chapter 13 plan.

The bankruptcy court stated “Ameriquest must adjust its accounting practices because of Nosek’s bankruptcy. The Bankruptcy Code is not a cafeteria; lenders do not decide which of its provisions apply to them. Once a debtor files for Chapter 13, the Bankruptcy Code, and only the Bankruptcy Code, dictates the protections afforded to the lender and the obligations (such as the separate accounting for pre-and-post petition payments) required of them.

Sanchez v. Ameriquest Mortgage Co., Case No. 02-45416; Adversary No. 06-0671 (S.D. Texas, Houston)

Issue: Pre-Confirmation and Post-Confirmation charges

When seeking to recover Pre-Confirmation charges as an oversecured creditor, documentation of the charges must be provided in order for the court to determine their reasonableness. In addition, the charges must arise from the original agreement between the parties.

State law governs the recovery of Post-Confirmation charges based upon the loan agreement. The court will consider eight factors to determine whether the charges are reasonable.

The Court has declared that parties are subject to both actual and punitive damages for violation of the automatic stay under 11 U.S.C. § 362(h).

Requirements for Pre-confirmation charges:

1. An oversecured creditor under 11 U.S.C. § 506(b), is allowed to assess pre-confirmation charges, but is required to show that the charges are reasonable and in the original agreement under which the claim arose.
2. **“Any entity seeking to charge a Chapter 13 debtor’s estate must provide documentation of these charges so that the court, the debtor, and other parties-in-interest can review and analyze each application for compensation.”**

Requirements for Post-Confirmation Charges:

1. State law governs based on the Loan agreement. Rule 506(b) is not applicable to post-confirmation charges pursuant to the decisions from the Supreme Court and the Fifth Circuit.
2. In considering the reasonableness of post-confirmation charges the following factors may be considered:
 - a. the time and labor involved, the novelty and difficulty of the questions involved, and the skill required to perform the legal services properly;
 - b. the likelihood that the acceptance of the particular employment will preclude other employment by the lawyer;
 - c. the fee customarily charged in the locality for similar legal services;
 - d. the amount involved and the results obtained;
 - e. time limitations imposed by the client or the circumstances;
 - f. the nature and length of the professional relationship with the client;
 - g. the experience, reputation, and ability of the lawyer or lawyers performing the services; and
 - h. whether the fee is fixed or contingent.

Violation of Automatic Stay:

In order to violate an automatic stay under 11 U.S.C. § 362(h), the following must be shown:

1. the creditor knew of the existence of the stay
2. acted in an intentional way; and
3. the acts must violated the stay

Actual or punitive damages may be accessed for violation of an automatic stay under § 362(h).

IN RE PREVO, 2008 WL 4425799 (Bankr. S.D. Tex.)

Memorandum Opinion Sustaining in part the debtor's Objection to Citi's POC.

Judge Bohm issued a very stern and additional warning to creditors and servicers by the issuance of this Memorandum Opinion. The issue relates to the imposition of fees and costs in proofs of claims. Judge Bohm clearly warns:

Because some lenders have turned a deaf ear to the warning in *Parsley*, the Court must reiterate its message: it will not tolerate lenders who attempt to nickel and dime Chapter 13 debtors with unsupported fees and charges only to expect absolution when, due to objections challenging these charges, they file an amended proof of claim. (Pg. 1.)

The creditor's original proof of claim contained the following fees and costs:

Previously accrued late charges	\$ 155.26
Foreclosure Fees & Costs	\$ 1141.58
BPO fees	\$ 105.00
Escrow Advance	\$4793.08

The debtor asserted that the fees and costs were unsubstantiated and excessive. The court agreed with the debtor and stated that the filing of a "proof of claim without any documents attached is not in and of itself cause to disallow a claim, [however] it does result in the loss of *prima facie* validity."

The creditor failed to provide any evidence relating to the fees it had incurred, such as invoices, which is "essentially the same information that would be included in a fee application."

The Court compared the issues in *Prevo* with the issues that were addressed in *Sanchez* in that § 506(b) was designed to protect the debtor and other creditors by preventing secured creditors from charging unreasonable fees. *In re Sanchez*, 372 B.R. at 304.

The filing of amended proofs of claims following a debtor's objection was looked upon with great distaste by the Court. The withdrawal of "fees that should not have been included in the first instance is unsatisfactory because it does not address the larger problem with the way mortgage companies are filing proofs of claims." *Prevo* at 3.

Based upon the Court's involvement in numerous cases, it directly stated that it believes "that ***certain members of the mortgage industry are intentionally attempting to game the system*** by requesting undocumented and potentially excessive fees and then reducing those fees in amended proofs of claim only after being exposed by debtor's counsel." *Id.* (emphasis added).

Lastly, the Court issued a show cause order and stated that a hearing was to be held because of the following issues:

- (1) Citi filed a proof of claim in this Court with no documentation to support the fees and costs charged to the Debtor;
- (2) The Debtor filed an objection to the proof of claim;
- (3) Citi requested, and received, a continuance of the hearing on the Objection for the purpose of filing an amended proof of claim;
- (4) Citi filed an amended proof of claim which still contained no documentation to support the fees and costs charged to the Debtor;

(5) Citi appeared at the continued hearing on the Objection without any such documentation or any witnesses to testify about the fees and costs; and

In closing, the Court stated that the creditor could avoid the show cause hearing if it paid the debtor's fees and costs which were incurred in prosecuting the objection.

In re PADILLA, 2008 WL 2573259 (Bkrctcy.E.D.Pa.)

A creditor holding a long-term residential mortgage debt with which a Chapter 13 debtor proposed to deal under the cure-and-maintenance provision of the Bankruptcy Code had no obligation to give the debtor notice, or to obtain court approval, of post-petition legal expenses to which it was allegedly entitled under an attorney fee provision in the mortgage document. The creditor was allowed to collect the legal expenses from the debtor after completion of her plan payments and entry of a discharge order. While imposition of such an obligation might make sense as a matter of policy, no such obligation was imposed by the Code provision dealing with the rights of oversecured creditors, by the cure-and-maintenance provision itself, or by F.R.B.P. 2016(a).

In re HAQUE, 2008 WL 4717448 (Bkrctcy.S.D.Fla.) Oct. 28, 2008

FACTS: Florida Default Law Group (FDLG) filed a motion for relief on behalf of its client, Wells Fargo. A sworn affidavit signed by a Wells Fargo employee accompanied the motion, which declared that Wells was entitled to "penalty interest."

ISSUE: Were the affidavits filed by FDLG on behalf of Wells properly reviewed? Was Wells entitled to a motion for relief?

HOLDING:

The court held that Wells Fargo and FDLG had engaged in a "systematic process of churning out unrefined and unexamined form pleadings, instead of producing and filing carefully considered legal papers. This has resulted in an abuse of the system and sanctions to deter continued recklessness are warranted."

Wells' MFR was granted because sufficient evidence was presented to support the motion. However, the court imposed sanctions against Wells and its servicer, FDLG due to the circumstances that surrounded a "fictitious claim for money owed." (penalty interest)

Joint and several liability for the imposed sanction: \$ 95,130.45

COURT ANALYSIS & RULES OF LAW:

1. FDLG and Wells Fargo conceded that the inclusion of "penalty interest" was erroneous and that the creditor was never entitled to payment for it. Penalty interest, under the terms of the loan, was a fee chargeable for the prepayment of the loan during the first three years.
2. "Since the Debtor is in bankruptcy and the Motion was filed based on the Debtor's default, the notion that the Debtor paid off his loan in full to the Creditor is absurd. It is utterly perplexing to me how the Creditor or its law firm could or did assert such a claim."
3. "Of perhaps greater relevance is the question as to whether the lawyers at FDLG are examining any of the documents they are filing "on the bankruptcy side." FDLG seems to suggest that state court foreclosure actions are real and important proceedings but that

the bankruptcy court is merely an administrative hurdle that warrants no particular consideration as a legal body, and that filing any old pleading without undertaking any investigation into its accuracy is perfectly acceptable practice. That position is unacceptable.”

4. “What is evident is that FDLG prepared the affidavit in this case and the Creditor's employee signed it without any review.” (emphasis added)
5. The court was dissatisfied with the “brief review” conducted by FDLG and Wells with respect to “their wayward accounting.”
6. “The actual ramifications of this conduct are still unclear to me. What is even more troublesome is that this conduct was not unique to this case. Once counsel and Creditor realized their wayward accounting, it should have set off alarms, not just a “brief review.” Instead, a lackadaisical approach was taken in which the parties threw up their hands and said “no harm, no foul,” but without, in fact, determining either the full extent of the false affidavit problem in the bankruptcy court stay relief motions or that no false affidavits had been filed in the subsequent state court foreclosure proceedings.”
7. “Since FDLG has provided no more than a cursory estimate as to the cases in which FDLG filed false affidavits claiming “penalty interest” and vaguely fleshed out an analysis as to this conduct, I am left baffled by FDLG's lack of appreciation for the severity of the problem presented and by its casual response. It is well worth noting that this is not the first occasion in which I have witnessed sloppy and unprofessional conduct in FDLG's practice of law. On numerous occasions I have confronted FDLG lawyers about incomplete and insufficient motions for relief from stay. Based on this discussion, sanctions will be levied for purposes of deterrence.”
8. The judge stated: “my concern is with the integrity of the process and whether people are viewing what gets filed as a serious matter or whether it's sort of being done on the fly and with all of the diligence and attention that goes into sausage making.” (emphasis added)

1st Campbell Ruling

In re Campbell, 2008 WL 3906382 (C.A.5-Tex.). AUG 2008

[Loan Servicer's Proof of Claim Didn't Violate Stay](#)

A mortgage loan servicer did not violate the automatic stay when it filed a proof of claim asserting a right to increased post-petition mortgage payments under the loan documents, based on the Chapter 13 debtors' failure to make their prepetition escrow payments. The Bankruptcy Code permits creditors to assert any claim, even if contingent, unmatured, or disputed, and if the debtor objects, the bankruptcy court determines whether to allow the claim. In the debtors' case, the loan servicer's filing prompted the debtors to object, and the court sustained that objection. *Campbell v. Countrywide Home Loans Inc.*,

Fifth Circuit—In re Campbell Oct. 13, 2008

No. 07-20499

Background: Chapter 13 debtors brought adversary proceeding against loan servicer for their residential mortgage loan, alleging that loan servicer willfully violated automatic stay by increasing amount of their post-petition escrow payments. On reconsideration, the United States Bankruptcy Court for the Southern District of Texas, Marvin P. Isgur, J., 361 B.R. 831, granted partial summary judgment in debtors' favor, finding that loan servicer had willfully violated automatic

stay. Loan servicer was allowed to bring interlocutory appeal.

The Court of Appeals held that:

(1) debtors' escrow obligations under mortgage loan documents that arose pre-petition were "claims" for purposes of automatic stay, and

(2) loan servicer did not violate automatic stay when it filed proof of claim asserting right to increased post-petition mortgage payments under loan documents.

Affirmed in part and reversed and rendered in part.

Rules:

Automatic stay prohibits collection of any pre-petition debt, but does not apply to claims that arise post-petition. 11 U.S.C.A. § 362(a).

Chapter 13 debtors' escrow obligations under mortgage loan documents that arose pre-petition were "claims" for purposes of automatic stay, and loan servicer could not attempt to collect those amounts post-petition absent court authorization, notwithstanding loan servicer's contention that any claim for unpaid escrow amounts would only accrue when it paid escrow expense and there were insufficient funds in debtors' escrow account to cover that expense, given that, under loan documents, loan servicer had right to pre-petition escrow payment which matured into claim on loan servicer's behalf each time debtors failed to make payment. 11 U.S.C.A. §§ 101(5)(a), 362(a).

Unpaid escrow payments that accumulate pre-petition in the year that a bankruptcy petition is filed, and which the creditor had a right to collect under the loan documents, constitute a "claim" under the Bankruptcy Code. 11 U.S.C.A. § 101(5)(a).

Mortgage loan servicer did not violate automatic stay when it filed proof of claim asserting a right to increased post-petition mortgage payments under loan documents, based on Chapter 13 debtors' failure to pay pre-petition escrow payments. 11 U.S.C.A. §§ 362(a), 501.

The court determined only that unpaid escrow payments that accumulate pre-petition in the year that a bankruptcy petition is filed, and which the creditor has a right to collect under the loan documents, constitute a "claim" under the Bankruptcy Code.

In re PARSLEY Case No. 05-90374, S.D. Texas

**Memorandum Opinion on Show Cause Order of
February 12, 2007 and May 18, 2007**

PARTIES:

1. Countrywide – Mortgage Loan Servicer for Fannie Mae
2. McCalla, Raymer (MR) (CW's law firm—located in Georgia)
3. Barrett, Burke (BB) (MR's local counsel—located in Houston)

Facts:

1. Barrett Burke (BB) filed a motion to lift stay—12/29/06
2. Debtor's Atty filed a response opposing motion
 - a. Pymt history inaccurate—based on pymt history received from CW the day before
 - i. Erred in applying 1st post-petition pymt to pre-petition arrears rather than 11/05 pymt
 - ii. Erred in not applying full pymt for 05/06

3. Preliminary Hearing 01/23/07
 - a. Knesek—BB atty said she needed to verify pymt history but said debtor was still delinquent
 - b. Requested prelim hearing be passed to a final hearing
4. Final Hearing 02/06/07
 - a. Thurmond—BB atty stated that CW wanted to withdraw the motion.
 - b. Ct asked if the pymt history was wrong
 - c. BB atty said it was a good motion, but he would check into it and get back to the court—never informed the court of his research

Issues:

1. **whether misrepresentations were made to the court re: the accuracy of the motion: and**
2. **ensuring that the debtor was not charged atty fees for a motion that should not have been filed.**

Who is the client?

1. John Schlotter—MR Assoc—
 - a. Testified that Barrett Burke's client was MR and NOT CW
 - b. That MR directs BB on how any file is to be handled
 - c. Payment history
 - i. Prepared by paralegal staff
 - ii. No atty at MR reviews loan histories
 - d. he authorized the withdrawal of the motion to lift stay when Thurmond told him about the response opposing the motion and that there were discrepancies in the pymt history
 - e. Communication from BB had to be to MR NOT CW because under agreement with local counsel, the reason CW would hire MR is b/c it didn't want to deal with 50 firms across the country...all communication goes through the MR office.
 - i. **Ct concern the CW doesn't have sufficient communication with attorneys across the country that are representing them in the courtroom**

United States Trustee

1. filed pleading re: "why CW & BB should not be sanctioned for filing a motion for relief containing inaccurate debt figures and inaccurate allegations concerning payments received from the debtor"
 - a. based on bad faith failure to investigate the factual basis of the motion
 - b. CT---HELD—UST was within its authority to investigate activities of CW, MR & BB to determine if activities undermined the integrity of the BK system.

Holding: The court decided NOT to sanction the law firms involved (this time) based upon the parties' representations that they had changed internal procedures. However, the court was irate that the firms were filing MFRs without verifying the accuracy of the pleadings and debt figures and that the servicer was not reviewing any of the figures before it was signed by an attorney.

In re Robin HAYES, No. 07-13967, U.S. Bk. Court, D. Mass.

Aug. 19, 2008.

Background: Motion was filed for relief from stay as to mortgaged property, and Chapter 13

debtor-mortgagor challenged movant's standing. Debtor also objected to proof of claim filed by movant for sums allegedly owing on mortgage note.

Holdings: The Bankruptcy Court, held that:

(1) entity moving for relief from stay as to mortgage property as trustee of corporate entity other than that named as mortgagee in original mortgage documents failed to satisfy burden of tracing mortgage from this original mortgagee to separate entity for which it was allegedly acting as trustee, and did not have standing, as party in interest, to pursue stay relief; and

(2) movant's failure to establish its status as holder or servicer of mortgage, for purpose of seeking stay relief as to mortgaged property, also prevented allowance of its proof of claim.

Rules:

To have standing to seek relief from automatic stay, movant must establish that it is "party in interest," and that it is asserting its rights and not those of another entity. 11 U.S.C.A. § 362(d).

Generally, "real party in interest" is the one who, under applicable substantive law, has legal right which is sought to be enforced or is party entitled to bring suit.

Entity moving for relief from stay as to mortgaged property as trustee of corporate entity other than that named as mortgagee in original mortgage documents failed to satisfy burden of tracing mortgage from this original mortgagee to separate entity for which it was allegedly acting as trustee, and did not have standing, as party in interest, to pursue stay relief; mortgage lender, its affiliates, assignees, and agents, through convoluted process of securitization, by submitting a 191-page, incomplete pooling and servicing agreement (PSA), and by relying on back-dated, unrecorded assignments, had confounded identity of current holder of mortgage for purpose of filing motion for relief from stay. 11 U.S.C.A. § 362(d).

Movant's failure to establish its status as holder or servicer of mortgage, for purpose of seeking stay relief as to mortgaged property, also prevented allowance of its proof of claim for sums allegedly owing under mortgage note over objection by Chapter 13 debtor-mortgagor.

Those parties who do not hold mortgage or mortgage note, and who do not service mortgage, do not have standing to pursue motions for relief from stay as to mortgaged property or other actions arising from mortgage obligation. 11 U.S.C.A. § 362(d).

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