AMERICAN BANKRUPTCY INSTITUTE

Consumer Remedies for Lender Misconduct

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ABI Southwest Bankruptcy Conference

Las Vegas, Nevada

2008

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July 13, 2008 New York Times

"Dan A. Baily Jr. was desparate when he sat down on May 19 to send an e-mail message to his mortgage lender, the Countrywide Financial Corporation, pleading, yet again, for help."

Mr. Bailey was behind on his payments and fearful of losing his home of 16 years – a 900 square foot bungalow in Wilmington, N.C."

- Mr. Bailey had been lobbying Countrywide for months, unsuccessfully.

- Mr. Bailey promised in his e-mail message that he would pay every nickel he owned if Countrywide would modify his mortgage in a way that allowed him to keep his home.

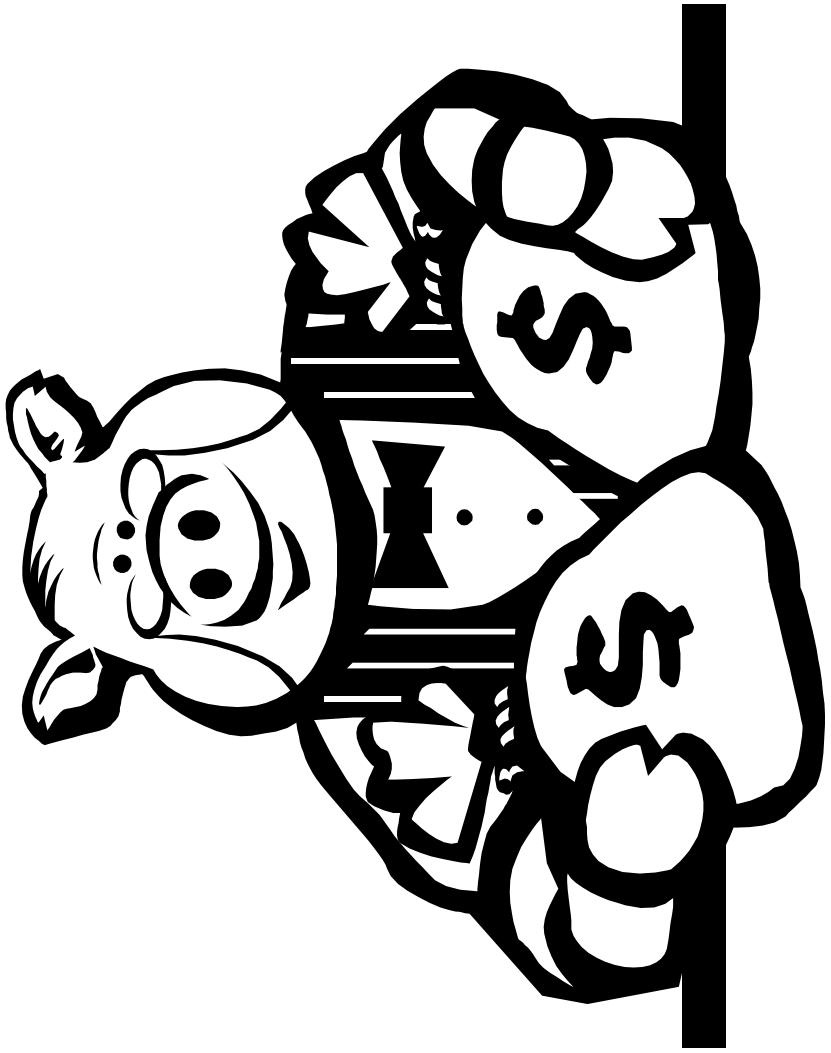
- One of the recipients of the e-mail was Angelo Mozilo, Countrywide chief executive and co-founder.

- Mr. Mozillo's response to Mr. Bailey:

"This is unbelievable. Most of these letters now have the same wording. Obviously they are being counseled by some other person on the Internet. ***Disgusting***."

- Angelo's Mozilo's compensation in 2007?

$132 Million



- Think it's bad that lenders won't work with consumers who took out loans they now can't pay back?
  - Borrowers said they were misled about many things, the adjustable rate, the ability to refinance later.
  - Others say the borrowers took out loans they could not afford.
  - In these cases, no one disputes that the borrower is now behind on his mortgage.

But what if the borrower is not behind?

- What if the borrower sought protection under the federal laws of the United States Bankruptcy Code?
- What if the borrower filed chapter 13 and made every single payment the borrower was supposed to make, both to the Chapter 13 Trustee and to his lender?

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- Surely lenders aren't foreclosing on borrowers who are actually current on their loans, right?

Foreclosure Charges by Lender Investigated

The New York Times, September 28, 2007

"The federal agency monitoring the bankruptcy courts has subpoenaed Countrywide Financial, the nation's largest mortgage lender and loan servicer, to determine whether the company's conduct in two foreclosures in Southern Florida represented abuses of the bankruptcy system."

U.S. Expands Scrutiny of Home Lenders/Services

WSJ, December 3, 2007

"Attorneys from the U.S. Trustee Program, a division of the Justice Department, have taken aim at mortgage lenders, servicers and their lawyers in at least six states, including Georgia, Massachusetts and Pennsylvania… The agency is probing representations made to courts about what homeowners owe and the handling of their payments during bankruptcy, both areas in which consumer advocates say there are pervasive problems."

Lender Abuses Alleged by Debtors

- Lenders overinflate amounts alleged due in proofs of claim.
- Lenders pursue discharged debts not properly reaffirmed.
- Lenders fail to account for the debtor's payments and the Chapter 13 Trustee's payments during the life of the plan.
- Lenders add fees and charges not approved by the Bankruptcy Court.

- Lenders “double dip” by making the debtors pay them the same amounts being cured by the Chapter 13 Trustee.
- Lenders do not properly document their proofs of claim or motions for relief from stay.
- Lenders do these things continually in numerous cases across the country.

Debtors Allege Such Actions Lead To:

- Lenders filing proofs of claim for inflated amounts.
- Lenders filing motions for relief from stay alleging the debtor is behind, when in fact, the debtor is not behind, or not behind in amount claimed.
- After discharge, lenders quoting inflated payoff amounts and collecting amounts not owed.
- After discharge, lenders asserting that the debtor is in default, begin foreclosure proceedings, and actually foreclose.

Types of Relief Sought

- Restitution of overpayment
- Sanctions for creditor's violation of Code sections
- Actual damages (including emotional distress)
- Statutory damages
- Punitive damages
- Attorneys' fees
- Injunctive Relief

- Declaratory relief that debtors are current
- Proof-of-Claim objections
- New plan provisions (524(i))
- End-of-case procedures by Chapter 13 Trustee, court or debtor's counsel
- Other injunctive relief
- Damages against lenders' law firms

- Damages for Violation of Other Federal Statutes
  - Fair Debt Collection Practices Act
  - RESPA
  - HOEPA
  - TILA
  - Fair Credit Reporting Act
- Damages for Violation of State Consumer Protection Laws

Courts Provide Relief to the Debtors

- Code provisions create substantive rights for debtors
    - *In re NGC Settlement Trust*, 118 F.3d 1056, 1063 (5th Cir. 1997) (discharge injunction is substantive right)
- Court can redress lender abuses of the Bankruptcy Code, including awarding actual damages, punitive damages, disgorgement, attorneys' fees and issuing sanctions and injunctions
- Use 105(a), contempt powers
    - *In re Bessette*, 230 F.3d 439 (1st Cir. 2000)
    - *In re Terrebonne Fuel and Lube, Inc.,* 108 F.3d 609, 612-13 (5th Cir. 1997(court can use 105(a) for contempt of discharge injunction)

11 U.S.C. Section 105(a)

"The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process."

» *In re Marrama*, 127 S.Ct. 1105 (2007)

Attempting to Collect Discharged Debt Without Proper Reaffirmation Agreement

Remember the "Sears" Cases?

- *Conley v. Sears, Roebuck & Co.*, No. 97-11149 (D. Mass.), *Conley v. Sears, Roebuck & Co.*, 222 B.R. 181, 185--86 (D. Mass. 1998) and *Brioso v. Sears, Roebuck & Co.*, Adv. Proc. No. 97-1222 (Bankr. D. Mass.)(settlement returned 150% of debt collected pursuant to invalid reaffirmations to approximately 190,000 debtors);

- *In re Coggin*, 155 B.R. 934 (Bankr. E.D. N. C. 1993) (Court certified nationwide class concerning Sears reaffirmation agreements);

- *In re General Electric Capital Corp. Consumer Bankruptcy Debtor Class Action Litigation*, MDL No. 1192 (N.D. Ill.) ($100 million settlement; 100,000 class members [approximate]);

- *Mazola v. May Dept. Stores Co.*, No. 97-10872 (D. Mass.) ($20 million settlement, 40,000 class members [approximate]);

- *Lafromboise v. Greenwood Trust Co.*, No. 97-30091 (D. Mass.) ($4 million settlement, 23,000 class members [approximate]).

Attempting to Collect Discharged Debt Without Proper Reaffirmation Agreement –

10 Years Later

Prisoners of Debt, BusinessWeek, November 1, 2007

"In a financial version of *Night of the Living Dead*, debts forgiven by bankruptcy courts are springing back to life to haunt consumers. Fueling these miniature horror stories is an unlikely market in which seemingly extinguished debts are avidly bought and sold."

"U.S. Bankruptcy Judge Robert Drain asked a lawyer for JPMorgan Chase (JPM) how the bank had managed to sell consumer credit-card debts that had been discharged. 'I don't know who would buy a discharged account,' the perplexed judge said.

'Happens all the time, your honor,' the Chase lawyer … responded."

- *In re Herrera*, 380 B.R. 447 (Bankr. W.D. Tex. 2007)

  After discharge, FMCC threatened debtor that must sign reaff agreement, then got her to "reopen" her case to try to get the reaff approved after the deadline.

"If FMCC is routinely pursuing the course of action that it pursued in this case, then it could fact significant liability on a scale not seen since the debacle involving Sears, Roebuck & Co. more than a decade ago. [citations omitted]"

"As a matter of public policy, this sort of practice could not be tolerated by any court in the country."

"If FMCC has been attempting to give debtors the impression that untimely reaffirmation agreements such as this one are enforceable, then FMCC would do well to review the *In re Lantanowich* opinion."

Trying to Collect Discharged Debts by Failing to Update Credit Reports

"Bankruptcy Courts have recently recognized that a failure to update a tradeline to reflect the status of an account may be an intentional – and effective – tool to induce a debtor to make payments on an account."

- *McKenzie-Gilyard v . HSBC Bank., Nev. (In re McKenzie-Gilyard,* 2007 Bankr. LEXIS 4598 (Bankr. E.D.N.Y. December 11, 2007)(discussing numerous cases)

- *Torres v. Chase Bank USA*, 367 B.R. 478 (Bankr. S.D.N.Y. 2007)(same)

Undisclosed Fees

- *In re Tate*, 253 B.R. 653 (Bankr. W.D. N.C. 2000)(granting summary judgment to debtor class because undisclosed fees are *per se unreasonable)*
- *In re Sheffield*, 281 B.R. 24, 33 (Bankr. S.D. Al. 2000) ("Fees which are not disclosed at all, fees which are not properly claimed with specificity, or are not included in the arrearage claim to be paid through the plan if the plan so provides, are *per se unreasonable because they are improperly charged.")*

- *In re Harris*, 280 B.R. 876, 885 (Bankr. S.D. Al. 2001)("A fee which is charged, but not fully disclosed to the debtor is not owed.")

- *In re Slick*, 2002 Bankr. LEXIS 772 (Bankr. S.D. Ala. May 10, 2002).
  - In certified nationwide class action, Judge Mahoney sanctioned Norwest (now Wells Fargo) $2,000,000 for failure to disclose post-petition fees:

"The Court concludes that $2,000,000 in punitive damages should be paid to the plaintiffs. This represents less than $100 per debtor. This sum is large enough to send a message to Norwest and other lenders about the necessity of disclosing fees in bankruptcy cases."

- *Padilla v. Wells Fargo Home Mortgage, Inc. (In re Padilla)*, 379 B.R. 643, 661 (Bankr. S.D. Tex. 2007)("Debtors cannot realistically obtain a 'fresh start' if mortgage lenders can charge a debtor's account without disclosure.")

- *Sanchez v. Ameriquest Mortgage Co. (In re Sanchez)*, 372 B.R. 289, 303-05 (Bankr. S.D. Tex. 2007)(holding that the entity seeking reimbursement for expenses from the estate must comply with Section 506(b) and Rule 2016)

False Motions to Lift Stay

- In re Gorshtein, 285 B.R. 118 (Bankr. S.D.N.Y. 2002)
  - Rejected “dog ate my homework” defense. In each of three separate cases at issue, the servicer’s actions had created a danger that a family would lose its home without just cause and in violation of the bankruptcy code.

- *In re Osborne*, 375 B.R. 216 (Bankr. M.D. La. 2007)
  - Judge Doug Dodd awarded sanctions against creditor's counsel for a baseless stay relief motion of $5,000 (emotional distress damages) and reasonable attorney's fees.

In re Fagan
376 B.R. 81 (Bankr. S.D.N.Y. 2007)

"Motions to lift the stay may be routine and inconsequential to secured creditors and their counsel. But to a debtor and his or her family, such a motion and the consequent loss of the family home may be devastating. Most creditors and counsel are conscientious. But some are callous by design or inadvertence, as exemplified by this motion and two others presented to the Court the same week."

"The danger here is that a debtor who does not have an attorney or the resources of intellect or spirit to defend against a baseless motion may lose his/her home ***despite being current on post-petition mortgage and plan payments***."

- *In re Willard*, 2004 Bankr. LEXIS 958 (Bankr. Ne. February 13, 2004)
  - Court sanctions law firm and lender ($25,000) for false motion for relief from stay.
- *In re Parsley*, 384 B.R. 138 (Bankr. S. D. Tex. 2008)
  - Although Judge Bohm ultimately did not impose any monetary sanctions, the opinion itself is a scathing indictment (citing numerous cases on a variety of abuses)(opinion attached)
  -

Accounting Misdeeds

- *In re Rathe*, 114 B.R. at 253, 257 (Bankr. S.D. Idaho 1990)

  "A lender cannot arbitrarily direct principal, interest or arrearage payments under a confirmed chapter 13 plan to reserve account deficits accruing prior to plan completion without court authorization for the recoupment of such administrative expenses during the plan process."

"Payments made during the pendency of the Chapter 13 plan should have been applied by [the lender] to the current payments due and owing with the arrearage amounts to be applied to the back payments. [The lender] *cannot utilize its accounting procedures to contravene the terms of a confirmed Chapter 13 plan and the Bankruptcy Code.*"

"[The lender's] accounting procedure applied payments to the earliest payments due and not to the payments due and owing during the pendency of the plan. The purpose of a Chapter 13 plan is to allow a debtor to pay arrearages during the pendency of the plan while continuing to make payments at the contract rate."

- *In re McCormack*, 203 B.R. 521 (Bankr. N.H. 1996)
  - Chase, among other misdeeds, continued to carry a specifically disallowed attorney fee on its records "for collection down the road" and failed to separately account for mortgage and cure payments made by the debtor and the Trustee.
  - Court awards $10,000 in damages

- *Nosek v. Ameriquest Mortgage Co. (In re Nosek)*, 363 B.R. 643, 645 (Bankr. D. Mass. 2007)
  - Follows *Rathe* and awards $750,000 in actual damages and sanctions.

    "This is exactly the point; 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."

In re Jones, 2007 Bankr. LEXIS 2984 (Bankr. E.D. La. August 29, 2007)

"Wells Fargo avers that it was Debtor's burden to discover that it had clandestinely assessed and paid itself for undisclosed fees and charges otherwise not due. Incredibly, Wells Fargo also argues that it was Debtor's burden to verify that its accounting was correct, even though Wells Fargo failed to disclose the details of that accounting until it was sued."

"The final assault on the Bankruptcy Code is Wells Fargo's position that not only can it secretly assess a debtor's account postpetition, but it can *collect* payment on these charges without seeking Court permission…

Depending on how much and how often the lender siphoned off funds, payable under a confirmed plan for other purposes, a debtor might or might not satisfy the obligations contemplated by his or her plan.

To allow such a practice is to eviscerate the provisions of the automatic stay and this court's power to protect the Debtor and property of the estate."

- *In re Schuessler*, 2008 Bankr. LEXIS 1000, at *65 - 66, 84 - 85 (Bankr. S.D.N.Y. April 10, 2008)
  - Court found that the accounting system utilized by Chase Home Finance to deal with bankruptcy debtors was an abuse of process

- *Maxwell v. Fairbanks*, 281 B.R. 101 (Bankr. D. Mass. 2002)
  - Court found that Fairbanks violated the FDCPA, RESPA and the Massachusetts TILA. Noted that "Fairbanks, in a shocking display of corporate irresponsibility, repeatedly fabricated the amount of the Debtor's obligation to it out of thin air." Case settled for full discharge of mortgage, $50,000 in damages and attorneys fees.

Courts Certify Class Actions for Lender Bankruptcy Abuses

- Mobile Proof of Claim Fees Cases:
  - *In re Noletto*, 280 B.R. 868 (Bankr. S.D. Ala. 2001);
  - *In re Powe*, 278 B.R. 539 and 280 B.R. 728 (Bankr. S.D. Ala. 2002);
  - *In re Sheffield*, 281 B.R. 24 (Bankr. S.D. Ala. 2002);
  - *In re Harris*, 280 B.R. 876 (Bankr. S.D. Ala. 2001), app. dism, *Chrysler v. Financial Corp. v. Powe*, 312 F.3d 1241;
  - *In re Slick*, Case No. 98-14378-MAM, Adv. No. 99-1136, 2002 Bankr. LEXIS 772 (Bankr. S.D. Ala. May 10, 2002)(Wells Fargo sanctioned $2 million)
- *Lau v. Arrow Financial Services, LLC*, 245 F.R. 620 (N.D. Ill. 2007)(district court certifies FDCPA class against creditor alleged to be collecting discharged debts);
- *Tate v. Nationsbanc Mortgage Corp. (In re Tate)*, 253 B.R. 653, 663 (Bankr. W.D. N.C. 2000)(court certifies district-wide case on unapproved fees in proofs of claim);
- *Harris v. Washington Mutual Home Loans (In re Harris)*, 297 B.R. 61 (Bankr. N.D. Miss. 2003), aff'd *Harris v. Washington Mut. Home Loans, Inc. (In re Harris)*, 312 B.R. 591 (N.D. Miss 2004)(after district court affirmed lower court's ruling that it had jurisdiction over nationwide class, at least two defendants settled on class-wide basis);
- *In re Sims*, 278 B.R. 457 (Bankr. E.D. Tenn. 2002)(class settlement);
- *In re Morrow*, C.A. No. 99-70087, slip opinion (Bankr. N.D. Ala. 2003) (in materials)(court certifies district-wide class).

Lenders' Law Firms Held Accountable

- Judge Morris Stern fined a new Jersey law firm for filing 250 court pleadings in which the signature page had been "pre-signed" before review by the servicer.
    - *In re Rivera*, 342 B.R. 435 (Bankr. D.N.J. 2006)
- Judge Steen recounts numerous instances of Texas law firm being sanctioned by bankruptcy courts for improper filings – fining firm $75,000.
    - *In re Allen*, No. 06-60121 (Bankr. S.D. Tex. June 18, 2007)(discussing other cases where same law firm had been fined or sanctioned)
- Judge Bohm issued a show cause order as to why Countrywide and its counsel should not be sanctioned for filing a motion for relief from stay that was allegedly inaccurate. Court later ruled that the U.S. Trustee had standing to appear and be heard on matters raised in show cause orders and had the right to conduct discovery under Rule 2004. (in materials)
    - *In re Parsley*, 384 B.R. 138 (Bankr. S. D. Tex. 2008)
- Judge Doug Dodd awarded sanctions against creditor's counsel for a baseless stay relief motion of $5,000 (emotional distress damages) and reasonable attorney's fees.
    - *In re Osborne*, 375 B.R. 216 (Bankr. M.D. La. 2007)

Lender/Servicer Responses

- Bankruptcy Requirements Vary -- Often By District and Even By Judge
- Many Questions Unresolved By Code Or By Caselaw, Which Is Sparse
- Servicing Loans Across Country Is Challenging
- Defaulted Loans Are Particularly Difficult To Service
  - Uneven Payments - including from trustees
  - Third Parties' Invoices

Merits Defenses to the Causes of Action

- Vary depending on claim
- Some courts have agreed with some of the lender's defenses
- One example, proof of claim fees
  - They are legal – E.g., *Majchrowski v. Norwest Mortgage, Inc*., 6 F. Supp. 2d 946, 966 (N.D. Ill. 1998); *In re Atwood*, 293 B.R. 227 (9th Cir. BAP 2003); *In re Powe*, 278 B.R. at 557.
  - Minimal or no additional disclosure requirements
  - Cause of action inconsistent with Section 1322 – *In re Bateman*, 331 F. 3d 821 (11th Cir. 2004)
  - No cause of action under 506(b) or 105; no violation of 362
    - *In re Henthorn*, 299 B.R. 351, 356 (E.D. Pa. 2003)(506(b) and 105)
    - *Pertuso v. Ford Motor Credit,* 233 F.3d 417 (6th Cir. 2000)(105); *Holloway v. Household Auto. Fin. Corp.,* 227 B.R. 501, 506 (N.D. Ill. 1998) (105)
    - *Mann v. Chase Manhattan Mortgage Corp*., 316 F.3d 1 (1st Cir. 2003)(362)

Additional Merits Defenses

- Factual
  - Often, what is alleged did not occur
  - If it did, it was an exception –
    - Bankruptcy often a "manual process"
    - Courts actually asking for individualized consideration – humans make mistakes
  - Third parties (especially local attorneys) err or do not follow instructions
- Courts or debtors request inconsistent things
  - Monthly statements –*Wetzel v. HomEq*, C.A. No. 07-42 (S.D. Ohio)
- Courts or debtors request things not required
- "Enact a local rule" – *In re Smith*, Adv. No. 00-3148 (Bankr. W.D.N.C. 2000)

Articles, Treatises

- Corrine Ball & Micelle J. Meises, Current Trends in Consumer Class Actions in the Bankruptcy Arena, 56 Bus. Law 1245 (May 2001)
- Elizabeth Warren and Jay Westbrook, Class Actions for Post-Petition Wrongs: National Relief Against National Creditors, 22 –2 ABIJ (March 2003)
- Robert P. Wasson, Article: Remedying Violations of the Discharge Injunction Under Bankruptcy Code 524, Federal and Non-Bankruptcy Law and State-Law Comports with Congressional Intent, Federalism and Supreme Court Jurisprudence for Identifying the Existence of an Implied Right of Action, 20 Bankr. Dev. J. 77 (2003)
- 1 Collier Pamphlet Ed. Overview 1334, Mathew Bender & Co., Inc., 2006, p. 6-7
- Katherine Porter, Abstract, Misbehavior and Mistake in Bankruptcy Mortgage Claims, 2008, University of Iowa, available at http://ssrn.com/abstract=1027961

Questions?

Disclaimer: This presentation summarizes certain cases, arguments and developments, and is for educational purposes only. It should not be attributed as the views either of the presenters or of their clients.

Attorney or Party Name, Address, Telephone & FAX Numbers, and California State Bar Number	FOR COURT USE ONLY
☐ Individual appearing without counsel ☐ Attorney for:	
UNITED STATES BANKRUPTCY COURT **CENTRAL DISTRICT OF CALIFORNIA**	
In re Debtor(s).	CHAPTER 13 CASE NO.

Addendum to Chapter 13 Plan Concerning Debtors Who are Repaying Debt Secured by a Mortgage on Real Property or a Lien on Personal Property the Debtor Occupies as the Debtor's Principal Residence

(A) **Scope: Consumer Debts Secured by a Mortgage on Real Property, or Secured by Manufactured Housing that the Debtor Occupies as the Debtor's Principal Residence**

(1) For purposes of this Addendum, which is incorporated into the debtor's chapter 13 plan (the "Plan"), the term "Mortgage Creditor" includes all creditors whose claims represent consumer debts secured in whole or in part by a security interest in real property or manufactured housing, which real property or manufactured housing constitutes the debtor's principal residence. The provisions of this Addendum are effective until the earlier of: (a) dismissal of the case; (b) the closing of the case; (c) entry of an order granting the debtor a discharge; and (d) entry of an order terminating the automatic stay under 11 U.S.C. § 362(d) as the stay applies to the Mortgage Creditor.

(2) Except as provided in paragraphs (3) and (4) below, if the Mortgage Creditor provided monthly statements to the debtor pre-petition, the Mortgage Creditor must provide monthly statements to the debtor. The monthly statements must contain at least the following information concerning post-petition mortgage payments to be made outside the Plan:

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(a) The date of the statement and the date the next payment is due;

(b) The amount of the current monthly payment;

(c) The portion of the payment attributable to escrow, if any;

(d) The post-petition amount past due, if any, and from what date;

(e) Any outstanding post-petition late charges;

(f) The amount and date of receipt of all payments received since the date of the last statement;

(g) A telephone number and contact information that the debtor or the debtor's attorney may use to obtain reasonably prompt information regarding the loan and recent transactions; and

(h) The proper payment address.

(3) No monthly statement will be required in this case where post-petition mortgage payments are to be made to the chapter 13 trustee through the Plan, unless the amount of the monthly payment is scheduled to change (because of adjustable interest rate, charges paid by the Mortgage Creditor for taxes, insurance, attorney's fees or any other expenses or fees charged or incurred by the Mortgage Creditor, such as property inspection fees, servicing fees or appraisal fees). If a Mortgage Creditor does send a monthly statement to the debtor or the chapter 13 trustee and the statement complies with subsection (B)(2) below, the Mortgage Creditor is entitled to the protections set out in such subsection.

(4) If, pre-petition, the Mortgage Creditor provided the debtor with "coupon books" or some other pre-printed, bundled evidence of payments due, the Mortgage Creditor is not required to provide monthly statements under subsection (2) of this section. However, the Mortgage Creditor must supply the debtor with additional coupon books as needed or requested in writing by the debtor. If a Mortgage Creditor does send a monthly statement to the debtor or the chapter 13 trustee and the statement complies with subsection (B)(2) below, the Mortgage Creditor is entitled to the protections set out in such subsection.

(5) The Mortgage Creditor must provide the following information to the debtor upon the reasonable written request of the debtor:

(a) The principal balance of the loan;

(b) The original maturity date;

(c) The current interest rate;

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(d) The current escrow balance, if any;

(e) The interest paid year to date; and

(f) The property taxes paid year to date, if any.

(6) The Mortgage Creditor must provide the following information to the debtor, the debtor's attorney and, when the debtor is making ongoing mortgage or arrearage payments through the chapter 13 trustee, the chapter 13 trustee, at least quarterly, and upon reasonable written request of the debtor or the chapter 13 trustee: (a) any other amounts due or proposed change in payments arising from an adjustable interest rate, charges paid by the Mortgage Creditor for taxes, insurance, attorney's fees or any other expenses or fees charged or incurred by the Mortgage Creditor, such as property inspection fees, servicing fees or appraisal fees; (b) the nature of the expense or charge; and (c) the date of the payment.

(7) If the secured consumer debt payable to the Mortgage Creditor is not modified by or paid through the Plan and the Mortgage Creditor believes the debtor to be in default, the Mortgage Creditor must send a letter alleging such default to the debtor and the debtor's attorney upon any perceived or actual default by the debtor and before taking any steps to modify the automatic stay.

(B) **Form of Communication; Modification of the Automatic Stay; and Motions for Order to Show Cause**

(1) For the purposes of this Addendum, Mortgage Creditors will be considered to have sent the requisite documents or monthly statements to the debtor or the debtor's attorney, as applicable, when the Mortgage Creditor has placed the required document in any form of communication, which in the usual course would result in the debtor and the debtor's attorney receiving the document, to the address that the debtor and the debtor's attorney last provided to the Court. The form of communication may include, but is not limited to, electronic communication, United States Postal Service or use of a similar commercial communications carrier.

(2) To the extent that the automatic stay arising in this case would otherwise prohibit such conduct, the automatic stay is modified as follows: Mortgage Creditors who provide account information or monthly statements under subsections (A)(1-6) above will not be found to have violated the automatic stay by doing so, and Mortgage Creditors may contact the debtor about the status of insurance coverage on property that is collateral for the Mortgage Creditor's claim, may respond to inquiries and requests for information about the account from the debtor and may send the debtor statements, payment coupons or other correspondence that the Mortgage Creditor sends to its non-debtor customers, without violating the automatic stay. <u>In order for communication to be protected under this provision, the communication must indicate it is provided for information purposes and does not constitute demand for payment</u>.

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(3) As a result of a Mortgage Creditor's alleged non-compliance with this Addendum, the debtor may file a Motion for Order to Show Cause in compliance with Local Bankruptcy Rule 9020-1 no earlier than sixty days after the Mortgage Creditor's failure to comply with sections (A) or (B). Before filing the motion, the debtor must make good faith attempts in writing to contact the Mortgage Creditor and to determine the cause of any non-compliance, and must indicate in the Motion for Order to Show Cause the good faith steps taken, together with a summary description of any response provided by the Mortgage Creditor.

(4) If a Mortgage Creditor's regular billing system can provide a statement to the debtor that substantially complies with this Addendum, but does not fully conform to all of its requirements, the Mortgage Creditor may request that the debtor accept such statement. If the debtor declines to accept the non-conforming statement, a Mortgage Creditor may file a motion, on notice to the debtor, the debtor's attorney and the chapter 13 trustee, seeking a declaration of the Court that cause exists to allow such non-conforming statements to satisfy the Mortgage Creditor's obligations under this Addendum. For good cause shown, the Court may grant a waiver for purposes of this case and for either a limited or unlimited period of time.

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Instructions for Attaching

Addendum to Chapter 13 Plan Concerning Debtors who are Repaying Debt Secured by a Mortgage on Real Property or a Lien on Personal Property the Debtor Occupies as the Debtor's Principal Residence

This optional addendum concerns chapter 13 debtors who are repaying debt secured by a mortgage on real property or a lien on personal property the debtor occupies as the debtor's principal residence.

A chapter 13 debtor may attach this addendum to his/her chapter 13 plan. This is a court-approved form and may not be altered, except for interlineations clearly marked on the court-approved form which are subject to the Court's review and approval upon consideration of the plan for confirmation. When attaching this form to the chapter 13 plan form (F 3015-1.1), the debtor must indicate in section V.F. (Page 6) of the chapter 13 plan form that the "Addendum to Chapter 13 Plan (F 3015-1.1A) is attached."

Misbehavior and Mistake in Bankruptcy Mortgage Claims

© Katherine Porter* *2007*

Abstract

The greatest fear of many families in serious financial trouble is that they will lose their homes. Bankruptcy offers a last chance for families to save their homes by halting a foreclosure and by repaying any default on their mortgage loans over a period of years. Mortgage companies participate in bankruptcy by filing claims with the court for the amount of the mortgage debt. To retain their homes, bankruptcy debtors must pay these amounts. This process is well-established and, until now, uncontroversial. The assumption is that the protective elements of the federal bankruptcy shield vulnerable homeowners from harm.

This Article examines the actual behavior of mortgage companies in consumer bankruptcy cases. Using original data from 1700 recent Chapter 13 bankruptcy cases, I conclude that mortgage companies frequently do not comply with applicable law. A majority of mortgage claims are missing one or more of the required pieces of documentation for a bankruptcy claim. Furthermore, fees are often poorly identified, making it impossible to verify if such charges are legally permissible or accurate. In nearly all cases, debtors and mortgage companies disagree on the amount of outstanding mortgage debt.

Despite these irregularities, mortgage claims in bankruptcy are infrequently contested. Imposing unambiguous legal rules does not ensure that a system will actually function to safeguard the rights of parties. The findings of this Article are a chilling reminder of the limits of formal law to protect consumers. Observing that laws can underperform has crucial implications for designing legal systems that will function as intended and for evaluating the appropriate scope of consumer protection.

Misbehavior or mistake by mortgage servicers can have grave consequences. Undocumented or bloated claims jeopardize a family's ability to save its home. Beyond bankruptcy, poor or abusive mortgage servicing undermines America's homeownership policies by exposing families to risks of overpaying or unjustified foreclosures. This Article's findings offer an empirical measure of whether consumers can trust mortgage companies to adhere to applicable laws.

* Associate Professor of Law, University of Iowa. David Baldus, Patrick Bauer, Robert Lawless, Lynn LoPucki, Ronald Mann, and Elizabeth Warren provided helpful comments on this Article. I thank Tara Twomey for her participation as co-investigator in developing the Mortgage Study database, and Ann Casey for invaluable empirical help with data collection and analysis. John Eggum, Sarah Hartig, Chris Jerry, Gina Lavarda, Brian Locke, and Nece McDaniel provided research assistance.

MISBEHAVIOR AND MISTAKE IN BANKRUPTCY MORTGAGE CLAIMS

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INTRODUCTION

Families in serious financial trouble are under great stress. The telephone rings with repeated calls from debt collectors, each paycheck is at risk of garnishment, and the next knock on the door could be a process server or a repo agent. Yet, for many families, the greatest fear is losing their home to foreclosure. A home is not only most families' largest asset, but also a tangible marker of their financial aspirations and middle-class status. A threatened or pending foreclosure can signal the end of a family's ability to struggle against financial collapse and an unrecoverable tumble down the socioeconomic ladder.

Bankruptcy offers these families one last chance to save their homes. A bankruptcy filing halts a pending foreclosure and gives families the right under federal law to cure any defaults on mortgage loans over a period of years.[1] The bankruptcy system offers refuge from the vagaries of state foreclosure law, substituting the protections of a federal court system and uniform legal rules to ensure that families get one final opportunity to preserve their homes.

But this protection comes at a cost. Mortgage companies file proofs of claim with the bankruptcy court for the amount of the mortgage debt. In turn, bankrupt debtors must pay these claims or lose their homes. The balance between the family and the mortgage lender is clearly spelled out in the bankruptcy laws, which specify the manner in which the amount owed is to be established and obligate both the homeowner and the mortgage company to disclose information accurately.

[1] Raisa Bahchieva, Susan Wachter & Elizabeth Warren, *Mortgage Debt, Bankruptcy, and the Sustainability of Homeownership*, *in* CREDIT MARKETS FOR THE POOR 73 (Patrick Bolton & Howard Rosenthal eds., 2005) (stating that Chapter 13 bankruptcy is frequently used by families who face foreclosure).

This claims process is well-established and, until now, uncontroversial. Homeowners—backed up by lawyers, policymakers, and news reporters—assume that bankruptcy functions according to the official rules and, by following these rules, that bankruptcy provides a realistic opportunity for families to save their homes. The data revealed in this Article suggest, however, that mortgage companies often disobey the law and that the legal system does not substantiate the amounts that lenders assert that consumers owe. These problems can cripple a family's efforts to save its home and undermine policies of sustainable homeownership.

This Article examines the actual behavior of mortgage companies in the consumer bankruptcy system. Using original data from 1700 recent Chapter 13 bankruptcy cases, I conclude that mortgagees' behavior significantly threatens bankruptcy's purpose of helping families save their homes. Despite unambiguous federal rules designed to protect homeowners and to ensure the integrity of the bankruptcy process,[2] mortgage companies frequently fail to comply with the laws that govern bankruptcy claims. A majority of mortgage claims lack the required documentation necessary to establish a valid debt. Fees and charges on bankruptcy claims often are identified poorly and sometimes do not appear to be legally permissible. On an aggregate level, mortgage creditors assert that bankrupt families owe them at least one billion dollars more than the families who file bankruptcy believe they owe. Although infractions are frequent and irregularities are sometimes egregious, the bankruptcy system routinely processes mortgage claims that do not comply with legal procedures. Far from serving as a significant check against mistake or misbehavior, the bankruptcy system routinely processes mortgage claims that cannot be validated and are not, in fact, lawful.

These findings are important because they offer a rare glimpse into the high-stakes world of mortgage servicing. Whether a bankrupt family can save its home turns on the family being able to find the dollars to cure its mortgage arrearage. The data on missing documentation, unsubstantiated fees, and discrepancies in recordkeeping, combined with the growing body of case law sanctioning mortgage servicers for their conduct, raise the specter that many families may be overcharged or may unfairly lose their homes. Such realities undermine bankruptcy's goal of helping families save their homes.

The misbehavior or mistakes of mortgage servicers identified in the bankruptcy data are not specific to the bankruptcy process. Indeed, the reliability of mortgage servicing may be worse for ordinary, non-bankrupt Americans. When such families face foreclosure, they lack the safeguards of the bankruptcy system such as specific and uniform federal laws, bankruptcy trustees, specialized federal courts, and representation by counsel, to ensure that mortgage servicers are complying with consumer protection laws. This Article's findings suggest that flawed mortgage servicing practices are a key contributor to the current crisis in the home mortgage market. Crafting an effective policy response to help homeowners requires regulators and policymakers to recognize how poor mortgage servicing threatens families' efforts to save their homes.

The evidence of unreliable mortgage servicing also provides a powerful lesson on the limits of formal law. The procedures for bankruptcy claims were thoughtfully designed to balance the concerns of consumers and industry. The written law contains clear

[2] *See, e.g.*, *In re* Matus, 303 B.R. 660, 675 (Bankr. N.D. Ga. 2004) ("The [bankruptcy] statutes are designed to insure that complete, truthful and reliable information is put forward at the outset of the proceedings, so that decisions can be made by the parties in interest based on fact rather than fiction.").

instructions, and parties are given the opportunity to object to inappropriate conduct. Indeed, the claims system has functioned for decades without generating calls for reform. Yet, reality is far from the ideal suggested by these external markers of system reliability. The data show that there are significant defects in the bankruptcy system, a chilling reminder that imposing unambiguous legal rules does not ensure that a system will actually function to protect the rights of parties. In the context of consumer transactions, where individuals are not repeat players or institutional actors, observing that laws underperform has crucial implications that echo far beyond bankruptcy policy. An effective legal system requires more than merely putting words into law and relying on silence as an indication of acceptable and just behavior. These data suggest that effective enforcement mechanisms or structural incentives for industry compliance can be as important as the rigor of the substantive rules.

Part I of this Article examines the incentives for mortgage servicers to comply with applicable laws and describes reported incidences of abusive servicing. Part II describes the study's methodology. Part III presents original data on the legality and accuracy of mortgage claims. These data show a high incidence of unreliable servicing behavior, even in the context of the heightened procedural protections in bankruptcy. Part IV develops the policy implications of the findings and proposes structural solutions to reduce the risks that poor mortgage servicing imposes on homeowners and the legal system. Without improved procedures and enforcement activity, homeowners in financial trouble—both inside and outside bankruptcy—remain vulnerable to mortgagees' misbehaviors and mistakes.

I. STATEMENT OF PROBLEM

Americans pursue homeownership to build wealth and to improve their financial position. The explosion of subprime lending and the rapid maturation of the securitization market for mortgages have fueled occasional criticisms of mortgage servicers, who are intermediaries between consumers and mortgage holders.[3] Consumers have complained of overcharges and difficulty in obtaining accurate loan information. Increasingly, these problems are erupting into litigation, most frequently in bankruptcy courts. Although policymakers have focused on loan origination,[4] consumers can suffer dire harms from poor mortgage servicing. Errors or overcharges increase the cost of homeownership and expose families to the risk of wrongful foreclosure. This part explains the serious consequences of mortgage servicing and collects the scattered reports of servicing abuse. This review highlights the need for a systematic examination of the reliability of mortgage servicing.

A. The Structure and Function of Mortgage Servicing

Mortgage servicing is the collection of payments from borrowers and the disbursement of those payments to the appropriate parties such as lenders, investors, taxing authorities, and

[3] In this Article, I refer only to servicers, but lenders who service their own loans may engage in similar behavior to third-party servicers.

[4] *See, e.g.*, Press Release, Iowa Attorney General, States Settle with Household Finance: Up to $484 Million for Consumers (Oct. 11, 2002), *available at* http://www.state.ia.us/government/ag/latest_news/releases/oct_2002/Household_Chicago.html (reporting that settlement with Household Finance for misrepresentation and disclosure violations at loan origination was the largest-ever direct restitution settlement).

insurers.[5] The rise of servicing as a distinct industry results from the widespread use of securitization in the mortgage market.[6] Put simply, securitization is the process of creating debt instruments (usually bonds) by pooling mortgage loans, transferring those obligations to a trust, and then selling investors fractional interests in the trust's pool of mortgages.[7] These investors receive periodic payments on their investments. Servicers act as intermediaries between the borrower and the other parties to the securitization. A pooling and servicing agreement sets out the servicer's responsibilities for collecting and remitting the mortgage payments. The participation of servicers complicates the borrower-lender relationship and limits flexibility in loss mitigation and default situations.

Mortgage servicers do not have a customer relationship with homeowners; they work for the investors who own the mortgage-backed securities.[8] Borrowers cannot shop for a loan based on the quality of the servicing, and they have virtually no ability to change servicers if they are dissatisfied with the servicers' conduct.[9] The only exit strategy is refinancing the mortgage, and even then, the homeowner may find the new loan assigned to its prior servicer. Because their customers are the trustees who hire them to collect on behalf of investors, servicers have few reputational or financial constraints to work to satisfy homeowners with their performance.[10]

In fact, servicers have a financial incentive to impose additional fees on consumers. Mortgage servicers earn revenue in three major ways. First, they receive a fixed fee for each loan. Typical arrangements pay servicers between .25% and 1.375% of the note principal for each loan.[11] Second, servicers earn "float" income from accrued interest between when consumers pay and when those funds are remitted to investors. Third, servicers often are permitted to retain all, or part, of any default fees, such as late charges, that consumers pay.[12] In this way, a borrower's default can boost a servicer's profits.[13] A significant fraction of servicers' total revenue comes from retained fee income.[14] Because of this structure, servicers' incentives upon default may not align with investors' incentives.[15] Servicers have incentives to make it difficult for consumers to cure defaults.

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[5] Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers*, 15 HOUSING POLICY DEBATE 753, 755 (2004).

[6] Statement of Sheila C. Bair, Testimony before U.S. House Comm. on Financial Services (Apr. 17, 2007) ("Prior to the widespread use of securitization, home finance typically involved a bank or savings institution granting a loan to a borrower. The lending institution would make the decision to grant credit, fund the loan, and collect payments.").

[7] *See generally* STEVEN L. SCHWARCZ, BRUCE A. MARKELL & LISSA L. BROOME, SECURITIZATION, STRUCTURED FINANCE, AND CAPITAL MARKETS (2004) (providing an introduction to securitization and examining the legal issues relevant to securitized transactions).

[8] Lenders do have a customer relationship with borrowers and may want to retain them as repeat customers. Some lenders retain the servicing obligations when they sell loans on the secondary market, but the active market for servicing contracts means that very few customers will find their loan is serviced by the originating lender.

[9] Jack Guttentag, *Why is Mortgage Servicing So Bad?*, Feb. 3, 2003, http://www.mtgprofessor.com/A%20-%20Servicing/why_is_servicing_so_bad.htm.

[10] *Id*.

[11] NAT'L CONSUMER LAW CENTER, FORECLOSURES 23 (2006 Supp.) [hereinafter Nat'l Consumer Law Center].

[12] Eggert, *supra* note 5, at 758 (explaining that servicers' conventional fee is a percentage of the total value of the loan but that servicers typically have the right to retain any default fees).

[13] NAT'L CONSUMER LAW CENTER, *supra* note 11 at 13.

[14] Some information can be gleaned from the securities filings of public companies that service mortgages. Late charges account for approximately 11% of revenues for Ocwen's residential mortgage servicing division in 2006. *See* Ocwen Financial Corp., Annual Report (Form 10-K), at 30 (Mar. 16, 2007). *Cf.* RONALD MANN, CHARGING AHEAD 23 (2006) (reporting that credit card issuers earn 9% of their revenue from penalty fees).

[15] Statement of Sheila C. Bair, *supra* note 6, at 9.

A consumer is only obligated to pay charges if the charges are permitted by the terms of the mortgage and by state and federal law. To validate such charges, consumers must know how the servicer calculated the amount due and whether such fees are consistent with their loan contract. A lending industry representative has admitted that "[m]ost people don't understand the most basic things about their mortgage payment."[16]Mortgage servicers can exploit consumers' difficulty in recognizing errors or overcharges by failing to provide comprehensible or complete information. In fact, poor service to consumers can actually maximize servicers' profits.[17] Indeed, it appears that servicers fail to satisfy customers. A study of consumer satisfaction with business services found that only 10% of borrowers are happy with their mortgage servicer.[18]

Spiking foreclosure rates and pressure from Wall Street may exacerbate problems with mortgage servicing.[19] Falling real estate prices have changed the profit calculus of foreclosure, encouraging lenders to reach out to delinquent borrowers. Facing political and financial pressure, lenders and servicers are struggling to develop cost- and time-effective strategies for loss mitigation.[20] However, cash-strapped lenders have fewer resources than ever to devote to loan servicing. Just as more borrowers risk losing their homes, servicers may have to lay off employees, skimp on procedural safeguards, or reduce investment in technology. These changes do not portend well for borrowers in high-cost loans or those seeking loan modifications.[21] Mortgage servicing is a crucial part of the homeownership process that must be part of any response to the rising foreclosure rate and downturn in the mortgage market.

B. Homeowners in Bankruptcy

Most consumers who file Chapter 13 bankruptcy cases are homeowners.[22] The requirements of the Bankruptcy Code impose new burdens on mortgage servicers. In turn, these complexities create new opportunities for mortgage servicing abuse. The harms of poor mortgage servicing are heightened in bankruptcy, a refuge for families trying to save their homes.

When a borrower files bankruptcy, the creditor is barred by the automatic stay from pursuing other legal action to collect the debt.[23] Pending foreclosures may not proceed against the debtor's home, unless the court grants the creditor permission to do so.[24] Many homeowners

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[16] *Lenders Look for Way to Avoid Bankruptcy Maze*, NAT'L MORTGAGE NEWS, Aug. 30, 2004.
[17] Guttentag, *supra* note 9.
[18] Press Release, J.D. Powers and Associates, Customer Service and Attention to Detail Drive Home Mortgage Satisfaction (Nov. 26, 2002), http://www.jdpower.com/corporate/news/releases/pressrelease.aspx?ID=2002144.
[19] Posting of Tara Twomey to *Credit Slips* blog, Subprime Servicing Getting Worse, http://www.creditslips.org/creditslips/2007/03/subprime_servic.html (Mar. 19, 2007).
[20] Ruth Simon, *Digging Out of Delinquency*, WALL ST. J., Apr. 11, 2007, at D1 ("The sharp rise in delinquencies in recent months is straining mortgage companies' ability to respond quickly to borrowers, with such solutions as new repayment plans or modifications to loan agreements."); Carrick Mollenkamp, *Faulty Assumptions*, WALL ST. J., Feb. 8, 200, at A1 (describing HSBC's expanded loss mitigation efforts).
[21] *See* Kurt Eggert, *What Prevents Loan Modifications*, 18 HOUSING POLICY DEBATE 279 (2007) (documenting barriers that servicers face in loan modifications).
[22] TERESA SULLIVAN, ELIZABETH WARREN, JAY LAWRENCE WESTBROOK, THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT 202 (2000) (half of all bankruptcy debtors are homeowners); Bahchieva, Wachter & Warren, *supra* note 1, at 104–05 (explaining that homeowners disproportionately choose Chapter 13 because Chapter 7 does not protect home equity).
[23] 11 U.S.C. § 362(a).
[24] 11 U.S.C. § 362(b).

are in default on their mortgage loans when they seek bankruptcy relief.[25] Because families typically struggle for months before filing bankruptcy,[26] their mortgage accounts at the time of bankruptcy may be loaded with default charges, penalty fees, and foreclosure costs. To retain their homes in bankruptcy, Chapter 13 requires debtors to pay, in full, these arrearage amounts (including any regular monthly payments that were not made before the bankruptcy.)[27]

To establish the arrearage amount that must be cured, creditors usually file proofs of claim.[28] Even if a loan is not in default, many mortgagees will file a claim to establish the amount of outstanding principal. While liens on a debtor's property pass unaffected through bankruptcy,[29] barring a specific challenge based on special bankruptcy avoidance powers, [30] creditors who wish to receive distributions from trustee must file claims.[31] Liens on debtor's property pass through bankruptcy unaffected, unless there is a specific challenge based on special bankruptcy avoidance powers. However, creditors who wish to receive distributions from the trustee must file claims. Trustees normally pay arrearage amounts to servicers from debtors' Chapter 13 payments. In some jurisdictions, trustees also collect and transmit the regular ongoing mortgage payments to servicers.[32]

A claims process is incorporated into every bankruptcy case to determine how much each creditor is owed and to adjudicate any disputes about the debt. These proofs of claims are bankruptcy's alternative mechanism to a separate lawsuit by each creditor to collect a debt. In the mortgage context, a proof of claim functions similarly to a complaint to foreclose and collect a deficiency judgment. That is, the claim should establish a creditor's interest in the debtor's home as a mortgagee and the amount owed on the mortgage note. The debtor has the opportunity to "answer," by objecting to the claim. The bankruptcy court then has authority to fix the claim. Because proofs of claim are the most common interaction between debtors and creditors in the

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[25] Bahchieva, Wachter & Warren, *supra* note 1, at 104 (finding that bankrupt homeowners are about 50 percent more likely to file Chapter 13 than Chapter 7 and attributing this preference to Chapter 13's special protections for home owners in default.).

[26] The median bankruptcy filer reported that they seriously struggled with debts for more than one year before filing bankruptcy. This query was posed to Chapter 7 and Chapter 13 debtors in telephone interviews one year after the respondent filed bankruptcy. N=585 (17 missing from total respondent sample of 602). 2001 Consumer Bankruptcy Project (data on file with author).

[27] 11 U.S.C. § 1322(b)(5).

[28] Creditors are not required to file proofs of claim. *See* David Gray Carlson, *Proofs of Claim in Bankruptcy: Their Relevance to Secured Creditors*, 4 J. BANKR. L. & PRAC. 555 (1995).

[29] Marianne B. Culhane & Michaela M. White, *Debt After Discharge: An Empirical Study of Reaffirmation*, 73 AM. BANKR. L.J. 709, 712 (1999).

[30] 11 U.S.C. §§ 544, 547.

[31] *See* ELIZABETH WARREN & JAW LAWRENCE WESTBROOK, THE LAW OF DEBTORS AND CREDITORS 219 (5th ed. 2005) ("[T]o receive any distribution, each chapter 7 or chapter 13 creditor must submit a proof of claim.")

[32] Practices on paying mortgage creditors in Chapter 13 cases vary. In some jurisdictions, ongoing mortgages are paid "outside the plan," meaning that the debtor continues to make the ongoing principal and interest payments directly to the mortgage servicer without trustee involvement. Even in these jurisdictions, the trustee usually collects the debtor's payment of any arrearages on the mortgage loan. In other districts, the trustee collects both the arrearage amounts and the ongoing mortgage payments. These practices are yet another example of the well-documented phenomena of "local legal culture" in bankruptcy cases. *See* Lynn M. LoPucki, *Legal Culture, Legal Strategy, and the Law in Lawyers' Heads*, 90 NW. U. L. REV. 1498 (1996); Teresa A. Sullivan, Elizabeth Warren & Jaw Lawrence Westbrook, *The Persistence of Local Legal Culture: Twenty Years of Evidence From the Federal Bankruptcy Courts*, 17 HARV. J.L. & PUB. POL'Y 801 (1994); Jean Braucher, *Lawyers and Consumer Bankruptcy: One Code, Many Cultures*, 67 AM. BANKR. L.J. 501 (1993).

bankruptcy system,[33] they offer an excellent mechanism for examining the behavior of mortgage servicers in bankruptcy cases.

C. The Harms of Abusive Servicing

Mortgage servicing abuse can take several forms. The Federal Trade Commission believes that poor servicing can be a serious problem for homeowners and has identified several abusive practices, including the imposition of unwarranted late fees, unnecessary force-placed insurance, and illegal fees.[34] Two cases illustrate the problems that incorrect or inaccurate mortgage servicing imposes on borrowers. In *Rawlings v. Dovenmuehle Mortgage, Inc.*,[35] the servicer repeatedly asserted that the homeowners had failed to make payments, imposed late fees, and sent notices of default. Consumers spent over seven months to resolve the servicers' error in applying the payments to the wrong account. In another instance, borrowers refinanced but the prior servicer continued to threaten to foreclose on their home and to report adverse information to credit bureaus.[36] This year, the *Boston Globe* reported that mortgage companies typically include projected foreclosure costs in payoff amounts given to borrowers in default.[37] These fees are estimates for anticipated services that may never be incurred. While a consumer advocate described the practice as a "license to steal from homeowners," an industry representative conceded that it was "pretty much industry standard."[38]

The likelihood that such practices translate to concrete harms is sharpened because consumers report serious difficulty in communicating with mortgage servicers when they perceive an error or overcharge has occurred.[39] Consumers allege that they have to speak with dozens of representatives to address servicing mistakes or to receive basic information such as a payment history. These problems are exacerbated when a borrower defaults on a loan, in part because the loan is often transferred to the loss mitigation department or sold to a different servicer who specializes in troubled loans.

Abusive servicing can push a homeowner into default or can make it hard or impossible for a homeowner to climb out of trouble. Research has shown that the quality of loan servicing can affect the incidence of loan default.[40] Servicers may alter their practices and delay foreclosure to drive up their profits because they do not have incentives to care about preventing foreclosure.[41] While preventive servicing can reduce loss severities, abusive servicing can

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[33] While claims are the most common creditor activity in bankruptcy cases, claims are not filed by every creditor. *See* 1 KEITH M. LUNDIN, CHAPTER 13 BANKRUPTCY § 67.1 (3d ed. 2000 & Supp. 2004) (stating that numerous creditors fail to file proofs of claim).

[34] Federal Trade Commission, *Mortgage Servicing: Making Sure Your Payments Count*, *at* http://www.ftc.gov/bcp/conline/pubs/homes/mortgserv.htm.

[35] 64 F. Supp. 2d 1156 (M.D. Ala. 1999).

[36] Islam v. Option One Mortgage Corp., 432 F. Supp. 2d 181 (D. Mass. 2006).

[37] Sacha Pfeiffer, *Hidden Legal Fees Push Some Into Foreclosure*, BOSTON GLOBE Jan. 18, 2007.

[38] *Id.*

[39] *See, e.g.*, S.P. Dinnen, *Mortgage Complaints Can Take Extra Effort*, DES MOINES REGISTER, May 2, 2004; A. Pesquera, *Paper Trail of Problems: Some Fairbanks Clients Report Nightmare Errors*, SAN ANTONIO EXPRESS-NEWS, Aug. 9, 2002.

[40] Anthony Pennington-Cross & Giang Ho, *Loan Servicer Heterogeneity &The Termination of Subprime Mortgages* (Federal Reserve Bank of St. Louis, Working Paper No. 2006-024A, 2006, *available at* http://research.stlouisfed.org/wp/2006/2006-024.pdf (finding that individual servicer affected chance of default to substantial degree among large sample of subprime mortgages).

[41] Yingjin Gan & Christopher Mayer, *Agency Conflicts, Asset Substitution, and Securitization* (Nat'l. Bur. of Econ. Res., Working Paper No. 12359 2006), *available at* http://www.nber.org/papers/w12359.

heighten them.[42] Without servicers' reaching out to consumers and spending the necessary time and money, sensible loan modification opportunities will be missed. Families who could have saved their homes with a repayment plan or modification will lose their homes, and investors will suffer unmitigated losses.[43]

The harms of servicing abuse may be even higher for families in bankruptcy, who often file Chapter 13 in a final effort to save their homes. If bankruptcy claims contain illegal fees, debtors face increased burdens in confirming repayment plans and are forced to find extra income to make bloated payments. Even if the servicing harm is limited to informational problems, debtors suffer harms. As one bankruptcy court recognized, mistakes by creditors, who are in control of the accounts, impose additional costs to sort out such problems on debtors, the party that can least afford such expense.[44] Servicing problems also jeopardize the ability of courts and trustees to administer bankruptcy cases correctly and fairly. Other creditors are harmed if mortgage companies wrongly divert money that should be available to pay unsecured creditors and increase the administrative costs of bankruptcy. If servicing abuse is routine, an additional harm is to our collective confidence in the integrity of the bankruptcy system and the power of law to balance the rights of consumers and businesses.

D. Litigation on Mortgage Servicing Practices

Mortgage servicing abuse is a nascent legal issue.[45] Depending on the type of misbehavior, consumers may have federal and state claims and both common law and statutory remedies.[46] While the case law is growing, there are still relatively few adjudicated decisions on mortgage servicing problems. Several explanations exist. Consumers may not be aware of their rights or be able to afford an attorney. The relative youth of mortgage servicing as an industry means that few attorneys or judges understand the legal and factual issues. Regulatory authority for mortgage servicing is fractured. The paucity of decisions suggests that many consumers may respond to mortgage claims by "lumping it," rather than seeking any formal redress.[47] Consumers who litigate these disputes face all the challenges of typical consumer protection litigation, including limited access to attorneys, expensive and complicated evidentiary issues, and insufficient remedies to justify such suits.[48]

Most litigation against mortgage servicers has occurred in the context of bankruptcy cases.[49] Bankruptcy changes the dynamic between borrowers and servicers. The vast majority of consumers hire an attorney to represent them in their bankruptcy.[50] Without counsel, consumers

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[42] MICHAEL A. STEGMAN, ET. AL., *Preventive Servicing Is Good for Business and Affordable Homeownership Policy*, 18 HOUSING POLICY DEBATE 243 (2007).
[43] Eggert, *supra* note 21, at 282.
[44] Williams v. Fairbanks Capital Corp. (*In re* Williams), 2001 WL 1804312, at *2 (Bankr. D.S.C. 2001) (awarding punitive damages to debtor as a result of actions and misrepresentations of creditor).
[45] NAT'L CONSUMER LAW CENTER, *supra* note 11, at 23.
[46] *Id*.
[47] Marc S. Galanter, *Reading the Landscape of Disputes: What We Know and Don't Know (And Think We Know) About Our Allegedly Contentious and Litigious Society*, 31 UCLA L. REV. 4, 14 (1983) ("Even where injuries are perceived, a common response is resignation, that is, 'lumping it.').
[48] *See* JOHN A. SPANOGLE ET. AL., CONSUMER LAW 772 (3d ed. 2007) (discussing barriers to consumer litigation).
[49] *See Lenders Look for Way*, *supra* note 16, (quoting employee of servicer remarking that "[b]ankruptcy is becoming a fertile ground for a lot of loopholes and a lot of lawsuits and a lot of costs to servicers").
[50] TERESA SULLIVAN, ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA 22–23 (1989) (finding only 4% of debtors in a sample of 1529 cases filed *pro se* petitions).

may be unable to raise such claims. They may also have trouble identifying an attorney who is familiar with such issues or willing to take such a suit on a stand-alone basis. As part of the bankruptcy case, the attorney may find it difficult to obtain the cooperation of the mortgage servicer and litigation may be necessary to fulfill their duty of representation. While bankruptcy is the context for most servicing disputes, the problems are identified in bankruptcy cases often originated months or years earlier and are equally likely to occur when a borrower is in default but does not file bankruptcy.[51]

Bankruptcy courts have repeatedly expressed frustration with mortgagees' failure to provide complete and accurate information.[52] Courts and litigants have struggled to obtain comprehensible records from servicers. *In re Maxwell*, the court described the creditor's pleadings. "Thus, Fairbanks, in February 2000, represented that the Debtor owed it $48,691.36 *less* than what it demanded of the Debtor in April of 1998 and $192,963.64 *more* than it demanded of her on July 13, 1999."[53] The court found that "Fairbanks, in a shocking display of corporate irresponsibility, repeatedly fabricated the amount of the Debtor's obligation to it out of thin air." The court held that this behavior violated both federal and state law. After the court's ruling on liability, the debtor settled the case for a full discharge of her mortgage, $50,000 in damages, and attorney's fees.

Other courts have identified a similar pattern of confusing or incomplete recordkeeping as evidenced by servicers' proofs of claim. Unable to decipher a servicer's records, even after ordering further document production, one court finally resorted to creating its own amortization table. The judge stated that "[t]he poor quality of papers filed by Fleet to support its claim is a sad commentary on the record keeping of a large financial institution. Unfortunately, it is typical of record-keeping products generated by lenders and loan servicers in court proceedings."[54] In some instances, mortgagees apparently are unable to offer any accounting to support their claim. In *Litton Loan Servicing v. Garvida,* when the servicer failed to respond to a court order to provide information, Bankruptcy Appellate Panel affirmed that a downward adjustment of the mortgagee's claim was an appropriate remedy.[55] Another court reduced a mortgagee's claim under the equitable theory of recoupment after finding that the servicer violated the Real Estate Settlement Procedures Act in failing to respond to the debtor's requests for an account balance. The opinion's first sentence reveals the court's frustration: "Is it too much to ask a consumer mortgage lender to provide the debtor with a clear and unambiguous statement of the debtor's default prior to foreclosing on the debtor's house?"[56] In one egregious case, a mortgage company filed a proof of claim for more than $1 million when the principal balance on the note was $60,000.[57] The inaccuracy stemmed from the claimants' mistake in reporting the cost of the

[51] E-mail from the Honorable Keith M. Lundin (June 9, 2003) (on file with author) (describing session at Nat'l. Ass'n. of Chapter 13 trustees meeting on mortgage issues in Chapter 13). The grievances aired were: servicers are unable to prepare correct pre-petition claims in Chapter 13 cases; creditors file proofs of claim without balances or that are bloated with illegal and fraudulent fees sometimes totaling several thousand dollars; irreconcilable and unexplained balances appear on amended proofs of claim; servicers provide no contact information; and servicers refuse to provide loan payment histories.

[52] Henry R. Hildebrand III, *The Sad State of Mortgage Service Providers*, 22 AM. BANKR. INST. L. REV. 10 (2003) (describing mortgage servicers' inability or lack of effort to make their records match the debtor's plan or to comply with the requirements of the Bankruptcy Code such as disclosing fees and costs).

[53] Maxwell v. Fairbanks Capital Corp. (*In re* Maxwell), 281 B.R. 101, 114 (Bankr. D. Mass. 2002).

[54] *In re* Wines, 239 B.R. 703, 709 (Bankr. D.N.J. 1999).

[55] *In re* Garvida, 347 B.R. 697 (9th Cir. B.A.P. 2006).

[56] *In re* Thompson*,* 350 B.R. 842, 844–45 (Bankr. E.D. Wis. 2006).

[57] The proof of claim was filed in a Northern District of Texas Chapter 13 case and is on file with the author.

insurance policy that the servicer forced on the debtor after the debtor's insurance lapsed. These problems led a prominent Chapter 13 trustee to conclude that mortgage servicing in bankruptcy is in a "sorry state."[58]

Mortgagee servicing problems have surfaced in other procedural contexts besides proofs of claims. The nature of this misconduct is rarely due to the posture of the case, however, and similar problems may infect mortgage claims or non-bankruptcy servicing. For example, bankruptcy motions for relief from stay put debtors at direct risk of losing their home in a state law foreclosure action. This context may spur debtors and their attorneys to respond to confront servicing inaccuracies that went unidentified in proofs of claim. Several courts have complained about unsubstantiated or patently false allegations in mortgagees' motions for relief from the stay. Courts have lamented mortgage servicers' practice of filing motions to vacate the automatic stay based on poor accounting practices or non-existent records, rejecting what one court termed the mortgage servicers' "dog ate my homework excuses" for such problems.[59] These courts have emphasized two main harms: damage to the judicial process when a court is asked to rule on incorrect or baseless facts and a danger that a family would lose its home without just cause and in violation of the Bankruptcy Code.

In *Jones v. Wells Fargo Home Mortgage*, the court identified a variety of accounting errors and impermissible behavior by a mortgage company, including miscalculations of both prepetition and postpetition obligations and attempts to collect impermissible fees.[60] Wells Fargo also applied payments in violation of the debtor's confirmed Chapter 13 plan—a practice that increased the interest charged above what was actually due.[61] The court noted that Wells Fargo's actions resulted in "such a tangled mess that neither Debtor, who is a certified public accountant, nor Wells Fargo's own representative could fully understand or explain the accounting offered."[62] In another protracted dispute, a court that initially was concerned about whether a creditor lacked a basis for a motion for relief from stay or may have misapplied plan payments eventually heard hours of evidence on the propriety of servicers' and attorneys' practices in bankruptcy cases.[63] The participation of the U.S. Trustee program in the litigation was hotly contested,[64] but undoubtedly changed the character of the litigation to focus on whether servicers engage in a pattern of misconduct, an issue usually relevant to crafting an appropriate sanction for misbehavior.

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[58] *See* Hildebrand, *supra* note 52.

[59] *In re* Gorshtein, 285 B.R. 118, 126 (Bankr. S.D.N.Y. 2002).

[60] *In re* Jones, No. 03-16518, 2007 WL 1112047 (Bankr. E.D. La. 2007). Perhaps most egregiously, Wells Fargo charged the debtor for sixteen property inspections during the bankruptcy case but its representative "could not list a single reason why an inspection would have been ordered postpetition, nor could she detail any reason why continuous monitoring of the property was necessary or reasonable." *Id.* at *11.

[61] *Id.* at *3.

[62] *Id.* at *4. As a remedy, the court imposed a sanction award of $67,202.45 and ordered Wells Fargo to implement an accurate accounting system for cases in the court's jurisdiction. Michael L. Jones v. Wells Fargo Home Mortgage (*In re* Jones), Case. No. 03-16518; Adv. No. 06-01093. Supplemental Memorandum Opinion (Aug. 29, 2007).

[63] Order Requiring Countrywide Home Loans, Inc. to Appear and Show Cause Why It Should Not Be Sanctioned for Filing a Motion for Relief From Stay Containing Inaccurate Debt Figures and Inaccurate Allegations Concerning Payments Received From the Debtor, *In re* Parsley, No. 05-90374 (Bankr. S.D. Tex. Feb. 12, 2007).

[64] Order Granting in Part and Denying in Part Motion of Barrett Burke Wilson Castle Daffin & Frappier, L.L.P. to Strike or, In the Alternative, Limit Issues and/or Continue Show Cause Hearing, *In re* Parsley, No. 05-90374 (Bankr. S.D. Tex. Mar. 6, 2007) (finding that U.S. Trustee has standing to participate under 11 U.S.C. § 307 and finding that Federal Rule of Bankruptcy Procedure 2004 permitted requested discovery).

Some courts also have targeted the creditors' law firms for misbehavior.[65] A New Jersey law firm was fined for filing 250 court pleadings in which the signature page had been pre-signed before review by the servicer.[66] The court's opinion sternly reminds servicers and attorneys that technological "advances" do not absolve the responsible humans of their duty to the court.[67] Another court has observed "instances in which attorneys representing alleged mortgagees or their servicing agents did not know whether the client was a mortgagee or a servicing agent, or how their client came to acquire its role."[68] In addition, several class-action lawsuits have been filed based on allegedly inappropriate efforts to collect attorneys' fees in bankruptcy.[69]

When problems are systemic, private lawsuits may be an ineffective solution. The Federal Trade Commission joined the National Consumer Law Center in bringing a class-action lawsuit against a large servicer, Fairbanks Capital Corporation, for alleged violations of consumer protection laws. The lawsuit settled in 2003 after Fairbanks agreed to pay $47 million, including funding a $5 million foreclosure-redress fund for consumers who lost their homes in part due to unwarranted charges or difficulties in obtaining information from Fairbanks.[70] Despite this victory, the FTC has not pursued any other major enforcement activities against servicers. The Department of Housing and Urban Development also has authority to address servicing misbehavior. It enforces the Real Estate Settlement Procedures Act, which obligates mortgage servicers to provide certain information to homeowners upon receiving a "qualified written request."[71] While a failure to respond to a qualified written request can give rise to a private right of action, there is no empirical evidence on how frequently this law is used to help consumers.[72] Forty percent of consumer complaints to HUD concern servicing issues,[73] yet HUD does not routinely investigate these complaints or collect data from servicers on compliance issues.

The anecdotal reports of mortgage servicing abuse are growing, and the cited decisions are quite recent. However, regulatory enforcement remains weak, and cases outside of bankruptcy are exceedingly rare. Given the millions of consumer who may face foreclosure in the next few years, and the hundreds of thousands of homeowners who annually file Chapter 13 bankruptcy to save their homes, there is a definite need to probe the reliability of mortgage

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[65] *See, e.g.*, *In re* Allen, Memorandum Opinion regarding Sanction of Creditor's Attorneys, Case No. 06-60121 (Jan. 9, 2007) (finding that large creditor's firm had filed erroneous and unsubstantiated objection to plan confirmation).
[66] *In re* Rivera, 342 B.R. 435 (Bankr. D.N.J. 2006).
[67] *Id.* at 467. *See also In re* Allen, *supra* note 65 (describing the close relationship between servicers and their "outside" counsel, who receive some pleadings "set up" with data from the servicer's computer system).
[68] *In re* Schwartz, No. 06-42476JBR, 2007 WL 1188348 (Bankr. D. Mass. Apr. 19, 2007). In that case, the "creditor" claimed to have foreclosed before the bankruptcy filing but was ultimately unable to show that it had the right to undertake any foreclosure activity.
[69] *See In Re* Harris, No. 96-14029-MAM, 00-11321-MAM, Adv. No. 99-1144 (Bankr. S.D. Ala. Jan. 13, 2005); *In Re* Slick, No. 98-14378-MAM, Adv. No. 99-1136 (Bankr. S.D. Ala. Nov. 22, 2002). In Nevada, a proposed class-action was filed to challenge Ocwen Federal Bank's practice of including a "proof of claim fee" in claims filed in Chapter 13 cases. The case was transferred to the Panel on Multidistrict Litigation and remains pending. *In re* Ocwen Federal Bank FSB Mortgage Servicing Litigation, 04-CV-2714, MDL-1604, N.D. Ill.
[70] Fairbanks Capital Corporation settlement documents, http://www.consumerlaw.org/initiatives/mortgage_servicing/index.shtml.
[71] 12 U.S.C. § 2605.
[72] Consumers themselves or their attorneys (including bankruptcy attorneys) may not be aware of the law. Also consumers often do not hire attorneys until foreclosure is imminent, at which time a qualified written request and its sixty-day response window may not be an expedient option.
[73] Guttentag, *supra* note 9.

servicing. The harms from poor servicing carry severe consequences, and empirical data can help draw attention to the need to consider how servicing contributes to failed homeownership.

II. METHODOLOGY

The Mortgage Study is a large, multi-state study of the home loans of families in financial distress. Its principal objective was to create an original database to facilitate new research on the intersection of mortgage lending and bankruptcy. Tara Twomey[74] and I are the principal investigators in the Mortgage Study, which was funded by the National Conference of Bankruptcy Judge's Endowment for Education.[75]

The Mortgage Study sample contains 1733 Chapter 13 bankruptcy cases filed by homeowners. The sample includes cases from forty-four judicial districts in twenty-four states, which represented 61% of all Chapter 13 cases filed in 2006.[76] The sample captures variations in local bankruptcy practice and ensures that all large mortgage lenders and servicers are represented. In each district, the sample was constructed by selecting every fifth case filed in April 2006 in which the debtor owned a home.[77] If a case was converted from another chapter or the debtor did not own a home, that case was excluded and the next case that met the selection criteria was included in the sample. Thus, the sample roughly reflects the proportional size of Chapter 13 filings among all judicial districts in the sample.[78]

The sample is not representative of all homeowners in bankruptcy for two reasons. First, the sample includes only Chapter 13 bankruptcy cases and excludes Chapter 7 cases. Prior studies have confirmed that the percentage of homeowners in Chapter 13 bankruptcy is much higher than in Chapter 7 bankruptcy.[79] The exclusive focus on Chapter 13 enhances the data's usefulness to examine bankruptcy as a home-saving device.[80] Chapter 13 is particularly attractive to homeowners who are in default on their mortgage loans because it permits them to retain their home by curing arrearages over time through repayment plans.[81] Although the data are only from

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[74] When the study began, Tara Twomey was a clinical instructor at Harvard Law School. She is currently a Lecturer in Law at Stanford Law School and a consultant for the National Association of Consumer Bankruptcy Attorneys and the National Consumer Law Center. Neither organization had any involvement in this research.

[75] The Endowment for Education is a non-profit and non-partisan organization. In funding the grant, the Endowment does not endorse or express any opinion about the methodology utilized, or any conclusions, opinions, or results contained in this Article or any other findings based on the research funded by the Endowment.

[76] American Bankruptcy Institute, *Annual Non-business Filings by Chapter (2000-2006)*, http://www.abiworld.org/AM/AMTemplate.cfm?Section=Home&CONTENTID=47461&TEMPLATE=/CM/ContentDisplay.cfm (last visited Jan. 19, 2008).

[77] All homeowners were included in the sample, regardless of whether they had mortgages. In the sample, 96% of homeowners had outstanding mortgage debt when they filed bankruptcy.

[78] For example, in a district with few Chapter 13 filings, such as Wyoming, only two cases are in the sample. At the other extreme, the sample contains 164 cases from the Northern District of Georgia because that district has a large number of Chapter 13 cases filed.

[79] Consumer Bankruptcy Project III (CBP) data indicate that homeownership is much more prevalent among Chapter 13 debtors than Chapter 7 debtors. In the CBP's core sample of 1250 cases filed in 2001 in five judicial districts, 30% of Chapter 7 cases were filed by homeowners. In contrast, 75% of Chapter 13 debtors owned their homes when they filed bankruptcy (data on file with author).

[80] Scarce data exist on how homeowners fare in bankruptcy. *See* Melissa B. Jacoby, *Bankruptcy Reform and Homeownership Risk*, 1 ILL. L. REV. 323, 352 (2007) ("Although scholars of mortgage debt and foreclosure generally may be aware that some homeowners with housing problems file for bankruptcy, chapter 13's specific mortgagor protection feature has not received sufficient discrete and sustained scholarly attention."). The most extensive study to date was conducted based on cases filed in 2001 and did not rely on proofs of claim or home loan documents. *See* Bahchieva, Wachter, & Warren, *supra* note 1, at 74.

[81] *See* 11 U.S.C. §§ 1322(b)(3) and (b)(5), 1325(a)(5) and 362(a).

Chapter 13 cases, the rules and procedures to ensure accurate bankruptcy claims are identical for Chapter 7 cases. However, mortgage claims are much less frequently filed in Chapter 7 cases because there are fewer homeowners who file Chapter 7 and because Chapter 7 does not offer the remedies to homeowners in default that Chapter 13 does.

Second, the sample was drawn only from districts where the applicable state law permits non-judicial foreclosures of debtors' principal residences.[82] We limited the sample in this way because the more favorable remedies available to mortgagees in non-judicial foreclosure states may reduce servicers' incentives to negotiate with consumers after default. That is, because non-judicial foreclosure is faster and less expensive than judicial foreclosure,[83] debtors may have a greater need to file bankruptcy in non-judicial foreclosures states to contest a foreclosure. Sampling states that permit non-judicial foreclosure probably boosted the proportion of homeowners in default on mortgage loans in the sample. Because bankruptcy law is uniform nationally on the requirements for proofs of claims and the rights of homeowners with mortgages in default,[84] a random national sample (including judicial foreclosure states) may not produce different data.[85]

Data were drawn from the public court records filed in each case.[86] Like other leading studies of consumer bankruptcy, [87] we coded data from debtors' schedules. Filed under penalty of perjury, these schedules may provide more complete and reliable evidence of debtors'

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[82] Our sample represents 49% of the judicial districts in the United States. The twenty-four states in the sample are: Alabama, Arkansas, California, Colorado, District of Columbia, Georgia, Idaho, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, New Hampshire, North Carolina, Rhode Island, South Dakota, Tennessee, Texas, Utah, Virginia, West Virginia, and Wyoming.

[83] GRANT NELSON & DALE WHITMAN, REAL ESTATE FINANCE LAW 635 (2002); BARLOW BURKE, REAL ESTATE TRANSACTIONS 336 (2006) ("[Power of sale foreclosure] is cheaper than judicial foreclosure and takes less time."). Judicial foreclosure procedures vary depending on state law. Typically these steps include the filing of a lawsuit and a judgment, followed by a court order authorizing a judicial sale conducted pursuant to statutory procedures. *Id.* at 334. Non-judicial foreclosure typically proceeds under a deed of trust that permits a third-party trustee, upon default, to sell the property in a private sale. Although some public notice is required by all states, a non-judicial foreclosure, as its name suggests, does not require court supervision or the filing of a lawsuit. *Id.* at 337.

[84] Notwithstanding the law's uniformity, practices in bankruptcy do vary in remarkable ways, often due to "legal culture." *See generally* sources cited in note 32, *supra*.

[85] For those cases in which a foreclosure was filed before bankruptcy, it is possible that in judicial foreclosure states the lender was more likely to have retained an attorney before the bankruptcy than in non-judicial foreclosure states. It is unclear if such attorney involvement would result in more complete or accurate bankruptcy pleadings.

[86] Most documents were obtained from PACER. We thank the Chief Judges of each district in the Mortgage Study (with the sole exception noted below) for granting us a research waiver of PACER fees. The Southern District of Texas denied the application for a fee waiver, stating that it had a blanket policy against such waivers, notwithstanding the written policy of the Judicial Conference of the United States that individual researchers associated with educational institutions are eligible for waivers if they can show cause. *See* Electronic Public Access Fee Schedules, http://pacer.psc.uscourts.gov/documents/epa_feesched.pdf (last visited Sept. 9, 2006). When PACER did not appear to contain complete court files, we obtain paper records. For example, in the Eastern and Middle Districts of North Carolina, proofs of claim are not made available on PACER. We thank Edward Boltz of the Law Offices of John T. Orcutt and Reid Wilcox, Clerk of the Bankruptcy Court for the Middle District of North Carolina, for their help in obtaining these documents.

[87] Teresa Sullivan, Elizabeth Warren & Jay Lawrence Westbrook, *Less Stigma or More Financial Distress: An Empirical Analysis of the Extraordinary Increase in Bankruptcy Filings*, 59 STAN. L. REV. 213 (2006); Scott Norberg & Andrew J. Velkey, *Debtor Discharge and Creditor Repayment in Chapter 13*, 39 CREIGHTON L. REV. 473 (2006); Marianne B. Culhane & Michaela M. White, *Debt After Discharge: An Empirical Study of Reaffirmation*, 73 AM. BANKR. L.J. 709, 712 (1999).

financial situations than survey or interview methods.[88] For each case, we coded a debtor's income, the debtor's valuation of her home, and any information about mortgage obligations on the debtor's principal residence,[89] including total debt, any arrearages, and the amount of monthly payments.[90]

The innovation of the Mortgage Study was to code mortgage creditors' proofs of claim and supporting documentation. These files give more information on home loans than is available from debtors' schedules. Data came from four documents, when available: the proof of claim itself, an itemization of the amount claimed; a copy of the mortgage that secured the obligation, and a copy of the note evidencing the debt. From these documents, we coded the type and terms of each loan; the names of the mortgagee, originating lender, and servicer; the amount of the initial mortgage debt; and the amount of mortgage debt, including arrearages, when the bankruptcy was filed. We also coded any objections to mortgage creditors' proofs of claim and any amended claims. For a case with only one mortgage loan, we coded 152 data points; when debtors had more loans, there were more data points to capture.[91] Combining data from creditors' and debtors' pleadings, the Mortgage Study database offers a rich and detailed picture of bankrupt families' mortgages.

Data were coded into a specially designed database. We deployed several standard procedures to ensure the data's accuracy. First, if the initial coding six months after the cases' filing did not locate a mortgagee proof of claim or an objection to any filed proof of claim, we rechecked the court records a year later to locate any records that were filed later or missed in the initial coding. These were added to the database. To reduced concerns about coding reliability, we used only three coders, each of which either had law degrees or prior experience on academic bankruptcy projects. All coders received individual training on practice cases to develop consistent coding practices. Coders referred to a written manual while coding and noted any unusual situations or questions. We individually reviewed the coding in each of these flagged cases. We also performed two types of error checks on the data. First, we ran error traps to improve the accuracy of the database,[92] and corrected any identified errors. Second, a random sample of 10% of the cases (approximately 175 cases) was recoded blind, without reference to the prior coding. We then compared each variable of each case between the initial coding and the recoding, noted any discrepancies, and checked for mistakes in the initial coding. The data were 99% accurate, and no systematic errors were identified between coders.[93]

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[88] RONALD J. MANN, CHARGING AHEAD 61 (2006) (noting problems with the Federal Reserve's Survey of Consumer Finance data); David B. Gross & Nicholas S. Souleles, *Do Liquidity Constraints and Interest Rates Matter for Consumer Behavior? Evidence From Credit Card Data*, 117 Q. J. ECON. 149, 151, n.2 (2001) ("SCF households substantially underreport their bankcard debt.").

[89] Real property that was not the debtor's principal residence was ignored, as were any corresponding proofs of claim for such properties. No debtor was permitted to have more than one principal residence.

[90] We coded data from the docket, petition, Schedules A, C, D, I, and J, Form B22, and the Chapter 13 plan. These documents were available and complete in over 99% of sampled cases; there are very few missing observations. We coded only the original version of the schedules, including any separately or later-filed schedules that were not included in the original schedules. We did not code amendments to schedules because we were interested in the debtors' initial abilities to gauge the amounts of their mortgage debts.

[91] The exact number of data points actually coded varied with each case based on several factors, including the number of home loans, the type of loan, and the quantity of documentation attached to the proof of claim.

[92] Two examples illustrate this type of check: we reviewed any proof of claim dates before April 2006 when the cases were filed; we checked for any dollar figures that began with a decimal point or exceeded one million dollars.

[93] The error rate was 1.04%. To calculate the error rate, we compared the original coding and the recoding and determined the number of errors in the initial coding, and divided this number by the number of data points.

The final data were transferred to Microsoft Excel and SPSS for Windows for analysis. All dollar figures are presented as reported in court records without adjustment for inflation.

III. FINDINGS

The Mortgage Study data permit multiple analyses of the reliability of mortgage claims. The overall pattern of findings is disturbing. Many creditors do not comply with applicable law governing claims. Routinely, fees are not identified with specificity, making it impossible to determine if these charges are legal. In most instances, mortgagees believe the debt is greater than debtors do; these differences typically represent thousands of dollars. Yet, creditors are rarely called to task for these behaviors. The vast majority of all claims (96%) pass undisturbed through the bankruptcy system without objection. Attorneys do not aggressively enforce their clients' rights against mortgage companies because the costs are too high and the incentives are too low in the current system. The combination of widespread deficiencies in claims and the lack of objections weakens the integrity of the bankruptcy process and can harm both debtors and other creditors by skewing distributions in favor of mortgage creditors.

A. Required Documentation for Mortgage Claims

Mortgage creditors who want to receive distributions from the bankruptcy estate for mortgage arrearages must file a proof of claim. Claims also establish the amount of the debtor's future mortgage payment during the bankruptcy case. In the Chapter 13 cases in the sample, mortgage creditors filed proofs of claim to correspond with 81.7% of the home loans that debtors listed on their bankruptcy schedules.[94]

Creditors who file claims are required to use Official Form 10 or a similar document that substantially conforms to the form.[95] Form 10 directs creditors to attach an itemized statement if their claim "includes interest or other charges" in addition to the principal amount.[96] This requirement would apply to nearly all typical mortgage claims, as these obligations bear interest. Federal Rule of Bankruptcy Procedure 3001 imposes two additional evidentiary requirements on proofs of claim:[97] a copy of the writing if one evidences the claim;[98] and evidence of perfection if the creditor asserts a security interest in the property of the debtor. [99]

Requiring this trio of documentation (itemization, note and mortgage) permits all parties in a bankruptcy case—debtor, trustee, other creditors—to ensure the accuracy and legality of the claim. Without documentation, parties cannot verify that the claim is correctly calculated and that it reflects only amounts due under the terms of the note and mortgage and permitted by other

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[94] As noted in Part II (Methodology), *supra*, we checked at two points (six months after each case's filing date and over one year after the cases' filing date) to ensure the completeness of the proof of claim data. *See also* text near notes 28–33, *supra*, for mortgagees' incentives to file claims.

[95] Fed. R. Bankr. P. 3001(a).

[96] Official Form 10, *available at* http://www.uscourts.gov/bankform/formb10new.pdf.

[97] It is possible that a single integrated document could perform the function of both the note and the mortgage in creating the parties' rights and obligations in the transaction. We did not identify such instances in the sample. Because consumer home loans are typically intended for sale on the secondary market, separation of the note and the mortgage helps ensure that the note is a negotiable instrument that will be subject to the holder-in-due-course defense upon transfer.

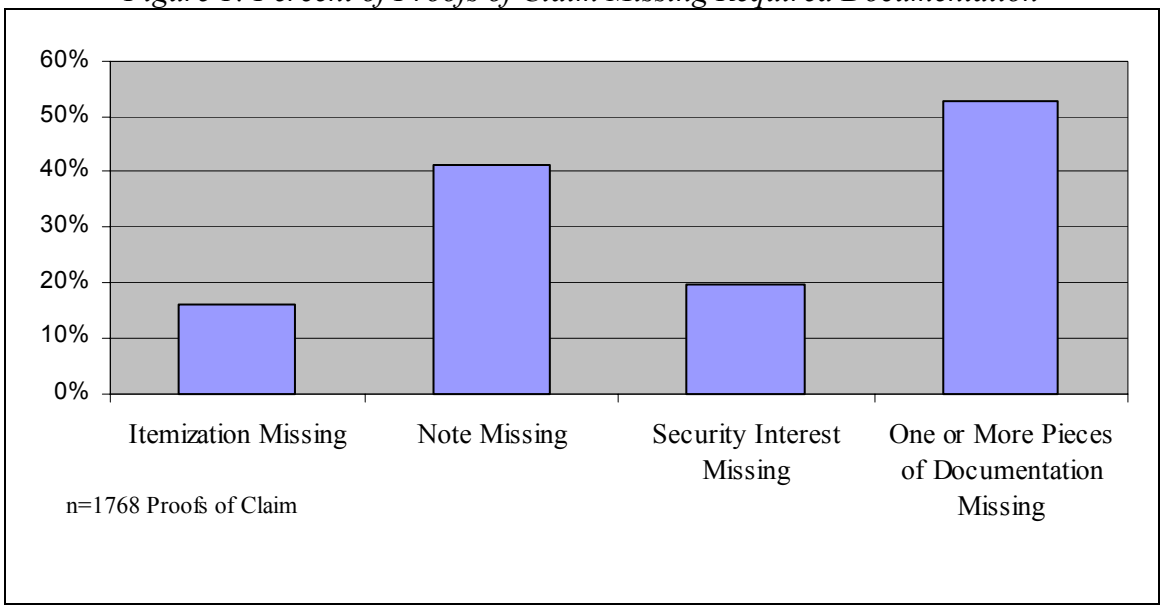
[98] Fed. R. Bankr. P. 3001(c) ("When a claim, or an interest in property of the debtor securing the claim, is based on a writing, the original or a duplicate shall be filed with the proof of claim.").

[99] Fed. R. Bankr. P. 3001(d) ("If a security interest in property of the debtor is claimed, the proof of claim shall be accompanied by evidence that the security interest has been perfected.").

applicable law.[100] A lack of documentation hampers efforts to ensure that any payments on mortgage claims are made in accord with the Bankruptcy Code.

The documentation requirements for mortgage proofs of claim are unambiguous and long-standing. Nevertheless, these laws were not consistently respected. A majority of claims (52.77%) lacked one or more required attachments. Figure 1 illustrates the findings for mortgagees' proofs of claim on loans secured by a debtor's home.[101] The data show that in a majority of instances mortgagees to not provide the required documentation.

Figure 1: Percent of Proofs of Claim Missing Required Documentation



A majority of claims (83.9%) had the itemization attached to them. Despite the applicable, clear instruction on Form 10, the remaining fraction (16.1%) did not have any itemization attached. For the one in six claims that was not supported by an itemization, the debtor and other parties are unable to discern the specific bases for a creditor's asserted right to be paid the total amount of the claim. Further, as discussed in Part B, *infra*, the usefulness of these itemizations varied greatly.

The most fundamental piece of evidence to support a claim is a copy of the promissory note or instrument establishing the existence and terms of the debt. A note is necessary to establish the existence of a debt, its key terms, and the creditor's standing to collect the debt. Despite its importance, a note was not attached to 41.1% of claims.

The finding that four of ten claims were not supported by a note is troubling for several reasons. First, the note is not easily available from another source. Unlike mortgages, notes are not recorded in public records. If the debtor does not have a copy of the note, and the servicer

[100] For example, some states have specific laws that govern foreclosure costs and fees. *See, e.g.*, Mich. Comp. Laws Ann. 600.2431 (West 2000) (capping attorneys' fees in a non-judicial foreclosure at no more than $75 if the mortgage does not specifically contract for such attorneys' fees).

[101] These data come from the proof of claim initially filed in each case and do not reflect any attachments that may have been added if mortgagees filed amended claims. The purpose here is to measure compliance with the clear obligations of the rules in the first instance, not whether creditors responded if a party objected or requested information.

does not provide one, the servicer has an informational advantage, which the rule was presumably designed to eliminate. Next, the promissory note or other debt instrument is absolutely necessary to enable the debtor, trustee, and other creditors to verify that the amount asserted to be owed on the proof of claim is correct. The note contains the initial account balance, the applicable interest rate, and the terms that govern the mortgagee's ability to charge fees upon default.[102] In subprime loans, such terms are non-standard and may vary widely, increasing the importance of having a copy of the note. Finally, Rule 3001(c)'s requirement that a copy of a writing be attached applies widely. Nearly all debts are evidenced by writing in today's commercial economy. Yet, even when the claim is for a large debt such as a mortgage, creditors do not comply with the proof of claim rules. The mortgage data hint that compliance with Rule 3001(c) may be even worse for smaller claims evidenced by a writing, such as credit-card debts.[103]

Creditors were more diligent about attaching documentation to prove a valid security interest in the debtor's home. A perfected security interest such as a copy of a recorded mortgage or deed of trust accompanied 80.4% of mortgagees' proofs of claim. As shown in Figure 1, 19.6% of claims were not supported by a security interest to document the creditor's lien in the debtor's home. In light of the dismal compliance on attachment of notes, it may be tempting to view the security interest data as a relative success that may not merit policy attention. However, several risks are created when creditors do not prove a valid security interest.

The first potential harm is to the integrity of the bankruptcy system. The data show that nearly one in five mortgagees ignores a clear disclosure rule when they participate in a bankruptcy case. With much less evidence of misbehavior by debtors,[104] Congress imposed audits on debtors' schedules to ensure full disclosure of assets and permitted dismissal of debtors' cases as a penalty for failing to provide documentation.[105] These laws evidence Congress' belief that bankruptcy is a serious and important process and that full disclosure is necessary to preserve the system's integrity. Creditors who make affirmative filings to a court, such as a proof of claim, also affect public confidence in the integrity of the bankruptcy

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[102] In most instances, the note contains broad language on charges and costs. For example, the Fannie Mae uniform instrument gives the note holder a "right to be paid back by [the borrower] for all of its costs and expenses in enforcing this Note to the extent not prohibited by applicable law. Those expenses include, for example, reasonable attorneys' fees." *See* Fannie Mae, Multistate Fixed Rate Note—Single Family, 6e, https://www.efanniemae.com/sf/formsdocs/documents/notes/pdf/3200.pdf. Even under this broad language, debtors may have challenges to the mortgagees' claim. For example, they could contest the "reasonableness" of asserted attorneys' fees or argue that the language on "costs and expenses" is modified by "enforcing this Note" so that costs such as fax fees cannot be justified by this provision.

[103] John Rao, *Debt Buyers Rewriting of Rule 3001: Taking the "Proof" Out of the Claims Process*, 23 AM. BANKR. INST. L. REV. 16 (July/Aug. 2004).

[104] *See* Steven W. Rhodes, *A Preview of "Demonstrating a Serious Problem with Undisclosed Assets in Chapter 7 Cases*", 5 NORTON BANKR. L. ADVISER 1 (May 2002) (finding in a one district sample that 41% of asset cases—a small fraction of all Chapter 7 cases generally—contained inaccuracies in debtors' lists of assets and valuations); Recommendations for Reform of Consumer Bankruptcy Law by Four Dissenting Commissioners, REPORT OF THE NAT'L BANKRUPTCY REVIEW COMMISSION, ch. 5, at 14. ("The Commission repeatedly heard testimony that the information reported in the debtors' schedules is unreliable.").

[105] Bankruptcy Abuse Prevention and Consumer Protection Act (hereinafter "BAPCPA"), Pub. L. No. 109-8, § 603, 119 Stat. 23, 122 (authorizing random audits of debtors); Pub. L. No. 109-8, §316, 119 Stat. 23, 92 (codified at 11 U.S.C. § 521(i)) (Supp. V. 2005) (automatically dismissing bankruptcy case if debtor does not provide required information, such as payment advices).

system.[106] The failure of approximately twenty percent of creditors to attach security interests to their claims damages the structural integrity of the process to ensure that claims are accurate and all assets are distributed according to bankruptcy law and procedure.

The second reason that the finding on attachment of mortgages is troubling results from the serious distributional consequences to all parties in a bankruptcy if a mortgagee cannot prove it holds a valid security interest. Under bankruptcy law, a mortgage that is not properly perfected can be avoided.[107] Avoidance typically relegates the obligation to unsecured status in bankruptcy and dramatically reduces the debtor's obligation to pay the full amount of the debt.[108] Even a credible threat of avoidance can cause an allegedly secured party to lower its claim to prevent litigation risk of its secured status. Thus, the ability to challenge whether a mortgage is properly perfected redounds to the benefit of both the debtor and to all unsecured creditors, whose distributions from the bankruptcy estate will be higher if the mortgage is not entitled to treatment as a secured claim. In light of these very powerful benefits, the rate of non-compliance is alarming. The failure to attach a security interest should serve as a red flag that prompts scrutiny of the claim. While some trustees or debtors may themselves be checking the public records to determine if the creditor holds a valid mortgage, this state of affairs effectively reflects creditors' ability to shift the burdens of their disclosure duties on to other parties in the system. The law requires creditors to prove that they are entitled to preferential treatment as secured creditors; their failure to do so creates a risk that some creditors who may not in fact have valid mortgages will receive higher payments than those to which the law entitles them.[109]

Finally, the security interest is necessary for the same reasons as the note: it contains the terms that bear on the calculation of the amount owed. Further, the mortgage usually contains provisions on how a loan should be serviced. For example, the model Fannie Mae instrument requires the lender to either apply or refund partial payments within a "reasonable period of time."[110] Based on this language, a debtor could challenge a servicer's practice of holding payments in suspense accounts for extended periods.

Mortgagees' compliance with the documentation requirements for claim varied among judicial districts. Figure 2 shows the variation among districts for the three types of claims documentation.[111] The boxes in Figure 2 demarcate the middle two quartiles of documentation

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[106] Because debtors almost always affirmatively seek bankruptcy relief, it may be fair to impose increased burdens for disclosure on them as the "moving party." Nonetheless, creditors who participate in cases also submit themselves to federal process and should be required to comport with the rules that govern their actions in bankruptcy cases.

[107] 11 U.S.C. §§ 544, 548. These provisions are commonly called the "strong arm" powers, because they empower the trustee or other party in interest to "knock off" security interests that are not properly perfected under state law to defeat certain other types of creditors.

[108] Without a security interest, the mortgage is an unsecured obligation and the house is owned free and clear. This not only frees up the house as an asset for the debtor to borrow against in the future, it permits the debtor to discharge any remaining obligation on the mortgage claim after committing all disposable income for the applicable commitment period in the Chapter 13 case.

[109] In addition to failure to have properly perfected the mortgage by complying with state recording statutes, some trustees who routinely demand and scrutinize mortgage documents have identified other errors that invalidate a mortgage (such as the failure for a notary to witness the mortgage, for example).

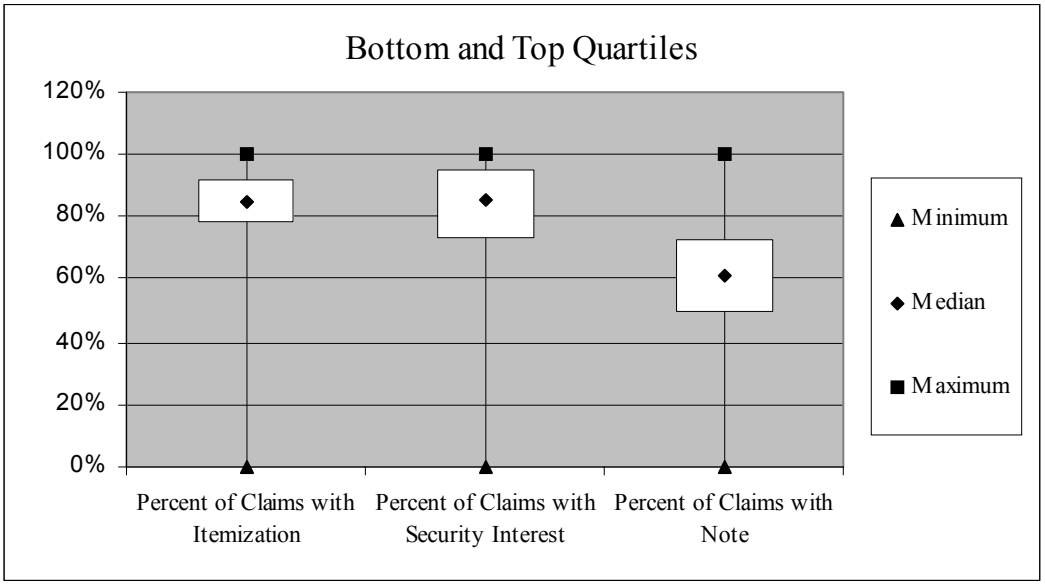
[110] Fannie Mae/Freddie Mac Uniform Instrument (standard), *available at* https://www.efanniemae.com/sf/formsdocs/documents/secinstruments/#standard.

[111] The top and bottom of the lines in Figure 2 show that there was at least one district in which no claims (0%) had a required type of documentation and at least one district in which all claims (100%) had a required type of documentation. These findings largely result from the presence of some districts in the sample with very few cases. Because the addition of a single case could dramatically change the compliance rate, the absolute range of

compliance. The bottom of each box shows the percent of attached documentation in the district that was at the first quartile (25% of districts had worse compliance). The top of each box shows the percent of attached documentation in the district that was at the top quartile (75% of districts had worse compliance). The diamond in the middle of each box shows the rate of attached documentation in the median district.

The relatively small height of the boxes in Figure 2 indicates that most jurisdictions do not approach full compliance with documentation requirements. The overall pattern of findings is not driven by outlying districts with very poor compliance. Even in the districts that boast compliance that is better than the other three quartiles of districts, the fraction of claims without documentation is significant. The problem is particularly acute with respect to mortgagees' failure to attach notes. Among the districts with the worst compliance (those in the bottom quartile), the percentage of claims with a note attached was 50 percent or below, ranging all the way to zero complying claims. In these jurisdictions, a majority of claims will not be supported by a copy of the note.

Figure 2: Variation among Judicial Districts in Attached Documentation



The variation among districts reinforces concerns about uniformity, a feature of bankruptcy law that is explicit in the U.S. Constitution's bankruptcy clause.[112] While uniformity challenges to bankruptcy law have had little success,[113] the variations in claims documentation reveal systematic differences based on where a debtor files bankruptcy. While the law is identical, the realities of compliance vary among judicial districts. Proofs of claim are another example of a "local legal culture" effect in bankruptcy.[114] To the extent that uniformity is crucial to ensure the integrity of the bankruptcy system, creditors' inconsistent compliance with claims

compliance is not very useful. Thus, the data on inter-district variation are best used to observe a general pattern as shown by the quartile findings.

[112] U.S. CONST. art. I, § 8, cl. 4; Erwin Chemerinsky, *Constitutional Issues Posed in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 571, 592–94 (2005).

[113] *See id*. (cataloguing unsuccessful challenges under the uniformity clause).

[114] *See* sources cited in note 32, *supra* (describing other examples of local legal culture phenomenon in bankruptcy).

procedures is troubling. Depending on place of residence, debtors and their counsel receive varying amounts of information about mortgage obligations.

The data on proofs of claim show that in at least one important respect creditor behavior is not uniform, and that the reality of practice does not match the clear requirements of the law. Despite long-standing and unambiguous documentation rules that apply in all bankruptcy cases, most mortgage proofs of claim lack one or more pieces of documentation. This pattern of noncompliance undermines the purpose of the proof of claim rules and effectively shifts the burden to debtors or trustees to verify the accuracy of claims. Undocumented or insufficiently documented claims create obstacles to ensuring that mortgage creditors are paid in accordance with the law. At worst, creditors' failure to provide documentation can manipulate the bankruptcy system to overpay on these obligations, harming the debtor and all other creditors.[115] The requirements for claims documentation should be consistently respected and enforced to prevent these harms.

B. Default Fees in Mortgage Claims

Itemizations were the most common documentation attached to claims. The prevalence of itemizations, however, is a misleading cue as to their usefulness in ensuring the accuracy of mortgage claims. Two major problems undermined the itemizations as a tool to evaluate the propriety of a creditor's claim. First, there is no standard form for itemizations. Even among a single servicer or attorney, the itemization format and amount of detail varied.[116] Without a standard format, itemizations cannot be reviewed using a semi-automated or routine process. In high-volume system such as consumer bankruptcy, the result is to dramatically limit the scrutiny of claims. For a debtor to afford a bankruptcy, the consumer attorney has to employ standardized procedures that can be applied in hundreds of cases a year. Trustees are similarly bound by cost and efficiency concerns. The wide variation in the form of itemizations means that debtors and trustees will be severely hampered in reviewing and objecting to claims. The result is a system that does not ensure that even obvious mistakes or overcharges in claims will be reviewed and objections filed, if appropriate.

The second, and related, problem is tremendous variation in the quantity of detail provided on itemizations. Some "itemizations" contain so little detail as to be a perversion of the proof of claim form's use of that term to describe the attachment. In a few instances, the itemization simply consisted of a break-out of the amount of arrears that was part of the creditor's total claim. Since the proof of claim form itself already requires that information, the itemization added nothing to the one-page claim form itself. Other creditors merely listed three categories: the total amounts of principal, interest, and "other/miscellaneous."

To analyze the variation in detail, the Mortgage Study coded all the itemization detail into several categories based on the types of charges that debtors allegedly owe.[117] Despite using

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[115] *See* Opinion Resolving Show Cause Order Entered on March 8, 2007, *In re* Wingerter, No. 06-50120 (Oct. 1, 2007) ("A policy of filing a proof of claim without having possession of the supporting documents, but withdrawing the claim if the debtor subsequently files an objection to the claim's validity smacks of gamesmanship and creates an unacceptable risk that distributions to other creditors will be unfairly reduced.").

[116] In some districts, the variation was obviously due to the differing practices of the attorney hired to represent the servicer. In other instances, however, the same attorney filed proofs of claim in several different formats, probably reflecting the fact that the servicer itself is preparing the proof of claim and merely transmitting it to the attorney for review and filing with the court.

[117] Each charge was categorized as one of the following: principal, interest, escrow, late charges, foreclosure fees or costs, non-sufficient funds charges, property inspection fees, broker price opinions or appraisals, corporate

the servicing industry's own categories,[118] 43% of itemizations either made reference to fees that did not fit one of the dozen specific categories or proffered an aggregate sum of many types of varying charges that could not be separated. One common technique was the use of a temporal category that did not provide any legal basis for the permissibility of the charges. For example, several itemizations labeled charges only as "pre-petition," without identification of whether these amounts resulted from missed payments, default charges, or accrued interest.[119] Among claims with debt identified only as "pre-petition," the average of this type of debt was $1651, a fairly substantial sum without any specific basis. Another common label was "prior/previous servicer," which again does not pinpoint the basis for the charges or permit any examination of whether the amount claimed is correct. Perhaps most egregiously, some amounts were labeled merely "other" or included in a column of summed figures with absolutely no description at all.[120] These vague or temporal descriptions do not meet the requirement of Form 10 to "detail" any additional charges and do not permit meaningful review of the accuracy or legality of the servicer's calculation of the debt.

The itemizations were plagued another troubling feature: the use of laundry-list descriptions. The most common such label in the sample was "Inspection, Appraisal, NSF, and other charges." Over thirty proofs of claim used that recitation (with the words in that order and no additional breakdown of fees in that line item). For this description to be literally accurate, the servicer should have actually conducted an inspection and an appraisal, one or more of the debtor's payments should have been returned for non-sufficient funds, and the debtor should have engaged in some other behavior that resulted in a permissible charge. While plausible, the laundry-list description with its inclusion of "other charges" suggests that servicers are taking shortcuts in describing the actual fees that debtors owe.

The poor quality of itemizations has real harms. First, confidence in the bankruptcy system is undermined when the quality of information provided does not satisfy the rules designed to ensure fair claims distribution. Vague or laundry-list descriptions do not satisfy the instructions on the proof of claim form, which were written to balance the rights and needs of debtors and creditors. Second, without a true itemization that identifies the nature of each fee, parties cannot verify that a mortgage claim is correctly calculated. The service could have made a mistake when aggregating fees and charges. Alternatively, the servicer could be overreaching and charging fees that are not permitted by law or the terms of the contract. The case law described in Part I, *infra*, shows that when courts scrutinize the nature of mortgage claims, they frequently find evidence of servicer misbehavior. Yet, the itemizations do not provide sufficient information to permit a review of the charges' legality. Individual debtors would need to engage in extensive discovery to verify the permissibility of the servicer's calculations. This reality makes it equally impossible to use the Mortgage Study data to apply systematic analyses to determine if servicers are actually charging illegal fees. The available bankruptcy court records

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advances, post-petition fees, suspense funds, or other. The last category was residual and used when the charge did not fit another category or the fees were not broken out into one of the above categories.

[118] The categories set forth in note 117, *supra*, are consistent with those on the Model Proof of Claim itemization developed by a joint committee of Chapter 13 trustees and mortgage servicers. *See* Model Proof of Claim Attachment, NAT'L ASS'N OF CHAPTER THIRTEEN TRUSTEES, REPORT OF MORTGAGE COMMITTEE (June 28, 2007) (on file with author).

[119] Charges or amounts labeled merely as pre-petition were identified in 63 claims, fewer than 5% of all claims. This count excludes any fees labeled pre-petition attorneys' fees.

[120] For example, one claim's "itemization" listed $5391 described only as "other." CDCA 12. Another claim requested $3023 for "delinquency expenses." NDGA 146.

simply do not provide the necessary information. Indeed, the courts that have adjudicated disputes over mortgage claims have needed dozens of hours of evidentiary testimony to decipher the basis for the total amount claimed by mortgage servicers. This, in fact, is the key point. By obscuring the information needed to determine the alleged basis for the charges, servicers thwart effective review of mortgage claims. The system can only function as intended if complete and appropriate disclosures are made.

Notwithstanding the limitations of the servicers' itemizations, I attempted to conduct an individual review of claims that were merely categorized as "other." Given that the categories used to code the claims data (e.g., "foreclosure costs") were deliberately broad to encompass all likely charges, these charges seemed *per se* suspicious. I identified dozens and dozens of claimed fees that appeared to be impermissible, or at minimum, should have been challenged to ensure that the creditor had a basis for such unusual charges. Table 1 gives a few examples of causes for concern.

Table 1: Actual Fees from Mortgagees' Claims

Description	**Id. No.**	**Fee amount**
Attorney's fees	WDVA 4	$31,273
Bankruptcy fees & costs	NDGA 56	$2275
Broker price opinion fee	ED AR 18	$1489
Demand fee	DMA 18	$145
Overnight delivery	EDMI 91	$137
Payoff statement fee	SDCA 7	$60
Fax fee	EDVA 21	$50

The law constrains the charges that debtors must pay in several ways. On their face, the fees in Table 1 appear vulnerable to legal challenge. Yet, none of these claims were objected to by any party in the bankruptcy. The law's various limits on fees were never invoked to test the validity of these charges.

The first legal constrain on fees and charges is private contract law. The note and mortgage themselves are agreements that limit the parties' obligations.[121] Most mortgage notes only obligate the borrower to pay the lender for "reasonable" costs incurred to collect on the debt or enforce the security interest.[122] The standard mortgage permits the lender, upon default (including a bankruptcy filing) to "do and pay for whatever is reasonable or appropriate" to protect the lender's interest in the property and rights under the security agreement.[123] While this

[121] This point reinforces the problems created when claims are not supported by this documentation, particularly for subprime loans, which do not conform to Fannie Mae/Freddie Mac standards.

[122] For example, one of the mortgages MDTN 44 contains the following language: "COSTS OF COLLECTION AND ATTORNEYS' FEES—I agree to pay you all reasonable costs you incur to collect this debt or realize on any security. This includes, unless prohibited by law, reasonable attorneys' fees."

[123] *See* Fannie Mae/Freddie Mac Uniform Instrument (standard), *available at* https://www.efanniemae.com/sf/formsdocs/documents/secinstruments/#standard ("If [Borrower defaults including

language is quite broad, it is not unlimited. For example, at least one court has held that payoff fees are impermissible because they constitute a non-reimbursable expense under the terms of the note.[124] The typical amount of a fax fee ($50) could also be challenged as unreasonable. Such requests are apparently handled automatically by fax-back technology at minimal cost to the servicer.[125] Thus, some of the fees shown in Table 1 may be neither reasonable nor permitted by contract. Paying such claims would distort the claims distribution process and impose unfair burdens on debtors in making bankruptcy payments.

State or federal statutes also limit the fees that debtors must pay. Certain charges appear on proofs of claim simply are not legal. Some states prohibit the pyramiding of late fees[126] or have promulgated specific rules about the use of suspense accounts to hold partial payments in abeyance.[127] Because mortgage servicers operate on a national basis, they may be unaware of these state laws. Alternatively, servicers may apply the same fees to all loans covered by a securitization agreement, despite the fact that varying state law actually applies. The propriety of fees may be impossible to verify without a payment history for the loan, which almost never was attached to the proof of claim.[128] For example, the payment history may show that the servicer imposed late charges on the homeowner, despite the homeowner's check clearing the bank before the payment was due,[129] or that the servicer held funds in "suspense accounts" without application to the amount due.[130]

Some servicing practices may constitute consumer abuse. For example, the Federal Trade Commission alleged that Fairbanks Capital Corporation had engaged in an unfair or deceptive practice by repeatedly and unnecessarily assessing property preservation fees, which usually

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by filing bankruptcy], then Lender may do and pay for whatever is reasonable or appropriate to protect Lender's interest in the Property and rights under this Security Instrument, including protecting and/or assessing the value of the Property, and securing and/or repairing the Property. Lender's actions can include, but are not limited to: (a) paying any sums secured by a lien which has priority over this Security Instrument; (b) appearing in court; and (c) paying reasonable attorneys' fees to protect its interest in the Property and/or rights under this Security Instrument, including its secured position in a bankruptcy proceeding.").

[124] *See, e.g.*, Ga. Code Ann. § 7-6A-3(4) (prohibiting payoff fee or limiting fee to $10 if borrower requests a faxed copy of payoff amount or has other recent payoff requests); Dougherty v. N. Fork Bank, 753 N.Y.S.2d 130 (N.Y. App. Div. 2003) (holding that payoff quote fee of $100 was not permissible under state law).

[125] *See* Michael LaCour-Little, *The Evolving Role of Technology in Mortgage Finance*, 11 J. OF HOUSING RESEARCH 173, 192 (2000) ("Payoff requests can be handled by incorporating the related fax-back technology, in which printed payoff statements (as would be required for a refinance loan) can be automatically faxed back to a telephone number entered during the same automated telephone transaction.").

[126] The Fannie Mae note seems to prohibit pyramiding late fees, stating that the borrower will pay a late charge "only once on each late payment." *See* Fannie Mae, Multistate Fixed Rate Note—Single Family, 6a, *available at* https://www.efanniemae.com/sf/formsdocs/documents/notes/pdf/3200.pdf. Some transactions used different notes (and thus, it is important that a copy of the note accompany the proof of claim), and some servicers may not honor the terms of the notes, either intentionally or inadvertently.

[127] JOHN RAO, ODETTE WILLIAMSON & TARA TWOMEY, NATIONAL CONSUMER LAW CENTER, FORECLOSURES: DEFENSES, WORKOUTS, AND MORTGAGE SERVICING 154–55 (2d. ed. 2007).

[128] The instruction on the proof of claim form says that the claimant "must attach to this proof of claim form copies of documents that show the debtor owes the debt claimed." This arguably requires not just the note to show the existence of the original debt, but a current payment history that supports that the debtor actually owes the amount of the claim.

[129] *See In re* Ocwen Fed. Bank F.S.B. Mortgage Servicing, 2006 WL 794739 (N.D. Ill. Mar. 22, 2006) (denying motion to dismiss a multi-district litigation suit that alleged, *inter alia*, that servicer misapplied payments and improperly imposed late fees).

[130] Most loan instruments specify how payments are to be applied, and a violations of this language is a potential breach of contract.

means an agent drove by the property to determine its condition. The settlement enjoined the assessment of such fees more frequently than every thirty days and permitted such charges only if Fairbanks was unable to contact the borrower or had determined that the property was vacant.[131] Recently, one bankruptcy court stated that it was "done allowing lenders reimbursement for property preservation fees," unless the lenders can show "that those property inspections actually happened and that they're worthwhile."[132] If the fees cannot meet these criteria, they may not legally be charged. Imposing such fees could give rise to a counterclaim against the servicer for engaging in an unfair or deceptive practice. The amount of the property preservation fees in the sampled itemizations varied greatly, suggesting either that many of these fees resulted from multiple inspections or that a few servicers may be charging an unreasonable amount for a single inspection service.[133] The "broker price opinion" charge in Table 1 would grossly exceed the standard cost for this type of property inspection, which is essentially an abbreviated appraisal. If the $1489 sum represents several inspections, the servicer should have separated these charges in its detail of fees.

Another limitation on charges is found in the general law of contracts. Even if the parties' agreement does not contain a "reasonableness" requirement for default fees, egregious charges could be challenged as unconscionable as a matter of contract law. For example, the overnight delivery charge of $137 in Table 1 may meet this standard. A court could rule that this charge violated public policy. It is quite possible, of course, that the $137 represents the sum of many charges, rather than one mailing. Alternatively, perhaps it reflects a data entry error and should have been $13, or $17, or $37. The crucial problem is that the bankruptcy system did not flag this item as a potential cause for concern and seek to determine if this charge was legally permissible.

Federal bankruptcy law imposes additional legal constraints on the charges that debtors must pay their mortgage companies. Many claims in the sample included a flat "bankruptcy fee" in the proof of claim.[134] The propriety of this practice is unclear. Some courts have held that, to the extent these fees are for creditors' attorneys' fees, it is impermissible to include them in a claim.[135] Instead, creditors must file a fee application pursuant to Federal Rule of Bankruptcy Procedure 2016.[136] Other courts have reached a contrary conclusion and permitted attorneys' fees in claims.[137] Some courts have modified this approach, requiring that the disclosure of the

[131] Order Preliminarily Approving Stipulated Final Judgment and Order as to Fairbanks Capital and Fairbanks Capital Holding Corp., United States v. Fairbanks Capital Corp., No. 03-12219 (D. Mass. Nov. 21, 2003), *available at* www.ftc.gov/os/2003/11/0323014order.pdf.
[132] Transcript of Hearing at 3, *In re* Waring, No. 06-40614 (Bankr. D. Mass. July 27, 2007).
[133] In addition to the example given in Table 1, two different proofs of claim requested payment of property preservation fees of $105, NDTX 69, NDTX 75; another property preservation fee was $240, SDGA 56. As discussed in the text accompanying notes 143–144, inspection and appraisal were frequently combined in a laundry list of fees, making it impossible to determine whether the inspection or appraisal parts of these charges were reasonable.
[134] In the remainder of this Section, I use the term "bankruptcy fee" as shorthand to describe these fees. I did not include any fees that were identified as related to actual post-petition litigation, such as a motion for relief from the stay or an objection to confirmation.
[135] *See, e.g.*, Tate v. NationsBanc Mortgage Corp., 253 B.R. 653 (Bankr. W.D.N.C. 2000) (ruling that creditor cannot "hide" attorneys' fees for preparing a proof of claim in the claim itself without court approval).
[136] *Id.* at 665; *In re* Ezzell, 07-34780 (Bankr. S.D. Tex. Jan. 14, 2008) (disallowing attorneys fees for failure to comply with Rule 2016).
[137] *See, e.g.*, *In re* Atwood, 293 B.R. 227, 232 (B.A.P. 9th Cir. 2003).

attorneys fees be "specific"[138] or ruling that while including fees is prima facie permissible, a fee application will be required if the debtor objects to the fees.[139] These inconsistent rulings make it more difficult for both servicers and attorneys to know how to handle these charges in preparing a bankruptcy claim.

The amounts of attorneys fee disclosed in the claims varied considerably. The data revealed several clusters of bankruptcy fees; the most common amounts were $125, $150, $250, $275, and $500. On a dollar basis, the difference in these amounts is small. On a percentage basis, however, many mortgagees charge two or three times as much as other mortgagees.[140] Because the fees varied within judicial districts, the discrepancy does not seem to be attributable merely to regional cost differences.[141] The consistency of such fees also suggests that many servicers use a flat fee, rather than a lodestar method based on hourly rate, which is required in some jurisdictions. Given the non-existent or minimal scrutiny of most mortgage claims,[142] the system appears to permit mortgagees to effectively make their own determinations of what constitutes reasonable attorneys' fees for a routine Chapter 13 bankruptcy.

A related problem is that one cannot discern from a flat bankruptcy fee whether such charges actually represent an actual expense for attorneys. Some creditors use such a bankruptcy fee to collect a "monitoring" fee due to the purported additional burden of having to service a loan in bankruptcy.[143] In other instances, servicers may seek to impose a bankruptcy fee for the purported administrative costs of preparing a proof of claim.[144] If such work is performed by internal employees and not by licensed attorneys, the corresponding fee cannot be claimed under the "reasonable attorneys' fees" provision of the security agreement or note. Arguably such expenses are mere costs of servicing a mortgage that the servicer was previously compensated for by the owners of the note.[145] Without better disclosure, bankruptcy courts cannot even ensure that creditors are respecting the bankruptcy law that governs attorneys' fees.

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[138] *In re* Madison, 337 B.R. 99, 103–04 (Bankr. N.D. Miss. 2006); *see also In re* Powe, 281 B.R. 336, 347 (Bankr. S.D. Ala. 2001).

[139] *In re* Plant, 288 B.R. 635, 644 (Bankr. D. Mass. 2003).

[140] A review of the data suggests that in May 2006, when the claims in the Mortgage Study were filed, the bankruptcy fee of Bank of America was $250. Yet, Chase Home Finance, LLC imposed a bankruptcy fee of half that amount, $125. These lenders are large, national institutions, and presumably their actual costs for preparing a proof of claim would be quite similar. Nevertheless, the data show a disparity. It appears that debtors whose mortgage is held by Bank of America must pay $125 more than debtors whose mortgage is held by Chase Home Finance, LLC in order to complete their plan.

[141] For example, in the Eastern District of Arkansas, bankruptcy fees ranged from $125 to $800.

[142] *See infra* Part III.D.

[143] The lodestar versus flat fee issue was apparently a point of contention in the work of the National Association of Chapter 13 Trustees' committee on proofs of claim. The servicers wrote separately on this issue to argue that a flat fee should be permissible, analogizing to the flat "no-look" fee that some courts permit for Chapter 13 representation to avoid debtors' counsel having to file a fee application pursuant to Rule 2016 in each case. *See* Notes by Mortgage Servicers on Mortgage Servicing during a Chapter 13 Bankruptcy at 3–4, Appendix to NAT'L ASS'N OF CHAPTER THIRTEEN TRUSTEES, REPORT OF MORTGAGE COMMITTEE (June 28, 2007) (on file with author).

[144] This may be particularly true when the charge was described as "POC prep fee" or "plan review" fee. Neither of the prior-quoted activities is strictly necessary to "defend the mortgage," nor are they costs from "prosecut[ing] all necessary claims and actions to prevent or recover for any damage to or destruction of the property." Further, the preparation or filing of a proof of claim and the review of a proposed Chapter 13 plan may not constitute an "appearance" by the lender, which is a required prerequisite to the borrower being obligated to pay the lenders' costs and expenses. Yet, these conditions are incorporated in standard mortgage documents upon which lenders rely to collect a bankruptcy fee.

[145] *See* JOHN RAO, ODETTE WILLIAMSON & TARA TWOMEY, NAT'L CONSUMER LAW CENTER, FORECLOSURES: DEFENSES, WORKOUTS, AND MORTGAGE SERVICING 177 (2d. ed. 2007) ("If all the lender is doing is "monitoring"

Delinquency and default fees can be a substantial source of profit for servicers.[146] The requirement that an itemization be attached to a bankruptcy claim could be a valuable check to the financial incentives of mortgage servicers to overreach and to charge unreasonable or illegal fees. However, the itemizations suffer two fatal defects—a lack of standardization and a lack of detail—that inhibit any meaningful review of the amount of mortgagees' claims. By describing charges in vague generalities, creditors can eviscerate the purpose of the proof of claim process, which is to ensure that creditors offer evidence of their debt.

Individualized review of "other" fees on claims highlights some instances of suspicious fees. While the data admittedly do not permit concrete findings of servicer misconduct, courts that have conducted evidentiary hearings to determine the validity of servicing fees have invalidated charges similar to these and sanctioned creditors for misbehavior.[147] The key point that can be substantiated by the itemization data is that servicers fail to provide the necessary information to allow debtors or trustees to review the claims. The resulting situation permits servicers to overcharge debtors without fear of challenge. These problems suggest that the bankruptcy system may be harboring mortgage servicing abuse, rather than functioning as a system to protect homeowners from impermissible charges.

Anecdotal reports suggest that creditors proffer similarly vague itemizations to borrowers facing state law foreclosure.[148] Indeed, given the additional safeguards inherent in the bankruptcy process, the data may understate the difficulty that nonbankrupt homeowners face in reviewing default or foreclosure costs. Inside or outside of bankruptcy, the law does not appear to be functioning as intended to ensure that creditors must satisfy the evidentiary burden to show that charges are permissible under applicable law.

C. Discrepancies between Debtors' Schedules and Mortgagees' Claims

The proof of claim process is the mechanism for fixing the amount of the debtor's obligation. When they file Chapter 13 bankruptcy, most homeowners are in default on their mortgages.[149] Thus, most claims seek to establish both the amount of the arrearage and the amount of the outstanding principal remaining on the loan. These amounts are treated differently in Chapter 13 cases. To retain their homes, debtors must "cure any default within a reasonable time,"[150] normally by making payments over the period of the Chapter 13 plan (three to five years) or a shorter period as fixed by the bankruptcy court.[151] Any regular mortgage payments also continue to be due as set forth in the note. Debtors must pay both the arrearages and their ongoing mortgage payments to retain their homes and receive a discharge of remaining unsecured debt.[152] Thus, part of the pre-bankruptcy calculus that debtors and their attorneys

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the bankruptcy . . . then these activities do not constitute the practice of law and should not be compensable as an attorney fee. These routine administrative services are generally not compensable under any reading of typical mortgage provisions." (citations omitted)).

[146] *See* Gretchen Morgenson, *Can These Mortgages Be Saved?*, N.Y. TIMES, Sept. 30, 2007 ("Borrower advocates fear that fees imposed during periods of delinquency and even foreclosure can offset losses that lenders and servicers incur.").

[147] *See* Part I.D., *supra* (discussing *Jones v. Wells Fargo* and *In re* Parsley cases).

[148] *See* Morgenson, *supra* note 146 (reporting that a payoff demand statement that Countrywide provided to a borrower had line items identified only as "fees due" and "additional fees and costs" that totaled $8525).

[149] *See* note 25, *supra*.

[150] 11 U.S.C. § 1322(b)(5).

[151] 2 KEITH LUNDIN, CHAPTER 13 BANKRUPTCY § 133.1 (3d ed. 2000) ("It is astonishing and baffling that a significant portion of listed claims are never filed in Chapter 13 cases.").

[152] 11 U.S.C. § 1328(a).

should consider in determining whether a debtor can save their home in bankruptcy is whether the debtor will have sufficient income to both payments.[153] To weigh the viability of Chapter 13 and consider alternatives such as Chapter 7 bankruptcy or surrendering the home, debtors and their attorneys need a fairly accurate estimate of the amount of the outstanding arrearage and the amount of the total mortgage debt.

This section analyzes data to measure whether debtors and creditors agree on the amount of the mortgage debt. The goal was to determine if either party had a substantial misunderstanding of the amount of the debt. For this analysis, I matched each home loan listed on a particular debtor's schedule to its corresponding proof of claim.[154] I then measured the direction and extent of the gap between debtors' and mortgagees' calculations of the mortgage debt.[155] If the amount on the claim exceeded the mortgage debt on the debtor's schedule, I termed the gap in the "creditor's favor." In these instances, the creditor is asserting that more dollars are owed in the mortgage debt than the debtor believed was owed. Conversely, if the scheduled amount of mortgage debt exceeded the amount on the mortgagee's claim, I termed the gap in the "debtor's favor." Here, the gap between the schedule and the claim resulted from the debtor overreporting the amount of mortgage debt.

Figure 3 shows what fraction of claims fell into each of three categories based on the existence of a discrepancy between the claim and the scheduled amount of debt. Debtors and creditors agreed on the amount owing for only 74 of 1675 loans (4.4%). For the vast majority of loans (95.6%), the debtor and mortgagee did not agree on the amount of mortgage debt. In about one-quarter of instances (25.2%), the debtor's scheduled amount exceeded the mortgagee's claim. However, the majority of claims exceeded the debtor's calculation. Seven in ten (70.4%) claims asserted that the mortgage debt was greater than what the debtor listed on the schedule.

[153] Melissa Jacoby, *Consumer Bankruptcy and Credit in the Wake of the 2005 Act: Bankruptcy Reform and Homeownership Risk*, 2007 U. ILL. L. REV. 323, 337 (2007) (arguing that failure of debtors' lawyers to screen their clients for ability to complete a Chapter 13 repayment plan results in more unsuitable debtors in Chapter 13).

[154] It was not possible to perform this matching for every home loan. Among the 2164 home loans in the sample, only 1768 proofs of claim were filed.

[155] For the gap analysis, some loans and their corresponding claims had to be eliminated. First, loans were eliminated if the Schedule D or the proof of claim had a zero or a blank entry for the amount of the debt. These are usually placeholders, akin to listing the debt as "unknown." Second, loans were eliminated if the schedules and claims were not attempting to calculate the same thing. This usually occurred because one party listed only the arrearage amount and the other calculated the entire outstanding mortgage debt, both arrearage and principal. These cases were excluded from the gap analysis because the disagreement was in large part a result of the parties not trying to communicate the identical debt. In a very small number of instances, when both the creditor and the debtor clearly provided only the arrearage amount, the cases were used in gap analysis because the discrepancy in calculation can be fairly compared. Finally, twelve loans were removed as outliers. Two criteria were used to identify these situations. Six loans were eliminated because the gap between the claim and the scheduled debt exceeded 200% of the amount of the scheduled debt. An additional six loans were deemed outliers because the gap exceeded $100,000 in absolute dollars and the gap was greater than 50% of the amount of the scheduled debt.

Figure 3: Percent of Claims by Type of Gap Between Claim and Scheduled Debt

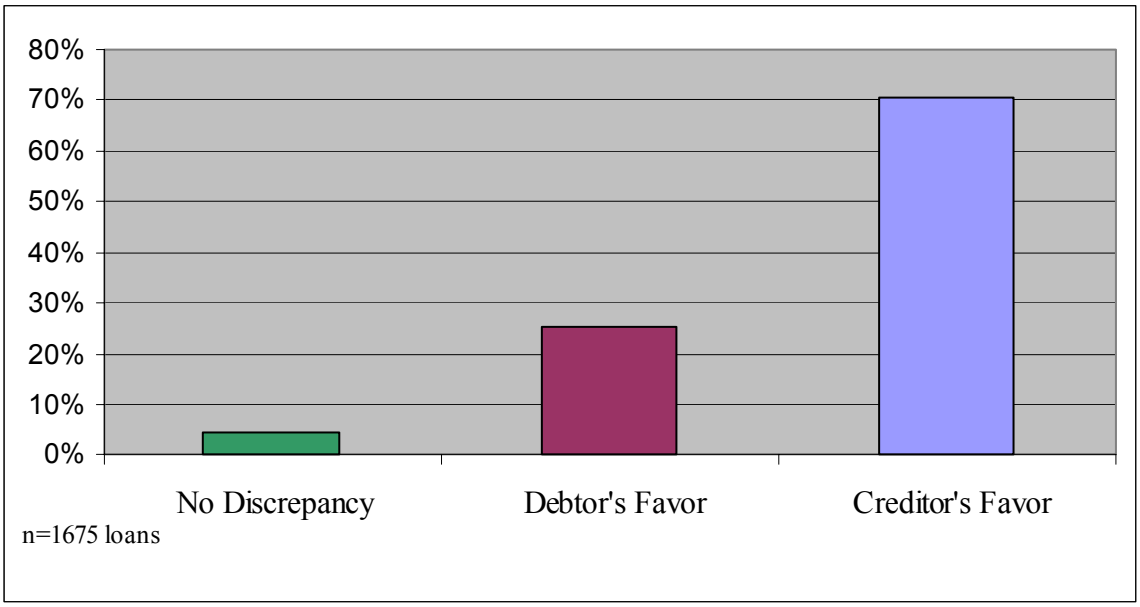


Figure 3 shows that as an initial matter the debtor and creditor do not agree on the amount of the debt in a vast majority of cases. The mere existence of discrepancies is not itself alarming. The findings in Figure 3 could merely reflect minor differences in recordkeeping. Alternatively, the claims could consistently be larger because of the addition of modest and explainable post-bankruptcy charges such as accrued interest.[156] I explore these explanations with additional analyses, ultimately concluding that the data do not suggest that either reason can fully explain the discrepancies in creditors' and debtors' calculations.

The first indication that the disagreements may be genuine and serious comes from evidence on the dollar size of the gaps. Among all loans, the median claim exceeded its corresponding scheduled debt by $1366. The average difference between a claim and its scheduled debt was $3533.[157] In the typical bankruptcy, a mortgage creditor asserts that it is owed a significantly larger amount than the debtor believed was the home debt. These errors are too large to reflect small recordkeeping situations, such as a single late charge imposed since the debtor's most recent mortgage statement or a post-bankruptcy property inspection.

The second indication that post-bankruptcy charges cannot explain most of the differences in debtors' and creditors' calculations is the existence of claims in which the debtor overestimated the amount of the debt. Post-bankruptcy charges can only explain discrepancies in favor of creditors. Debtors do not know whether such charges will be imposed and cannot include them in their schedules. The debtor's favor gaps suggest that the disagreement occurs for a different reason, at least in many instances.

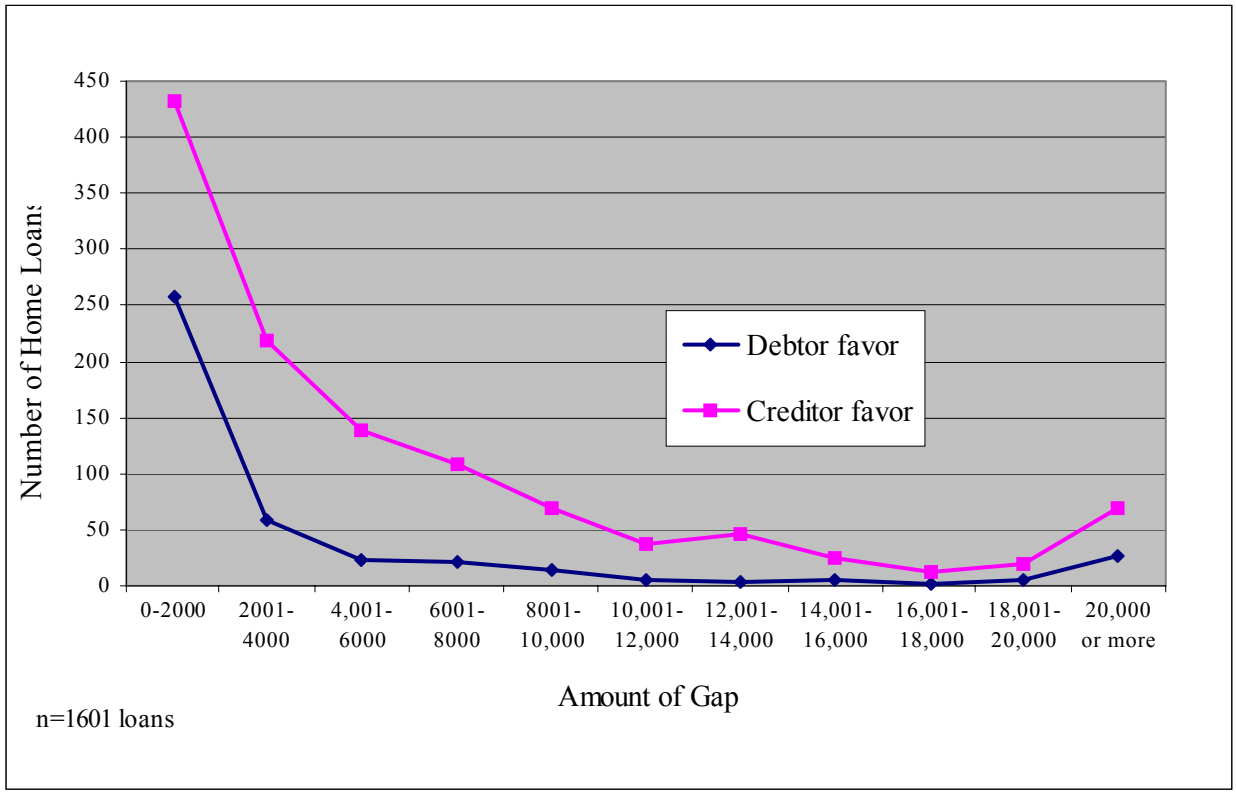
Further analysis reinforces the conclusion that the gaps between claims and scheduled debts reflect a serious misunderstanding. Figure 4 shows the distribution of the size of the gap

[156] The debtors' schedules should only reflect the amount due at the time of the bankruptcy. The proof of claim form should be identical, as the instructions specify that the amount should be the "Total Amount of Claim at Time Case Filed." However, some creditors ignored this instruction and listed charges that arose after the bankruptcy was filed and before the claim was filed (a period of usually less than sixty days).

[157] N=1675. The analysis included those loans in which the claim and scheduled amount were identical (no gap). The standard deviation for the entire sample was 11,480.

amounts between claims and the corresponding scheduled debt. At every interval, the number of loans in which the creditor's claim exceeded the scheduled amount was greater than the number of times in which debtors estimated a higher debt. While the disagreements go in both directions (with debtors and creditors each reporting a higher amount of debt in some instances), creditor more frequently charge more than debtors think is owed.

Figure 4: Gap Between Proofs of Claim and Schedule D Amounts



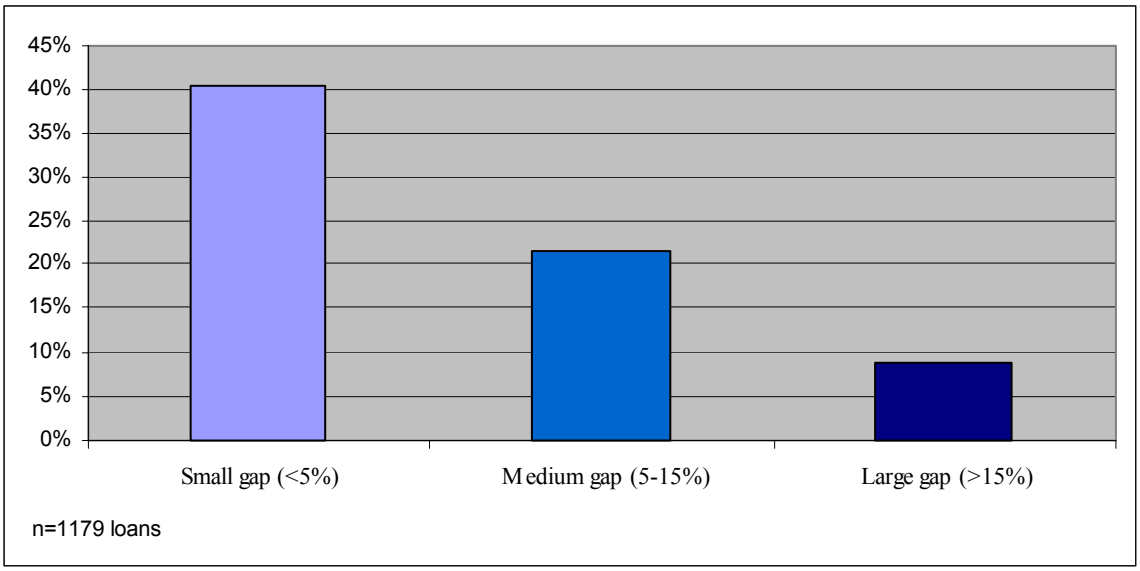
Creditor-favor gaps were consistently larger than debtor-favor gaps. The median gap for loans in which the claim exceeded the scheduled amount (creditor's favor) was $3311. The average creditor's favor gap was $6309. The size of the typical gap in the debtor's favor was much less. The median was $1090, less than one third of the gap for creditor's favor loans ($3311).[158] The bottom line in Figure 4 shows that debtor-favor gaps were of modest amounts, with the vast majority of such differences in calculations less than $2000. The top line in Figure 4, however, shows that very large gaps were much more common when the creditor's calculation exceeded the debtor's calculation. Many creditors requested payment on the proof of claim of several thousand more dollars than debtors thought they owed.

Of course, mortgage debts are relatively large in absolute size. It is difficult to articulate an exact standard for a "minor" versus "major" disagreement and to know at what point the gaps are sufficiently large that the bankruptcy process is undermined if these discrepancies are not being identified and resolved. An alternative to measuring the gaps in absolute dollars large is to

[158] The average gap among the debtors' favor claims was $5376. As with the creditors' favor claims, the size of the average reflects a substantial number of claims with very large gaps. The standard deviation of the debtors' favor claims was 13,704. The standard deviation for the creditors' favor claims was 9143.

consider the size of the gaps in relation to the amount of the claims. For this analysis, I calculated the percentage size of each gap in relation to the amount of the debtor's scheduled debt. For example, if a debtor's schedule listed an outstanding mortgage obligation of $100,000 and the corresponding proof of claim was for $110,000, the gap is $10,000. As a percentage of the amount of scheduled debt, the gap is 10%. I grouped these percentage-size data into categories as shown in Figure 5 for creditor's favor claims (70.6% of all loans). About four in ten (40.4%) of all loans in the Mortgage Study sample had a mortgage claim that exceeded the corresponding debtor's scheduled amount by less than 5%. The more alarming findings concern the portion of claims in which the creditor's claim was much higher than the debtor's amount. The gap was between 5 and 15% of the debtor's calculation of the mortgage debt for 21.4% of all loans in the sample. Another 8.8% of loans had mortgage claims that were more than 15% higher than the amount of debt as calculated by the debtor on their schedules. Given their size, it seems implausible these discrepancies resulted from valid post-bankruptcy charges amounts or an underestimation by debtors relying on the prior month's mortgage statement to complete the bankruptcy schedules. Instead, the magnitude of these differences suggests a real misunderstanding between debtors and creditors about the amount of mortgage debt.

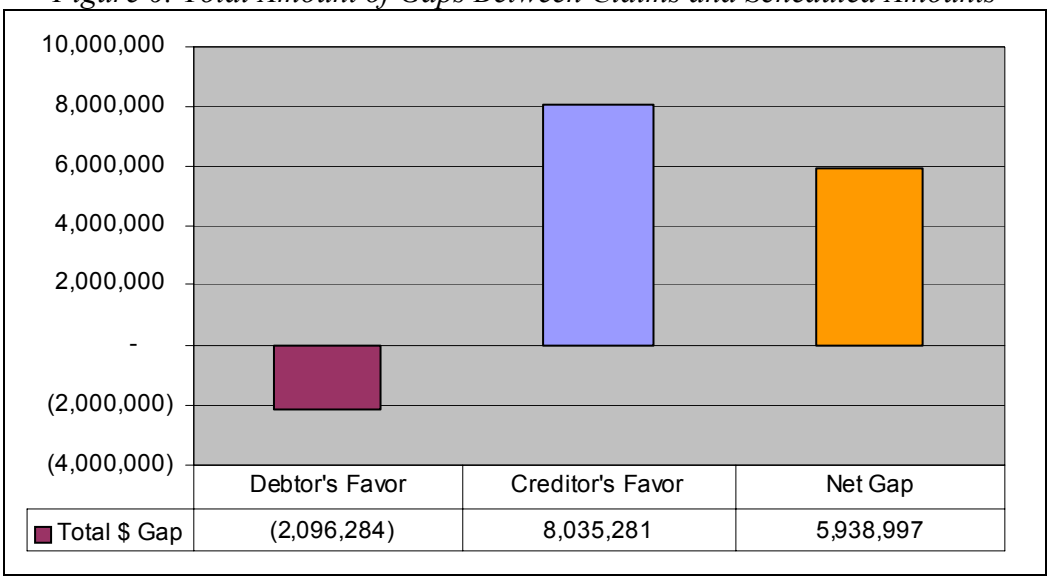
Figure 5: Frequency of Creditors' Favor Gaps, Calculated as Percentage of Claimed Amount



Unfortunately, the data do not permit an analysis of what portion of the disagreement about the debts relate to arrearage and what fraction, if any, is due to differing calculations of outstanding principal. Creditors and debtors were not consistent enough in separating these amounts to make any systematic comparison. Given that the outstanding principal appears on each mortgage statement that a debtor receives, it seems likely that at least some fraction of the disagreement is attributable to default charges and fees. These costs cannot be easily calculated by debtors, who may only take into account missed payments in determining the arrearage amount. To the extent the gaps between claims and scheduled amounts represent default fees, they offer a powerful reminder of how quickly mortgage debt can mushroom and how difficult it can be for debtors to find the income to cure arrearages.

A final rebuttal to the assertion that the gap data indicate the existence of only minor misunderstandings comes from a system-wide analysis. On an aggregate basis, the disagreements between debtors and mortgagees are a multi-billion dollar problem. Based solely on the Mortgage Study sample of approximately 1700 loans, millions of dollars are at risk of misallocation. Figure 6 shows the total of all debtor's favor claims (scheduled amount exceeded claim) and all creditor's favor claims (claim exceeded scheduled amount). When viewed from a systems standpoint,[159] the cumulative effect of the discrepancies is enormous. Mortgage creditors requested nearly six million dollars more on proofs of claims than the debtors reflected on their schedules. The mismatch between debtors' and creditors' calculations tilts sharply in favor of creditors.

Figure 6: Total Amount of Gaps Between Claims and Scheduled Amounts



Extrapolating this finding beyond the Mortgage Sample shows the scope of the problem for the entire bankruptcy system. About 400,000 homeowners have filed Chapter 13 bankruptcy in recent years.[160] Multiplying the six million dollar gap from the sample of 1700 cases to the total homeowners in Chapter 13 indicates that each year mortgagees claim over one billion dollars more than debtors believed was owed. If even a small fraction of this billion dollar aggregate sum represents creditors overreaching in their claims, the damage to the bankruptcy process is tremendous. Debtors are surprised after filing bankruptcy by the burden of paying their mortgage debt, and distributions to other creditors could be unfairly skewed.

The substantial number of cases with large discrepancies shows that debtors and creditors operate in bankruptcy with very different understandings of the amount of mortgage debt. The most likely explanation for this phenomenon may be that debtors and creditors simply have different records or lack reliable records. The finding that debtors overestimate their obligations in just over one quarter of loans is consistent with this hypothesis. Debtors get no benefit from inflating their mortgage debt on their bankruptcy schedules. In most cases, neither debtors nor

[159] Lynn M. LoPucki, *The Systems Approach to Law*, 82 CORNELL L. REV. 479 (1997).
[160] American Bankruptcy Institute, *Quarterly Non-Business Filings by Chapter (1994–2007)*, http://www.abiworld.org/AM/AMTemplate.cfm?Section=Home&CONTENTID=49785&TEMPLATE=/CM/ContentDisplay.cfm (last visited Feb. 8, 2008).

their attorneys appear to confirm the amount of the mortgage debt with the creditor at the time of the bankruptcy filing.[161] The data strongly suggest that many debtors file bankruptcy without knowing how much their mortgage creditors thinks is owed. The problem could reflect a different phenomenon. Creditors' claims may themselves be bloated and overstate the accurate amount of the debt. Such problems could result from servicers' practices of loading claims with default fees that are not disclosed to debtors, or because of mistaken calculations of the amount due in preparing the proof of claim; case law has documented both effects.[162]

Regardless of which party's calculation is correct, and even assuming all parties' behavior is unintentional, serious policy consequences occur from the system's failure to resolve these discrepancies. If the mortgagee is actually owed a smaller amount than the debtor thought was due, the counseling process regarding the advisability of bankruptcy was based on misinformation. If the arrearages were significantly less than the debtor believed, viable alternatives could have existed to Chapter 13 bankruptcy. Perhaps the debtor could have borrowed the amount necessary to cure the default in one payment. Or perhaps the debtor would have tried asking the servicer for a repayment plan outside of bankruptcy.

The creditor-favor gaps raise equal, or more serious, harms. Additional amounts of mortgage debt have meaningful effects on families in bankruptcy. If creditors are overreaching by even half of the amount suggested by either the absolute dollar or percentage analysis, they are imposing a hefty burden on debtors' disposable income and diverting money from unsecured creditors. Claims that are bloated by default fees or enlarged due to a servicer's miscalculations diminish bankruptcy's potential as a home-saving device.

To prevent the harms from either type of gap, two changes are needed. Debtor's attorneys should obtain an up-to-date statement of their client's mortgage obligations from the creditor before counseling a debtor to file Chapter 13. Then, after a bankruptcy is filed, attorneys and debtors should verify the accuracy and reasonableness of mortgagees' claims, examining the source of any discrepancy between the claim and the scheduled amount. To enable this latter practice, creditors must be held to the evidentiary standard for proofs of claims and must produce complete and clear documentation of their calculations. Without these changes, the functioning of the bankruptcy process is impaired.

D. Claims Objections

The findings in the prior parts of the Article offer a trio of indicia that undermine confidence in the claims system. Mortgagees often presented claims without required documentation; many claims contained requests for suspicious fees; and mortgagees' claims and debtors' records were rarely identical. The proof of claim process has an existing, internal mechanism to address such problems. Under section 502(a) of the Bankruptcy Code, any party in interest may object to a claim.[163] If such an objection is made, "the court, after notice and hearing, shall determine the amount of such claim."[164]

Despite these procedures, mortgage creditors are rarely called to task for the widespread deficiencies in their claims. Objections were identified to correspond with only 67 of the 1768

[161] Servicer practices may deter debtors from getting such information. As explained above in Part I.A, servicers have no reputational concern about poor customer service response, and so many servicers make it time-consuming and difficult for a debtor to reach them. Additionally, the industry practice of imposing a "payoff" fee or a "statement fee" discourages debtors from making an account inquiry.
[162] *See supra* text accompanying notes 60–64.
[163] 11 U.S.C. § 502(a).
[164] 11 U.S.C. § 502(b).

proofs of claim in the sample. In other words, objections were filed in response to only 4% of all claims. Debtors, trustees, and other creditors simply do not object to mortgagees' claims—even when such claims do not meet the standard for prima facie validity because the claims did not comply with the unambiguous requirements of Rule 3001;[165] even such claims contained vague or suspicious fees; and even when such claims exceeded the debtors' calculation of the debt by thousands of dollars. A debtor's attorney who has developed a training program to educate attorneys about mortgage servicing issues has concluded "that the vast majority of Chapter 13 debtors and their attorneys do little or nothing about these illegal fees and charges."[166]

Among the objections that were filed, there were no observable patterns. The objections came from a variety of districts.[167] While many districts had only one objection, no district had more than seven objections. It appears that no jurisdiction has a strong local practice of reviewing and objecting to claims that would distinguish it from national norms.

Debtors filed more than two thirds of all objections (44 objections); Chapter 13 trustees filed the remaining objections. Debtors' objections usually alleged substantive problems with the claims. The most common basis for objection was a disagreement about the amount of the claim. These situations alleged a variety of wrongs: the claim contained excessive fees; the escrow amount was incorrect; the attorney fees were not itemized; or the mortgagee double-charged for property tax. In a few instances, the debtor contested the inclusion of any arrearages in the claim because the debtor believed the loan was current. Chapter 13 trustees typically focused on procedural problems with claims. The trustees' most frequent basis for objection was simply that a claim was a duplicate of a previously filed claim. Trustees' other objections were for egregious or facial errors. The sample contains trustee objections because a claim was for a borrower other than the bankruptcy debtor or because the claim was filed after the bar date for filing claims. The tiny number of objections makes it difficult to develop any useful model of why objections were filed in these cases and not in other claims with documentation deficiencies, unidentified fees, or discrepancies with debtors' schedules.

Neither the few high profile cases about mortgage servicing abuse nor the anecdotal allegations of widespread problems with the reliability of mortgage claims appear to have sparked more scrutiny of claims. The formal objection process for deficient or incorrect claims is largely dormant. The written law that governs claims does not appear in reality to translate into a functional check on mortgage servicing abuse. Many mortgage claims fail to comply with the bankruptcy rules and procedures, request unidentified or suspicious fees, or reflect a serious discrepancy between debtors' and creditors' records. Yet, no objection was filed in response to 96% of all claims, despite these problems. While Congress has emphasized the importance of a reliable bankruptcy system that garners the public's trust,[168] creditors face no meaningful consequences when they disregard the law and this public policy and submit incomplete or unsubstantiated claims for judicial approval.

The number of formal objections could understate the scrutiny that claims receive. Parties could be informally working out disagreements about claims. This hypothesis, however, is incongruent with the rare incidence of amended claims. Amended claims were located to

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[165] Fed. R. Bankr. Proc. 3001(f) ("A proof of claim executed and filed in accordance with these rules shall constitute prima facie evidence of the validity and amount of the claim.").

[166] O. Max Gardner III, *Mortgage Securitization, Servicing, and Consumer Bankruptcy*, 2 GP Solo Law Trends & News (Sept. 2005), http://www.abanet.org/genpractice/newsletter/lawtrends/0509/business/mortgagesecuritization.html.

[167] Twenty-five of the forty-four judicial districts had at least one claims objections.

[168] *See supra* text accompanying notes 105–06.

correspond with only 9.7% of all mortgagees' initial claims. If creditors were being called to task through informal processes like phone calls from debtors' counsel or negotiations at plan confirmation hearings, the result in most of such situations should be an amended claim.[169] Further, my interviews with dozens of consumer attorneys before beginning this study revealed only a few practitioners have a regular practice of reviewing all mortgage claims.[170] The high-volume nature of consumer practice undoubtedly explains this situation, but does not excuse it. The missing documentation and the lack of standardized and detailed itemizations only heighten the financial and time costs to review claims.

The data offer a cautionary tale about relying on the formal law to actually function as intended to protect parties. Very few mortgage claims meet the ideal of the bankruptcy process; a majority of claims lack documentation and reflect a sizeable discrepancy in recordkeeping between the debtor and creditor. Unambiguous law exists to address such problems. For decades, the system has relied on these procedures to safeguard the integrity of bankruptcy distributions. Yet, the paucity of objections shows a collective failure of the system to identify even patently defective claims.

Verifying that debtors only pay amounts to which creditors are legally entitled should be a routine part of bankruptcy representation. This is a reasonable burden to impose on attorneys given the large size of mortgage claims and the requirement that a debtor must pay all mortgage arrearage debt in full to save their home. Similarly, trustees have a statutory obligation to object to improper claims,[171] yet rarely do so. The current system fails to offer sufficient incentives to encourage attorneys and trustees to obtain the additional information necessary to ensure that the amounts paid to mortgagees are correct. Similarly, the current system suggests that creditors can operate with the knowledge that their claims will not be reviewed or challenged. Combined with the financial incentives of servicers to overreach and the anecdotal evidence of servicing abuse,[172] there is a serious risk that overreaching or errors by servicing is imposing unfair burdens on families trying to save their homes. The evidence from the bankruptcy courts calls into question the ability of consumers to trust their mortgage servicers to accurately and fairly account for their payments and assess charges.

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[169] Another possibility is that the plan confirmation process serves as a check on the accuracy of claims. In their proposed Chapter 13 repayment plans, debtors may be relying on their calculations of the amounts due, rather than using the amount of the mortgagee's claim as the basis for the required repayment. If the creditor does not object to the plan, the order confirming the plan would trump the claim for purposes of the required payment in bankruptcy. Conversely, creditors may be objecting to the amount of mortgage debt in the plan and if the objections are sustained, the plans would be conformed to the creditors' claims. The extent to which confirmed Chapter 13 plans reflect the creditors' claims or the debtors' scheduled amounts or some compromise between these discrepant numbers is an empirical question. The difficulty in testing this hypothesis is that in most districts, the plan contains only the amount of prepetition arrearage. Yet, some claims did not specify the arrearage or combined prepetition and postpetition amounts. Thus, despite my efforts to do so, it is impossible to compare either the total claim or the total arrearage between confirmed plans and the proofs of claim in any significant fraction of cases.

[170] O. Max Gardner III is the most prominent example of a debtor's counsel who always reviews mortgage claims. Indeed, he has developed a "boot camp" to train other attorneys on this practice. ABC Nightline, *Bankruptcy Bootcamp*, Dec. 14, 2007, http://abcnews.go.com/Business/RealtyCheck/story?id=4002397&page=1 (last visited Feb. 8, 2008).

[171] 11 U.S.C. § 704(a)(5).

[172] *See* Part I.A and D, *supra.*

IV. IMPLICATIONS

The systemic failure of the claims process to ensure that mortgage creditors are collecting only what they are legally owed harms debtors, other non-mortgage creditors, and the integrity of the bankruptcy system. Yet, the most distressing implication may be the data's suggestion that mortgage servicing abuse may be even more prevalent beyond bankruptcy.

A. Proof of Claim Process

The problems with mortgage claims are structural. Creditors should comply with federal law if they expect to receive distributions in bankruptcy. Debtors and their attorneys also must bear responsibility for ensuring accurate payments. Objections to claims do not appear with sufficient frequency to police claims, even with regard to large debts such as mortgages. The current claims process is malfunctioning.

Mortgagees' failure to satisfy Rule 3001 should not be dismissed as a mere technicality. The rules governing claims were implemented to prevent substantive harm. Without documentation of the debt, the debtor and other creditors cannot verify the legitimacy or accuracy of claims, each of which cuts into the limited dollars available for distribution. Poor compliance with the claims rules effectively deflects creditors' obligations onto cash-strapped bankrupt families, who must choose between the costs of filing an objection or the risks of overpayment. Deficiencies in the claims process can permit unmeritorious or excessive claims to dilute the participation of legitimate creditors and prevent the just administration of bankruptcy estates.[173] Further, from a systems standpoint, it is hard to discern the benefit of allowing parties to "opt-out" of rules at will. Reforms to the claims process will protect the integrity of the bankruptcy system.

Mortgagees' frequent failure to comply with Rule 3001 results from weaknesses in the current rules, which do not deter creditors from disregarding the documentation requirements. While the rules themselves use mandatory language, phrased in terms of "shall,"[174] the reality is that some creditors treat them as aspirations—or ignore them entirely. In most instances, there is no negative consequence to the mortgagee from its failure to attach the required documentation. Under the current system, the main tool to fight improper claims is Federal Rule of Bankruptcy Procedure 9011, which requires all factual contentions in pleadings to have evidentiary support.[175] While courts have sanctioned creditors for filing unsubstantiated claims,[176] Rule 9011 was not designed to correct the systematic failure of other rules. Rule 3001(f) provides a "carrot" to encourage compliance by granting prima facie validity to claims that are executed and filed in compliance with Rule 3001.[177] Yet, as a practical matter, all claims receive this treatment if

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[173] Gardner v. State of N.J., 329 U.S. 565, 573 (1947).

[174] Fed. R. Bankr. P. 3001(c)–(d). The proof of claim form (B10) also contains a sheet of instructions, which states, in relevant parts, that "[y]ou must attach to this proof of claim form copies of documents that show the debtor owes the debt claimed or, if the documents are too lengthy, a summary of those documents. If the documents are not available, you must attach an explanation of why they are not available" and "[y]ou must . . . attach copies of the documentation of your lien, and state the amount past due on the claim as of the date the bankruptcy case was filed." Instructions for Proof of Claim Form, Office Form 10[9/97], *available at* http://www.uscourts.gov/bankform/formb10new.pdf.

[175] Fed. R. Bankr. P. 9011.

[176] *See, e.g., In re* Cassell, 254 B.R. 687 (B.A.P. 6th Cir. 2000) ("Proofs of claim must meet the standards of [Rule 9011.]"; *In re* Berghoff, 2006 WL 1716299 (Bankr. N.D. Ohio. 2006) (finding that mortgage lender violated Rule 9011 by including certain fees in claim that were not warranted by existing law).

[177] Fed. R. Bankr. P. 3001(f).

neither the debtor nor another party in interest objects to the claim. Creditors can rely on the lack of scrutiny to validate their claims and sidestep the burdens of Rule 3001.

The consequences of disregarding Rule 3001 needs to be sharpened. Even when an objection is filed, there is typically no sanction for missing documentation. Some courts have concluded that failure to comply with Rule 3001 is not a permissible basis for disallowing a claim,[178] because this behavior is not listed in section 502(b) of the Bankruptcy Code, which governs claims allowance. A few jurisdictions have taken a different approach and ruled that incomplete claims documentation can be a basis for disallowing a claim.[179] The majority rule seems to be that a claim that does not comply with Rule 3001 loses its prima facie evidentiary effect, which shifts the burden to mortgagees to prove their claim. However, courts usually require the debtor to advance some evidence that disputes the claim and not merely point to noncompliance with the rule.[180] If the servicer is uncooperative, and for example, refuses to promptly provide a complete and comprehensible payment history, the debtor may have a difficult time actually forcing the creditor—the party in control of the records—to meet the burden that the rules impose upon it. An affidavit from the debtor may suffice in such cases, and the courts seem to be increasingly sympathetic to debtors' frustrations with obtaining information from mortgage servicers.[181]

The simplest route to boosting the reliability of mortgage claims is to revise section 502(b) to include the failure to provide the attached documentation as a basis for claims disallowance. This reform would ratchet up the consequences for failing to attach a note or security interest. In effect, a creditor, who could not validate the existence of the purported debt with a note (or could not adequately explain why a note was unavailable), could not receive more in bankruptcy than it would have been entitled to had it been put to its proof in a judicial-foreclosure lawsuit. In this way, the bankruptcy process would be at least as rigorous as the foreclosure scheme outside of the federal system.

Another strategy is to squarely impose the burden of reviewing mortgage claims on trustees. The Bankruptcy Code already states that a trustee shall "if a purpose would be served, examine proofs of claims and object to the allowance of any claim that is improper."[182] Many trustees apparently believe that no purpose would be served by objecting to claims without the

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[178] *See, e.g.*, *In re* Stoecker, 5 F.3d 1022 (7th Cir. 1993); *In re* Heath, 331 B.R. 424 (B.A.P. 9th Cir. 2005); *In re* Gurley, 311 B.R. 910 (Bankr. M.D. Fla. 2001). *See also* Alane A. Becket, *Proofs of Claims: A Look at the Forest* 23 AM. BANKR. INST. L. REV. 10 (Dec./Jan. 2005) (concluding that disallowance on Rule 3001 grounds is not within a court's statutory authority because bankruptcy rules are not supposed to abridge, enlarge or modify substantive rights under 28 U.S.C. § 2075).

[179] *See, e.g.*, *In re* Shaffner, 320 B.R. 870 (Bankr. W.D. Mich. 2005); *see also* WESTLAW BANKRUPTCY LAW MANUAL § 6:4 (5th ed. 2007) ("There is a split of authority on whether the failure to comply with Rule 3001(c) requires disallowance of the claim."). *Cf. In re McLaughlin*, 05-63927 (Ct. Aug. 31, 2007) (disallowing claims filed by trustee pursuant to Rule 3004 because trustee did not reasonably investigate claims and provide documentation to support the claims.).

[180] *In re* Campbell, 336 B.R. 430, 434 (B.A.P. 9th Cir. 2005) (holding that a proof of claim that lacks documentation required by Rule 3001(c) is not disallowed unless the debtor's claim objection contests the amount of the debt and not merely the rule violation).

[181] *See In re* Heath, 331 B.R. 424, 437 (B.A.P. 9th Cir. 2005) ("Moreover, a creditor's lack of adequate response to a debtor's formal or informal inquiries in itself may raise an evidentiary basis to object to the unsupported aspects of the claim, or even a basis for evidentiary sanctions, thereby coming within Section 502(b)'s grounds to disallow a claim." (citations omitted)).

[182] 11 U.S.C. § 704(a)(5).

documentation required by law. For example, while notes were missing from forty percent of claims, trustees filed only one or two objections that raised that issue.

The U.S. Trustee Program could mandate mortgage claims review as an official duty of panel and standing trustees in their program handbook, and trustees could be evaluated, in part, on their fulfillment of this duty. This solution is informal, requiring no legislative reform. The proposal merely posits that the U.S. Trustee Program would ensure that trustees carry out the statutory mandate in a rigorous fashion. This solution eliminates the need to create incentives for debtors' attorneys to make claims objections in the first instance. The U.S. Trustee Program could use standards and procedures that parallel those used when auditing debtors' schedules. If the Chapter 13 trustees' examinations revealed serious or systematic misconduct, the problems could be referred to the U.S. Trustee for enforcement activity. In 2007, the U.S. Trustee took a step in this direction by becoming involved in litigation over alleged wrongdoing by mortgage servicers.[183]

A complementary tactic to these enforcement strategies would improve the clarity of claims. The varying formats and level of detail in the itemizations dramatically increase the costs in reviewing claims, rendering it prohibitively expensive and inefficient for the high-volume consumer bankruptcy system. If itemizations were standardized, it would be easier to train legal assistants and junior attorneys to review claims. Standardization would also facilitate the development of computer programs to analyze the creditors' calculations for items such as escrow accounts and arrearage payment streams. A model itemization attachment was promulgated by a committee of mortgage industry representatives and Chapter 13 trustees and mortgage servicers.[184] The model attachment would require servicers to provide details such as the type of the loan, its interest rate, and any payment adjustment dates. It also sets out a standardized format for servicers to break out the amount of any pre-petition arrearages, categorize each charge, and report how many times each type of charge had been imposed. The Advisory Committee on Bankruptcy Rules should review the model itemization and consider incorporating it into the Official Form 10 and Rule 3001(a), at least for mortgage claims. Voluntary adoption seems unlikely as the form has not yet been adopted, despite its existence for many months. Notably, the participation of industry representative in creating the model itemization does reflect some willingness by servicers to admit that their bankruptcy procedures need improvement.

The solutions outlined here would systematically improve mortgage claims.[185] Given the empirical evidence of widespread problems with mortgage claims, these approaches may be the most efficient solution. The realities of consumer bankruptcy practice may dictate structural solutions that do not rely on the voluntary participation of individual actors. While such reforms

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[183] *See* Statement of the United States Trustee Regarding This Court's Order Requiring Countrywide Home Loans, Inc. [and Barrett Burke Wilson Castle Daffin & Frappier, L.L.P. Attorneys and Personnel] to Appear and Show Cause Why [They] Should Not Be Sanctioned for Filing a Motion for Relief From Stay Containing Inaccurate Debt Figures and Inaccurate Allegations Concerning Payments Received From the Debtor, *In re* Parsley, No 05-90374, (Bankr. S.D. Tex. Mar. 3, 2007).

[184] Model Proof of Claim Attachment, NAT'L ASS'N OF CHAPTER THIRTEEN TRUSTEES, REPORT OF MORTGAGE COMMITTEE (June 28, 2007) (manuscript on file with author). The model attachment would also require the creditor to provide the MERS number for the loan, the real property tax number and parcel number, and a contact person for the servicer (and not just the servicer's attorney).

[185] *Cf. In re* Coates, 292 B.R. 894, 899–900 (Bankr. C.D. Ill. 2003) (noting that frequent appearance of attorneys' fees and expenses in mortgage claims justifies a systematic approach to this aspect of Chapter 13 cases).

would modestly increase the administrative burdens, the benefits of increased reliability in mortgage claims justify these policy changes.

B. Bankruptcy as a Home-saving Device

Mortgage claims are a key determinant of the outcome of consumer bankruptcy cases. A core function of Chapter 13 bankruptcy is helping families save their homes,[186] which the Bankruptcy Code effectuates by permitting debtors to cure arrearages on mortgages over time.[187] Because mortgage creditors are most Americans' largest creditor, their actions in bankruptcies heavily influence debtors' success in saving their homes from foreclosure.[188] A family's ability to confirm a Chapter 13 plan or cure a default may turn on the amount fixed as owing to the mortgage creditor.[189] Debtors cannot easily generate additional disposable income if alleged obligations to mortgagees magically increase or if fees multiply without justification. The debtor's ability to pay mortgage arrearages, as a practical matter, determines the success of a case. Not only does plan confirmation turn on this issue, if the debtor misses any plan payments, the mortgage creditor frequently will seek relief from the stay to proceed with a foreclosure and the debtor's bankruptcy may be dismissed. Thus, the amounts of mortgage proofs of claim have direct effects on bankruptcy's usefulness as a home-saving device.

Miscalculations about mortgage debt have grave consequences for families at nearly every point in the bankruptcy system. From the outset, debtors may be harmed if they make the bankruptcy filing decision without accurate knowledge of their mortgage debts. If debtors underestimate the amount of their outstanding obligations to mortgagees, which the data show occurs in the majority of cases, their attorneys may misadvise them about the feasibility of confirming a Chapter 13 plan and the likelihood that they can cure their mortgage default. Conversely, if debtors overestimate the arrearage, they could file bankruptcy without pursuing other types of relief, such as borrowing from families or friends, seeking forbearance from the mortgagee, or selling an asset. Debtors' inability to report their mortgage debt with reasonably accuracy indicates a serious shortcoming in the pre-bankruptcy counseling process. The data suggest that attorneys who do not verify the mortgage debt may give suboptimal advice to their clients about the advisability of Chapter 13 bankruptcy. This situation could be one factor that contributes to the low success rate of debtors completing Chapter 13 repayment plans.[190]

After families file bankruptcy, discrepancies in debtors' and creditors' records of the amount of mortgage debt and incomplete mortgagee proofs of claim lead to either of two undesirable consequences. In most instances, the data show that debtors do not verify the amount requested on the mortgagees' claim and risk overpaying that creditor. In so doing, debtors increase their burden in confirming and completing a Chapter 13 plan. This outcome, however,

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[186] *See* 1 KEITH LUNDIN, CHAPTER 13 BANKRUPTCY, § 129.1 (3d ed. 2000) ("[I]t is not unusual for rehabilitation of a home mortgage to be the principal reason for filing a Chapter 13 case.").

[187] *See* 11 U.S.C. § 1325(b)(5).

[188] Bahchieva, Wachter & Warren, *supra* note 1, at 74. ("Our results also suggest that rising mortgage debt has important consequences for federal bankruptcy policy.").

[189] *In re* Coates, 292 B.R. 894, 899 (Bankr. C.D. Ill. 2003) ("A debtor's obligation to cure the prepetition mortgage arrearage is enforceable as a condition of confirmation. A plan that fails to provide for a complete cure is not confirmable over the objection of the mortgagee. Most of the Chapter 13 cases filed in this District involve the cure of a prepetition mortgage arrearage.").

[190] *See*, *e.g.*, Scott Norberg, *Consumer Bankruptcy's New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13*, 7 AM. BANKR. INST. L. REV. 415, 439 (1999) (finding that approximately one-third of Chapter 13 debtors complete their plans).

saves the debtor the litigation and negotiation costs of seeking clarification from the mortgagee. When mortgagees' claims are challenged, the debtor faces increased costs for their attorneys' time in this work. Proofs of claim with unexplained or impermissible fees, or without adequate documentation, drive up the expense of bankruptcy relief, a consequence that financially-strapped families can ill afford.

Despite these costs, debtors may benefit substantially from challenging mortgage claims. Bloated claims make it more difficult for a family to confirm repayment plans. Because arrearages must be paid in full, every dollar of savings is a direct benefit to a family who would have to dismiss their Chapter 13 case and surrender its home if the original arrearage amount were allowed to stand. Improved accuracy by mortgage servicers in bankruptcy cases could save litigation costs in response to motions for relief from stay that are based on incorrect accounting.

Scrutinizing the proof of claim to ensure that only valid fees are included in arrearage claims can help reduce the burdens that debtors face in making all required Chapter 13 plan payments. Reduced arrearages could improve the success rate of debtors in completing Chapter 13 plans and receiving a discharge. Better outcomes in Chapter 13 could help encourage more debtors to consider this alternative, and boost recovery to all creditors. Further, ensuring that the mortgagees' accounting is accurate at the time of the confirmation can help prevent disputes about the amount of mortgage debt that remains to be paid after the bankruptcy case is complete.

Debtors would benefit substantially if consumer bankruptcy attorneys incorporated a routine review of mortgage claims in the scope of their representation. Given the recent escalation in attorneys' fees that occurred after BAPCPA,[191] it is discouraging to suggest that the solution lies in passing the costs of claims review along to debtors. The structural changes suggested in the prior section would reduce the costs of claims review in various ways, and in some instances they would change the incentives of debtors' attorneys to monitor the accuracy of claims.

Taking those suggestions a step further, debtors' attorneys need to be educated about the potential benefits to their practice of challenging mortgage claims. While challenging a claim does not *per se* generate revenue for an attorney, claims review can reveal other causes of action. Most obviously, if consumer attorneys request information from mortgage servicers and receive no response or an inadequate response, the servicer may have violated the Real Estate Settlement Procedures Act ("RESPA"). If successful, these claims entitle plaintiffs to actual damages and the costs of reasonable attorneys' fees.[192] An objection may also generate evidence of a practice that can be challenged under a state's unfair or deceptive practices act, which typically also permits the recovery of attorneys' fees if the plaintiff is successful.[193] In some instances, review of mortgage claims can reveal causes of action that allege violations in how the loan was originated. For example, a review of the Truth-in-Lending disclosure can give rise to a claim for actual or statutory damages, or even rescission of the loan under some circumstances.[194] The Truth in Lending Act also is fee-shifting so that mortgage companies may be ordered to pay the

[191] In 2001, the Consumer Bankruptcy Project found that the median attorneys' fee for a Chapter 13 case among five judicial districts was $1550 (in 2001 dollars; no inflation adjustment) (data on file with author). A recent survey suggests that on a national basis, Chapter 13 fees are nearly twice the 2001 amount, with many districts having a presumptively permissible fee of $3000 or more. Nat'l Ass'n of Consumer Bankruptcy Attorneys, Survey of Presumptive Chapter 13 Fees (Apr. 22, 2007) (on file with author).
[192] 12 U.S.C. § 2605(f)(3).
[193] DOUGLAS J. WHALEY, PROBLEMS AND MATERIALS ON CONSUMER LAW 482 (3d. ed. 2002).
[194] 15 U.S.C. §§ 1635 & 1640.

attorneys' fees and costs of successful actions.[195] These examples show how bankruptcy can be the locus for identifying a variety of illegal lending activity. Reviewing mortgage claims should be merely the first step in helping a family stop a foreclosure or untangle itself from the harm of an inappropriate or predatory home loan.

The data provide systematic evidence that mortgage servicers do not adequately document their claims and may be engaged in overreaching in assessing fees and calculating outstanding obligations. The current state of mortgage claims puts debtors at risk. Each time a family loses its home based on an inaccurate claim, the bankruptcy system fails. Inflated mortgage claims undercut a core bankruptcy policy of helping families in financial trouble save their homes and right themselves financially.

C. Sustainable Homeownership Policy

The findings on the unreliability of mortgagees' claims have implications beyond bankruptcy. All families who are trying to pay off a home loan are put at risk if subject to poor or predatory mortgage servicing. Most families rely on their mortgage servicer to credit payments, calculate pay-off balances, and apply fees only when justified. Most families do not and cannot separately verify the servicers' accounting. Bankruptcy data provide a lens for examining whether Americans should trust servicers to carry out these tasks and whether the servicing industry is adequately regulated.

It seems likely that default by a borrower may exacerbate servicing problems because default triggers the imposition of fees, and sometimes a transfer to a loss mitigation department or even to a new servicer. Nonetheless, the reality is that most defaults and pending foreclosures occur outside the bankruptcy system.[196] Thus, most families in default on their mortgages lack the protections—albeit, the existing weak protections—of the bankruptcy claims process to shield them from impermissible or unreasonable default fees. Indeed, servicers' accounting should be better inside the bankruptcy system than outside it because, at least in theory, a bankruptcy is a check on mortgage overreaching. If a Chapter 13 case is filed, the servicer usually hires an attorney who is supposed to review the claim for accuracy and illegality, and the servicer knows that homeowners usually have retained an attorney to represent them. Not only are mortgagees' misbehavior or mistakes probably not confined to bankruptcy debtors, the frightening prospect is that servicing problems among non-bankrupt families who are behind on their mortgages may be even worse than the bankruptcy data reveal.

Very recent case law lends legitimacy to this fear. In late 2007, two federal courts in Ohio dismissed dozens of foreclosure lawsuits on standing grounds because the plaintiffs could not

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[195] 15 U.S.C. § 1640(a)(3).

[196] Foreclosure filings appear to outnumber bankruptcy cases filed by homeowners by a ratio of four to one. In 2006, there were 597,965 non-business bankruptcy filings. *See* Administrative Office of the U.S. Courts, *Bankruptcy Filings Plunge in Calendar Year 2006* (Apr. 26, 2007), http://www.uscourts.gov/Press_Releases/bankruptcyfilings041607.html. The best available data, the 2001 Consumer Bankruptcy Project, indicate that about 52.5% of all families in bankruptcy are homeowners. *See* Bahchieva, Wachter & Warren, *supra* note 1, at 92. Accordingly, about 300,000 bankruptcy cases were filed by homeowners. In the same year (2006), there were 1,259,118 foreclosure filings. *See More Than 1.2 Million Foreclosure Filings Reported in* 2006, REALTY TRAC, Jan. 25, 2007, http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=1855&accnt=64847. *See also* Dennis R. Capozza and Thomas A. Thomson, *Subprime Transitions: Lingering or Malingering in Default?* 33 J. OF REAL EST. FIN. & ECON. 241–58 (2006) (reporting that only 11% of subprime borrowers in default by ninety days or more subsequently filed bankruptcy in the preceding eight months).

prove they were the record owner of the mortgage and note.[197] Two class action lawsuits are pending that allege that consumers pay bloated, illegal fees for default charges.[198] Mortgage servicers are increasingly being fingered as the primary party who is frustrating homeowners' efforts to obtain modifications of unaffordable loans.[199]

Poor mortgage servicing is an assault on America's policy of promoting sustainable homeownership. If families are hit with unreasonable fees and cannot understand what is owed on their mortgage loan, they are at risk of foreclosure. Servicing abuse can begin before bankruptcy, but may ultimately drive some families into bankruptcy as a last resort for trying to address this issue. The current policy debate on homeownership is focused on loan origination issues, such as whether mortgage brokers or lenders placed families in appropriate loans.[200] Servicing problems may be less visible, but no less harmful. Research shows that the quality of preventive servicing affects the incidence and outcome of default.[201] The rising foreclosure rate will only escalate the number of families who must struggle to understand the amount of their arrearage and who are at risk of having to pay unreasonable default costs to save their home.[202] Policies that aim to protect families from foreclosure should address the weaknesses in mortgage servicing, and not just alter the process for loan origination. For families who are already trapped in unaffordable loans, other relief will come too late. Improving mortgage servicing would provide immediate protection to families facing foreclosure.

Paying a mortgage is most families' most important financial obligation. Unreliable servicing can cause ordinary families to overpay, even for those who avoid default and bankruptcy. For example, inaccurate pay-off balances can penalize families when they refinance a home loan. Even families who try to get ahead on their mortgage may lose such benefits if servicers fail to credit additional payments to principal, instead holding them in suspense or treating them as prepayments despite instructions to the contrary from the borrower. These practices create a needless barrier to homeownership.

Under the current regime, consumers have no choice in servicers. Any market exists solely based on the needs of lenders and bond issuers, whose concerns are distinct—if not opposed—to borrowers. Jack Guttentag, emeritus professor at the Wharton School of Business, has suggested that consumers be allowed to "fire" their servicer, essentially receiving a one-time option to choose a different servicer.[203] He postulates that servicers would compete for this

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[197] *In re* Foreclosure Cases, 07CV2282 (N.D. Ohio. Oct. 31, 2007) (Boyko, J.); *In re* Foreclosure Cases, 07CV043 (S.D. Ohio Nov. 15, 2007) (Rose, J.).

[198] *Harris v. Fidelity Nat'l Information Serv.*, No. 03-44826, Complaint (Bankr. S.D. Tex. Jan. 16, 2008) (class action suit alleging that default servicers had impermissible and undisclosed arrangements with attorneys to retain portion of fees); *Trevino v. MERS*, 07-568, Complaint (D. Del. Nov. 6, 2007) (class action alleging that MERS overcharges borrowers).

[199] Eggert, *supra* note 21 at 282.

[200] Home Mortgage Disclosure Act Data and FTC Lending Enforcement Before the H. Comm. on Financial Services, 110th Cong. 1, 5–9 (2007), *available at* http://www.ftc.gov/os/testimony/P064806hdma.pdf (describing FTC collection of data on pricing of subprime mortgages marketed to consumers).

[201] Anthony Pennington-Cross & Giang Ho, *Loan Servicer Heterogeneity and the Termination of Subprime Mortgages* (Fed. Res. Board of St. Louis, Working Paper No. 2006-024A 2006).

[202] *See generally Foreclosure Activity Up Over 55% in First Half of 2007*, REALTYTRAC, July 30, 2007), http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=2932&accnt=64847; Danielle Reed, *Rising Foreclosure Rates Point to a Normalizing Market*, REAL ESTATE JOURNAL.COM, Apr. 17, 2006, http://www.realestatejournal.com/buysell/markettrends/20060417-reed.html?refresh=on.

[203] Jack Guttentag, *Borrowers Should Be Able to Fire Mortgage Servicers*, Feb. 2, 2004, http://www.mtgprofessor.com/A%20-%20Servicing/borrowers_should_be_able_to_fire_servicers.htm.

additional business, driving up quality, and balancing servicers' incentives between lenders and borrowers. Another policy response to concerns about mortgage servicing is to step up enforcement action. However, single actions against egregious servicers may not produce systematic reform, as the Mortgage Study data suggest that servicing issues are industry-wide. A bigger problem may simply be focusing the Department of Housing and Urban Development ("HUD") on its duties to enforce RESPA and to police mortgage servicers. HUD's website for complaints does not even mention mortgage servicing,[204] and the Federal Trade Commission, rather than HUD, has taken the lead in recent actions against servicers.

The Mortgage Study data suggest that policymakers who focus on promoting homeownership need to concern themselves with mortgage servicing, which is a crucial aspect to enabling families to achieve homeownership. Mortgage servicing abuse weakens families' efforts to manage their mortgages successfully and can result in families being wrongfully deprived of their homes through foreclosure or unsuccessful outcomes in bankruptcy. Mortgagees' failure to honor the terms of their loans and applicable law weakens America's homeownership policies and threatens families' financial well-being.

The findings are a tangible reminder that merely enacting a law does not ensure its success. Without the correct structural incentives and without robust safeguards, a law can fail to deliver its promised protections. In the consumer context, this observation has particular power. Consumers face disadvantages to industry in a legal system: consumers are not repeat players; they have fewer resources; and they do not have institutional incentives to shape the system. The bankruptcy claims process exemplifies the difficulty in developing and monitoring an effective legal system. The findings should caution policymakers and advocates from blindly trusting in the written law as a decontextualized instrument to shape behavior.

CONCLUSION

Hundreds of thousands of Americans file Chapter 13 bankruptcy each year hoping to save their homes from foreclosure. Reliable claims are crucial to the success of the bankruptcy system because the claims mechanism implements the two core goals of bankruptcy policy: to help debtors obtain a fresh start by paying their debts and to ensure that creditors receive a fair share of debtors' assets. From external indicia, the claims process in consumer bankruptcy cases may seem like an exemplar of a well-designed legal system that balances the interests of debtors and creditors. The claims rules are unambiguous; all parties typically are represented by attorneys; the federal judicial system brings uniformity to the procedures; and specialized actors such as bankruptcy judges and trustees police the system.

Yet, despite these reassuring features, the empirical data establish the widespread, current practice of mortgagees' filing incomplete claims with vaguely identified fees. This hinders any effective scrutiny of whether servicers are only charging the correct amounts to struggling homeowners. The existing system is insufficient to ensure the integrity of the bankruptcy system and its home-saving purpose. The problems with mortgagees' calculations are likely to be even worse outside of bankruptcy, where the rules are less clear and the procedural safeguards are fewer. Systematic reform of mortgage servicing is needed to protect all homeowners—inside and outside of bankruptcy— from overreaching or illegal behavior. The findings on the unreliability of mortgage servicing are a high-stakes reminder of the challenges of designing a legal system that actually functions to protect consumers.

[204] U.S. Dept. of Housing and Urban Dev. Complaints, http://www.hud.gov/complaints/ (last visited Sept. 11, 2007).

With respect to the payment history attached to the Motion, Schlotter testified that his firm's paralegal staff prepared this history "[a]nd the reason they're prepared this way is because we've had different courts require legible payment histories. And when we submitted screens, we've got courts that have rejected them. And other courts have said, 'We can't read these. We want something that's legible, that shows exactly how the payments are applied, that somebody who doesn't have an accounting background can read it.'" [March 5, 2007 Hr'g Tr. 80:25-81:7.] Schlotter testified that no attorney at McCalla Raymer reviews the loan histories prepared by the paralegals. [March 5, [**22] 2007 Hr'g Tr. 96:1-97:5.]

Schlotter also testified that he became aware of the errors in the Debtor's payment history when he received a call from Thurmond, who told him that the Debtor had filed a response opposing the Motion and that there were some discrepancies in the payment history. [March 5, 2007 Hr'g Tr. 90:15-19.] Based upon this information from Thurmond, Schlotter personally authorized Thurmond to withdraw the Motion. [March 5, 2007 Hr'g Tr. 88:19-21.]

Finally, Schlotter testified--just as Sanov had--that any communications from Barrett Burke must be directed to McCalla Raymer, not Countrywide. [March 5, 2007 Hr'g Tr. 79:11-20; 99:18-100:6.] Indeed, [*150] he stated that if Barrett Burke were to contact Countrywide directly without going through McCalla Raymer, it would be a problem: "It can be [a problem]. It usually is . . . Because, pursuant to agreement with local counsel, the reason that Countrywide would hire us is because it wants to deal with one firm. It doesn't want to have 50 firms calling it on every case that it handles in the country. So it asks that all communication goes through our office." [March 5, 2007 Tr. 94:21-95:3.] The Court was concerned that Countrywide [**23] has insufficient lines of communication with those attorneys throughout the country who are representing Countrywide in the courtroom.

C. The Court's concerns arising from the March 5, 2007 hearing

Based upon the testimony of these three witnesses, the Court had further concerns about the activities of Barrett Burke, McCalla Raymer, and Countrywide in connection with the filing of the Motion. Two of these concerns have already been discussed above: (1) Barrett Burke's contractual obligation to refrain from any and all communication with Countrywide; and (2) Countrywide's lack of a written policy against charging debtors for withdrawn motions. Third, the Court was concerned as to why Schlotter testified that he was the attorney-in-charge when Sanov signed the Motion and Schlotter did not file a notice of appearance or review the Motion prior to its filing. [7] Fourth, Sanov and Schlotter both testified that McCalla Raymer was the client of Barrett Burke; yet, the Motion represented that Barrett Burke was the attorney for Countrywide, not McCalla Raymer. Finally, Sanov, Ortiz, and Schlotter all testified that the loan payment history contained several inaccuracies, and Schlotter testified [**24] that it was Thurmond who informed him of these errors. Yet, when this Court had asked Thurmond on February 6, 2007 if the Motion contained inaccurate allegations, he represented to this Court that "from what I read in our system this morning, and from what I could tell from this, the answer is it was a good motion." [Feb. 6, 2007 Tr. 5:8-10.] Accordingly, this Court decided to issue the Second Show Cause Order to obtain clarification of these various issues.

7 Local Rule 11.1 of the United States District Court of the Southern District of Texas states: "On first appearance through counsel, each party shall designate an attorney-in-charge. Signing the pleading effects designation." The District Local Rules are made applicable to all bankruptcy court proceedings by Bankruptcy Local Rule 1001(b).

IV. The Second Show Cause Order

After reviewing the transcript of the March 5, 2007 hearing, the Court issued a second show cause order (the Second Show Cause Order). [Docket No. 57.] The Second Show Cause Order set forth that the Court was concerned about the following issues: (1) why Thurmond expressly represented to this Court that the Motion was "good" when Sanov, Ortiz, and Schlotter all testified [**25] that the pay history attached to the Motion failed to account for the Debtor's November 9, 2005 and May 6, 2006 payments, and when Schlotter himself testified that he learned about these errors from Thurmond; (2) the language in paragraph 16 of McCalla Raymer's referral guidelines prohibiting Barrett Burke--or any firm retained by McCalla Raymer--from communicating directly with Countrywide; (3) Schlotter's confusing testimony that Barrett Burke's client was McCalla Raymer, not Countrywide, and that he was the attorney-in-charge

to know Mr. Thurmond, is when the motion was filed, are the allegations in the motion just flat-out wrong?" [Feb. 6, 2007 Hr'g Tr. 4:2-7.] Thurmond's answer on February 6, 2007 that it was "a good motion," and his subsequent explanation of that answer at the July 27, 2007 hearing, artfully [**29] dodges the subject of the Court's inquiry--whether the Motion contained factual inaccuracies. Thurmond knew full well that the payment history attached to the Motion did not account for the November 9, 2005 payment or the May 6, 2006 payment, and that therefore the allegations in the Motion concerning the defaults and post-petition arrearage were, in fact, "flat-out wrong." Indeed, under cross examination by the UST, Thurmond conceded that he knew about the errors in the Debtor's payment history when he came to court on February 6, 2007. [Aug. 10, 2007 Hr'g Tr. (afternoon session) 46:11-47:9.]

Moreover, this Court has no doubt that Thurmond knew about these problems with the payment history because Schlotter convincingly testified that "I got involved in this case either a day or two before the final hearing on the motion for relief in February of 2007, when I got a call from Walter Thurmond at Barrett Burke telling me that there were some discrepancies with the payment history, and it didn't appear that the debtor was now more than 60 days delinquent in his recommendation. And he asked for my consultation on it and an agreement that we would withdraw that motion." [10] [Aug. 8, 2007 [**30] Hr'g Tr. 13:16-23.] Indeed, Schlotter had a distinct and credible recollection of a conversation with Thurmond the day *before* the February 6, 2007 hearing:

> The Court: All right. Let's go through that. Did you call Mr. Thurmond or did Mr. Thurmond call you?
>
> Schlotter: He called me.
>
> The Court: All right. Morning or afternoon, if you remember?
>
> Schlotter: I'm trying to remember, but I think--I don't know for sure, but it seems like it was sometime close to lunch.
>
> The Court: And do you recollect what Mr. Thurmond told you? Tell me everything he told you.
>
> Schlotter: He said, 'John, I think this one, there's a problem with the loan history, and the debtor is saying that they made more payments, and I got a history from the client showing that there were payments that weren't reflected, and if he's correct, then the loan isn't as far delinquent as we said in the motion. So, you know, it's a Fannie Mae loan, but it's not 60 days delinquent. Assuming the debtor is correct in his assertions, I think we should withdraw this, and I'd like to do that.'
>
> [*153] The Court: Okay. And what did you say?
>
> Schlotter: I said, you know, I talked to him. I asked him what were the problems on the history, and he told me basically [**31] that there was misapplied pre- or post-petition payment, and that there was an annual statement that went out to the debtor that showed receipt of a payment. No, that was after the fact. There was one, I think a May payment or something had not been applied properly, so that would have been two payments, which meant that at that point, then, the debtor was probably only one month behind. And I agreed with him that it was a good idea we should withdraw it instead of pursuing it.
>
> The Court: So, are you telling me that Mr. Thurmond was knowledgeable about payment problems?
>
> Schlotter: When he spoke to me, he was, yes.
>
> [Aug. 8, 2007 Hr'g Tr. 70:2-71:11] [11]

10 Schlotter's testimony that the Debtor was not more than 60 days delinquent refers to a Fannie Mae guideline setting forth that no motion to lift stay should be filed unless the debtor is at least 60 days delinquent (i.e. has failed to make two monthly payments). *See* Sec. IV.E.5 *infra*.

11 Schlotter's recollection of his telephone

doubt that Knesek knew of the errors in the Motion. Therefore, Thurmond, who testified that he spoke with Knesek prior to going to court on February 6, 2007 [Aug. 10, 2007 Hr'g Tr. (afternoon session) 34:2-35:13], had to have known that the Motion contained inaccurate factual allegations.

As a final note on the issue of Thurmond's misrepresentation that "it was a good motion," the Court asked several witnesses what would have been their response had they been standing in Thurmond's place at the February 6, 2007 hearing when the Court inquired about the factual inaccuracies in the Motion. Although hindsight is 20/20, their answers are telling.

Mary Daffin, the Barrett Burke partner in charge of the bankruptcy department, responded to this hypothetical as follows: "If you had asked me if it contained inaccurate factual allegations, I would have told you, yes, sir, it does contain inaccurate factual allegations." [July 27, 2007 Hr'g Tr. 336:15-17.]

The following [**36] exchange between this Court and Sanov occurred at the July 27, 2007 hearing:

> The Court: Let's assume you had come [to the February 6, 2007 hearing].
>
> Sanov: Okay.
>
> The Court: And you had gone up to the podium and said [just like Thurmond did] "Judge, we want to withdraw the Motion." And let's assume I said to you, "why?" What would you have said?
>
> Sanov: I would have said that a mistake was made on the pay history and that the loan was not sufficiently delinquent when the Motion was filed.
>
> The Court: And if I had said to you, "You mean you're telling me that the Motion to Lift Stay contains factual allegations that are not true," what would your answer have been?
>
> Sanov: I would have said that I now know that they are not true.
>
> [July 27, 2007 Hr'g Tr. 221:21-222:10.]

Finally, the following exchange between this Court and Schlotter occurred at the August 8, 2007 hearing:

> The Court: If I had said, ' Are there allegations in the motion that are incorrect?', what would you have said to me?
>
> [*155] Schlotter: I would have said, 'It appears that there are, yes.'
>
> [Aug. 8, 2007 Hr'g Tr. 72:25-73:4.]

In addition to the "good motion" misrepresentation, the Court had a second concern about Thurmond's other statements [**37] at the February 6, 2007 hearing. After Thurmond told this Court that the Motion was a "good motion," the undersigned judge stated that "what I'm going to do is take a look at the motion myself." [Feb. 6, 2007 Hr'g Tr. 4:14-15.] Thurmond then replied that he would "check when I go back and see what the deal was with it." [Feb. 6, 2007 Hr'g Tr. 4:20-21.] This statement led the Court to believe that Thurmond would return to his office, check with his colleagues to determine whether the Motion contained inaccurate factual allegations, and, if he was incorrect, file a notice with the Court correcting his prior misstatement that the Motion was a "good motion."

Thurmond never reported back to the Court. Indeed, his silence was deafening. At the July 27, 2007 hearing, Thurmond could offer no explanation as to why he did not report back to the Court:

> The Court: Did you check?
>
> Thurmond: Yes, I did.
>
> The Court: Did you get back with the Court?
>
> Thurmond: I did not.
>
> [July 27, 2007 Tr. 374:10-13; *see also* Aug. 10, 2007 Hr'g Tr. (afternoon session) 62:4-23.]

Thurmond's concession that he did not report back to

instead of telling the truth the first time? Is that what you're saying?

(Witness reviews the transcript)

Schlotter: Well, that's what I said.

UST: How many times do you have to be asked the same question to give you enough time to tell the truth?

Schlotter: That's a question I can't answer. I guess it depends on what I understand of the question. I certainly didn't intend to mislead the Court, and I don't at this point intend to mislead the Court, but I certainly want to clarify what happened.

[March 5, 2007 Hr'g Tr. 43:2-45:14.]

After all was said and done, this Court has no doubt now that everyone understands that Barrett Burke's client is Countrywide. It is disconcerting that Schlotter, an attorney with 28 years of experience, would think otherwise. His initial testimony [*158] underscores the need for McCalla Raymer to properly train its attorneys.

2. Who was the attorney-in-charge?

District Court Local Rule 11.1 of the Southern District of Texas requires each party [**45] to designate an attorney-in-charge, and signing the first pleading for that party is effective designation. Local Rule 11.2 states: "The attorney-in-charge is responsible in that action for the party. That individual attorney shall attend all court proceedings or send a fully informed attorney with authority to bind the client."

On July 27, 2007, Sanov testified that she was definitively the attorney-in-charge of the Debtor's file under Local Rule 11.2. [July 27, 2007 Hr'g Tr. 201:2-11.] This testimony directly contradicts Schlotter's testimony at the March 5, 2007 hearing that he was the attorney-in-charge of the Parsley file. [March 5, 2007 Hr'g Tr. 90:25-91:3.] However, when Schlotter took the stand again on August 8, 2007, he recanted this testimony:

MR's Attorney: At the time you answered [the UST's] questions [on March 5, 2007] and the Court's follow up question, were you aware that the phrase 'attorney-in-charge' had special significance under the Local Rules in the Southern District of Texas?

Schlotter: No, I was not.

MR's Attorney: Have you since read the Local Rules of the Southern District of Texas?

Schlotter: Yes, I have.

MR's Attorney: Are you, under those Rules, the attorney-in-charge [**46] of the Parsley matter?

Schlotter: No.

MR's Attorney: Did you sign the initial pleading, the motion for relief filed in the Parsley matter that brings us down here today?

Schlotter: No.

MR's Attorney: Were you designated as the attorney-in-charge under the Southern District of Texas Local Rules?

Schlotter: No.

MR's Attorney: Did you mean to answer to the Court and to [the UST] that you were the attorney-in-charge under the Local Rules in the Southern District of Texas?

Schlotter: No, I did not. I did not comprehend the concept because I hadn't read the Local Rules.

[Aug. 8, 2007 Hr'g Tr. 17:14-18:10.]

Thomas testified that Barrett Burke was the "lead counsel for the Motion for Relief in the Southern District of Texas." [Aug. 7, 2007 Hr'g Tr. 42:16-17.] Her testimony conflicted with Schlotter's testimony at the March 5, 2007 hearing when he testified that he was the attorney-in-charge. That two seasoned attorneys at

an erroneous charge, is that the case--

Ortiz: Assuming, yeah.

[*160] [Aug. 10, 2007 Hr'g Tr. 34:10-35:10; 36:13-37:4.]

Smith also testified that the charges related to the Motion will be removed only when the Debtor receives his discharge:

UST: This $ 550 was part of the fee that Countrywide had assigned to Mr. Parsley for the filing of the withdrawn Motion for Relief from Stay; was it not?

Smith: That's correct.

UST: And then there's the $ 150, which was the court costs for the filing of that withdrawn Motion for Relief from Stay, correct?

Smith: That's correct.

UST: And we see two entries again on March 12th, 2007. And the last entry on March 12th after all the reclassification has been done, what is the balance on Mr. Parsley's account for the fees he owes to Countrywide?

. . .

Smith: Twelve thousand sixty or, I'm sorry, $ 1,260.53 would be the balance. Now, but did you say that would be owed by Mr. Parsley?

UST: Isn't that what the balance shows?

Smith: Well, no, not directly. That would be the [**51] balance that would be in the fees due. However, again, that would not be chargeable because it's been reclassified. So once the loan was completed it would actually be--it would go through a process we call "book loss" to actually book the fees off of the loan.

UST: Why is [sic] there two entries on March 12th as debits in the amount of $ 550 and $ 150? Why do you debit it, which increases the balance total back to what it was before you re-classed these fees for the withdrawn Motion for Relief from Stay?

Smith: Again, it's--it would be an internal accounting function. Again, that's part of the book loss process that I spoke about before. But it would be reclassified, so Mr. Parsley would not have been charged for that.

UST: But the running balance reflected in your system has it the same amount, correct?

Smith: It has a running total of the same amount. But, again, it's being reclassified to a non-claimable amount. So when the loan is completed we book that item off of the system. It's just an accounting function.

UST: Mr. Parsley's loan is a 30-year loan, correct?

Smith: That's correct.

UST: So in 2029 someone at Countrywide is going to remember to go back and book loss this amount?

Smith: [**52] No. Actually, this would occur--in this case in the bankruptcy context we would book loss the loan as soon as--typically, as soon as it would come out of the bankruptcy environment.

. . .

UST: Where on Countrywide's system would the balance be reflected that Mr. Parsley owes?

Smith: He would have to--and I'm not aware if you can create a report to show, to just pull out the recoverable items. But you would have to add up those items that

> Countrywide to file the document with the Clerk of Court and the Court will amend [**56] this Memorandum Opinion to include the verbatim language in the document as an addendum. Countrywide shall have ten (10) days from the entry of this Memorandum Opinion on the docket to file this document with the Court.

This Court is certainly not going to write Countrywide's policies. However, given the representation made by Countrywide's counsel, the Court expected a plain and simple sentence declaring that Countrywide will not charge borrowers any fees related to any motion to lift stay withdrawn as a result of Countrywide's own errors. Countrywide appears unwilling to take this basic step towards accepting responsibility for motions which are incorrectly filed based upon its own errors and the mistakes of its counsel.

Moreover, Countrywide represented that it has not changed its practice of determining whether fees are recoverable at the time of discharge. There is no justifiable reason that these types of fees cannot be *immediately* written off. If Countrywide allows up to five years to pass before deciding whether to charge a debtor for these fees, it is very likely that a debtor, who may not have the assistance of counsel at that point, will be willing to pay these fees out of [**57] a desire to extricate himself from bankruptcy and move on with his life. [18] When asked why this policy had not been changed, and why Countrywide was still waiting until discharge to make the non-recoverability determination, its counsel responded, "Your Honor, I'm not prepared to answer that question today." [Dec. 12, 2007 Hr'g Tr. 80:23-24.] Countrywide's unwillingness to put into effect a straight-forward policy and to reconsider when fees are deemed non-dischargeable makes this Court all the more concerned about Countrywide's policies.

> 18 The Debtor's Chapter 13 petition was filed prior to the effective date of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). Thus, his plan will last only 54 months. However, with a certain narrow exception, all Chapter 13 cases filed after BAPCPA must last 60 months unless unsecured creditors receive payment in full of their claims. *See 11 U.S.C. § 1325(b)(4)(A)* and *(B)*. Accordingly, in most cases, under Countrywide's present policy of deciding whether the fees and costs are recoverable only at the date of discharge, this decision will not be made until five years after the confirmation of the plan.

E. The general conduct [**58] **of Barrett Burke, McCalla Raymer, and Countrywide in connection with the Motion**

The issues discussed above were specifically enumerated in the Second Show Cause Order. Due to the UST's thorough investigation and examination, the Court heard testimony on many other issues regarding miscellaneous conduct of Barrett Burke, McCalla Raymer, and Countrywide which related to the Motion specifically and to their business practices generally. The Court would be remiss if it failed to address these other issues which in some cases are as, if not more, disconcerting than the ones already discussed above. Primarily, this analysis is organized around the flow of information through the system created by the parties in this case. Tracing the steps leading up to the filing of the Motion shows that this is an assembly [*163] line process. There are attorneys involved throughout this process that should be catching these errors. However, the attorneys, do not dedicate sufficient time and care to ensure adequate quality control. Eventually, despite being passed through the hands of several paralegals and attorneys, the Court receives an erroneous motion that should never have been filed.

1. Countrywide's Payment [**59] **History**

This process begins with Countrywide and, ultimately, must end with Countrywide because the actions of McCalla Raymer and Barrett Burke were done on behalf of Countrywide. As Ortiz testified, the mistakes Countrywide made in the Debtor's payment history are the root cause of the Motion being filed. As previously stated, she conceded that Countrywide did not acknowledge the Debtor's bankruptcy filing in their electronic files until several days after he filed and Countrywide had received notice of the filing. [March 5, 2007 Hr'g Tr. 68:12-24.] Thus, the Debtor's post-petition payment on November 9, 2005 was posted as a pre-petition payment, and Countrywide's records indicated that the Debtor missed his first post-petition payment. Although this was not the only mistake in the payment history that the Court eventually received, it was the first.

Ortiz also testified that no one at Countrywide

of lien.

c. The Second Amended Proof of Claim

On October 1, 2007, nearly two months after four days of testimony laying bare the extensive problems with the original Proof of Claim and First Amended Proof of Claim, Countrywide filed a Second Amended Proof of Claim. This Second Amended Proof of Claim was signed by John Smith and not by an attorney at McCalla Raymer. [Proof of Claim 8-1.] The Second Amended Proof of Claim did not include any of the late charges, pre-petition attorneys' fees and costs, or post-petition fees discussed above. *[Id.]* However, Countrywide included the following notice: "By filing this Second Amended Proof of Claim, Countrywide Home Loans, Inc. does not concede that amounts listed in the Amended Proof of Claim are not recoverable from the Debtor's estate, but rather waives its right to collect such amounts." This statement is cavalier in light of the fact that Countrywide's own representative [**78] admitted that, at a minimum, the pre-petition attorneys' fees and costs were not recoverable. Given the testimony presented above, it is disconcerting that Countrywide continued this awkward posturing. Despite all of the errors made by Countrywide and its attorneys in the case at bar, Countrywide continues to leave the door open for collecting these fees.

5. The Motion was filed in violation of Fannie Mae guidelines

Schlotter testified that under Fannie Mae guidelines for loans serviced by Countrywide, [*170] a motion to lift stay should not be filed unless the debtor is 60 days delinquent. [Aug. 8, 2007 Hr'g Tr. 11:1-18.] Smith confirmed that Fannie Mae guidelines dictate that the Motion should not have been filed because the Debtor was not 60 days in default. [Aug. 8, 2007 Hr'g Tr. 149:10-16; Aug. 9, 2007 Hr'g Tr. 36:21-24.] Ortiz also testified that it was a mistake for Countrywide to refer the Debtor's file to McCalla Raymer because the Debtor was not 60 days delinquent. [Aug. 10, 2007 Hr'g Tr. 19:19-20:7; 85:4-14.]

From time to time during the hearing, Barrett Burke argued that even though the Motion should not have been filed under Fannie Mae guidelines, the Debtor was nevertheless one [**79] post-petition payment in arrears and that this fact was a sufficient legal basis for filing the Motion. [Dec. 12, 2007 Hr'g Tr. 22:18-19.] Indeed, in an attempt to justify his stating that the Motion was a "good motion," Thurmond had the following exchange with counsel for Barrett Burke:

> Counsel: Did the existence of one payment default have any impact on your assessment of the motion to the Court?
>
> Thurmond: Right. Yes, it did because if there was zero default, then it would have been a completely bad motion. If there's a default or multiple defaults, it's a different situation.
>
> [July 27, 2007 Hr'g Tr. 354:5-9.]

The Court is skeptical of Barrett Burke and Thurmond's attempt to disregard the Fannie Mae guidelines in order to justify filing the Motion with only one delinquent post-petition payment. Given that Barrett Burke--and, for that matter, McCalla Raymer--adhere to all other Fannie Mae guidelines, the justification articulated by Barrett Burke and Thurmond is less than compelling. The fact remains that the Debtor was only one payment in default, not three as alleged in the Motion, and Thurmond should have responded with a simple "yes" when the Court asked if the Motion contained inaccurate [**80] factual allegations. Additionally, Thurmond's later justification of his "good motion" answer is inconsistent with Fannie Mae policy. Thus, if all of the facts had been correctly stated in the Motion, it should not have been filed and was not a "good motion" under the very Fannie Mae guidelines followed by Barrett Burke.

6. The inaccurate factual allegations in the Motion

However, all the facts were not correctly stated in the Motion. Reilly conceded that the Motion contained inaccurate factual allegations because the payment history attached to the Motion failed to account for the Debtor's November 9, 2005 payment, May 6, 2006 payment, and December 13, 2006 payment. [July 27, 2007 Tr. 108:7-19; *see also* 112:20-113:17.] Likewise, Sanov testified that the payment history attached to the Motion was neither accurate nor current despite the representation in the Motion that "the attached payment history is a current payment history reflecting all payments, advances, charges, and credits from the beginning of the loan." [July 27, 2007 Hr'g Tr.

Barrett Burke's counsel also argued that this Court should not impose sanctions because the conduct called into question by this Court's Show Cause Orders an isolated incident of human error that is not commonplace. "Your Honor, the other observation that I would make is that if, in fact, the system is so egregious and so inadequate and so imperfect and so, fraught with errors, wouldn't we see it everywhere? Wouldn't we see the mistakes in every case, in every court, in every jurisdiction? And yet, we don't." [Dec. 12, 2007 Hr'g Tr. 149:13-17.] This Court begs to differ, both as to the consumer practice in general and Barrett Burke in particular.

Less than a year ago, the Honorable Wesley W. Steen, Chief Bankruptcy Judge for the Southern District of Texas, imposed sanctions of $ 150,000.00 against Barrett Burke as a result of its committing numerous mistakes related to a motion to lift in a Chapter 13 case. *In re Allen, 2007 Bankr. LEXIS 2063 (Bankr. S.D. Tex. June 18, 2007).* [30] Applying the factors set forth by the Fifth Circuit in *Topalian v. Ehrman, 3 F.3d 931 (5th Cir. 1993)*, Judge Steen noted that the [*175] conduct of Barrett Burke sought to be deterred by the sanction was, among [**93] other things, "the filing of pleadings with the court that are clearly wrong (even contrary to the information in Barrett Burke's own files) or that otherwise are not thoughtful, considered, and intelligible." *2007 Bankr. LEXIS 2063, [WL] at *6.*

> 30 This amount was remitted in half "because Barrett Burke recognizes the gravity of its actions and takes responsibility for those actions" and Barrett Burke had taken actions to correct its deficiencies. *Allen, 2007 Bankr. LEXIS 2063, at *43.* Such actions included implementing extra levels of document review and hiring former Bankruptcy Judge Bill Brister as an independent auditor. *2007 Bankr. LEXIS 2063, [WL] at *28.*

Thereafter, Judge Steen reviewed another factor from *Topalian:* what is the least severe sanction adequate to achieve the purpose of the rule under which it was imposed? He noted that answering this question requires review of several factors, including whether the improper conduct was part of a pattern of activity or an isolated event. *2007 Bankr. LEXIS 2063, [WL] at *7.* He then spent several pages discussing eight consumer cases in which Barrett Burke's conduct was woefully deficient. *2007 Bankr. LEXIS 2063, [WL] at *9-25.* In five of these instances, Barrett Burke filed motions to lift stay that contained inaccurate allegations [**94] about the debtors' payment defaults and/or failed to attach basic documentation such as the promissory note. *In re Thompson, Case No. 01-10399, 2003 Bankr. LEXIS 2197 (Bankr. N.D. Tex. 2003)*; *In re Smith,* Case No. 04-41212 (Bankr. S.D. Tex. 2004); *In re Gaytan,* Case No. 04-50242 (Bankr. S.D. Tex. 2005); *In re Clansy,* Case No. 04-40504 (Bankr. S.D. Tex. 2005); *In re Cordova,* Case No. 04-50312 (Bankr. S.D. Tex. 2005). A sixth case involved Barrett Burke filing an agreed order which was materially contrary to the terms negotiated by counsel for the debtor and the Barrett Burke attorney. *In re Davis, Case No. 02-10389, 2003 Bankr. LEXIS 1583 (Bankr. N.D. Tex. 2003).* A seventh case involved Barrett Burke filing a proof of claim with no supporting documents. *In re Anderson, 330 B.R. 180 (Bankr. S.D. Tex. 2005).* [31] The eighth case involved Barrett Burke submitting fee statements to the Court that, contrary to the testimony of the Barrett Burke attorney who sought to prove them up as business records, were actually non-contemporaneously-kept timesheets prepared in anticipation of litigation. *In re Porcheddu, Case No. 05-40177, 338 B.R. 729 (Bankr. S.D. Tex. 2006).* After reviewing all of these [**95] error-laden examples, Judge Steen quite reasonably concluded that "the improper conduct [in *Allen]* was part of a pattern of activity and that Barrett Burke has been warned numerous times to correct its deficiencies." *2007 Bankr. LEXIS 2063, [WL] at *9.*

> 31 Thurmond was the Barrett Burke attorney involved in *Anderson.* The Court, in denying the mortgagee's motion to vacate an order sustaining the debtor's objection to proof of claim, noted that Thurmond was not as diligent as he should have been in representing the mortgagee. *Anderson, 330 B.R. at 187.*

This Court is at a loss to understand how Barrett Burke's counsel--who, it should be noted, was also Barrett Burke's counsel in *Allen*--could suggest that the mistakes made in the case at bar are an isolated incident. As shown in *Allen,* Barrett Burke has repeatedly made the same kind of mistakes as those in the case at bar within the Southern District of Texas.

To the extent that the remarks of Barrett Burke's counsel were intended to suggest that the conduct in the case at bar has not been called into question in

payment history which was then forwarded to Barrett Burke. There was also a lack of candor to the Court: Thurmond's statement that "it was a good motion" was as deceptive as S&D's filing of certifications signed by an individual who was no longer employed by that law firm. Here, as in the three cases cited above, the partners at Barrett Burke and McCalla Raymer have not sufficiently supervised their associates and established sufficient controls to assure that professional standards are maintained.

In sum, there are published opinions from New Jersey, South Carolina, and Louisiana evidencing substantial and material errors in motions to lift stay filed by law firms representing mortgagees in consumer bankruptcies in several states. Contrary to the suggestion of Barrett Burke's counsel, there are [**100] mistakes similar to the ones in the case at bar occurring in jurisdictions throughout the country.

V. Actions to be taken by this Court as a result of the hearings on the Show Cause Orders

A. The Show Cause Orders were issued pursuant to *11 U.S.C. § 105(a)* and the Court's inherent power and were not in the nature of either civil or criminal contempt

The Court issued the First Show Cause Order under its inherent power "pursuant to *Chambers v. NASCO, 501 U.S. 32, 111 S. Ct. 2123, 115 L Ed. 2d 27 (1991)*, and *11 U.S.C. § 105(a)*." *Section 105(a)* states:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

In *Chambers,* the Supreme Court recognized that courts have an inherent power to issue sanctions against litigants for their bad-faith conduct. *Chambers, 501 U.S. at 43-46*. Although *Chambers* involved a district court, the inherent [**101] powers described by the Supreme Court "are equally applicable to the bankruptcy court." *In re Case, 937 F.2d 1014, 1023 (5th Cir. 1991)*. The limits on a bankruptcy court's power to sanction under its inherent powers and *§ 105(a)* are essentially coterminous. *Caldwell v. Unified Capital Corp. (In re Rainbow Magazine, Inc.), 77 F.3d 278, 284 (9th Cir. 1996)* ("By providing that bankruptcy courts could issue orders necessary 'to prevent an abuse of process,' Congress impliedly recognized that bankruptcy courts have the inherent power to sanction that *Chambers* recognized exists within Article III courts."); *In re Courtesy Inns, Ltd., Inc., 40 F.3d 1084, 1089 (10th Cir. 1994)* ("We believe, and hold, that *§ 105* intended to imbue the bankruptcy courts with the inherent power recognized by the Supreme Court in *Chambers.")*.

It is undisputed that, within the Fifth Circuit, a bankruptcy court lacks [*178] criminal contempt power. *Placid Ref. Co. v. Terrebonne Fuel & Lube (In re Terrebonne Fuel & Lube), 108 F.3d 609, 613 n.3 (5th Cir. 1997)*. Barrett Burke mistakenly argues that these proceedings have been in the nature of criminal contempt. Therefore, Barrett Burke argues that this Court lacked jurisdiction [**102] throughout the entire duration of these proceedings. This argument is based upon the incorrect assumption that the Show Cause Orders relied upon the Court's contempt power. Neither of the two Show Cause Orders ever mentions contempt nor do they seek to enforce any order of the Court. The power to issue the Show Cause Orders and conduct the hearings in this matter were solely derived from *§ 105(a)* and the inherent power of the Court to regulate the parties before it. *See Chambers, 501 U.S. at 46* (noting that inherent powers can be used without resorting "to the more drastic sanctions available for contempt of court."). Thus, Barrett Burke's argument that the Court lacks jurisdiction is without merit.

In its post-hearing brief, Countrywide argued that: "The issues regarding Countrywide in this Show Cause Proceeding are governed by *Rule 9011*. Because the Motion was withdrawn before the Show Cause Order was entered, Countrywide cannot be monetarily sanctioned for filing the Motion." [Docket No. 231, p. 2.] Barrett Burke made a similar argument. [Docket No. 232, pp.26-35.] This argument is apparently derived from the following language in *Chambers:* "when there is bad-faith conduct in the [**103] course of litigation that could be adequately sanctioned under the Rules, the court ordinarily should rely on the Rules rather than the

his past misbehavior.

The case at bar is not the first time Thurmond has engaged in bad faith conduct in the Southern District of Texas. *See In re Porcheddu, 338 B.R. 729 (Bankr. S.D. Tex. 2006)*. In *Porcheddu,* Bankruptcy Judge Marvin Isgur, after issuing a show cause order, imposed sanctions against Barrett Burke and one of its attorneys, R.J. Bryant, for intentionally and dishonestly submitting fee statements that were not kept contemporaneously as required by applicable Fifth Circuit case law. Indeed, part of the dishonest conduct involved misleading or downright false testimony and representations made by Thurmond. Set forth below is how Judge Isgur characterized Thurmond's statements:

> In closing arguments, Barrett Burke took solace in Mr. Thurmond's carefully chosen words on October 7, 2004. His statement was only that the task records were contemporaneous, not that the corresponding time entries were contemporaneous. Notably, he did not affirmatively advise the Court that the fee statement's time entries were made after-the-fact. Thurmond described the fee statement as a "summary" [**112] of Barrett Burke's records; it was not a summary. The fee statement included the task entries (which were contemporaneous and were summarized from the firm's records) but also included time entries that had not previously existed at all. It is not possible to create a summary from non-existent records. The inclusion of new information--not captured in Barrett Burke's records--makes the document something other than a summary. Instead, it is a document prepared for the purposes of litigation. In this case, it was a document prepared for litigation for the purpose of avoiding the hearsay rule. *Far from meeting a duty of candor to the Court, Thurmond's October 7, 2004 statement appears to have been intended to misdirect the Court. That sleight of hand was carried forward for a year and culminated in Bryant's false testimony on October 21, 2005.*
>
> *Porcheddu, 338 B.R. at 733* (emphasis added).

Judge Isgur's description of Thurmond's conduct is identical to his conduct in the case at bar. Just as he deliberately failed to make complete disclosures of the facts regarding Barrett Burke's timesheets to Judge Isgur, Thurmond intentionally refused to make full disclosure concerning the accuracy of [**113] the Motion's allegations to the undersigned judge. Thurmond attempted to misdirect Judge Isgur by not affirmatively advising him that Barrett Burke's time entries were created after-the-fact. [35] Similarly, Thurmond attempted [*182] to mislead the undersigned judge by advising him that the Motion was "good," which did not answer the actual question posed by the Court.

> 35 The Court notes that Judge Isgur did not impose sanctions against Thurmond, but only against Bryant and Barrett Burke. The reason that he did not do so is that when he issued his show cause order, he named only Bryant and Barrett Burke as the subjects of the order--no doubt due to his belief at the time of the issuance of the order that Bryant was the only attorney whose conduct needed to be scrutinized. The language in Judge Isgur's written opinion about Thurmond's conduct leaves little doubt that if Thurmond's name had been set forth in the show cause order, Judge Isgur would have imposed sanctions against him. Indeed, Judge Isgur wrote that "Although the Court's analysis of the sanctions identifies other persons employed by Barrett Burke, only Bryant and Barrett Burke were the subjects of this Court's show cause order. Accordingly, [**114] the Court has not considered sanctions against any other person." *Porcheddu, 338 B.R. at 732*. In short, Judge Isgur was properly concerned about lack of due process to Thurmond and therefore did not impose sanctions against him. In the case at bar, this Court has no such due process concerns, as both the First Show Cause Order and the Second Show Cause Order put Thurmond on notice that it was scrutinizing his conduct. Moreover, Thurmond was represented by competent counsel in the case at bar.

However, "[b]ecause of their very potency, inherent powers must be exercised with restraint and discretion."

and appearing in court without properly preparing for the hearings. These lawyers appear in court with little or no knowledge because they have been poorly trained. Indeed, the case at bar shows that the attorneys from Barrett Burke and McCalla Raymer often appear in court ill-prepared to think or effectively communicate.

This fixed-fee business model appears to have been an overwhelming financial success. In *Allen,* Bankruptcy Judge Steen noted that Barrett Burke's revenues totaled between approximately $ 9.7 million and $ 11.6 million per annum. *Allen, 2007 Bankr. LEXIS 2063 at *42*. Based upon the testimony at the show cause hearings, this Court estimates that McCalla Raymer has generated revenues of approximately $ 28 million over the past decade from representing solely Fannie Mae. [37] Meanwhile, [**119] the profession [*184] has suffered from the ever decreasing standards that firms like Barrett Burke and McCalla Raymer have heretofore promoted.

> 37 Thomas testified that McCalla Raymer made approximately 140,000 referrals under the Fannie Mae program (which included Countrywide, among other servicers) over the past ten years. [Aug. 7, 2007 Hr'g Tr. 43:5-11.] When one multiplies 140,000 times $ 200 (i.e. the net amount received by McCalla Raymer), the result is $ 28 million--substantial revenues, particularly for a firm with relatively few partners. Aside from Thomas' testimony, Smith testified that McCalla Raymer's revenues from all Countrywide referrals (as opposed to just Fannie Mae files) on an annual basis total approximately $ 10,440,000.00. [Aug. 9, 2007 Hr'g Tr. 261:19-24.]

This demise must stop. The problems at Barrett Burke and McCalla Raymer are not limited to training lawyers; there are other aspects of these firms' culture that is disconcerting. What kind of culture condones a firm signing an engagement letter which prevents its attorneys from communicating with its client? What kind of culture condones its lawyers preparing, signing, and filing motions to lift stay without having [**120] the client review the final version for accuracy? What kind of culture condones its attorneys signing proofs of claims without even contacting the client to review and confirm the debt figures? What kind of culture condones attorneys testifying to basic facts and then, at the next hearing, recanting the testimony on the grounds that the attorney had not sufficiently prepared to testify? And above all else, what kind of culture condones its lawyers lying to the court and then retreating to the office hoping that the Court will forget about the whole matter?

Countrywide's corporate culture is no better. What kind of culture condones blockading personnel from communicating with outside counsel? What kind of culture discourages the checking of outside counsel's work? What kind of culture promotes payment histories that are so confusing to the vast majority of persons, including attorneys and judges--not to mention borrowers--that it becomes necessary for legal assistants to "simplify" them--leading to more errors and confusion?

Barrett Burke and McCalla Raymer complain that this Court expects perfection from the attorneys who appear in this Court. While perfection is too much to demand, [**121] preparedness and candor are not. The vast majority of attorneys who appear in this Court easily meet these standards. There is no reason why the attorneys from Barrett Burke and McCalla Raymer cannot do the same.

With respect to Countrywide, this Court would hope that this entity would reevaluate its policies and procedures in order to improve upon the accuracy of payment histories and to ensure that its actions do not undermine the integrity of the bankruptcy system. Countrywide's business is directly tied to a quintessentially American aspiration--homeownership. If Countrywide does not properly maintain payment histories and effectively communicate with its counsel, the consequences can be very harmful. As Professor Porter has noted: "Mortgage servicing abuse weakens families' efforts to manage their mortgages successfully and can result in families being wrongfully deprived of their homes through foreclosure or unsuccessful outcomes in bankruptcy. Mortgagees' failure to honor the terms of their loans and applicable law weakens America's homeownership policies and threatens families' financial well-being." Katherine Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims,* U. [**122] of Iowa Legal Studies Research Paper No. 07-29, Nov. 6, 2007, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1027961.

This Court trusts that Barrett Burke, McCalla Raymer, and Countrywide will mend their broken practices. The Court [*185] will continue to verify that its trust is well-placed.

Name	Description	Dates testified
	13 Trustee for the Northern District of Georgia.	
Walter	Former Barrett Burke associate who appeared at	July 27; Aug.
Thurmond	the final hearing on February 6, 2007 to withdraw	
	the Motion.	10

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1 Set [**123] forth above are the names of the witnesses to whom this Court refers in its Memorandum Opinion. Several other witnesses also testified, but their names are not referenced in the Memorandum Opinion and therefore they are not identified in this addendum.

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF LOUISIANA

WELLS FARGO BANK, N.A., f/k/a WELLS FARGO HOME MORTGAGE, INC.	**CIVIL ACTION**
VERSUS	**NO. 07-3599 & CONSOLIDATED CASES**
MICHAEL L. JONES	**SECTION "C" (2)**
	BANK. NO.: 03-16518 "A"
	ADV. NO.: 06-01093

ORDER AND REASONS

This consolidated matter comes before the Court on appeal from the Bankruptcy Court. Wells Fargo Bank, N.A. f/k/a Wells Fargo Home Mortgage, Inc. ("Wells Fargo") has filed eight (8) Notices of Appeal, or Motions Seeking Leave to Appeal in this matter.[1] In the interests of judicial efficiency, the Court has consolidated these appeals, and asked the parties to submit omnibus briefs addressing all of the issues raised in the individual appeals.[2] Having considered

[1] Case Numbers 07-3599, 07-7993, 07-7994, 07-7995, 07-7996, 07-7997. 07-7998, and 07-9229. In addition, Wells Fargo filed a Motion to Stay Judgment Pending Appeal, case no. 07-3973.0

[2] Wells Fargo requested permission to file a 146 page brief, Rec. Doc. 33, which was granted. Unfortunately, much of that brief was excessively redundant and unduly hyperbolic, raising some issues that were borderline frivolous and at times mischaracterized the facts and the

the parties briefs, exhibits and the applicable law, the Court AFFIRMS IN PART, AND REVERSES IN PART the Bankruptcy Court's rulings.

I. BACKGROUND

On August 26, 2003, this matter originated in Bankruptcy Court when Michael L. Jones, the debtor-appellee ("Jones"), filed for Chapter 13 relief. Jones's bankruptcy petition automatically stayed Wells Fargo's pending mortgage foreclosure action. However, Wells Fargo did not dismiss the foreclosure suit.[3] As part of the bankruptcy action, Wells Fargo filed a proof of claim reflecting pre-petition arrearage of $22,259.69.[4] Jones's Chapter 13 plan provided that Jones was to make all future monthly mortgage payments directly to Wells Fargo, while a Chapter 13 Trustee was to make payments on Wells Fargo's pre-petition arrearage claim. In addition, the plan provided for 100% payment to all unsecured creditors. The plan was confirmed by the Bankruptcy Court on October 28, 2003.

On November 1, 2003, Jones suffered a heart attack and missed payments both to the Trustee under the plan and mortgage payments to Wells Fargo. The Bankruptcy Court extended the term of Jones's plan by three months to compensate for the missed plan payments. In addition, and under a Consent Order with Wells Fargo, Jones agreed to pay $9,348.22 directly to Wells Fargo to cure the post-petition default on his mortgage.[5] Following the Consent Order, Jones made payments to both the Trustee and Wells Fargo; the Trustee forwarded payments to

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law. This voluminous and unnecessary briefing made it all the more difficult to separate the wheat from the chafe.

[3] *In re Jones*, 366 B.R. 584, 586 (Bkrtcy.E.D.La. 2007).

[4] Rec. Doc. 48, Exhibit A.

[5] *In re Jones*, 366 B.R. at 587.

Wells Fargo to cover the pre-petition arrearage.

In the summer of 2005, Jones requested authorization to refinance his mortgage. Jones attempted to use the equity in his house to satisfy his debt to Wells Fargo and all of his unsecured creditors.[6] Due to Hurricane Katrina, a hearing on the motion to refinance the debt was not held until November 15, 2005. On December 7, 2005, the Bankruptcy Court approved Jones's request to refinance. On December 15, 2005, Jones requested a payoff statement of the amounts due to Wells Fargo. On January 3, 2006, Wells Fargo faxed an itemized payoff statement, indicating a payoff balance of $231,463.97.

Jones asserts that he disagreed with the amount listed on the payoff statement, specifically the $6,741.67 for Sheriff's Commissions. Yet, the new loan could not be closed without a release of the Wells Fargo mortgage, and the mortgage would not be released by Wells Fargo unless it received its payoff demand. Thus, Jones remitted the entire $231,463.97 to Wells Fargo, even though this left insufficient funds to satisfy Jones's remaining obligations under his plan.

After closing, Jones received a letter from Wells Fargo, dated January 12, 2006, indicating that Wells Fargo had collected sums in excess of the amount necessary to satisfy the debt, and that Wells Fargo would refund Jones's overpayment in about 15 days.[7] Jones did not receive reimbursement within 15 days. On March 30, 2006, Jones filed an adversary action

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[6] Jones's request to refinance was based on a commitment from Option One to lend $275,000. According to the Bankruptcy Court, $275,000 was an amount sufficient to satisfy the costs of refinancing, the outstanding claims of Wells Fargo, and the remaining obligations due under his plan. *In re Jones*, 366 B.R. at 587.

[7] *In re Jones*, 366 B.R. at 588.

against Wells Fargo to recover the overpayment. On April 20, 2006, Wells Fargo deposited $7,598.64 in the registry of the Bankruptcy Court pending the outcome of the adversary proceeding. Following a trial, the Bankruptcy Court found that Wells Fargo misapplied funds between pre- and post-petition debts, which violated the terms of Jones's plan.

In a "Memorandum Opinion" dated April 13, 2007, the Bankruptcy Court held that Wells Fargo erred by: (1) miscalculating pre-petition debt; (2) assessing additional pre-petition charges, without amending the proof of claim; (3) miscalculating post-petition debt by misallocating payments to pre- and post-petition debt, thereby increasing interest charges over the life of the plan; (4) assessing unauthorized post-petition fees and charges.[8]

Based on these findings, the Bankruptcy Court concluded that Wells Fargo violated the Bankruptcy Code's automatic stay. *In re Jones*, 366 B.R. at 600. Furthermore, the Bankruptcy Court held that Jones was entitled to recover "actual damages" under § 362(h) of the Bankruptcy Code.[9] Finally, the Bankruptcy Court scheduled a subsequent hearing to determine the appropriateness of sanctions against Wells Fargo. *Id.* at 604.[10]

On April 23, 2007, Wells Fargo filed a motion to reconsider the Judgment. The Bankruptcy Court denied the motion to reconsider on May 1, 2007. *In re Jones*, 2007 WL 1302549 (Bkrtcy.E.D.La. 2007). Specifically, the Bankruptcy Court found no grounds for reconsideration because "the application of estate property to undisclosed fees and charges was

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[8] *In re Jones*, 366 B.R. at 591-98.

[9] The Bankruptcy Court ordered Wells Fargo to remit $16,852.01 to Jones.

[10] The Bankruptcy Court entered a "Judgment" upon the record on April 13, 2007. In addition to ordering reimbursement, the Judgement noted, "[t]he Court will hold an evidentiary hearing on the propriety of a sanction award on May 16, 2007, at 2:00 p.m."

an unrefuted fact." *Id.* at *2.

Wells Fargo filed a Notice of Appeal from the April 13, 2007 "Judgment" with this Court on May 10, 2007.[11] Yet, proceedings continued in the Bankruptcy Court. On May 29, 2007, the Bankruptcy Court conducted an evidentiary hearing to determine whether sanctions were appropriate against Wells Fargo. At the hearing, counsel for Wells Fargo represented that Wells Fargo was willing to enter into a Consent Order regarding a change in their business and accounting practices to ensure that other debtors would be properly treated, in lieu of punitive damages.[12] However, Wells Fargo's consent to enter a Consent Order is an issue on appeal.

Wells Fargo filed a Motion to Submit Additional Evidence or Reopen the Evidence on July 24, 2007.[13] In the Motion to Reopen, Wells Fargo argued that the April 13, 2007 Judgment was a final judgment, but that they should be allowed to submit a payoff statement, dated July 21, 2005, to contradict part of Jones's testimony at the trial. Specifically, Wells Fargo claimed that the July 2005 payoff statement would undermine Jones's testimony regarding the date that Wells Fargo provided the payoff information. The Bankruptcy Court denied the Motion to Reopen, holding that evidence regarding the date on which the payoff letter was transmitted would provide, "at best," minimal probative value of the underlying sanctionable conduct: the misapplication and miscalculation of payments, fees, and charges.[14]

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[11] Case No. 07-3599.

[12] Bankruptcy Case No. 06-01093, Rec. Doc. 126, Transcript of Hearing Held may 29, 2006, p. 80-83.

[13] Bankruptcy Case No. 06-01093, Rec. Doc. 121.

[14] *Id.*, Rec. Doc. 137. The Bankruptcy Court also found that Wells Fargo had not met any of the factors in *Garcia v. Woman's Hospital of Texas*, 97 F.3d 810 (5th Cir. 1996) to admit new evidence.

On August 13, 2007, Wells Fargo filed a Motion to Vacate the Judgment.[15] Wells Fargo argued that Jones failed to disclose a pending lawsuit against the maker of Vioxx in violation of the debtor's duty to notify the court of any pending or potential lawsuit in which the debtor was a plaintiff.[16] On that basis, Wells Fargo asserted that the April 13, 2007 Judgment must be vacated, and that all claims against Wells Fargo be dismissed. On August 20, 2007, the Bankruptcy Court denied the Motion to Vacate, stating that the failure to disclose the Vioxx lawsuit was not material to "Wells Fargo's actions that violated the automatic stay and confirmation order; its misapplication and miscalculation of payments, fees, charges, and the interest rate." Bankruptcy Case No. 06-01093, Rec. Doc. 143.

On August 22 and 23, 2007, Wells Fargo entered four (4) Notices of Appeal and two (2) Motions for Leave to Appeal in the Bankruptcy Court record.[17] The Bankruptcy Court promulgated an Amended Judgment on August 29, 2007.[18] The Amended Judgment awarded $67,202.45 to Jones as damages and sanctions against Wells Fargo.[19] In addition, the Amended Judgment ordered Wells Fargo to implement new accounting procedures.[20] A Second Amended Judgment was entered in the record on September 14, 2007 to correct clerical error.[21]

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[15] Bankruptcy Case No. 06-01093, Rec. Doc. 138.

[16] Bankruptcy Case No. 06-01093, Rec. Doc. 138, p. 3.

[17] Bankruptcy Case No. 06-01093, Rec. Docs. 145, 146, 147, 149, 150, and 151.

[18] Bankruptcy Case No. 06-01093, Rec. Doc. 154.

[19] *Id*.

[20] *Id*.

[21] Bankruptcy Case No. 06-01093, Rec. Doc. 183. The Second Amended Judgment states, "This Judgment is being entered to change the word 'inspections' to 'insurance' in the

In this matter, Wells Fargo has filed a total of eight (8) appeals. The case numbers for the appeals are: 07-3599, 07-7993, 07-7994, 07-7995, 07-7996, 07-7997, 07-7998, and 07-9229. The Court notes that the issues presented in these appeals substantially overlap.[22] Indeed, 07-7993 and 07-7997 are duplicates in terms of the issues presented, just as 07-7996 and 07-7998

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third sentence of paragraph two in the accounting procedures."

[22] Case No. 07-3599 is an appeal both from (1) the Bankruptcy Judgment filed April 13, 2007; (2) the Order denying motion to reconsider, filed May 1, 2007.

Case No. 07-7993 is an appeal from the Bankruptcy Judge's Order denying Wells Fargo's Motion to Strike a "non-party" response, filed August 13, 2007 (filed as an appeal "as of right").

Case No. 07-7994 appeals: (1) the Bankruptcy Judgment, filed April 13, 2007; (2) the Order denying motion to reconsider, filed May 1, 2007; (3) the Amended Judgment, filed Aug. 29, 2007; (4) the Order partially granting motion to alter or amend the Judgment, filed Sept. 14, 2007; (5) the Second Amended Judgment, filed Sept. 14, 2007; (6) the Order, filed Sept. 14, 2007; (7) the Amended Order, filed Sept. 24, 2007.

Case No. 07-7995 appeals the Bankruptcy Judge's Order denying Wells Fargo's motion for relief from judgment, filed August 20, 2007.

Case No. 07-7996 appeals the Bankruptcy Judge's Order denying Wells Fargo's Motion for leave to submit additional evidence or alternatively, to re-open the evidence, filed August 13, 2007 (filed as an appeal "as of right").

Case No. 07-7997 appeals the Bankruptcy Judge's Order denying Wells Fargo's Motion to Strike a "non-party" response, filed August 13, 2007 (filed as a "motion for leave to appeal").

Case No. 07-7998 appeals the Bankruptcy Judge's Order denying Wells Fargo's Motion for leave to submit additional evidence or alternatively, to re-open the evidence, filed August 13, 2007 (filed as a "motion for leave to appeal").

Case No. 07-9229 appeals the Bankruptcy Judge's decision to stay only part of that court's judgment pending appeal. Wells Fargo argues that the Bankruptcy Judge only had authority to set the amount of the supersedeas bond, not to parse the effectiveness of the stay against the monetary and non-monetary aspects of the judgment.

are duplicates.[23] The difference between these appeals is their designation as "appeals of right" vs. "motions for leave to appeal." Under the Bankruptcy Rules, a district court may entertain appeals from interlocutory orders of the bankruptcy courts, if leave is granted.[24]

II. STANDARD OF REVIEW

The Fifth Circuit has consistently held that the standard of review applicable to bankruptcy appeals in a district court is the same as the standard applied by a Court of Appeals to a district court proceeding. *In re Killebrew*, 888 F.2d 1516, 1519 (5th Cir. 1989). Furthermore, Bankruptcy Rule 8013 requires that a bankruptcy court's findings of fact are subject to clearly erroneous review. Fed. R. Bankr. P. 8013; *see also, In re Multiponics, Inc*., 622 F.2d 709, 713 (5th Cir. 1980). Conclusions of law, on the other hand, are reviewed *de novo*. *Id.*; *Killebrew*, 888 F.2d at 1519.

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[23] See n. 2, *supra*.

[24] Generally, a district court should grant leave sparingly, "since interlocutory bankruptcy appeals should be the exception, rather than the rule." *United States Trustee v. PHM Credit Corp*. (*In re PHM Credit Corp*.), 99 B.R. 762, 767 (E.D. Mich. 1989). Regarding appeals, the Bankruptcy Code states:

> (a) The district courts of the United States shall have jurisdiction to hear appeals
> (1) from final judgments, orders, and decrees;
> (2) from interlocutory orders and decrees issued under section 1121(d) of title 11 increasing or reducing the time periods referred to in section 1121 of such title; and
> (3) with leave of the court, from other interlocutory orders and decrees;
>
> and, with leave of the court, from interlocutory orders and decrees, of bankruptcy judges entered in cases and proceedings referred to the bankruptcy judges under section 157 of this title. An appeal under this subsection shall be taken only to the district court for the judicial district in which the bankruptcy judge is serving.

28 U.S.C. § 158(a).

III. LAW & ANALYSIS

As an initial matter, the Court must determine whether the orders appealed from in cases 07-7993, 07-7996, 07-7997, and 07-7998 are interlocutory. Again, the court notes that the issues presented in 07-7993 and 07-7997 are identical, just as the issues in 07-7996 mirror those in 07-7998. In 07-7993 & 07-7997, Wells Fargo seeks review of the Bankruptcy Court's dismissal of Wells Fargo's motion to strike a non-party pleading. And, in 07-7996 & 07-7998 Wells Fargo seeks review of the Bankruptcy Court's decision to deny its motion for leave to submit additional evidence or alternatively, to re-open the evidence.

An interlocutory appeal is one that occurs "before the trial court's final ruling on the entire case." BLACK'S LAW DICTIONARY 106 (8th ed. 2004). In these appeals, Wells Fargo is seeking review of orders entered before a final ruling was entered. Clearly, an order denying a motion to strike is entered before a court's final ruling on the entire case; similarly, an order denying the submission of additional evidence occurs before a court's final ruling. Thus, Wells Fargo is seeking interlocutory appeals.

As noted above, an appeal from an interlocutory order under 28 U.S.C. § 158(a) may be taken only with the leave of the district court. Unfortunately, the Bankruptcy Code does not contain any standards to govern whether leave should be granted. 10 COLLIER ON BANKRUPTCY ¶ 8003.03 (15th ed. rev. 2007). Thus, the standard of 28 U.S.C. § 1292(b), which governs the appeal of interlocutory orders from district courts to courts of appeals, is borrowed. *Id.* Section 1292(b) states:

> When a district judge, in making in a civil action an order not otherwise appealable under this section, shall be of the opinion that such order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance

> the ultimate termination of the litigation, he shall so state in writing in such order. The Court of Appeals which would have jurisdiction of an appeal of such action may thereupon, in its discretion, permit an appeal to be taken from such order, if application is made to it within ten days after the entry of the order: Provided, however, that application for an appeal hereunder shall not stay proceedings in the district court unless the district judge or the Court of Appeals or a judge thereof shall so order.

28 U.S.C. § 1292(b).

In *Rico v. Flores*, 481 F.3d 234, 238 (5th Cir. 2007), the Fifth Circuit stated that "Title 28, § 1292(b) of the United States Code permits a court to certify an interlocutory appeal where (1) a controlling question of law is involved, (2) there is substantial ground for difference of opinion about the question of law, and (3) immediate appeal will materially advance the ultimate termination of the litigation." In *U.S. v. Garner*, the Fifth Circuit held that "[t]he purpose of § 1292(b) is to provide for an interlocutory appeal in those exceptional cases" where the three part test is satisfied. *U.S. v. Garner*, 749 F.2d 281 (5th Cir. 1985).

In this matter, interlocutory appeals regarding a dispute over a motion to strike and a denial of a request to submit additional evidence does not satisfy the *Flores* test for appealability. Additionally, the interlocutory appeals present no exceptional circumstances. *United States Trustee v. PHM Credit Corp.* (*In re PHM Credit Corp.*), 99 B.R. 762, 767 (E.D. Mich. 1989). Therefore, Wells Fargo's Motions to appeal as of right in 07-7993 and 07-7996 are improperly designated. Additionally, the Court exercises its discretion to deny defendants' request for leave to appeal in 07-7997 and 07-7998. Merely for completeness, the issues in these appeals are addressed below.

1. Motion to Vacate

Wells Fargo's first argument is that Jones violated an affirmative duty to disclose a pending lawsuit during his bankruptcy. Wells Fargo asserts that Jones concealed a suit regarding Vioxx, and thus, the Bankruptcy Court abused its discretion in denying Wells Fargo's Rule 60 motion to vacate the April 13, 2007 judgment. Wells Fargo initially relies on *In re Superior Crewboats*, 374 F.3d 330 (5th Cir. 2004)[25] and *In re Coastal Plains, Inc*., 179 F.3d 197 (5th Cir. 1999) as examples of cases in which debtors failed to disclose personal injury claims.

In response to the motion to vacate, the Bankruptcy Court held that non-disclosure of the Vioxx suit was not material to the April 13, 2007 judgment, and thus, refused to vacate the judgment. Wells Fargo, relying on *Rozier v. Ford Motor Co*., 573 F.2d 1332 (5th Cir. 1978) as Fifth Circuit precedent, asserts that Rule 60 applies to misconduct in withholding information, even when the information is not material, or would not alter the result of a case.[26] In addition, Wells Fargo notes the similarity between the claims that Jones posited against both Merck, the maker of Vioxx, and Wells Fargo, including "mental anguish" and "medical expenses." Wells Fargo argues that Jones's failure to disclose the Vioxx lawsuit precluded Wells Fargo from presenting an affirmative defense.

Furthermore, Wells Fargo argues that the Bankruptcy Court abused its discretion in denying the Rule 60 motion to vacate without conducting an evidentiary hearing. Wells Fargo notes that when a "cognizable claim" was alleged in a Rule 60 motion, the Eighth Circuit

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[25] *In re Superior Crewboats* discussed the application of judicial estoppel to bar debtors from pursuing a personal lawsuit after failing to disclose the claim in bankruptcy court.

[26] In *Rozier,* the defendant, Ford Motor Co., withheld discoverable materials, in violation of Rule 26. The *Rozier* court held that Ford prejudiced the plaintiff because the concealed material would "have made a difference in the way plaintiff's counsel approached the case or prepared for trial." *Rozier*, 573 F.2d at 1342.

reversed a trial court for denying a Rule 60 motion without a hearing.[27]

The Bankruptcy Court did not abuse its discretion by denying Wells Fargo's Rule 60(b) Motion to Vacate. "The purpose of Rule 60(b) is to balance the principle of finality of a judgment with the interest of the court in seeing that justice is done in light of all the facts." *Hesling v. CSX Transp., Inc*., 396 F.3d 632, 638 (5th Cir. 2005). The grant or denial of a motion to vacate a judgment under Rule 60(b) is within the sound discretion of the trial court, and will only be reversed upon a showing of abuse of this discretion. *Blois v. Friday*, 612 F.2d 938, 940 (5th Cir. 1980). A party seeking relief under Rule 60(b)(3) based on fraud, misrepresentation, or other misconduct "must establish (1) that the adverse party engaged in fraud or other misconduct, and (2) that this misconduct prevented the moving party from fully and fairly presenting his case." *Hesling,* 396 at 641 (citing *Gov't Fin. Servs. One Ltd. P'ship v. Peyton Place*, 62 F.3d 767, 772 (5th Cir. 1995)).

Wells Fargo's argument, based on *Rozier v. Ford Motor Co.*, 573 F.2d 1332, 1339 (5th Cir. 1978), is not convincing. *Rozier* merely re-states the second prong of the *Hesling* test; yet, Wells Fargo has not shown that Jones's failure to disclose his Vioxx lawsuit prevented a full and fair presentation of Wells Fargo's case in the adversary proceeding. Wells Fargo cites language from *Rozier* to argue that the Bankruptcy Court should not have considered the "materiality" of the failure to disclose. Indeed, in *Hesling* the Fifth Circuit cites *Rozier* to distinguish the subsections of Rule 60: "Unlike Rule 60(b)(2), 60(b)(3) does not require that the information withheld be such that it can alter the outcome of the case." *Hesling*, 396 F.3d at 641. Yet, the Fifth Circuit in *Hesling* upheld the denial of a Rule 60(b)(3) motion because the withheld

[27] Wells Fargo cites *Kansas City Laborers Pension F. v. Paramount*, 829 F.2d 644 (8th Cir. 1987).

documents were irrelevant to the issue under consideration. *Hesling*, 396 F.3d at 642 (noting "the failure to produce the documents did not affect how Hesling's case was presented to the court"). Following the Fifth Circuit's determination in *Hesling*, a Rule 60(b)(3) determination must focus on the withheld information's impact at the beginning of a lawsuit.

In this case, it appears that Jones failed to disclose a suit that he filed against Merck, the manufacturer of Vioxx, in violation of his duty to disclose all assets under the Bankruptcy Code.[28] Even assuming that Jones violated the duty to disclose, and thus, triggered the first prong for relief under *Hesling*, the Court does not find that the Bankruptcy Judge abused her discretion by denying the Motion to Vacate. Simply, Wells Fargo has not demonstrated that the alleged misconduct prevented a full and fair presentation of its case.

Similar to the plaintiff in *Hesling*, Wells Fargo argues unconvincingly that the failure to disclose the Vioxx litigation precluded Wells Fargo from developing alternative defenses and arguments. It is undisputed that Jones's Vioxx suit alleged physical injury after ingesting the drug, while Jones's adversary proceeding against Wells Fargo alleged recovery overpayments and violations of the Bankruptcy Code's automatic stay. Even with the benefit of hindsight, Wells Fargo has not presented sufficient evidence to connect the Vioxx suit to an alternative trial strategy in the bankruptcy proceeding. Therefore, the Court concludes that Wells Fargo's lack of knowledge about the pending Vioxx suit did not prohibit a full and fair presentation of the issues surrounding the stay violation. Consequently, Wells Fargo was not entitled to relief under Rule 60(b)(3).

Furthermore, Wells Fargo's assertion that the Bankruptcy Court based its decision to

[28] Jones disputes that the duty to disclose encompassed his Vioxx suit because the cause of action arose post-petition.

deny the Motion to Vacate on an erroneous view of the law is unconvincing. Wells Fargo argues that the bankruptcy Court's language improperly focused on the Vioxx suit's hypothetical effect on the result of the proceeding: "Debtor's failure or neglect to disclose the Vioxx lawsuit is immaterial and would have no effect on the April 13, 2007 Judgment."[29] The Bankruptcy Court's characterization of the Vioxx suit as "immaterial," however, is not wholly incompatible with the *Hesling* standard. Again, the *Hesling* Court investigated whether the withheld information would have altered the uninformed party's trial preparation and presentation. *Hesling*, 396 F.3d at 641-42. The Bankruptcy Court's statement that the Vioxx case was "immaterial" is similar to stating that disclosure of the Vioxx case would not have affected Wells Fargo's trial presentation. Because Wells Fargo has not demonstrated a connection between the issues in the Vioxx case and the adversary proceeding, there is insufficient evidence to support Wells Fargo's position.

In addition, Wells Fargo's reliance on *In re Superior Crewboats, Inc*., 374 F.3d 330 (5th Cir. 2004) is misplaced. *Superior Crewboats* involved the application of judicial estoppel to prevent claimants from establishing a personal injury lawsuit following a bankruptcy case.[30] Therefore, *Superior Crewboats*' holding is not relevant to the adversary proceeding between Jones and Wells Fargo, but only to Jones's ability to recover in the Vioxx case. Finally, the Bankruptcy Court did not commit reversible error by failing to conduct an evidentiary hearing on

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[29] Bankruptcy Case No. 06-01093, Rec. Doc. 143.

[30] Essentially, *Superior Crewboats* holds that debtors cannot recover pre-petition personal injury claims if the debtors failed to disclose the cause(s) of action to their creditors during bankruptcy proceedings. *In re Superior Crewboats, Inc*., 374 F.3d at 335 (applying judicial estoppel because "omission of the personal injury claim from their mandatory bankruptcy filings is tantamount to a representation that no such claim existed.")

the Motion to Vacate because Wells Fargo did not present a cognizable claim under Rule 60.

2. $67,202.45 in Attorney's Fees and Costs

Wells Fargo claims that the Bankruptcy Court abused its discretion in awarding Jones $67,202.45 in attorney's fees and costs. Wells Fargo claims that the award for sanctions and damages is a *de facto* award of attorney's fees. Essentially, Wells Fargo asserts that there was no factual basis for an award of $67,202.45. Citing *Pembrook v. Gulf Oil Corporation*, 454 F.2d 606 (5th Cir. 1971), Wells Fargo notes that the Fifth Circuit reversed an award for fees due to an absence of proof that the fees were paid, or that the obligation to pay had arisen. In the alternative, Wells Fargo argues that the award of $67,202.45, if imposed as a sanction for violating the automatic stay, is improper. Finally, Wells Fargo avers that the award of $67,202.45 is excessive because the Bankruptcy Court failed to properly apply the Lodestar Method in determining the award.

On August 29, 2007, the Bankruptcy Court entered an "Amended Judgment" on the record, awarding $67,202.45 as "sanctions and damages." Bankruptcy Case No. 06-1093, Rec. Doc. 154. Wells Fargo asserts that there was no factual basis for an award of $67,202.45. In opposition, Jones asserts that the Bankruptcy Judge was required to impose costs under the Bankruptcy Code, 11 U.S.C. § 362. Additionally, Jones seeks an award of attorney's fees and costs in association with resisting Wells Fargo's appeals under Bankruptcy Rule 8013.

The Bankruptcy Code gives debtors the right to sue for violations of the automatic stay, "specifying that [a]n individual injured by any willful violation of a stay provided by this section **shall recover** actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages." *In re Chestnut*, 422 F.3d 298, 302 (quoting 11

U.S.C. § 362(h), which is now 11 U.S.C. § 362(k)) (internal quotations omitted) (emphasis added). Wells Fargo's reliance on *Pembroke* appears to be misplaced. *Pembroke* states:

> No direct, affirmative evidence of what amount would reasonably compensate the attorneys for their participation was introduced at trial. It is well settled that in cases in which attorneys fees are allowed, absence of proof that fees have been paid or that an obligation has been incurred to pay defeats recovery. The complete absence of proof on this issue is, therefore, dispositive and fully supports the district court's judgment.

Pembrook v. Gulf Oil Corporation, 454 F.2d 606, 613 (5th Cir. 1971). First, *Pembroke* was a breach of contract case; it did not involve the awarding of attorney's fees or costs under Section 362 of the Bankruptcy Code. However, even applying *Pembroke* to this matter does not support Wells Fargo's position. First, the facts of this case are in direct contrast to those of *Pembroke*. In *Pembroke*, "[n]o direct, affirmative evidence of what amount would reasonably compensate the attorneys for their participation was introduced at trial." In contrast, counsel for Jones **and** counsel for Wells Fargo submitted time sheets and bookkeeping records to assist the Bankruptcy Court in fashioning a reasonable award. Bankruptcy Case No. 06-1093, Rec. Docs. 75 & 110. Thus, evidence of the legal fees incurred by both parties were available for the Bankruptcy Court's review and assisted the Bankruptcy Judge in finding that $67,202.45 was a reasonable award.

In addition, Wells Fargo relies on *In re Hutchings*, 348 B.R. 847 (Bkrtcy.N.D.Ala. 2006) to argue that only the person who actually paid or incurred the obligation to pay costs and attorney's fees may recover under Section 362 of the Bankruptcy Code. Wells Fargo asserts that Jones did not prove that he actually paid or incurred the obligation to pay attorney's fees, and thus, the $67,202.45 award is improper under *Hutchings*. This Court finds that *Hutchings* is not directly applicable because the debtor in that case was not "injured" by the creditor's stay

violation when the creditor merely contacted debtor via mail and telephone. *In re Hutchings*, 348 B.R. at 881.[31] The *Hutchings* court stated, "because [debtor] was not injured by [creditor's] stay violation, [debtor] is not entitled, under section 362(h), to recover any of the costs and expenses, including attorneys fees, which he has incurred in maintaining said action." Clearly, the posture of this matter is opposite that of *Hutchings* because the Bankruptcy Court determined Jones was injured by Wells Fargo's willful stay violations. *In re Jones*, 366 B.R. at 600 (finding injury to Jones because "Wells Fargo charged Debtor's account with unreasonable fees and costs."). Consequently, the statements in *Hutchings* regarding the recovery of attorney's fees are not on point.

Moreover, the Fifth Circuit has ruled that the submission of legal invoices is sufficient evidence to affirm a district court's fee award. *K3C Inc. v. Bank of America, N.A.*, 204 Fed.Appx. 455, 467 (5th Cir. 2006). Upon reviewing the affidavits submitted by counsel for Jones and counsel for Wells Fargo, the Court finds sufficient evidence of legal invoices, billing, and record keeping to uphold the Bankruptcy Court's award. Consequently, Wells Fargo has failed to show that the Bankruptcy Court abused its discretion by awarding $67,202.45 as costs and fees under Section 362 of the Bankruptcy Code.

In the alternative, Wells Fargo avers that the award of $67,202.45 is excessive because the Bankruptcy Court failed to properly apply the Lodestar Method in determining the award. Wells Fargo relies on *Saizan v. Delta Concrete Products Co., Inc*., 448 F.3d 795 (5th Cir. 2006)

[31] *In re Hutchings* noted, "(1) [creditor] placed eight to ten telephone calls to [debtor] relating to the collection of his mortgage debt; (2) as a result of those calls [creditor's] representatives had five conversations with [debtor] relating to the collection of his mortgage debt; and (3) [creditor] sent five items of correspondence to [debtor] relating to the collection of his mortgage debt. [Creditor] admits as much, and this Court concludes, that those ten or so contacts constituted violations of the automatic stay."

to note that an award of attorney's fees has to be reasonable. In addition, Wells Fargo cites *Johnson v. Georgia Highway Express, Inc*., 488 F.2d 715 (5th Cir. 1974) to argue that the Fifth Circuit generally applies the "Lodestar Method" to calculate attorney's fee awards.

Neither *Saizan* not *Johnson* are bankruptcy cases. *Saizan* was a Fair Labor Standards Act ("FLSA") case in which the Fifth Circuit noted, "[u]nder the [FLSA], the District Court **may** award reasonable attorney's fees to the prevailing party." *Saizan*, 448 F.3d at 799 (emphasis added). *Johnson* was a Title VII race discrimination case in which the Fifth Circuit noted, "In any action or proceeding under [Title VII] the Court, in its discretion, **may** allow the prevailing party ... a reasonable attorney's fee as part of the cost of the litigation." *Johnson*, 488 F.2d at 716 (emphasis added). The language of the FLSA and Title VII allowing for the possibility of attorney's fees appears to be substantially different from the language of the Bankruptcy Code which requires the award of attorney's fees.[32] However, a review of the record demonstrates that the Bankruptcy Judge properly applied the *Johnson* factors to this matter.

First, the Bankruptcy Judge noted that Jones's counsel charged a reasonable and "customary rate for bankruptcy litigation" of $175 and then $200 per hour, which was then multiplied by 350.90 (the total number of hours worked).[33] In addition, the Bankruptcy Judge's Supplemental Memorandum Opinion weighed the *Johnson* factors as follows:

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[32] Again, Section 362 states, "[a]n individual injured by any willful violation of a stay provided by this section **shall recover** actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages." 11 U.S.C. § 362(k).

[33] Bankruptcy Case No. 06-1093, Rec. Docs. 75 and 153. Rec. Doc. 75 lists the attorney's fees incurred from February 20, 2006 through April 25, 2007, and shows 350.90 as the total number of hours billed during that period. Rec. Doc. 153 is a Supplemental Memorandum Opinion, signed August 29, 2007, finding that the time Jones's counsel spent on the case was high, "but not unreasonably so." Rec. Doc. 153, p. 6-7.

> The issues involved [in this case] were novel, difficult, complex, and ones of first impression in this district. As a result, the issues presented required a level of expertise in bankruptcy not generally possessed by those with general litigation skills. Although the issues were complex and the litigation of this matter was time consuming, there is no evidence before the Court to suggest that Debtor's counsel actually turned away clients due to the acceptance of this case. However, the Court notes that Debtor's counsel is a small firm, and Debtor's counsel did spend a considerable amount of time on the case. Perhaps the most important factor concerns the results obtained. The Court entered a Partial Judgment in the amount of $16,852.01 for unreimbursed overcharges on Debtor's loan. While the amounts obtained are relatively small, particularly in relation to the fees generated, the importance of the issues settled by this litigation are significant and far reaching. The conduct of Wells Fargo is neither limited to this case nor unique to this lender. Therefore, this decision will have ramifications on many other cases pending in the district and perhaps beyond.

Bankruptcy Case No. 06-1093, Rec. Doc. 153, p. 8. Accordingly, Wells Fargo has failed to demonstrate that the $67,202.45 was an excessive sanction under the circumstances.

3. MOTION TO REOPEN

Wells Fargo claims that the Bankruptcy Judge abused her discretion by denying a Motion to Reopen the Evidence. Wells Fargo avers that the Fifth Circuit requires a court to re-open and admit "conclusive evidence." Further, Wells Fargo asserts that a payoff letter, dated July 21, 2005, was conclusive evidence in support of Wells Fargo's position. Wells Fargo relies on *Ferrell v. Trailmobile, Inc*., 223 F.2d 697 (5th Cir. 1955), *Capital Marine Supply, Inc., v. M/V ROLAND THOMAS, II*, 719 F.2d 104 (5th Cir. 1983) and *Caracci v. Brother Intern. Sewing Mach. Corp. of LA*, 222 F.Supp. 769 (E.D.La. 1963) to assert that the Bankruptcy Court abused her discretion.

However, the controlling Fifth Circuit precedent regarding the extent of a trial court's discretion to re-open evidence is contained in *Garcia v. Woman's Hosp. of Texas*, 97 F.3d 810 (5th Cir. 1996). The factors discussed in *Garcia* were applied by the Bankruptcy Court in its

Order Denying the Motion to Submit Additional Evidence or Reopen the Evidence. Bankruptcy Case No. 06-1093, Rec. Doc. 137. As the Fifth Circuit stated in *Garcia* "[a]mong the factors the trial court should examine in deciding whether to allow a reopening are the importance and probative value of the evidence, the reason for the moving party's failure to introduce the evidence earlier, and the possibility of prejudice to the non-moving party." *Garcia*, 97 F.3d at 814. *Garcia* also notes, "Trial courts as a rule act within their discretion in refusing to reopen a case where the proffered 'new' evidence is insufficiently probative to offset the procedural disruption caused by reopening." *Id.* (quoting *Rivera-Flores v. Puerto Rico Telephone Co.*, 64 F.3d 742, 746 (1st Cir.1995)). Finally, *Garcia* states: "Should a district court conclude that a litigant is engaging in any form of chicanery, it properly denies the motion. The same result obtains where the litigant was negligent in failing to introduce the evidence." *Id.*

In this matter, the Bankruptcy Court specifically found that "Wells Fargo was negligent ... and that it has failed to provide a bona fide reason for its failure to introduce the document in a timely manner." Bankruptcy Case No. 06-1093, Rec. Doc. 137, p. 2. Because the Bankruptcy Court found Wells Fargo to be negligent regarding the 2005 payoff letter, Wells Fargo has not provided sufficient evidence to demonstrate that the Bankruptcy Judge abused her discretion by denying Wells Fargo's motion to reopen under *Garcia*.

Moreover, Wells Fargo's reliance on *Ferrell v. Trailmobile* 223 F.2d 697 (5th Cir. 1955) is misplaced. In *Ferrell*, the Fifth Circuit stated, "conclusive evidence" should be admitted post-trial because "the ends of justice may require granting a new trial even though proper diligence was not used to secure such evidence for use at the trial." *Id.* at 698. That statement appears to be at odds with the Fifth Circuit's statement in *Garcia* that a court properly denies a motion to

reopen "where the litigant was negligent in failing to introduce the evidence." *Garcia*, 97 F.3d at 814. Wells Fargo's reliance on *Ferrell* appears to be misplaced because *Ferrrell* discussed a Rule 60 motion for a new trial, whereas *Garcia* directly addressed the standards regarding motions to reopen.

Furthermore, the payoff letter does not appear to be "conclusive evidence" under *Ferrell*. The Court notes that in *Ferrell*, the untimely submitted evidence was deemed "conclusive evidence" because it showed that defendant was not liable to plaintiff (plaintiff untimely submitted conclusive evidence that he had already paid defendant the amount due). In contrast, Wells Fargo does not suggest that the payoff letter is conclusive proof that it did not violate the automatic stay. Indeed, Wells Fargo merely suggests that the letter is evidence that the Voluntary Payment Doctrine should apply. The Court is not convinced that the Voluntary Payment Doctrine applies, nor that the application of the Voluntary Payment Doctrine would immunize Wells Fargo from liability for violating the Bankruptcy Code's automatic stay.

The Voluntary Payment Doctrine requires that a debt be actually owed between debtor and creditor.[34] In this case the Bankruptcy Judge found that Wells Fargo collected "Sheriff's Fees" from Jones even though the Sheriff testified that the fees were improperly collected. *In re Jones*, 366 B.R. 584, 601 n. 68 (Bkrtcy.E.D.La. 2007). Because the Voluntary Payment Doctrine was rejected by the Bankruptcy Judge, and there is evidence that the doctrine is simply not applicable, Wells Fargo's assertion that the 2005 payoff letter is admissible under *Ferrell's* "conclusive evidence" standard is not convincing. Thus, Wells Fargo's argument that the

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[34] *See e.g., In re Ark-La-Tex Timber Co., Inc.*, 482 F.3d 319 (5th Cir. 2007) (noting "A person who has received a payment of a thing not owed him is bound to restore it to the person from whom he received it.") (quoting La. Civ.Code Ann. art. 2299).

Bankruptcy Court committed reversible error for failing to admit evidence regarding a possible defense, not an absolute defense, is unconvincing under *Ferrell*.

Finally, Wells Fargo asserts that the Bankruptcy Court erred in failing to hold an evidentiary hearing regarding the motion to reopen. Wells Fargo relies on *Matter of First Colonial Corp. Of America*, 544 F.2d 1291 (5th Cir. 1977) to assert that a court abuses its discretion by canceling an evidentiary hearing when one party is attempting to prove a historical fact. *Matter of First Colonial Corp. of America* states:

> Determining a reasonable attorneys' fee is a three-step process. In the first phase, the bankruptcy judge or district court must ascertain the nature and extent of the services supplied by the attorney. To this end, each attorney seeking compensation should be required to file a statement which recites the number of hours worked and contains a description of how each of those hours was spent. If there are disputed issues of fact, an evidentiary hearing must be held to facilitate their resolution.

Matter of First Colonial Corp. of America, 544 F.2d 1291, 1299-1300 (5th Cir. 1977).

Again, Wells Fargo errs in taking the Fifth Circuit's language out of context and applying it to the matter under review. As quoted above, *Matter of First Colonial Corp. of America* requires an evidentiary hearing to determine attorney's fees. The Bankruptcy Court held an evidentiary hearing regarding attorney's fees on May 29, 2007. Bankruptcy Case No. 06-1093, Rec. Docs. 109 & 137. Therefore, the Bankruptcy Court complied with the mandate of *Matter of First Colonial Corp. of America*. Wells Fargo's assertion that the Bankruptcy Court erred under *Matter of First Colonial Corp. of America* because it failed to hold an evidentiary hearing regarding a motion to reopen is too broad a reading of *Matter of First Colonial Corp. of America's* text. Thus, the Court does not find reversible error in Wells Fargo's assertion regarding the failure to conduct an evidentiary hearing with respect to its motion to reopen.

4. INTERPRETATION OF THE BANKRUPTCY COURT'S ORDERS

Wells Fargo claims that the Bankruptcy Court improperly threatened counsel for Wells Fargo with sanctions for arguing a particular interpretation of the Bankruptcy Court's previous orders. Wells Fargo argues that the Bankruptcy Court's judgment must be vacated because the Judge's threat infringed Wells Fargo's due process rights. During the bankruptcy proceedings, counsel for Wells Fargo and the Bankruptcy Judge disagreed about Wells Fargo's entitlement to collect the amount shown on Wells Fargo's proof of claim versus the amount due under the mortgage. The Bankruptcy Judge stated that she did not authorize Wells Fargo to collect "hidden charges." In addition, the Bankruptcy Judge stated that Wells Fargo would "have to come in and prove up their debt before . . . authoriz[ing] a dime to them." Wells Fargo construes the exchange as a threat of future sanctions for merely advancing a reasonable argument.

After a thorough review of the transcript, it appears that counsel for Wells Fargo and the Bankruptcy Judge disagreed about the holding of *Nobleman v. American Savings Bank*, 508 U.S. 324 (1993). During the allegedly threatening exchange, the Bankruptcy Judge stated that Wells Fargo should have filed an amended "proof of claim" so that the Bankruptcy Court could have approved the amount that Wells Fargo was attempting to collect. Counsel for Wells Fargo replied, "Well, there's no requirement that the creditor provide such an accounting." and the Bankruptcy Court responded, "I disagree. I disagree. I think there is an absolute requirement under the Bankruptcy Code that legal fees be approved by this Court post-petition, that the reasonableness of the charges be approved that are discretionary. I don't have to rely on Wells Fargo's complete and total discretion on whether a charge is reasonable or not." Bankruptcy Case No. 06-1093, Rec. Doc. 49, Transcript of Proceedings held January 5, 2007, p. 345-46.

Wells Fargo relies on *Armstrong v. Office of the President*, 1 F.3d 1274 (D.C. 1993) and *Sizzler Family Steak Houses v. Western Sizzlin Steak House, Inc*., 793 F.2d 1529 (11th Cir. 1986) to assert that the threat of future sanctions is an absolute denial of due process. However, in *Armstrong*, the trial court placed the appellant under an "conditional" contempt order, and in *Sizzler*, the trial court ordered a "prospective fine schedule." *Armstrong*, 1 F.3d at 1289; *Sizzler*, 793 F.2d at 1534 n. 2.

The facts in this case do not remotely align with *Armstrong* or *Sizzler*. The Bankruptcy Court neither threatened to invoke its contempt powers, nor issued a "prospective fine." A review of the transcript demonstrates that counsel for Wells Fargo and the Bankruptcy Court disagreed about a substantive issue of law, and that the Bankruptcy Judge warned that she would rigorously review Wells Fargo's future filings with her court based on the disagreement regarding the underlying law. Wells Fargo's analogy to *Armstrong* and *Sizzler* is unfounded, and thus, there are no grounds for finding a due process violation.

5. *NOBLEMAN*, THE ANTI-MODIFICATION RULE AND AN ALLEGED CONFLICT BETWEEN SECTION 506 AND SECTION 1322

Wells Fargo claims that the Bankruptcy Court committed reversible error because it did not have the power to modify Wells Fargo's rights to recover interest and inspection fees because these expenses were controlled by the mortgage agreement. However, Wells Fargo's claim of error misstates the grounds upon which the Bankruptcy Court ruled.

Wells Fargo argues that the Bankruptcy Court erred in awarding Jones $16,852.01 under § 506 because § 1322 contains an anti-modification rule. Relying on *Nobleman v. American Savings Bank*, 508 U.S. 324 (1993), Wells Fargo claims that it was an oversecured creditor, and that its rights under the mortgage could not be modified. Essentially, Wells Fargo argues that the

Bankruptcy Court committed reversible error because it did not have the power to modify Wells Fargo's rights to recover interest and inspection fees because these expenses were controlled by the mortgage agreement. Wells Fargo relies on *Nobleman v. American Savings Bank*, 508 U.S. 324 (1993)[33] to assert that bankruptcy courts cannot modify the rights of secured creditors. In addition, Wells Fargo points to the Eleventh Circuit's opinion in *Telfair v. First Mortgage Corp*., 216 F.3d 1333, 1337 n. 8 (11th Cir. 2000) as support for the position that the collection of attorney's fees during and after discharge in a Chapter 13 case is allowed.

In *Nobelman*, the Supreme Court considered the question of whether a partially-secured claim secured by a homestead lien could be bifurcated into its secured and unsecured components, and "stripped down" to the value of the secured claim. The debtors argued that, under § 506(a), the holder of an undersecured mortgage - for which the value of the claim exceeds the value of the property - only holds a "secured claim" to the extent of the value of the property, and holds an "unsecured claim" for the excess value of the mortgage. Because § 1322(b)(2) only protects the rights of "holders of secured claims," they maintained that only the secured portion of the mortgage was entitled to protection and, therefore, that the value of the mortgage could be effectively reduced to its secured value.

The Supreme Court rejected this approach of bifurcation and stripping down, primarily because the debtors' argument failed to consider the fact that § 1322(b)(2) focuses on the modification of the rights of holders, not the status of claims. Although the Court found that it

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[33] *Nobleman* discusses the interaction of a secured creditor's "rights" in relation to Sections 506 and 1322(b) of the Bankruptcy Code. The Supreme Court noted that the contractual rights of a home mortgage lender are subject to the Bankruptcy Code. *Nobleman*, 508 U.S. at 330-31 (stating, "[t]he lender's power to enforce its rights-and, in particular, its right to foreclose on the property in the event of default-is checked by the Bankruptcy Code's automatic stay provision.").

was proper to look to § 506(a) for a judicial valuation of the collateral, the creditor was still the holder of a secured claim. Therefore, it was entitled to the protections of the anti-modification clause.

Further consideration of the Supreme Court's interpretation of § 1322(b)(2) is necessary. In *Nobelman*, the Fifth Circuit concluded that "section 1322(b)(2) appears to conflict with section 506(a)," and resolved the conflict in favor of § 1322(b)(2). *Nobleman v. Am. Sav. Bank* (*In re Nobleman*), 968 F.2d 483, 488 (5th Cir. 1992). However, the Supreme Court took a different approach, giving effect to both statutes in its interpretation of "claim" in the antimodification clause. The Supreme Court found that "claim secured only by" is not equivalent to the term of art "secured claim." *In re Zimmer*, 313 F.3d 1220, 1225 (9th Cir. 2002). "Instead, noting that § 506(a) itself uses the phrase 'claim ... secured by a lien' to encompass both portions of an undersecured claim, the Court found that the antimodification clause similarly applied to both the unsecured and secured components of the mortgage claim." *Id.*

Neither the facts, nor law discussed in *Nobleman* appear to be applicable to this matter. In this case, the Bankruptcy Court did not modify Wells Fargo's rights under the adjustable rate mortgage between Wells Fargo and Jones. Instead, the Bankruptcy Court found that Wells Fargo violated the Bankruptcy Code's automatic stay because Wells Fargo applied funds obtained from Jones and the Trustee to both pre- and post-petition debt. Specifically, the Bankruptcy Court ruled that "Wells Fargo applied [Jones's] direct postpetition installment payments to those payments owed prepetition" in derogation of the terms of the plan. *In re Jones*, 366 B.R. at 589. In addition, the Bankruptcy Court found that Wells Fargo's accounting

procedures "failed to recognize that prepetition charges, fees, and missed payments were to be separately paid by the Trustee under the plan and did not bear interest." *Id.* Furthermore, the Bankruptcy Court found that Wells Fargo's proof of claim overstated the costs that were actually incurred. *Id.* at 591 (noting that Wells Fargo listed $1,283.87 in prepetition foreclosure costs, but that the testimony at trial demonstrated that the actual amount was $743.87). The Bankruptcy Court also noted Wells Fargo's admission that it "had collected sums in excess of the amounts necessary to satisfy the loan." *Id.* at 588 (referencing a January 12, 2006 letter from Wells Fargo to Jones).

Additionally, the Bankruptcy Court found that Wells Fargo "added to its prepetition arrearage without amendment to its proof of claim or disclosure to the Trustee or Court." *Id.* at 592. And, Wells Fargo inappropriately applied "postpetition installments . . . to prepetition installments, prepetition costs or fees, and postpetition charges not authorized or disclosed to [Jones], the Court, or the Trustee." *Id.* at 593. Specifically, the Bankruptcy Court determined that Wells Fargo improperly applied the post-petition payment for September 2003 to the pre-petition January 2003 installment. *Id.* Because "the Trustee was already scheduling payments to Wells Fargo to satisfy [the] earlier payments," and thus, "Wells Fargo denied [Jones] the benefit of the lower [interest] rate by collecting two installments at the higher rate." *Id.*

Indeed, the Bankruptcy Court stated that Wells Fargo may have been entitled to the post-petition charges incurred prior to confirmation, but found that the failure to disclose the charges for a "reasonableness" review was error, citing *Rake v. Wade*, 508 U.S. 464 (1993), Section 506, and Bankruptcy Rule 2016. *In Re Jones*, 366 B.R. at 594 n. 40 (and accompanying text). Moreover, the Bankruptcy Court stated that Wells Fargo "offered no evidence as to the nature of

the fees or their reasonableness" at trial. *Id.* at 595. Next, the Bankruptcy Court held "[b]ecause Wells Fargo has not only charged [Jones's] account with undisclosed post confirmation charges, but satisfied those charges with estate funds delivered to it to pay other debt, there can be no doubt that Wells Fargo's assessment of post confirmation attorney's fees and expenses directly relates to [Jones's] estate." *Id.* Finally, the Bankruptcy Court held:

> The contractual right to seek reimbursement is not the equivalent of a right to collect an undisclosed charge from the estate. While Wells Fargo argues that the accrual of fees is not a violation of the automatic stay, the application of estate funds to their payment without Court authority is clearly a violation. In this instance, Wells Fargo assessed and paid itself for additional pre and postpetition charges from payments designed to satisfy a prepetition arrearage contained in its proof of claim and accruing postpetition installment payments. The payments were tendered by [Jones] or Trustee for the specific purposes outlined in [Jones's] plan and authorized by the Order confirming same. Wells Fargo had absolutely no right to divert these payments to other obligations without Court authority.

In re Jones, 366 B.R. at 600.

Based on all of the above, it appears that the Bankruptcy Court found Wells Fargo in violation of Bankruptcy Code's automatic stay because Wells Fargo failed to implement the proper procedures for obtaining the funds it used to satisfy the accruing charges. Therefore, Wells Fargo's assertion that the Bankruptcy Court modified Wells Fargo's rights in violation of *Nobleman* and Section 1322(b)(2) is a false argument.

Wells Fargo's final argument concerning this issue relies on *Matter of Howard*, 972 F.2d 639 (5th Cir. 1992). Wells Fargo asserts that overly secured mortgage holders may actually ignore the Bankruptcy Court and demand payments outside the plan. This statement is supported by the Fifth Circuit's conclusion in *Matter of Howard*, but only under certain conditions:

> We conclude that a Chapter 13 plan which purports to reduce or eliminate a creditor's secured claim is res judicata as to that creditor only if the debtor has filed an objection to the creditor's claim. If no objection is filed to a secured

> claim, the creditor is entitled to rely upon its lien and not participate in the bankruptcy proceedings.

Matter of Howard, 972 F.2d 639, 639 (5th Cir. 1992). However, the facts of *Howard* do not align with this matter. In *Howard*, the secured creditor filed a proof of claim before the confirmation hearing. *Howard*, 972 F.2d at 640. The debtors did not file an objection to the proof of claim. *Id.* The creditor did not participate in the confirmation proceedings beyond filing its proof of claim, and no objection was made to the plan's confirmation. *Id.*

In contrast to *Howard*, the debtor in this matter objected to Wells Fargo's payoff letter; indeed, Jones initiated the underlying adversary proceeding to recover monies from Wells Fargo. Because Jones objected to Wells Fargo's acquisition of funds in this matter, *Howard* is inapplicable. Further evidence of *Howard's* inapplicability is that *Howard* focused on the *res judicata* effect of plan confirmation, not the creditors miscalculation of amounts due, nor possible violations of the automatic stay for misapplying funds to prepetition and postpetition debts.

6. BURDEN OF PROOF

Wells Fargo claims that the Bankruptcy Court misplaced the burden of proof. Wells Fargo asserts that Jones, as the Plaintiff in the adversary action, had to carry the burden of proof by clear and convincing evidence. Wells Fargo alleges that the Bankruptcy Court, however, improperly placed the burden of proof on the defendant.

In contrast, Jones asserts that the Bankruptcy Court acknowledged that Jones, as plaintiff in the adversary proceeding, carried the burden of proof. Jones argues that Wells Fargo has "distort[ed] the concept of burden of proof." Rec. Doc. 48, p. 46. Jones states that the burden of

proof has two components: 1) the burden of producing evidence; 2) the burden of persuasion. Jones avers that the burden of persuasion always rests with the plaintiff, but that the burden of production may shift between parties.

In the Memorandum Opinion dated April 13, 2007, the Bankruptcy Court stated, "Wells Fargo simply failed to meet its burden of proof" regarding the reasonableness of the fees it imposed on Jones. *In re Jones*, 366 B.R. at 595 (citing *In re Ransom*, 361 B.R. 895 (Bankr.D.Mont.2007) (noting creditor has burden of proof to establish the reasonableness of fees and costs); *see also In re Hudson Shipbuilders Inc*., 794 F.2d 1051 (5th Cir. 1986)). The Bankruptcy Court also held that "[u]nder Louisiana law, the creditor bears the burden of establishing its debt." *Id.* at 597. The Bankruptcy Court provided the following explanation for its determination that Wells Fargo was not entitled to post-confirmation attorney's fees:

> At trial, Wells Fargo offered no evidence as to the nature of the attorney's fees imposed post confirmation or their reasonableness. It neglected to produce invoices identifying the counsel who performed the services or any description regarding the services performed, time spent, or amounts charged. As a result, the Court cannot determine the reasonableness of the fees incurred because the Court was given no evidence as to what services were performed, much less, why they were necessary. Wells Fargo simply failed to meet its burden of proof on this issue. Therefore, the attorney's fees not previously approved by the Court and identified on Wells Fargo's accounting as owed post confirmation are denied.

In re Jones, 366 B.R. at 597. The Bankruptcy Court also referenced this issue when it stated, "Wells Fargo bears the burden of establishing that the charges it seeks to impose against Debtor's loan are reasonable. Based on the testimony of Wells Fargo and the inspection reports offered into evidence, this Court concludes that Wells Fargo has failed to meet its burden." *Id.* at 598.

The Bankruptcy Court also addressed Wells Fargo's claim that the burden of proof had been improperly shifted at trial in its "Reasons for Order Denying Motion for Reconsideration of Judgment." *In re Jones*, 2007 WL 1302549 (Bkrtcy.E.D.La. May 1, 2007). In response to Wells Fargo's motion for reconsideration, the Bankruptcy Court held:

> Upon review the Opinion and record, the Court finds that it properly placed the initial burden of proof on Jones. Jones met his burden by presenting testimony and evidence that demonstrated Wells Fargo improperly applied payments and caused Jones to pay more than required under the terms of his Note and Mortgage. After this point was established, Wells Fargo was given the opportunity to explain the obvious errors in its accounting and ultimately the calculation of its claim. It did not. The initial burden was properly placed upon Jones to establish errors in the calculation of the Wells Fargo debt. That burden was met based on documentary evidence, including accounting records and testimony supplied by Wells Fargo.
>
> Additionally, the evidence showed that Wells Fargo assessed and collected postpetition charges without notifying the Court, Trustee, Jones, or his counsel; this factual finding was acknowledged by Wells Fargo. Once this was established, Wells Fargo was required to demonstrate that the fees or costs imposed were reasonable.

In re Jones, 2007 WL 1302549 at *1-*2.

> The Supreme Court has noted:
>
> For many years the term 'burden of proof' was ambiguous because the term was used to describe two distinct concepts. Burden of proof was frequently used to refer to what we now call the burden of persuasion-the notion that if the evidence is evenly balanced, the party that bears the burden of persuasion must lose. But it was also used to refer to what we now call the burden of production-a party's obligation to come forward with evidence to support its claim.

Director, Office of Workers' Compensation Programs, Dept. of Labor v. Greenwich Collieries, 512 U.S. 267, 272 (1994). In *Greenwich Collieries*, the Supreme Court made an attempt to clarify the phrase "burden of proof" by describing an "emerging consensus" on the term's definition. *Id.* The Supreme Court quoted several evidence treatises for the proposition that

"[t]he burden of proof is the obligation which rests on one of the parties to an action to persuade the trier of the facts, generally the jury, of the truth of a proposition which he has affirmatively asserted by the pleadings." *Id.* at 275. In addition, the Court wrote that the "party with the burden of proof bears the 'burden of persuasion,' though the opposing party may bear a burden to 'go forward with evidence.'" *Id.* at 274-75 (citing *Commercial Molasses Corp. v. New York Tank Barge Corp*., 314 U.S. 104, 111 (1941)).

The Fifth Circuit has stated: "It is recognized that as to any given issue the burden of persuasion and the burden of production of evidence generally both fall on the same party at the beginning of trial, that the burden of persuasion does not thereafter shift, but that the burden of production may shift back and forth as each side produces evidence, takes advantage of presumptions or the like." *Simpson v. Home Petroleum Corp*., 770 F.2d 449, 503 (5th Cir. 1985). In *Simpson*, the Fifth Circuit quoted heavily from Ray, *Texas Law of Evidence* § 96 (3rd ed. 1980):

> It is the generally accepted view of courts [citing twelve Texas cases in a footnote] and textbook writers, including Professors Wigmore and Thayer, that the burden of persuasion never shifts. We have already seen that considerations of fairness and policy based on experience ultimately determine which party shall have this burden on each issuable fact. These considerations are usually disclosed by the pleadings. Thus, before the trial begins, the location of the burden is fixed. The view that this burden never shifts, but remains upon the same party throughout the trial, is based upon considerations of practical convenience.
>
> * * * * *
>
> In contrast with the accepted view that the burden of persuasion remains on the same party throughout the trial, it is everywhere agreed that the other burden, i.e., the burden of producing evidence (called by the Texas courts the burden of introducing evidence, the burden of evidence, and the weight of the evidence), may and often does shift back and forth between the parties like a tennis ball in play.... A party cannot be sure beforehand when it will be cast upon him or when

> it will be discharged or the amount of kind of evidence necessary to remove it, except, of course, where a presumption has by precedent been given that effect.

Simpson, 770 F.2d at 503.

Based on the above, it appears that the Bankruptcy Court complied with "generally accepted view" regarding the burdens of persuasion and production, as described by the Supreme Court and the Fifth Circuit. The Bankruptcy Court found that Jones produced evidence to demonstrate a prima facie case of a stay violation. *In Re Jones*, 2007 WL 1302549 at *2 Bkrtcy.E.D.La. 2007) (stating "Jones was able to demonstrate that Wells Fargo violated the automatic stay when it applied payments from property of the estate to satisfy undisclosed fees and charges without Court authority."). Wells Fargo was given the opportunity to explain the obvious errors in its accounting, but the Bankruptcy Court could not "determine the reasonableness of the fees incurred because the Court was given no evidence as to what services were performed, much less, why they were necessary." *In re Jones*, 366 B.R. at 597. Thus, Jones met the initial burden of production; however, Wells Fargo could not hit the "tennis ball" back over the net because they did not meet their burden of production. Because Wells Fargo could not adequately explain its accounting procedures, Jones was able to succeed on the ultimate burden of persuasion. Accordingly, Wells Fargo's claim that the Bankruptcy Court improperly shifted the burden of proof lacks merit.

7. BANKRUPTCY COURT'S CALCULATIONS

Again, Wells Fargo argues that the terms of the mortgage agreement cannot be modified by a bankruptcy judge. Wells Fargo claims that the Bankruptcy Court erred in applying simple interest calculations to the amounts due. Indeed, Wells Fargo asserts that a 360-day amortization method is the proper procedure of accounting under the terms of the mortgage. Moreover, Wells

Fargo avers that the Bankruptcy Judge erred by performing any calculations because the judge should have relied on expert testimony, instead of applying her own knowledge of accounting to the matter. In addition, Wells Fargo asserts that the Bankruptcy Judge erroneously acted as Jones's expert, and compounded the error by refusing Wells Fargo's request to rebut with an outside expert.

A. Simple Interest

Wells Fargo's assertion that the Bankruptcy Court violated the anti-modification rule is discussed, analyzed, and disposed of above. Again, the Bankruptcy Court held:

> the contractual right to seek reimbursement is not the equivalent of a right to collect an undisclosed charge from the estate. While Wells Fargo argues that the accrual of fees is not a violation of the automatic stay, the application of estate funds to their payment without Court authority is clearly a violation. In this instance, Wells Fargo assessed and paid itself for additional pre and postpetition charges from payments designed to satisfy a prepetition arrearage contained in its proof of claim and accruing postpetition installment payments. The payments were tendered by [Jones] or Trustee for the specific purposes outlined in [Jones's] plan and authorized by the Order confirming same. Wells Fargo had absolutely no right to divert these payments to other obligations without Court authority.

In re Jones, 366 B.R. at 600.

Wells Fargo now argues that the Bankruptcy Court erred by applying simple interest calculations to the amount Jones owed, when the terms of the mortgage called for a 360 day mortgage amortization calculation. Rec. Doc. 34, p. 76. However, the phrase "simple interest" does not appear in Bankruptcy Court's rulings. The Bankruptcy Court did state:

> the portion of the installments designed to amortize principal should not be included in the prepetition arrearage amount because the full principal balance was also paid postpetition. To collect any principal or escrow payments from the Trustee (as part of the prepetition past due installments) would result in an overpayment of principal and escrow. Therefore, the prepetition installments have been reduced to eliminate escrow and principal repayment and now only provide for past due interest.

In re Jones, 366 B.R. at 591-92. The Bankruptcy Court's finding that Wells Fargo's mis-calculated the amount due does not seem to be in error. The Bankruptcy Court's opinion indicates that it found a violation because pre- and post-petition debts were not treated separately by Wells Fargo (i.e. the Bankruptcy Court found that Wells Fargo applied funds to both pre- and post-petition debt in violation of terms of Jones's plan). Wells Fargo has not cited any authority to contradict the premise that pre-and post-petition must be treated differently.

Instead, Wells Fargo again relies on the argument that a bankruptcy courts cannot modify the terms of an existing mortgage. This argument simply does not apply to this case. The Bankruptcy Court did not attempt to modify the terms of Wells Fargo's security interest; the Bankruptcy Court found that Wells Fargo misapplied pre- and post- petition funds. Furthermore, Wells Fargo's claim that the Bankruptcy Court erred by using "simple interest" calculations is not supported by the record. Footnote 31 of the Bankruptcy Court's opinion specifically states that the Bankruptcy Court adopted Wells Fargo's 360 day year method of calculation:

> Wells Fargo's representative could not explain how interest was calculated in the accounting Wells Fargo supplied. The Court's review of Wells Fargo's accounting reveals that interest was calculated by applying the applicable interest rate on the full outstanding principal balance due at the time a payment was applied for a 360 day year. **The Court's interest calculations have adopted this formula**.

In re Jones, 366 B.R. at 592, n. 31 (emphasis added).

B. Bankruptcy Court as Expert

Wells Fargo asserts that the Bankruptcy Judge improperly assisted Jones by acting as an expert in accounting. The Bankruptcy Court addressed this issue on May 1, 2007 in an order

denying Wells Fargo's Motion to Reconsider. In the May 1, 2007 Order, the Bankruptcy Court ruled:

> [Wells Fargo] argues the Court relied upon Jones's interpretation of Wells Fargo's accounting in its Opinion and objects to the Court's alleged reliance on non-expert testimony. This argument fails for a number of reasons. First, after consideration of the record and evidence, the Court formulated the factual findings contained in the Opinion. The Court's Opinion references the accounting offered into evidence by Wells Fargo as well as the testimony of its representative. It also references correspondence delivered by Wells Fargo to plaintiff and admitted into evidence, as well as the stipulated or unrefuted facts in these proceedings. Contrary to Wells Fargo's assertion, the Opinion does not rely in principal on the testimony of Plaintiff or his non-expert opinions.

In re Jones, 2007 WL 1302549, at *2 (Bkrtcy.E.D.La. 2007). Wells Fargo's argument that the Bankruptcy Court acted as Jones's expert is unconvincing. It is apparent that the Bankruptcy Court made findings of fact unfavorable to Wells Fargo;[34] however, Wells Fargo has failed to produce evidence that the Bankruptcy Court improperly acted as an advocate for Jones.

8. VOLUNTARY PAYMENT DOCTRINE

Wells Fargo asserts that Jones voluntarily paid the fees included in the payoff, and thus, the voluntary payments cannot be recovered. In addition, Wells Fargo argues that the Bankruptcy Court committed an error of fact in failing to apply the Voluntary Payment Doctrine. Wells Fargo notes that the Bankruptcy Court's decision regarding the Voluntary Payment Doctrine rested, in part, on the finding that "there was no pending action" between Jones and Wells Fargo. However, Wells Fargo asserts that the foreclosure against Jones was pending during the bankruptcy and there need not be "pending action" to apply the Voluntary Payment

[34] The Bankruptcy Court specifically held, "Wells Fargo's accounting also failed to recognize that prepetition charges, fees, and missed payments were to be separately paid by the Trustee under the plan and did not bear interest. All of these mistakes had the combined effect of increasing the interest charged and paid on the loan above that actually due." *In re Jones*, 366 B.R. at 589.

Doctrine. Wells Fargo strenuously maintains that the Voluntary Payment Doctrine controls the case.

Further, Wells Fargo asserts that the Bankruptcy Court incorrectly distinguished *New Orleans & N.E.R. Co. v. Louisiana Const. & Imp. CO.*, 33 So. 51 (La. 1902) from the matter under review based on an error of fact. Wells Fargo notes that the Bankruptcy Court distinguished *New Orleans & N.E.R. Co.* in part because the Bankruptcy Court found that there was "no pending action" between Wells Fargo and Jones when Jones made the payments to Wells Fargo. *In re Jones*, 366 B.R. at 602. Wells Fargo asserts that there was a pending action because Wells Fargo had already foreclosed against Jones.

Wells Fargo specifically relies on *New Orleans & N.E.R. Co. v. Louisiana Const. & Imp. Co.*, 33 So. 51 (La. 1902) and *Chris Albritton Const. Co., Inc. v. Pitney Bowes*, 304 F.3d 527 (5th Cir. 2002) to argue that the federal Voluntary Payment Doctrine should apply to this case.

In *Pitney Bowes*, the Fifth Circuit noted the elements of the Voluntary Payment Doctrine under Mississippi law,

> If the Plaintiffs voluntarily paid for something they did not owe, the voluntary payments cannot be recovered. 'The general principle is that, where the party **with full knowledge**, actual or imputed, of the facts, there being no duress, fraud or extortion, voluntarily pays money on a demand, although not enforceable against him, he cannot recover it back.'

Pitney Bowes, 304 F.3d at 531 (quoting *Graham McNeil Co. v. Scarborough*, 135 Miss. 59, 99 So. 502, 503 (Miss.1924)) (emphasis added). The Supreme Court of Louisiana announced a similar rule in *New Orleans & N. E. R. Co.*: "[i]t is an established rule of law that if a party, **with a full knowledge** of the facts, voluntarily pays a demand unjustly made on him and attempted to

be enforced by legal proceedings, he cannot recover back the money." *New Orleans & N. E. R. Co.*, 33 So at 55 (emphasis added).

In this matter, the Bankruptcy Court reviewed Jones's knowledge of the facts and circumstances pertaining to Wells Fargo's claims. The Bankruptcy Court determined that "Wells Fargo did not disclose [the charges or fees] to Debtor at any point in time prior to the institution of this adversary proceeding." *In re Jones*, 366 B.R. at 601. Specifically, the Bankruptcy Court held, "Under these circumstances the Court finds that [Jones's] payment of the disputed fees and charges **was not voluntary or knowing**." *In re Jones*, 366 B.R. at 601 n. 67 (emphasis added). Because Wells Fargo relies on case law requiring the debtor's "full knowledge of the facts" for the Voluntary Payment Doctrine to apply, there is insufficient evidence that Bankruptcy Court erred when it distinguished *New Orleans & N. E. R. Co.*

Indeed, Wells Fargo's assertion that Jones "was sufficiently knowledgeable about the disputed charges"[35] does not overcome the Bankruptcy Court's finding that Jones lacked "full knowledge." As noted above, a bankruptcy court's findings of fact are subject to clearly erroneous review. Fed. R. Bankr. P. 8013. Again, the Bankruptcy Court reviewed the facts and found that Jones had less than "full knowledge:"

> At the outset, the Court notes that Wells Fargo has charged Debtor's account, post confirmation, with previously undisclosed attorney's fees, inspection charges, and a 'statutory expense.' These fees were accrued and paid from amounts delivered by the Trustee to satisfy Debtor's arrearage claim or from direct mortgage installment payments of Debtor tendered to satisfy principal, accrued interest, and escrow charges. Only after the institution of this adversary [proceeding] did Debtor discover, through discovery, the existence of these charges as they were not previously disclosed on any statement, coupon, or notice to Debtor, nor were they identified for the Trustee or Court.

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[35] Rec. Doc. 34, p. 82.

In re Jones, 366 B.R. 595. This Court determines that Wells Fargo's bare assertion that Jones had "sufficient knowledge" does not overcome the "clearly erroneous" standard.

9. JONES VIOLATED THE AUTOMATIC STAY

Wells Fargo claims that Jones violated the automatic stay by paying his attorney $5,206.25. Wells Fargo asserts that a conflict of interest was created between Jones, his attorney, and the plan because the funds paid to counsel could have satisfied the creditors. In addition, Wells Fargo argues that the Bankruptcy Court erred by failing to disqualify Jones's attorney following the unauthorized post-petition transfer of $5,206.25. Finally, Wells Fargo claims that the Bankruptcy Court committed manifest error when it denied Wells Fargo's motion to strike the request for attorney's fees without a hearing.

Wells Fargo's assertion that Jones violated the automatic stay originated in Wells Fargo's post-trial Motion to Strike Request for Attorney's Fees, filed February 16, 2007.[36] On March 9, 2007, the Bankruptcy Court summarily dismissed Wells Fargo's Motion to Strike Request for Attorney's Fees, holding that Wells Fargo's Motion to Strike "was filed prematurely."[37]

After a thorough review of the record, it does not appear that this issue was ever substantively addressed by the Bankruptcy Court. Furthermore, the Court has been unable to determine in which appeal(s), 07-7993,07-7994, 07-7995, 07-7996, 07-7997, 07-7998, 07-9229, Wells Fargo initially raised this issue. Because the Bankruptcy Court did not address the merits of Wells Fargo's argument, this issue does not appear ripe for review. Moreover, this is a

[36] Bankruptcy Case No. 06-1093, Rec. Doc. 53.

[37] Bankruptcy Case No. 06-1093, Rec. Doc. 64.

spurious issue because it has no bearing on the Bankruptcy Court's finding that Wells Fargo violated the Bankruptcy Code's automatic stay.

10. INSPECTION FEES AND OTHER CHARGES

Wells Fargo asserts that the Bankruptcy Court committed manifest error in ruling that the inspection fees and other charges that Wells Fargo assessed were unreasonable. Wells Fargo argues that it is inherently reasonable for a lender, holding a defaulted loan, to inspect the property, and to assess $15.00 fees for the inspections. Again, Wells Fargo claims that it is improper for a bankruptcy court to interfere with a bank's policies to protect collateral when the right to inspect was established as part of the mortgage agreement.

In the Memorandum Opinion, the Bankruptcy Court stated,

> Wells Fargo bears the burden of establishing that the charges it seeks to impose against Debtor's loan are reasonable. Based on the testimony of Wells Fargo and the inspection reports offered into evidence, this Court concludes that Wells Fargo has failed to meet its burden. Wells Fargo did not show that Debtor's property was improperly maintained, nor did it show that Debtor had a history of failure to maintain his property. The inspection reports change little from month to month, and nothing in them gives cause for concern. Thus, nothing in the reports justified continued monitoring. Given Wells Fargo's failure to explain the necessity of the services or their reasonableness, the charges may not be assessed against Debtor's account.

In re Jones, 366 B.R. at 598 (footnote omitted). Wells Fargo now argues that it was manifest error for the Bankruptcy Court to rule that ALL of the inspection fees were reasonable. However, Wells Fargo has failed to support its position with case law or other authority.

This Court reviews the Bankruptcy Court's legal rulings *de novo*. Because Wells Fargo has not supported its assertion with authority, even under the less stringent *de novo* standard, there are no grounds to reverse the Bankruptcy Court's ruling. Indeed, the inspection fees are inherently unreasonable in this case because the Bankruptcy Code's automatic stay should have

halted Wells Fargo's foreclosure proceedings, and Wells Fargo should have treated the loan as current as of the petition date.[38] The fact that Wells Fargo continued to amass undisclosed fees against Jones was unreasonable given these circumstances.

11. WELLS FARGO'S STAY VIOLATION

Wells Fargo argues that the Bankruptcy Court erred by finding Wells Fargo in violation the automatic stay. Again, Wells Fargo asserts that the amount due in the payoff letter was proper because the Bankruptcy Court authorized Jones's refinancing, on the condition that Wells Fargo be paid the amount due under the mortgage, not just the amount in the proof of claim. As argued above, Wells Fargo reiterates its position that it was entitled to make assessments against Jones's account for reasonable post-petition costs, including inspection fees.

Again, the Bankruptcy Court did not find that Wells Fargo violated the automatic stay because of the terms of the mortgage agreement. Instead, the Bankruptcy Court found that Wells Fargo was in violation because it failed to disclose the fees to Jones, the court, or the Trustee, in combination with Wells Fargo's mis-application of funds. "Wells Fargo applied [Jones's] direct postpetition installment payments to those payments owed prepetition" in derogation of the terms of the plan. *In re Jones*, 366 B.R. at 589. Specifically, the Bankruptcy Court found that Wells Fargo's accounting procedures "failed to recognize that prepetition charges, fees, and missed payments were to be separately paid by the Trustee under the plan and did not bear

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[38] *In re Jones*, 366 B.R. at 590 (noting, "[r]ather than recalibrate the loan as current on the petition date, Wells Fargo continued to carry the past due amounts contained in its proof of claim in Debtor's loan balance. Wells Fargo applied any amounts received, regardless of source or intended application, to pre and postpetition charges, interest and noninterest bearing debt."). Furthermore, during the adversary proceeding, "[t]he Sheriff also testified that if the foreclosure suit had been dismissed on the petition date, no commissions or other charges would have been due, and the Sheriff would have refunded the unused portion of the deposit." *Id.* at 591.

interest." *Id.* Furthermore, the Bankruptcy Court found that Wells Fargo's proof of claim overstated the costs that were actually incurred. *Id.* at 591 (noting that Wells Fargo listed $1,283.87 in prepetition foreclosure costs, but that the testimony at trial demonstrated that the actual amount was $743.87). The Bankruptcy Court also noted Wells Fargo's admission that it "had collected sums in excess of the amounts necessary to satisfy the loan." *Id.* at 588 (referencing a January 12, 2006 letter from Wells Fargo to Jones). Therefore, Wells Fargo's assertion the Bankruptcy Court "erred when it ruled that the assessment of interest, fees, commissions, and costs due to Wells Fargo under the terms of the mortgage violated the stay" is a misstatement of the Bankruptcy Court's findings. Stated another way, Wells Fargo either does not understand the Bankruptcy Court's rationale for finding a stay violation, or is mischaracterizing the Bankruptcy Court's findings on appeal. Consequently, Wells Fargo's argument does not undermine the Bankruptcy Court's findings.

12. AMENDED AND SECOND AMENDED JUDGMENTS EXCEEDED BANKRUPTCY COURT'S AUTHORITY

Wells Fargo asserts that the Bankruptcy Court did not have the authority to fashion the remedies in the amended judgments because the Bankruptcy Court's ruling limited the rights of Wells Fargo to collect post-petition amounts due under the mortgage. Indeed, Wells Fargo argues that the amended judgments go beyond the authority granted under the Bankruptcy Code. Specifically, Wells Fargo objects to the requirement that it issue annual notices of post-petition charges. Again, relying on *Nobleman*, Wells Fargo claims that bankruptcy courts can modify the **claims** of secured creditors, but not the **rights** of such lenders. Furthermore, Wells Fargo argues that the Bankruptcy Court did not have the authority to regulate non-parties by ordering that the amended judgments apply to all "debtors with pending bankruptcy cases."

1. Invited Error

As an initial matter, the Court notes an inconsistency in the record. The Amended and Second Amended Judgments ordered Wells Fargo to implement new accounting procedures "[a]s an alternative to the imposition of punitive monetary damages.[39] It appears that the new

[39] The Second Amended Judgment, Bankruptcy Case No. 06-1093, Rec. Doc. 183, states:

1. Upon the filing of a chapter 13 bankruptcy petition, the amounts outstanding on a debtor's loan will be divided into two new, internal administrative accounts. The first account will contain the sums to be paid under debtor's plan by the Chapter 13 Trustee; typically the pre-petition past due amounts including past due interest, costs, charges, and fees ("Account One"). The opening balance on Account One should directly correlate to the amounts reflected on Wells Fargo's proof of claim. Account One will also include any amounts added by subsequent court order to the plan for payment by the Trustee during the case's administration. All payments made by the Trustee will be applied to the reduction of the amounts owed on Account One.

The second account will reflect the principal amount due on the petition date3 ("Account Two"). No other sums should be owed on Account Two at the start of the case. Account Two will include post-petition interest accrual, post-petition property insurance or property tax expenditures, and other court authorized post-petition charges as provided in paragraph 2 below.4 A debtor's regular monthly note payments will be posted to this account, reducing post-petition interest accrual, post-petition property and tax expenditures, and principal. The account's first posting will typically be the first installment payment due on the loan following the petition date.

Wells Fargo may maintain, post-petition, its customary records on the loan provided that the two new internal accounts shall control the loan's administration during the pendency of the case.

2. With the exception of post-petition property taxes and property insurance expenditures, Wells Fargo may provisionally accrue, but not assess or collect, any post-petition charges, fees, costs, etc. allowed by the note, security agreement and state law. Post-petition property tax and insurance expenditures may be assessed against debtor's account and collected after the delivery of a ten day written notice to debtor, debtor's counsel, and the Trustee. The assessment and collection of expenditures for post-petition property insurance and taxes will not require approval of the bankruptcy court unless a written objection is filed within 10 days of the notice of assessment and collection. If authorized by Wells Fargo's note, security agreement, and state law, the collection of amounts necessary to pay post-petition insurance and property tax expenditures may be made in advance through the use of escrow accounts. If escrows are utilized, Wells Fargo must give a written accounting of the amounts collected at the time it seeks to apply the escrowed funds to payment of the insurance or property tax expenditures.

"accounting procedures" were actually proposed by Wells Fargo. Indeed, the Bankruptcy Court's Supplemental Memorandum Opinion, Bankruptcy Case No. 06-1093, Rec. Doc. 153, p. 10, states, "As an alternative to the imposition of punitive monetary damages, **Wells Fargo has**

As to Post-Petition Charges, annually, between January 1 and February 28 of each year during a case's administration, Wells Fargo shall file with the Court and serve upon the debtor, debtor's counsel, and the Trustee, notice of any Post-Petition Charges (which do not include property taxes or insurance), accrued in the preceding calendar year. The notice shall contain an itemization describing the charge, amount provisionally incurred, the date incurred, and if relevant, the name of the third party to whom the charge was paid. The notice will also provide a direct reference to the provisions of the note, security agreement, or state law under which Wells Fargo asserts its authority to assess each type of charge.

The notice shall also state that debtors, the Trustee, and any other interested party, shall have 30 days within which to object to any or all assessments outlined in the notice. It shall contain a statement to the effect that debtor may elect to add the charges to his plan with approval of the bankruptcy court, satisfy the charges directly outside the plan, or defer repayment until the conclusion of his case.

If no objection to the amounts provisionally assessed is filed, or if filed, upon entry of an order approving some amount of the provisional charges, Wells Fargo may submit a proposed *ex parte* order authorizing assessment of the Post-Petition Charges as set forth in its notice or as approved by the court, as applicable. However, Wells Fargo may not collect on any approved Post- Petition Charges unless the debtor voluntarily delivers payment separate and above from that due as a regular monthly installment or obtains approval of the court to modify the plan and satisfy the amounts due through periodic payments by the Trustee. If the approved Post-Petition Charges are to be paid through the modified plan, they will be added to Account One and satisfied by the Trustee. If to be paid by the debtor, they may be added to Account Two. If no provision for payment is made by a debtor, the collection of the approved Post-Petition Charges must be deferred until the close of the case or relief from the stay is obtained.

3. If Wells Fargo does not issue a notice of Post-Petition Charges, in accordance with paragraph 2, for any given year of the case's administration, then Wells Fargo shall be prohibited from collecting or assessing any charges accrued against the debtor for that year and shall treat the debtor as fully current at the time of discharge.

4. Upon the issuance of a discharge, Wells Fargo shall adjust its permanent records to reflect the current nature of debtor's account. Provided however, that if debtor elected to defer the payment of approved Post-Petition Charges until the conclusion of the case's administration, then Wells Fargo shall be authorized to collect said sums in accordance with the provisions of its note, security instrument, and state law.

offered to revise its practices in connection with all loans administered in the Eastern District of Louisiana . . . Wells Fargo has proposed [the identical procedures listed in n. 39]."[40]

Wells Fargo's right to appeal the imposition of the new "accounting procedures" is uncertain because Wells Fargo proposed the new "accounting procedures." The doctrine of "invited error" may bar Wells Fargo's claim. "The invited error doctrine provides that 'a party may not complain on appeal of errors that he himself invited or provoked the court . . . to commit.'" *Munoz v. State Farm Lloyds of Texas*, 522 F.3d 568, 573 (5th Cir. 2008) (quoting *United States v. Sharpe*, 996 F.2d 125, 129 (6th Cir.1993)). Invited error doctrine is usually applied in the context of evidentiary errors; however, the doctrine may apply under these circumstances. *See Capella v. Zurich General Acc. Liability Ins. Co.*, 194 F.2d 558, 660 (5th Cir. 1952) (stating, "counsel may not invite error and then complain of it.").

Furthermore, Wells Fargo's assertion that the new accounting procedures impermissibly modify the *rights* of secured creditors is unconvincing. The accounting procedures in the Amended Judgments state, "Wells Fargo may provisionally accrue, but not assess or collect, any post-petition charges, fees, costs, etc. allowed by the note, security agreement and state law."[41] Clearly, the language of the Amended Judgments does not inhibit Wells Fargo's *right* to accrue charges against debtors; however, the Amended Judgments outline a set of procedures for collecting the amounts due during bankruptcy proceedings.

2. Bankruptcy Court's Authority to Impose "New Procedures"

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[40] See the discussion, *infra*, detailing an in court discussion between Wells Fargo's counsel, Wells Fargo's corporate representative, Ms. Miller, and the Bankruptcy Judge about Wells Fargo's consent to implement new accounting procedures.

[41] Bankruptcy Case No. 06-1093, Rec. Doc. 183, "Second Amended Judgment," ¶ 2.

First, "[t]he issue of awarding punitive damages is also appropriately reviewed under an abuse of discretion standard." *In re Adomah*, 368 B.R. 134, 137 (S.D.N.Y. 2007) (citing *In re Fugazy Express*, 124 B.R. 426, 430 (S.D.N.Y.1991)). Section 362(k)(1) of the Bankruptcy Code states that "any individual injured by any willful violation of the stay provided by this section shall recover actual damages . . . and, in appropriate circumstances, **may recover punitive damages**." 11 U.S.C. § 362(k)(1) (emphasis added).

As the Bankruptcy Court noted, "[p]unitive damages are warranted when the conduct in question is willful and egregious, or when the defendant acted 'with actual knowledge that he was violating the federally protected right or with reckless disregard of whether he was doing so.'" *In re Jones*, 2007 WL 2480494, at *4 (Bkrtcy.E.D.La. 2007) (citing *In re Ketelsen*, 880 F.2d 990, 993 (8th Cir. 1989); quoting *In re Sanchez*, — B.R. —, 2007 WL 2137790, at * 18 (Bankr.S.D.Tex. 2007)).

Section 105 of the Bankruptcy Code defines a bankruptcy court's power:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

11 U.S.C. § 105(a).

The First Circuit noted that Section 105, "[a]lthough expansively phrased . . . affords bankruptcy courts considerably less discretion than first meets the eye, and in no sense constitutes a roving commission to do equity." *In re Ludlow Hosp. Soc., Inc*., 124 F.3d 22, 27 (1st Cir. 1997). "Instead, the equitable discretion conferred upon the bankruptcy court by

section 105(a) is limited and cannot be used in a manner inconsistent with the commands of the Bankruptcy Code." *Id.*

Similarly, the Ninth Circuit has stated, "whatever equitable powers remain in bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." *In re Myrvan*, 232 F.3d 1116, 1124 (9th Cir. 2000) (quoting *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988)). The Ninth Circuit then described the trend to limit Section 105 powers:

> More recent opinions at the circuit level are equally insistent that a bankruptcy court's application of § 105(a) is limited to those situations where it is "a means to fulfill some specific Code provision." *In re Fesco Plastics Corp*., 996 F.2d 152, 154 (7th Cir. 1993); see *IRS v. Kaplan* (*In re Kaplan*), 104 F.3d 589, 597-98 (3d Cir. 1997) ("'[T]he fact that a [bankruptcy] proceeding is equitable does not give the judge a free-floating discretion to redistribute rights in accordance with his [or her] personal views of justice and fairness, however enlightened those views may be.'" (alterations in original) (quoting *In re Chicago, Milwaukee, St. Paul and Pac. R.R.*, 791 F.2d 524, 528 (7th Cir. 1986))); *Noonan v. Secretary of Health and Human Servs*. (*In re Ludlow Hosp. Soc'y, Inc*.), 124 F.3d 22, 27 (1st Cir. 1997) ("[T]he equitable discretion conferred upon the bankruptcy court . . . 'cannot be used in a manner inconsistent with the commands of the Bankruptcy Code.' " (quoting *In re Plaza de Diego Shopping Ctr., Inc*., 911 F.2d 820, 824 (1st Cir. 1990))).

Id. at 1124-25.

The Fifth Circuit discussed Section 105, holding:

> While the bankruptcy courts have fashioned relief under Section 105(a) in a variety of situations, the powers granted by that statute may be exercised only in a manner consistent with the provisions of the Bankruptcy Code. That statute does not authorize the bankruptcy courts to create substantive rights that are otherwise unavailable under applicable law, or constitute a roving commission to do equity.

U.S. v. Sutton, 786 F.2d 1305, 1308 (5th Cir. 1986).

In this case, the Bankruptcy Judge ordered that Wells Fargo implement new accounting procedures to prevent Wells Fargo from violating the automatic stay in other bankruptcy cases. The Bankruptcy Judge imposed the new accounting procedures to help protect future debtors

from harm;[42] this is injunctive relief.[43] The Supreme Court has stated that bankruptcy courts "are essentially courts of equity, and their proceedings inherently proceedings in equity." *Continental Illinois Nat. Bank & Trust Co. of Chicago v. Chicago, R.I. & P. Ry. Co.*, 294 U.S. 648, 675 (1935) ("[t]he power to issue an injunction when necessary to prevent the defeat or impairment of its jurisdiction is, therefore, inherent in a court of bankruptcy.").

"[T]he main prerequisite to obtaining injunctive relief is a finding that plaintiff is being threatened by some injury for which he has no adequate legal remedy." Wright & Miller, 11A FED. PRAC. & PROC. CIV. 2d § 2942. Additionally, the Fifth Circuit adheres to the traditional test for injunctive relief:

> a permanent injunction must meet a four-part test. It must establish (1) success on the merits; (2) that a failure to grant the injunction will result in irreparable injury; (3) that said injury outweighs any damage that the injunction will cause the opposing party; and (4) that the injunction will not disserve the public interest.

VRC LLC v. City of Dallas, 460 F.3d 607, 611 (5th Cir. 2006).

The Bankruptcy Court clearly had the authority to impose punitive damages against Wells Fargo pursuant to Section 362 because the Bankruptcy Court determined that Wells Fargo's conduct was "egregious."[44] However, the record does not indicate that the Bankruptcy

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[42] The Bankruptcy Judge specifically stated, "The imposition of monetary sanctions to reimburse Debtor for costs and legal fees incurred will not, in this Court's opinion, deter Wells Fargo from future objectionable conduct." *In re Jones*, 2007 WL 2480494, at *5 (Bkrtcy.E.D.La. 2007).

[43] Douglas Laycock, MODERN AMERICAN REMEDIES 235 (2002) (noting "an injunction is a court order, enforceable by sanctions for contempt of court, directing defendant to do or refrain from doing some particular thing. The injunction against future violations of law is the simplest use of the injunction.")

[44] Specifically, the Bankruptcy Court stated,

> Wells Fargo assessed post-petition charges on a loan being paid through a plan of

Court considered whether imposing the new accounting procedures, as equitable relief, was warranted because there was "no adequate legal remedy." Instead, the Bankruptcy Court found:

> the imposition of monetary sanctions to reimburse Debtor for costs and legal fees incurred will not, in this Court's opinion, deter Wells Fargo from future objectionable conduct. Wells Fargo is a national lender, listed on the New York Stock Exchange, with considerable financial resources. The imposition of a $67,202.45 damage award is de minimus, and insufficient to act as a deterrent to future misconduct.

In re Jones, 2007 WL 2480494, at *5 (Bkrtcy.E.D.La. 2007). In addition, it does not appear from the record that the Bankruptcy Court considered the four-part test for injunctive relief before imposing the new accounting procedures "[a]s an alternative to the imposition of punitive monetary damages."[45] Again, this Court notes that the action of the Bankruptcy Judge may well have seemed justified in light of Wells Fargo having proposed the new accounting procedures in the first place. However, it appears that Wells Fargo's "consent" to the new accounting procedures has been revoked.[46] Accordingly, the equitable remedy that the Bankruptcy Judge imposed must be remanded for additional consideration.

13. INITIAL "FINAL" JUDGMENT DIVESTED BANKRUPTCY COURT'S AUTHORITY TO ENTER AMENDED AND SECOND AMENDED JUDGMENTS

> reorganization. However, it was not the assessment of the charges, but the conduct which followed that this Court finds sanctionable. Despite assessing post-petition charges, Wells Fargo withheld this fact from its borrower and diverted payments made by the Chapter 13 Trustee ("Trustee") and Debtor to satisfy claims not authorized by the plan or Court. Wells Fargo admitted that these actions were part of its normal course of conduct, practiced in perhaps thousands of cases. The Court finds this conduct to be egregious.

In re Jones, 2007 WL 2480494, at *4 (Bkrtcy.E.D.La. 2007).

[45] *In re Jones*, 2007 WL 2480494, at *5 (Bkrtcy.E.D.La. 2007).

[46] See discussion of Wells Fargo's consent, *infra*

Wells Fargo asserts that the April 13, 2007 Judgment was a final decree, and that filing the notice of appeal on May 10, 2007 divested the Bankruptcy Court of jurisdiction. On that basis, Wells Fargo argues that the Amended Judgments, entered in August and September 2007, were promulgated without authority. Wells Fargo extends the argument to assert that the later reformation of the April 13, 2007 "judgment" into a "partial judgment" was error, and the award of $67,202.45 is void.

The April 13, 2007 "Judgment" was not a "final judgment" ripe for appeal because the Bankruptcy Court explicitly reserved the issue of damages for a hearing on May 16, 2007.[47] As the Fifth Circuit noted in *Matter of Morrell*:

> where assessment of damages or awarding of other relief remains to be resolved [judgments] have never been considered to be 'final' within the meaning of 28 U.S.C. § 1291. The concept of finality employed to determine appealability under the Bankruptcy Code is 'open to a more liberal interpretation' than that applicable to civil litigation governed by 28 U.S.C. § 1291 but this liberality stems from practicality, and is limited by it in turn. Determinations of liability without an assessment of damages are as likely to cause duplicative litigation in bankruptcy as they are in civil litigation, and because bankruptcy litigants may appeal to district as well as to appellate courts, the waste of judicial resources is likely to be greater.

Matter of Morrell, 880 F.2d 855, 856-57 (5th Cir. 1989) (quoting *Liberty Mutual Ins. Co. v. Wetzel*, 424 U.S. 737, 744 (1976); 1 Collier on Bankruptcy § 3.03[6][b] at 3-181 (1989) (internal citations and footnotes omitted)).

Wells Fargo's reliance on *Budinich v. Becton Dickinson & Co.*, and its assertion that "a decision on the merits is a 'final decision' for purposes of § 1291 whether or not there remains

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[47] Bankruptcy Case No. 06-1093, Rec. Doc. 68, "Amended Judgment," ¶ 3.

for adjudication a request for attorney's fees"[48] is unconvincing and inapplicable. The Bankruptcy Court explicitly stated in the April 13, 2007 Judgment that "an evidentiary hearing on the propriety of a sanctions award" would be held at a later date. Bankruptcy Case No. 06-1093, Rec. Doc. 68, "Amended Judgment," ¶ 3. A determination of a "sanctions award" is not the same as an adjudication of attorney's fees. In this case, the Bankruptcy Court imposed a requirement that Wells Fargo implement new "accounting procedures" in the Amended and Second Amended Judgments. Therefore, the Bankruptcy Court retained jurisdiction to determine more than mere attorney's fees. Accordingly, *Matter of Morrell* is controlling over *Budinich*, and thus, the Bankruptcy Court's April 13, 2007 "judgment" was not a "final judgment."[49]

14. WELLS FARGO'S CONSENT (LACK OF CONSENT)

Wells Fargo asserts that it did not consent to the deferred ruling on sanctions and punitive damages, and thus, the Bankruptcy Court committed a reversible error of fact in finding that Wells Fargo consented. Wells Fargo specifically argues that "Wells Fargo discussed the possibility of a consent order with the Bankruptcy Court but there was no consent." Rec. Doc. 34, p. 139 of 146.

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[48] Rec. Doc. 34, p. 135 of 146 (citing *Budinich v. Becton Dickinson & Co.*, 486 U.S. 196 (1988)).

[49] In other words, Wells Fargo's initial appeal from the April 13, 2007 "Judgment" was an interlocutory appeal. The Eight Circuit has held that when a bankruptcy court retains jurisdiction when appellant lodges an interlocutory appeal. *In re Smith*, 212 Fed.Appx. 577, 578 (8th Cir. 2006) (citing *In re Christian & Porter Aluminum Co*., 584 F.2d 326, 334 (9th Cir.1978) (general rule that properly filed notice of appeal deprives trial court of jurisdiction to proceed further except by leave of appellate court does not apply in bankruptcy proceedings)).

The Court finds Wells Fargo's assertion regarding its lack of consent disingenuous. On May 29, 2007, the following exchange took place between counsel for Wells Fargo and the Bankruptcy Judge:

> MR. RUMAGE: [Wells Fargo] really want[s] to try and make sure that this does not happen again in the future. They really -- and Ms. Miller [corporate representative][50] is here to testify if the Court wants her testimony. **They are prepared to implement these accounting procedures**, to audit every account before the discharge, to make sure that they are doing everything that they possibly can to make sure that they are in compliance with the Court's order.
>
> THE COURT: Are they willing to enter into a **consent order** on those terms?
>
> MS. MILLER: Yes.
>
> MR. RUMAGE: Yes, Your Honor.
>
> MS. MILLER: Yes, Your Honor.
>
> THE COURT: Okay. Because that would at least give me something to enforce in the future if there was a problem in the future. Okay.

Bankruptcy Case No. 06-1093, Rec. Doc. 126, Trial Transcript, p. 83 (emphasis added). Assuming that Ms. Miller, as Wells Fargo's Vice President for Bankruptcy, had the authority to bind the company, there is sufficient evidence in the record to support the Bankruptcy Court's finding that Wells Fargo consented to the imposed sanctions. Stated another way, the Bankruptcy Judge reasonably relied on Wells Fargo's statement that it was willing to enter into a consent order because both counsel for Wells Fargo and Wells Fargo's Vice President of the Bankruptcy Department made the affirmative statement, "yes," on the record in response to the Bankruptcy Judge's question: "Are they willing to enter into a **consent order** on those terms?" The Court notes that the Bankruptcy Judge's question was phrased in the future tense, but the

[50] Ms. Miller is a vice president of Wells Fargo, in charge of the Bankruptcy Department, nationwide. Bankruptcy Case No. 06-1093, Rec. Doc. 126, Trial Transcript, p. 45.

Court finds no further indication in the bankruptcy court record that Wells Fargo ever revoked their intent to be bound by the consent order. Indeed, Wells Fargo seems to have shifted its position on the consent order solely for the purposes of seeking reversible error on appeal.

15. THE BANKRUPTCY COURT'S AUTHORITY TO AMEND DISTRICT COURT'S STAY

Wells Fargo argues that the Bankruptcy Court had no authority to amend this Court's September 28, 2007 order granting Wells Fargo's Motion for Stay of Judgment. In the September 28, 2007 order, this Court ruled:

> IT IS ORDERED, that the emergency motion for stay of judgment and orders is GRANTED. The judgments and orders of April 13, 2007 and September 14, 2007 are stayed pending perfection of the supersedeas bond to be set by the Bankruptcy Court.

District Court Case No. 07-5973, Rec. Doc. 3.

On October 16, 2007, the defendant filed a motion to approve the supersedeas bond with the Bankruptcy Court. Bankruptcy Case No. 06-1093, Rec. Doc. 224. On October 19, 2007, the Bankruptcy Court approved the supersedeas bond and then issued an order *partially* granting a stay. Bankruptcy Case No. 06-1093, Rec. Doc. 227. The Bankruptcy Court bifurcated the order of this Court, ruling:

> IT IS ORDERED that Wells Fargo's Motion for a Stay Pending Appeal is GRANTED, IN PART, and the monetary judgment portion of the Second Amended Judgment is stayed, provided Wells Fargo submits a bond in the amount of $100,891.24.
>
> IT IS FURTHER ORDERED that Wells Fargo's Motion for a Stay Pending Appeal is DENIED, IN PART, and the non-monetary portion of the Second Amended Judgment that requires new accounting procedures will not be stayed.

Bankruptcy Case No. 06-1093, Rec. Doc. 227.

Wells Fargo correctly argues that Bankruptcy Rule 8005 authorizes district courts to issue a stay in matters that are appealed from the bankruptcy courts. Rule 8005 states, "subject to the power of the district court and the bankruptcy appellate panel, reserved hereinafter, the bankruptcy judge may suspend or order the continuation of other proceedings in the case under the Code or make any other appropriate order during the pendency of an appeal . . . ." 11 U.S.C.A. § 8005 (West 2005). Again, this Court ruled that "[t]he judgments and orders of April 13, 2007 and September 14, 2007 are stayed pending perfection of the supersedeas bond to be set by the Bankruptcy Court." Under these circumstances, the Bankruptcy Judge could reasonably assume that this Court's stay was automatically lifted once the supersedeas bond was set. Therefore, Wells Fargo's assertion that the Bankruptcy Judge exceeded her authority is unconvincing. In addition, the new accounting procedures will be revisited on remand in the bankruptcy court.

IV. CONCLUSION

Accordingly,

IT IS ORDERED, that the Judgments of the Bankruptcy Court are AFFIRMED IN PART, REVERSED IN PART, and the matter is REMANDED for further action consistent with this Order and Reasons.

New Orleans, Louisiana, this 1st day of July, 2008.

HELEN G. BERRIGAN
UNITED STATES DISTRICT JUDGE