



AMERICAN  
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*Concurrent Session:*  
**Ethical Issues for Creditors  
in Consumer Cases**

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**Ethical Issues for Creditors in Consumer Cases  
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**Issues in Representing Mortgage Servicers**

The widespread use of securitization in the mortgage market fed the rapid growth of the mortgage servicing industry.<sup>1</sup> The mortgage servicer acts as the intermediary between the borrower and the investors, and its primary function is to collect payments from borrowers for the benefit of the investors.<sup>2</sup>

Once a borrower has filed a bankruptcy petition, particularly in chapter 13, inaccurate and improper fees and charges assessed pre-petition may show up in erroneous proofs of claims and objections to the confirmation of the debtor's chapter 13 plan. The servicer may also misapply payments received post-petition, resulting in fees and charges assessed in error and improper motions for relief from stay.<sup>3</sup> Worse yet, these post-petition errors may not be disclosed until after the debtor has received his discharge, in which event he may face a foreclosure action.<sup>4</sup> And even if the servicer timely received and properly applied all payments received post-petition, the debtor may still face foreclosure immediately following discharge because of undisclosed post-confirmation escrow and payment changes.

Recently, a number of bankruptcy courts have imposed substantial sanctions on mortgage servicers, and in some cases, their counsel. This outline illustrates the types of practices that the courts have found objectionable and of which counsel should be aware.

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<sup>1/</sup> See Katherine Porter, Misbehavior and Mistake in Bankruptcy Mortgage Claims, 87 Tex. L. Rev. 121, 126 (2008). Securitizing mortgages involves the creation of a trust into which a group of secured mortgage loans are transferred. Fractional interests in the trust are sold to investors, who receive periodic payments on account of those interests. Id.

<sup>2/</sup> Id.

<sup>3/</sup> A chapter 13 debtor may provide for the cure of a pre-petition mortgage arrearage through the confirmed plan. 11 U.S.C. § 1322(b)(5). Jurisdictions vary as to whether the debtor is required to pay ongoing, post-petition mortgage payments through the plan. Thus, the filing of a chapter 13 bankruptcy case requires that the mortgage servicer separately account for the pre- and post-petition payments, which may be received from the trustee or, in many instances, from both the trustee and the debtor.

<sup>4/</sup> As demonstrated below, the law is unsettled as to the servicer's ability to assess, and its obligation to provide notice of, post-petition fees and charges. Generally, a debtor may amend a confirmed plan to include post-petition fees and charges, in accordance with the requirements of 11 U.S.C. § 1329.

## **I. Recent Bankruptcy Decisions Finding Sanctionable Conduct by the Creditor.**

Most of these cases involve inaccurate or improper proofs of claim, objections to discharge, motions for relief from stay, or post-discharge foreclosures. These courts have imposed a variety of sanctions, including attorneys' fees, punitive damages, and injunctive relief.

### **A. The Jones Decisions.**

**Jones v. Wells Fargo Home Mortgage (In re Jones)**, 366 B.R. 584 (Bankr. E.D. La. 2007) (Jones I). Wells Fargo improperly assessed post-petition and post-confirmation fees and charges, including fees for 16 property inspections, foreclosure charges that were never incurred or were reversed, and attorneys' fees, and misapplied payments intended to cure the pre-petition arrearage and meet post-petition obligations. The court found that Wells Fargo was not entitled to collect attorneys' fees for the post-petition, pre-confirmation period because it had not sought approval of these fees under 11 U.S.C. § 506(b) and Fed. R. Bankr. P. 2016(a). The court held that post-confirmation fees and costs are governed by state law and the mortgage contract. The court determined that Wells Fargo violated 11 U.S.C. § 362(a)(3) and (a)(6), concluding that the mortgage creditor's satisfaction of post-petition charges constituted a taking of property of the estate and impacted the debtor's ability to comply with the terms of the plan. After finding a violation of the automatic stay, the court found that section 362(k) applied, and set a further hearing to determine whether sanctions were appropriate for violation of the stay.

In a subsequent opinion, **Jones v. Wells Fargo Home Mortgage (In re Jones)**, Adv. No. 06-01093, 2007 WL 2480494 (E.D. La. Aug. 29, 2007) (Jones II), the court awarded the debtor attorneys' fees and costs of \$67,202 and, as an alternative to punitive damages, ordered the mortgage company to implement detailed accounting procedures for debtors with pending bankruptcy cases.

Wells Fargo appealed and, in **Wells Fargo Bank, N.A., f/k/a Wells Fargo Home Mortgage, Inc. v. Jones (In re Jones)**, 391 B.R. 577 (E.D. La. 2008) (Jones III), the district court affirmed in part, reversed in part, and remanded. It rejected Wells Fargo's argument that the \$67,202 award was not based on the lodestar method and that there was no factual basis for the amount. It also rejected the argument that the lender was entitled to assess post-petition inspection and other fees under its loan documents and therefore did not violate the automatic stay. The court found that the detailed accounting procedures imposed by the bankruptcy court in lieu of punitive damages were in the nature of an injunction, and remanded for the court to apply the four-part test for injunctive relief set forth in VRC LLC v. Dallas, 460 F.3d 607, 611 (5th Cir. 2006).

**B. In re Stewart**, 391 B.R. 327 (Bankr. E.D. La. 2008), *appeal filed*, No. 08-03225 (E.D. La. filed May 12, 2008). Following at least three hearings on the debtor's objection to Wells Fargo's proof of claim and request for an accounting, the bankruptcy court determined that Wells Fargo charged or collected erroneous, unreasonable, or unsubstantiated fees without notice to the court or the debtor, including inspection fees (43 inspections over 79 months at

\$15/inspection), broker's price opinions, escrow for insurance and property taxes, attorneys' fees, and late fees. The court also determined that the alleged third-party broker's price opinions were actually payments with an improper profit component to Premiere Asset Services, a division of Wells Fargo. The bankruptcy court further found that Wells Fargo improperly applied payments to these improper fees and charges first, rather than to escrow, principal, and interest, as required by the note and mortgage. The court awarded damages of \$10,000; imposed a \$2,500 sanction upon Wells Fargo, payable to the debtor, for presenting the court with a "consent" adequate protection order, including fees not agreed to between the parties; imposed an additional \$2,500 sanction for filing erroneous proofs of claim and misrepresenting the costs associated with Premiere Asset Services to the court; further sanctioned Wells Fargo \$12,350 for the debtor's legal fees; and ordered Wells Fargo to file an amended proof of claim.

In addition, the bankruptcy court found that Wells Fargo had taken insufficient remedial action in light of Jones v. Wells Fargo Home Mortgage (In re Jones), 366 B.R. 584 (Bankr. E.D. La. 2007) (Jones I), and Jones v. Wells Fargo Home Mortgage (In re Jones), Adv. No. 06-01093, 2007 WL 2480494 (E.D. La. Aug. 29, 2007) (Jones II), *supra*. The bankruptcy court ordered Wells Fargo to conduct an audit of all proofs of claim filed on its behalf in the Eastern District of Louisiana in cases pending on, or filed after, April 13, 2007 (the date of Jones I), and to provide a loan history on every account.<sup>5</sup> As to pending cases, the court ordered Wells Fargo to file the loan histories on the claims register and amend proofs of claim where necessary. For closed cases, the court ordered Wells Fargo to deliver the loan histories to the debtor, debtor's counsel, and the chapter 13 trustee.

**C. In re Fitch**, 390 B.R. 834 (Bankr. E.D. La. 2008), *appeal filed*, No. 08-03852 (E.D. La. filed June 26, 2008). Debtors objected to Wells Fargo's proof of claim and sought documentation to support undisclosed fees and charges, including broker's price opinions, inspection fees, and past due escrow amounts. The court scheduled several hearings to allow Wells Fargo time to document these fees and the balance due on the claim. Wells Fargo provided partial payment histories which each showed a different amount due and none of which matched the proof of claim on file. The court found that Wells Fargo improperly calculated the escrow account balance and substantially overstated the amount owed, and struck the charges attributable to broker's price opinions, inspection fees, and past due escrow amounts. The court also found that Wells Fargo violated RESPA, entitling the debtors to reasonable fees of \$3,500, but the court did not sanction Wells Fargo further so long as it complied with the court's prior decisions in Stewart and Jones II, *supra*.

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<sup>5/</sup> See AO 2008-2 (Bankr. E.D. La. May 9, 2008) (available at <http://www.laeb.uscourts.gov>), *appeal filed*, Wells Fargo Bank, N.A. v. Stewart (In re Stewart), No. 08-CV-3669 (E.D. La. filed June 9, 2008) (consolidated with Case No. 08-CV-3225).

**D. The Nosek Decisions.**

**Nosek v. Ameriquest Mortgage Co. (In re Nosek)**, No. 04-04517, 2006 WL 1867096 (Bankr. D. Mass. 2006) (**Nosek I**). The bankruptcy court in **Nosek** imposed substantial sanctions against a mortgage servicer in connection with its violation of 11 U.S.C. § 1322(b) in connection with its failure to account for and distinguish pre- and post-petition payments made by the debtor. The debtor's chapter 13 plan provided for payment of both a pre-petition arrearage and his ongoing mortgage. The debtor's challenge as to how payments were credited brought to light that the payment histories provided to the debtor reflected no distinction between the pre- and post-petition treatment of the debtor's mortgage. In fact, the servicer's internal procedures caused payments to be paid into a "suspense" account, creating the impression of perpetual default. The court found that the creditor violated RESPA and state consumer protection laws, but awarded no damages on these claims. The court also determined that the servicer violated 11 U.S.C. § 1322(b) by its inability to account for and properly distinguish between pre- and post-petition payments, and awarded damages of \$250,000.

On appeal, **Nosek v. Ameriquest Mortgage Co. (In re Nosek)**, 354 B.R. 331 (D. Mass. 2006) (**Nosek II**), the district court ruled that claims under RESPA and for breach of contract were unavailable to the debtor, but remanded for consideration of the state law consumer protection claim. The district court also remanded on the bankruptcy court's determination that the creditor violated 11 U.S.C. § 1322(b), holding that the bankruptcy court erred in grafting onto the plan an implied covenant of fair dealing, and must instead assess any damages under the court's equitable powers pursuant to 11 U.S.C. § 105(a). On remand, **Nosek v. Ameriquest Mortgage Co. (In re Nosek)**, 363 B.R. 643 (Bankr. D. Mass. 2007) (**Nosek III**), the bankruptcy court dismissed the state consumer protection claim, but assessed damages for the violation of section 1322(b) under its section 105(a) equitable powers. The court assessed actual damages of \$250,000 (consistent with the original damages awarded in **Nosek I**), plus punitive damages of \$500,000 for the creditor's "wholly unacceptable" accounting practices. The district court affirmed.

The First Circuit Court of Appeals reversed, **Ameriquest Mortgage Co. v. Nosek (In re Nosek)**, 544 F.3d 44 (1st Cir. 2008) (**Nosek IV**), finding that 11 U.S.C. § 105(a) could be used only to enforce compliance with court orders or the Bankruptcy Code. Thus, the court held that section 105(a) could not be used to sanction conduct unless that conduct violated some right provided elsewhere in the Code or a court order. The First Circuit also held that 11 U.S.C. § 1322(b) merely provides optional elements for a plan, and does not impose any obligations on a creditor. The court found that nothing in the debtor's plan obligated Ameriquest to follow any particular accounting method for the payments it received from the debtor. The First Circuit also found that the bankruptcy court erred by holding that Ameriquest had violated the debtor's right to cure her default, since there was no evidence that her right to cure had been impaired by Ameriquest's actions. In *dicta*, the First Circuit suggested that if the debtor's ability to cure her default was threatened, the proper response would have been an amendment to the plan clarifying the accounting practices necessary to eliminate that threat. Because no violation of the Bankruptcy Code or the plan occurred, the First Circuit concluded that the section 105(a) award

was improper and remanded the case to the bankruptcy court with instructions to dismiss the debtor's complaint.

In the interim, the debtor filed a separate adversary proceeding against the creditor demanding payment of the judgment rendered in Nosek III and attorneys' fees, Adv. Nos. 04-04517 and 07-04109 (Nosek V). During the proceeding, Ameriquest informed the court for the first time that it was not the holder of the mortgage. The court determined that Ameriquest had originated the mortgage in 1997, but had assigned it five days later to Norwest Bank, Minnesota, N.A., now known as Wells Fargo Bank. The assignment was recorded in 2000, and Ameriquest ceased acting as the servicer on the loan in 2005. The court found that Ameriquest misrepresented its role throughout the course of the proceedings, both in pleadings and representations to the court. The court then imposed sanctions on Ameriquest of \$250,000 for its repeated misrepresentations and unreasonable failure to disclose its role. The court also imposed sanctions of \$250,000 against Wells Fargo for its attempt to "turn a blind eye to the actions of the servicers." Nosek v. Ameriquest Mortgage Co. (In re Nosek), 386 B.R. 374, 385 (Bankr. D. Mass. 2008). The court found that since Wells Fargo had not engaged in the appropriate oversight, it was never able to correct the misrepresentations. Finally, the court imposed sanctions against the attorneys: \$25,000 on Ameriquest's local counsel because they had relied on their client's representations without reviewing their own files – which would have shown that Wells Fargo was the real party in interest; and \$100,000 against Ameriquest's national counsel for its role as "one of the prime sources of the problem in this case." Id. at 384.

Wells Fargo, Ameriquest and counsel appealed to the district court the award of sanctions (District Court of Massachusetts Case Nos. 08-40095, 08-40115, and 08-40116). The district court consolidated all of these appeals under Case No. 08-40095 and administratively closed the case pending the First Circuit's decision. Following the First Circuit's decision, the district court reopened the consolidated appeal and briefing is ongoing.

**E. In re Prevo**, 394 B.R. 847 (Bankr. S.D. Tex. 2008). In ruling on a proof of claim objection, the court disallowed foreclosure fees, previously accrued late charges, and broker price opinion fees because the creditor did not provide supporting documents and the court could not determine whether the fees were reasonable. The court looked to 11 U.S.C. § 506(b), which the court noted is "designed to protect the debtor and other creditors by preventing secured creditors from charging unreasonable fees." Id. at 850-51. When the debtor objects to a proof of claim and the "creditor continues to fail and refuse to provide such documentation or adduce testimony, the court has no choice but to find that the fees and costs are unreasonable and unrecoverable." Id. at 851. Amending proofs of claim to remove objectionable fees and charges when debtors file claim objections is unsatisfactory, as some creditors are trying to "game the system" by requesting undocumented excessive fees and then reducing those fees only when challenged. Id. The court issued an order to show cause and set the matter for hearing so the creditor could explain why it should not pay the debtor's fees incurred in prosecuting the proof of claim objection, or alternatively pay the debtor's attorneys' fees in advance of the hearing. The creditor paid the fees of debtor's counsel (approximately \$3,000) and filed an amended proof of claim in advance of the hearing. Counsel also advised the court that the attorney

previously handling the matter had been terminated. The court declined to impose any further sanctions.

F. **In re Schuessler**, 386 B.R. 458 (Bankr. S.D.N.Y. 2008). Chase Home Finance, LLC (“Chase”) filed a motion for relief from stay, claiming that the debtors missed two payments and lacked equity in the property. The debtors argued that while they paid late on occasion, they were not in default, and Chase’s local branch had refused their attempt to make a payment. The court denied the motion for relief from stay because the motion alleged erroneous facts (for example, that debtors lacked equity when debtors had as much as \$120,000 in equity) and omitted other facts (such as that debtors were not in default, or that the local bank refused to accept the debtors’ payment). The court also found that Chase’s system of handling bankruptcy cases amounted to an abuse of process because it made no effort to obtain appraisals or to determine whether it lacked adequate protection, permitted an analyst to decide whether relief from stay was warranted, and allowed supervisors to sign affidavits prepared by others without independently investigating the asserted facts. The court imposed sanctions against Chase in the amount of the debtors’ attorneys’ fees and costs, and other costs and expenses, including time lost from work and travel. The court also provided notice, “not just to Chase [ ] and other mortgage servicers, but to all individuals and entities involved in the process, along the line – analysts, supervisors and other personnel employed by mortgage servicers; third-party vendors; regional law firms; and local counsel – that the conduct identified here, in this Court’s view, constitutes an abuse of process.” *Id.* at 493.

G. **Payne v. Mortgage Electronic Registration Systems, Inc. (In re Payne)**, 387 B.R. 614 (Bankr. D. Kan. 2008). After disputing the amount of arrearage, the debtor and creditor stipulated to the amount of the pre-petition arrearage, disallowing amounts for late charges and other costs. The lender nevertheless applied the chapter 13 trustee’s disbursements to post-petition amounts due and the fees and charges that had been disallowed, held some of the payments in a suspense account for several months without applying them at all, and lost two payments altogether. The court found that the lender improperly applied post-petition disbursements received from the trustee to post-petition payments not provided for in the plan, failed to apply three payments and then charged late fees, held the plan payments in suspense for months, applied payments to late fees before insurance and taxes as required by the loan documents, and assessed inspection fees and other charges without cause or notice. It found that these actions showed contempt for the confirmation order and violated RESPA. It also found that the lender’s application of plan payments to disallowed fees, and its refusal to remove the disallowed amounts from its accounting system, constituted a violation of the automatic stay. In addition to actual damages, the court awarded punitive damages, damages for emotional distress, and legal fees.

H. **Myles v. Wells Fargo Bank, N.A. (In re Myles)**, 395 B.R. 599 (Bankr. M.D. La. 2008). Debtors alleged that Wells Fargo did not comply with the terms of the confirmed plan by continuing to treat their mortgage debt as in default instead of current on the petition date, by improperly applying payments to charges generated because the mortgage was treated as still in default, and by improperly holding post-petition payments in a suspense account. On Wells

Fargo’s motion for judgment on the pleadings, the court let stand the debtors’ claims for breach of contract and violation of the automatic stay. The court reasoned that the debtors’ allegation that Wells Fargo billed and collected amounts not due as a result of payment misapplications was more than mere “bookkeeping entries” and stated a claim under 11 U.S.C. § 362(k). The bankruptcy court also ruled that no private right of action exists under 11 U.S.C. §§ 506(b), 105(a),<sup>6</sup> 1322 or 1327, or under Fed. R. Bankr. P. 2016. In *dicta*, the court stated that 11 U.S.C. § 524(i) does not apply and may not afford relief until after the debtor is discharged.

**I. In re Sanchez**, 372 B.R. 289 (Bankr. S.D. Tex. 2007). The debtors in this chapter 13 case sought damages for violation of the automatic stay and the plan confirmation order against their mortgage lender for its application of plan payments received from the chapter 13 trustee to satisfy post-petition attorneys’ fees, costs, and property inspection fees it unilaterally assessed in the chapter 13 case. The court concluded that the satisfaction of post-petition charges with plan payments based on the debtor’s post-petition earnings violated 11 U.S.C. § 362(a)(3) by taking property of the estate without court approval. The court further determined that the debtors could recover damages under the pre-BAPCPA version of section 362(h) (currently enacted at 11 U.S.C. § 362(k)). Finally, the court determined that, in soliciting a forbearance agreement signed by the debtors post-confirmation, the creditor illegally modified the amended plan in violation of 11 U.S.C. § 1329, and invalidated the forbearance agreement. The court set for trial additional issues to determine the amount of all unreasonable charges assessed by the creditor that the debtors would be allowed to recover, and ordered the creditor to file an amended proof of claim describing in detail what the debtors owed.

**J. In re Sullivan**, 367 B.R. 54 (Bankr. N.D.N.Y. 2007). Washington Mutual filed a proof of claim that did not include any attorneys’ fees, although the attorney who filed the proof of claim billed Washington Mutual \$500. The debtor, who had made almost 30 years of payments on his residence, sold it post-petition. In the payoff letter, Washington Mutual included a line item for attorneys’ fees of \$500. The debtor alleged that the law firm also refused to release the abstract of title or otherwise delayed the closing because of the legal fee issue, and ultimately the debtor had to escrow the \$500 for the closing to take place. The attorney testified that \$150 was for pre-confirmation services and \$350 was post-confirmation. The court found that: (1) the \$500 fee was billed at confirmation and therefore subject to 11 U.S.C. § 506(b); (2) Washington Mutual failed to include the fee in the proof of claim and therefore could not charge it; and (3) attempts to collect the fee by sending a payoff letter, which was more than merely “informational” in nature since it was designed to collect the fee and acted more as a condition precedent to closing the real estate sale, violated 11 U.S.C. § 362(a)(3)’s stay of actions to obtain property from the estate. The court further found that the violation was willful under the pre-BAPCPA version of section 362(h) (currently enacted at 11 U.S.C. § 362(k)), and awarded \$1,000 as damages for emotional distress, plus attorneys’ fees.

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<sup>6/</sup> The bankruptcy court noted that, while a court can order creditors to disgorge moneys improperly obtained from debtors, 11 U.S.C. § 105(a) does not empower the court to create a private right of action derivatively when another Bankruptcy Code section does not provide substantive relief.

**K. Moffit v. America's Servicing Co. (In re Moffitt)**, 390 B.R. 368 (Bankr. E.D. Ark. 2008). The debtors used personal injury proceeds to pay off their plan three years early and also sent a check to the mortgage lender in the amount of \$10,000, with instructions to apply it entirely to principal. The court then granted the debtors a discharge and closed the case. However, the lender misapplied at least 14 payments, failed to follow the debtors' written instructions, and began collection efforts over the next two years for amounts that were not due. The debtors reopened their case and filed a complaint and motions for a temporary restraining order and permanent injunctive relief. The court found that the lender misapplied the \$10,000, incorrectly applied the trustee disbursements under the plan, and lost a portion of one payment when it attempted to correct its records (which caused the account to be one month behind for the next 18 months). The court further found that the lender made no effort to investigate its mistake and took six months to begin work on the file. The court found that the debtors had satisfied the requirements for injunctive relief, had suffered emotional distress, and set the matter for trial.

**L. Winslow v. Salem Five Mortgage Co., LLC (In re Winslow)**, 391 B.R. 212 (Bankr. D. Me. 2008). The debtor alleged that Salem Five Mortgage Company, LLC ("Salem") published an inaccurate credit report and issued improper default notices relating to a mortgage for which the debtor's personal liability was discharged in chapter 7. Years after the discharge, the debtor became aware that the mortgage company was still reporting the mortgage loan as an open account, and had sent default notices with debtor's name on it. Salem did not correct the report despite the debtor's requests. The court found that Salem's ongoing refusal to correct the credit report was coercive, as was Salem's insistence that the debtor still owned the house in question and Salem had a legally binding contract. The court found that, under the "objectively coercive" standard from Pratt v. Gen. Motors Acceptance Corp. (In re Pratt), 462 F.3d 14, 20 (1st attorneys' fees Cir. 2006), Salem's conduct amounted to a violation of the discharge injunction under 11 U.S.C. § 524(a)(2). The court further found that the default notices were threatening to the debtor and demonstrated an intent to violate the discharge injunction. While the debtor did not offer any evidence of damages beyond attorneys' fees, the court awarded the debtor fees and costs in the amount of \$39,384 for Salem's violations of the discharge injunction.

**M. In re Crawford**, 388 B.R. 506 (Bankr. S.D.N.Y. 2008), *appeal pending*, **HSBC Bank USA v. Crawford (In re Crawford)**, No. 08-cv-06617 (S.D.N.Y. filed June 30, 2008). In a show cause proceeding, the court found that a foreclosure sale conducted by a state court-appointed referee following commencement of the debtor's chapter 13 case was *void ab initio*. It also found that the actions of the mortgage lender's sub-agent in appearing at the auction sale and bidding on the property, after the referee announced to interested bidders that it appeared that the mortgagor had filed for bankruptcy and that the sale might be void, was a "willful" violation of the automatic stay attributable to the mortgage lender. The court awarded \$66.83 in damages, struck \$8,500 in foreclosure fees and costs from the mortgage lender's proof of claim, and awarded \$60,000 in punitive damages, or \$10,000 per servicer, sub-servicer, etc., involved in the mortgage lender's complex servicing system.

## **II. Recent Bankruptcy Decisions Sanctioning Attorneys Representing Mortgage Creditors.**

Sanctions in creditor abuse cases are not limited to the creditors. A number of courts have found egregious conduct warranting sanctions against counsel for the mortgage servicer as well.

**A. In re Rivera**, 342 B.R. 435 (Bankr. D.N.J. 2006). This case involved a law firm's use of certifications of default in support of relief from stay motions previously resolved by stipulation. The court determined that the law firm's practice of using pre-signed certifications appended to subsequently prepared summaries of mortgage defaults that were never reviewed by the person who signed the certification violated Fed. R. Bankr. P. 9011. During the show cause process, the court discovered that the individual who signed the certificates had not been employed by the mortgage creditor for over a year, during which time the certification was used more than 250 times. The court imposed a sanction of \$125,000 on the law firm and \$500 on the lawyer in the specific case before the court, and entered an injunction prohibiting such conduct in the future. Upon remand after appeal by the mortgage lender, **In re Rivera**, 369 B.R. 193 (D.N.J. 2007), the bankruptcy court approved a permanent injunction prohibiting the mortgage lender from engaging in the pre-signed certification practice and required the lender to develop policies and procedures to prevent such conduct in the future.

**B. In re Haque**, 395 B.R. 799 (Bankr. S.D. Fla. 2008). In considering Wells Fargo's motion for relief from stay in a chapter 7 case, the court questioned the "penalty interest" claimed by Wells Fargo in its supporting affidavit. Wells Fargo and its counsel admitted that the "penalty interest" was an erroneous charge. Based on testimony that a number of filings contained the erroneous charge, the bankruptcy court concluded that the parties "engaged in the systemic process of churning out unrefined and unexamined form pleadings" that resulted in "an abuse of the system." *Id.* at 805. Invoking its inherent authority and 11 U.S.C. § 105(a), the bankruptcy court sanctioned Wells Fargo and counsel \$95,130.45 (equal to a total of 45 false affidavits multiplied by \$2,114.10, the amount of the erroneous claim in the case at bar), jointly and severally.

**C. Nosek v. Ameriquest Mortgage Co. (In re Nosek)**, No. 02-46025, Adv. No. 07-04109 (Bankr. D. Mass. April 25, 2008) (slip op.) (Nosek IV), *supra*. (The court found that Ameriquest misrepresented its role throughout the course of the proceedings and imposed the following sanctions: \$250,000 against Ameriquest; \$250,000 against Wells Fargo for failing to engage in the appropriate oversight to correct the misrepresentations; \$25,000 on Ameriquest's local counsel because they failed to review their own files, which would have shown that Wells Fargo was the real party in interest; and \$100,000 against Ameriquest's national counsel.)

**D. In re Parsley**, 384 B.R. 138 (Bankr. S.D. Tex. 2008). The bankruptcy court issued several show cause orders which required Countrywide Home Loans, Inc. and its counsel to show cause why they should not be sanctioned for their conduct in prosecuting a motion for

relief from stay that contained factual inaccuracies. The court found that both Countrywide and its attorneys acted negligently and failed to correct all mistakes and deficiencies in Countrywide's original proof of claim or to explain discrepancies in its documents. The court noted the "sloppy practices and training at Countrywide," and found that "Countrywide does not want to devote any employee time to reviewing the pleadings drafted by its own counsel." *Id.* at 171. The court applied a clear and convincing standard in determining whether there had been bad faith conduct necessary to sanction the parties. Ultimately, the court declined to sanction Countrywide and one of its law firms, stating that although it was disheartened by their conduct, "it was unable to say that their conduct transcended from mere negligent bungling to full-blown bad faith." *Id.* at 183. Although the court found that Countrywide's other law firm and one of its attorneys did act in bad faith, it did not sanction them because of their curative actions.

### **III. A Potential Trap for the Unwary: How Does the Servicer Assess Post-Confirmation Attorneys' Fees and Other Fees and Charges?**

It depends. Some courts require court approval, or the filing of a statement under Bankruptcy Rule 2016. Others say that the creditor must provide notice of post-confirmation charges. Still others reject those approaches. It is imperative that counsel know the prevailing law in their district.

**A. Padilla v. Wells Fargo Home Mortgage, Inc. (In re Padilla)**, 379 B.R. 643 (Bankr. S.D. Tex. 2007). The court consolidated two chapter 13 cases and examined the creditor's post-petition "reimbursable expenses," including inspection fees, attorneys' fees, and costs. On summary judgment, the court held that Fed. R. Bankr. P. 2016(a) and 11 U.S.C. § 506(b) apply to pre-confirmation reimbursements. The court also ruled that as to post-confirmation charges and collection, Fed. R. Bankr. P. 2016(a), the plan confirmation order, and applicable state law govern. As remedies, the court held that the collection of payments from the debtor and alleged misapplication did not violate 11 U.S.C. § 362(a)(3). Rather, the court concluded that lenders are bound by confirmed chapter 13 plans and are subject to debtors' challenges to fees and expenses under state contract law or RESPA, as well as claims for disgorgement of such fees that are actually collected under Fed. R. Bankr. P. 2016(a) and 11 U.S.C. § 105(a). The dispute over whether the fees were ever actually collected during the term of the debtors' plans was a question of fact in the case to be decided at trial.

**B. Rodriguez v. Countrywide Home Loans, Inc. (In re Rodriguez)**, 396 B.R. 436 (Bankr. S.D. Tex. 2008). In discussing mortgages in chapter 13 generally, the court found that requiring lenders to seek reimbursable expenses as they are incurred during a chapter 13 plan does not conflict with 11 U.S.C. § 1322(b)(2)'s anti-modification provisions, particularly since section 1322(b)(5) is an exception to 1322(b)(2). The court explained that in order to give the debtor his fresh start and meaning to sections 1322(b)(5), 1322(c) and 1327(a), once the debtor has fully performed the plan and made all of the regular post-petition payments, the debtors are again current on the mortgage. While section 1322(b)(2) prohibits a *plan* from modifying a mortgage lender's contract rights, section 1322(b) does not "override every other provision" in

the Code and does not eliminate the court's ability to use 11 U.S.C. § 105(a) to enforce substantive rights explicitly provided for in the Code.

C. **In re Johnson**, 384 B.R. 763 (Bankr. E.D. Mich. 2008). The debtor objected to the mortgage lender's proof of claim, arguing that the lender's advances to pay taxes and insurance could not be included absent notice to the debtor under the Real Estate Settlement Procedures Act ("RESPA"). The court found that the lender failed to give the debtor notice of escrow account shortages over a five-year period, that insurance and taxes were not being paid, or that the debtor was supposed to pay the shortages himself. The court further found that, because the debtor was in a previous chapter 13 case during most of that five-year period (that case was dismissed following plan confirmation), local rules required the lender to give notice of any changes in the periodic payments under the plan. Thus, the court concluded that the lender waived its right to recover the portion of its proof of claim covering the taxes and insurance.

D. **In re Watson**, 384 B.R. 697 (Bankr. D. Del. 2008). Mortgage lenders objected to confirmation of several plans that: (1) contained extensive notice requirements regarding the assessment of post-petition fees and other charges; and (2) provided that the lenders' failure to supply the required notice would result in the disallowance of these fees and charges. The lenders argued that although the court could limit or disallow their claims for fees and charges while the case was pending, their rights to collect pursuant to 11 U.S.C. § 1322(b)(2) survived and they were entitled to pursue full payment after the case closed. The court found that a plan could deviate from the standard form to provide for the notice procedures, allocation of payments, and adjudication of disputes. It also held that, while section 1322(b)(2) prohibits a plan from modifying a lender's rights, it does not prevent a court from determining whether fees and charges are reasonable under state law and the mortgage documents, and thus allowable. The court adopted the accounting practices from Jones II, supra, and ruled that the plans could be confirmed if amended to conform to the Jones II procedures.

E. **In re Armstrong**, 394 B.R. 794 (Bankr. W.D. Pa. 2008). The bankruptcy court analyzed its own Chapter 13 Procedure No. 9, which requires that mortgage creditors provide notice of post-petition monthly payment changes so that debtors can amend their plan to provide for such changes. The court held that Procedure No. 9 does not violate 11 U.S.C. § 1322(b)(2), "but merely establishes a mechanism for the enforcement of those rights while enabling debtors to achieve their Chapter 13 goals." Id. at 800. The bankruptcy court further found that where a mortgage lender fails to comply with the notice requirements, the consequence is a "waiver of its rights associated with that failure." Id. Under the facts of the case, the court disallowed interest amounts claimed by the creditor under its adjustable rate mortgage with the debtor prior to providing the required notice.

F. **Padilla v. GMAC Mortgage Corp. (In re Padilla)**, 389 B.R. 409 (Bankr. E.D. Pa. 2008). The debtor sought class certification against GMAC Mortgage Company ("GMACM"), alleging that GMACM systemically demanded improper payment of various post-petition fees, including attorneys' fees. Narrowly construing the court's power under 11 U.S.C. § 105(a), the court dismissed most of the debtor's claims. The court found that GMACM was

not required to: (a) obtain court approval of post-petition legal expenses; or (b) give the debtor notice during the pendency of the case that charges were incurred post-petition. Rejecting cases such as **Jones v. Wells Fargo Home Mortgage (In re Jones)**, 366 B.R. 584 (Bankr. E.D. La. 2007) (**Jones I**), *supra*, the court found that 11 U.S.C. § 506(b) was not applicable post-confirmation, and that Fed. R. Bankr. P. 2016 was not applicable to creditors for reimbursement of post-petition legal expenses. The court further held that it would not enter a contempt order against a creditor acting contrary to the terms of a confirmed plan because “the confirmation order is not a coercive court order directing creditors to act in conformity with the terms of a confirmed plan.” However, the court allowed the debtor to proceed on her claim that GMACM’s demand for pre-petition charges after conclusion of the bankruptcy case violated 11 U.S.C. § 1327(a), which the court could remedy through 11 U.S.C. § 105(a).

**G. In re Hight**, 393 B.R. 484 (Bankr. S.D. Tex. 2008). In ruling on an objection to a proof of claim, and based on the facts presented, the court allowed the creditor’s claim for principal and arrearage, late charges, property preservation and inspection fees plus a portion of claimed attorneys’ fees. The court disallowed the creditor’s claim as to an alleged escrow arrearage shortage and a portion of claimed pre-petition attorneys’ fees. The court further found that because the creditor failed to comply with the Fed. R. Bankr. P. 2016 disclosure requirements, it cannot collect post-petition attorneys’ fees.