Trial Practice:
And Your Little House, Too!!!

Plenary Session

Announcer

C.R. "Chip" Bowles Jr.
Greenebaum Doll & McDonald PLLC
Louisville, Ky.

Cast:

Boris Badenough:
Robin E. Phelan
Haynes and Boone, LLP; Dallas

Boris's Lawyer:
J. Ted Donovan
Goldberg Weprin Finkel Goldstein LLP
New York

Mary Munchkin the Debtor:
Jennifer M. Meyerowitz
Epiq Systems, Inc.; Atlanta

Mary's Lawyer:
W. Austin Jowers
King & Spalding LLP; Atlanta

Panelists:

Diarmuid Gorham
Office of the U.S. Trustee; Washington, D.C.

Hon. Katharine M. Samson
U.S. Bankruptcy Court (S.D. Miss.); Gulfport

David B. Wheeler
Moore & Van Allen PLLC; Charleston, S.C.

THE ABI PLAYERS PRESENT:

And Your Little House Too

A two act play with scholarly commentary by our elite panel of experts.

Disclaimer mandated by our lawyers.
The story you see is a total fantasy, although it contains at least a grain of truth. The names have not been changed as they are fictional people. The location of the court has not been disclosed to protect the innocent from financial scorn.

Back Story

In December 2006, Mary Munchkin ("Mary") and her boyfriend, Frank "Brick" Rhodes ("Brick"), purchased their dream house, a $500,000 condo. As both Mary and Brick were performance artists, whose combined annual income was only $50,000, they had to get a "creative" home mortgage from Wizard Loans and Mortgages ("Wizards") in order to purchase the condo. Wizards gave them a 15-year $700,000.00 mortgage with a $200,000 interest reserve, which had monthly payments of $4,000 per month with a variable balloon payment at the end of its term. Mary and Brick made a $5,000.00 down payment that Wizards used as its "processing fee." Mary and Brick, on instructions from Wizards, did not disclose their actual annual income, but instead "estimated" their income at $250,000 per year. The Wizards' loan officer informed them that this was standard procedure , subsequently verifying this fact, and admitting that Wizards prepared their income statement, in an e-mail to Mary which she has kept.

Two months after Mary and Brick closed their loan, Brick vanished after a tornado and has not been seen since. However, due to the interest reserve, the monthly payments on the mortgage were made until January of 2011 even though Mary's income dropped to $30,000 per year.

Mary's loan was financed by Palace Guard Mortgages, which went bankrupt in 2007 due to an 85% default rate on their mortgages. Their loan portfolio, including Mary's loan, was purchased by 6 separate investment funds over the next 3 years and were finally purchased at a bankruptcy auction by Flying Monkey LLC ("Flying Monkey"), Boris Badenough's Vulture Mortgage Fund in early 2010. Although the mortgage was properly recorded in 2006 in the state real property records, no mortgage assignments were recorded in state real estate records as

required by state law. The mortgages from Palace Guard, which Flying Monkey actually acquired were only transferred in the Mortgage Electronic Registration System ("MERS"). Also, the original of the Mortgages are (apparently) stored at the 12 acre warehouse of Western International Title Collection and Holding Company ("WITCH"), which services all of Flying Monkey's 200,000 defaulted loans. WITCH is represented on a national basis by W. "Kid" West and the firm Evell Trees and Associates ("Evell"). Kid personally owns 20% of WITCH and has guaranteed its $25,000,000 line of credit with Pottsylvania Investments LLC, an entity owned by Boris Badenough.

Evell oversees all foreclosure and bankruptcy litigation involving Flying Monkey residential loans and hires "local counsel" to do the actual filings in individual cases. Local counsel can only communicate with Evell under their contracts and are provided with all pleadings and documentation by Evell. WITCH maintains all records related to the Flying Monkey Loans for all periods before January 2010 (the date when Flying Monkey acquired the Loans).

In late January of 2011, Mary was given notice of default on her mortgage by WITCH. It claimed that no payments had ever been made on the loan, even though the $200,000.00 interest reserve had paid the loan through December 2010 and she had made the January 2011 payment. The notice said Flying Monkey was the owner of her Mortgage. This was strange because Mary timely made the January payment with her life savings. Mary, who had never heard of Flying Monkey, called both WITCH and Flying Monkey to discuss her and Brick's mortgage and attempted to have the mortgage modified, as her income from her 3 jobs after taxes was only $4,000 per month. After a month of failing to talk to any human connected with either WITCH or Flying Monkey, she went to see Scare and Crow, whose late night TV ads promised

immediate relief from threatened mortgage foreclosure. After meeting with an intake associate and paralegal, providing all requested documentation by January 25, 2011 and paying $2,000 for a Chapter 13 Bankruptcy, Mary's case was filed on March 25, 2011.

While Mary was working on her Chapter 13, WITCH filed a foreclosure action against Mary's missing boyfriend, Brick. This action was dismissed, without prejudice, by the State Court on its own motion due to: 1) the failure of WITCH to name Mary, who was a co-owner of the property; and 2) the inability of WITCH to prove either that Flying Monkey was the owner of the Wizards' mortgage or that WITCH was properly authorized to file a foreclosure suit. They were preparing a second foreclosure suit naming Mary as a defendant when they got notice of Mary's bankruptcy.

We take you now to the Headquarters of Flying Monkey (and all other entities):

Boris (B): Politically correct greetings (due to Court Order)

Kid (K): Politically correct greetings (due to Bar disciplinary order)

B: Well, here is WITCH's contract for loan services for this year. The Annual Payment will cover your loan with Pottsylvania for this year and reduce the loan balance to $22,000,000.00.

K: Great! See, I told you we would pay you off.

B: Yeah, but your investment in Lehman Brothers in 2008 was still a bad idea.

K: Yes, but it did generate my new business model, Subprime Loan Services.

B: Yeah, it is cheap. How do you do it on $150.00 per foreclosure or mortgage.

K: Two phrases: "starving lawyers" and "Peggy."

B: Yeah, I love starving lawyers. Keep them hungry and they will do almost anything, but Peggy?

K: You know, the guy in the credit card commercial.

B: Yeah, it's a hoot.

K: Actually he and his company are real.

B: No, not possible.

K: Yep, the country of Idanatbelieveaston currency is cheap, and they provide customer service to all the deadbe..., er, debtors on your mortgages.

B: So the commercial is just a joke?

K: Yeah, they really are not that good, but they keep the "debtors" from bothering people.

B & K: Laughter

B: Okay, but I did get a notice about a foreclosure that went bad, a Mary Munchkin and Brick Rhodes?

K: How did you..., er, just a paperwork error, its one of the Wizards originated loans.

B: Those guys..., their loans put the term "liar" in liar loans.

K: Well yeah, but they at least filed the mortgage in this case.

B: Did we pick this mortgage up in Bankruptcy auction in 2010?

K: Yes, I think so.

B: You think...?

K: Well, we are pretty sure. The debtor Lolipop Loan's records were pretty bad and the description of what we acquired was "all remaining loans not reflected on Exhibit A." This mortgage was not on Exhibit A and is still on MERS. It was also transferred to Lolipop and not transferred to any other party. We just haven't been able to find the actual copies of the note and mortgage.

B: Great, so we have overwhelming evidence of ownership. Did MERS show a transfer to Flying Monkey?

K: No, processing is still working on the transfers but we are doing the transfer to Flying Monkey right now.

B: Good, then get her out of there, looks like a nice condo and my snow globe collection could use a good home.

K: One of the owners filed bankruptcy.

B: So get stay relief, file our claim, and remember to add the $10,000 legal services/foreclosure fee and the 38 fees we have established.

K: Err, does this note and mortgage cover these charges?

B: Don't know, but all the paper I have seen covers all "reasonable charges" related to collection, so add them on and see what happens.

K: Okkk...

B: How many payments did she make?

K: Printout says that there was never any principal payments, but no missing payments until January. There is a $4,000.00 balance in a tax escrow account but no taxes due. We also show a "crank" voicemail from Mary that she made a $4,000.00 payment in January.

B: Well, computers never lie, so go for it.

K: Well, I do have the pre-signed affidavits of default, so I guess it will work.

B: Good… and about "Peggy," if you cut some of his deadwood, you could really save costs.

With this, lets now go to the office of Roger Tinman, sole permanent attorney at Scare and Crow as he meets with Mary.

Roger Tinman (T): Martha, it is good to see you again.

Mary Munchkin (M): It's Mary, and we have never met. I have been waiting for three hours to see you about this stay motion. Am I going to have to give back my house or can I restructure the mortgage?

T: Well lets see, their printout and affidavit of default says you have never made a payment and had the mortgage for more than five years, so yes, Maria, they will get stay relief unless you want me to oppose the motion and I can probably get you a few more months.

M: Their motion is wrong. I only missed my February and March 2011 payments. All prior payments were made under an interest reserve and I made the January payment, which they don't give me credit for! Here is the cancelled check.

T: Well, it will cost you a few hundred dollars to defend but the check gives us some chance.

M: Why more fees, I paid you $2,000 to do the case?

T: That payment only goes for work through the first meeting of creditors, its in your engagement letter.

M: I never got an engagement letter.

T: Oh, you must have lost it so I will give you another one.

M: Whatever, but why can't we win the stay motion?

T: Because you are in default under the mortgage. Look, they even have an affidavit of default.

M: But the affidavit is impossible.

T: Oh, I know they are hard to read but...

M: No, I know the lady who signed it, Ms. Emm, she was my first grade teacher and worked for Lolipop Loans and the company that bought them. She died over six months ago.

T: She's dead?

M: Yes, I was at her funeral and that's her handwriting, but the latest it could have been signed was August 2010.

T: Michelle, you have done it, we can counterclaim against them! Their affidavit is clearly false. This is beyond robo signing, this is **Zombie signing**. I'll make a fortune on the class action, [presses intercom]. "Alice" get me Dave at Dewey Cheatham and Howe LLC, he will be a perfect co-counsel on this suit and I will get at least 30% of h is fees.

M: But what about me, I just want out of the house because I can't pay for it and I want to get out of Chapter 13? How is this going to help?

T: Trust me, Marsha, everything will be great for me… er … I mean you.

PANEL DISCUSSION

Flying Monkey Issues

1) Has WITCH properly serviced Mary's Mortgage" **NO!!!**

Can WITCH be sanctioned for improper mortgage servicing.

See In re Cothern, 442 B.R. 494 (Bkrtcy. N.D. Miss. 2010) (Servicer's egregious conduct in servicing the mortgage loan warranted sanctions); In re Galindo, 2006 WL 2168125 (S.D. Tx 2006) (upholding $75,000.00 sanction against servicer who failed to correct the Debtor's mortgage balance after having been sanctioned for prior failures to correct the Debtor's mortgage balance). See Also Issues in representing Mortgage Servicers by Diarmuid Gorham attached hereto as Exhibit A. (Hereinafter "Mortgage Servicers Issues").

2) Did Evell and Kid West property investigate Mary's mortgage loan background before filing the stay relief motion? Again No. Can Evell and Kid West be sanctioned for their failure to properly determine whether their stay relief motion was well grounded. See Rule 9011. See also In re Cabrera-Mejia 402 B.R. 335 (Bkrtcy. C.D. Cal 2008) (Sanctioning counsel $21,000 under Rule 9011 for violations of pleading standards). In re Hague, 395 B.R. 799 (Bkrtcy S.D. Fla 2008) (Sanctioned Counsel and Wells Fargo $95,130.45 for improper conduct under 11 U.S.C. § See also Mortgage Servicers issues.

3) Are Robo, Zombie or pre-signed certifications of default of in support of stay motions violations of Rule 9011

See In re Rivera 342 B.R. 435 (Bkrtcy D. NJ 2006) (Pre-signed certificates of default filed by an employee who left loan services violation of Rule 9011). See also In re Ulmer, 363 B.R. 777 (Bkrtcy D.S.C. 2007) (unnotarized affidavits of default violations of rule 9011).

4) Does Flying Monkey or WITCH have standing to file a stay relief motion?

See, e.g. Harris v. HSBC Bank USA, 2010 WL 3860603 (D. Mass 2010) (Finding that movant under Stay Relief motion had no standing to pursue Stay Relief Motion) and In re Mentag 430 B.R. 439 (E.d. Mich 2010) (Actual owner of mortgage where MERS is listed as Nominee for Lender has standing to bring motion). See also Mortgage Servicers Issues

Scare & Crowe Issues

1) Does Scare & Crowe's procedure of not having attorneys meet clients or participate in the preparation of Schedules violate the Bankruptcy code or the attorney state law duty to client?

See In re Burnett, 2011 WL 174 0081 (Bkrtcy E.D. ark 2011) (Attorney sanctioned for abdicating responsibilities over preparing bankruptcy petition); In re Faher 2009 WL 2855728 (Bkrtcy S.D. Tx 2009) (Failure to oversee paralegal preparing bankruptcy petitions results in sanctions).

2) Did Scare & Crowe violate 11 U.S.C. §526 – 528 by failing to

a) Failing to give Mary an engagement Letter (yep, he was fibbing). 11 U.S.C. §§527(b) and 528(a)(i).

b) Failing to represent Mary as represented by his staff I connection with Stay relief motion. 11 U.S.C. §526 (a)(1). See also In re Irons, 379 B.R. 680 (Bkrtcy S.D. Tx 2007)

c) By placing its interests over Mary's in ignoring her instructions or wishes?

3) Is Scare & Crowe's "idea" to delay foreclosure on Mary's house by filing what he believes is a meritless response to stay relief a violation of rule 9011 or 28 U.S.C. §1927?

4) Are Tinman and Scare & Crowe violating state ethical laws or the bankruptcy code by possibly splitting fees with the proposed "special counsel"?

We now go to WITCH's Offices after they received mary's Counterclaim and Proposed Class Action.

Boris: What the [incredibly nasty set of curse words] is this? Mary what's her name is suing Flying Monkey for improper loan activities!! What have you been doing servicing my loans?

K: Now Boris, it's just a tactic to get out of a Stay Motion.

B: No way, they say WITCH did not properly account for her loan and the payments, charged inappropriate fees and can't prove either WITCH or flying Monkey had standing and that you could not transfer the mortgage to Flying Monkey. This is not a tactic.

K: But how can I do any more at $150 per action, I mean I am way over budget over these cases, also the records stinks.

B: Hey I didn't have a gun to your head when you signed the service agreement (just when you took out your loan), you wanted the work, anyway arguing will not get us anywhere what are they arguing and what are our defenses?

K: Well, the didn't give us a safe harbor notice under Rule 11 so their claims so we can defend on that.

B: Comforting. Anything else?

K: Err…wait this…naw it's just a mistake.

B: What?

K: Well Tinman just sent over an agreed order for stay relief in the Mary Munchausen case, which is one number different from Mary Munchkin's case, but they only agreed to stay relief in the Munchausen case not this case.

B: Great! Litigate it!

K: But it is clearly a mistake!

B: Who do you want suing you? Mary M or my lawyers who use tire irons for their briefs?

K: Well, when you put it that way, we will litigate.

B: Also what is this about Fair Debt Collections Practices Act Violations against both Flying Monkey and WITCH?

K: Don't think they can bring this and we will fight it.

B: Good. What about "Peggy" your researchers who are trying to find the loan history and mortgages. Could their computer issues be a defense?

K: What compu. . . . Oh, yeah! Major crash! That may work!

B: Good, now polish this snow globe!

Panel Discussion

1) Can WITCH and Flying Monkey avoid the counterclaim seeking, in effect Rule 9011 sanctions, by withdrawing the Stay Motion?
See Rule 9011. See also In re Cabrera-Mejia 402 B.R. 335 (Bkrtcy. C.D. Cal 2008), (Sanctioning firm which withdrew motions under rule 9011 and 11 U.S.C. §105)

2) Can WITCH assign "ownership" of mortgages from MERS to Flying Monkey?
See turner v. Lerner Sampson & Rothfuss 2011 WL 834064 (N.D. Ohio 2011) (FDCP Collection process act suit properly alleged where allegations that law firm's execution of assignments on behalf of MERS without proper authorizations.)

3) Can WITCH and Flying Monkey successfully allege that the problems arose from a computer problem?

4) What sanctions can Flying Monkey and WITCH face? See Mortgage Services Issues.

See, e.g., Payne v. Mortgage Elec. Registration Sys. (In re Payne), 387 B.R. 614, 625 (Bkrtcy. D. Kan. 2008) (focusing on the fact that the creditor did not change its accounting when a homeowner filed bankruptcy, and describing how the creditor misapplied the debtor's Chapter 13 plan payments); Nosek v. Ameriquest Mortgage Co. (In re Nosek), 363 B.R. 643, 650 (Bkrtcy. D. Mass. 2007) (rejecting computer-software shortcomings as an excuse for failing to correctly apply the debtors' payments).

5) Can WITCH litigate the mistaken "agreed" stay relief order? See In re Martinez, 393 B.R.27 (Bkrtcy D. Nev 2008) (Lender sanctioned and Lender's counsel reprimanded for refusal to withdraw Mistalsen Stay relief Order).

We now journey to Scare & Crowe offices where Mary is discussing her lawsuit against flying Monkey and WITCH.

M: Finally! I have been calling and calling, I am worried about my case!

T: Why? With your lawsuit the Stay motion will at least go away Millie.

M: I am worried about a lot of things, including that question about "Credit Counseling" the Chapter 13 Trustee asked at last week's first meeting. I remember signing up for it at your office but not completing it.

T: Oh that, well when we realized you didn't take the counseling we had Melinda, our receptionist finish the course for you, she has the same name.

M: It is M A R Y. . . Mary but if it fixes the problem OK but I still want to settle the case and get out of my Chapter 13. I can't even afford to maintain the condo or pay the taxes and insurance anymore!

T: Ms Munchkin, you cannot just walk away from your wonderful condo, and the proceeds from the class action could reduce your debt by err……$2,000.00.

M: Mr. Tinman, I owe over $700,000, there is no way I can pay it and all I get from this suit is to live in a condo I cannot afford while you make a fortune.

T: Well…..err…..I know! What if I agree to share at least $300,000 of my fees. Also I can get you a loan from my home refinance company to buy the condo as ….ummm….as part of a settlement?

M: Is that okay? I mean can you do that?

T: Certainly! Remember? Somewhere over the rainbow there is a pot of gold!!

Panel Discussion

1) Can Tinman give part of his fees to the debtor in connection with the Litigation against flying Monkey and WITCH?

You may not think there would be a case on this but See McClure v. Bank of America, 430 B.r. 358 (Bkrtcy N.D. Tx 2010) (Debtor's counsel disallowed $71,000.00 in fees due to agreement to share 50% of any legal fees awarded him with the debtors).

2) Did Scare & Crowe and Tinman violate the provisions of the Bankruptcy Code by having his Receptionist "complete" the credit counseling course?

See Burns v. George Basilitas Trust, 599 F.3d 673 (d.C. Cir. 2010) (Filing a chapter 13 for Debtor which had not completed credit counseling was in violation of Rule 9011). See also, In re Paguduan, __ B.R. ___ 2011 WL 1113281 (D. Nev. 2011) Aff in part, 429 B.R. 752 (Bkrtcy D. Nev. 2010) (Debtor for chapter 13 debtor sanctioned form impersonating debtors in completing credit counseling courts).

3) Could Tinman represent Mary if he arranges to refinance a buyout of her loan? Unbelievably there is a case on this. See In re McGregory, 340 B.R. 915 (8yh Cir BAP 2006) (Attorney which represents both a lender on a refinance and debtor in a Chapter 13 has an impermissible conflict of interest and should be denied fees).

American Bankruptcy Institute's
16th Annual Southeast Bankruptcy Workshop

Plenary Session: Trial Practice
Saturday, July 30, 2011 (7:30 a.m. - 9:00 a.m.)

Issues in Representing Mortgage Servicers

The widespread use of securitization in the mortgage market fed the rapid growth of the mortgage servicing industry.[1/] 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.[1/]

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.[1/] 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.[1/] 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.

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.

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

[1/] 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.

[2/] Id.

[3/] 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.

[4/] 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.

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. **Noland v. Wells Fargo Bank (In re Noland)**, No. 07-ap-70055, slip op., 2009 WL 4758651 (Bankr. N.D. Ala. Dec. 7, 2009). The debtors brought a claim against Wells Fargo, as trustee for the lender Option One, for a willful violation of the automatic stay when it initiated foreclosure proceedings in contravention of the bankruptcy court's order automatically lifting the stay if the debtors failed to timely render their payments. Upon receiving notice of the intent to foreclose, the debtors faxed copies of payment receipts confirming that all payments were current, but Wells Fargo nevertheless pursued its foreclosure action and filed a notice of default in the bankruptcy court. The debtors moved for sanctions, and the bankruptcy court agreed. The court imposed sanctions on Wells Fargo totaling $7,000, including compensatory damages for emotional distress of $6,000 and punitive damages of $1,000, plus attorneys' fees, describing its litigation conduct and disregard for the evidence as "reprehensible."

B. **In re Stewart**, 391 B.R. 327 (Bankr. E.D. La. 2008), *aff'd,* Case No. 08-3225, 2009 WL 2448054 (Aug. 7, 2009) (E.D. La. Aug. 10, 2009); *appeal pending* **Wells Fargo Bank NA v. Dorothy Stewart, et. al,** No. 09-30832 (5th Cir. filed Sept. 14, 2009). 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.[1/] 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.

Wells Fargo appealed the bankruptcy court's ruling. The District Court in **In re Stewart**, Civil Nos. 08-3225, 08-3669, 08-3852, 08-3853 and 08-4805, slip op., 2009 WL 2448054 (E.D. La. Aug. 7, 2009) upheld the bankruptcy court's authority to require Well Fargo to audit and amend proofs of claim in cases within the Eastern District of Louisiana. The court rejected Wells Fargo's argument that the order to prospectively audit and amend claims unlawfully shifted the burden of proof because the Bankruptcy Code and Rules create an entitlement of *prima facie* validity upon filing. The court concluded that it is the supporting documentation, and not the filing of the proof of claim in and of itself, that provides *prima facie* status. *Id*. at *7. Because the burden of proof ultimately rests with the claimant, and the claimant's inaccurate and inappropriate filings created a systemic threat, the district court determined that the bankruptcy court's remedy was "well within its authority, inherent and under section 105, to protect and manage its docket." *Id*. at *12.

The district court also ruled that the prospective remedy was a permissible exercise of the bankruptcy court's authority and that it was not necessary to find fraud or bad faith under section 105. *Id*. at *13. Distinguishing between the bankruptcy court's discretionary authority to enforce provisions of the Bankruptcy Code and its exercise of contempt powers under section 105, the district court found that the bankruptcy court was exercising its enforcement authority when it mandated that Wells Fargo comply with (1) the specified procedural and evidentiary requirements in order for a claim to receive *prima facie* status and (2) the existing, continuing, and affirmative duty to correct erroneous proofs of claims. *Id*. The district court also found that the authority for such a prophylactic remedy could be based in a bankruptcy court's inherent authority, statutory authority under section 105, or as civil contempt under section 105 and Rule 9011. *Id*. Alternatively, it held, even if the remedy were to be construed as injunctive relief, the systemic nature of the problem and the burden on both the court and other debtors satisfied the traditional four-part test for injunctive relief. *Id*. at *15.

Wells Fargo appealed to the Fifth Circuit. Briefing was completed in December 2010.

C. The Jones Decisions.

[5/] See AO 2008-2 (Bankr. E.D. La. May 9, 2008) (available at http://www.laeb.uscourts.gov), *aff'd,* Case No. No. 08-CV-3669, 2009 WL 2448054 (Aug. 7, 2009) (E.D. La. Aug. 10, 2009); *appeal pending* **Wells Fargo Bank NA v. Dorothy Stewart, et. al,** No. 09-30832 (5th Cir. filed Sept. 14, 2009).

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). On remand in **Jones v. Wells Fargo Home Mortgage Inc. (In re Jones), 418 B.R. 687 (Bankr. E.D. La. 2009)**, the bankruptcy court considered the propriety of injunctive relief in the form of accounting procedures versus other available alternative sanctions, including punitive damages. The court found that punitive damages alone would be insufficient to deter Wells Fargo's improper business practices, and that the imposition of both punitive damages and injunctive relief would be inappropriate. The court concluded that the imposition of the accounting procedures was both consistent with the Bankruptcy Code, as an exercise of the court's inherent authority under section 105(a), and necessary to prevent future violations of the automatic stay or of plan terms. On further appeal, the district court affirmed the bankruptcy courts decision in **Jones v. Wells Fargo Bank, N.A.**, Civ. No. 07-3599, 2010 WL 3398845 (E.D. La. Aug. 24, 2010).

D. **In re Fitch**, 390 B.R. 834 (Bankr. E.D. La. 2008), *aff'd,* Case No. 08-3852 (E.D. La. Aug. 10, 2009); *appeal pending* **Wells Fargo Bank NA v. Dorothy Stewart, et. al,** No. 09-30832 (5th Circuit Court of Appeals filed Sept. 14, 2009). 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.

E. 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 under Fed. R. Bankr. P. 9011 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 the award of sanctions to the district court (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 ultimately affirmed the imposition of sanctions against Ameriquest and its local counsel, but vacated the imposition of sanctions against Wells Fargo and Ameriquest's national counsel. **In re Nosek,** 406 B.R. 434 (D. Mass. 2009). Ameriquest appealed. In **Ameriquest Mortg. Co. v. Nosek (In re Nosek)**, 609 F.3d 6 (1st Cir. 2010), the First Circuit reduced the sanction to $5,000, holding that the sanction was excessive. The court reasoned that Ameriquest's representation that it was the holder of the mortgage was not a deliberate falsehood or intended in any way to mislead court or debtor, or achieve anything for itself; that the agent arguably could have sued "as if" it were the holder of the note; and that the debtor was not prejudiced by the misrepresentation.

F. **McClure v. Bank of Am. (In re McClure)**, 430 B.R. 358 (Bankr. N.D. Tex.

2010). Debtors brought a claim against Bank of America and its collection agencies for a violation of the discharge injunction after Bank of America referred previously discharged debts to the collection agencies. The court held that Bank of America and the collection agencies had willfully violated the discharge injunction because they failed to have adequate policies and procedures in place to ensure that information given to employees was passed to the individuals working on the specific accounts. The bankruptcy court awarded the debtors $2,500 in damages, $79,839.14 in attorneys' fees and costs, and a combined $150,000 in suspended sanctions against both creditors, conditional upon the creditors showing that their internal procedures had been corrected to ensure against future violations of the discharge injunction. The creditors moved for reconsideration, arguing that the sanctions were improper and excessive. On reconsideration, the bankruptcy court affirmed its prior reasons for finding liability, but in light of discovering that the debtors and their attorney had engaged in an improper fee sharing arrangement, the court limited the fee award to the $8,074.51 the debtors had incurred in costs. The court also vacated the conditional sanctions award. Although the court maintained that it had the authority to impose the conditional sanctions under § 105(a) – and despite the creditors' protest, they could demonstrate no appellate court decision to the contrary – the court believed that the debtors' misconduct rendered the case "too tainted to present fairly the issue of this court's ability to require parties to adopt procedures that will ensure compliance with the Code."

G. **In re Adams**, No. 04-003875, slip op., 2010 WL 2721205 (Bankr. E.D.N.C. July 7, 2010), *aff'd*, No. 5:10-cv-340-BR (E.D.N.C. Jan. 24, 2011). Chapter 13 debtors sought contempt sanctions against mortgage servicer Ocwen Loan Servicing, LLC ("Ocwen") for violating the court's previous order which deemed all mortgage payments due from the debtors to Ocwen current as of the date of the order and enjoined Ocwen from any action to collect any discharged amounts. After entry of the order, debtors refinanced their property with a new lender; Ocwen then sent an erroneous payoff statement and loan history to the new lender. The loan history showed that the debtors' home was in foreclosure, when in fact the home had never been in foreclosure. Ocwen claimed to be unaware of the debtors' discharge, yet when presented with proof of same from debtors' counsel, failed to change the reported foreclosure status of the home. The bankruptcy court held that Ocwen knowingly, willfully, and flagrantly violated the court's order as well as the discharge injunction by continuing to assess discharged principal, fees, and costs. The court held Ocwen in contempt and ordered it to pay attorneys fees and expenses to both debtors' counsel and the chapter 13 trustee, $2,500 in compensatory damages to the debtors, and $66,300 in punitive damages to the debtors.

H. **Fleming v. National City Mortgage Co.**, Adv. No. 07-2361, slip op. (Bankr. S.D. Ohio Sept. 28, 2009). Debtors confirmed chapter 13 plan provided for ongoing post-petition payments to be made directly to National City Mortgage and $14,000 to be paid through the plan on account of the pre-petition arrearage. The debtors were unable to refinance their mortgage in 2006 because National City claimed the debtors were six months in arrears and owed previously undisclosed fees and charges. In total, the payoff statement provided by National City was $7,688.90 higher than the balance sought in its proof of claim filed two years earlier. Moreover, National City continued to report to credit reporting agencies that the debtors' payments were late and that the debtors were in foreclosure. When the debtors again attempted to refinance in 2008 they discovered that, despite regular payments both inside and outside the plan,

the payoff amount had again increased, including, "foreclosure costs" totaling $21,420 despite the proof of claim listing only $3,000 for foreclosure costs. The debtors initiated an adversary proceeding. After protracted discovery and other disputes, including filings by National City inconsistent with earlier rulings by the court, the court invited the debtors to file a motion for default judgment. In granting judgment in the debtors' favor, the court found that National City had engaged in litigation and discovery tactics "that increased costs to obtain answers" and that the debtors would "never be able to match the Defendant's financial resources and inevitably would have to abandon their cause and their home." The court ordered National City to amend its records, including payoff statements to conform with the balances contained in payment records maintained by the chapter 13 trustee. National City was also required to correct the debtors' credit reports and to pay $26,412 in costs and attorneys' fees.

I. **Brown v. Ameriquest Funding II, LLC (In re Brown)**, 431 B.R. 309 (Bankr. D. Mass. 2010). The issue before the bankruptcy court was whether Deutsche Bank, the holder by assignment of the chapter 13 debtor's mortgage, should be permitted to amend a proof of claim originally filed by loan servicer AMC Mortgage Services, Inc. Previously, the debtor had successfully challenged the *prima facie* validity of the claim filed by AMC under Fed. R. Bankr. P. 3001 because AMC failed to attach a copy of either the note or the mortgage to the proof of claim. Deutsche Bank here sought reconsideration of the claim and permission to amend the claim under section 502(j) in order to correct substantial errors. The debtor objected to the amended proof of claim because Deutsche Bank filed it almost two years after the claims bar date. The court allowed the amendment upon the condition that Deutsche Bank pay the debtor's reasonable attorneys' fees and costs associated with the original objection and the present proceedings. The court reasoned that because Deutsche Bank was correcting the calculation of the pre-petition arrearage and deficiencies in the claim's statement of ownership, and was not attempting to assert a new deficiency claim, the fee award would remedy the prejudice the debtors have suffered due to Deutsche Bank's conduct.

J. **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.

K. **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.

L. **Payne v. Mortg. Elec. Regn. 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.

M. **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),[1/] 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.

N. **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 debtors' 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.

O. **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.

[6/] The bankruptcy court noted that, while a court can order creditors to disgorge monies 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.

P. **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 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.

Q. **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. 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. **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.

D. **In re Cabrera-Mejia,** No. LA08-13505SB, 402 B.R. 335 (Bankr. C.D. Cal. 2008)*, appeal filed,* No. 2:09-cv-00631 (C.D. Cal. filed Jan. 27, 2009). Having noticed numerous defects in declarations supporting lift stay motions involving real estate, the court began a practice of issuing orders subsequent to the filing of a motion for relief from the stay, directing the declarant to appear and testify. After the court instituted these procedures, the law firm at issue began filing and later withdrawing its motions for relief from the automatic stay. Over two months, the law firm filed twenty-one motions for relief from stay, withdrawing all but two of these motions within a week or less of the hearing (the remaining two motions were denied). In some cases, the firm requested continuances to allow its witness to make travel plans only to later withdraw the motion. The court issued a show cause order why the law firm and its clients should not be sanctioned for filing stay relief motions with no intent to proceed to hearing. After examining its authority to sanction pursuant to Fed. R. Bankr. P. 9011, 11 U.S.C. § 105, and its inherent authority, the court found that the law firm had filed twenty-one relief from stay motions in bad faith and with the improper purpose of delaying and increasing the

costs of litigation. The court further found that the law firm knowingly or recklessly filed the motions with inadequate evidentiary support, despite full knowledge of the Court's evidentiary requirements. In issuing sanctions, the court explained that the filing of the motions "with no intent to proceed to a hearing on the merits caused unnecessary delay to chapter 7 debtors and needless cost of litigation to creditors in twenty-one cases." *Id* at * 8. The court issued sanctions in the amount of $1,000 per motion for a total sanction of $21,000.

E. **Stoker v. Aurora Loan Serv., Inc. (In re Stoker)**, No. 09-3349, slip op., 2010 WL 958030 (Bankr. S.D. Tex. Mar. 10, 2010). The chapter 13 debtor filed a complaint against Aurora Loan Services for a violation of the automatic stay. Pre-petition, the debtor executed a mortgage in the name of her elderly mother pursuant to a valid power of attorney, but the debtor was the only occupant of the property and was financially responsible for all mortgage payments. After the debtor defaulted on the mortgage, Aurora moved to foreclose on the property. Post-petition, the debtor directly informed Aurora's counsel, Brice, Vander, Linden & Wernick, that the debtor had filed for chapter 13 bankruptcy relief and claimed an interest in the property. Counsel left the decision whether to foreclose to Aurora, which decided to proceed with the foreclosure based upon the opinion of a paralegal that failed to investigate the debtor's claim. The bankruptcy court held that Aurora violated the automatic stay, finding that Aurora's decision was "shocking" and expressed concern "that a licensed Texas attorney would proceed with a stayed foreclosure based on the decision of an out-of-state paralegal."

F. **In re Taylor**, No. 09-2479, slip op., 2010 WL 624909 (E.D. Pa. Feb. 18, 2010), *appeal docketed*, *Udren Law Firm v. HSBC Mortgage Corp. et al.,* No. 10-2154 (3d. Cir. April 27, 2010). The bankruptcy court had held that HSBC and the Udren Law Firm, its local counsel, violated Fed. R. Bankr. P. 9011 by filing two erroneous pleadings in which all the information in the pleadings was computer-generated and had been provided to counsel without any human oversight, and about which the law firm made no investigation before filing the pleadings. The bankruptcy court limited its sanction to non-monetary relief, requiring HSBC to circulate a copy of the decision to its other outside counsel, and ordering two senior attorneys at the law firm to obtain ethics and other training. The law firm, but not HSBC, appealed. The district court reversed the sanctions against all parties, including HSBC, holding that the bankruptcy court abused its discretion in issuing these remedies. The district court determined that there was insufficient basis for sanctions based on the record, given that the bankruptcy court held that the pleadings themselves were not sanctionable and the law firm's failure to obtain accurate information and correct the record was an insufficient basis standing alone for imposing sanctions. Further, the district court held that bankruptcy court was more concerned with the practices of attorneys representing mortgage companies in general, rather than limiting its review to the practices involved in this case. The United States Trustee has appealed to the Third Circuit.

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 contact 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 ("GMAC"), alleging that GMAC 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 GMAC 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 GMAC'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.

H. **Patterson v. Homecomings Financial, LLC (In re Patterson)**, 444 B.R. 564 (Bankr. E.D. Wis. Feb. 23, 2011). Chapter 13 debtors brought adversary proceeding against servicer Homecomings Financials, LLC ("Homecomings"), alleging that Homecomings collection of post-petition, pre-confirmation $350 attorney fee in connection with a refinance of the property violated the automatic stay and Fed. R. Bankr. P. 2016(a). The fee was never disclosed to the court. Homecomings moved to dismiss for failure to state a claim. Then bankruptcy court denied the motion, holding that debtors stated claims for willful violation of the automatic stay and Fed. R. 2016(a). The bankruptcy court held that because the fee was collected from the property of the estate in the form of refinancing proceeds, and that fee was never disclosed to the court, plaintiffs stated claims for relief.

I. **Sandlin v. Ameriquest Mortg. Co. (In re Sandlin)**, No. 08-191, slip op., 2010 WL 1416699 (Bankr. N.D. Ala. Apr. 8, 2010). Chapter 13 debtors sued Ameriquest Mortgage Company and AMC Mortgage Services, LLC asserting a violation of the automatic stay and alleging that Ameriquest attempted to charge and collect previously undisclosed post-petition, pre-confirmation fees and charges, which the debtor discovered on the payoff statement from Ameriquest in connection with the sale of their home. The debtors alleged that Ameriquest: (1) improperly assessed the fees without first obtaining approval from the bankruptcy court under section 506(b); (2) applied payments from the chapter 13 trustee to the fees instead of the pre-petition arrears pursuant to the repayment plan; and (3) collected the fees out of the proceeds from the sale of the home. Ameriquest moved for summary judgment, arguing: (1) that it had no duty to disclose the fees; and (2) there was no violation of the stay because the hidden assessment and application of payments were not acts to collect pre-petition debt from the estate and, prior to receiving the proceeds from the sale, it had obtained stay relief to satisfy the mortgage balance. The bankruptcy court denied Ameriquest's motion, holding that although there was no violation of the stay, Ameriquest had an obligation under section 506(b) to disclose the fees in order to allow the debtors to object to the reasonableness of the fees or satisfy the fees within their section 1322(b)(5) right to cure arrears. Accordingly, the court held that the fees were discharged because Ameriquest failed to provide the debtors with adequate notice of the fees prior to confirmation of the repayment plan.