

# **Burn the House Down!**

## Mortgage Issues in Consumer Cases

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### **Hon. Pamela Pepper**

U.S. Bankruptcy Court (E.D. Wis.); Milwaukee

## MORTGAGE ISSUES IN CONSUMER CASES

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1. Loss Mitigation in Bankruptcy
  - a. Current Industry Challenges
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5. U.S. Trustee 2004 Exams of Mortgage Creditors

## **Burn the House Down – Mortgage Issues in Consumer Cases**

**Kelley Callard**

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## 2004 Exams of Mortgage Servicer

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### **Background**

In recent months, national attention has focused on the practices of some of the country's largest mortgage servicers. Investigations and media coverage have brought to light disturbing reports that suggest mortgage servicers and their agents have filed inaccurate and deficient pleadings in federal and state courts and have too often failed to pay careful attention to paperwork used in support of debt collection and foreclosure. Acting pursuant to their statutory role to maintain the integrity of the bankruptcy system, United States Trustees are carefully reviewing filings by mortgage servicers, in bankruptcy courts across the country.

### **INQUIRY** - Review of Court Documents by the United States Trustee

1. Proofs of Claim
2. Motions for Relief
3. Objections to Notice of Payment Change
4. Motions to Compel
5. Objections to the Chapter 13 Trustee's Notice of Completion of Plan Payments

### **ACTION**

1. Request for Relief/Motion for 2004 Exam filed authorizing the issuance of a subpoena duces tecum
  - a. Compelling the mortgage servicer to produce documents
  - b. Compelling knowledgeable officer(s) or agent(s) of the mortgage servicer to give testimony under oath
2. Motion
  - a. Case Specifics
    - i. Background
    - ii. Why this came to the United States Trustee's attention
  - b. Necessary Documents and Topics for Examination
    - i. Case specific documents. The documents that are necessary will be different in each case.

- ii. Policies and Procedures. These will be different in each case as well. It is important to make the request case specific.

## **CHALLENGES**

### 1. Standing

- a. 28 U.S.C. §§586(a)(3)(G) and (a)(5)
  - i. Specific duties of the United States Trustee
- b. 11 U.S.C. §307
  - i. Section 307 confers broad standing on the United States Trustee to “raise[,] . . . appear and be heard on *any issue in any case* or proceeding” arising under the Bankruptcy Code
  - ii. Rule 2004 refers to motions by “a party in interest” without expressly mentioning the United States Trustee. Although the Bankruptcy Code does not define “party in interest,” it is well-established that the term “party in interest” includes the United States Trustee for some purposes under the Bankruptcy Code. For example section 1121 states that a debtor filing a plan in a small business case is required to “provid[e] notice to parties in interest . . . including *the United States trustee.*” 11 U.S.C. § 1121(e)(3)(A).
  - iii. Where Congress has chosen to limit the standing of the United States Trustee compared to other parties in interest, it has done so expressly. *See United States Trustee v. Clark (In re Clark)*, 927 F.2d 793, 796 (4th Cir. 1991). Section 707 refers to motions “filed by a party in interest (*other than . . . the United States [T]rustee.*)” 11 U.S.C. § 707(b)(5)(A) (emphasis added).
- c. Section 1121(c) permits any party in interest to file a chapter 11 reorganization plan, section 307 qualifies this statement by providing that section 1121(c) does not apply to the United States Trustee.
- d. The United States Trustee’s Standing to Protect the Public Interest Confers Standing to Conduct 2004 Examinations.
  - i. The United States Trustee is a party in interest when carrying out the public interest to prevent an abuse of the bankruptcy process. *In re A-1 Trash Pickup, Inc.*, 802 F.2d 774 (4<sup>th</sup> Cir. 1996).

- ii. The Sixth Circuit held likewise when, even after the enactment of section 307, it first based the United States Trustee's appellate standing on its protection of the public interest. *Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 499 (6th Cir. 1990) ("That is the interest the [United States Trustee] has pursued in this case, and that interest gives him standing to appeal.").
- e. Several cases have confirmed the power of the United States Trustee to conduct 2004 Examinations
  - i. The importance of the United States Trustee's role in uncovering bankruptcy abuse was recently discussed at length in another decision involving mortgage servicers, in which the bankruptcy court observed: While the Court would prefer not to have to invoke § 105(a) and instead have debtors' attorneys lodge objections to ill-founded proofs of claim and motions to lift stay, in actual practice serious and thorough challenges are rarely mounted. The absence of such challenges argues in favor of this Court and the [United States Trustee] becoming more – not less– involved in scrutinizing payment histories and conduct of mortgagees to avoid abuse of the bankruptcy system becoming accepted practice. *In re Parsley*, 384 B.R. 138, 173 (Bankr. S.D. Tex. 2008); *see also id.* at 146 ("Although it is uncommon, and possibly unprecedented until recently, for the [United States Trustee] to focus on the conduct of a mortgagee, a servicer, or its counsel in a Chapter 13 case, it does not follow that the [United States Trustee] is outside of its Congressional mandate.").
  - ii. In two related cases in the Southern District of Florida, Countrywide Home Loans, Inc. ("Countrywide") objected to Rule 2004 motions filed by the United States Trustee because, according to Countrywide, the United States Trustee lacked the statutory authority to conduct Rule 2004 examinations. The Court rejected this argument in both cases. *See In re Del Castillo*, 07-13601, order at 2 (Bankr. S.D. Fla. June 27, 2008); *In re Chadwick*, 05-37014, order at 2 (Bankr. S.D. Fla. Dec. 10, 2007)
  - iii. In *In re Countrywide Home Loans, Inc.*, 384 B.R. 373 (Bankr. W.D. Pa. 2008), a United States Trustee sought to conduct a Rule 2004 examination and

serve subpoenas *duces tecum* on Countrywide in ten cases. The United States Trustee had reason to believe Countrywide had engaged in questionable conduct in those and other cases that threatened the integrity of the bankruptcy system. The court concluded that the United States Trustee has the power under section 307 to conduct Rule 2004 exams. *In re Countrywide*, 384 B.R. at 384 (“The Court . . . has no difficulty concluding that the plain meaning of the power to ‘raise’ and to ‘appear and be heard’ as to any issue in any bankruptcy case or proceeding includes the ability to conduct examinations pursuant to Rule 2004 in the right circumstances.”). According to the court: The [United States Trustee] is a ‘party in interest’ in this case. The [United States Trustee] has a sufficient stake in this case because she has been charged to act as a watchdog to protect the integrity of the bankruptcy system. Assuming for the moment that the [United States Trustee] has at least averred sufficient allegations of fact to raise the possibility of Countrywide’s abuse of the bankruptcy system, the [United States Trustee] certainly has an interest in looking further into this possibility for no other reason than she is required to do so because of her statutory duties as interpreted by applicable case law

- iv. “As long as the Rule 2004 motion adequately alleges facts that demonstrate the integrity of the bankruptcy system might be at stake, § 307’s statutorily imposed duty gives the United States trustee a sufficient stake in a case to qualify as a party in interest for purposes of Rule 2004. The [United States] Trustee has standing to pursue a Rule 2004 examination of any entity,” including the debtor’s creditors.” *In re Currin*, No. 10-13556, mem. op. at 8 (Bankr. W.D. Tenn. Feb. 22, 2011).
- v. In *In re Romas*, No. 10-90007 (Bankr. D.S.C. Feb. 3, 2011), the Bankruptcy Court for District of South Carolina held that “the United States Trustee is a party in interest for the purposes of Rule 2004.” *Id.* at 5. The court rejected arguments to the contrary by Wells Fargo Home Mortgage and found that the United States Trustee’s authority rested on section 307, as well as the United States Trustee’s more general standing to protect the public interest. *Id.* (citing *In re A-1 Trash Pickup*, 802 F.2d at 774). According to the court, “the

procedures available under Rule 2004 are an invaluable tool for carrying out the statutory mission of the United States Trustee Program.” *Id.* at 8.

- vi. The Bankruptcy Court for the Central District of California recognized the authority of the United States Trustee to conduct a Rule 2004 Examination. *In re Luna*, No. 10-mp-00101 (Bankr. C.D. Cal. Jan. 28, 2011). In those cases, The United States Trustee had sought to conduct examinations and subpoena documents of BAC Home Loan Servicing LP (“BAC”). BAC raised similar arguments to those advanced here. The Court rejected BAC’s arguments and held that “section 307’s broad language nonetheless serves to ensure that the [United States Trustee] possesses the flexibility necessary to carry out its ‘watchdog’ responsibilities in bankruptcy cases, including the ability to conduct 2004 examinations in an effort to prevent abuse. . . . It would make no sense to confer investigative powers on the United States Trustee and give them the same rights as a party in interest and not to afford rights to utilize 2004 examinations.” *Id.* at 5. The court also expressly adopted the reasoning of *Countrywide*. *Id.*
- vii. The District Court for the Northern District of Ohio is the first district court to address the United States Trustee’s authority to conduct rule 2004 examinations. *In re Santiago*, No. 1:11–CV–561, 2011 WL 1257209 (N.D. Ohio Mar. 31, 2011). In denying a motion by BAC for leave to appeal an order of the bankruptcy court, the District Court considered the merits of BAC’s arguments concerning the authority of the United States Trustee to conduct Rule 2004s. The Court stated it “has no doubts that the Trustee is a ‘party in interest’ with authority to compel a Rule 2004 examination.” *Id.* at \*3.

1. This is currently on appeal.

2. Good Cause

- a. If the party subject to an examination objects, the party seeking to conduct a Rule 2004 examination must demonstrate “good cause” for the examination to proceed. *In re Countrywide Home Loans, Inc.*, 384 B.R. 373, 393 (Bankr. W.D. Pa. 2008); *In re Wilcher*, 56 B.R. 428, 433 (Bankr. N.D. Ill. 1985).

- b. Good cause may ordinarily be shown if the examination and requested documents are necessary to establish the claim of the party seeking the examination, or that denial of such request would cause it undue hardship or injustice. *Wilcher*, 56 B.R. at 434-35.
- c. Good cause is established if the one seeking the Rule 2004 examination has shown that such an examination is reasonably necessary for the support of a legitimate interest. *See In re Hammond*, 140 B.R. 197, 201 (S.D. Ohio 1992) (citing *Boeing Airplane Co. v. Coggeshall*, 280 F.2d 654 (D.C. Cir. 1960)).
- d. The United States Trustee’s legitimate interest is based, inter alia, upon his role as a watchdog in the bankruptcy system. The United States Trustee, an officer of the United States Department of Justice and the “watchdog” who guards against fraud and abuse of the bankruptcy system, does just that. *See* H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 1, 88 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6049 (“The proposed United States Trustees will . . . serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena.”); *see also In re South Beach Secs., Inc.*, 606 F.3d 366, 371 (7th Cir. 2010) (Posner, J.) (the United States Trustee is “the congressionally ordained watchdog – he has a statutory interest in making sure that bankruptcy law isn’t abused”).
  - i. “While the Court would prefer not to have to invoke § 105(a) and instead have debtors’ attorneys lodge objections to ill-founded proofs of claim and motions to lift stay, in actual practice serious and thorough challenges are rarely mounted. The absence of such challenges argues in favor of this Court and the [United States Trustee] becoming more – not less– involved in scrutinizing payment histories and conduct of mortgagees to avoid abuse of the bankruptcy system becoming accepted practice.” *In re Parsley*, 384 B.R. 138, 173 (Bankr. S.D. Tex. 2008); *id.* at 146 “Although it is uncommon, and possibly unprecedented until recently, for the [United States Trustee] to focus on the conduct of a mortgagee, a servicer, or its counsel in a Chapter 13 case, it does not follow that the [United States Trustee] is outside of its Congressional mandate. *Id.* at 146

## 3. Scope

- a. Rule 2004 is extremely broad in scope and great latitude in discovery is ordinarily permitted. *In re Edic*, No. 05-41557, 2005 WL 6443541, at \*1 (Bankr. N.D. Tex. Oct. 7, 2005) (citing 8 Collier on Bankruptcy ¶ 2004.02[1] (15th ed. Rev. 2005)); *see also Dynamic Fin. Corp. v. Kipperman (In re North Plaza, LLC)*, 395 B.R. 113, 122 n.22 (S.D. Cal. 2008) “It is well established that the scope of a Rule 2004 examination is exceptionally broad and provides few of the procedural safeguards found in Federal Rule of Civil Procedure 26.”); *In re Table Talk, Inc.*, 51 B.R. 143, 145 (Bankr. Mass. 1985).
- b. A Rule 2004 examination is “commonly recognized as permitting discovery in the nature of a ‘fishing expedition.’” *In re Washington Mutual, Inc.*, 408 B.R. 45, 50 (Bankr. D. Del. 2009) (citation omitted); *In re Wilcher*, 56 B.R. at 433; *In re Vantage Petroleum Corp.*, 34 B.R. 650, 651 (Bankr. E.D.N.Y. 1983).
- c. This broad construction of Rule 2004 permits broader inquiry than that allowed under the Federal Rules of Civil Procedure. *Wilcher*, 56 B.R. at 433.
  - i. Each of the document requests and topics for examination are tailored to the facts of this case and fit within the “unfettered and broad” discovery permitted by Rule 2004. *In re Table Talk, Inc.*, 51 B.R. at 145

**Decisions within the Eastern District of Michigan**

1. *In re Greene*, Case No. 06-42999-SWR [Docket No. 129 ] (Judge Rhodes)
  - a. Ocwen concedes the United States Trustee has standing to conduct a 2004 Examination but argues there is no good cause to conduct the examination and the requested information is overly broad based on the circumstances.
2. *In re Gray*, Case No. 10-60999-SWR [Docket No. 95] (Judge Rhodes)
  - a. Wells Fargo argues the United States Trustee did not have good cause and the scope of the requested documents was too broad. The Court ruled in favor of the United States Trustee.
  - b. Wells Fargo appealed the Bankruptcy Court’s Order and filed a Motion for Leave to Appeal [Docket ] and a Motion to Stay Pending appeal [Docket ]
  - c. Judge Rhodes denied Wells Fargo’s Motion to Stay Pending Appeal

- d. The District Court [Judge Cook] denied the Motion for Leave to Appeal. The Order for the 2004 Examination is not a final Order and cannot be appealed. 2011 WL 9027333 (E.D. Mich).
3. *In re Evans*, Case No. 10-63038-TJT [Docket No. 52] (Judge Tucker)
  - a. Because the confirmed Chapter 13 Plan surrendered the subject property and Wells Fargo was not going to receive a distribution the Court ruled the United States Trustee failed to show good cause.
4. *In re Johnson*, Case No. 10-70636-MBM [Docket No. 73] (Judge McIvor)
  - b. Litton argued the United States Trustee lacked standing, failed to show good cause, and the scope of the requested documents are overly broad and unduly burdensome.
  - c. The Court granted the United States Trustee's Motion for a 2004 Examination.
5. *In re Ellis*, Case No. 10-50910-PJS [Docket No. 90] (Judge Shefferly)
  - a. HSBC argued the United States Trustee lacked standing, failed to show good cause, and the scope of the requested documents are overly broad and unduly burdensome.
  - b. The Court granted the United States Trustee's Motion for a 2004 Examination.
6. *In re Hoffman*, Case No. 09-36120-DOF [Docket No.66] (Judge Opperman)
  - a. HSBC did not respond to the United States Trustee's Motion for a 2004 Examination.
  - b. HSBC filed a Motion to Set Aside the Order and Quash the Subpoena. HSBC argued the Order should be set aside because of its excusable neglect in failing to respond to the Motion
  - c. The Court denied the Motion and an Order was entered giving HSBC time to comply with the subpoena
7. *In re Garland*, Case No. 10-62362-TJT [Docket No. ] (Judge Tucker)
  - a. Wells Fargo argued that it had provided, in its response to the Motion, all the documents necessary to satisfy the United States Trustee's inquiry and there was no longer good cause. In the alternative, the document request was overly broad.
  - b. The Court granted the United States Trustee's Motion but modified and in some cases limited the scope of the requests made.

**OTHER ISSUES**

1. Right to Financial Privacy
  - a. RFPA prohibits a financial institution from releasing a customer's financial records to a Government authority until that authority certifies in writing its compliance with RFPA. 12 U.S.C. § 3403(b). That certification is known as a certificate of compliance.
  - b. The United States Trustee complies with RFPA
2. Protective Orders
  - a. Even if there is an agreed resolution to the Motion for 2004 Examination, there may be other road blocks.
3. The Role of the Debtor and the United States Trustee
  - a. Interests of the Debtor may be different from that of the United States Trustee

## Revocation of Abandonment

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### CREATING THE ESTATE

1. When a case is commenced a bankruptcy estate is created. 11 U.S.C. §541(a).
2. Debtors are required to schedule their assets and liabilities. 11 U.S.C. §521(a)(1)(B)(i).

### REOPENING THE CASE AND ABANDONMENT

1. A bankruptcy case can be reopened to administer assets, offer relief to the debtor, or for other cause. 11 U.S.C. § 350(b).
2. When a Trustee files a report of no assets and the case is closed the Trustee abandons any interest in scheduled estate assets. 11 U.S.C. § 554(c).

### REVOKING ABANDONMENT

1. Revocation of abandonment is governed by Fed. R. Civ. Pro. 60(b) as made applicable to bankruptcy cases by Fed. R. Bankr. Pro. 9024. *LPP Mortgage, Ltd. v. Brinley (In re Brinley)*, 547 F.3d 643 (6<sup>th</sup> Cir. 2008).
  - a. Rule 60(b) states: **(b) Mistakes; Inadvertence; Excusable Neglect; Newly Discovered Evidence; Fraud, Etc.** On motion and upon such terms as are just, the court may relieve a party or a party's legal representative from a final judgment, order, or proceeding for the following reasons: (1) mistake, inadvertence, surprise, or excusable neglect; (2) newly discovered evidence which by due diligence could not have been discovered in time to move for a new trial under Rule 59(b); (3) fraud (whether heretofore denominated intrinsic or extrinsic), misrepresentation, or other misconduct of an adverse party; (4) the judgment is void; (5) the judgment has been satisfied, released, or discharged, or a prior judgment upon which it is based has been reversed or otherwise vacated, or it is no longer equitable that the judgment should have prospective application; or (6) any other reason justifying relief from the operation of the judgment.

2. Chapter 7 Trustee’s Argument

- a. The abandonment is merely technical, (11 U.S.C. 554(c)), and no express or affirmative action took place to abandon the property so the standard for review should be more flexible than a typical 60(b) analysis.
- b. *Brinley* requires extraordinary circumstances and a faultless Trustee. The Trustee could have had no way of knowing that mortgage companies would “underbid” at a foreclosure sale – that is, bid less than the value of the property.
- c. The underbid was extraordinary and no Trustee could have known that was going to happen.
- d. Equity is created by the underbid and the property can be administered by the Trustee for the benefit of creditors.

3. United States Trustee’s Argument

- a. Statutory abandonment, by operation of law, does not create a lower standard of review when determining whether revocation of abandonment is appropriate.
- b. The circumstances and facts in these types of cases do not meet the strict requirements of 60(b)(5) or 60(b)(6).
- c. In these specific types of cases in the Eastern District of Michigan there is a strong policy of finality.

**CHAPTER 7 LIEN STRIP**

1. 11 U.S.C. § 506.
  - a. *Dewsnup v. Timm*, 502 U.S. 410, 116 L.Ed. 2d 903, 112 S.Ct. 773 (1992)
  - b. *Talbert v. City Mortgage Services (In re Talbert)*, 344 F.3d 555 (6th Cir. 2003)
2. Valid theory of consent – a motion to sell that seeks to pay the second lien as a general unsecured creditor. 11 U.S.C. §363(f)(2).
  - a. *Futuresource LLC v. Reuters Ltd.*, 312 F.3d 281, 285 (7<sup>th</sup> Cir. 2002).

**DECISIONS FROM THE EASTERN DISTRICT OF MICHIGAN**

1. *In re Reiman*, 431 B.R. 901 (Bankr. E.D. Mich. 2010) (Chief Judge Shefferly).
2. *In re Pioch*, 2010 Bankr. Lexis 2952 (Bankr. E.D. Mich. Sept. 1 2010) (Judge Shapero)

3. *In re Smith*, Case No. 09-65940-MBM [Docket No. 27] (Judge McIvor)
4. *In re Shick*, Case No. 09-70103-TJT [Docket No. 93] (Judge Tucker)
5. *In re Tisler*, Case No. 09-73374-SWR [Docket No. 48] (Judge Rhodes)

### **TRENDS AND REMAINING QUESTIONS**

1. Leaving cases open
2. Filing motions under 11 U.S.C. 554(d)
3. Lien Stripping
4. Consider the options and the best interests of your client

**Lien Avoidance**

**The Chapter 7 Trustee and Defective Mortgages**

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## INTRODUCTION

Over the past decade the business of mortgage loans has changed. More loans are being made by more institutions, the paperwork is being handled differently and chapter 7 trustees are increasingly looking to real estate assets encumbered by defective mortgages as a source of recovery for unsecured creditors. An growing number of adversary actions are being brought in the bankruptcy court to avoid mortgages, either completely or in part and to allow the trustee to sell what initially appeared to be fully encumbered assets. While many of these disputes result in a settlement between the trustee and the institutions and other companies involved in the mortgage transaction, more and more cases are being filed that are calling upon the bankruptcy court to make decisions regarding the validity of liens on real estate.

### 1. The Bankruptcy Code.

The primary basis for the trustee's standing to challenge a mortgage is 11 U.S.C. §544(a)(3):

(a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by -

(3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists.

The term bona fide purchaser (BFP) when used in the context of real estate refers to an innocent party who purchases property without notice of any other party's claim to the title of that property. The designation as a bona fide purchaser generally results in the BFP taking valid title to the property despite the competing claims of other parties.

It is also worth noting that under §544 the trustee has certain powers as a lien creditor under sections (a)(1) and (2).

If the trustee can either find or create a circumstance whereby the real estate can have value to the bankruptcy estate, the trustee under the terms of 11 U.S.C. §363 sections (f) through (j) has varied and far-reaching powers to sell the estate's interest in the property. Under various statutory circumstances and tests, the sale can include even those interests held by a non-debtor owner and can take place whether the property is held by "tenancy in common", "tenancy by the entirety" and in spite of "dower" and "curtesy" interests held by non-debtors. Depending on whether the rights enjoyed by the bankruptcy estate include the full ownership interest in the property or only a fractional interest, a portion of sale proceeds may be distributed upon closing outside of the bankruptcy estate.

## 2. State Law and Differences in Ownership Interest and Execution Requirements.

A chapter 7 bankruptcy trustee when dealing with interests in real estate tests the extent of ownership and the validity of liens under the laws of the state where the property is located. Two common definitions for describing the ownership of real estate are **tenancy in common** and **tenancy by the entirety**.

In a state that permits property to be held by **tenancy in common**, title of the property is held by two or more persons in whom each has an "undivided interest" in the property and all have the equal right to use the property. There is no "right of survivorship" if one of the tenants in common dies and each interest may be separately sold, mortgaged or willed to another. The majority of states recognize tenancy in common.

Other states permit **tenancy by the entirety**. This is a joint ownership of title by husband and wife in which both have the right to the entire property and, upon the death of one, the full fee interest in the title will pass to the other. This is analogous to **community property** and may be effective as a shield against an execution claim by a creditor of only one of the co-owners against the property titled and held in tenancy by the entirety. Some states have moved

away from tenancy by the entirety to a tenancy in common with right of survivorship form of ownership. This creates a risk that the property will be vulnerable to the claims of creditors of any one of the joint owners.

States also differ with regard to their statutory foreclosure proceedings. Some states, such as Michigan, permit foreclosure by forfeiture which provides for a more expedient enforcement of the mortgage though a statutory period in which the owner holds a right of redemption may be provided under state law. Other states, such as Wisconsin, Ohio and Illinois, provide for a judicial foreclosure which requires the filing of a lawsuit, the service of summons, the filing of pleadings, the opportunity to file answers and assert defenses and the potential for time consuming litigation. As the court system becomes glutted by the influx of foreclosure cases in judicial proceeding states, the process is becoming extremely slow and some counties are designating judges to primarily or exclusively deal with these cases.

Also, potential factors in the case of real estate held by a married couple are the old English common law rights of **dower** and **curtesy**. Dower is the common law right of a widow to take 1/3 of her late husband's estate and curtesy is the surviving husband's equivalent right. In a case where only one person of a married couple holds title to real estate, the non-owner spouse will be required to execute the mortgage even if he or she is not a borrower, using certain statutory language to release and/or convey his or her dower interest and to provide the mortgagee with a full and complete lien on all of the interests affecting the real estate.

### 3. Attestation.

Each state has its own rules and standards with regard to the attestation of documents transferring real estate. Some states require witnesses and an oath or acknowledgment before a notary public while other states require only the involvement and attestation of the execution by

a notary public. A failure to comply with the particular state requirements has become a major source of the cases in which trustees challenge mortgage validity.

#### 4. The Trustee's Review.

Traditionally the trustee's examination on real estate issues had focused on the questioning of the debtors. That has now shifted to include a review of the documents. This involves a review of the documents as filed and executed and not the copies given to the debtors after the real estate closing. Trustees are continually being shocked by the fact that counsel for the debtors are "surprised" at the meeting of creditors when defects are discovered. A "best" practice by debtor's counsel should be to ask the same questions that would come from the trustee and to examine the same documents with their clients that the trustee would review.

The documents commonly reviewed by the trustee would be the deed, the mortgage, the mortgage note, the assignments of the mortgages and occasionally records of the county auditor to determine the transfer history of the property and whether or not there are any parcels or lots that were omitted from mortgage documents.

Many of the problems that are found are based on the drafting and handling of the documents.

- Who signed the promissory note?
- Was it executed by both of the co-owners or both husband and wife or is only one of the parties obligated by the underlying debt?
- Who is the borrower under the mortgage? Again, is it only one of the parties or is it both the husband and wife? All mortgage forms are not the same. Some mortgages specifically identify the borrower by name and an omission of a name can limit the responsibility for the debt. Other mortgages define the borrower as

being any one who signs the document in which case a single signature at the end of the document may be sufficient.

- What is the effect of the “naked” signature of a non-owner/non-borrower spouse?
- Is a spouse becoming a borrower and pledging his or her interest in the real estate for the debt and/or are they just releasing their dower interest?
- Is the legal description complete and accurate?
- If the particular piece of property is made up of multiple lots or parcels, are all of the lots and/or parcels pledged as collateral?
- Is the attestation as required under the state law requirements defective?
- If witnesses are required, was the document signed in their presence?
- Are the standards for witnesses required by the state statute met or did the witnesses sign as an afterthought to make the document appear valid on its face?

More and more we are hearing the term “robo-signing” usually with regard to the chain of the transfer and ownership of a mortgage and or the promissory note secured by the mortgage but similar practices have gone on for years with regard to the mass processing and witnessing of mortgage documents.

- Was the notary present, did he or she witness the execution of the document or were the signatures otherwise acknowledged before them in accordance with the state statutes?
- Did the notary execute their portion of the document using all of the necessary language required by the state law? Examples of the potentially necessary language may include names of the people who appeared, their relationship (husband and wife) and the purpose of their signature (release of dower).

The failure to properly follow the state statutes regarding title standards and requirements for the execution of documents can render a mortgage defective and vulnerable to attack by the trustee.

The doctrine of **lis pendens**, which refers to a written notice that a lawsuit has been filed which concerns the title to real property or some interest in that property, is becoming a common defense to an action brought by a trustee against a potentially defective mortgage. Trustees generally believe that this application of the doctrine of **lis pendens** is a flawed use of this doctrine as a mortgage is not a unilateral public assertion of a claim against real property as would be done by the filing of a mechanic's lien or a materialman's affidavit of lien but rather that a mortgage is a transfer of an interest in real estate and as such is subject to the state law requirements of formality that must be met for the document to be legally effective.

Other common defects are simply the failure to file a mortgage at all or the failure to amend certain critical documents. An example of the latter could arise in a case of a refinance where the bank originally provided a mortgage which contained a cap on the amount to be borrowed. The bank may then allow a refinancing by the owners to increase the amount borrowed against the property but in choosing to keep the original mortgage in place, the bank simply has the debtors execute a new promissory note at the higher dollar figure. Occasionally, the new promissory note is for an amount in excess of the mortgage cap which renders the debt partially unsecured.

Sometimes the problem is as simple as filing a mortgage in the wrong jurisdiction. There is a small municipality near Cincinnati, Ohio by the name of Loveland which actually sits in three different counties. Sometimes mortgages are canceled by mistake and sometimes the failure to file a mortgage may be discovered on the eve of bankruptcy and a last minute but

untimely recording of the mortgage can be subject to a challenge as a preference or fraudulent conveyance.

Different jurisdictions can be subject to some unusual technical requirements. Ohio has a long-standing statute known as the Torrens Act which creates a type of real estate ownership known as Registered Land. In Registered Land when ownership is transferred, a Registered Land Certificate is issued that is similar to a motor vehicle title and for a lender to have a lien interest in this type of real estate, the mortgage or lien must be recorded on the certificate of title that is maintained in the offices of the county recorder. A failure to properly file a mortgage against Registered Land will produce a recorded document that appears valid on its face but which is ineffective as a lien.

#### **5. The Business of Refinancing and its Unintended Consequences.**

During the last ten years, the business of real estate mortgages has changed dramatically and mortgages have become a mass investment commodity. Instead of banks making real estate loans, the market now involves title companies, servicing companies and realtors. This also includes the now well-known MERS.

Mortgages that are issued and closed at the time property buyers, especially home buyers, purchase their real estate rarely produce problems. They are usually done by a bank and are generally more carefully drafted and executed. Refinancing a property that was done from the middle of the decade, 2000 – 2010, appear to produce a higher percentage of defects. One could argue that the year 2005 is a prime year for mortgage defects with the combination of the peak of the real estate refinancing boom plus the circumstance of people realigning their financial affairs due to the change in the Bankruptcy Code.

## 6. Review by Debtor's Counsel

As stated above, not only the trustee but debtor's counsel should look at the documents if possible before the filing of the bankruptcy and at the latest prior to the meeting of creditors so that they can themselves look for possible defects. They should also make sure that they don't just rely on the first set of documents given to them by their client and that they determine whether or not the debtor refinanced their property and/or whether or not there are second and third mortgages. They should also look for a change in the marital status. Someone may have acquired the real estate as a single person but at the time of a refinance they may have been married therefore creating a spouse who has a dower interest.

If a refinancing was done with a non-traditional bank or lending institution, the debtor should be asked where the closing was held; i.e., was it held in a bank, in an office or in their home. A large number of refinancing mortgages were executed either in the person's home or by mail. Those types of closings seemed to produce a higher percentage of defective documents. If it was closed in their home, how many visits were made. The following are sample questions that are often used:

- If the closing was at your home, did you receive documents in advance by mail?
- Did you sign all the documents at one time or did you sign the application and have another visit where you signed the mortgage and note?
- Did you take the documents to a bank or a real estate office to have your signatures notarized?
- After you signed the note and mortgage, did the people who were conducting the closing take these documents with them?
- How many people came to your house (once you establish how many people came, you ask them to identify the people by sex). The following is a question used if only one person came?
- Was it a man or a woman?

Many times people remember that only one person came to the house and somehow the gender of the notary public attesting the document is different than the gender of the one and only person who closed the loan. People seem to have clearer memory about real estate closings that take place in their dining room than they do at a bank or a title company. If they answer that the person who came was a different gender than the notary, I will show them the signature of the notary and ask if that refreshes their recollection or if they still believe that this person was not the notary. Having the notary sign the documents outside of the presence of the debtors generally creates a defective mortgage. To try and make sure I am not attacking a mortgage by mistake or that the people do not have flawed memories, I will often ask them to check to see if they have any closing binders at home that may contain the business cards of the people who came and/or that they think about the questions for a few days and if they still are convinced that their testimony was correct I ask that they sign an affidavit regarding the facts that they recall. Only then will I commence the action to avoid the mortgage.

#### 7. The MERS Dilemma.

The involvement of MERS (Mortgage Electronic Registration Service) is becoming an active topic for debate and bankruptcy trustees are still forming their opinions as to its effect on the chapter 7 trustee. One school of thought is that the primary issue of MERS is who holds the note and mortgage and that if the note and mortgage were properly executed, someone holds it and there is no sound basis for the trustee to try and seek to avoid the MERS transaction as a secured obligation. There is also, however, a school of thought that if a note and mortgage are separated and end up not being held by the same party through the transfers and assignments, that there is no valid enforceable security agreement and that the trustee can be successful in generating funds for the unsecured creditors. Tactically speaking, some trustees feel that if they bring an action to avoid a mortgage that has been transferred multiple times by MERS, that the

true real party in interest may not be able to raise a timely defense to the avoidance to defeat the trustee.

While the actions by the chapter 7 trustee to avoid mortgages may seem like a course of conduct would be always detrimental to the interest of the debtor, sometimes this may not be the case. If the trustee has the ability to avoid a mortgage and promptly sell a property, they may enable the debtor to have the property cleared out of their name and to avoid potential post-petition liability by having the more expedient sale process.

## 8. Miscellaneous Cases

### A. Document Defects. Misidentification of Parties.

*In re: Earl, Henry E. Menninger, Jr. Trustee, Plaintiff v. Mortgage Electronic Registration Systems, et al., Defendants, 2010 Bankr. LEXIS 1993.* The *Earl* case involved real estate held by husband and wife in which only the husband was the debtor in bankruptcy. In the mortgage documents the borrower was defined in the singular in the name of the debtor and the mortgage document only referred to the borrower in the singular. In spite of the fact that both the husband and wife signed at the end of the document, the bankruptcy court ruled that apart from the wife's single signature there was no dispositive language in the mortgage itself in reference to the wife and, as a result, the mortgage was found to not encumber the ½ interest in the subject property of the wife.

*Kindt v. ABN AMRO Mortg. Group (In re: Wallace), 2007 Bankr. LEXIS 4651 (Bankr. S.D. Ohio 2007).* This court reached the same result as the *Earl* case under circumstances where both debtor spouses initialed each page of the mortgage document but there was only one pre-printed signature line for the single borrower spouse and the other borrower spouse added a signature line which read "& Marcia Wallace". Again, the body of the mortgage only defined one spouse as the borrower. The court again held that the mortgage was not

sufficient to convey or to create a security interest in the ½ ownership interest of Marcia Wallace.

*SFJV 2005, LLC v. Donna Ream*, 187 Ohio app. 3d 715 (April 10, 2010). This case is a state court case that reaches an opposing result to *Earl* and *Wallace*. The Ohio Appellate Court ruled in this case that even though the promissory note identified only the wife as the borrower, in light of the fact that the husband initialed each page and signed the signature page as a borrower was sufficient to produce a reasonable conclusion that the husband signed for the purpose of mortgaging his interest in the property.

It is worth noting that in the *Earl* and *Wallace* cases the bankruptcy court decided the drafting and execution ambiguities in favor of the trustee while in the *Ream* case the state court of appeals found in favor of the mortgagee in the face of similar ambiguities in the fact pattern.

#### B. Notary Attestation Cases.

In the case of *Ann Marie Leahy*, 2007 LEXI 3305 (Sept. 28, 2007), the court set forth the standards for proper attestation under the Ohio Rev. Code §5301.01(A) which state that:

- (1) The mortgage must be signed by the mortgagor;
- (2) Signing of the mortgage must be acknowledged before a notary public;
- (3) The notary public must certify the acknowledgement; and
- (4) The notary public must subscribe his name to the certificate of acknowledgment.

The court found that the attestation in *Leahy* was defective as the mortgagor's name was omitted from the acknowledgement clause. The court followed a similar line of reasoning in *In re: Bozman*, 365 B.R. 824 (S.D. Ohio, 2007) where the mortgage document that did not contain any acknowledgement language but rather only the signature of the notary and the imprint of the seal was found to be defective under the Ohio Code. The court in setting forth its decision stated

that it found as a matter of law that a notary signature and seal without additional language similar in content was not the same as the language of Ohio Rev. Code §147.55 and that as such was insufficient to constitute an acknowledgement of the execution of the mortgage.

*In re: Vance*, 99 Fed. Appx. 25 (6<sup>th</sup> Cir. 2004) In this case the trustee successfully challenged the validity of the mortgage on grounds that the defects in the acknowledgement clause included the omission of the name of the county in which the acknowledgement taken not being stated, the omission of the identity and/or names of those executing the mortgage and that the date of the acknowledgement was also missing. The court found that these omissions were sufficient to render the mortgage defective and therefore not entitled to record or constructive notice.

An Ohio bankruptcy court took the *Vance* line of reasoning even further in its March 4, 2011 opinion *In re: Phalen, Susan L. Riehl, Plaintiff v. The Huntington National Bank, Defendant, Bankruptcy Court Southern District of Ohio, Eastern Division Case 09-62256*, where the court found that in a case where the bank had failed to name or otherwise identify the mortgagor in a certificate of acknowledgement that caused the mortgage to be defectively executed and therefore failed to provide constructive notice to a bona fide purchaser of the claimed mortgage interest. The court then went further and cautioned that the continued pressing by lenders and their counsel of legal theories and blank acknowledgement adversary proceedings that the court felt were indefensible raised issues regarding the conduct of the lenders and their counsel in light of Rule 9011 of the Fed. R. Bankr. P.

A different decision was rendered in the case of *In re: Copperman*, 2008 Bankr. LEXIS 2343 (Bankr. S.D. Ohio Sept. 18, 2008), where the court examined a case involving the acknowledgement clause that contained the notary stamp and seal but not the signature of the

notary. The court, in viewing the mortgage document in its totality found that the document supplied within itself the means of making the correction to an otherwise defective acknowledgment clause and that “ the Notary’s failure to sign the Acknowledgement on the Mortgage was a mere clerical omission, and that the Acknowledgement was in substantial compliance. . .” with the Ohio Rev. Code.

**C. The Bona Fide Purchaser Under Bankruptcy §544  
v. The Doctrine of Lis Pendens**

As was previously stated, Bankruptcy Code §544(A)(3) states that the trustee shall have the rights and powers of a “bona fide purchaser of real property. . . that obtains the status of a bona fide purchaser. . . whether or not such a purchaser exists.” This status and doctrine was previously relied upon by the courts in the case of *In re: Zaptocky*, 205 F.3d 1023, 1028 (6<sup>th</sup> Cir. 2001) whereby the court held that the powers granted to the trustee cloak the trustee with the authority to stand in the place of the **hypothetical** bona fide purchaser and avoid improperly executed mortgages.

The trustees seeking to use the §544 characterization as a bona fide purchaser are being confronted by the decision rendered in *In re: Periandri*, 266 B.R. 651; 2001 FED. App. 0008P (6<sup>th</sup> Cir.), which states that a bona fide purchaser can only avoid an improperly executed mortgage under Ohio law if he did not have actual or constructive knowledge of that transaction. The court further held that the trustee was barred by the doctrine of “lis pendens” and that the existence of the lawsuit and the doctrine of lis pendens are sufficient to thwart the bona fide purchaser avoidance powers of the trustee based on constructive knowledge of a claimed mortgage, even if that mortgage is proved to be defective.

Two approaches are being used by trustees with some success to avoid preclusion of their avoidance powers under the code in light of *Periandri* and the doctrine of lis pendens by finding,

as was done in *Phalen*, that the defect was so obviously contrary to state law that the trustee could not be charged with having constructive notice of the existence of the mortgage. The other approach that has been successful occurs in cases where rather than seeking to avoid the mortgage in full, the trustee simply seeks a declaratory judgment which defines the mortgage in terms that holds that the mortgage simply does not encumber the full interest of all parties involved in the bankruptcy proceeding. *Wells Fargo Bank, N.A., Appellant v. Richard D. Nelson, Trustee, Appellee*, 2009 U.S. Dist. LEXIS 49550 (June 10, 2009).

#### D. The ‘Metaphysical’ Bona Fide Purchaser

The 9<sup>th</sup> Circuit case of *In Re: Deuel*, 594 F.3d 1073 (9<sup>th</sup> Cir. 2010), has potentially taken the next step in defining the bona fide purchaser definition under Bankruptcy Code §544 by finding that the trustee, in the role of the hypothetical bona fide purchaser, is a “metaphysical” person; as opposed to a “real” person with the capacity for actual constructive notice. The Supreme Court has declined the opportunity to hear the creditor’s appeal in this case.

#### E. MERS and Issues of Standing.

Generally, cases involving the Mortgage Electronic Registration System, aka MERS, as a “nominee” for the original lender have been litigated more in state court by property owners resisting foreclosure rather than having been challenged by the trustee in bankruptcy court where the trustee may have determined that the mortgage and note were originally properly executed before they began their sometimes separate journeys through the assignment process. In a recent decision dated February 10, 2011, Bankruptcy Judge Robert E. Grossman in the United States Bankruptcy Court for the Eastern District of New York in the case of *Ferrel L. Agard, Case No. 801-77338-REG* conducted an extensive analysis of the issues raised by MERS as the claimed “mortgagee of record” and nominee for the original lender. While granting the MERS motion for relief from stay in this case as the motion was unopposed, the court continued with it’s

analysis and reached the conclusion that MERS, as a moving party seeking relief from stay, must be able to show that it validly holds both the mortgage and the underlying note in order to establish standing before the court. This language in Judge Grossman's decision at least raises the question as to whether or not MERS can successfully defend an action by a trustee to avoid a mortgage, in whole or in part, if it cannot again prove that it holds both the mortgage and the note.

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**Lien Stripping and Standing Issues in Cases  
Involving Mortgage Liens**

ABI Central States Bankruptcy Workshop

June 10-11, 2011

Hon. Pamela Pepper

U.S. Bankruptcy Court

E. D. Wisconsin (Milwaukee)

A. STATUTES TO KEEP IN MIND

**11 U.S.C. §1322(b)(2):** “The [Chapter 13] plan . . . may . . . modify the rights of holders of secured claims, *other than a claim secured only by a security interest in real property that is the debtor’s principal residence, . . .*”

**11 U.S.C. §1322(b)(3):** “The [Chapter 13] plan . . . may . . . provide for the curing or waiving of any default.”

**11 U.S.C. §1322(b)(5):** “The [Chapter 13] plan . . . may . . . notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due.”

**11 U.S.C. §1325(a)(5)(B)(i):** “Except as provided . . . , the court shall confirm a plan if— . . . with respect to each allowed secured claim provided for by the plan— . . . the plan provides that – (I) the holder of such claim retain the lien securing such claim until the earlier of– (aa) the payment of the underlying debt determined under nonbankruptcy law; or (bb) discharge under section 1328 . . . .”

**11 U.S.C. §1327(b):** “Except as otherwise provided in the plan or in the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.”

**11 U.S.C. §1328(f):** “Notwithstanding subsections (a) and (b), the court shall not grant a discharge of all debts provided for in the plan . . . if the debtor has received a discharge– (1) in a case filed under chapter 7, 11, or 12 of this title during the 4-year period preceding the date of the order for relief under this chapter, or (2) in a case filed under chapter 13 of this title during the 2-year period preceding the date of such order.”

B. RULES TO KEEP IN MIND

**Fed. R. Bankr. P. 3001(f):** “Evidentiary Effect. A proof of claim executed and filed in accordance with these rules shall constitute prima facie evidence of the validity

and amount of the claim.”

**Fed. R. Bankr. P. 3007(b):** “Demand for Relief Requiring an Adversary Proceeding. A party in interest shall not include a demand for relief of a kind specified in Rule 7001 in an objection to the allowance of a claim, but may include the objection in an adversary proceeding.”

**Fed. R. Bankr. P. 7001(2):** “An adversary proceeding is governed by the rules of this Part VII. The following are adversary proceedings: . . . (2) a proceeding to determine the validity, priority, or extent of a lien or other interest in property, other than a proceeding under Rule 4003(d).

**Fed. R. Bankr. P. 7026-7037:** General provisions governing discovery.

C. SPECIFIC ISSUES

1. Lien stripping

a. What procedure should a debtor use to strip an unsecured lien?

i. *Adversary proceeding?*

**See:**

**In re Forrest, 424 BR 31 (Bankr. N.D. Ill. 2009)**

**In re Ginther, 427 B.R. 450, 456-457 (Bankr. N.D. Ill. 2010)**

**In re Charlick, \_\_\_ B.R. \_\_\_, 2011 WL 781586, \*4 (Bankr. E.D. Mich., March 4, 2011)**

ii. *Motion?*

**See:**

**In re Fuller, 255 B.R. 300 (Bankr. W.D. Mich. 2000)**

**In re Robert, 313 B.R. 545 (Bankr. N.D.N.Y. 2004)**

**In re Bennett, 312 B.R. 843 (Bankr. W.D. Ky. 2004)**

**In re Stewart, 408 B.R. 215 (Bankr. N.D. Ind. 2009)**

iii. *Through the Chapter 13 plan?*

**See:**

**In re King, 290 B.R. 641 (Bankr. C.D. Ill. 2003)**  
**In re Hill, 304 B.R. 800 (Bankr. S.D. Ohio, 2003)**  
**In re Claar, 368 B.R. 670, 678 (Bankr. S.D. Ohio 2007)**  
**In re Stassi, 2009 WL 3785570 (Bankr. C.D. Ill. 2009)**

b. Can a debtor use a Chapter 13 case to strip off, or avoid, a junior, unsecured mortgage if that debtor is not eligible for a Chapter 13 discharge (because the debtor had received a Chapter 7 discharge within the 4 years prior to filing the Chapter 13 petition)? Why or why not?

*Cases which say that a debtor who is not eligible for a Chapter 13 discharge CANNOT use the Chapter 13 to strip the unsecured junior mortgage:*

**In re Jarvis, 390 B.R. 600 (Bankr. C.D. Ill. 2008)** (lien strip)  
**In re Picht, 428 B.R. 885 (B.A.P. 10th Cir., May 4, 2010)** (lien release)

*Cases which say a debtor who is not eligible for a Chapter 13 discharge CAN use the Chapter 13 to strip the unsecured junior mortgage:*

**In re Casey, 428 B.R. 519 (Bankr. S.D. Cal. 2010)** (lien strip)  
**In re Burnett, 427 B.R. 517 (Bankr. S.D. Cal. 2010)** (lien avoidance)  
**In re Tran, 431 B.R. 230 (Bankr. N.D. Cal. 2010)** (lien strip)  
**In re Mulder, \_\_\_ B.R. \_\_\_, 2010 WL 4286174 (Bankr. E.D.N.Y., Oct. 26, 2010)** (lien avoidance)

c. When is the lien strip effective—as of the date of confirmation of the plan, or upon plan completion? Why?

**See:**

**In re Fenn, 428 B.R. 494 (Bankr. N.D. Ill. 2010)**  
 lien strip effective upon *completion* of plan  
**In re Tran, 431 B.R. 230 (Bankr. N.D. Cal. 2010)**  
 lien strip effective upon *confirmation* of plan  
**In re Avendano, \_\_\_ B.R. \_\_\_, 2010 WL 5158390 (Bankr. S.D. Fla., Dec. 3, 2010)**  
 wholly unsecured creditor retains lien until discharge, and if case is converted or dismissed, lien is not avoided

**In re Ellis, \_\_\_ B.R. \_\_\_, 2010 WL 5067425 (Bankr. D. Neb., Dec. 7, 2010)**  
same as Avendano

d. Does good faith matter?

**In re Tran, 431 B.R. 230 (Bankr. N.D. Cal. 2010)–YES.**

Debtor filed Chapter 13 solely to strip unsecured junior lien that could not have been stripped in the previous Chapter 7.

**In re Grignon, \_\_\_ B.R. \_\_\_, 2010 WL 5067440 (Bankr. D. Or., Dec. 7, 2010)–YES.**

But court found evidence that the debtors did not file the Chapter 13 solely for the purpose of stripping the lien.

**In re Burnett, 427 B.R. 517 (Bankr. S.D. Cal. 2010)–YES.**

Where the Chapter 13 debtor isn't eligible for a discharge, court's good faith analysis "may be more exhaustive."

e. Topics for discussion:

\* Do the judges in your districts utilize any form orders for lien strips/lien avoidance? If so, what are they?

\* Does your district have a mandatory model Chapter 13 plan, and does that matter?

\* How do debtors ensure that they've provided adequate notice to/service on the creditor of the intent to strip the lien?

2. Standing issues

a. Debtors/trustees challenging the "standing" of a creditor/servicer/nominee to file a motion asking for relief from the stay to pursue remedies against real property:

**See:**

**In re Kraus, 414 B.R. 243 (Bankr. S.D. Ohio 2009)**

Chapter 7 trustee filed class action on behalf of himself and other trustees, alleging that creditor did not have standing to file motions for relief from stay where creditor had not obtained valid assignments of mortgages or recorded assignments; trustee did not prevail

**In re Box, \_\_\_ B.R. \_\_\_, 2010 WL 2228289 (Bankr. W.D. Mo. June 03, 2010)**

In a Chapter 7 case, trustee filed objection to creditor's standing to file motion for relief from stay, and prevailed

**In re Tucker, 441 B.R. 638 (Bankr. W.D. Mo., 2010)**

In a Chapter 7 case, trustee filed objection to creditor's motion for relief from stay, and prevailed

- b. Debtors/trustees challenging the "standing" of a creditor/servicer/nominee to file a proof of claim alleging an interest secured by real estate.

**See:**

**In re Wells, 407 B.R. 873 (Bankr. N.D. Ohio 2009)**

Debtors objected to claim, alleging that servicer did not have standing. Debtors prevailed, the court having concluded that the servicer had not shown that it was the holder of the note.

**Kemp v. Countrywide Home Loans, Inc. (In re Kemp), \_\_\_ B.R. \_\_\_, 2010 Bankr. LEXIS 4085 (Bankr. D. N.J., Nov. 16, 2010)**

Court sustained debtor's objection to proof of claim, because claimant could not prove that it held, or was entitled to enforce, the note.

- c. Creditors objecting to confirmation of plans, and debtors/trustees responding by arguing that the creditor does not have a valid claim and therefore does not have standing to object to confirmation.
- d. Issues specific to the standing of services—in particular, Mortgage Electronic Registration Systems ("MERS")

**See:**

**In re Tucker, 441 B.R. 638 (Bankr. W.D. Mo. 2010)**

**In re Agard, \_\_\_ B.R. \_\_\_, 2011 WL 499959 (Bankr. E.D.N.Y., Feb. 10, 2011)**

- e. Topics for discussion:
  - \* Is your state a judicial foreclosure state, or a non-judicial foreclosure state? Does it matter?
  - \* Is your state a mortgage state, or a deed of trust state? Does it matter?
  - \* Does it matter whether a part challenging standing is

proceeding under a contract theory, or an Article 9 theory, or an Article 3 theory?

- \* When a debtor who intends to retain a home visits an attorney, what factors should that attorney consider in deciding whether to file a Chapter 7 or a Chapter 13 petition?
  
- \* When a client asks counsel to prepare a proof of claim or a motion for relief from stay, or asks counsel to object to confirmation of a plan, what documentation should counsel request of that client before proceeding?

## **LOSS MITIGATION IN BANKRUPTCY**

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### **TRADITIONAL LOSS MITIGATION**

- 1) Delinquent loans only
- 2) Proprietary modifications, short sales, forbearance plans, partial claims
- 3) Loans in bankruptcy were generally excluded from loss mitigation/modification options
- 4) Small support staff in most servicing shops

### **CURRENT LOSS MITIGATION MODEL**

- 1) Delinquent and "imminent default" loans are eligible
- 2) MHA (HAMP), HAFA, HARP, as well as the traditional options exist
- 3) Bankruptcy loans are not excluded, although offer unique challenges
- 4) Servicer staff has shifted considerably, but still not enough manpower and knowledge
- 5) Modification requirements are much more stringent than loan origination requirements for many borrowers, presenting a significant challenge.

### **HAMP**

- 1) Introduced in March 2009 by the Obama Administration
- 2) There is only one allowed bite of the "HAMP" apple every 12 months.
- 3) GOAL: To modify loans to a sustainable level
- 4) Original requirements allowed borrowers to enter into trial modifications without verified documentation. This policy allowed many borrowers to enter trials, but likely lead to a higher number of conversion failures than anticipated. Trials now require full income verification and documentation prior to entry into a trial plan.
- 5) Program requirements are more stringent than traditionally required and leave little flexibility for servicers. The program has changed a number of times, making it difficult for servicers to keep staff trained on current requirements. The GSE (Fannie Mae and Freddie Mac) have their own versions of HAMP that force loan servicers to have numerous standards for their portfolio based on loan type and investor.
- 6) Basic Requirements for Borrowers

- a) Delinquent or imminent risk of default
  - b) Borrower's primary residence
  - c) Mortgage originated prior to 1/1/2009
  - d) Unpaid Principal Balance no greater than \$729,750 for single unit properties
  - e) Current payment must be above 31% of pretax monthly income
- 7) HAMP Payment Adjustment Goal
- a) Reduce payment to 31% of the borrower's total pretax monthly income by a systematic waterfall application:
    - i) Reduction of interest rate to 2%
    - ii) Extend the term to 40 years
    - iii) Forbear a portion of the principal until the loan is paid off with no interest.

### **HAMP LOAN MODIFICATIONS IN BANKRUPTCY**

- 1) HAMP Supplemental Directive 10-02 released 3/24/10
  - a) Modifications can be requested by debtor, debtor's attorney or trustee.
  - b) Bankruptcy cannot stop a HAMP trial nor be the cause of denial.
  - c) Servicers may not be required to solicit accounts in bankruptcy, but may choose to do so.
  - d) Trial plan may be waived in some cases.
    - i) All post petition payments remitted prior to effective date of HAMP agreement and at least 3 of those payments are equal to or greater than proposed modified payment
    - ii) Modification is approved by the court
    - iii) The investor allows the waiver
  - e) Bankruptcy documents may be substituted for some of the required financials in some cases.
  - f) Bankruptcy Protection Language is required: "if you are not obligated on the debt or if the debt has been discharged in a bankruptcy proceeding, this is for information purposes only and is not an attempt to assess or collect the debt from you personally".

### **NON-HAMP MODIFICATION**

- 1) Many servicers have chosen not to be HAMP participants.
- 2) Even HAMP participants may have "back-up" modification options for borrowers.
- 3) Non-HAMP modifications may have fewer documentation requirements, which may have greater conversion rates. Long term success is difficult to gauge.

**GENERAL ISSUES**

- 1) The establishment of an escrow account may require a higher payment than anticipated and again affect plan administration
- 2) Solicitation/communication challenges and concerns
- 3) Court approval – when is it needed and whose job is it?
- 4) Plan modifications
  - a) Chapter 13 – pre/post confirmation
  - b) Chapter 7
- 5) Payment adjustments and proof of claim adjustments

**PLAN SUGGESTIONS/BEST PRACTICES**

- 1) Plans that seek to incorporate a loan modification
  - a) Non-objectionable language
    - i) Acknowledgement that the actual final, permanent modification will govern, e.g. "The terms of the fully executed and approved loan modification shall be incorporated by reference and may supercede the following provisions as stated herein".
    - ii) If the new payment is based on a sliding scale, include that information briefly, e.g., "The payment will follow the schedule as outlined in the modification ". Many of these scales do not adjust for the first 5 years and thus listing numerous payments is not necessary.
    - iii) Most modifications make the loan escrowed. All escrows are subject to change and therefore the Trustee should be made aware, e.g. "Payments are subject to change based on yearly escrow changes".
    - iv) Handling the arrearage claim, e.g., "Upon final approval of the loan modification, the Trustee shall cease disbursements on Creditor's class 4 arrearage claim without any further amendment of Creditor's claim".
    - v) If there is a pre-confirmation amended plan, to alleviate the need for a separate order by the Creditor and allow the continuous stream of payments needed "The Creditor shall be granted APO payments in the amount of \$XXX.XX".
    - vi) If the Trustee will continue to make disbursements, rather than becoming direct pay, the following language advising on method of payment is suggested, e.g. "Creditor X shall continue to be paid by the Chapter 13 Trustee".

**IDEAS FROM OTHER DISTRICTS**

- 1) Local rules that protect loss mitigation solicitations direct to debtors. Does
- 2) Court sponsored loss mitigation programs and case law supporting the authority of courts to direct these programs . *In re Sosa*, \_\_\_ B.R. \_\_\_, 2011 WL 258673 (Bankr. D.R.I., Jan. 28, 2011). Also see *ABI Journal* March 2011.
- 3) Legislation: S222: Introduced in 1/2011 by Senator Whitehouse of Rhode Island. This legislation would amend section 105 of the code to allow for court sponsored loss mitigation programs. While the program would be mandatory, it would not go so far as to require the modification of an otherwise protected mortgage.

**CONTACTING LENDERS**

- 1) Directly
  - a) Through website is likely best starting point
- 2) Through Counsel
  - a) Realize that counsel may not have authority for loss mitigation
- 3) Through DMM, LLC
  - a) Default Mitigation Management (Defaultmitigation.com). DMM is a communication portal that some lenders are using for the uploading and tracking of loss mitigation packages. Allows debtor counsel to upload packages and track status.