THE LOSS MITIGATION PROGRAM PROCEDURES FOR THE UNITED STATES BANKRUPTCY COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

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INTRODUCTION

Ms. Lawrence struggled to support her two sons after the death of their father.[1] *She sacrificed precious time with her children in order to make a living, commuting several hours a day to work 10-hour shifts as a New York City bus driver. Unfortunately, her salary was not enough to cover the payments on her two mortgages, and she quickly fell behind on her monthly payments. She lived with the horror that her sons, having already lost their father, would be thrown out of their home. After numerous unsuccessful attempts outside of bankruptcy to modify her home loan and with foreclosure looming, she retained her bankruptcy lawyer in tears, desperate for help, and afraid that she and her sons would soon be homeless.*

After just a few months in bankruptcy, Ms. Lawrence successfully removed the second mortgage lien from her home, but her efforts to reorganize would fail if she was unable to make post-petition payments on the primary home loan. If she fell behind again, the bank almost certainly would ask for permission to continue the foreclosure. Filing for bankruptcy alone could not make her home more affordable—something more needed to be done if Ms. Lawrence was going to save the family home.

Luckily, Ms. Lawrence was able to take advantage of the Southern District of New York's Loss Mitigation Program Procedures. At first, her secured creditor denied her a loan modification, and with the cooperation of the creditors' counsel, Ms. Lawrence and her attorney were able to effectively communicate with the bank and supply important financial information that the bank had missed. Eventually she was offered a loan modification, in which the bank lowered her interest rate, saving her more than $700 per month. Ms. Lawrence and her sons' home would almost certainly have been lost to foreclosure, if not for the Loss Mitigation Program Procedures.

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[1] Debtor's name has been changed to protect her privacy. Her actual name and case number are on file with the Court.

For many years, cash-strapped homeowners have filed for bankruptcy as a last-chance effort to catch up on late mortgage payments through a chapter 13 plan. In recent years, bankruptcy courts saw a spike in the number of debtors filing to stop foreclosure.[2] Many of these debtors were regularly employed, solidly middle-class, and all struggling to make monthly mortgage payments. They often filed the day before a scheduled sale, and they all complained that they had been calling their creditors to try to work out a settlement regarding the home loan, without a response.

These debtors were desperate. They wanted very much to talk to someone at "the bank" to see if something could be done to prevent foreclosure, but they had trouble "getting through" to someone with authority to make a deal. Some debtors disputed being in default at all.[3] The debtors described a bewildering creditor structure of investors, servicers, bank branches, internal departments, processors, and law firms, which did not seem to effectively communicate with each other. Some debtors reported that they had been contacted by organizations that promised to negotiate a loan modification for them—but after paying thousands of dollars, the individuals would find that the foreclosure process had not stopped, and no loan modification had been offered.[4]

As more and more people filed for bankruptcy in an effort to stop the foreclosure of their homes, the courts experienced an explosion of bankruptcy litigation.[5] Debtors challenged the amounts of money that creditors claimed were

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[2] *See* Michelle Arnopol Cecil, *A Reappraisal of Attorney's Fees in Bankruptcy*, 98 KY. L.J. 67, 67 (2009) (noting unprecedented number of home foreclosures from past few years led to large increase in bankruptcy filings); John Golmant & James A. Woods, *Aging and Bankruptcy Revisited*, AM. BANKR. INST. J., Sept. 2010, at 75 (stating recent housing crisis increased foreclosure rates and bankruptcy filings); R. Travis Santos, Comment, *The Legal Way to Defeat Optimus Sub-Prime*, 25 EMORY BANKR. DEV. J. 285, 291 (2008) (discussing recent increases in foreclosure).

[3] *See* Michelle Conlin, *AP IMPACT: Caught By Mistake In Foreclosure Web*, HUFFINGTON POST, Dec. 8, 2010, *available at* http://www.huffingtonpost.com/2010/12/08/foreclosure-mistakes-_n_794080.html (describing homeowners being served with foreclosure papers, even though they were not in default or did not have home loan); Margaret Cronin Fisk & Kathleen M. Howley, *The Foreclosure Mess Could Last for Years*, BUSINESSWEEK, Oct. 11, 2010, *available at* http://www.businessweek.com/magazine/content/10_42/b4199043406256.htm?chan=magazine+channel_news+-+markets+%2B+finance; Diana B. Henriques, *A Reservist in a New War, Against Foreclosure*, N.Y. TIMES, Jan. 27, 2011, at A1 (discussing disputed or incorrect foreclosures of military members' homes in violation of federal laws).

[4] *See* Kyle Gaffaney, *The FTC Takes Action on Stop-Foreclosure Scams*, 22 LOY. CONSUMER L. REV. 134, 135 (2009) (describing "phony counseling" foreclosure rescue scams); Allison D. Matthews, Note, *To Stop A Predator: Is a Complete Ban on For-Profit Foreclosure Rescue Operations the Best Way to Prevent Equity Stripping?*, 20 LOY. CONSUMER L. REV. 477, 481–82 (2008) (discussing "phantom help" foreclosure rescue scams).

[5] *See* Melissa B. Jacoby, *Home Ownership Risk Beyond a Subprime Crisis: The Role of Delinquency Management*, 76 FORDHAM L. REV. 2261, 2263 (2008) (asserting increase in homeownership led to increases in foreclosures and homeowner bankruptcies); Sarah Spangler Rhine, *Criminalization of Housing: A Revolving Door that Results in Boarded Up Doors in Low-Income Neighborhoods in Baltimore, Maryland*, 9 U. MD. L.J. RACE, RELIGION, GENDER & CLASS 333, 366 (2009) (discussing increases of bankruptcy filings from foreclosures in both low and high income areas); Pamela C. Tseng, Comment, *The Case Against "Bad Faith" Dismissals of Bankruptcy Petitions Under 11 U.S.C. §707(a)*, 59 AM. U. L. REV.

owed. The debtors demanded explanations for "escrow" and "interest" charges; some of them alleged that they were current with their monthly payments. The creditors alleged that they were not being paid enough in the debtors' chapter 13 plans, and requested permission to pursue foreclosure in state court.

In deciding these legal matters, the bankruptcy courts produced a body of decisions that expressed frustration with the seemingly impenetrable and indifferent creditor infrastructure. The courts struggled to find a remedy for the debtors' inability to find the person on the creditors' side that could help them resolve their concerns regarding their home loans, whether it was locating a lost payment or discussing a modification of an unworkable home loan. The creditors' practices often fell just short of the finding of egregious bad faith that is necessary to support severe sanctions. It became clear to the courts that conventional bankruptcy litigation alone could not resolve the breakdown in communication that characterized the disputes between this new class of debtors, creditors and their counsel.

Meanwhile, a disturbing trend emerged on the creditors' side: counsel filing legal papers with false or incomplete factual allegations, papers which, if believed, could lead to the unjustified loss of the debtor's home.[6] The bankruptcy courts discovered a new kind of attorney-client relationship among the creditors' bar and their clients, where attorney communications with the secured creditor client were restricted, and the attorneys were inhibited in their duty to verify facts and determine whether the creditor had a legitimate cause for the relief it wanted to pursue.

After months of evidentiary and disciplinary hearings in bankruptcy courts across the country, it became obvious that a new way to communicate between debtors and their mortgage holders was required. A major creditor law firm approached the Southern District of New York Bankruptcy Court and inquired whether it could offer loan modifications to particularly chosen debtors. The lawyers saw an opportunity and an obligation to decrease their clients' losses by allowing some debtors to stay in their homes. They were concerned that contacting debtors about loan modifications would put them at risk of punishment for violating the bankruptcy law and wished the court's approval to contact certain debtors. When the creditors did risk reaching out to the debtors, they had trouble getting a response—many debtors, shell-shocked from the foreclosure process, had stopped

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685, 686 (2009) (stating bankruptcy filings increased due to mortgage foreclosure crisis amongst other things).

[6] *See In re* Schuessler, 386 B.R. 458, 464 (Bankr. S.D.N.Y. 2008) (describing loan servicer's efforts to prevent receipt of post-petition payments from debtors in order to force lift-stay proceedings and ultimately foreclosure); *In re* Parsley, 384 B.R. 138, 156 (Bankr. S.D. Tex. 2008) (stressing system in which local counsel had no direct communication with servicer on whose behalf motion was filed could not possibly comply with Rule 9011 when local counsel could only communicate with national counsel, which was not required to monitor debtors' post-petition payments); Barry Meier, *A Foreclosure Mess Draws in the Lawyers, Too*, N.Y. TIMES, Oct. 16, 2010, at B1 (discussing potentially unethical practices of "foreclosure mill" law firms).

opening mail and answering the telephone. The court wanted to ensure that each debtor would have the same opportunity as every other debtor to communicate with the home lender. After many meetings with debtors' and creditors' counsel, the Southern District of New York adopted the Loss Mitigation Program Procedures (the "Loss Mitigation Program" or the "Program").[7]

The purpose of the Loss Mitigation Program is to function as a forum for debtors and lenders to reach consensual resolution whenever a debtor's residential property is at risk of foreclosure by opening the lines of communication between the debtors' and lenders' decision-makers.[8] The Loss Mitigation Program is a procedural mechanism that provides the debtor and the creditor the opportunity to get a decision regarding the home loan, so that the debtor can take the next step in the bankruptcy, whether it is confirming a chapter 13, three to five year, plan, or seeking an immediate discharge in chapter 7.[9] The Loss Mitigation Program requires the parties to appoint representatives with full settlement authority and provide their direct contact information, and sets a detailed timeframe to govern the loss mitigation process.[10] The Program does not compel the parties to enter into a loan modification, only to engage in the loss mitigation process.[11] The court finds success in every case in which the parties participate in good faith, including when the process concludes with the debtor consenting to foreclosure or surrendering the home.[12]

The premise of the Loss Mitigation Program is simple: Put the decision-making parties in direct contact with each other, and set a schedule for their discussion as to what can be done about the debtor's home. Parties to loss mitigation may use the Program to take a proactive step towards negotiating a loan modification, and they may use the Program to resolve questions concerning payment arrears and disputed charges. The Program pulls debtors and creditors out of the foreclosure limbo, because it sets deadlines for determining whether a modification is possible, and helps the parties define their rights and responsibilities with respect to the bankruptcy case and the loan.[13]

The Loss Mitigation Program is fundamentally concerned with establishing channels of communication between the parties. First, a party, usually (but not

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[7] General Order M-364 (Bankr. S.D.N.Y. 2008), *available at* http://www.nysb.uscourts.gov/orders/m364.pdf (adopting Loss Mitigation Program in United States Bankruptcy Court for the Southern District of New York) , *amended by* General Order M-413 (Bankr. S.D.N.Y. 2010).

[8] *See* Loss Mitigation Program Procedures at 1 (Bankr. S.D.N.Y. 2010), *available at* http://www.nysb.uscourts.gov/pdf/lossmit/RevisedLossMitigationProcedures.pdf (showing Loss Mitigation Program designed so debtors and lenders can reach joint resolutions).

[9] *Id.* (describing range of bankruptcy possibilities debtor may use to avert foreclosure).

[10] *Id.* at 4, 6 (indicating contact information of debtor and creditor be provided within seven days of Order and such contact with settlement authority be present at mitigation sessions).

[11] *Id.* at 1 (showing loss mitigation may include loan modification, but is one of number of solutions listed).

[12] *See id.* at 4 (stating loss mitigation parties shall negotiate in good faith).

[13] *See id.* at 3–4 (indicating, for example, seven day filing deadline when written report is required).

always) the debtor, will file and serve a request for loss mitigation.[14] If no opposition is received, after an opportunity for a hearing, the court will enter the Loss Mitigation Order.[15] The Loss Mitigation Order requires the parties to appoint people with authority to negotiate a possible loan modification, and to provide their direct contact information.[16] The Loss Mitigation Order sets a schedule for the debtor to provide personal financial information, and for the parties to engage in a loss mitigation session, similar to a settlement conference.[17] The parties are required to report to the court at regular status conferences, and the Loss Mitigation Order will lapse and terminate at determined times, which may be extended.[18] The creditor has the right to oppose the loss mitigation request, and seek to terminate loss mitigation.[19] The court may grant this request after notice and an opportunity for a hearing, which protects the due process rights of everyone involved.[20] The parties must obtain the court's approval of any settlement or loan modification they reach.[21] The loss mitigation process is controlled by the Loss Mitigation Order and the order approving the loan modification.[22]

The court's authority to establish a loss mitigation program and to approve loan modifications flows from its inherent power to manage its docket;[23] its broad authority over the property of the debtor's bankruptcy estate;[24] and several provisions of the Bankruptcy Code and Rules that govern property of the estate and case management.[25] Bankruptcy courts may not compel a modification of a debtor's home loan,[26] but to say that they have no authority over whether a debtor can

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[14] *Id.* at 2 (stating any party may request to participate in Loss Mitigation).

[15] *Id.* (demonstrating debtor can submit Loss Mitigation Order if creditor fails to object within 21 days of service of plan).

[16] *Id.* at 4 (listing contact information requirements).

[17] *Id.* at 3–4 (listing deadlines).

[18] *Id.* at 5 (discussing status report requirements).

[19] *Id.* at 6 (noting party may request termination).

[20] *Id.* (explaining notice and hearing requirement prior to termination).

[21] *Id.* at 7 (noting court will consider any settlement).

[22] *Id.* at 8 (showing loss mitigation final report procedures).

[23] *See, e.g.*, 11 U.S.C. § 105(a) (2006) (outlining court's power to implement court orders or rules); General Order M-413 (Bankr. S.D.N.Y. 2010), *available at* http://www.nysb.uscourts.gov/orders/m413.pdf ("Accordingly, the 'Loss Mitigation Program Procedures' were adopted, pursuant to 11 U.S.C. § 105(a)."); COLLIER ON BANKRUPTCY, ¶ 105.02 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2010), *available at* LEXIS, 2-105 Collier on Bankruptcy P 105.02 (noting court has power to regulate who appears).

[24] *See, e.g.*, 11 U.S.C. § 361 (articulating court has power to require trustee to make payments from estate to secured creditors, to provide creditors additional lien on estate property, or grant "other relief" to adequately protect secured creditors); 28 U.S.C. § 1334(e) (2006) (explaining court has jurisdiction over all debtor and estate property upon filing of bankruptcy); Lois R. Lupica, *Revised Article 9, Securitized Transactions and the Bankruptcy Dynamic*, 9 AM. BANKR. INST. L. REV. 287, 313 & n.147 (2001) (asserting if secured creditor's collateral is "necessary to an effective reorganization," court may deny creditor's motion to lift stay and grant creditor "adequate protection").

[25] *See, e.g.*, 11 U.S.C. § 363(b)(1) (explaining trustee may "use, sell, or lease" property of estate); *id.* § 541(a) (explaining property enters estate upon commencement of bankruptcy proceeding); *id.* § 544 (articulating trustee has power of creditors and may avoid transfers).

[26] *See* 11 U.S.C. § 1322(b)(2) (explaining court may modify rights of secured creditors other than loan secured by debtor's principal residence); Universal Am. Mortg. Co. v. Bateman (*In re* Bateman), 331 F.3d

negotiate a loan modification grossly oversimplifies and misrepresents the court's power over the borrower, the lender, and the home. Bankruptcy law provides a myriad of tools that debtors and creditors may use to reorganize a debt secured by the debtor's home, and provides the ultimate forum for modifying a home loan.[27] With its power to facilitate settlements and define a homeowner's obligations to creditors,[28] the court has profound authority to establish the Loss Mitigation Program.

The Loss Mitigation Program is the first court-annexed program to address the crisis of miscommunication regarding home loans that has haunted the bankruptcy courts in recent years, and it embodies the spirit of innovation and judicial economy that characterizes the operation of the federal courts. Part I will discuss the broad principles of bankruptcy in which the Loss Mitigation Program is rooted, including the court's dominion over the property of the estate, the comprehensive reorganization of the debtor, and the important role played by voluntary settlements. Part II will describe the historical context for the Loss Mitigation Program, including a survey of the groundbreaking cases in which the bankruptcy courts first confronted the total breakdown in communication that tortured the relationships between debtors and the entities that control their home loans. Additionally, Part II will show that many of the disruptive practices of the creditors and their lawyers continue today, underscoring the ongoing demand for court-annexed loss mitigation programs. Part III discusses the specific legal powers that authorize federal courts to adopt programs and procedures that promote judicial efficiency and alternative dispute resolution. Part IV describes some of the extraordinary resolutions debtors and creditors have achieved pursuant to the Loss Mitigation Program, and concludes with a description of the revised Loss Mitigation Program Procedures that took effect at the end of 2010.

821, 826 (11th Cir. 2003) ("[Section] 1322(b)(2) specially prohibits any modification of a homestead mortgagee's rights . . . ."); Williamson v. Wash. Mut. Home Loans, Inc., 400 B.R. 917, 922 (M.D. Ga. 2009) (holding appellants' claim was secured by security interest in real property; therefore, claim cannot be modified).

[27] *See, e.g.*, 11 U.S.C. § 361 (explaining creditors can get multiple forms of relief in order to adequately protect their secured claim); Lend Lease v. Briggs Transp. Co. (*In re* Briggs Transp. Co.), 780 F.2d 1339, 1342 (8th Cir. 1985) (noting section 362(d) reconciles competing creditor and debtor interests in relation to secured claims); Lupica, *supra* note 24, at 313 (asserting if secured creditor's collateral is "necessary to an effective reorganization," court may deny creditor's motion to lift stay and grant creditor "adequate protection").

[28] *See* 11 U.S.C. § 105(a) (asserting court may issue "any order, process, or judgment" necessary or appropriate to carry out Bankruptcy Code provisions); Shearson Lehman Bros., Inc. v. Munford, Inc. (*In re* Munford, Inc.), 97 F.3d 449, 454–55 (11th Cir. 1996) (explaining court's power under section 105(a) includes special proceedings to encourage settlement). *See generally In re* Grau, 267 B.R. 896, 899 (Bankr. S.D. Fla. 2001) (holding bankruptcy court had authority to approve binding settlement agreement and overrule creditor's objections to exemptions because bar to objection was integral to settlement).

I. BANKRUPTCY BASICS[29]

An unfair stigma attaches to bankruptcy, based on the misguided assumption that it offers irresponsible people an easy escape from their obligations to pay their debts.[30] In reality, many debtors file for bankruptcy after several difficult months—or even years—of struggling to pay creditors.[31]

The law of bankruptcy is a solid, longstanding system of rules and policies that governs the reorganization of debt.[32] A broad injunction, the automatic stay, stops most efforts to collect debt and holds creditors at bay while the debtor reorganizes.[33] The stay takes effect upon the commencement of a bankruptcy case.[34] By seeking the protection of the bankruptcy law and the automatic stay, the consumer debtor gains time to deal with the creditors in the most efficient and orderly manner.[35] Reorganization in bankruptcy allows the debtor to put creditors into a priority queue according to the types of debt that is owed to each, and pay them back according to their place in the line, using rules that control the debtor's assets, income and time.[36]

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[29] This Article is intended for a broader audience beyond the specialized bankruptcy bar and bench, and it provides some introductory discussion on concepts including the automatic stay, definitions of claims, and the chapter 13 plan.

[30] *See* A. Mechele Dickerson, *Bankruptcy Reform: Does the End Justify the Means?*, 75 AM. BANKR. L.J. 243, 262–63 (2001) (explaining critics of bankruptcy believe bankruptcy laws encourages people to "run up debts" because of discharge potential); Chelsey W. Tulis, *Get Real: Reframing the Debate over How to Calculate Projected Disposable Income in § 1325(b)*, 83 AM. BANKR. L.J. 345, 349–50 (2009) (discussing argument bankruptcy system is broken because debtors turn to bankruptcy "as a first resort rather than a last resort"); David K. Stein, Comment, *Wrong Problem, Wrong Solution: How Congress Failed the American Consumer*, 23 EMORY BANKR. DEV. J. 619, 636 (2007) (articulating people believe "affordable and available" bankruptcy system causes high credit card debt).

[31] *See* NAT'L BANKR. REVIEW COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS 82 (1997), *available at* http://govinfo.library.unt.edu/nbrc/reportcont.html (asserting evidence portrays today's bankrupt debtors experience same financial crisis as debtors decades prior); Dickerson, *supra* note 30, at 264–65 (explaining while some bankruptcy filers abuse system, many others "hopelessly" burdened with debt due to "financial naivete"); Tulis, *supra* note 30, at 349 (noting statistical evidence demonstrates individuals filing bankruptcy do so "only when facing financial crisis").

[32] *See* Marrama v. Citizens Bank of Mass., 549 U.S. 365, 367 (2007) (explaining purpose of Bankruptcy Code as whole to give debtor fresh start from past debts); NLRB v. Bildisco, 465 U.S. 513, 528 (1984) (asserting Bankruptcy Code empowers debtors to reorganize debts); 3 COLLIER ON BANKRUPTCY, ¶ 1.01, at 1-4 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2010) (explaining longstanding policy of Supreme Court to enable debtors to reorganize debts under Bankruptcy Code).

[33] *See* 11 U.S.C. § 362(a)(2) (outlining automatic stay); *see also In re* Henry, 266 B.R. 457, 468 (Bankr. C.D. Cal. 2001) (discussing how stay impacts creditors); *In re* Medicar Ambulance Co. Inc., 166 B.R. 918, 925 (Bankr. N.D. Cal. 1994) (showing how stay does more than protect debtors).

[34] *See* 11 U.S.C. § 362(a)(1) (describing operation of automatic stay); *see also* Smith v. First Am. Bank, N.A. (*In re* Smith), 876 F.2d 524, 526 (6th Cir. 1989) (stating date of filing of petition is pertinent date); *In re* Keen, 301 B.R. 749, 753 (Bankr. S.D. Fla. 2003) (explaining how effective date stands despite creditor knowledge).

[35] *See* 11 U.S.C. § 362(a)(6) (highlighting debtor's protections); *see also In re* Dolen, 265 B.R. 471, 478 (Bankr. M.D. Fla. 2001) (outlining purpose of automatic stay); *In re Medicar Ambulance Co. Inc.*, 166 B.R. at 925 (discussing protections of automatic stay).

[36] *See* 11 U.S.C. § 507 (explaining priority of claims in bankruptcy); *see also In re* H.H. Distributions, L.P., 400 B.R. 44, 51 (Bankr. E.D. Pa. 2009) (discussing cram down under absolute priority rule); *In re*

In making and executing the plan, the debtor pays the creditors according to their places in the scheme of priorities described by bankruptcy law—creditors are treated differently according to the kind of debt they are owed, such as secured debt, child support, taxes or credit card debt.[37] Creditors are required to obey the bankruptcy law and be bound by the results of the bankruptcy process forever, and, if they fail to respect the law, they may be punished.[38]

The bankruptcy judge is the "gatekeeper."[39] The bankruptcy judge considers the issues raised by the creditors, and applies the facts to the bankruptcy law to determine whether the debtor should be allowed to carry out the plan of reorganization, or whether to allow the creditors to deal with the debtor under nonbankruptcy law. The judge must consider the unique situation of each debtor, to determine whether the proposed plan of reorganization makes sense and can be carried out, and whether the debtor sought the protection of bankruptcy with good intentions.[40]

The United States Trustee is a unit of the federal Department of Justice, and has as its mission to guard and protect the bankruptcy system.[41] The Bankruptcy Code allows the United States Trustee to make an argument on any matter in any bankruptcy case.[42] Traditionally, the United States Trustee is vigilant to abusive conduct of debtors, as for instance people seeking to discharge debt when they have the means to pay some of it back, or using the bankruptcy laws to cause delay and prejudice to creditors.[43] The United States Trustee monitors employment and

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Medicar Ambulance Co. Inc., 166 B.R. at 925 (examining possible alternative payment methods to return maximum value to entire creditor body).

[37] *See* 11 U.S.C. § 507 (discussing payment priority of claims); *see also id.* § 362(b) (specifying how automatic stay does not apply to domestic support obligations); *In re* Johnson, 408 B.R. 811, 815 (Bankr. W.D. Mo. 2009) (discussing definition of unsecured creditors for priority).

[38] *See* 11 U.S.C. § 362(k) (emphasizing debtor may recover for willful violations of automatic stay by creditor); *In re Smith*, 876 F.2d at 526 (explaining any action taken in violation of automatic stay is void); *In re Dolen*, 265 B.R. at 478 (noting automatic stay extends to almost all proceedings against debtor and continuation is violation).

[39] *See In re* Prod. Assocs., Ltd., 264 B.R. 180, 186 (Bankr. N.D. Ill. 2001) (describing duties of gatekeeper); *see also* Lockyer v. Mirant Corp., 398 F.3d 1098, 1113 (9th Cir. 2005) (discussing district court may also impose stay pursuant to outcome of bankruptcy proceeding). *But see In re* Henry, 266 B.R. 457, 468 (Bankr. C.D. Cal. 2001) (stating Bankruptcy Code provides powerful injunctions without aid of individual judge orders).

[40] *See* 11 U.S.C. §§ 1129, 1325 (providing requirements for chapters 11 and 13 plan confirmation, including, *inter alia*, good faith); N.Y.C. Emps.' Ret. Sys. v. Sapir (*In re* Taylor), 243 F.3d 124, 129–30 (2d Cir. 2001) (listing litany of possible factors judge can consider for confirmation of chapter 13 plan); *In re* Adelphia Commc'ns Corp., 368 B.R. 140, 165 (Bankr. S.D.N.Y. 2007) (discussing debtor's input in creation of plan); *see also* Callaway v. Benton, 336 U.S. 132, 139 (1949) (explaining factors judge may analyze to determine whether to confirm plan); *In re* Allegheny Int'l, Inc., 118 B.R. 282, 304 (Bankr. W.D. Pa. 1990) (depicting considerations for determination of fair and equitable plan).

[41] *See* 28 U.S.C. § 586 (2006) (establishing duties of United States Trustee in supervising and monitoring bankruptcy cases).

[42] 11 U.S.C. § 307 (noting trustee may raise and be heard on any bankruptcy issue).

[43] *See id.* § 707(b)(1) (providing trustee may move to dismiss case if abuse); *see also In re* Lenton, 358 B.R. 651, 662 (Bankr. E.D. Pa. 2006) (granting motion to dismiss for totality of circumstances); 3 COLLIER

payment of professionals that work on the bankruptcy reorganization, to make sure that their labors help make the payment of the creditors' claims possible, instead of wastefully consuming the estate's limited resources.[44] When the United States Trustee finds abuse or waste, it may seek dismissal of the case, disgorgement or denial of fees, or other sanctions.[45]

A. Commencement of a Bankruptcy Case

Upon commencing a case, an estate is created, which includes all the debtor's legal and equitable interests in property.[46] Property of the estate is used to pay creditors in accordance with bankruptcy law.[47] In chapter 13 cases, property of the estate includes the debtor's post-petition income.[48] In chapter 7 cases, property of the estate does not include the debtor's post-petition wages.[49]

The bankruptcy court has broad jurisdiction over property of the estate, even when it is subject to a lien or has been removed from the debtor's possession and control.[50] The court in which a bankruptcy case is commenced or pending has

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ON BANKRUPTCY, ¶ 1307.04 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2010) (discussing United States Trustee's duty to monitor proceedings and take appropriate action when necessary).

[44] *See* 11 U.S.C. § 327(a) (providing trustee with ability to hire professionals to assist in duties); s*ee also In re* Sieling Assoc. Ltd. P'ship, 128 B.R. 721, 722–23 (Bankr. E.D. Va. 1991) (affirming trustee's right to appoint professionals); *In re* Seatrain Lines, Inc., 13 B.R. 980, 980–81 (Bankr. S.D.N.Y. 1981) (allowing trustee to employ professionals).

[45] *See* 11 U.S.C. § 329 (permitting courts to cancel agreements with attorneys if found to be excessive or return excess payments to estate); Arnes v. Boughton (*In re* Prudhomme), 43 F.3d 1000, 1003 (5th Cir. 1995) (supporting bankruptcy court's disgorgement of excessive attorney's fee); Anderson v. Anderson (*In re* Anderson), 936 F.2d 199, 204 (5th Cir. 1991) (noting bankruptcy courts' broad discretion in awarding or denying attorneys' fees).

[46] *See* 11 U.S.C. § 541(a) (noting commencement of case creates estate); *see also* Bracewell v. Kelley (*In re* Bracewell), 454 F.3d 1234, 1237 (11th Cir. 2006) (stating key date for creation of estate is commencement); *In re* Taronji, 174 B.R. 964, 967 (Bankr. N.D. Ill. 1994) (noting estate includes legal and equitable interests of debtor).

[47] *See* 11 U.S.C. § 704(a) (providing trustee shall collect and reduce to money property of estate); *id.* § 726 (describing distribution of property of estate); *see also* Neuton v. Danning (*In re* Neuton), 922 F.2d 1379, 1382 (9th Cir. 1990) (noting debtor's contingent future interest in trust can be used to satisfy creditors' claims); *In re Taronji*, 174 B.R. at 967 (declaring estates "can be liquidated to satisfy the claims of creditors").

[48] *See* 11 U.S.C. § 1306 (providing property of estate includes all of debtor's interests in property acquired and wages earned post-petition; debtor remains in possession of property of estate); *In re* Rasberry, 264 B.R. 495, 498–99 (Bankr. N.D. Ill. 2001) (comparing inclusion of post-petition wages in chapter 13 cases as compared to chapter 7 and chapter 11 cases); *In re* Mack, 46 B.R. 652, 656 (Bankr. E.D. Pa. 1985) (confirming wages earned post-petition and during proceedings as property of estate).

[49] *See* 11 U.S.C. § 348(f)(1)(A) (providing property of estate consists of all property of estate at date of petition); *see also* Stamm v. Morton (*In re* Stamm), 222 F.3d 216, 218 (5th Cir. 2000) (holding wages earned after filing of chapter 13 petition not part of chapter 7 estate); *In re* Crews, No. 06-10338, 2007 WL 1958868, at *1 (Bankr. S.D. Ala. June 26, 2007) (stating post-petition wages not part of chapter 7 case).

[50] *See* 28 U.S.C. § 157 (2006) (codifying bankruptcy court's broad jurisdiction); *see also* Celotex Corp. v. Edwards, 514 U.S. 300, 308 (1995) (discussing congressional intent giving broad jurisdiction to bankruptcy court to promote efficiency of cases); Pacor, Inc. v. Higgins, 743 F.2d 984, 994 (3d Cir. 1984) (stating

exclusive jurisdiction of all the property, wherever located, of the debtor as of the commencement of the case, and of property of the estate.[51] This property can include property that is located outside the United States; an example would be the contents of a bank account.[52] Property of the estate includes secured property even if the property is subject to the interest of another person or entity, like a mortgage securing a home loan or a judgment lien filed after a lawsuit.[53]

Even a slight interest of the debtor in property is enough to bring it under the jurisdiction of the bankruptcy court as property of the estate.[54] "[A]n interest in

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Congress intended to grant broad jurisdiction to bankruptcy courts "so that they may deal efficiently and expeditiously with all matters connected with the bankruptcy estate").

[51] *See* 28 U.S.C. § 1334(e)(1) (granting district court exclusive jurisdiction over all property of estate, wherever located); *see also In re* La. Ship Mgmt., Inc., 761 F.2d 1025, 1026 (5th Cir. 1985) (discussing exclusive jurisdiction of court where chapter 11 proceeding pending); Landry v. Exxon Pipeline Co., 260 B.R. 769, 782 (Bankr. M.D. La. 2001) (commenting bankruptcy court has exclusive jurisdiction over property of estate). 28 U.S.C. § 1334(e) gives the relevant district court, and, by jurisdictional grant pursuant to 28 U.S.C. § 157(a), the bankruptcy court, exclusive jurisdiction of all property of the debtor and its estate wherever located. The United States Code provides that the district court shall have original and exclusive jurisdiction over all bankruptcy cases, and that it may transfer jurisdiction to the bankruptcy court. *See* 28 U.S.C. § 157 (codifying bankruptcy court's broad jurisdiction over property of estate); *id.* § 1334(e) (granting district court exclusive jurisdiction over all property of estate, wherever located). In the Southern District of New York, bankruptcy cases are referred from the district court to the bankruptcy court by the Standing Order of Reference signed by Acting Chief Judge Robert J. Ward, dated July 10, 1984. *See* Order M-61 (Bankr. S.D.N.Y. 1984), *available at* http://www.nysb.uscourts.gov/orders/m61.pdf (ordering jurisdiction of all proceedings under title 11 referred to bankruptcy judges for district).

[52] *See* 28 U.S.C. § 1334(e)(1) (granting district court exclusive jurisdiction over all property of estate, wherever located); *In re* Rajapakse, 346 B.R. 233, 236 (Bankr. N.D. Ga. 2005) (holding property of estate includes property inside and outside of United States); *see also In re* Nakash, 190 B.R. 763, 768 (Bankr. S.D.N.Y. 1996) (stating stay also applies to debtor's property outside United States because bankruptcy court has jurisdiction over property wherever located).

[53] *See* 11 U.S.C. § 541(a) (codifying what constitutes property of bankruptcy estate); *see also id.* § 363(f) (commenting trustee may sell property subject to lien free and clear); *In re* Talbert, 268 B.R. 811, 816 (Bankr. W.D. Mich. 2001) (discussing debtor's rights with respect to property subject to lien).

[54] *See* 11 U.S.C. § 541(a) (codifying "all legal or equitable interests of debtor in property" become part of estate); *see also In re* Brewster-Raymond Co., 344 F.2d 903, 909–10 (5th Cir. 1965) (commenting levy does not operate to pass title, but only gives lien against debtor and is within jurisdiction of bankruptcy); *In re* Alpa Corp., 11 B.R. 281, 282 (Bankr. D. Utah 1981) (commenting if debtor has any interest at all on property, it is property of estate). In *In re Alpa Corp.*, the court required the IRS to return to the debtor's estate property that it had levied upon pre-petition, finding that it had jurisdiction over the property as a whole because the debtor retained a limited interest in the property after the levy. 11 B.R. at 283. The court rejected the proposition that a pre-petition levy pursuant to tax law (28 U.S.C. § 6331) constituted a complete transfer of ownership. *Id.* The court noted that the estate holds only the debtor's interest in the property, which might be limited, but "an interest in property which falls within the definition of 'property of the estate' and thus, within the jurisdiction of the bankruptcy court, subjects that property, in its entirety, to other provisions of the Bankruptcy Code and specifically to rights given to the debtor-in-possession or trustee under the Code." *Id.* at 289.

> The fact that the creditor may have a "significantly greater interest" in the property than the debtor provides no bar to the right of the debtor-in-possession to compel a turnover. Rather, the extent of the creditor's interest in the property is relevant only in the context of determining adequate protection or entitlement to relief from the stay, if requested.

property which falls within the definition of 'property of the estate' and thus, within the jurisdiction of the bankruptcy court, subjects that property, in its entirety, to other provisions of the Bankruptcy Code and specifically to rights given to the debtor-in-possession or trustee under the Code."[55]

Also upon commencing the bankruptcy case, the automatic stay arises.[56] The automatic stay is a phenomenon in law, a broad injunction that takes effect without notice to creditors, and stops efforts to collect pre-petition debts.[57] With only a few exceptions, the automatic stay protects and preserves the property of the estate while the debtor reorganizes by preventing creditors from taking action to satisfy their debts against property of the estate.[58] The stay provides debtors a "breathing spell" to assess their assets and financial prospects for reorganization.[59] For most debtors, the practical effect of the automatic stay is that the collection calls and wage garnishments stop, and the foreclosure proceeding or sale is put on hold.[60]

"The stay is effective upon the date of the filing of the petition, and formal service is not required. Actions taken in violation of the stay are void even when there is no actual notice of the existence of the stay."[61] An act done in violation of

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Id. at 290. The court found that complete turnover of the property was consistent with the "spirit" of Chapter 11 bankruptcy behind corporate reorganization. *Id.* at 290–91. The court held that the IRS was only a lienholder with extraordinary statutory powers, and ordered turnover of the debtor's property, subject to adequate protection to the IRS. *Id.* at 291.

[55] *In re Alpa Corp.*, 11 B.R. at 289.

[56] 11 U.S.C. § 362(a) (codifying automatic stay in bankruptcy proceeding); *see In re* Martin, 440 B.R. 779, 780 (Bankr. N.D. Ohio 2010) (holding "upon commencement of a bankruptcy case, an automatic stay arises as a matter of law"); *see also In re Alpa Corp.*, 11 B.R. at 289 (stressing property becomes subject to automatic stay even if interests of debtor in property limited).

[57] *See* 11 U.S.C. § 362(a) (listing protections of automatic stay); *see also In re* Carter, 16 B.R. 481, 483–84 (W.D. Mo. 1981) (stating filing of petition is enough notice of automatic stay); *In re* LaTempa, 58 B.R. 538, 540 (Bankr. W.D. Va. 1986) (noting automatic stay in section 362(a) does not require actual notice to creditors).

[58] *See* 11 U.S.C. § 362(a) (listing protections given to debtor under automatic stay); *see also In re* Freeman, 331 B.R. 327, 329 (Bankr. N.D. Ohio 2005) (stating stay in effect automatically upon commencement of bankruptcy case). *But see* 11 U.S.C. § 362(b) (listing exceptions to automatic stay where debtor is not protected from collection efforts).

[59] *In re* Sherman, 491 F.3d 948, 971 (9th Cir. 2007) (stating legislative history of Bankruptcy Code indicates section 362(a) was enacted to provide breathing spell for debtors against creditors); Borman v. Raymark Indus. Inc., 946 F.2d 1031, 1036 (3d Cir. 1991) (noting section 362(a) provides debtor breathing spell against collection efforts); Variable-Parameter Fixture Dev. Corp. v. Morpheus Lights, Inc., 945 F. Supp. 603, 608 (S.D.N.Y. 1996) (quoting legislative history of section 362, which gives debtors breathing spell from creditors).

[60] The automatic stay does not stop every act; for example, it does not stop certain criminal or family law matters. *See* 11 U.S.C. § 362(b) (listing exceptions to automatic stay provision); *see also In re* Stringer 847 F.2d 540, 551 (9th Cir. 1988) (mentioning stay exception in family law issues); *In re* Pickett, 321 B.R. 663, 665 (Bankr. D. Vt. 2005) ("The Court finds that the plain language of the Bankruptcy Code excepts the application of the automatic stay to criminal proceedings . . . .").

[61] *In re* Eisenberg, 7 B.R. 683, 686 (Bankr. E.D.N.Y. 1980); *accord In re* Brown, 311 B.R. 721, 728–29 (Bankr. W.D. Pa. 2004) (holding case commenced when debtor handed petition to intake clerk and tendered filing fee; foreclosure sale held minutes later violated stay); *In re* Stucka, 77 B.R. 777, 781 (Bankr. C.D. Cal. 1987) (noting automatic stay effective upon bankruptcy filing regardless of notice to creditor).

the stay is void from the beginning.[62] If the violator knows that the stay is in effect, and intentionally takes actions that have the effect of violating the stay, then the bankruptcy court must make the violator pay the debtor's actual damages, such as attorney fees.[63] The bankruptcy court may award punitive damages as well, if the court finds bad faith, or if it feels that the damages will have a deterrent effect on future conduct of the violator.[64]

After the case is commenced and the stay takes effect, the creditors may ask the bankruptcy court to terminate the stay.[65] If the court terminates or lifts the automatic stay, then the creditor can pursue whatever nonbankruptcy rights it had before the case was filed, most often to continue a foreclosure proceeding.[66] Upon request of a party, the court grants relief from the stay for cause, including lack of "adequate protection."[67] If the party seeks to act against property of the estate, then the party must show that the debtor does not have equity in the property, and that the property is not necessary for an effective reorganization.[68]

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[62] *See* Fleet Consumer Disc. Co. v. Graves (*In re* Graves), 33 F.3d 242, 247 (3d Cir. 1994) (holding court orders in violation of automatic stay provision void when issued); *In re* Crawford, 388 B.R. 506, 518 (Bankr. S.D.N.Y. 2008) ("Even where a stay violation is not willful, the act taken in violation of the stay is void *ab initio*."); *In re* LaTempa, 58 B.R. 538, 540 (Bankr. W.D. Va. 1986) (holding actions taken in violation of stay provision automatically void *ab initio*).

[63] *See* 11 U.S.C. § 362(k) (indicating debtor is entitled to damages for willful violation of automatic stay provision); *see also* Crysen/Montenay Energy Co. v. Esselen Assocs., Inc. (*In re* Crysen/Montenay Energy Co.), 902 F.2d 1098, 1105 (2d Cir. 1990) (noting deliberate actions in violation of stay justifies damages); *In re Crawford*, 388 B.R. at 518 (holding deliberate violation of stay warrants sanctions).

[64] *See* 11 U.S.C. § 362(k) (entitling debtor to damages for willful violation of automatic stay provision); *see also In re Crawford*, 388 B.R at 524 (listing factors court may consider in awarding punitive damages: "(1) the nature of the defendant's conduct; (2) the defendant's ability to pay; (3) the defendant's motives; (4) any provocation by the debtor; and sometimes, (5) the defendant's level of sophistication"); *In re* Lile, 103 B.R. 830, 841 (Bankr. S.D. Tex. 1989) (holding debtor entitled to punitive damages in excess of actual damages suffered).

[65] *See* 11 U.S.C. § 362(d); *see also In re* Schuessler, 386 B.R. 458, 479–80 (Bankr. S.D.N.Y. 2008) (describing "cause" for relief from stay); *In re* Self, 239 B.R. 877, 880 (Bankr. E.D. Tex. 1999) (discussing creditor's burden on lift-stay motion); James A. Janaitis, Comment, *Bankruptcy Collides With Antitrust: The Need For a Prohibition Against Using § 1110 Protections Collectively*, 25 EMORY BANKR. DEV. J. 197, 232 (2008) (explaining creditor's option to request relief from automatic stay).

[66] *See In re* Air Vt., Inc., 45 B.R. 931, 935 (Bankr. D. Vt. 1985) (holding relief from automatic stay should be granted and lessor could repossess aircraft); James W. Giddens & Sandor E. Schick, *Section 1110 of the Bankruptcy Code: Time for Refueling?*, 64 AM. BANKR. L.J. 109, 113 (1990) (discussing foreclosure and repossession of aircraft after stay lifted); Janaitis, *supra* note 65, at 232 (allowing repossession after automatic stay terminated).

[67] 11 U.S.C. § 362(d)(1) (including lack of adequate protection as "for cause" reason to terminate stay); *see* Janaitis, *supra* note 65, at 232 (indicating debtor's inability to pay represents cause).

[68] *See* 11 U.S.C. § 362(d)(2) (enumerating two requirements that must be shown before stay can be lifted); *see also* Siobhan Rafferty, *Chapter 11 Cases Under Section 362(d)(2): Does This Include Liquidation?*, 1 EMORY BANKR. DEV. J. 159, 160–61 (1984) (indicating debtor must not have equity in property and property must be unnecessary for successful reorganization to obtain relief from stay); Jack F. Williams, *Application of the Cash Collateral Paradigm to the Preservation of the Right to Setoff in Bankruptcy*, 7 EMORY BANKR. DEV. J. 27, 29 (1990) (discussing creditor's request to terminate stay on property that is both without equity and unnecessary for reorganization).

Lift-stay motions must be considered on a case-by-case basis. The unique facts, goals, assets, and relationships in each bankruptcy case prevent the courts from applying a strict formula to determine whether the stay should be lifted. For example, a debtor usually provides adequate protection for the home lender by making the regular monthly mortgage payment after filing for bankruptcy; if the debtor has substantial equity in the home, then the court might find that the stay should not be lifted, even if the debtor missed payments after filing the bankruptcy case.[69]

A lift-stay motion is a contested matter.[70] A contested matter is a significant event in the bankruptcy case that has profound and permanent effects on the rights of a party in interest.[71] In a contested matter, the parties follow the Federal Rules of Civil Procedure regarding service of process and discovery of evidence, to the extent that they are incorporated by the Federal Rules of Bankruptcy Procedure and made applicable to contested matters.[72] Service of legal papers in a contested

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[69] *See In re Schuessler*, 386 B.R. 458 at 480 (holding equity cushion provided adequate protection); *In re* Heath, 79 B.R. 616, 618 (Bankr. E.D. Pa. 1987) (denying relief from stay in spite of debtor's failure to make mortgage payments); *see also* 11 U.S.C. § 361 (describing adequate protection for interest in property).

[70] *See* John D. Ayer, Michael Bernstein & Jonathan Friedland, *An Overview of the Automatic Stay*, AM. BANKR. INST. J., Dec./Jan. 2004, at 70 (defining motion to lift stay as contested matter as opposed to adversary proceeding); *see also* John P. Hennigan, Jr., *Toward Regularizing Appealability in Bankruptcy*, 12 EMORY BANKR. DEV. J. 583, 603 (1996) (mentioning motion to lift stay constitutes contested matter).

[71] > Whenever there is an actual dispute, other than an adversary proceeding, before the bankruptcy court, the litigation to resolve that dispute is a contested matter. For example, the filing of an objection to a proof of claim, to a claim of exemption, or to a disclosure statement creates a dispute which is a contested matter.
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> FED. R. BANKR. P. 9014 advisory committee's note. The legal events that constitute "contested matters" are listed in the Federal Rules of Bankruptcy Procedure: motion to convert or dismiss, Rule 1017(f); objection to confirmation and post-confirmation modification of a plan in a chapter 13 case, Rule 3015(f) and (g); modify a plan post-confirmation in an individual chapter 11 case, Rule 3019(b); objection to chapter 9 or 11 plan, Rule 3020(b); motion for relief from the stay, Rule 4001(a); motion to use cash collateral, Rule 4001(b); motion to obtain credit, Rule 4001(c); motion to avoid a lien, Rule 4003(d); motion to sell property free of liens, Rule 6004(c); objection to proposed use of property, Rule 6004(b); sale of personally identifiable information, Rule 6004(g); proceeding to assume or reject an executory contract or unexpired lease, Rule 6006(a) and (b); contempt proceedings, Rule 9020. Although a debtor's objection to a proof of claim is not expressly denominated a contested matter in the Rules, judges in the Bankruptcy Court for the Southern District of New York routinely treat claims objections as contested matters.
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> In *In re Boykin*, the court described the distinction between notice and service of process in bankruptcy cases: notice of the bar date is given to all creditors, Rule 2002(a)(7); the trustee objects to a proof of claim, which is a contested matter and service is required pursuant to Rules 7004 and 9014; the trustee and the creditor resolve the objection and send a notice of settlement pursuant to Rules 2002(a)(3) and 9019(a); and the objection to the settlement is a contested matter. 246 B.R. 825, 829 (Bankr. E.D. Va. 2000) (distinguishing notice and service of process for bankruptcy matters defined by Federal Rules of Bankruptcy Procedure).

[72] *See* FED. R. CIV. P. 81(a)(2) (stating Federal Rules of Civil Procedure apply to bankruptcy proceedings to extent provided by Federal Rules of Bankruptcy Procedure); FED. R. BANKR. P. 9014.

matter requires a higher standard for notice than that required for serving notice of the bankruptcy itself.[73]

B. Claims

In bankruptcy, "debt" means liability on a "claim," and "claim" means a right to payment.[74] The terms are closely intertwined; simply put, a debtor has debts and a creditor has claims.[75] The debtor may be liable for a claim even if the claim is disputed or in an unknown amount.[76]

Bankruptcy establishes a hierarchy among creditors, ranking them according to the character of their claims, establishing a uniform system for distributing the assets of the estate.[77] Secured claims are given the highest priority.[78] Next in the line are the domestic support obligations of the debtor.[79] Then, the costs of preserving the estate, administrative expenses, must be paid.[80] Administrative expenses might include the debtor's attorney fees incurred for legal work done after the commencement of the case.[81] Other priority claims follow, and general unsecured creditors are the last to be paid.[82]

The priority of claims is crucial to understanding bankruptcy. It governs the distribution of the property of the estate and controls the viability of the bankruptcy case.[83] For example, the chapter 13 plan must provide for the payment of all the

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[73] *See In re* Barry, 330 B.R. 28, 34 (Bankr. D. Mass. 2005) (explaining differences in service standards). *Compare* FED. R. BANKR. P. 7004(b)(1) (requiring service at individual's "dwelling house or usual place of abode"), *with* FED. R. BANKR. P. 7005 (applying FED. R. CIV. P. 5 to adversary proceedings).

[74] *See* 11 U.S.C. § 101(12) (defining "debt"); *see also id.* § 101(5) (defining "claim").

[75] *See* Energy Coop., Inc. v. SOCAP Int'l, Ltd. (*In re* Energy Coop., Inc.), 832 F.2d 997, 1001 (7th Cir. 1987) ("By defining a debt as a 'liability on a claim,' Congress gave debt the same broad meaning it gave claim."); *In re* McGovern, 122 B.R. 712, 714 (Bankr. N.D. Ind. 1989) (discussing congressional intent in regards to definitions of "claim" and "debt"); *In re* Burgat, 68 B.R. 408, 409 (Bankr. D. Colo. 1986) (highlighting interplay between definitions of "debt" and "claim").

[76] *See* 11 U.S.C. § 101(5)(A) (defining "claim" to include "disputed" and "unliquidated" rights to payment); *In re McGovern*, 122 B.R. at 714 ("[L]iability on a claim exists even though that claim has not been finally determined and is disputed, contingent, or unliquidated."); *In re* Vasu Fabrics, Inc., 39 B.R. 513, 517 (Bankr. S.D.N.Y. 1984) (finding Bankruptcy Code's definition of "claim" includes contingent and unliquidated rights to payment).

[77] *See* 11 U.S.C. §§ 503(b), 507.

[78] *See id.* § 724(b) (allowing claims secured by property of estate to be paid first); *see also id.* § 507(b) (giving priority over all others to secured claims without adequate protection).

[79] *See id.* § 507(a)(1)(A).

[80] *See id.* § 507(a)(2).

[81] *See id.* § 330(a)(1)(A); *see also* Yermakov v. Fitzsimmons (*In re* Yermakov), 718 F.2d 1465, 1470 (9th Cir. 1983) (holding debtor's attorney entitled to compensation under section 330 as attorney facilitates orderly administration of estate). *But see In re* Reed, 890 F.2d 104, 105 (8th Cir. 1989) (rejecting debtor's attorneys' fees as administrative expense since services only benefited debtor, rather than estate).

[82] *See* 11 U.S.C. § 507 (listing general unsecured creditors as last to be paid from estate).

[83] *See id.* (listing priority claims and expenses); *see also In re* King, 392 B.R. 62, 67 (Bankr. S.D.N.Y. 2008) (stating first distributions of estate in chapter 7 case are to those given priority under section 507); *In re* Laredo, 334 B.R. 401, 412–13 (Bankr. N.D. Ill. 2005) (outlining steps in distribution of estate under priority rules).

secured arrears on the home loan before the distribution to other creditors can be determined.[84] If the arrears are substantial, then only a tiny amount of money might be left over for the unsecured creditors.[85] Similarly, if a lengthy legal proceeding strikes the case, such as a contested plan confirmation or a lift-stay motion, then the debtor might incur more legal fees than planned for at the outset of the case.[86] Attorney fees are high-priority administrative claims, and if they are approved by the court, they must be paid in full before unsecured creditors can be paid.[87]

In a chapter 7 or 13 case, a creditor must file a proof of claim if it wants to be paid from the bankruptcy estate.[88] In a chapter 11 case, a creditor is not required to file a proof of claim if it agrees with the characterization of the debt in the schedules, as long as the debt is not disputed.[89] The proof of claim is an official form of the bankruptcy courts in which the creditor describes the amount and nature of the debt: mortgage loan, personal loan, taxes.[90] Supporting documents must be attached to the filed proof of claim.[91]

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[84] *See* Mendoza v. Temple-Inland Mortg. Corp. (*In re* Mendoza), 111 F.3d 1264, 1268 (5th Cir. 1997) (concluding chapter 13 plan may be modified to include post-petition mortgage payments in arrears); *In re* Anderson, 382 B.R. 496, 505 (Bankr. D. Or. 2008) (holding language in proposed chapter 13 plan stating debtor would cure default on mortgage by making payments on arrears through plan was ambiguous); *In re* Cruz, 152 B.R. 866, 869 (Bankr. S.D.N.Y. 1993) (holding payments to cure mortgage arrears during life of chapter 13 plan must be made first).

[85] *See* 11 U.S.C. § 507 (listing unsecured creditors as last to be paid from estate); *see also In re* Trombetta, 383 B.R. 918, 923 (Bankr. S.D. Ill. 2008) (stating it to be violation of Bankruptcy Code to allow payment to general unsecured creditors before priority creditors paid in full); Jeffrey S. Theuer, *Aligning Environmental Policy and Bankruptcy Protection: Who Pays for Environmental Claims Under the Bankruptcy Code?*, 13 T.M. COOLEY L. REV. 465, 476 (1996) (stating in many cases no distribution left for unsecured creditors).

[86] *See* Cle-Ware Indus., Inc. v. Sokolsky (*In re* Cle-Ware Indus.), 493 F.2d 863, 865 (6th Cir. 1974) (stating few areas of bankruptcy are as clouded by uncertainty as question of attorneys' fees); James B. Hirsch, Note, *Bankruptcy Fee Applications: Compensable Service or Cost of Doing Business?*, 58 FORDHAM L. REV. 1327, 1344 (1990) (stating in bankruptcy cases attorneys' fees paid from bankruptcy estate); Don W. Pickels, Comment, *Attorneys' Fees in Bankruptcy Proceedings*, 54 TEX. L. REV. 762, 762 (1976) (asserting legal fees in bankruptcy proceedings confuse veteran practitioners due to various authorities that must be taken into account when setting fees).

[87] *See In re* Shorb, 101 B.R. 185, 186 (B.A.P. 9th Cir. 1989) (citing legislative history to conclude administrative expenses such as attorneys' fees must be paid in full before or contemporaneously with payments to other creditors); *In re* Harris, 304 B.R. 751, 757 (Bankr. E.D. Mich. 2004) (finding unpaid, allowed administrative expense must be paid in full before any other creditor paid); *In re* Tenney, 63 B.R. 110, 111 (Bankr. W.D. Okla. 1986) (asserting advance payment of attorneys' fees regularly paid in chapter 7, 11, and 13 cases).

[88] *See* 11 U.S.C. §§ 501, 502; FED. R. BANKR. P. 3001.

[89] *See* 11 U.S.C. § 1111(a) (indicating proof of claim deemed filed unless disputed); FED. R. BANKR. P. 3003(c)(2) (stating only disputants must file); Stephen J. Ware, *Bankruptcy Law's Treatment of Creditor's Jury-Trial and Arbitration Rights*, 17 AM. BANKR. INST. L. REV. 479, 480 n.7 (2009) (noting chapter 11 creditors need not file proof of claim unless disputing characterization).

[90] *See* FED. R. BANKR. P. 3001(a) (requiring substantial conformation to official form); Admin. Office of the U.S. Courts, Official Bankr. Form B10, *available at* http://www.uscourts.gov/FormsAndFees/Forms/BankruptcyForms.aspx (listing official proof of claim forms for various bankruptcy situations); *see also* NANCY C. DREHER & JOAN N. FREENEY, 2 BANKRUPTCY LAW MANUAL § 13:12 (5th ed. 2010) (denoting Official Form 10 for creditor use); 4 COLLIER ON BANKRUPTCY, ¶ 501.02[3][b], at 501-10 (Alan N. Resnick & Henry J. Somme reds., 16th ed. 2010) (remarking proof of claim should conform substantially to official

The clerk's office, the administrative arm of the bankruptcy court, sends a notice of the bankruptcy filing to creditors, using addresses provided by the debtor.[92] The notice itself is another official form of the bankruptcy courts, and advises the creditors of the bankruptcy filing and several important dates and other legal information that will affect the payment of their claims.[93] In a chapter 13 case, the notice of the bankruptcy provides the debtor's name, address, and last four digits of the debtor's Social Security number; the date of the meeting of creditors, at which creditors may appear and question the debtor about assets; the last date to object to the plan; and the deadline to file proofs of claim.[94] The notice warns creditors against taking further actions to collect the debts owed to them, and provides basic descriptions of some of the features of the bankruptcy: the meaning of a bankruptcy filing, a proof of claim, and the discharge.[95] The address that the debtor supplies for the notice must be one that is geared to provide the creditor reasonable notice of the bankruptcy case.[96] The debtor bears the burden of finding the correct addresses for the creditors, and must use reasonable diligence in doing so.[97] If a creditor is totally

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form); 7 NORTON BANKRUPTCY LAW AND PRACTICE § 146:6, at 146-26 (William L. Norton, Jr. ed., 3d ed. 2008) (highlighting need for proof of claim to adhere to official form).

[91] *See* FED. R. BANKR. P. 3001(c), (d) (stating original writing or proof must be submitted with proof of claim); 4 COLLIER ON BANKRUPTCY, ¶ 501.02[3][b], at 501-10 (Alan N. Resnick & Henry J. Somme reds., 16th ed. 2010) (noting proof must accompany claim); 7 NORTON BANKRUPTCY LAW AND PRACTICE § 146:6, at 146-26 (William L. Norton, Jr. ed., 3d ed. 2008) (explaining proof must accompany claim).

[92] *See* FED. R. BANKR. P. 2002(a)(1) (stating clerk must give creditors at least twenty-day notice); Notice of Chapter 13 Bankruptcy Case, Meeting of Creditors & Deadlines Official Form B9I (Bankr. S.D.N.Y. 2010), *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/BK%20Forms%201210/B_9I_1210.pdf.

[93] Notice of Chapter 13 Bankruptcy Case, Meeting of Creditors & Deadlines Official Form B9I (Bankr. S.D.N.Y. 2010), *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/BK%20Forms%201210/B_9I_1210.pdf.

[94] *Id.* In chapter 7 cases in which there are no assets to distribute to general unsecured creditors, the creditors are directed not to file a proof of claim. Notice of Chapter 7 Bankruptcy Case, Meeting of Creditors, & Deadlines Official Bankr. Form B9A (Bankr. S.D.N.Y. 2010), *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/BK%20Forms%201210/B_9A_1210.pdf. In chapter 11 cases, the debtor usually sets its own bar date for proofs of claims. *See* General Order M-386 at 3 (Bankr. S.D.N.Y. 2009), *available at* www.nysb.uscourts.gov/orders/m386.pdf.

[95] *See, e.g.*, Notice of Chapter 7 Bankruptcy Case, Meeting of Creditors, & Deadlines Official Form B9A (Bankr. S.D.N.Y. 2010), *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/BK%20Forms%201210/B_9A_1210.pdf; Notice of Chapter 11 Bankruptcy Case, Meeting of Creditors, & Deadlines Official Form B9E (Bankr. S.D.N.Y. 2010), *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/BK_Forms_1207/Form_9E_1207.pdf; Notice of Chapter 13 Bankruptcy Case, Meeting of Creditors & Deadlines Official Form B9I (Bankr. S.D.N.Y. 2010), *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/BK%20Forms%201210/B_9I_1210.pdf.

[96] *See, e.g., In re* O'Shaughnessy, 252 B.R. 722, 729 (Bankr. N.D. Ill. 2000) (stressing address must give reasonable notice); *In re* Glenwood Med. Grp., 211 B.R. 282, 285 (Bankr. N.D. Ill. 1997) (discussing purpose of address is to provide notice); *In re* Kleather, 208 B.R. 406, 410 (Bankr. S.D. Ohio 1997) (requiring address of creditor be reasonably calculated to provide due process).

[97] *See, e.g., In re* Fauchier, 71 B.R. 212, 215 (B.A.P. 9th Cir. 1987) (upholding burden on debtors to use reasonable diligence in completing schedules); *In re* Stacy, 405 B.R. 872, 879 (Bankr. N.D. Ohio 2009) (expecting debtors to use reasonable diligence in schedule completion); *In re O'Shaughnessy*, 252 B.R. at 734–35 (placing burden on debtor to use reasonable diligence to find creditor's address).

unaware of the bankruptcy, the debt might not be discharged, or the creditor might be allowed to file a late proof of claim, depending on the circumstances of the case.[98]

Timely filing a proof of claim may determine whether the creditor gets paid from the bankruptcy estate, and how much money it will receive. First, an unchallenged claim is deemed allowed as described in the proof of claim.[99] The proof of claim is accepted at its face value as being proper and legal.[100] A secured creditor is not required to file a proof of claim, but if it does not, it might be limited in its ability to collect the debt.[101] A secured creditor that does not file a proof of claim may move for relief from the stay to collect against the collateral, but it likely will be limited to the proceeds of sale of the collateral.[102]

The debtor can object to an improper claim.[103] Claims objections are contested matters, which should not be confused with adversary proceedings, actual lawsuits in which the debtor attacks the true merits and legal validity of the claim.[104] Adversary proceedings include a proceeding to determine the validity of a lien, in which a debtor might challenge the legality of a loan or a creditor's standing to

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[98] *See* 11 U.S.C. § 523(a)(3) (2006) (listing exception to discharge); *see also In re O'Shaughnessy*, 252 B.R. at 730–31 (determining when late proof of claim will be allowed); *In re* Faden, 170 B.R. 304, 308 (Bankr. S.D. Tex. 1994) (discussing notice requirement exception for discharge of debts).

[99] *See* 11 U.S.C. § 502(a) (discussing allowance of claims).

[100] *See* FED. R. BANKR. P. 3001(f) (noting proof of claim constitutes evidence of validity of claim); *see also In re* Samson, 392 B.R. 724, 734 (Bankr. D. Ohio 2008) (holding claim to be valid and legal); *In re* Irons, 343 B.R. 32, 39 (Bankr. N.D.N.Y. 2006) (discussing objecting party's burden of proof to overcome claim's prima facie evidence of validity).

[101] *See* Lindsey v. Fed. Land Bank of St. Louis (*In re* Lindsey), 823 F.2d 189, 190 (7th Cir. 1987) ("A lienor need not, in order to enforce his lien, file a claim in his debtor's bankruptcy proceeding, though if he does not he loses the chance of enforcing any deficiency judgment against the assets of the bankruptcy estate."); *In re* Tarnow, 749 F.2d 464, 465 (7th Cir. 1984) (explaining how secured creditor may utilize lien for debt satisfaction instead of bankruptcy); *In re* Sneijder, 407 B.R. 46, 53 (Bankr. S.D.N.Y. 2009) (internal footnotes omitted) ("Even though secured creditors need not file proofs of claim for their liens to ride-through a chapter 13 debtor's bankruptcy, the only way for the creditor to recover money under a plan in the event an under-water debtor surrenders the property is to file a claim.").

[102] *See In re* George, 426 B.R. 895, 901 (Bankr. D. Fla. 2010) (suggesting if secured creditor does not file proof of claim and collateral is insufficient, it "cannot later surprise a debtor with a deficiency request"); *In re* Matthews, 313 B.R. 489, 494 (Bankr. M.D. Fla. 2004) (stressing secured creditor's responsibility to file proof of claim to recover beyond value of collateral).

[103] *See* 11 U.S.C. § 502(a) (noting debtor may object to claim); FED. R. BANKR. P. 3007 (discussing procedure for objecting to claims); *see also In re* Keyworth, 47 B.R. 966, 971 (Bankr. D. Colo. 1985) (noting debtor's proper objection to claim).

[104] *See* Donald S. Bernstein, *A Reorganization Lawyer's Perspective on Professor Warren's Vanishing Trials: The New Age of American Law*, 79 AM. BANKR. L.J. 943, 944–45 (2005) (distinguishing adversary proceedings from contested matters); Hon. Christopher M. Klein, *Bankruptcy Rules Made Easy (2001): A Guide to the Federal Rules of Civil Procedure that Apply in Bankruptcy*, 75 AM. BANKR. L.J. 35, 38–41 (2001) (explaining differences between claim objections and adversary proceedings); Eric S. Richards, *Due Process Limitations on the Modification of Liens Through Bankruptcy Reorganization*, 71 AM. BANKR. L.J. 43, 55–56 (1997) (highlighting how objection combined with demand for relief may change contested matter to adversary proceeding).

enforce a mortgage.[105] In adversary proceedings and contested matters that require litigation, the parties are entitled to discovery, dispositive motions, and evidentiary hearings and trials.[106]

C. The Chapter 13 Plan

> Unlike chapter 7 which contemplates payment of creditors from the liquidation of assets, the chapter 13 statutory scheme is oriented toward the payment of creditors from projected future earnings of debtors who have regular income. It provides a vehicle through which an honest debtor can achieve fiscal rehabilitation by devoting all disposable income into a plan to pay creditors.[107]

Debtors struggling to save their homes from foreclosure can file for chapter 13 to bring their home loan back to normal by resuming a regular payment schedule and making up lost payments gradually over a three- or five-year term.[108] However, the debtor cannot force the home lender to modify the loan to make it more affordable.[109] In practice, this restriction means that the court may not compel a secured creditor to accept a lower principal balance or reduced interest rate on a home loan, even if the home is worth less than what is owed.

If the debtor does not want to keep the home, it may be possible to surrender the home to the mortgagee as part of a chapter 13 plan.[110] The "surrender" provision of

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[105] *See* FED. R. BANKR. P. 7001(2) (discussing adversary proceeding includes determination of validity of lien); *see also In re* Colortran, Inc., 218 B.R. 507, 510 (B.A.P. 9th Cir. 1997) (requiring adversary proceeding to determine validity of lien); *In re* Koontz, Bankr. No. 09–30024 HCD, Adv. No. 10–3005, 2010 WL 5625883, at *1 (Bankr. D. Ind. Sept. 30, 2010) (noting adversary proceeding was proper to determine mortgage validity).

[106] *See* FED. R. BANKR. P. 7003 (applying Federal Rules of Civil Procedure to bankruptcy rules); *In re* Kleibrink, 346 B.R. 734, 749–50 (Bankr. N.D. Tex. 2006) (comparing procedures required in contested matters versus procedures required in adversary proceeding); Klein, *supra* note 104, at 38–39 (describing characteristics of adversary proceeding).

[107] *In re* Trumbas, 245 B.R. 764, 767 (Bankr. D. Mass. 2000) (internal citations omitted) (denying unsecured creditor's motion to modify debtor's confirmed plan on account of her increased home equity).

[108] *See* 11 U.S.C. § 1322(b)(3), (5); *see also* David Gray Carlson, *Rake's Progress: Cure and Reinstatement of Secured Claims in Bankruptcy Reorganization*, 13 BANKR. DEV. J. 273, 275 (1997) (describing reinstatement of loan as valuable part of chapter 13 plan, and can be paid within three to five years); Veryl Victoria Miles, *The Bifurcation of Unsecured Residential Mortgages Under § 1322(b)(2) of the Bankruptcy Code: The Final Solution*, 67 AM. BANKR. L.J. 207, 209 n.7 (1993) (explaining three to five year repayment plan under chapter 13 is reflection of bankruptcy law sensitivity towards individual debtors and relief from debt).

[109] *See* 11 U.S.C. § 1322(b)(2) (providing plan may modify rights of secured claimholders other than one secured by real property and is debtor's principal residence); *see also* Carlson, *supra* note 108, at 345 (finding courts interpret right to cure under chapter 13 as not requiring secured creditor to modify mortgage); Miles, *supra* note 108, at 217 (stating chapter 13 does not allow debtors to modify claims against principal home of debtor).

[110] 11 U.S.C. § 1325(a)(5)(C) states that the court shall confirm a plan if, with respect to each allowed secured claim provided for by the plan, that the debtor surrenders the property securing the secured claim to

chapter 13 is controversial, because the law is unclear on the specific details and effects of surrender. What legal actions are necessary to constitute a surrender, whether the creditor's consent is required for surrender in full or partial satisfaction of the debt, and whether the creditor may file a deficiency claim if the home sells for less than what is owed are still unsettled questions of interpretation.[111] The parties must see to the public transfer of title from the debtor to the secured creditor. When surrender is not accomplished properly, the consequences to the debtor might be dire. Property taxes and penalties continue to accumulate, without notice to the chapter 13 debtor, and might take years to discover.[112]

The debtor must develop the chapter 13 plan and start making payments early in the case,[113] even though claims might be slow to come in and the nuances of the plan are unclear. The debtor must file a copy of the plan within fourteen days of commencing the bankruptcy case.[114] The first plan payment is due within thirty days of commencing the bankruptcy case.[115] A copy of the plan or a summary of the plan must be served on all creditors.[116]

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secured creditor, among other possible treatments for secured claims. *Accord In re* Behanna, 381 B.R. 631, 640 (Bankr. W.D. Pa. 2008) ("The Bankruptcy Code specifically allows a confirmed plan to deal with a secured claim by including in the plan a provision that the Debtor will surrender the property securing the claim to the claim holder."); *In re* Covington, 176 B.R. 152, 155 (Bankr. E.D. Tenn. 1994) (discussing option to surrender mobile home under chapter 13 plan).

[111] *See, e.g.*, *In re* Harris, 244 B.R. 556, 557 (Bankr. D. Conn. 2000) (confirming plan over creditor's objection to surrender; court noted transfer by deed conveyance would require creditor's consent for surrender to be effective); *In re* Stone, 166 B.R. 621, 623 (Bankr. S.D. Texas 1993) ("This court finds that the physical abandonment by Debtor of the homestead and the statements in the plan indicating a surrender of the homestead and the accounts do not constitute a surrender of these properties within the meaning of § 1325(a)(5)(C)."); *cf. In re* Cormier, 434 B.R. 222, 233 (Bankr. D. Mass. 2010) (holding secured creditor could not be compelled to take deed in lieu of foreclosure under section 1325(a)(5)(C), and was entitled to exercise its options under mortgage and state law).

[112] *See In re* Armstrong, 434 B.R. 120, 130 (Bankr. S.D.N.Y. 2010) (holding surrender in plan was not effective; debtors alleged local government was pursuing them for about $15,000 in back property taxes); *In re* Vitt, 250 B.R. 711, 720 (Bankr. D. Colo. 2000) (finding debtor failed to surrender property).

[113] *See In re* Maurice, 167 B.R. 114, 123 (Bankr. N.D. Ill. 1994) (affirming chapter 13 plans must be promptly filed); *In re* Greene, 127 B.R. 805, 807 (Bankr. N.D. Ohio 1991) (dismissing chapter 13 case for failure to file plan promptly); *cf. In re* Neary, 54 B.R. 94, 94–95 (Bankr. E.D. Pa. 1985) (declining to dismiss when plan submitted two days after deadline).

[114] *See* FED. R. BANKR. P. 3015(b) ("If a plan is not filed with the petition, it shall be filed within 14 days thereafter.").

[115] *See* 11 U.S.C. § 1326(a)(1) (requiring debtor begin payments within thirty days of filing plan or petition unless court orders otherwise); *see also id.* § 1302(b)(5) (indicating trustee responsible for ensuring payments made); 8 COLLIER ON BANKRUPTCY, ¶ 1326.02, at 1326-5 (Alan N. Resnick et. al. eds., 16th ed. 2010) (noting rarity of filing plan before filing order of relief means payments commence thirty days after filing order of relief).

[116] *See In re* Westbrook, 246 B.R. 412, 417 n.5 (Bankr. N.D. Ala. 1999) (observing plan or summary of plan must be sent to all creditors); General Order M-406 (Bankr. S.D.N.Y. 2010) (amending General Order M-405), *available at* http://www.nysb.uscourts.gov/orders/m406.pdf; S.D.N.Y. LOCAL BANKR. R. 3015-1, 3015-2. *Compare* FED. R. BANKR. P. 3015(d) (mandating inclusion of plan or summary with mailed notice of hearing on confirmation), *with* FED. R. BANKR. P. 2002(b) (requiring notice of hearing on confirmation to be mailed to all creditors).

The chapter 13 debtor pays all post-petition wages and income into the plan, after accounting for basic living needs such as food and the monthly mortgage payment.[117] The plan must pay pre-petition arrears on secured debts in full, as well as all administrative and priority unsecured claims over the life of the plan.[118] The plan must pay the general unsecured creditors more than they would receive if the debtor's assets were sold in a chapter 7 liquidation.[119] As a result of the hierarchy of claims, general unsecured creditors often receive a very small percentage of their claims in chapter 13 cases, and the rest is ultimately discharged when the debtor completes the plan.[120] The debtor must also continue to make post-petition payments on secured debts as they come due.[121]

A secured creditor can object to the plan if it will not receive full payment on the pre-petition arrears.[122] An objection by a secured creditor or priority unsecured creditor may result in denial of the plan.[123] Similar to a lift-stay motion and a claim

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[117] *See* 11 U.S.C. § 1322(a)(1) (commanding debtor to commit all "future earnings" necessary to plan); *see also* Ransom v. FIA Card Servs., N.A., 131 S. Ct. 716, 721 (2010) (noting "means test" determines debtor's payments); 8 COLLIER ON BANKRUPTCY, ¶ 1325.LH, at 132584 (Alan N. Resnick et. al. eds., 16th ed. 2010) (observing required payment determined by subtracting certain allowed expenses from debtor's "current monthly income").

[118] *See* 11 U.S.C. § 1322(a)(2) (providing for full payment of section 507 priority unsecured claims); *see also* 8 COLLIER ON BANKRUPTCY, ¶ 1322.03, at 1322-11 (Alan N. Resnick et. al. eds., 16th ed. 2010) (indicating priority claims must be paid in full subject to two exceptions); Scott F. Norberg, *Consumer Bankruptcy's New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13*, 7 AM. BANKR. INST. L. REV. 415, 424 (1999) (positing secured creditors entitled to full payment in chapter 13).

[119] *See* 11 U.S.C. § 1325(a)(4); *see also* David Gray Carlson, *The Chapter 13 Estate and Its Discontents*, 17 AM. BANKR. INST. L. REV. 233, 237–38 (2009) (observing section 1325(a)(4) establishes superiority of chapter 13 over chapter 7); Norberg, *supra* note 118, at 423 ("[D]ebtor must pay creditors at least as much as they would receive from a liquidation of assets in a chapter 7 case.").

[120] *See* Jean Braucher, *Consumer Bankruptcy as Part of the Social Safety Net: Fresh Start or Treadmill?*, 44 SANTA CLARA L. REV. 1065, 1090 n.130 (2004) (noting chapter 13 plans primarily repay secured debt and only small portion is general unsecured); Melissa B. Jacoby, *The Bankruptcy Code at Twenty-Five and the Next Generation of Lawmaking*, 78 AM. BANKR. L.J. 221, 233 (2004) (observing general unsecured creditors are losers of chapter 13 because they receive small amount of payments); Norberg *supra* note 118, at 433 n.61 (claiming in 1998 only 19.1% of chapter 13 payments went to general unsecured creditors).

[121] *See* 11 U.S.C. § 1325(a)(5)(B)(i); *see also In re* Thomas, 364 B.R. 207, 209 (Bankr. E.D. Va. 2007) (noting most popular way to handle post-petition payments on secured claims is curing delinquencies and requiring timely future payments); Roger S. Cox, *Bankruptcy and Creditors' Rights*, 54 SMU L. REV. 1141, 1152–53 (2001) (indicating chapter 13 debtor typically must stay current on post-petition mortgage payments).

[122] *See* 11 U.S.C. § 1325(a)(5) (indicating court cannot confirm plan without secured creditors' consent); *see also* 8 COLLIER ON BANKRUPTCY, ¶ 1325.06, at 1325-30 (Alan N. Resnick et. al. eds., 16th ed. 2010) (positing secured creditors' failure to object to plan is equivalent to acceptance); Nicholas M. Hudalla, Note, *Back to Basics: Leaving the Hanging Paragraph Hanging*, 7 DEPAUL BUS. & COM. L.J. 357, 378 (2007) ("A secured creditor's objection is limited to Section 1325(a)(5).").

[123] *See* 11 U.S.C. § 1325(a)(5); *see also* Andrews v. Loheit (*In re* Andrews), 49 F.3d 1404, 1409 (9th Cir. 1995) (referring to ability of secured creditors to object to debtor's chapter 13 plan); *In re* Brown, 108 B.R. 738, 740 (Bankr. C.D. Cal. 1989) (noting creditors confirm chapter 13 plans by not objecting). In contrast, the chapter 13 trustee and lower-ranking unsecured creditors can also object to the plan, but their objections will be overruled if the debtor proposes the plan in good faith and promises to pay all projected disposable income into the plan. *See* 11 U.S.C. § 1325(a)(3) (providing plan confirmed if given in good faith); *id.* § 1325(b)(1) (noting court shall confirm plan even if unsecured claim holder objects); *see also In re Andrews*,

objection, an objection to the debtor's chapter 13 plan is a contested matter, in which the court may require a scheduling order or settlement conference.[124]

D. Judicial Liens and Second Mortgages

One of the greatest tools of bankruptcy is the power to avoid liens, which causes a claim to become unsecured and changes the creditor's place in the line.[125] A judicial lien is an involuntary lien, which a judgment creditor may file against the debtor's home.[126] A mortgage is a consensual lien, to which the debtor agrees for consideration, and is secured by debtor's real property.[127]

Debtors in chapter 7 and chapter 13 may avoid judicial liens pursuant to bankruptcy law to the extent they interfere with the debtor's homestead exemption.[128] Nowadays, with many homes worth less than what is owed on the home loans, the power to avoid judicial liens means that judgment creditors will

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49 F.3d at 1409 (affirming trustee's authority to object to chapter 13 plan); Deans v. O'Donnell (*In re* Deans), 692 F.2d 968, 970–71 (4th Cir. 1982) (discussing good faith requirement for unsecured creditors to effectively object to debtor's chapter 13 plan). This means that the debtor can pay less than the full amount of these low-priority claims and discharge the difference, as long as the debtor pays all the money that remains after accounting for the personal needs of the debtor and the debtor's family—housing, food, and transportation. *See* 11 U.S.C. § 1325(b)(1) (explaining plan can be confirmed over objection in two exceptions); *see also In re* Rhein, 73 B.R. 285, 288 (Bankr. E.D. Mich. 1987) (holding debtor must pay all disposable income if creditors are to receive less than full value of their claims). *But see In re* Otero, 48 B.R. 704, 708 (Bankr. E.D. Va. 1985) (explaining plan was not intended to take "last son"). Whether or not the debtor has committed all projected disposable income can be a hotly litigated question in chapter 13 cases, particularly if the debtor wants to keep a luxury item such as a vacation home, or if the debtor's income improves after the case is filed. *See In re* Tobiason, 185 B.R. 59, 65 (Bankr. D. Neb. 1995) (regarding debtor's withholding of stock option as violation of good faith requirement despite debtor's claim option had no value); *In re Rhein*, 73 B.R. at 288 (sustaining objection of creditors because debtor withheld additional $147 in monthly income); *In re* Kern, 40 B.R. 26, 28–29 (Bankr. S.D.N.Y. 1984) (holding debtor's failure to include wife's salary as violating duty to accurately disclose projected disposable income).

[124] *See* FED. R. BANKR. P. 3015(f) (discussing procedures for objection to plan); *see also In re* Schiffman, 338 B.R. 422, 425 (Bankr. D. Or. 2006) (accommodating possible settlement conference in response to objections to chapter 13 plan); *In re* Dues, 98 B.R. 434, 440 (Bankr. N.D. Ind. 1989) (treating confirmation of plan as contested matter when objection to plan raised).

[125] *See* 11 U.S.C. § 544 (discussing power of trustee as lien creditor); *id.* § 545 (noting trustee may avoid liens); *see also* John C. McCoid, II, *Preservation of Avoided Transfers and Liens*, 77 VA. L. REV. 1091, 1107–08 (1991) (noting lien avoidance could cause junior liens to rank above senior liens).

[126] *See* 11 U.S.C. § 101(36) (defining "judicial lien"); *see also* United States v. Ron Pair Enter., Inc., 489 U.S. 235, 240 (1989) (acknowledging judicial liens are involuntary); *In re* Trobaugh, 330 B.R. 559, 560 (Bankr. W.D. Ky. 2005) (noting judicial liens do not require debtor's consent).

[127] *See In re* Laskin, 222 B.R. 872, 875–76 (B.A.P. 9th Cir. 1998) (treating mortgage as consensual lien); *In re* Smith, 262 B.R. 594, 600 (Bankr. E.D.N.Y. 2001) (referring to mortgage liens as consensual liens); *In re* Giordano, 177 B.R. 451, 455 (Bankr. E.D.N.Y. 1995) (noting mortgage is consensual).

[128] *See* 11 U.S.C. § 522(f) (listing exemptions); *see also In re* Steck, 298 B.R. 244, 248–49 (Bankr. D.N.J. 2003) (acknowledging debtor's right to avoid liens that would impair exemptions); *In re* Tash, 80 B.R. 304, 306 (Bankr. D.N.J. 1987) (noting debtor's right to avoid liens). For a discussion of how to calculate the amount of the claim that is made unsecured, see *In re* Higgins, 270 B.R. 147, 155 (Bankr. S.D.N.Y. 2001) (discussing calculation of claim).

more often have their liens removed in their entirety, and their claims become unsecured claims.[129]

In most bankruptcy courts, chapter 13 debtors may remove second mortgages pursuant to bankruptcy law if they do not have equity in their homes after the first mortgage is satisfied.[130] This power causes the second mortgage, a secured claim, to become a general unsecured claim.[131] Chapter 7 debtors may not strip off second mortgages, because, among other reasons, to do so would totally extinguish the mortgagee's rights to recover some money on the debt—the mortgagee would have its lien erased, preventing foreclosure, and would not be able to pursue the debtor personally for the money, because of the discharge.[132]

Lien avoidance plays a lead role in bankruptcy reorganizations because it embodies the policy of equal treatment of creditors and broadens property of the estate.[133] It can dramatically reduce the amount of top-priority secured debt, making the chapter 13 plan feasible for many debtors with significant mortgage arrears.[134] A

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[129] *See* 11 U.S.C. § 522(f)(2)(A) (discussing process); *see also* Holland v. Star Bank, N.A. (*In re* Holland), 151 F.3d 547, 549–50 (6th Cir. 1998) (affirming debtor's power to avoid judicial lien when debtor had practically no equity in home); *In re* Hall, 327 B.R. 424, 425, 428 (Bankr. W.D. Miss. 2005) (authorizing avoidance of judgment creditor's lien when debtor's mortgages exceeded value of home).

[130] *See, e.g.*, Pond v. Farm Specialist Realty (*In re* Pond), 252 F.3d 122, 125 (2d Cir. 2001) (noting this avoidance as "antimodification"); McDonald v. Master Fin. (*In re* McDonald), 205 F.3d 606, 610 (3d Cir. 2000) (discussing how most courts have adopted this view); *In re* Lam, 211 B.R. 36, 41–42 (B.A.P. 9th Cir. 1997) (ruling second mortgages may be removed in bankruptcy). The Supreme Court has not decided whether debtors have the right to avoid junior mortgages on homes without equity. *See* Nobelman v. Am. Sav. Bank, 508 U.S. 324 (1993) (failing to discuss extent of holding applicability to holder of unsecured homestead lien); *In re Pond*, 252 F.3d at 125 (discussing how Supreme Court left issue in doubt); *In re McDonald*, 205 F.3d at 610–11 (noting division among bankruptcy courts on this issue); *In re* Mann, 249 B.R. 831, 834–35 (B.A.P. 1st Cir. 2000) (noting how Supreme Court left uncertainty). A majority of courts have held that the Supreme Court's opinion on splitting a partially secured junior mortgage into secured and unsecured claims does not apply to situations where there is no equity in the home to which the mortgage can attach. *See In re Pond*, 252 F.3d at 125 (discussing spilt in interpretation of *Nobelman*); *In re McDonald*, 205 F.3d at 610–11 (noting how majority of courts have taken this position); *In re Lam*, 211 B.R. at 41–42 (allowing removal of second mortgage in bankruptcy).

[131] *See* 11 U.S.C. § 506(a) (explaining determination of unsecured claim is one where lien exceeds value); *id.* § 1322(b)(2) (providing chapter 13 bankruptcy plan may modify unsecured claims); *see also In re* Lane, 280 F.3d 663, 664 (6th Cir. 2002) (concluding where creditor holds second mortgage valued less than first mortgage, holder of second mortgage has only unsecured claim); *In re* Claar, 368 B.R. 670, 675 (Bankr. S.D. Ohio 2007) (holding if no equity in property exists to secure second mortgage, after taking into account first mortgage, then claim is unsecured).

[132] *See* Dewsnup v. Timm, 502 U.S. 410, 417 (1992) (holding chapter 7 debtor not permitted to strip down second mortgage); *In re* Pomilio, 425 B.R. 11, 13 (Bankr. E.D.N.Y. 2010) (discussing *Dewsnup*); *In re* Blosser, No. 07-28223-svk, 2009 WL 1064455, at *1 (Bankr. E.D. Wis. Apr. 15, 2009) (reiterating chapter 7 debtors not permitted to avoid liens).

[133] *See, e.g.*, 11 U.S.C. § 544(a) (discussing power of trustee to avoid liens); *see also In re* Schwartz, 383 B.R. 119, 126 (B.A.P. 8th Cir. 2008) (observing avoidance is sufficient remedy under preferences of Bankruptcy Code); *In re* First Capital Mortg. Loan Corp., 60 B.R. 915, 919 (Bankr. D. Utah 1986) (mentioning fundamental bankruptcy policy of creditor equality and avoidance benefits all creditors).

[134] *See In re* Hill, 440 B.R. 176, 184 (Bankr. S.D. Cal. 2010) (explaining debtors were insolvent, unemployed, have non-dischargeable student debt, property taxes, and $18,000 in arrearage of the senior lien on their residence; therefore, stripping junior mortgage to provide more for chapter 13 plan was appropriate); *In re* Fenn, 428 B.R. 494 (Bankr. N.D. Ill. 2010).

debtor who must cure only one mortgage has a much better chance of succeeding in bankruptcy than a debtor who must cure two mortgages, because the amount of secured arrears—which must be paid in full—will be lower. The payout to general unsecured creditors as a group will be greater, because there will be fewer secured creditors to take priority from the plan payment. Judgment creditors who managed to secure low-priority debts are put back in the pool of general unsecured creditors. If the debtor wishes to sell or refinance the property during or after the bankruptcy, the debtor will have had the opportunity to clear title by removing the judgment liens.[135]

E. Enforcement

Bankruptcy reorganization is controlled by special rules that promote honesty and diligence by the debtor, creditors, and their lawyers. Attorneys have an ethical duty to be honest with the court, and they may not use the legal system for purposes of harassment.[136] This duty includes telling the truth in filings and when addressing the court, and correcting false statements and mistakes after they are discovered.[137] When parties and their counsel act improperly in a bankruptcy case, the court has broad authorization to issue penalties, which depend on the nature and extent of the misconduct.[138] Because the kind of sanction that is assessed may vary depending upon the authority under which the court acts, the court must specify the rule under which it issues the sanction.[139]

First, the bankruptcy court may sanction parties pursuant to its inherent power as a federal court, with respect to matters that directly relate to the bankruptcy.[140]

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[135] *Cf. In re* Simonson, 758 F.2d 103, 111 n.6 (3d Cir. 1985) ("Where judgment liens are junior to mortgages which encumber the entire value of the property, 'no interest remains to which the defendant's judicial lien could attach.'"); *In re Hill*, 440 B.R. at 184 (granting motion to void junior lien on residence to benefit plan as whole); *In re* Snyder, 32 B.R. 59, 60 (Bankr. M.D. Pa. 1983) (permitting exemption to extent of debtor's aggregate interest).

[136] *See* ABA MODEL R. PROF. CONDUCT §§ 3.1 (Non-Meritorious Claims and Contentions), 3.3 (Conduct Before a Tribunal), 3.4 (Fairness to Opposing Party and Counsel) (2010); S.D.N.Y. LOCAL CIV. R. 1.5 (incorporating New York state ethics rules). *But see* Lonnie T. Brown, Jr., *Ending Illegitimate Advocacy: Reinvigorating Rule 11 Through Enhancement of the Ethical Duty to Report*, 62 OHIO STATE L.J. 1555, 1594 (2001) (remarking lawyers do not always consider misconduct unethical).

[137] *See* ABA MODEL R. PROF. CONDUCT §§ 3.3, 3.4; *accord In re* Parsley, 384 B.R. 138, 179–80 (Bankr. S.D. Tex. 2008) (requiring truth in filings).

[138] *See, e.g.*, 11 U.S.C. § 105(a) (acknowledging bankruptcy court's power to sanction misconduct); *In re* Lehtinen, 564 F.3d 1052, 1059 (9th Cir. 2009) (stating bankruptcy court has power to disbar or suspend attorney under inherent authority power); *In re* Dyer, 322 F.3d 1178, 1196 (9th Cir. 2003) (requiring court make explicit finding of bad faith or willful misconduct before imposing sanctions).

[139] *See* Coltrade Int'l, Inc. v. United States, 973 F.2d 128, 132 (2d Cir. 1992) (expressing authority and conduct is enough for sanctions); *In re* Ciancioso, 187 B.R. 438, 444 (E.D.N.Y. 1995) (noting judge must specify sanctionable conduct and authority).

[140] *See In re* Plumeri, 434 B.R. 315, 328 (S.D.N.Y. 2010) (explaining bankruptcy court has inherent powers to order sanctions); *In re Parsley*, 384 B.R. at 177 (explaining bankruptcy court's power to order sanctions limited to bankruptcy matters); *In re* Chateaugay Corp., 213 B.R. 633, 638 (S.D.N.Y. 1997) (explaining Bankruptcy Code allows court to enforce own orders).

The inherent power of the court includes powers to police the conduct of attorneys, who are officers of the court, and to punish their misconduct.[141] Inherent powers must be exercised with restraint, and the sanction must be the least onerous sanction that can be made to address the situation.[142]

The equitable power of the bankruptcy court is preserved in Bankruptcy Code section 105(a), which allows the bankruptcy court to take whatever action is appropriate or necessary to carry out the provisions of the Bankruptcy Code.[143] Section 105(a) should be exercised in connection with a specific provision of the Bankruptcy Code or Rules.

Bankruptcy courts may enforce their orders by holding a party in civil contempt, to force compliance with the order, and to remedy the harm of noncompliance.[144] A court may hold a party in civil contempt when (1) the order with which the party allegedly failed to comply is clear and unambiguous, (2) the proof of noncompliance is clear and convincing, and (3) the party has not diligently attempted in a reasonable manner to comply.[145] "In the context of civil contempt, the clear and convincing standard requires a quantum of proof adequate to demonstrate reasonable certainty that a violation occurred."[146] A bankruptcy court might authorize a sanction under its inherent powers, even if the sanction is not authorized by its contempt powers.[147]

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[141] *See In re Plumeri*, 434 B.R. at 328 (citing United States v. Seltzer, 227 F.3d 36, 41 (2d Cir. 2000)) (explaining inherent powers of court); *In re* Chase, 372 B.R. 142, 156–57 (Bankr. S.D.N.Y. 2007) (noting federal courts have inherent power to control conduct of attorneys and sanctioning attorney who stopped representing client during trial, without being relieved as counsel by court order).

[142] *See In re Plumeri*, 434 B.R. at 328 (explaining sanctions must be imposed with restraint); *In re Parsley*, 384 B.R. at 182 (discussing restraint requirement); *In re* Schuessler, 386 B.R. 458, 492 (Bankr. S.D.N.Y. 2008) (holding for restraint requirement).

[143]
> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

11 U.S.C. § 105(a); *see also* Solow v. Kalikow (*In re* Kalikow), 602 F.3d 82, 96–97 (2d Cir. 2010) (holding section 105(a) "is the power to exercise equity in carrying out the *provisions* of the Bankruptcy Code, rather than to further the purposes of the Code generally, or otherwise to do the right thing"); *In re Schuessler*, 386 B.R. at 492 (citing Casse v. Key Bank Nat'l Ass'n (*In re* Casse), 198 F.3d 327 (2d Cir. 1999)) (explaining authority of bankruptcy court).

[144] *See* Price v. Lehtinen (*In re* Lehtinen), 564 F.3d 1052, 1059 (9th Cir. 2009) (noting bankruptcy courts may exact penalties "to coerce compliance"); Badgely v. Santacore, 800 F.2d 33, 36 (2d Cir. 1986) (explaining objectives of civil contempt); *In re* Chief Exec. Officers Clubs, Inc., 359 B.R. 527, 534 (Bankr. S.D.N.Y. 2007) (discussing objectives of civil contempt).

[145] *See* King v. Allied Vision, Ltd., 65 F.3d 1051, 1058 (2d Cir. 1995) (setting forth requirements); *In re Chief Exec. Officers Clubs, Inc.*, 359 B.R. at 535 (explaining rule).

[146] *In re Chief Exec. Officers Clubs, Inc.*, 359 B.R. at 535.

[147] *See, e.g., In re* Deville, 280 B.R. 483, 495–96 (B.A.P. 9th Cir. 2002) (holding bankruptcy court properly imposed sanctions and awarded attorney fees); *In re* Ngan Gung Rest., Inc., 195 B.R. 593, 596–99 (S.D.N.Y. 1996) (questioning power of bankruptcy court to issue sanctions for criminal contempt); *In re*

In addition to their powers to sanction and hold parties in contempt, bankruptcy courts may discipline parties under the authority of Bankruptcy Rule 9011, which requires attorneys to certify the legal and factual basis of the papers they file, and to certify that the papers are not being filed for an improper purpose.[148] An attorney must conduct a reasonable inquiry into the validity of any document filed with the court, and whether the inquiry was reasonable is objectively judged by factors such as the facts of the case, the reasonableness of the legal paper, and the circumstances of the filing.[149]

Further, the bankruptcy court may sanction a party if it does not participate in a settlement conference in good faith. Federal Rule of Civil Procedure 16 authorizes the court to require parties to a lawsuit to appear for settlement conferences.[150] Rule 16 applies in adversary proceedings, and the bankruptcy court may order it to apply in any contested matter.[151] Where the court has ordered the parties to attend a settlement conference and a party does not participate in good faith, the court may sanction that party.[152] Courts acting under Rule 16 typically order the offending party to pay the other's fees and costs, including attorney fees, and the court can order a more severe sanction where the circumstances of the case require.[153]

Faust, 270 B.R. 310, 315 (Bankr. M.D. Ga. 1998) (explaining bankruptcy court may issue sanctions under statutory powers when parties willfully frustrate judicial process).

[148] FED. R. BANKR. P. 9011 (requiring signature of attorney representing party to certify veracity of filing).

[149] *See, e.g.*, *In re* Ryan, 411 B.R. 609, 618–19 (Bankr. N.D. Ill. 2009) (refusing to impose sanctions pursuant to FED. R. BANKR. P. 9011 because plaintiff's attorney made reasonable inquiry into applicable law and relevant facts before filing complaint); *In re* Garcia, 260 B.R. 622, 632, 637–38 (Bankr. D. Conn. 2001) (ordering hearing for plaintiff's attorneys to show why they should not be sanctioned when complaint they signed was amended and pursued for clearly improper purposes); *In re* Reid, 92 B.R. 21, 25 (Bankr. D. Conn. 1988) (evaluating facts and circumstances to impose sanctions on attorney who signed motion to modify plan completely unsupported by current statutory and case law).

[150] FED. R. CIV. P. 16(a) ("In any action, the court may order the attorney and any unrepresented parties to appear for one or more pretrial conferences for such purposes as . . . facilitating settlement.").

[151] *See* FED. R. BANKR. P. 7016 (incorporating FED. R. CIV. P. 16); FED. R. BANKR. P. 9014(c) ("The court may at any stage in a particular matter direct that one or more of the other rules in Part VII [such as Bankruptcy Rule 7016] shall apply."); *accord In re* Chase, 372 B.R. 142, 153 (Bankr. S.D.N.Y. 2007) (recognizing court's power to sanction creditor for failure to appear on orally agreed upon second day of trial but imposed sanctions on other grounds).

[152] *See* FED. R. CIV. P. 16(f) (authorizing court to impose sanctions if party fails to comply with order of court to appear at pretrial conference); *In re* Kowalske, No. 08-14774, 2009 WL 1299551, at *1 (E.D. Mich. May 1, 2009) (imposing sanctions on debtor's attorney, where debtor failed to appear without good cause at court ordered settlement conference).

[153] *See, e.g.*, *In re* The 1031 Tax Group, No 07-11448, 2010 WL 2851300, at *6 (Bankr. S.D.N.Y. July 16, 2010) (determining for extreme sanctions under Rule 16(f), courts consider "(a) willfulness or bad faith of the noncompliant party; (b) the history . . . of noncompliance; (c) the effectiveness of lesser sanctions; (d) whether the noncompliant party had been warned about the possibility of sanctions; (e) the client's complicity; and (f) prejudice to the moving party" (quoting Am. Cash Card Corp. v. AT&T Corp., 184 F.R.D. 521, 524 (S.D.N.Y. 1999))); *see also* Ehrenhaus v. Reynolds, 965 F.2d 916, 920–21 (10th Cir. 1992) (observing decision of correct sanction to be imposed is fact specific inquiry); Ho v. Target Constr. of N.Y., Corp., No. 08-CV-4750, 2010 WL 2292202, at *3 (E.D.N.Y. June 3, 2010) (warning courts that, while harsh sanctions, such as motion to dismiss or precluding parties from offering evidence, are available under FED. R. CIV. P. 16(f)(1), those sanctions should only be used in extreme situations).

F. Settlement

Settlement has long played a vital role in bankruptcy. For example, in a chapter 11 case, the plan may provide for the settlement or adjustment of any claim or interest belonging to the debtor or to the estate.[154] Chapter 13 debtors might negotiate the claims of uniquely situated creditors, such as people holding claims for fraud.[155] Parties frequently stipulate to the value of an asset or the amount of a claim to be paid in a plan.[156]

The court may approve settlements in chapter 13 cases pursuant to Bankruptcy Rule 9019.[157] In chapter 13 cases, the debtor has the rights of the trustee with regard to the use, sale and lease of property outside the ordinary course of business.[158] The

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[154] *See* 11 U.S.C. § 1123(b)(3) (2006) ("Subject to subsection (a) of this section, a plan may provide for the settlement or adjustment of any claim or interest belonging to the debtor or to the estate . . . ."); *see also In re* G-I Holdings Inc, 420 B.R. 216, 256–57 (D.N.J. 2009) (confirming chapter 11 plan including settlement agreement in asbestos litigation because settlement was fair and equitable result of negotiations); *In re* Texaco, 84 B.R. 893, 901 (Bankr. S.D.N.Y. 1988) (explaining power of bankruptcy courts to approve compromises or settlements of debtor's or estate's claims as part of reorganization plan or during course of bankruptcy proceeding). For example, in *In re McClelland*, the debtor and his former business partners agreed to divide the value of some real estate that they owned together. Stipulation of Settlement at 11–14, *In re* McClelland, No. 03-37997 (Bankr. S.D.N.Y. June 18, 2004) (detailing how jointly owned property will be sold and value distributed to parties). The debtor had filed for bankruptcy after years of litigation with his former business partners. *Id.* at 1–6. The business partners alleged that the debtor defrauded them of about $1.3 million, and defrauded their businesses of another $6 million. *Id.* at 5. With the help of the bankruptcy court, the parties agreed that they would appraise the value of the property and businesses they owned together, and divide the value among them, satisfying the claims for fraud and putting an end to years of litigation. *Id.* at 10.

[155] For example, in *In re Garcia*, the debtor and his former business partner settled the partner's claim for fraud, even though no court had yet determined whether the debtor had defrauded the partner. Stipulation and Order of Settlement at 2–3, *In re* Garcia, No. 08-37536, Adv. P. No. 09-09011 (Bankr. S.D.N.Y. Nov. 16, 2010), ECF No. 19. The former business partner had filed a lawsuit in the bankruptcy case to prevent the discharge of his claim, alleging that the debtor defrauded him of more than $300,000. *Id.* at 1–2. Ultimately, the parties settled the matter, with the debtor agreeing to pay the business partner $50,000. *Id.* at 2–3.

[156] For example, in *In re Lindsay*, the chapter 7 trustee and the debtor stipulated to the value of debtor's house and the amount of money the debtor would have to pay the trustee. Order Determining Value at 2, *In re* Lindsay, No. 06-36352, Adv. P. No. 08-09091 (Bankr. S.D.N.Y. Sept. 27, 2010), ECF No. 62; Order Authorizing Settlement, *In re* Lindsay, No. 06-36352, Adv. P. No. 08-09091 (Bankr. S.D.N.Y. Jan. 4, 2011), ECF No. 68 (granting Motion to Approve, ECF No. 64). The court had found that the debtor fraudulently transferred his home and other assets to his wife before filing for bankruptcy. *In re* Lindsay, No. 06-36352 (CGM), Adv. P. No. 08-09091, 2010 WL 1780065 (Bankr. S.D.N.Y. May 4, 2010). The debtor was required to turn over the transferred assets to the trustee. *See id.* The trustee entered an agreement with the debtor setting the value of the house at $517,000, and they settled the payment for the house at $490,000. *See* Order Determining Value, *In re* Lindsay, No. 06-36352, Adv. P. No. 08-09091 (Bankr. S.D.N.Y. Sept. 27, 2010), ECF No. 62.

[157] "On motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement. Notice shall be given to creditors, the United States trustee, the debtor, and indenture trustees as provided in Rule 2002 and to any other entity as the court may direct." FED. R. BANKR. P. 9019(a). Twenty-one-days' notice should be given of the hearing to approve a compromise, and that notice should be sent to the debtor, the trustee, and all creditors. FED R. BANKR. P. 2002(a)(3).

[158] *See* 11 U.S.C. §§ 363(b), 1303; *see also In re* Fatsis, 405 B.R. 1, 8 (B.A.P. 1st Cir. 2009) ("[A] chapter 13 debtor has the exclusive right to use, sell or lease property, *other* than in the ordinary course of business

chapter 13 debtor has standing to bring lawsuits, because legal claims that arose before the bankruptcy case are considered property of the estate.[159] For example, the chapter 13 debtor might seek approval of a loan modification as a use of property of the estate, or as a settlement regarding the use of property of the estate.

A chapter 7 debtor might negotiate a loan modification in deciding whether to reaffirm a debt secured by the home.[160] Chapter 7 debtors may reaffirm debts that are secured by property of the estate.[161] Reaffirmation agreements ideally represent a fully voluntary, negotiated deal accepted by both the debtor and the creditor.[162] The debtor might want to remain personally liable for the debt and take the opportunity to negotiate new terms to the agreement.[163]

Parties who are entitled to full payment of their claims will frequently settle for a lesser payment in full satisfaction of the debt.[164] Even when the creditor's rights

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with leave of the court."); *In re* Belyea, 253 B.R. 312, 314 (Bankr. D.N.H. 1999) (discussing how section 1303 "grants Chapter 13 debtors certain trustee powers").

[159] *See In re* McConnell, 390 B.R. 170, 176–77 (Bankr. W.D. Pa. 2008) (noting pre-petition causes of action are property of estate, chapter 13 debtor has rights of trustee to use property of estate, and only way to "use" as cause of action is to bring suit upon it or settle it); *see also* Maritime Elec. Co., Inc. v. United Jersey Bank, 959 F.2d 1194, 1209 n.2 (3d Cir. 1991) ("Chapter 13 debtors are empowered to maintain suit even after a bankruptcy trustee has been appointed in their case: an essential feature of a chapter 13 case is that the debtor retains possession of and may use all the property of the estate, including his prepetition causes of action, pending confirmation of his plan."); *In re* Tippins, 221 B.R. 11, 16 (Bankr. N.D. Ala. 1998) ("When a debtor files a chapter 13 petition, an estate is created and 'all legal or equitable interests of the debtor in property' become property of the estate . . . The scope of § 541 is broad and includes as property of the estate causes of action which accrue to the debtor pre-petition.").

[160] See 11 U.S.C. § 105(a) (explaining court's equitable power) exercised in conjunction with *id.* §§ 521(a)(2) (discussing debtor's intent to retain secured property) and 524(f) (providing debtor may voluntarily repay debt). *See, e.g.*, *In re* Hart, 402 B.R. 78, 86–87 (Bankr. D. Del. 2009) (discussing "reduced interest rate[s] or an adjustment to the term of the loan" as potential loan modifications when deciding whether to reaffirm debt secured by home); *see also In re* Lopez, 440 B.R. 447, 448 (Bankr. E.D. Va. 2010) (noting reduction of interest rate as potential concession made in deciding whether to reaffirm debt secured by home).

[161] *See In re Lopez*, 440 B.R. at 448 ("The credit union made no concession in the reaffirmation agreement such as reducing the interest rate. There is no benefit to the debtor to reaffirming this debt."); *In re Hart*, 402 B.R. at 86 (discussing when court may disapprove agreement); *see also In re* Coleman, No. 10-10171, 2010 WL 5067429, at *2–3 (Bankr. D.S.D. Dec. 7, 2010) (disapproving reaffirmation agreement regarding debtor's home loan).

[162] *See* Jamo v. Katahdin Fed. Credit Union (*In re* Jamo), 283 F.3d 392, 397–98 (1st Cir. 2002) (concluding "that section 524(c) envisions reaffirmation agreements as the product of fully voluntary negotiations by all parties"); *see also* Whitehouse v. LaRoche, 277 F.3d 568, 575 (1st Cir. 2002) (noting "entirely voluntary, fully informed reaffirmation agreement meeting requirements of Bankruptcy Code § 524 enables creditor to undertake lawful efforts to recover reaffirmed debt as though no petition in bankruptcy had been filed . . ."); *In re* Ripple, 242 B.R. 60, 63–64 (Bankr. M.D. Fla. 1999) (discussing requirements for valid reaffirmation agreement).

[163] *See* 11 U.S.C. § 524(c) (allowing debtor to reaffirm debt and enter new loan agreement with creditor); *see also* Capital Commc'ns Fed. Credit Union v. Boodrow (*In re* Boodrow), 126 F.3d 43, 49 (2d Cir. 1997) (noting parties can negotiate new terms in reaffirmation agreements); *In re* Porter, 399 B.R. 113, 116 (Bankr. D.N.H. 2008) (stating wide latitude to renegotiate terms in reaffirmation agreement).

[164] *See, e.g.*, *In re* Eiler, 390 B.R. 920, 926 (Bankr. E.D. Wis. 2008) (examining bank's attempts to collect more than agreed during reaffirmation of security interest in home); *In re* Shop N'Go P'ship, 261 B.R. 810, 817 (Bankr. M.D. Pa. 2001) (holding IRS did not have to disgorge payment debtor made pursuant to

are clearly defined in a contract or legal judgment, it might accept a lesser payment in a bankruptcy case. The reasons that might prompt a party to settle vary, and might include the uncertainty of litigation and the uncertainty of collection.[165] Settlements achieved in the bankruptcy court remain subject to the jurisdiction of the bankruptcy court, and the orders approving them can be enforced with the court's power to hold a party in contempt.[166] The administration of the settlement will take place under the supervision of the bankruptcy court, and the settlement might be funded with property of the estate.[167] If a high-priority creditor accepts a lesser amount and causes the bankruptcy to be a success, then the creditor does not have to compete with lower-priority creditors for the limited resources of the debtor as it would outside of bankruptcy.[168] Creditors might also prefer settlement over litigation of the amount, nature, and repayment of the debt.

G. Conclusion

Bankruptcy is fundamentally concerned with reorganizing the debtor's entire financial persona and putting the debtor on the path towards a fresh start. The bankruptcy court has broad power over the property of the estate, regardless of whether someone else has an interest in the property that is superior to the debtor's. The automatic stay provides a "breathing spell" that benefits the creditors as much as it does the debtor, because it stops all actions to collect a debt, including situations in which the debtor does not have enough resources to satisfy all debts. The Bankruptcy Code establishes a scheme of priorities, in which creditors are grouped according to the nature of their claims—secured, administrative, priority,

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settlement agreement and prior to conversion to chapter 7); Joann Henderson, *The Gaglia-Lowry Brief: A Quantum Leap from Strip Down to Chapter 7*, 8 BANKR. DEV. J. 131, 161 (1991) (stating creditors can renegotiate new terms).

[165] *See, e.g.*, Henderson, *supra* note 164, at 141 (explaining restorations allow debtor to retain home without paying bank discharged debt).

[166] *See* 11 U.S.C. 105(a) ("The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."); *see also In re* Clark, 91 B.R. 324, 334 (Bankr. E.D. Pa. 1988) ("We therefore conclude that § 105(a), as amended, provides statutory authority for us to punish actions which are contemptuous of our orders."), *supplemented*, 96 B.R. 569 (Bankr. E.D. Pa. 1989); *In re* Haddad, 68 B.R. 944, 953 (Bankr. D. Mass. 1987) ("The existence of civil contempt powers in bankruptcy courts is also consistent with their other unquestioned powers. Bankruptcy courts have inherent power to enforce settlement agreements between parties.").

[167] *See* FED. R. BANKR. P. 9019 ("On motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement."); *In re* High Tech Packaging, Inc., 397 B.R. 369, 371 (Bankr. N.D. Ohio 2008) (determining "whether the compromise of a claim held by the estate directly involves the administration of estate property" requires agreement to be "both fair and equitable, and in the best interest of the estate"). *But see In re* Mavrode, 205 B.R. 716, 719 (Bankr. D.N.J. 1997) (agreeing to settlement paid with non-estate funds in lieu of litigation surrounding incorrect petition of assets).

[168] *In re* SPM Mfg. Corp., 984 F.2d 1305, 1308 (1st Cir. 1993) (explaining agreement with secured creditor to maximize debtor's assets provided return to general unsecured creditors, and successful plan); *In re* TSIC, Inc., 393 B.R. 71, 76 (Bankr. D. Del. 2008) (examining decision of *In re SPM Manufacturing Corp.* to permit secured creditor's agreement).

and general unsecured. The system of priorities eases competition among creditors, because assets of the estate are distributed to the creditors according to their priority, each superior class being paid in full before the next receives payment. Instead of an uncoordinated scramble to the courthouse to enforce judgments of varying priority against limited resources, bankruptcy establishes uniform rules for reorganization that maximize the value of property to pay claims in a predictable manner.

II. THE HOUSING CRISIS—THE FRUSTRATION OF THE COURTS MANIFESTED IN JUDICIAL DECISIONS REGARDING THE CONDUCT AND ORGANIZATION OF CREDITORS

> *In the Court's own experience, the prospect of dealing with a mortgage lender or mortgage servicer over a delinquency, or anything else other than the ordinary payment plan, clearly inspires feelings of dread, mystery and frustration in the average borrower. If the present case is at all representative, those feelings are substantially justified.*[169]

A. The Servicing Industry

In her article *Misbehavior and Mistake in Bankruptcy Mortgage Claims*,[170] Professor Katherine Porter describes how secured creditors commonly include inaccurate, unnecessary and illegal charges in their proofs of claim, and discusses the debtors' struggles—and, oftentimes, their inability—to challenge these claims.

She conducted a broad survey of proofs of claim filed in chapter 13 cases in nonjudicial foreclosure states, and found that a substantial amount of claims were not supported with required documentation and that itemizations of charges were unclear.[171]

Professor Porter succinctly describes the relationships among owners of the home loan, servicers and borrowers:

> Mortgage servicing is the collection of payments from borrowers and the disbursement of those payments to the appropriate parties, such as lenders, investors, taxing authorities, and insurers. The rise of servicing as a distinct industry resulted

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[169] *In re* Hill, 437 B.R. 503, 548 (Bankr. W.D. Pa. 2010) (sanctioning creditor and counsel for misrepresenting debtor had knowledge of default after learning payment-change notices had not been mailed).

[170] Katherine Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*, 87 TEX. L. REV. 121 (2008) (noting mortgages fail to comply with bankruptcy law).

[171] *See id.* at 151 (showing collected data to prove most mortgage proofs of claim lacked pieces of documentation).

> from the widespread use of securitization in the mortgage market. Put simply, securitization is the process of creating debt instruments (usually bonds) by pooling mortgage loans, transferring those obligations to a trust, and then selling to investors fractional interests in the trust's pool of mortgages. . . . Servicers act as intermediaries between the borrower and the other parties to the securitization. A pooling and servicing agreement sets out the servicer's responsibilities for collecting and remitting the mortgage payments. The participation of servicers complicates the borrower-lender relationship and limits flexibility in loss mitigation and default situations.
>
> *Mortgage servicers do not have a customer relationship with homeowners; they work for the investors who own the mortgage-backed securities.*[172]

The foregoing description of the relationships among borrowers, servicers and owners of the home loans is crucial to understanding the need for the Loss Mitigation Program, because the layers of parties complicate communication regarding the home loan and impair compliance with the basic requirements of bankruptcy law.[173] As stated in Part I, the court has broad jurisdiction over property of the estate, and property of the estate includes the debtor's house even when the debtor is in default on the home loan. For most individual debtors, their home is their most significant asset and the object of their bankruptcy reorganization. Bankruptcy provides several tools for reorganizing debt associated with the home—the benefit of the stay, the ability to remove judicial liens and second mortgages, and the three- to five-year plan period in which to repay mortgage arrears.[174]

In recent years, when debtors filed for bankruptcy, it was discovered that they were frequently at the mercy of a creditor with whom they did not have a customer relationship—the servicer—, who could be unresponsive to the debtors' and the courts' demands for information and compliance with bankruptcy law.[175] The true, actual owners of the loan—the individual investors—appeared to be

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[172] *Id.* at 126 (emphasis added).

[173] See discussions *supra*, Parts I.A, E, of *In re* Schuessler, 386 B.R. 458, 485 (Bankr. S.D.N.Y. 2008) (discussing unfounded lift-stay motion based on creditor policies), *In re* Parsley, 384 B.R. 138, 155 (Bankr. S.D. Tex. 2008) (noting impermissible restriction on attorney communication with servicer), and *In re* Crawford, 388 B.R. 506, 523 (Bankr. S.D.N.Y. 2008) (involving illegal post-petition foreclosure sale).

[174] *See* 11 U.S.C. § 362(a) (2006) (providing automatic stay for petitioner upon bankruptcy petition); *id.* § 506(d) (classifying "lien secur[ing] a claim against the debtor that is not an allowed secured claim" as void); *id.* § 522(f)(1) (permitting debtor to avoid judicial lien on homestead properties); *id.* § 1325(b)(1)–(4) (requiring court's approved plan for repayment to be less than three or five years); Oliver B. Pollak & David G. Hicks, *"Please, Sir, I Want Some More," – Loopholes, Austerity and the Cost of Living – Nebraska Exemption Policy Revisited*, 73 NEB. L. REV. 298, 312 (1994) (stating most valuable asset of majority of debtors is their home).

[175] *See supra* Part I.A.

unascertainable. The authority of the servicer allegedly was set out in a document to which the debtor was not a party—the pooling and servicing agreement—causing confusion as to how the servicer could perform its contractual obligations to the entity that hired it without violating bankruptcy law. Quite often, the servicer files the proof of claim on behalf of the owner or investor, and the proof of claim might not have necessary supporting documentation.[176] Meanwhile, servicer "policies" led to unfounded motions for relief from the stay and other bankruptcy violations.[177] The courts found themselves conducting hearings in the dark, because the relationships among the parties—and their obligations to each other—appeared to be a mystery.

In *In re Wilborn*, the appellate court struggled with how debtors of limited means could economically challenge the charges listed in the lenders' proofs of claim.[178] A group of debtors formed a class, challenging fees that appeared to be allowed by the loan documents, and actually were incurred post-petition and not specifically approved by the bankruptcy court.[179] These fees might have been charged in violation of the bankruptcy laws that require court approval of post-petition fees and charges. The Fifth Circuit held that there can be class action lawsuits in bankruptcy, but found that the claims of the individual debtors did not warrant class adjudication.[180] There was too much variation among the circumstance of each debtor's relationship with the secured creditor, and too much variation in the events of the individual bankruptcy cases.[181]

> The circumstances surrounding the charging of fees require an individual assessment of the claims. . . . The bankruptcy court cannot require Wells Fargo to simply disgorge all fees that were not previously approved because it is evident that there has been a wide 'array of charges tailored' to each individual debtor.[182]

While not specifically concerned with loan servicing, *Wilborn* pinpoints the ongoing challenge debtors face when trying to litigate a claim with their servicers—

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[176] *See* FED. R. BANKR. P. 3001(b) (permitting creditor's authorized agent to execute proof of claim); *In re* Stewart, Nos. 08-3225, 08-3669, 08-3852, 08-3853, 08-4805, 2009 WL 2448054, at *12 (E.D. La. Aug. 7, 2009) (upholding bankruptcy court's order to audit and amend claims); Porter, *supra* note 170, at 160 (describing situation where servicer can overcharge debtor by failing to provide adequate information, thereby preventing debtors and trustee from reviewing claim).

[177] *See, e.g., In re* Payne, 387 B.R. 614, 633 (Bankr. D. Kan. 2008) (ruling mortgage company's bankruptcy policies regarding timing of analysis erroneously sabotaged debtor's bankruptcy plan); *In re Schuessler*, 386 B.R. at 485 (explaining motion for relief from stay is pursuant to its policy); *In re* Hampton, 319 B.R. 163, 172 (Bankr. E.D. Ark. 2005) (ruling servicer's policy requiring debtor to obtain code to start vehicle violated automatic stay).

[178] Wilborn v. Wells Fargo Bank, N.A. (*In re* Wilborn), 609 F.3d 748, 750–51 (5th Cir. 2010).

[179] *Id.*

[180] *Id.* at 754, 756.

[181] *Id.* at 756.

[182] *Id.*

how to fund an expensive and protracted legal struggle over a disputed claim. Individually, the charges can be small, a few hundred dollars here, a thousand there, sometimes less than $100. In the aggregate, the improper claims might create a substantial windfall to the mortgage servicers.[183] Every dollar that goes to a high-priority creditor is one dollar less that will be paid to the junior creditors, and the unsupported claims might add up to enough to burden the debtor with an unmanageable plan payment, which might lead to debtor's default and the dismissal of the bankruptcy case.[184]

B. Early Decisions Documenting the Judges' Frustrations With Creditors

Debtors have long sought the protection of chapter 13 bankruptcy to take advantage of the three- to five-year plan period to cure defaults on their home loans.[185] In recent years, an increasing number of debtors complained to the bankruptcy courts about difficulty in contacting their secured creditors, from inquiring about a possible loan modification to forcing compliance with a bankruptcy discharge. The debtors and their lawyers told the courts of repeated phone calls that went unreturned, foreclosure sales conducted while the debtors were under the protection of the stay, and bloated and incomprehensible claims filed by lenders and loan servicers. When the courts investigated the debtors' cases, they discovered a complex structure of investors and servicers that was unresponsive to the debtors and their counsel. Whether the debtor was trying to discuss a loan modification, obtain an escrow analysis to justify a proof of claim, or force compliance with the discharge, the creditors' system of servicers, attorneys,

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[183] *See* Porter, *supra* note 170, at 166 ("Mortgage creditors in the sample requested nearly $6 million more on proofs of claim than the debtors reflected on their schedules."); *see also* Mann v. Chase Manhattan Mortg. Corp., 316 F.3d 1, 2–3 (1st Cir. 2003) (discussing debtors challenging fees charged by mortgage company and listed on proofs of claim); Gretchen Morgenson, *Panel to Look at Foreclosure Practices*, N.Y. TIMES, Apr. 29, 2008, at C3 (discussing concerns regarding fees and other practices by mortgage companies in bankruptcy).

[184] *See* 11 U.S.C. § 1307(c)(6) (2006) (specifying court may dismiss chapter 13 case for cause for material default of term specified by plan); *see also In re* Grant, 428 B.R. 504, 507 (Bankr. N.D. Ill. 2010) (dismissing chapter 13 case where after sixty months debtor had not met payment obligations specified under plan); David Gray Carlson, *Modified Plans of Reorganization and the Basic Chapter 13 Bargain*, 83 AM. BANKR. L.J. 585, 639 (2009) (noting court may dismiss chapter 13 case because of missed payments). "Every penny that goes to pay a creditor's allowed claim necessarily diminishes the pool of funds available to pay other creditors while, at the same time, reducing the probability that the Chapter 13 debtor will be able to propose, and make payments on, a feasible plan of reorganization." *In re* Stewart, Nos. 08-3225, 08-3669, 08-3852, 08-3853, 08-4804, 2009 WL 2448054, at *11 (E.D. La. Aug. 7, 2009) (quoting *In re* DePugh, 409 B.R. 125, 136 (Bankr. S.D. Tex. 2009)).

[185] *See* 11 U.S.C. § 1322(b)(5) (debtor's plan may "provide for the curing of any default within a reasonable time and maintenance of payments . . . on any unsecured claim or secured claim . . ."); *see also In re* Harris, 312 B.R. 591, 597 (N.D. Miss. 2004) (noting congressional intent behind section 1322(b)(5) to allow chapter 13 debtors to cure arrearages on home loans by making regular payments to trustee); *In re* Kapp, 315 B.R. 87, 88 (Bankr. W.D. Mo. 2004) (stating debtors' confirmed chapter 13 plan included payment for pre-petition arrearage on home mortgage).

and other agents proved impenetrable and unresponsive. No matter the question the debtor needed to be answered, the consequence of failure was always the same—foreclosure.

The following body of caselaw emerged, in which the courts tried to force compliance with basic bankruptcy rules and ethics. Underlying these decisions are hundreds of complaints from debtors about creditors that sought to enforce often unjustified claims against the debtors' most cherished asset, their homes. As court after court ruled on the practices of the mortgage servicing industry, it became apparent that something proactive needed to be done to resolve the total breakdown in communication between debtors and their secured creditors.

1. *In re* Nosek—A Study in the Paradox of Mortgage Servicers in Bankruptcy Cases

Ms. Nosek, a Massachusetts debtor, filed three bankruptcies in two years in an effort to stave off the foreclosure of her home.[186] About a year into her third case, she tried to refinance her mortgage.[187] It was then that she learned that Ameriquest, which she thought was the owner of her home loan, had been putting her post-petition mortgage payments in a "suspense account," a kind of "collection bucket" used by servicers to hold payments that are not enough to satisfy a monthly payment.[188] This treatment of the payments made it look like Ms. Nosek had been in default for more than a year, when she really was current with the home loan.

Seven years and six *Nosek* opinions later, the bankruptcy community is without a clear standard to govern servicer practices with respect to borrowers in bankruptcy.[189] The *Nosek* saga illustrates the difficulties experienced by the bankruptcy courts in forcing mortgage servicers to comply with bankruptcy law. The practices of the mortgage servicing industry were proven to have devastating effects on debtors, yet the appellate court in *Nosek* ultimately found that the misconduct did not rise to the level of bad faith required to support an award of sanctions.[190] The paradox of *Nosek* is this: How to reform creditor practices that disrupt debtors' bankruptcy cases, when those practices do not conform to the

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[186] Ameriquest Mortg. Co. v. Nosek (*In re* Nosek), 544 F.3d 34, 38 (1st Cir. 2008) (explaining homeowner's first two chapter 13 bankruptcy petitions filed in 2001 were dismissed and third petition filed in 2002 resulted in parties entering into stipulation covered post-petition arrearages and continuing post-petition payments as they came due), *vacating* 363 B.R. 643 (Bankr. D. Mass. 2007).

[187] *Id.* at 39.

[188] *Id.*

[189] *See, e.g.*, *id.* at 49–50 (requiring chapter 13 plan to define application of payments if failure to apply payments is basis of sanction); *In re* Schuessler, 386 B.R. 458, 490–91, 493 (Bankr. S.D.N.Y. 2008) (approving of bankruptcy court's holding in *Nosek* and sanctioning servicer under 11 U.S.C. § 105(a) for abuse of process); *see also* 11 U.S.C. § 105(a) (2006) (authorizing bankruptcy courts' power to take whatever action is appropriate or necessary); Porter, *supra* note 170, at 151 (reporting proof-of-claim process, mechanism for fixing amount of debtor's obligation, differs among districts).

[190] *See In re Nosek*, 544 F.3d at 49 (sympathizing with debtor trying to prevent foreclosure of her home, but also recognizing remedy invoked must be proportional to harm caused by creditor).

requirements of bankruptcy law but do not rise to the level of bad faith required for sanctions?

In the first *Nosek* decision, the bankruptcy court for the District of Massachusetts sanctioned the servicer $250,000 for mishandling the debtor's post-petition payments, finding the mismanagement of the loan violated Massachusetts state law.[191] The bankruptcy court found that Ameriquest's treatment of the post-petition payments breached the implied covenant of good faith and fair dealing that parties to a contract owe to each other.[192] The court found that Ameriquest had breached this covenant with Ms. Nosek by its inability or unwillingness to account for and properly distinguish between pre- and post-petition payments, as well as its inability to promptly credit Ms. Nosek's account from the suspense account.[193] The court considered the evidence of the extreme depression Ms. Nosek suffered when she found out about the treatment of the payments, and awarded her damages for emotional distress in the amount of $250,000.[194]

On appeal, the district court held that the bankruptcy court needed to find a basis for the damages in Bankruptcy Code section 105(a), because the Bankruptcy Code, a comprehensive federal law, preempts state-law claims such as breach of the implied covenant of good faith and fair dealing.[195] The district court sent the matter back to the bankruptcy court for further consideration, and the bankruptcy court sanctioned Ameriquest $250,000, this time as actual damages that included emotional distress damages.[196] The bankruptcy court assessed a second award of damages under section 105(a), punitive damages in the amount of $500,000.[197] The district court affirmed the second decision of the bankruptcy court.[198]

Ameriquest appealed again, this time going up to the appellate court for the First Circuit.[199] The First Circuit reversed the awards of actual (emotional distress) damages and punitive damages, finding that although the bankruptcy court's concerns were legitimate, it had exceeded its authority in assessing such a harsh

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[191] *In re* Nosek, Case No. 02-46025-JBR, Adv. No. 04-4517, 2006 WL 1867096, at *10–11, 16 (Bankr. D. Mass. June 30, 2006) (observing every contract contains implied covenant of good faith), *vacated*, 544 F.3d 34 (1st Cir. 2008).

[192] *Id.* at *11 ("When asked by [Nosek] and . . . ordered by the Court to provide a detailed accounting, [Ameriquest] dragged its feet.").

[193] *Id.* (indicating mortgage company's record of Nosek's payments was "little more than a list of numbers showing no credit for payments made" and this was "opposite good faith behavior").

[194] *Id.* at *15–16 (finding treatment of payments "egregious" and they contributed to plaintiff's emotional distress).

[195] *In re Nosek*, 354 B.R. 331, 338 (D. Mass. 2006).

[196] *In re* Nosek, 363 B.R. 643, 648 (Bankr. D. Mass. 2007) (noting power provided to courts under section 105 to sanction party and award monetary relief for actual and punitive damages).

[197] *See id.* at 649 (finding Ameriquest's actions warranted punitive damages because its accounting practices were "wholly unacceptable for a national mortgage lender").

[198] *See* Ameriquest Mortg. Co. v. Nosek (*In re* Nosek), 544 F.3d 34, 42 (1st Cir. 2008).

[199] *See id.* at 42 (noting Ameriquest's appeal of district court decision that bankruptcy court exceeded terms of mandate awarded judgment without basis for doing so, and awarded emotional distress and punitive damages in contravention of section 105(a)).

penalty.[200] The appellate court held that section 1322(b) does not impose any specific duties on a lender; rather, the section only lists the elements that a debtor may incorporate into a chapter 13 plan.[201] The appellate court examined Ms. Nosek's confirmed plan and found that it did not provide the level of specificity regarding the payments to warrant damages pursuant to section 105(a).[202] The court further found that Ms. Nosek did not establish that her cure rights were violated or at risk of being violated.[203] The court held that amending the plan to specifically describe how mortgage payments should be applied would have been a more appropriate remedy.[204] The appellate court concluded its opinion, stating, "[I]t is troubling that Ameriquest had not established a more efficient and accurate way of handling the accounting issues revealed by this case at the time of trial. We fully understand the bankruptcy court's concerns about the practices that it described."[205]

Meanwhile, the bankruptcy court found out that, all along, Ameriquest was not the holder of Ms. Nosek's loan and mortgage, even though Ameriquest had taken legal actions in Ms. Nosek's bankruptcy case and defended the emotional distress lawsuit.[206] Rather, Ameriquest had assigned the mortgage to a company called Norwest in 1997, right after making the home loan to Ms. Nosek, and acted as a servicer of the loan on behalf of Norwest.[207] It is important to know who actually holds the note and mortgage, because it might be determinative of standing to file a proof of claim and receive payment in the bankruptcy, and to seek relief from the automatic stay.[208] It was only learned that Ameriquest was not really the holder of the note and mortgage after Ms. Nosek started a second lawsuit to collect her emotional distress damages, despite Ameriquest having filed the proof of claim, moved for relief from the stay, and defended Ms. Nosek's lawsuit over the payment history.[209]

The bankruptcy court issued a third set of sanctions, this time against Ameriquest, the holder of the mortgage, and the attorneys who represented

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[200] *See id.* at 49–50 (stating Nosek failed to demonstrate Ameriquest's practices caused her economic harm).

[201] *See id.* at 47 (explaining court must look to Nosek's plan to determine whether plan's terms were violated).

[202] *See id.*

[203] *See id.* at 48 (finding Nosek's evidence insufficient).

[204] *Id.* ("[T]he proper response of the bankruptcy court would have been an amendment to the Plan specifying the accounting practices necessary to eliminate that threat.").

[205] *Id.* at 49.

[206] *In re* Nosek, 386 B.R. 374, 377–78 (Bankr. D. Mass. 2008) (describing Ameriquest's legal representations despite assignment of note and mortgage to Norwest).

[207] *Id.* at 378 (stating Ameriquest assigned note and mortgage to Norwest).

[208] *See, e.g.*, *In re* Ebersole, 440 B.R. 690, 694 (Bankr. W.D. Va. 2010) (holding holder of note must establish standing to seek relief from stay); *In re* Mims, 438 B.R. 52, 57 (Bankr. S.D.N.Y. 2010) (finding movant failed to establish standing to pursue state law remedies); *In re* Tour Train P'ship, 15 B.R. 401, 402 (Bankr. D. Vt. 1981) (stating "real party in interest" has "right sought to be enforced or the legal right to bring the suit").

[209] *In re Nosek*, 386 B.R. at 377.

Ameriquest, in a total amount of $650,000.[210] The bankruptcy court punished the creditors and the law firm because they had violated Bankruptcy Rule 9011(b),[211] having wrongly represented to the court that Ameriquest was the holder of the note and mortgage, when in fact Ameriquest was just the servicer.[212] The bankruptcy court stated, "It is the *creditor's* responsibility to keep a borrower and the Court informed as to who owns the note and mortgage and is servicing the loan, not the borrower's or the Court's responsibility to ferret out the truth."[213]

Ameriquest appealed again, and the First Circuit reduced the penalty to $5000, finding the larger amount to be unreasonable under the circumstances—the debtor had amended her complaint to include Norwest as a defendant and the omission did not appear to have been deliberate or intended to mislead the court.[214] Stating the background for Rule 9011 sanctions, the appellate court noted, "Bankruptcy courts have a legitimate interest in policing the filings submitted, and sanctions can sometimes serve a useful function in this endeavor. Steep sanctions might be appropriate were a lender shown to have routinely misrepresented its role in bankruptcy cases, caused unnecessary litigation, or prejudiced another party."[215]

The *Nosek* saga epitomizes the frustration felt by bankruptcy courts across the country as they grappled with the inefficiencies and perplexing legal practices of the mortgage servicing industry and its lawyers. The First Circuit's first *Nosek* decision might be read to mean that a debtor must anticipate how the servicer will act during the bankruptcy case; such a requirement could make bankruptcy unworkable for the debtor because the pooling and servicing agreement defines the servicer's powers and controls its policies and practices, and obtaining this document might be difficult for the debtor. Most debtors are not able to plan for every unexpected event in their cases, such as finding an opportunity to refinance or modify their home loans. Meanwhile, the bankruptcy courts confronted servicer activities that caused a flood of Bankruptcy Code violations, meritless motions for relief from the stay, and violations of attorney ethics. The courts struggled with how to address these issues because the creditors' practices often fell just short of the threshold of bad behavior that they are allowed to punish. More often than not, the problems stemmed not from outright bad faith, but from apathy toward the requirements of

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[210] *Id.* at 385–86 (sanctioning Ameriquest ($250,000), Wells Fargo, apparently the successor to Norwest, ($250,000), and Ameriquest's counsel (the Ablitt firm, $25,000; Ablitt partner Robert Charlton, $25,000; the Buchalter firm, $100,000)).

[211] FED. R. BANKR. P. 9011(b)(3) (providing representations of fact made to court are deemed to have evidentiary support).

[212] *In re Nosek*, 386 B.R. at 383 (finding Ameriquest made repeated misrepresentations and ordering sanctions).

[213] *Id.* at 382 ("It is the *Creditor's* responsibility to keep a borrower and the Court informed as to who owns the note and mortgage and is servicing the loan, not the borrower's or the Court's responsibility to ferret out the truth.").

[214] *See* Ameriquest Mortg. Co. v. Nosek (*In re* Nosek), 609 F.3d 6, 9 (1st Cir. 2010) ("[N]othing indicates that Ameriquest's claim that it was the holder of the mortgage was a deliberate falsehood or intended in any way to mislead the court or Nosek or achieve anything for Ameriquest.").

[215] *Id.*

bankruptcy law, the complexity of the securitized mortgage market, and miscommunication among debtor, creditor, and counsel.

It was clear that the servicers' conduct with respect to bankrupt borrowers could not be allowed to continue if bankruptcy was to have any relevance and benefit for debtors and their creditors. As the bankruptcy courts digested *Nosek* and its fallout, they began to approach the debtors' problems with mortgage servicing as bankruptcy problems that needed bankruptcy answers. The bankruptcy courts relied on their inherent and equitable powers to sanction parties, and looked to special bankruptcy rules that authorized them to assess penalties for violations of the stay and misrepresentations to the court.[216]

For example, in *In re Parsley*, a Texas bankruptcy court investigated a motion for relief from the stay after the servicer's lawyer tried to withdraw it, and found out that the servicer's attorneys were impermissibly restricted from communicating with the servicer regarding the facts and legal viability of the motion.[217] The court uncovered a complicated relationship between the servicer and its lawyers that offended long-standing bankruptcy law and attorney ethics: the servicer (Countrywide) hired national counsel (McCalla Raymer).[218] National counsel hired local counsel (Barrett Burke) to actually draft the papers and instructed local counsel to never contact the servicer because "[Countrywide] doesn't want to have 50 firms calling it on every case that it handles in the country."[219] The local firm considered its client to be the national law firm, even though the legal work was done for the benefit of the servicer and local counsel indicated on the papers that they were the attorney for the servicer.[220]

Upon learning that the national counsel did not monitor whether debtors made post-petition payments, the court pinpointed the legal and ethical violations underlying the hyper-structured relationships among the servicer and the law firms:

> Given that [local counsel] must communicate only with [national counsel], and that [national counsel] is not required to monitor post-petition payments made by debtors, this Court is at a loss to understand how [local counsel] can possibly comply with Bankruptcy Rule 9011 before filing a motion to lift [the] stay. This

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[216] *See In re Nosek*, 386 B.R. at 382–83 (finding sanctionable conduct under Rule 9011 and noting burden to clarify roles of parties is on lenders and servicers).

[217] *See In re* Parsley, 384 B.R. 138, 156 (Bankr. S.D. Tex. 2008) (stressing system in which local counsel had no direct communication with servicer on whose behalf motion was filed could not possibly comply with Rule 9011 when local counsel could only communicate with national counsel, which was not required to monitor debtors' post-petition payments).

[218] *See id.*

[219] *Id.* at 150 (noting Countrywide hired national counsel McCalla Raymer for purpose of dealing with only one firm).

[220] *See id.* (acknowledging associate attorneys from both Barrett Burke and McCalla Raymer testified Barrett Burke's client was McCalla Raymer).

> arrangement truly creates a situation where the blind [national counsel] is leading the blind [local counsel].[221]

The arrangement offended the court because a debtor's failure to make post-petition payments is the paramount reason to grant a mortgagee relief from the stay. In *Parsley*, the local law firm, which filed the motion, could not contact its true client, Countrywide, to verify that post-petition payments had indeed been missed.[222] Local counsel had contracted itself into a situation in which it was filing—and thereby certifying the accuracy of—legal papers of which it could not verify the factual basis, other than by secondhand representations filtered through national counsel.[223] Given that debtors often do not have the means to defend a lift-stay motion, an illegal lift-stay motion can unjustly destroy the bankruptcy case and sentence the debtor to a wrongful foreclosure.

The court characterized the entire process of compiling and filing the lift-stay motion as an "assembly line" production in which numerous errors passed several attorneys and paralegals, which would never have been caught had the court not become involved.[224] The court described the pervasiveness of errors in lift-stay motions and other representations to the bankruptcy courts, conducting a broad survey of penalties assessed against law firms and noting, "[T]here are published opinions from New Jersey, South Carolina, and Louisiana evidencing substantial and material errors in motions to lift stay filed by law firms representing mortgagees in consumer bankruptcies in several states."[225]

Ultimately, the *Parsley* court refrained from sanctioning Countrywide and the law firms, emphasizing that the parties had taken corrective measures and noting that an attorney who lied to the court had been fired.[226] The court condemned the law firms' culture of inhibiting communications with the client and of filing legal papers without verification from the client.[227] The court concluded by advising the

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[221] *Id.* at 156.

[222] *See id.* (noting "McCalla Raymer's policy prohibiting local counsel such as Barrett Burke from communicating directly with Countrywide" despite fact that "McCalla Raymer is not required to monitor post-petition payments made by debtors").

[223] *See id.* (concluding arrangement made it impossible for local counsel to ensure accuracy of facts alleged within lift-stay motion in compliance with Rule 9011).

[224] *Id.* at 162–63 ("Tracing the steps leading up to the filing of the Motion shows that this is an assembly line process. There are attorneys involved throughout this process that should be catching these errors. However, the attorneys, do not dedicate sufficient time and care to ensure adequate quality control. Eventually, despite being passed through the hands of several paralegals and attorneys, the Court receives an erroneous motion that should never have been filed.").

[225] *Id.* at 177.

[226] *Id.* at 182–83 (acknowledging measures taken by local counsel Barrett Burke to prevent potential future conflicts).

[227] *Id.* at 184 (questioning conduct of law firms' evidencing decreasing standards of practice and lack of preparedness and candor).

law firms that it would continue watching them, to ensure that it had not misplaced its trust that they could mend their broken practices.[228]

In *In re Schuessler*, a New York bankruptcy court examined a motion for relief from the stay and discovered that it was based on the loan servicer's inexcusable failure to accept and account for the debtors' mortgage payments after they filed for bankruptcy.[229] The court sanctioned the servicer for misrepresenting that cause existed for relief from the stay; indeed, the policies of the servicer appeared largely responsible for manufacturing the purported default on which the lift-stay motion was based.[230] The servicer of the debtors' home loan moved for relief from the stay, based upon an alleged default of two months' post-petition payments.[231] The court learned that the servicer had instructed the bank branch to refuse to accept the payments the debtors tried to make at the bank branch, solely on account of the debtors' having commenced a bankruptcy case.[232] The court found that the servicer and its attorneys misrepresented the extent of the debtors' default and the alleged lack of equity in the home, both of which are determinative of whether cause exists for relief from the stay.[233]

Throughout the proceedings, the court struggled to make sense of a convoluted system of creditors and agents: the debtors' original lender was JP Morgan Chase Bank; the loan servicer was Chase Home Finance, LLC, which also might have been the owner of the loan (this was never proved); Citibank was referenced on motion papers as "trustee" and in testimony as an "investor," and might have been the owner of, and hirer of Chase Home Finance to act as a servicer of, the home loan.[234] When Chase Home Finance perceived that the debtors were in default, an "analyst" in the bankruptcy department contacted a "vendor," which sent the debtors' file to a regional law firm, which compiled a lift-stay motion and sent it to the analyst's "supervisor" for verification.[235] The regional law firm appeared by local counsel at hearings in the bankruptcy court.[236]

> When a secured creditor requests relief from the automatic stay, the Court must be able to trust that the motion is based upon a realistic and conscious assessment by the creditor, before the motion is

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[228] *Id.* at 184–85 (directing reform and warning of continued court oversight).

[229] *In re* Schuessler, 386 B.R. 458, 464 (Bankr. S.D.N.Y. 2008) (describing loan servicer's efforts to prevent receipt of post-petition payments from debtors in order to force lift-stay proceedings and ultimately foreclosure).

[230] *Id.* at 493.

[231] *Id.* at 484–85 (emphasizing proof established debtors made or attempted to make post-petition payments).

[232] *Id.* at 462 (noting "the Bank Branch refused to accept payments *on the instructions of the Mortgage Servicer*, solely because the Debtors filed for bankruptcy").

[233] *Id.* at 486–94 (discussing abuses of process by loan servicer and its attorneys).

[234] *Id.* at 476–78 (analyzing ownership of note and mortgage).

[235] *Id.* at 470–71.

[236] *Id.* at 466.

> filed, that the creditor really does lack adequate protection under the facts in that particular case.[237]

The court found that Chase's established policy to move for relief from the stay upon two missed payments was inconsistent with the analysis for cause required by the Bankruptcy Code: "Chase Home Finance's established policies ignore the definition of adequate protection in Section 361 and reads 'cause' in Section 362(d)(1) to mean 'two months behind in payments,' with no regard to any other factors that may be present in a particular case."[238] Further, when the creditors' "policies" have the effect of manufacturing the default, the court will not find that cause exists to lift the stay.[239]

The court held that both the system used by Chase Home Finance to deal with bankruptcy debtors and the lift-stay motion itself constituted abuses of process.[240] The court noted that otherwise proper contractual rights might be exercised in such a way as to violate the automatic stay, and that the servicer's practices disrupted the debtors' ability to make payments.[241]

The court denied the lift-stay motion, concluding that the servicer had filed an unwarranted motion for relief from the stay, having failed to consider all the relevant facts regarding whether cause existed for relief.[242] As a consequence of the servicer's "overly simplistic and myopic system," the court required Chase Home Finance to pay the debtors' attorneys fees and costs associated with the lift-stay motion and barred it from recovering its own legal fees from the debtors, pursuant to section 105(a) and Bankruptcy Rule 9011.[243]

In *In re Crawford*, the *Schuessler* court sanctioned a creditor and its agents for conducting an illegal foreclosure sale of the debtor's house after she filed for bankruptcy.[244] Relying on its power to issue penalties for violating the stay, the court awarded $10,000 against the creditor for each of the six layers of creditor agents and subagents that contributed to the post-petition foreclosure sale of the debtor's home, a shocking and egregious violation of the automatic stay.[245] The court unraveled a mind-boggling array of creditors and agents: the owner of the loan (HSBC), the servicer of the loan (Ocwen), the three agents hired to attend the

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[237] *Id.* at 478–79.

[238] *Id.* at 481.

[239] *See id.* ("Chase Home Finance's 'established policies' are not a substitute for the duty to make a *prima facie* showing of 'cause' for relief from stay and 'lack of adequate protection' as those terms are used in the Bankruptcy Code.").

[240] *Id.* at 484 (stressing lack of purpose behind lift-stay motion).

[241] *Id.* at 489–90.

[242] *Id.* at 492–93 ("Had Chase Home Finance begun by considering all of the facts surrounding the Debtors' loan and payment history, it would have never filed the Lift-Stay Motion.").

[243] *Id.* at 493.

[244] *In re* Crawford, 388 B.R. 506, 509–10 (Bankr. S.D.N.Y. 2008) (finding willful violation of automatic stay and assessing punitive damages).

[245] *Id.* at 527–28 (ordering $60,000 in punitive damages to discourage future stay violations).

foreclosure sale and bid on the home (including Mr. Didonato, employed by Nationwide Court Service, which was hired by FIS Agency Sales & Posting), and the creditors' law firm (Shapiro & DiCaro).[246] The court summarized its frustration with the case:

> With a chain of communication and instruction at least six layers deep, it is not surprising that a stay violation occurred somewhere along the line. The fact that HSBC prefers to operate in a manner that resembles a Rube Goldberg apparatus is not an excuse when a stay violation occurs.[247]

The court analogized the system of agents to the "colossus" of the Internal Revenue Service, and noted the rule that "[t]he inability of a bureaucracy to react in a timely manner to a bankruptcy filing by providing actual notice to its collection agents is not an excuse for violating the automatic stay."[248] The court struck all foreclosure costs and fees from HSBC's proof of claim, because it could not be determined whether they were incurred in connection with the illegal sale.[249] The court awarded punitive damages against HSBC in the amount of $60,000, noting, "The size and complexity of HSBC's system of agents, subagents and servicing agents is relevant to the amount of sanctions that will be necessary as a deterrent to their conduct in the future."[250]

C. The Judges' Continuing Frustration

The creation of the Loss Mitigation Program has helped hundreds of New York debtors get final decisions regarding their home loans, but in New York and across the nation, the bankruptcy courts continue to grapple with the breakdown of communication that underlay the legal matters addressed in *Nosek*, *Parsley*, *Schuessler* and *Crawford*. Bankruptcy courts regularly hand down orders and opinions sanctioning creditors and their counsel for practices that undermine bankruptcy law and illegally jeopardize debtors' homes and families. It is clear that the need for the Loss Mitigation Program has not passed, because the

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[246] *See id.* at 526 n.7.

[247] *Id.* at 526 (internal citations omitted).

[248] *Id.* at 520 (citing *In re* Santa Rosa Truck Stop, Inc., 74 B.R. 641, 643 (Bankr. N.D. Fla. 1987)).

[249] *Id.* at 524 (explaining lack of dates in HSBC's proof of claim prevented determination of whether charges were related to foreclosure sale). The ruling regarding the proof of claim was ordered without prejudice to HSBC's filing of an amended proof of claim with proper documentation and evidence of the date and purpose for the charges. *See id.* at 528 (striking certain costs and fees from HSBC's proof of claim).

[250] *Id.* at 527. The court assessed an award of punitive damages against Didonato, with the amount to be determined at a subsequent hearing. *Id.* at 528 (concluding amount of punitive damages could not be determined without evidence of Didonato's ability to pay). At the time of this writing, these damages were unresolved.

miscommunication and attendant misconduct continue to swamp the courts and devastate debtors today.

A judge of the Southern District of New York Bankruptcy Court sanctioned a creditor's law firm for its repeated failure to verify information and provide necessary documentation. In the case of Sonja Kahian, a law firm, Fein Such & Crane ("FSC"), filed two proofs of claim, a letter and a lift-stay motion, all of which described different—and inaccurate—amounts of arrears owed to the creditor.[251] The court entered a stipulation between the United States Trustee and FSC, in which FSC agreed to take certain efforts to verify the factual bases of the papers that it filed on behalf of its clients, usually loan servicers and mortgagees.[252] FSC agreed not to file a pleading unless the allegations have or likely have evidentiary support, and agreed to make reasonable inquiry into the priority of claims and to obtain a certification from the client regarding the amounts allegedly due from the debtor.[253]

Subsequently, in the case of Pamela Miano, a second judge of the Southern District of New York Bankruptcy Court learned that FSC had once again filed papers with incorrect or unverified information, this time moving for relief from the stay while the debtor was current, putting her home at risk of foreclosure without cause.[254] The matter was eventually resolved with a settlement in favor of the debtor, and the *Kahian* stipulation was amended with a codicil that allowed any party-in-interest to raise its terms, and any judge in the Southern District of New York to enforce its terms.[255]

After the hearings in *Kahian* and *Miano* concluded, the court learned that FSC once again had filed papers with incorrect or unverified information, this time a proof of claim with a disputed claim for property taxes in the case of Brian Abele.[256] After a lengthy hearing, the court determined that FSC could not explain how the amount of the tax claim had been determined. The court found that FSC had violated the terms of the *Kahian* stipulation, which was an order of the court,

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[251] Stipulation and Order at 1–4, *In re* Kahian, No. 07-22574 (Bankr. S.D.N.Y. Feb. 23, 2009), ECF No. 56 (noting United States Trustee's and FSC's stipulation to errors on numerous documents regarding amount of arrears due to creditor).

[252] *See id.* at 3–7 (acknowledging FSC's agreement to designate expert review of documents prior to filing with court).

[253] *See id.* at 4 (stating conditions for filing of pleadings).

[254] Order Directing (1) Everhome, (2) HSBC Bank USA, National Association, and (3) Fein, Such, & Crane, LLP to Appear and Show Cause Why They Should Not Be Sanctioned Pursuant to Rule 9011 of the Federal Rules of Bankruptcy Procedure at 1–3, *In re* Miano, No. 08-35452 (Bankr. S.D.N.Y. Mar. 30, 2009), ECF No. 38 (recognizing falsity of FSC's allegations regarding debtor's arrearage and finding filing of list-stay motion to be in violation of provisions of *Kahian* stipulation with United States Trustee).

[255] Codicil to February 23, 2009 Stipulation and Order at 1, *In re* Miano, No. 08-35452 (Bankr. S.D.N.Y. June 24, 2009), ECF No. 50 (supplementing *Kahian* Stipulation and Order).

[256] *See* Application in Support of an Order Pursuant to 11 U.S.C. § 502 and Federal Rule of Bankruptcy Procedure 3007 Disallowing and/or Modifying Claim of One West Bank. F.S.B. at 1–2, *In re* Abele, No. 09-38118 (Bankr. S.D.N.Y. June 15, 2010), ECF No. 11 (moving for modification of unverified portions of claim).

and sanctioned the law firm $10,000.[257] FSC promptly paid the penalty and did not appeal the sanction order.

In *In re Hill*, a Pennsylvania bankruptcy court sanctioned Countrywide and its regional law firm for making material misrepresentations to the court by proffering three back-dated payment-change notices, which purported to show that the debtor had been instructed to change the amounts of her payments when in fact no such notices were issued on the stated dates.[258] The court sanctioned Countrywide pursuant to Bankruptcy Rule 9011(c) for filing a motion in which it falsely stated that the difficulty came from failures by the debtor and chapter 13 trustee after receiving "proper" notices regarding the payment changes.[259] Having established that Countrywide and counsel knew at that point in the litigation that the payment-change notices had not been properly sent, the court sanctioned Countrywide in the form of public censure; a monetary penalty was not issued.[260] The court declined to sanction the creditor's law firm for violating the discharge, but found that the firm either intentionally or recklessly failed to advise debtor's counsel that the payment-change notices were fabricated, and that one of Countrywide's attorneys intentionally or recklessly made misstatements to the court at a hearing and a general counsel intentionally or recklessly made misstatements during a deposition.[261]

The court concluded its opinion by describing a chilling alternative ending, which almost certainly would have been the debtor's fate if her attorneys had not noticed a discrepancy in the payment-change notices:

> At some point the Debtor would have had to seriously consider, and most likely accept because of the mounting expenses her fight against Goliath was causing her to incur, capitulation. Soon, a practical, business decision most likely would require her to forego "principle" and settle the matter in an amount she could afford so as to make the obligation current, post-bankruptcy, and make the problem go away. Fortunately for her, that bridge never had to be

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[257] *See* Order Imposing Sanctions Upon Fein, Such & Crane, LLP For Violations of Southern District of New York Orders and Pursuant to Federal Rule of Bankruptcy Procedure 9011 at 2–3, *In re* Abele, No. 09-38118 (Bankr. S.D.N.Y. Sept. 15, 2010), ECF No. 17 (finding violations of *Kahian* and *Miano* orders and imposing $10,000 in sanctions).

[258] *See In re* Hill, 437 B.R. 503, 515, 549 (Bankr. W.D. Pa. 2010) (describing creation of payment change letters and ordering sanctions against Countrywide).

[259] *Id.* at 530–31.

[260] *Id.* at 549 ("[A] sufficient sanction so as to deter repetition of such conduct in the future or comparable conduct by others similarly situated[] is a 'public censure' of Countrywide and a reminder of its obligations under *Fed.R.Bankr.P. 9011(b)(3)* to make reasonable investigation before making factual allegations in documents filed with the Bankruptcy Court, or any other court for that matter.").

[261] *Id.* at 541. The court set a further hearing to determine the appropriate sanctions for the law firm, individual lawyer, and general counsel; at the time of this writing, the matter was unresolved. *Id.* at 549.

> crossed. But how many other, similarly situated debtors will be so fortunate?[262]

D. Conclusion

In recent years, bankruptcy courts around the country struggled to make sense of a system of creditors that spawned a crisis of miscommunication, which has the potential to devastate homeowners and undermine confidence in bankruptcy law. In *Schuessler*, the court confronted a situation in which the secured creditor pursued foreclosure of a property with substantial equity, all based on an inconsequential or imaginary default. The *Kahian* saga shows the continuing threat of wrongful foreclosure to debtors. Creditors' counsel face an ongoing struggle to verify the information provided by their clients and represent their interests in an onerously structured attorney-client relationship that stifles communication and encourages rote litigation, with limited regard for the actual circumstances of each debtor.

Although the debtor in *Hill* sought to enforce her discharge, her experience in trying to resolve the dispute with her mortgagee is painfully similar to the experience of debtors who want to get a loan modification. Debtors trying to save their home might face inflated claims, unwarranted lift-stay motions, and contested plan confirmations, all of which might be brought on by a single missed payment.[263] The bewildering practices of secured creditors and their counsel can result in an expensive, time-consuming, and maddening experience for debtors, with no progress made toward the correction of even the simplest errors, such as applying a payment or performing an escrow analysis. These practices can ruin homeowners, yet might fall just short of warranting a Rule 9011 sanction or finding of contempt. Bankruptcy judges faced the conundrum of reforming creditor practices that were clearly incompatible with bankruptcy law and that seemed to elude punishment on a case-by-case basis.

Several courts indicated that punitive damages could be assessed if the bad conduct was systematic or part of an overall pattern.[264] However, the Fifth Circuit found that a group of debtors could not form a class to challenge certain fees in their

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[262] *Id.* at 548.

[263] *See, e.g., id.* at 523 (remarking Countrywide admitted its failure to apply single monthly payment had "'cascading effect' that was largely responsible for the post-discharge miseries experienced by the Debtor"); *In re* Schuessler, 386 B.R. 458, 470 (Bankr. S.D.N.Y. 2008) (acknowledging mortgage servicer commenced unwarranted foreclosure due to "arrears" resulting from its own handling of case, rather than from actual default of debtor); *In re* Martinez, 281 B.R. 883, 884, 889 (Bankr. W.D. Tex. 2002) (denying mortgagee's motion for relief from stay when debtor's alleged failure to make two post-petition payments resulted from mortgagee's loss of checks).

[264] *See, e.g., In re* Cabrera-Mejia, 402 B.R. 335, 347–48 (Bankr. C.D. Cal. 2008) (sanctioning firm $21,000 because firm's conduct amounted to "a knowing and systematic disregard of the court's requirements committed in bad faith"); *In re Schuessler*, 386 B.R. at 493 (requiring creditor to pay costs and attorney fees incurred while debtor challenged motion to lift stay, thus remedying abuse of process and making debtor whole); *In re* Wiggins, 273 B.R. 839, 881 (Bankr. D. Idaho 2001) (internal citation omitted) (recognizing courts "may . . . award punitive damages . . . in cases of repeated or flagrant violations").

proofs of claim because of the variation among their cases.[265] If the debtors are restricted in their ability to file class action lawsuits to economically address these matters, the courts' ability to assess significant penalties and affect real change would be limited. If sanctions under section 105(a) and Bankruptcy Rule 9011 must be limited to only the most egregious cases on a debtor-by-debtor basis, reform of creditor practices would be inconsistent, expensive, and slow, because only a few debtors will be able to afford the litigation, and the facts of their cases might not support severe punishment. How then to address the problem?

The answer may lie in the Loss Mitigation Program. Most debtors do not want to go to war with the mortgage servicing industry; they only want to prevent their homes from being lost to foreclosure. The Loss Mitigation Program offers several benefits that may smooth over the legal problems experienced by the parties in a bankruptcy case that was filed to save the home. For example, the Loss Mitigation Order ("Order") is entered after notice and an opportunity for a hearing, and sets clear deadlines for the loss mitigation process.[266] These features of the Order provide ample due process to everyone involved, and establish the court's jurisdiction—and its powers of enforcement—over the loss mitigation process. After the Loss Mitigation Order is entered, the parties are required to appoint representatives with authority to modify the home loan,[267] which may resolve the question of creditor standing that plagued the court in *Nosek*. The Loss Mitigation Order cuts through the confusing creditor structure criticized by the court in *Schuessler* and *Crawford*; furthermore, the Order puts the burden of locating the right creditor on the claimants and their lawyers,[268] who are more suited to this task than the debtors. Protracted claims objections, lift-stay motions and plan confirmations may be prevented before they infect the bankruptcy case and divert time and money from other creditors.[269]

The Loss Mitigation Program arose out of the ongoing need for loan servicers and other secured creditors to conform their practices to comply with the requirements of bankruptcy law, creditors' counsel's difficulty in verifying information from their clients, and debtors' difficulty in communicating with their creditors regarding litigation surrounding their home loans and the possibility for a

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[265] *See* Wilborn v. Wells Fargo Bank, N.A. (*In re* Wilborn), 609 F.3d 748, 756–57 (5th Cir. 2010) (holding varying circumstances among bankruptcy cases, such as "whether and how fees and costs were imposed," requires each case to be examined individually).

[266] *See* Loss Mitigation Program Procedures at 3 (Bankr. S.D.N.Y. 2010), *available at* http://www.nysb.uscourts.gov/pdf/lossmit/RevisedLossMitigationProcedures.pdf (providing for Loss Mitigation Order only if parties "have had notice and an opportunity to object").

[267] *See id.* at 6 ("Each Loss Mitigation Party must have a person with full settlement authority present during a loss mitigation session.").

[268] *See id.* at 3 ("[A] party objecting to loss mitigation must present specific reasons why it believes that loss mitigation would not be successful.").

[269] *See id.* at 4 ("Except where necessary to prevent irreparable injury, loss or damage, a Creditor shall not file a Lift-Stay Motion during the Loss Mitigation Period. Any Lift-Stay Motion filed by the Creditor prior to the entry of the Loss Mitigation Order shall be adjourned to a date after the last day of the Loss Mitigation Period, and the stay shall be extended pursuant to Section 362(e) of the Bankruptcy Code.").

consensual resolution. It is clear that the practices and miscommunication that led to the creation of the Loss Mitigation Program continue today. The Loss Mitigation Program was developed to open the lines of communication between creditors and debtors, so that loan modifications can be discussed, and that questions regarding payments and charges may be resolved.[270]

III. THE LEGAL BASIS FOR THE LOSS MITIGATION PROGRAM

> *Courts have (at least in the absence of legislation to the contrary) inherent power to provide themselves with appropriate instruments required for the performance of their duties. . . . From the commencement of our government it has been exercised by the federal courts, when sitting in equity, by appointing, either with or without the consent of the parties, special masters, auditors, examiners, and commissioners*.[271]

A. Historical Authority for Alternative Dispute Resolution

Federal courts have a long tradition of using mandatory judicial mechanisms designed to promote efficiency and conserve resources. In *Capital Traction Company v. Hof*, the Supreme Court examined the Seventh Amendment and allowed a justice of the peace to conduct a trial where the local procedures allowed for a party to receive a jury trial after an appeal.[272] *Hof* stands for the proposition that the courts may impose restrictions on litigation to conserve resources and promote efficiency.[273] Similarly, in *Ex parte Peterson*, the Court approved the use of a court-ordered auditor to review the facts and evidence and prepare a report "simplifying" the information for the jury.[274] The Court found that the auditor's report would not constitute a final finding of fact, and, at most, would be *prima facie* evidence that could be attacked by either side before the jury.[275] In appointing the auditor, the district court exercised its inherent power to take actions required to perform its duties, and it did not matter whether the court sat in equity or at law.[276]

Today, federal courts manage their dockets by employing various administrative devices such as scheduling orders and mandatory mediation

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[270] *See id.* at 1 ("The Loss Mitigation Program is designed to function as a forum for debtors and lenders to reach consensual resolution whenever a debtor's residential property is at risk of foreclosure.").

[271] *Ex parte* Peterson, 253 U.S. 300, 312–13 (1920).

[272] 174 U.S. 1, 45 (1899).

[273] *See* Irving R. Kaufman, *Reform For a System in Crisis: Alternative Dispute Resolution in the Federal Courts*, 59 FORDHAM L. REV. 1, 26–27 (1990) (noting Supreme Court's grant of discretion to Congress to provide litigation alternatives "to prevent unnecessary delay and unreasonable expense" (quoting *Hof*, 174 U.S. at 44–45)).

[274] *See Ex Parte Peterson*, 253 U.S. at 304, 314 (finding such order to be "within the power of the court").

[275] *See id.* at 310–11.

[276] *See id.* at 314 (concluding district court held power to appoint auditor and prescribe auditor's duties).

programs. In *Atlantic Pipe Corporation*, the First Circuit found that district courts may order unwilling parties to participate in mandatory, nonbinding mediation as an appropriate exercise of their inherent power to manage and control their calendars.[277] The court cited *Peterson* for the rule that courts can appoint non-judicial personnel to assist them in their judicial duties, and noted that in nonbinding mediation, the mediator does not decide the merits of the case or coerce settlement.[278] The court concluded that ordering parties to mediation as an exercise of their inherent power "is justified by the important goal of promoting flexibility and creative problem-solving in the handling of complex litigation."[279]

B. Legal Bases for Court-Annexed Mediation Programs in Bankruptcy

As noted in *Atlantic Pipe*, federal courts have inherent power to control their calendars. The court should exercise this inherent power in a manner that: 1) is "reasonably suited to the enhancement of the court's processes, including the orderly and expeditious disposition" of cases; 2) does not contradict an applicable rule or statute; 3) "comport[s] with procedural fairness;" and 4) shows "restraint and discretion."[280] In *Atlantic Pipe*, the appellate court vacated the mediation order only because it did not contain restrictions on the duration and costs of the mediation.[281] The court expressly stated that the district court could re-order mediation; presumably, the mediation order would simply be amended with a date on which the mediation would take place.[282]

Bankruptcy courts have broad authority to manage their dockets, inherently and by the grant of power set out in Bankruptcy Code sections 105(a) and 105(d).[283] Section 105(a) authorizes the bankruptcy court to take any act to carry out its duties under the Bankruptcy Code; this power allows the court to control its docket.[284] Section 105(d) allows the court to hold status conferences "to further the

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[277] *In re* Atl. Pipe Corp., 304 F.3d 135, 143 (1st Cir. 2002) (citing Heileman Brewing Co. v. Joseph Oat Corp., 871 F.2d 648, 650 (7th Cir. 1989) (en banc)) (describing inherent power of district courts to manage their calendars).

[278] *See id.* at 146 (citing *Ex Parte Peterson*, 253 U.S. at 312) (disagreeing with proposition that appointment of private mediator is "per se improper").

[279] *Id.* at 148.

[280] *Id.* at 143 (internal citations omitted) (describing limiting principles).

[281] *Id.* at 147 ("Even when generically appropriate, a mediation order must contain procedural and substantive safeguards to ensure fairness to all parties involved.").

[282] *See id.* at 148 (permitting district court to re-order mediation).

[283] *See* 11 U.S.C. § 105(a) (2006) ("The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."); *id.* § 105(d) (authorizing status conferences and detailing bankruptcy courts' managerial powers); *In re* First Magnus Fin. Corp., 403 B.R. 659, 663 (D. Ariz. 2009) (emphasizing bankruptcy courts' inherent power to exercise wide discretion in controlling their dockets); White Family Cos. v. Dayton Title Agency Inc., 284 B.R. 238, 247 (S.D. Ohio 2002) (acknowledging bankruptcy courts' broad discretion in matters of docket control).

[284] *See In re* Stewart, Nos. 08-3225, 08-3669, 08-3852, 08-3853, 08-4805, 2009 WL 2448054, at *11–12 (E.D. La. Aug. 7, 2009) (noting section 105(a) authorizes bankruptcy courts to manage their dockets).

expeditious and economical resolution of a case."[285] For example, orders scheduling initial case management conferences are standing features of chapter 11 cases filed in the Southern District of New York.[286]

In re Stewart[287] provides an excellent example of the court's power to proactively regulate its docket under the power of section 105. In *Stewart*, the bankruptcy court required Wells Fargo to audit every proof of claim filed since April 2007 to ensure that supporting documentation was provided.[288] The appellate court affirmed, finding that the order to audit and amend was well within the power of the bankruptcy court to protect and manage its docket.[289] The court noted that section 105(d) was passed so that cases would be resolved expeditiously and economically, which could not happen if it fell on the bankruptcy court to examine every proof of claim to uncover systematic errors by Wells Fargo.[290] The appellate court rejected the creditor's argument that the preemptive audit offended the Constitution's requirement that an actual case or controversy exist before judicial action may be taken, finding that the bankruptcy court simply provided the creditor an earlier opportunity to amend defective claims.[291]

Court-annexed mediation programs in bankruptcy cases may be authorized by Federal Rule of Civil Procedure 16, which allows the bankruptcy court to direct the parties to attend settlement conferences in contested matters and adversary proceedings.[292] If the parties do not attend the settlement conference in good faith, then they may be punished.[293] Bankruptcy Rule 9029 allows bankruptcy courts to make rules in accordance with acts of Congress, such as the Alternative Dispute

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[285] 11 U.S.C. § 105(d)(1).

[286] *See* S.D.N.Y. LOCAL BANKR. R. 1007-2(e) (authorizing submission of initial case conference orders in chapter 11 cases, pursuant to 11 U.S.C. § 105(d)).

[287] 391 B.R. 327 (Bankr. E.D. La. 2008).

[288] *Id.* at 357.

[289] *See In re Stewart*, 2009 WL 2448054, at *12 ("The Bankruptcy Court's order to audit and amend is therefore well within its authority, inherent and under section 105, to protect and manage its docket.").

[290] *Id.* (reasoning goal of expeditious and economical resolution of bankruptcy cases cannot be accomplished "by requiring the Bankruptcy Court to individually sift through each proof of claim to uncover systematic errors").

[291] *See id.* at *7, *9 (rejecting argument that bankruptcy court's order violates U.S. Constitution's "requirement of a case or controversy by determining 'outcomes of disputes before they even exist'" and finding order "simply provided an earlier opportunity for Wells Fargo to supplement or amend where necessary").

[292] *See* FED. R. BANKR. P. 9014 (providing procedures for parties in contested matters and authorizing application of FED. R. BANKR. P. 7016, which incorporates FED. R. CIV. P. 16 regarding pretrial settlement conferences).

[293] *See* FED. R. CIV. P. 16(f)(1) (authorizing court to impose sanctions on parties for failure to appear or participate in good faith at pretrial conferences); *see also* Bulkmatic Transp. Co. v. Pappas, No. 99-Civ-12070, 2002 WL 975625, at *2 (S.D.N.Y. May 9, 2002) ("Although a court cannot force litigants to settle an action, it is well established that a court can require parties to appear for a settlement conference, and impose sanctions pursuant to Rule 16(f) if a party fails to do so."); Dan River, Inc. v. Crown Crafts, Inc., No. 98-Civ-3178, 1999 WL 287327, at *2 (S.D.N.Y. May 7, 1999) (stating court is authorized by FED. R. CIV. P. 16(f) to impose sanctions on party or its counsel for failure to obey scheduling orders).

Resolution Act of 1998, which was passed to promote the use of alternative dispute resolution programs.[294]

The Southern District of New York Bankruptcy Court adopted a court-annexed mandatory mediation program in 1993.[295] The court may order a matter to mediation on its own motion, or motion by any party in interest or the United States Trustee.[296] An order is entered to control the mediation process, and the mediator is required to file a report with the court indicating whether the parties complied with the requirements of the mediation program.[297] The mediation order will clarify that the costs shall be shared by the parties, provide the date by which they must select a mediator, require the parties to provide the mediator with the information the mediator requests, and provide timeframes for the mediator to advise the court if further sessions are needed and to file the final report.[298] The mediation order expressly incorporates the guidelines of the Mediation Program.[299]

C. The Legality of the Loss Mitigation Program

The Loss Mitigation Program adopted by the Southern District of New York and other districts is authorized by the inherent power of the bankruptcy court to manage its calendar and the conduct of the parties, as well as the power set forth in sections 105(a) and 105(d) exercised in conjunction with Bankruptcy Code sections 362, 363, 521, and 1322.[300] The program is also authorized by Bankruptcy Rules 3015, 4008, 9014, and 9019.[301]

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[294] *See* FED. R. BANKR. P. 9029(a)(1) ("Each district court acting by a majority of its district judges may make and amend rules governing practice and procedure in all cases and proceedings within the district court's bankruptcy jurisdiction which are consistent with – but not duplicative of – Acts of Congress and these rules and which do not prohibit or limit the use of the Official Forms."); *see also* 28 U.S.C. §§ 651–658 (2006) (authorizing district courts to develop dispute resolution procedures through local rules and prescribing guidelines with which those procedures must comply); *In re* Atl. Pipe Corp., 304 F.3d 135, 141 (1st Cir. 2002) (describing purposes and provisions of Alternate Dispute Resolution Act of 1998).

[295] *See* S.D.N.Y. LOCAL BANKR. R. 9019-1 (stating dispute resolution in Southern District of New York shall be governed by standing order, currently General Order M-390); General Order M-390 (Bankr. S.D.N.Y. 2009), *available at* http://www.nysb.uscourts.gov/orders/m390.pdf (superseding General Orders M-143 and M-211 and setting forth procedures governing dispute resolution program in Southern District of New York).

[296] *See* General Order M-390, at 2.

[297] *See id.* at 6.

[298] *See id.* at 4–7.

[299] *See id.* (incorporating elements of Court Annexed Mediation Program).

[300] *See* 11 U.S.C. § 105(a), (d) (2006) (giving bankruptcy courts power to carry out provisions of Bankruptcy Code, including power to hold status conferences and impose limitations and conditions to ensure "expeditious and economical" resolution of cases); *id.* § 362 (providing for automatic stay); *id.* § 363 (regulating trustee's ability to use, sell, or lease property of debtor's estate); *id.* § 521 (outlining debtor's duties); *id.* § 1322 (specifying contents of debtor's plan).

[301] FED. R. BANKR. P. 3015 (providing procedure for filing, objecting to, and modifying debtor's plan in chapter 12 or chapter 13 cases), FED. R. BANKR. P. 4008 (mandating procedure for filing of reaffirmation agreements), FED. R. BANKR. P. 9014 (defining procedure to be followed in contested matters), FED. R.

> The language from § 105(a) leaves no doubt that regardless of whether any party, including a debtor, complains about the actions of another, a bankruptcy court, on its own, may raise any issue and take any action to protect the integrity of the bankruptcy process. . . .
>
> The absence of such [challenges to ill-founded proofs of claim and motions to lift stay] argues in favor of this Court and the UST becoming more—not less—involved in scrutinizing payment histories and conduct of mortgagees to avoid abuse of the bankruptcy system becoming accepted practice.[302]

The same rules and policies that permit court-annexed mediation programs support court-annexed loss mitigation programs. As noted above, the Southern District of New York already employs standing scheduling orders setting case conferences in chapter 11 cases;[303] the policy of efficient case administration that supports that scheduling order also supports the Loss Mitigation Program. Whether the debtor disputes an alleged default or seeks a loan modification, the questions that surround the home loan will shape the distribution to creditors and determine the direction of the case. When the debtor's home is at stake, it usually represents the most significant asset of the estate and the largest claim in the case. Economic disposition of the case demands that a scheduling order be entered early in the case, and that the order be narrowly tailored to address questions regarding the home loan.

Like the preemptive audit in *Stewart*, loss mitigation can be commenced before a contested matter strikes because the fate of the debtor's home must be determined early in the bankruptcy case.[304] As noted in Part I, chapter 13 debtors must file their plans within fourteen days of commencing their bankruptcy cases.[305] In order to confirm a plan, chapter 13 debtors must resolve questions regarding the affordability of the home and the amount of the debt.[306] The debtors must establish

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BANKR. P. 9019 (authorizing courts to approve compromises or settlements and, upon stipulation by parties, final and binding arbitration).

[302] *In re* Parsley, 384 B.R. 138, 173 (Bankr. S.D. Tex. 2008).

[303] *See supra* note 286 (citing S.D.N.Y. LOCAL BANKR. R. 1007-2(e) (authorizing initial case conference orders in chapter 11 cases)).

[304] Loss Mitigation Program Procedures at 2–3 (Bankr. S.D.N.Y. 2010), *available at* http://www.nysb.uscourts.gov/pdf/lossmit/RevisedLossMitigationProcedures.pdf ("Parties are encouraged to request loss mitigation as early in the case as possible, but loss mitigation may be initiated at any time.").

[305] *See supra* note 114 (citing FED. R. BANKR. P. 3015(b) ("The debtor may file a chapter 13 plan with the petition. If a plan is not filed with the petition, it shall be filed within 14 days thereafter . . . .").

[306] *See generally* Flygare v. Boulden, 709 F.2d 1344, 1347 (10th Cir. 1983) (adopting "amount of the proposed payments" and "accuracy of the plan's statements of the debts" as relevant factors in determination of good faith under section 1325(a)(3)); *In re* Sweet, 428 B.R. 917, 920 (Bankr. M.D. Ga. 2010) (highlighting section 1325(a)(3) requirement that chapter 13 plan only be confirmed if, *inter alia*, "the plan has been proposed in good faith"). *But see In re* Casper, 153 B.R. 544, 547 n.6 (Bankr. N.D. Ill. 2004)

the amount of the arrears to be paid in the plan before it can be determined whether they can overcome objections by creditors and pay enough into the plan to provide an adequate distribution to their unsecured creditors.[307] Chapter 13 debtors have the right to use property of the estate and to settle lawsuits.[308] When the debtor engages in loss mitigation, the use of property of the estate is implicated because the debt secured by the home might be modified.[309] The monthly mortgage payment might be reduced, making post-petition wages available to pay the claims of unsecured creditors.[310] The amount of arrears might decrease, which further expands the portion of the plan payment that goes to unsecured creditors.[311]

The debtor and the creditor might work out the surrender of the home, which might be an integral part of the chapter 13 plan. The Loss Mitigation Program provides debtors and creditors a time- and cash-saving alternative to litigating the uncertainties that surround the procedure and effect the surrender of a home in a chapter 13 plan, which are discussed in Part I.[312] The parties may consensually

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("Often times [sic] . . . the time for filing claims expires after confirmation. As a result, the actual amount of debt to be paid is usually unknown at the time of confirmation.").

[307] *See* 11 U.S.C. § 1322(c)(1) (2006) (providing debtor may cure default on home mortgage); *id.* § 1325(a)(5) (describing conditions for plan confirmation over secured creditor's objections); *id.* § 1325(b)(1) (enumerating conditions for plan approval over unsecured creditor objections); Andrews v. Loheit (*In re* Andrews), 49 F.3d 1404, 1406 (9th Cir. 1995) (finding trustee had standing to object where plan did not provide for adequate protection of secured creditors' claims which included mortgage arrears); s*ee also In re* Euliano, 442 B.R. 177, 189 (Bankr. D. Mass. 2010) (dismissing debtor's case where chapter 13 trustee objected to plan for its failure to provide full payment of prepetition arrears on home mortgage).

[308] *See* 11 U.S.C. § 363(b)(1) ("The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate . . . ."); *id.* § 1303 ("Subject to any limitations on a trustee under this chapter, the debtor shall have, exclusive of the trustee, the rights and powers of a trustee under sections 363(b) . . . ."); *see also In re* Magee, No. 08-37600, 2011 WL 482723, at *7 (Bankr. S.D.N.Y. Feb. 3, 2011) ("The chapter 13 debtor may use property of the estate outside the ordinary course, such as by refinancing a mortgage or pursuing a lawsuit."); *In re* Ayre, 360 B.R. 880, 887 (Bankr. C.D. Ill. 2007) (upholding chapter 13 debtor's settlement payment).

[309] *See* 11 U.S.C. § 521(a)(2)(A) (enumerating debtor's duty to "file . . . a statement of his intention with respect to the retention or surrender of such property and, if applicable, specifying that such property is claimed as exempt, that the debtor intends to redeem such property, or that the debtor intends to reaffirm debts secured by such property"); *In re* Sosa, 443 B.R. 263, 268 (Bankr. D.R.I. 2011) ("To this Court's knowledge, except for the reasons specified in § 521(a)(2)(A), the only way debtors can retain secured property is via agreement with their secured creditors. If agreement is reached, no interest of the secured creditor has been affected. If mediation fails, the secured creditor still has its § 362(d) rights."); *In re* Simarra, No. 09–14245, 2010 WL 2144150, at *1 (Bankr. D.R.I. Apr. 14, 2010) (explaining Loss Mitigation Program encourages parties to negotiate agreements in regard to residential property of debtor's estate).

[310] *See generally* 11 U.S.C. § 1325(b)(1) ("If the trustee or the holder of an allowed unsecured claim objects . . . the court may not approve the plan unless . . . the plan provides that all of the debtor's projected disposable income to be received . . . will be applied to make payments to unsecured creditors under the plan."); Loss Mitigation Program Procedures at 1 (Bankr. S.D.N.Y. 2010), *available at* http://www.nysb.uscourts.gov/pdf/lossmit/RevisedLossMitigationProcedures.pdf (providing parties can negotiate lower mortgage payments, thereby creating disposable income for unsecured creditors); *In re* Rahman, 400 B.R. 362, 370 (Bankr. E.D.N.Y. 2009) ("Every dollar of expenses deducted from a debtor's current monthly income is another dollar which is not repaid to unsecured creditors.").

[311] *See* 11 U.S.C. § 1325(b)(1); Loss Mitigation Program Procedures at 1 (intending to save property of estate from foreclosure); *In re Rahman*, 400 B.R. at 370.

[312] *See supra* Part I.C.

resolve the questions of the creditor's acceptance of the home and whether an unsecured claim remains.[313] Further, they can set a firm timeline and manner for the transfer of title and resolution of the creditor's claim.[314]

Chapter 7 debtors are also required to take early and decisive action with respect to their home loans. They must file their statements of intent with respect to their home loans within thirty days of commencing their cases.[315] A chapter 7 debtor who requests loss mitigation indicates a willingness to remain personally liable on the home loan, albeit on more affordable terms.

The Loss Mitigation Program is consistent with the judicial initiative to clarify the matters that appear before the court, authorized by the Supreme Court in *Peterson*, and it embodies the creativity and vitality of court-annexed ADR programs honored by the First Circuit in *Atlantic Pipe*. In *Stewart*, the bankruptcy court properly required a major creditor to conduct a broad audit of claims filed so that deficiencies could be corrected before a flood of claims objections overwhelmed the court—or worse, before excessive claims could unjustly doom the cases in which they were filed.[316] Similarly, the Loss Mitigation Program requires the parties to provide direct contact information of parties with authority over the home loan, so that questions and disputes can be resolved before they turn into time-consuming and asset-gobbling contested matters.[317] The Loss Mitigation Program neatly fits the criteria described by the *Atlantic Pipe* court for determining whether the inherent power to control the court calendar is properly exercised: The Loss Mitigation Program promotes the orderly and expeditious disposition of cases because bankruptcy cases must progress to confirmation and discharge without burdensome litigation that wastes property of the estate.[318] It does not contradict an applicable rule or statute because loan modifications must be voluntary.[319] It

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[313] *See* Loss Mitigation Program Procedures at 1 ("Loss mitigation commonly consists of the following general types of agreements, or a combination of them: loan modification, loan refinance, forbearance, short sale, or surrender of the property in full satisfaction.").

[314] *See id.* at 5 (suggesting initial contact phase of Loss Mitigation includes discussion of "time and method for conducting the Loss Mitigation sessions" and "types of Loss Mitigation solutions under consideration by each party").

[315] The debtor must file the statement of intent within 30 days of commencing the case, or the meeting of creditors, whichever is earlier; the court can extend this period. *See* 11 U.S.C. § 521(a)(2). A reaffirmation agreement is enforceable only if, among other things, it was made before the granting of the discharge. *Id.* § 524(c)(1). It must be filed with the court no later than 60 days after the first date set for the meeting of creditors, and the court has discretion to enlarge the time for filing. *See* FED. R. BANKR. P. 4008(a).

[316] *See supra* notes 287–91 and accompanying text.

[317] *See* Loss Mitigation Program Procedures at 4.

[318] *See id.* at 1 ("While the Loss Mitigation Program stays certain bankruptcy deadlines that might interfere with the negotiations or increase costs to the loss mitigation parties, the Loss Mitigation Program also encourages the parties to finalize any agreement under bankruptcy court protection, instead of seeking dismissal of the bankruptcy case.").

[319] *See* 11 U.S.C. § 1322(b)(2) (providing 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 principle residence"); Universal Am. Mortg. Co. v. Bateman, 331 F.3d 821, 826 (11th Cir. 2003) ("[Section] 1322(b)(2) specially prohibits any modification of a homestead mortgagee's rights in the Chapter 13 plan.");

comports with procedural fairness because creditors may object to the loss mitigation request and seek to terminate loss mitigation.[320] It shows restraint and discretion, because the Loss Mitigation Order is a uniform scheduling device that sets clear deadlines to control the progress of the loss mitigation process.

In *Nosek*, *Parsley*, *Schuessler*, and *Crawford*, the courts criticized the mind-boggling convolution of the creditors' structure of owners, servicers, lawyers, and other agents, and expressed frustration at the inability of debtors to contact their creditors with respect to their home loans, the most significant debt to be reorganized in bankruptcy. The breakdown in communication impedes efficient case administration because debtors need to decide what to do about their homes early in the bankruptcy and must contact their creditors to determine the viability of the different options: cure, loan modification, surrender. The creditors' systems have been shown to lead to burdensome litigation that needlessly prejudices the debtors and other creditors. The Loss Mitigation Program provides a simple way to establish effective communication between the parties, and it efficiently calms the maelstrom of litigation surrounding home loans before it has a chance to devour the estate and overwhelm the court.

Recently, a bankruptcy court held that a court-annexed loss mitigation program is a proper exercise of its power to control its docket, and does not create or impair substantive rights in violation of the Bankruptcy Code.[321] The Bankruptcy Court for the District of Rhode Island adopted a loss mitigation program substantially similar to the one developed by the Southern District of New York.[322] A secured creditor objected to a debtor's request for loss mitigation, alleging that the loss mitigation program grants an unauthorized "retention option" for chapter 7 debtors with respect to debts secured by their homes, violates the provisions of the Bankruptcy Code that control the time constraints of the stay, and exceeds the bankruptcy court's powers under section 105(a).[323] The Rhode Island Bankruptcy Court overruled the objections and upheld the program, emphasizing that the program was meant to facilitate communication and manage a crowded docket: "This practice of parties repeatedly seeking more time simply because they had not yet connected was counterproductive, it was a waste of time for the parties and the Court, and was

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Williamson v. Wash. Mut. Home Loans, Inc., 400 B.R. 917, 925 (M.D. Ga. 2009) (holding bankruptcy court did not err in finding debtor's mobile home to be residential real property, which precluded modification of secured creditor's claim under section 1322(b)(2)).

[320] *See* Loss Mitigation Program Procedures at 3 ("Where any party files an objection, a Loss Mitigation Order shall not be entered until the bankruptcy court has held a hearing to consider the objection. At the hearing, a party objecting to Loss Mitigation must present specific reasons why it believes that Loss Mitigation would not be successful.").

[321] *In re* Sosa, No. 10-11702, 2011 WL 258673, at *6 (Bankr. D.R.I. Jan. 28, 2011) (modifying loss mitigation program to allow lift-stay motions to be filed during loss mitigation and retaining authority to evaluate propriety of fees for such motions).

[322] *See* Fourth Amended Loss Mitigation Program and Procedures at 1 (Bankr. D.R.I. 2011), *available at* http://www.rib.uscourts.gov/newhome/LossMitigation/040110%20CLEAN.pdf.

[323] *In re Sosa*, 2011 WL 258673, at *3.

forcing needless litigation, with costs and fees being wasted on useless services."[324] The *Sosa* court found that the program established settlement conferences consistent with Bankruptcy Code section 105(d) and Federal Rule of Civil Procedure 16, and its inherent power to control its docket.[325] The court found that it was permitted to extend the time for parties to perform their intentions with respect to secured debt and held that the program did not create any substantive right to "ride through" and stay current on home loan payments, which is not permitted in the First Circuit.[326]

D. Similarities between the Court's Mediation Program and the Loss Mitigation Program

In developing the Loss Mitigation Program, the court was guided by its longstanding Mediation Program. The Mediation Program lends several important factors to the Loss Mitigation Program that protect the parties' right to due process: participation by parties with full settlement authority, a court-ordered schedule to protect against waste and delay, comprehensive program guidelines and a detailed order that define the parties' responsibilities, the requirement of good faith participation; voluntary settlement; and finality. In both the Mediation Program and the Loss Mitigation Program, the court does not require the parties to reach a settlement; the court requires only that the parties participate in the process in good faith.[327]

1. An Overview of the Loss Mitigation Program

The Loss Mitigation Program contains numerous procedural elements that protect the parties' rights to due process, which also govern the Mediation Program and ordinary bankruptcy litigation. First, the debtor requests loss mitigation by filing a request for Loss Mitigation ("Request"), which must be served on the secured creditor.[328] The Request includes the debtor's name and contact information, and identifies the address of the property for which the debtor seeks loss mitigation.[329] The debtor signs the Request, certifying that the Request is made

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[324] *Id.* at *2.

[325] *Id.* at *3–4 ("That the Court has not compiled an all encompassing list of every relevant Code and Rule provision, does not indicate that the [Loss Mitigation Program] is a stand-alone artifice which purports to give debtors new rights, or interferes with the existing rights of creditors. To the contrary, the *LMP* is but one of the Court's many case management tools available to manage its caseload. If the mediation process is successful, the parties go forward in their new relationship, and the resolved matter is removed from the Court's calendar. If mediation fails, the issues are adjudicated in accordance with applicable law.").

[326] *Id.* at *5.

[327] *See* General Order M-390, at 5–6 (Bankr. S.D.N.Y. 2009), *available at* http://www.nysb.uscourts.gov/orders/m390.pdf (stating consequences for lack of good faith); Loss Mitigation Program Procedures at 4 (Bankr. S.D.N.Y. 2010), *available at* http://www.nysb.uscourts.gov/pdf/lossmit/RevisedLossMitigationProcedures.pdf (explaining requirement of good faith).

[328] Loss Mitigation Program Procedures at 3 (discussing first step in Loss Mitigation procedure).

[329] *See id.* at 4 (describing facts request may include).

according to the Loss Mitigation Program, that the debtor will participate in good faith, and that the loss mitigation is voluntary.[330] The creditor has at least two weeks to receive and review the request and prepare opposition if it considers the request to be inappropriate.[331] If the creditor opposes the request, the court holds a hearing to consider whether loss mitigation should proceed.[332]

If the Request for Loss Mitigation is not opposed, then the court enters the Loss Mitigation Order, which sets deadlines controlling the appointment and submission of contact information for parties with authority to modify the home loan.[333] The Loss Mitigation Order sets a schedule for contact, demand, and exchange of financial information, and the holding of a loss mitigation session.[334] The Loss Mitigation Order requires the parties to appear in court for a status conference and sets a date on which the loss mitigation period terminates.[335] The Loss Mitigation Order stays, but does not terminate nor deny, any pending motions for relief from the automatic stay, and extends the time for the creditor to file an objection to the debtor's plan of reorganization.[336] When communicating with the debtor regarding the loan modification, the creditor is protected from accusations of violating the stay.[337]

2. Characteristics Common to the Loss Mitigation Program and the Mediation Program

The Loss Mitigation Order and the Mediation Order share several analogous provisions. Just as the Loss Mitigation Order sets a deadline for appointing parties with full settlement authority,[338] the Mediation Order sets a schedule for the appointment of a mediator and requires participation by parties with full settlement authority.[339] The Loss Mitigation Order sets a schedule for the exchange of information and the holding of a conference;[340] likewise, the Mediation Order sets a time frame for the scheduling of the mediation session and requires the mediator to report to the court and advise whether further sessions will be needed.[341] Both

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[330] *See id.*
[331] *See id.* at 3.
[332] *Id.*
[333] *See id.*
[334] *See id.* at 3–4.
[335] *See id.* at 4.
[336] *See id.*
[337] *See id.* ("All communications and information exchanged by the Loss Mitigation Parties during Loss Mitigation will be inadmissible in any subsequent proceeding pursuant to Federal Rule of Evidence 408.").
[338] *See id.* at 3–4, 6 ("Each Loss Mitigation Party must have a person with full settlement authority present during a Loss Mitigation session.").
[339] *See* General Order M-390 at 4–5 (Bankr. S.D.N.Y. 2009), *available at* http://www.nysb.uscourts.gov/orders/m390.pdf ("A representative of each party shall attend the mediation conference, and must have complete authority to negotiate all disputed amounts and issues.").
[340] Loss Mitigation Program Procedures at 3–4 (describing deadlines contained in Loss Mitigation Order).
[341] *See* General Order M-390 at 5.

orders identify the detailed program guidelines that describe the parties' rights and responsibilities, including the requirement to participate in good faith and the possibility of sanctions for failure to do so.[342]

Like the Mediation Program, the Loss Mitigation Program requires participation by parties with full settlement authority.[343] The Mediation Program requires each side to locate their own party with settlement powers,[344] and failure to find an adequate representative might result in sanctions for failing to participate in good faith.[345] In the buildup to the creation of the Loss Mitigation Program, there appeared to be some confusion in the courts regarding whether the debtor was supposed to locate the proper party with control of the home loan. As noted in Part II, the *Nosek* bankruptcy court punished Ameriquest and the other creditors for allowing a lawsuit to proceed without the proper creditor, and held that in the context of mortgage securitization, the creditor was better suited than the debtor to locate the proper party in interest.[346] The sanction was ultimately reduced on appeal, with the First Circuit finding that the servicer had not intended to deceive the court and that no harm had been done.[347] When the court enacted the Loss Mitigation Program, it sought to remedy the persistent confusion with respect to who is the actual party with authority to modify the home loan. The Loss Mitigation Order clearly and unequivocally requires the creditor to provide the direct contact information of the person who has full settlement authority,[348] which achieves the fundamental goal of the Loss Mitigation Program—to open the lines of communication between debtor and creditor.[349] The Loss Mitigation Order unambiguously puts the burden on the creditor to locate the party with decision-making power over the home loan.[350]

Loss mitigation and mediation are governed by orders of the court, which set firm schedules and allow the court to oversee the process. Parties to loss mitigation

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[342] *See id.* at 5–6 ("The mediator shall report any willful failure to attend or participate in good faith in the mediation process or conference. Such failure may result in the imposition of sanctions by the court."); Loss Mitigation Program Procedures at 5 ("The Loss Mitigation Parties shall negotiate in good faith. A party that fails to participate in loss mitigation in good faith may be subject to sanctions.").

[343] Loss Mitigation Program Procedures at 6.

[344] *See* General Order M-390 at 5.

[345] *See* Nick v. Morgan's Foods, Inc., 270 F.3d 590, 597 (8th Cir. 2001) (upholding sanctions for breach of good faith when party failed to attend mediation). *But see In re* A.T. Reynolds & Sons, Inc., No. 10 Civ. 2917(WHP), 2011 WL 1044566 (S.D.N.Y. Mar. 18, 2011) (reversing bankruptcy court's award of sanctions).

[346] *See supra* Part II.B.1 (discussing sanctioning of mortgage servicer for mishandling debtor's post-petition mortgage payments).

[347] *See* Ameriquest Mortg. Co. v. Nosek (*In re* Nosek), 609 F.3d 6, 9–10 (1st Cir. 2010) (reducing sanctions against mortgage servicer after finding lack of intentional deception and actual prejudice).

[348] *See* Loss Mitigation Program Procedures at 4 ("Unless a Creditor has already done so as part of a request for loss mitigation, each Creditor shall provide written notice to the Debtor, identifying the name, address and direct telephone number of the contact person who has full settlement authority.").

[349] *See id.* at 1 ("The Loss Mitigation Program aims to facilitate resolution by opening the lines of communication between the debtors' and lenders' decision-makers.").

[350] *See id.* at 4.

must attend status conferences, at which the court may determine whether the process is being abused.[351] Similarly, the Mediation Program requires the mediator to report a failure to participate in good faith, by filing a confidential report with the court.[352] The orders set a timeline to control the processes, define the parties' rights, and provide enough notice and direction over the process that the court can employ its powers of enforcement, if need be.[353]

Parties to the court's loss mitigation and mediation programs are required to participate in good faith.[354] The court can assess sanctions for failure to participate in good faith.[355] The court will not discipline a party for failure to participate in good faith without notice and a hearing at which the accused party may defend its conduct.[356]

In mediation, the mediator is usually the one to report to the court if a party has failed to participate in good faith.[357] Given that the loss mitigation process usually takes place without the aid of a third-party neutral, the court requires regular status conferences in loss mitigation, to ensure that the parties are acting in good faith.[358] The parties must appear in court and explain the progress of the negotiations.[359] If the creditor has misplaced the debtor's financial information, or if the debtor has failed to supply it, the party must justify the default under the order.[360] If the creditor is taking a long time to make a decision on the modification or commit the deal to writing, the creditor must explain the delay.[361] If the debtor does not timely provide financial information, the creditor may request termination of loss

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[351] *See id.* (outlining deadlines and requiring parties to make verbal report when date and time for status conference is set by court in lieu of written reports).

[352] General Order M-390 at 5–6 (Bankr. S.D.N.Y. 2009), *available at* http://www.nysb.uscourts.gov/orders/m390.pdf.

[353] *See id.* at 2–9 (setting parameters of mediation program); Loss Mitigation Program Procedures at 2–8 (establishing structure, rules, procedure, and obligations of Loss Mitigation Program).

[354] *See* Loss Mitigation Program Procedures at 5.

[355] *See* FED. R. CIV. P. 16(f) (authorizing court to issue sanctions if party does not participate in good faith); Loss Mitigation Program Procedures at 5 (stating failure to participate in good faith is subject to sanctions).

[356] 60 E. 80th St. Equities, Inc. v. Sapir (*In re* 60 E. 80th St. Equities, Inc.), 218 F.3d 109, 117 (2d Cir. 2000) (internal quotation omitted) ("[D]ue process requires that courts provide notice and opportunity to be heard before imposing any kind of sanctions.").

[357] *See* General Order M-390 at 5–6 (requiring mediator to report failure to participate in good faith); *see, e.g.*, Nick v. Morgan's Foods, Inc., 99 F. Supp. 2d 1056, 1058 (E.D. Mo. 2000) (ordering party to show cause against imposition of sanctions because mediator reported party's lack of good faith during ADR process).

[358] *See* Loss Mitigation Program Procedures at 4 (requiring Loss Mitigation Order to contain deadlines set by court for status conferences or reports).

[359] *See id.* at 5 (obligating parties in mitigation to provide written status reports or appear at status conferences to give oral reports on number of sessions held and possible resolutions or termination of mitigation).

[360] *See id.* at 5–6.

[361] *See id.*

mitigation at a status conference, preserving the resources of the parties and the court, while protecting the debtor's due process rights.[362]

E. Why a Separate Loss Mitigation Program is Necessary

Critics of the Loss Mitigation Program ask why it was necessary to create a program distinct from the Mediation Program. After all, if the debtor objects to the allegations in a lift-stay motion or objects to confirmation, or objects to the proof of claim, the matter becomes a contested matter in which the parties might invoke mediation.[363]

Traditional mediation is primarily concerned with risk analysis.[364] A third-party neutral might be necessary to force the parties to confront their goals and risk, and force them to determine if litigation is truly worth the risk. In contrast, the Loss Mitigation Program is primarily concerned with establishing communication between the parties.[365] In all the cases analyzed in the section describing the buildup to the Loss Mitigation Program, the courts criticized the failure of the creditors to respond to the debtors' inquiries and the breakdown of communication between the debtors and the creditors.[366] Loss mitigation may be characterized as "mediation without a mediator;" once the Loss Mitigation Order is entered and the process is underway, the parties are usually competent to weigh their own risks and exchange offers.

Loss mitigation can be commenced early in the bankruptcy case because the Loss Mitigation Program promotes efficiency and conservation of resources, of both the court and the estate. As shown by the *Stewart* court's preemptive claims review, the bankruptcy court is not required to wait for its docket to become overloaded before taking action to manage its cases and their estates.[367] When the

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[362] *See id.* at 7 (terminating loss mitigation requires party to state specific reason for termination, provide notice to other parties, and court hearing to consider request).

[363] *See, e.g., In re* San Patricio Cnty. Cmty. Action Agency, 575 F.3d 553, 556–57 (5th Cir. 2009) (discussing settlement reached after mediation of contested matter just before going to trial); Morrow v. Microsoft Corp., 499 F.3d 1332, 1334–35 (Fed. Cir. 2007) (exploring situation where creditors committee entered into settlement of claims through several days of mediation); *In re* Smart World Techs., LLC, 383 B.R. 869, 872 (Bankr. S.D.N.Y. 2008) (describing court-ordered mediation of numerous claims in adversary proceedings by bankruptcy court).

[364] *See* Nancy A. Welsh, *I Could Have Been a Contender: Summary Jury Trial as a Means to Overcome Iqbal's Negative Effects on Pre-Litigation Communication, Negotiation and Early, Consensual Dispute Resolution*, 114 PENN ST. L. REV. 1149, 1174 (2010) (asserting mediation discussions are dominated by risk analysis); Nancy A. Welsh, *What is "(Im)partial Enough" in a World of Embedded Neutrals?*, 52 ARIZ. L. REV. 395, 413 n.108 (2010) (stating risk analysis is staple of alternative dispute resolution methods).

[365] *See* Loss Mitigation Program Procedures at 1 (stating purpose of Loss Mitigation Program is to open forum for debtors and lenders to reach consensual resolution to problems).

[366] *See supra* Part II.B (discussing numerous cases leading up to and aiding in creation of Loss Mitigation Program).

[367] *See In re* Stewart, Nos. 08-3225, 08-3669, 08-3852, 08-3853, 08-4805, 2009 WL 2448054 at *11–12 (E.D. La. Aug. 7, 2009) (asserting bankruptcy courts have power to manage dockets); *accord* 11 U.S.C. § 105(a) (2006) (granting bankruptcy court power to take necessary actions to implement Bankruptcy Code,

debtor files bankruptcy to save the family home, the court immediately obtains jurisdiction over the home because it is property of the estate.[368] The case usually cannot progress until the fate of the home is determined because it implicates the amount of the secured creditor's claim and the feasibility of the chapter 13 plan.[369] When a debtor must resolve an issue regarding the home loan, it is wasteful to compel the debtor to wait for a claim to be filed, or to fall into default to force a lift-stay motion, just so the mediation program can be invoked. Every dollar that is spent on unnecessary litigation or an unneeded mediator is a dollar that could go to other creditors, and reorganization is jeopardized as money is funneled away from the plan and into legal proceedings.[370] Additionally, months might pass before a claim is filed that the debtor can challenge or before the creditor can plead that cause exists to lift the stay. Once a claim objection or a lift-stay motion is filed, the parties must wait weeks for the hearing date, before appearing in court and requesting mediation.[371] Commencing loss mitigation early in a case can resolve questions concerning the home loan before they escalate into contested matters that can take several months and thousands of dollars to resolve. Most of the bases for contested matters—a missed payment, a disputed claim—can be resolved as incidents of the broader question of whether anything can be done to save the family home and reinstate a performing loan.

The Loss Mitigation Program is uniquely tailored to the mortgage servicing industry. The parties are directed to appoint representatives with authority to decide a single narrow issue: whether anything can be done to assist the debtor in staying in the home.[372] The process might end in the proper determination that the debtor

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including managing their dockets); Owens v. Murray, Inc., 365 B.R. 835, 839 n.5 (Bankr. M.D. Tenn. 2007) (stating bankruptcy courts have power to police dockets through inherent powers and section 105 of Bankruptcy Code).

[368] *See* 11 U.S.C. § 541(a) (creating bankruptcy estate consisting of any property in which debtor has legal or equitable interest at commencement of case); *see, e.g.*, Miller v. Chateau Cmtys., Inc., 282 F.3d 874, 878 (6th Cir. 2002) (holding home of debtor becomes property of estate upon filing of petition); *In re* Drahn, 405 B.R. 470, 476 (Bankr. N.D. Iowa 2009) (stating home was property of estate upon commencement of case).

[369] *See* Nobleman v. Am. Sav. Bank, 508 U.S. 324, 327 (1993) (stressing secured creditors' claims may be modified unless those claims are secured by interest in debtor's home); *In re* Clements, 421 B.R. 755, 757 (Bankr. W.D. Va. 2010) (explaining chapter 13 debtor may not modify secured claims against principal residence); *In re* Jordan, 330 B.R. 857, 859 (Bankr. M.D. Ga. 2005) (prohibiting plan from modifying secured claims on real property comprising principal residence).

[370] *See, e.g.*, Perez v. Peake, 373 B.R. 468, 472 (S.D. Tex. 2007) (stating lift-stay motions are costly and burdensome for debtor); *see also* Nancy A. Welsh, *You've Got Your Mother's Laugh: What Bankruptcy Mediation Can Learn from the Her/History of Divorce and Child Custody Mediation*, 17 AM. BANKR. INST. L. REV. 427, 427–29 (2009) (discussing increased use of mediation to save costs in bankruptcy but use of traditional neutrals combined with innovative procedures to encourage open dialogue and consensual resolution may be more effective).

[371] The Bankruptcy Code provides for notice and a hearing regarding certain matters, which actually means notice and an opportunity for a hearing. *See* 11 U.S.C. § 362(d) (authorizing court to lift stay after notice and hearing pursuant to party request); *see also* 11 U.S.C. § 102(1)(a) (defining "after notice and hearing" as notice and opportunity of hearing).

[372] *See* Loss Mitigation Program Procedures at 1 (Bankr. S.D.N.Y. 2010), *available at* http://www.nysb.uscourts.gov/pdf/lossmit/RevisedLossMitigationProcedures.pdf.

cannot afford the home; the Loss Mitigation Program requires only that the parties communicate in good faith regarding options for the reorganization of the home loan.[373]

Forcing the parties into litigation over a loan modification is inconsistent with the bankruptcy policy of global reorganization of the debtor. As noted in Part I, the court has broad jurisdiction over property of the estate, and voluntary settlement of nondischargeable claims plays a vital role in bankruptcy.[374] These settlements frequently are achieved without the use of a mediator. A loan modification achieved pursuant to the Loss Mitigation Program shares the same characteristics of these settlements—a consensual agreement regarding property of the estate, which permits the complete reorganization of the debtor.

The parties must obtain court approval of the loan modification,[375] which might not be necessary after a mediation. If the court approves the loan modification, an order will be entered to that effect.[376] The order finalizes the agreement, and may be enforced as any other bankruptcy order.[377] Court approval of the loan modification finalizes the process and eliminates any ambiguity with respect to the validity and permanence of the loan modification. A party must apply to the court for approval, using the rules of due process that govern motions to use property of the estate and to approve settlements.[378] Alternatively, the court might "so-order" agreements signed by the parties.[379]

IV. THE SUCCESS OF THE LOSS MITIGATION PROGRAM

Mr. Anderson commenced his first bankruptcy case in 2006, to stop a foreclosure sale.[380] *He struggled in chapter 13 for about a year, trying to cure the mortgage arrears in the plan while making mortgage payments as they came due. The burden of the double payments overwhelmed him, and his case was dismissed. He filed his second case in 2007 after the foreclosure sale was rescheduled. As in the first case, Mr. Anderson fought a lift-stay motion, as well as a contested confirmation.*

Throughout the bankruptcies and foreclosures, Mr. Anderson had been trying to negotiate a loan modification. He had steady income; his wife had her own

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[373] *See id.* at 5.

[374] *See supra* Parts I.A, F.

[375] *See* Loss Mitigation Program Procedures at 5.

[376] *See* General Order M-390 at 6 (Bankr. S.D.N.Y. 2010), *available at* http://www.nysb.uscourts.gov/orders/m390.pdf. (requiring parties to submit settlement reached in mediation to court for approval).

[377] *See, e.g., In re* Johnson, No. 6:09-bk-12369, 2010 WL 4257680, at *3 (Bankr. M.D. Fla. Oct. 18, 2010) (enforcing terms of mediation settlement approved by court).

[378] *See* FED. R. BANKR. P. 9014 (requiring parties to request resolution of contested matter by motion).

[379] *See generally* 22 N.Y.C.R.R. § 202.08(f) (2006) (discussing court's "so order" if parties agree and return form to court before date of motion).

[380] Debtor's name has been changed to protect his privacy. His name and case number is on file with the Court.

business. He offered $50,000 as a down payment—no response. Months went by, the bankruptcy cases and foreclosure proceedings came and went—no response.

With the trustee's motion to dismiss and the creditor's motion for relief from the stay pending, Mr. Anderson requested loss mitigation, hoping that a consensual review might achieve what two years of litigation could not. Four months later, Mr. Anderson and his creditor agreed on a loan modification. Mr. Anderson made a down payment of $60,000, and the creditor lowered the interest rate and put the delinquent arrears at the back of the loan, interest-free, to be paid in a balloon payment at the end of the term. Mr. Anderson's payments decreased by about $1000 per month.

A. The Success of the Loss Mitigation Program.

The fundamental goal of the Loss Mitigation Program is to establish effective communication between the parties regarding whether anything can be done to prevent the loss of the debtor's home to foreclosure.[381] The court finds success wherever the parties engage in the process in good faith and arrive at a decision regarding the home, even when they do not conclude the process with a loan modification. Nonetheless, the court has been inspired by the creativity shown in some of the solutions that have made homes more affordable to the debtors.

In the two years since the Loss Mitigation Program was adopted, debtors and creditors have achieved a broad spectrum of modifications pursuant to the Program, ranging from lowering interest rates to substantially reducing principal balances. The possibilities may vary depending on the borrower's ability to pay, the value of the home, and creditors' policies. Participation in the Loss Mitigation Program may result in creative loan modifications that incorporate a variety of changes. For example, in the case of Mr. and Mrs. Williams, the parties agreed on a principal reduction of $123,000, and the interest rate was reduced from 8.2% to 4.64% for about five years, then 6.75% thereafter. The Williams' monthly payment decreased by about $1600.[382] Similarly, in the case of Mr. Neville, the creditor agreed to put more than $60,000 in arrears in a balloon payment to be satisfied at the end of the loan, and the debtor would make an interest-only payment of just $386.67 for the first five years, saving him approximately $1400 per month.[383] Likewise, Ms.

[381] *See* Loss Mitigation Program Procedures at 1 (Bankr. S.D.N.Y. 2010), *available at* http://www.nysb.uscourts.gov/pdf/lossmit/RevisedLossMitigationProcedures.pdf (stating purpose of loss mitigation procedure).

[382] Debtors' names have been changed to protect their privacy. Their actual names and case number are on file with the Court.

[383] Debtor's name has been changed to protect his privacy. His actual name and case number are on file with the Court.

Holland and her creditor agreed on a substantial balloon payment and lowered interest rate, saving her approximately $700 per month.[384]

Creditors often agree to lower the interest rate and capitalize the arrears, bringing the missed payments, interest, and other charges back into the principal balance of the loan. Although it might result in a dramatically higher principal amount than what was originally borrowed, a debtor may benefit from this kind of modification because it brings the loan current, re-establishes the payment schedule, and erases the grounds for foreclosure. If the debtor's only debt was the home loan, a chapter 13 debtor might find that there is no need for a plan because there are no arrears left to cure. In such circumstances, the debtor might dismiss the bankruptcy or convert to chapter 7.

Dramatic loan modifications usually get the greatest fanfare, but the court also finds success when the debtor agrees to surrender the home to the creditor or consents to the foreclosure. The court accepts these agreements because the loss mitigation process has served as a "reality check" to the debtors, causing them to stop resisting the loss of a home that is a burden on them and their families. In these cases, the debtor can make a rational decision about how to rebuild a financial life. The loss mitigation process results in finality to the debtor, who hopefully may find comfort in knowing that the process led to an honest and informed answer.

Loss mitigation benefits unsecured creditors as well as the debtor and the secured creditor. If, after settlement, the secured creditor withdraws the proof of claim, then the unsecured creditors receive more of the plan payment. If the debtor's monthly payment decreases as a result of a lowered interest rate, there is more disposable income with which to pay unsecured creditors. If the debtor surrenders the home and the bankruptcy concludes, unsecured creditors benefit in this situation as well, because they do not have to experience the delay and cost of monitoring a floundering bankruptcy.

Secured creditors have much to gain from the Loss Mitigation Program. If the loan is modified, then the debtor recommits to the loan and starts paying on it, resulting in cash flow to the creditor. The loan may be accounted for as a performing asset. Anecdotally, some servicers have reported to the court that entry of the Loss Mitigation Order allows them to treat the loan as "in litigation," broadening their contractual power to modify the loan. The creditor is relieved of burdens associated with accumulating and maintaining an inventory of houses without equity. Creditors have great variation among their goals and policies toward loan modification, and they appear to have embraced the Loss Mitigation Program.

In fact, it appears that creditors are improving their infrastructure to facilitate loan modification. Creditors' counsel have informally reported conducting training sessions for loan servicers regarding modifying home loans. In addition, Web-

[384] Debtor's name has been changed to protect her privacy. Her actual name and case number are on file with the Court.

based portals are being developed to facilitate the submission of information and communication among the parties. One of these, Default Mitigation Management LLC ("DMM"), developed a pilot program specifically tailored to the court's Loss Mitigation Program.[385] The DMM portal allows the parties to use a common, transparent platform to build a record of the loss mitigation process.[386] Documents can be uploaded to the portal electronically, and the program provides a history of the submission of financial information and its acceptance by the creditors, as well as other communications between the parties.[387] The Court is heartened by the adaption of manpower and technology to meet the challenges presented by efforts to modify a home loan.

B. The Loss Mitigation Program, Version 2.0

Just as the bankruptcy community has evolved to better comply with the Loss Mitigation Program, the Program itself has grown to resolve some unforeseen complications. When administering alternative dispute resolution programs, the court must always be vigilant to waste and delay. These programs are rooted in the court's inherent power to efficiently administer cases, and when the participants pass time and accrue costs without good reason, the court must act to stop the abuse. In the case of the Loss Mitigation Program, the court saw many participants appear at status conferences, showing confusion and frustration with the other side's lack of activity in the process.

The Loss Mitigation Program was amended in 2010 to address concerns raised by debtors and creditors regarding delay.[388] Many creditors complained to the Court that the debtors had requested loss mitigation and failed to follow up with the order, leaving the creditors in limbo with respect to whether they could contact the debtor without violating the stay. The creditors alleged that debtors were taking too long in compiling financial documents, such as past years' tax returns and proof of income from a family business. The debtors often replied to these allegations by saying that they supplied the information and that it was lost or grew stale during the creditors' lengthy review process. It appeared in many cases that inactivity of either debtor or creditor was causing a stalemate, and that the parties were still unclear on what was required of them.

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[385] Informational materials on file with the Court. *See* Default Mitigation Management LLC (DMM), *Debtor's Counsel Loss Mitigation Web Portal Counselor USER Agreement*, at 1, *available at* https://www.dclmwp.com/docs/DCLMWP-Counselor-Agreement-120109.pdf (describing uses of web-based portal in assistance to Loss Mitigation process).

[386] *See id.* at 2 (enumerating archival services of portal).

[387] *See id.* (indicating portal will provide access to both property and loan information as well as to documents submitted by debtor).

[388] *See* General Order M-413 (Bankr. S.D.N.Y. 2010), *available at* http://www.nysb.uscourts.gov/orders/m413.pdf (amending General Order M-364); Richard Wilner, *Left at the Alter – NY Mortgage Plan Leaves Owners Hanging*, N.Y. POST, Feb. 14, 2010, at 37 (observing debtors' frustration with speed of Loss Mitigation Program).

The amendments to the Loss Mitigation Program increase judicial oversight of the process by causing the parties to build an official record of the communications. As part of the amendments, the Loss Mitigation Order now requires the creditor to file an affidavit documenting the date the demand for financial documents was served on the debtor and describing the actual documents requested.[389] Likewise, the debtor must file an affidavit stating the date the documents were provided, and listing the exact documents that were sent.[390] The court developed a standard request form that the creditor must use when seeking termination of the loss mitigation, on which the creditor indicates why it thinks the loss mitigation process should end.[391] These amendments provide the court with greater oversight of the loss mitigation process, and hopefully will quiet the grating refrain of hearsay regarding missing financial information. The affidavits will establish an official record of the loss mitigation process, furthering the court in its effort towards efficient case administration.

CONCLUSION: AN ANSWER

The Loss Mitigation Program is the first court-annexed program developed to address the crisis of miscommunication that struck the relationships of borrowers and the entities in control of their home loans. In recent years, debtors began coming to bankruptcy court with stories of wasted efforts to contact their lenders for answers about their home loans. It was always the same story, whether the debtor was seeking a loan modification or challenging an alleged default: no matter how many phone calls made and voicemails left, there was never a final answer to the debtor's question of whether anything could be done to prevent foreclosure. The bankruptcy courts began to investigate these stories and uncovered a complicated system of noteholders, loan servicers, lawyers, and other agents, which impaired effective communication among the parties. This complex system of creditors proved unresponsive to debtors' demands for information, and caused rampant violations of bankruptcy law, from the filing of unsupported proofs of claim to seeking relief from the stay without cause.

Historically, borrowers have long turned to the power and protection of bankruptcy law to reorganize their home loans.[392] When a bankruptcy case is

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[389] *See* Creditor Loss Mitigation Affidavit Official Form at 1 (Bankr. S.D.N.Y. 2010), *available at* http://www.nysb.uscourts.gov/pdf/lossmit/CreditorLossMitigationAffidavit.rtf.

[390] *See* Debtor Loss Mitigation Affidavit Official Form at 1 (Bankr. S.D.N.Y. 2010), *available at* http://www.nysb.uscourts.gov/pgf/lossmit/DebtorLossMitigationAffidavit.rtf.

[391] *See* Creditor's Request for Termination of Loss Mitigation Official Form (Bankr. S.D.N.Y. 2010), *available at* http://www.nysb.uscourts.gov/pdf/lossmit/CreditorRequestforTerminationLossMitigation.rtf (listing numerous grounds for termination, including debtor's failure to respond to document requests and debtor's insufficient income).

[392] *See* Melissa B. Jacoby, *Home Ownership Risk Beyond a Subprime Crisis: The Role of Delinquency Management*, 76 FORDHAM L. REV. 2261, 2287 (2008) ("[S]ome bankruptcy commentators and courts . . .

commenced, the automatic stay takes effect, protecting the debtor and all creditors from acts to collect debt.[393] The debtor gains time to evaluate options for reorganization, and may develop a plan of repayment.[394] The debtor's interests in property form an estate, which is used to pay creditors.[395] The court has exclusive jurisdiction over the property of the estate and controls the bankruptcy process and the players with its broad powers to manage its docket and the conduct of the parties that appear before it.[396]

With its diverse tools to broaden the property of the estate and prioritize claims, the bankruptcy court provides the ideal forum for a debtor struggling with an unmanageable home loan to achieve a consensual loan modification. The automatic stay prevents high-priority mortgagees from competing with judgment creditors to collect against the debtor's property.[397] Mortgage arrears can be cured over the years under a court-supervised plan.[398] Judgment liens and junior mortgages may be removed, clearing title and reclassifying secured claims.[399] Unsecured debt such as

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refer to bankruptcy as the only realistic option for individuals in foreclosure hoping to remain home owners."); Hon. David S. Kennedy, *House Considers Creation of Additional Bankruptcy Judgeships, Creation of Consumer Financial Protection Agency*, AM. BANKR. INST. J., July/Aug. 2009, at 72 (describing how financially distressed individuals seek protection of bankruptcy to protect home and minimize financial impact on families).

[393] *See* 11 U.S.C. § 362 (2006) (providing for automatic stay of particular actions against debtor); 3 COLLIER ON BANKRUPTCY, ¶ 362.03, at 362–23 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2010) (noting automatic stay protects debtor's fresh start as well as creditor's ability to collect); Henry E. Hildebrand, III, *Getting Noticed: The New Notice Requirements of Section 342*, 13 AM. BANKR. INST. L. REV. 533, 544–45 (2005) (positing automatic stay protects both creditors' assets and debtor's property).

[394] *See* Bank of N.Y. Trust Co. v. Pac. Lumber Co. (*In re* Scopac), 624 F.3d 274, 282 (5th Cir. 2010) (internal citation omitted) (noting automatic stay gives debtor "'breathing room' to reorganize"); John D. Ayer, Michael Bernstein & Jonathan Friedland, *The Life Cycle of a Chapter 11 Debtor Through the Debtor's Eyes*, AM. BANKR. INST. J., Sept. 2003, at 50 ("The automatic stay provides a respite for the debtor and also protects the creditors as a group by bringing to a halt actions by individual creditors."); J. Bradley Johnston, *The Bankruptcy Bargain*, 65 AM. BANKR. L.J. 213, 260 (1991) (internal citation omitted) (stating automatic stay "gives the debtor a breathing spell" and "permits the debtor to attempt a repayment or reorganization plan").

[395] *See* 11 U.S.C. § 541(a) (describing property of debtor's estate); *id.* § 726 (providing for distribution of estate property to creditors); Vickie L. Vaska, *Property of the Estate After Confirmation of a Chapter 13 Repayment Plan: Balancing Competing Interests*, 65 WASH L. REV. 677, 680 (1990) (describing creation of bankruptcy estate, which includes debtor's legal and equitable interests in property at filing).

[396] *See* 28 U.S.C. § 1334(e) (2006) (granting district court exclusive jurisdiction over all estate property); Tenn. Student Assistance Co. v. Hood, 541 U.S. 440, 447 (2004) ("Bankruptcy courts have exclusive jurisdiction over a debtor's property, wherever located, and over the estate."); *see also* Sec. Investor Protection Corp. v. Bernard L. Madoff Inv. Sec. LLC, 429 B.R. 423, 436 (Bankr. S.D.N.Y. 2010) (noting bankruptcy court's jurisdiction over administration and distribution of estate assets).

[397] *See* Vaska, *supra* note 395, at 680 ("The automatic stay facilitates debtor rehabilitation and equitable distribution of debtor's estate to creditors.").

[398] *See* Jonathan S. Fields, Note, *Taking Interest in a Cure: Compensation for the Time Value of Chapter 13 Residential Mortgage Arrears*, 13 CARDOZO L. REV. 2119, 2139 (1992) (footnote omitted) ("Congress granted homeowners the right to cure a defaulted mortgage and stay foreclosure under a chapter 13 plan.").

[399] *See* 11 U.S.C. § 522(f) (providing for avoidance of liens to extent they impair debtor's exemptions under subsection (b)).

credit card debt can be eliminated, making money available over the long term to pay the home loan.[400]

Aware of the potential to rehabilitate a home loan, a flood of debtors recently came to bankruptcy court looking for solutions to unmanageable home loans. A storm of legal activity followed them, as creditors asked the court for permission to continue foreclosure. These creditors often asserted incomprehensible claims and cited nonexistent or inconsequential defaults as cause for relief from the stay. The United States Trustee, the "watchdog over the bankruptcy process," began scrutinizing creditor practices.[401] It became clear to the bankruptcy courts that communication had broken down among the debtors, creditors and lawyers.

At first, the bankruptcy courts struggled with how to address the breakdown in communication. In the *Nosek* saga, the courts debated a loan servicer's responsibilities to the court and the debtor as they analyzed a loan history that appeared to have been prepared in violation of bankruptcy law.[402] The courts agreed that the servicer's practices were disturbing, yet the *Nosek* saga ultimately concluded with finding that the servicer had not purposefully violated the bankruptcy law or deceived the courts.[403]

Nosek set the stage for a spectacle of bankruptcy litigation in which the courts would explore their powers of enforcement and learn how to use them to address creditor practices that were incompatible with bankruptcy law. In *Parsley*, the bankruptcy court grappled with how to treat a law firm that had contracted itself into a situation in which it could not verify information with its client, a loan servicer.[404] In *Schuessler*, the court punished a creditor for bringing a lift-stay motion based on a default that it had created as a result of applying misguided internal policies.[405] In *Crawford*, the court sanctioned a creditor for allowing its agents to conduct a shocking and illegal post-petition foreclosure sale of a debtor's

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[400] *See* David A. Lander, *Essay: A Snapshot of Two Systems That Are Trying to Help People in Financial Trouble*, 7 AM. BANKR. INST. L. REV. 161, 169 (1999) (footnotes omitted) ("At the end of a liquidation case, a debtor obtains a discharge of most unsecured debts, thereby relieving his or her obligation to pay such debts; commonly credit card debts, medical bills and utility arrearages.").

[401] *See supra* Part II.C (discussing *Hill* and the Fein Such & Crane saga); *see also US Trustee Sides With Borrowers in Foreclosures With Questionable Assignments, MERS*, NAKEDCAPITALISM.COM, http://www.nakedcapitalism.com/2011/01/us-trustee-sides-with-borrowers-in-foreclosures-with-questionable-assignments-mers.html (last visited Feb. 25, 2011) (referencing United States Trustee's participation in two chapter 13 cases pending in Northern District of New York Bankruptcy Court); *About the United States Trustee Program & Bankruptcy*, U.S. TR. PROGRAM (Aug. 19, 2010), http://www.justice.gov/ust/eo/ust_org/about_ustp.htm#FT1.

[402] *In re* Nosek, 386 B.R. 374, 382–83 (Bankr. D. Mass. 2008) (sanctioning creditor for what appeared to be "very sloppy practice at best or an intentionally deceptive practice at worst").

[403] *See* Ameriquest Mortg. Co. v. Nosek (*In re* Nosek), 609 F.3d 6, 9 (1st Cir. 2010) (noting concerns over creditor's questioning practices but finding there was no intent to mislead court or debtor for gain).

[404] *In re* Parsley 384 B.R. 138, 156 (Bankr. S.D. Tex. 2008) (describing how attorney could only communicate with one person and how this limitation effected compliance with FED. R. BANKR. P. 9011).

[405] *In re* Schuessler, 386 B.R. 458, 464, (Bankr. S.D.N.Y. 2008) (examining administrative process causing creditor to falsely believe debtor defaulted and to file baseless lift-stay motion).

home.[406] Improper creditor practices continue in bankruptcy cases today, as claims are filed without documentation and lift-stay motions are brought without cause. If bankruptcy courts must address housing-related conflicts one by one, the process will be slow, expensive, inconsistent, and ultimately a failure for everyone involved.

The spike in filings and ensuing explosion of bankruptcy litigation both flow from one question: whether anything can be done to prevent the loss of the home to foreclosure. The Loss Mitigation Program provides an efficient and expeditious way to find an answer to this question by requiring the parties to appoint direct contacts so they can consider the question themselves. The debtor that seeks a loan modification encounters the same obstacles faced by the debtors who challenged their creditors in *Nosek*, *Parsley*, *Schuessler*, and *Crawford*: an incomprehensible system of creditor agents empowered to foreclose on the debtor's home, and apparently unable to answer the simplest questions regarding the home loan. Whether the debtor wants to modify the home loan, surrender the house to the creditor, or resolve a disputed payment, the Loss Mitigation Program allows the debtor and creditor to bypass an uncertain bout of litigation and consensually resolve questions surrounding the affordability of the home.

The heart of the Loss Mitigation Program is communication. Simply put, the court forces the parties to contact each other and talk about whether anything can be done to save the home. Parties engaging in loss mitigation follow a scheduling order, which requires the parties to appoint people with full settlement authority with respect to the home loan, and sets deadlines that control the exchange and review of financial information.[407] If the parties reach a settlement, they must obtain the court's approval of the agreement.[408]

Several core tenets of bankruptcy support the Loss Mitigation Program. First, the bankruptcy court has exclusive jurisdiction over property of the estate, which includes the debtor's house.[409] Second, the chapter 13 debtor must formulate a plan, the cornerstone of which is usually the rehabilitation of the home loan; likewise, chapter 7 debtors must decide whether to reaffirm their mortgage debt.[410] Third, the debtor may take out-of-the-ordinary actions with respect to property of the estate

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[406] *In re* Crawford, 388 B.R. 506, 526 (Bankr. S.D.N.Y. 2008) ("In the Court's view, punitive damages are necessary against HSBC to deter such conduct in the future.").

[407] *See* Loss Mitigation Program Procedures at 5–6. (Bankr. S.D.N.Y. 2010), *available at* http://www.nysb.uscourts.gov/pdf/lossmit/RevisedLossMitigationProcedures.pdf.

[408] *See id.* at 7.

[409] *See* 11 U.S.C. § 541(a)(2)(A) (2006) (listing interests considered property of the estate); 28 U.S.C. § 1334(e)(1) (2006) (granting court exclusive power over property of estate); *In re* Benner, 253 B.R. 719, 723 (Bankr. W.D. Va. 2000) (holding debtor's interest in joint tenancy property is included in estate).

[410] *See* 11 U.S.C. § 521(a)(2)(A) (requiring chapter 7 debtor to give notice of intent to reaffirm debts secured by interests in real property); *see also* Taylor v. AGE Fed. Credit Union (*In re* Taylor), 3 F.3d 1512, 1515 (11th Cir. 1993) (expressing commonly accepted analysis that section 521 requires debtor to choose to reaffirm debt, redeem collateral, or surrender collateral); *In re* Lock, 243 B.R. 332, 334 (Bankr. D. Ohio 1999) (following authority requiring debtors who retain collateral to redeem property or reaffirm debt).

with court approval, such as refinancing the home loan, selling the home, or entering a loan modification.[411] Court approval of most settlements is required, and settlements have a long tradition of facilitating creative and successful bankruptcy reorganizations.[412] Fourth, the court has inherent and statutory powers to manage its docket and enact programs that promote consensual resolution of claims.[413]

A debtor and creditor can participate in the Loss Mitigation Program from the outset of the case, without waiting for a legal battle to erupt. Bankruptcy courts' powers to manage their dockets extend to taking proactive steps to ensure compliance with bankruptcy law, such as entering a scheduling order and setting recurring case conferences. Since time is of the essence in every bankruptcy, the loss mitigation process can start from the moment the debtor files the case. If it appears that a party is not participating in good faith, then the court may enforce the Loss Mitigation Order using its traditional powers to control its docket and the conduct of the parties that appear before it.

The Loss Mitigation Program was enacted as a case management device, to promote court efficiency and to encourage compliance with bankruptcy law. In enacting the program, the court's goal was not to make a modification possible for every debtor that wanted one; the purpose of the program is to establish channels of communication, so that the parties may achieve a consensual resolution of issues regarding the home loan without wasting time and money on burdensome legal activities.[414] The court finds success in the loan modification process when the parties act in good faith, even when the debtor does not get a loan modification. If the parties complete the process and agree in good faith that surrender is the best option, then the court finds success. If the parties complete the process and agree in good faith that the loan should be left as it is and cured in a traditional plan, then the court finds success. The success is that the parties have arrived at an answer to the

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[411] *See* 11 U.S.C. § 363(b)(1) (authorizing use, sale, or lease of estate property outside ordinary course of business after notice and hearing); *id.* § 1329(a)(4) (giving debtor ability to request refinancing); *see, e.g.*, *In re* Caltex Swabbing Co., No. 10-10280-cag, 2010 WL 4780652, at *6 (Bankr. D. Tex. Aug 18, 2010) (permitting debtor and lender to modify loan).

[412] *See* FED. R. BANKR. P. 9019(a) (providing courts power to approve settlements); *In re* Smith, 409 B.R. 1, 4 (Bankr. D.N.H. 2009) (noting if loan modification acts as stipulation to settle contested matter between parties, court approval is needed); *In re* Dalen, 259 B.R. 586, 615 (Bankr. W.D. Mich. 2001) (approving settlement agreement between debtor and creditor regarding contested matter before litigation ensued).

[413] *See* Lisa A. Lomax, *Alternative Dispute Resolution in Bankruptcy: Rule 9019 and Bankruptcy Mediation Programs*, 68 AM. BANKR. L.J. 55, 56 (1994) (discussing benefits of using court-created alternative dispute resolution programs); Ralph R. Mabey, Charles J. Tabb & Ira S. Dizengoff, *Expanding the Reach of Alternative Dispute Resolution in Bankruptcy: The Legal and Practical Bases for the Use of Mediation and Other Forms of ADR*, 46 S.C. L. REV. 1259, 1261–63 (1995) (explaining trend among bankruptcy courts in creating alternative dispute resolution to alleviate stress on courts and save costs); Steven R. Wirth & Joseph P. Mitchell, *A Uniform Structural Basis for Nationwide Authorization of Bankruptcy Court-Annexed Mediation*, 6 AM. BANKR. INST. L. REV. 213, 233–34 (1998) (promoting use of court annexed alternative dispute resolution programs to save debtor costs, maximize creditor recovery, and relieve backlog on bankruptcy court dockets).

[414] *See* Loss Mitigation Program Procedures at 1 (Bankr. S.D.N.Y. 2010), *available* at http://www.nysb.uscourts.gov/pdf/lossmit/RevisedLossMitigationProcedures.pdf.

question of whether or not anything can be done to preserve title in the home with the debtor.

The story of the Loss Mitigation Program shows how long-standing bankruptcy powers can be tailored to resolve the crisis of miscommunication that struck bankruptcy courts, creditors, and debtors in recent years. The ongoing experience of the courts indicates that court-annexed loss mitigation programs can be a valuable tool as debtors continue to come to court with the same question: can anything be done to save the family home. For Ms. Lawrence, Mr. Anderson, and the thousands of debtors who have participated in the Loss Mitigation Program, there finally might be an answer: Yes.