DEALING WITH THE MORTGAGE HANGOVER:
MORTGAGE SERVICING AND RELATED RULE CHANGES

The mortgage problem just will not go away. The U.S. has too many delinquent loans, too many foreclosures, too many houses underwater and all of it is contributing to and deepening "The Mortgage Hangover." In bankruptcy cases, the Advisory Committee on Rules of Bankruptcy Procedure has tried to find ways to make the debtor-lender relationship clearer, with fewer possibilities of misunderstanding. Judges from state and federal courts have struggled with the law in regard to mortgages and notes and the standing of parties to bring mortgage related actions. This paper discusses what has been happening in the world of mortgages and bankruptcies over the last few years.

What is the "on the ground" situation with mortgages right now? There were $9.88 trillion in mortgage loans in September 2011, the lowest amount since December 2006.[1] Home prices fell dramatically in most major cities this year. There was a 4.4 % decline in 2011 year over year.[2] Nearly 29% of all mortgage loans are underwater.[3] In Atlanta, 58.7% of all mortgage loans are underwater.[4] Since 2007, $4 trillion in real estate wealth has been lost by homeowners.[5] Why is this important? In 2000-2005, consumers spent over $113 billion each year with funds they obtained from home equity loans. They spent another $63 billion each year on home renovations through funds obtained from home equity loans.[6] Now that spending is lost and has resulted in a depressed economy. Economists believe that prices will continue to drop in

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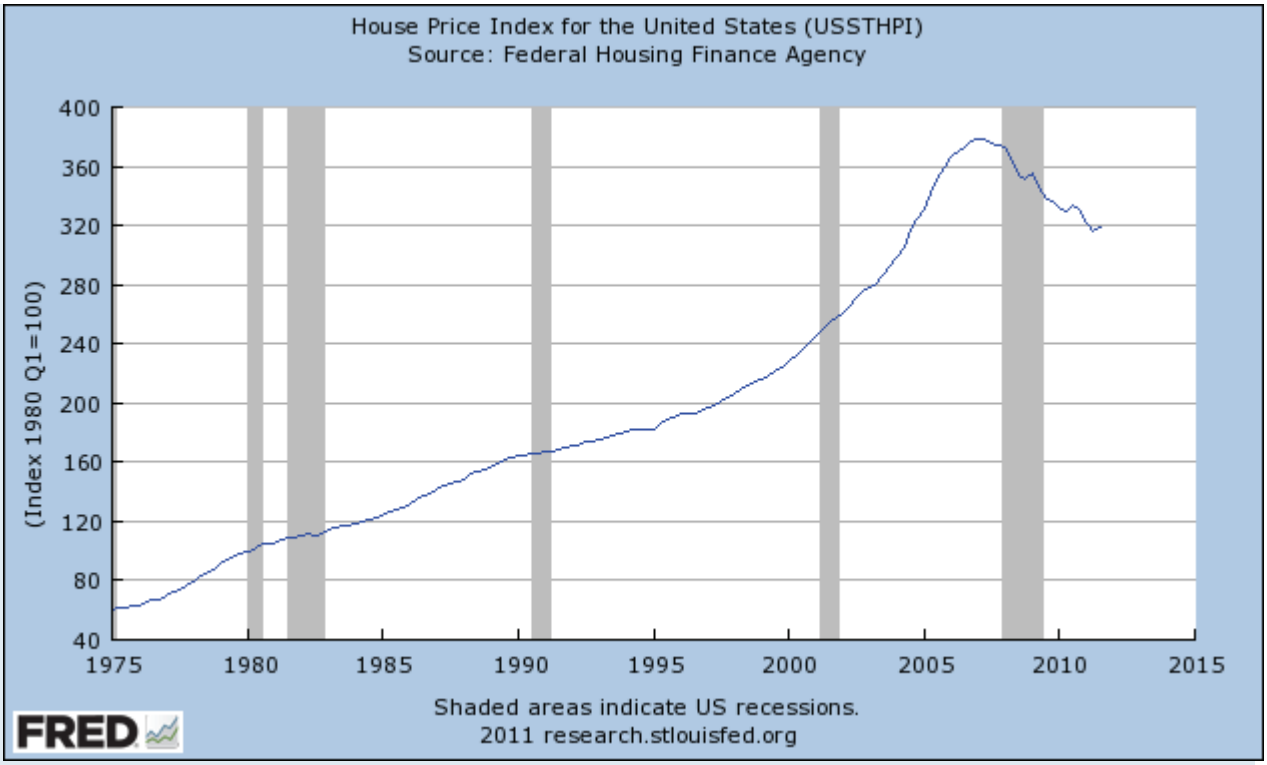
[1] John Gittelsohn & Kathleen M. Howley, U.S. Mortgage Debt Falls to Five-Year Low as Consumer Wealth Effect Fades, http://mobile.bloomberg.com/news/2011-12-08/falling-mortgage-debt-erodes-spending-as-wealth-effect-fades, last visited December 27, 2011.
[2] Jane Hodges, Nearly 29% of mortgaged homes underwater, report finds, http://www. cnbc.com, November 8, 2011, last visited November 8, 2011.
[3] *Id.*
[4] *Id*.
[5] Gittelsohn & Howley, *supra.*.
[6] *Id*.

2012 with the bottom in 2012.[7] This is so even though homebuyers and refinancers are experiencing the lowest mortgage rates ever, 3.91% for a 30-year loan.[8]

House Price Index for the United States (USSTHPI)



Economic Research, Federal Reserve Bank of St. Louis, December 16, 2011.

In the third quarter of 2011, 7.99% of mortgage loans on one-to-four unit residential properties were delinquent, a decrease from the prior quarter. The number of loans on which foreclosure actions were commenced was 1.08%, an increase from the prior quarter. Total loans

[7] Authentic Real Estate, 2012 Housing Market Predictions: Prices and Rates to Remain Low, December 26, 2011, http://authenticre.blogspot.com/2011/12/2013-housing-market-predictions-prices.html, last visited December 27, 2011.
[8] Prashant Gopal, Mortgage Rates in U.S. Fall to Lowest on Record With 30-Year Loan at 3.91%, http://www.bloomberg.com/new/print/2011-12-22/mortgage-rates-for-30-year-u-s-loans-fall-to-record-low-3-91-.html, last visited December 27, 2011.

in foreclosure totaled 4.43% of all loans.[9] For the average homeowner, from first missed payment to foreclosure auction, the process will take 674 days.[10] This number includes in the average states like Georgia and Alabama which have very quick non-judicial foreclosure processes! The number of existing and new homes sold in 2011 was 4.5 million. This number includes sales of foreclosed properties and short sales as well. This number may be lowered by as much to 10% to 20% because the National Association of Realtors reported in December 2011 that it had been calculating the number of sales incorrectly since at least 2007.[11]

A. Accuracy and itemization of interest, fees and charges, escrow arrearages/shortages, and cure amounts in proofs of claim

As of December 1, 2011, changes have been made to the Federal Rules of Bankruptcy Procedure that affect mortgage claims. Parts (a)-(c) of the rule are pertinent to mortgages and are set forth below. The part of the rule that was changed is underlined.

Rule 3001. Proof of Claim

> **(a) Form and Content.** A proof of claim is a written statement setting forth a creditor's claim. A proof of claim shall conform substantially to the appropriate Official Form.
>
> **(b) Who May Execute.** A proof of claim shall be executed by the creditor or the creditor's authorized agent as provided in Rules 3004 and 3005.
>
> **(c) Supporting Information.**
>
> (1) *Claim Based on a Writing*. When a claim or an interest in property of the debtor securing the claim, is based on a writing, the original or a duplicate shall be filed with the proof of claim. If the writing has been lost or destroyed, a statement of the

[9] Press Release, Mortgage Bankers Association, Delinquencies Decrease, Foreclosures Rise in Latest MBA Mortgage Delinquency Survey, dated 11/17/2011, http://www.mortgagebankers.org/NewsandMedia/PressCenter/78538.htm, (last visited January 5, 2012).
[10] Les Christie, Foreclosure free ride: 3 years, no payments, http://money.cnn.com/2011/12/28/real_estate/foreclosure/index.htm?iid=Popular, (last visited December 28, 2011).
[11] The Advertiser-Tribune, Garbage in, policy out of sync with reality, December 28, 2011, http://www.advertiser-tribune.com/page/content.detail/id/543066/Garbage-in-policy-out-of-sync-with-reality.html?nav=5006, (last visited January 4, 2012).

circumstances of the loss or destruction shall be filed with the claim.

(2) Additional Requirements in an Individual Debtor Case; Sanctions for Failure to Comply. In a case in which the debtor is an individual:

(A) If, in addition to its principal amount, a claim includes interest, fees, expenses, or other charges incurred before the petition was filed, an itemized statement of the interest, fees, expenses, or charges shall be filed with the proof of claim.

(B) If a security interest is claimed in the debtor's property, a statement of the amount necessary to cure any default as of the date of the petition shall be filed with the proof of claim.

(C) If a security interest is claimed in property that is the debtor's principal residence, the attachment prescribed by the appropriate Official Form shall be filed with the proof of claim. If an escrow account has been established in connection with the claim, an escrow account statement prepared as of the date the petition was filed and in a form consistent with applicable nonbankruptcy law shall be filed with the attachment to the proof of claim.

(D) If the holder of a claim fails to provide any information required by this subdivision (c), the court may, after notice and hearing, take either or both of the following actions:

(i)Preclude the holder from presenting the omitted information, in any form, as evidence in any contested matter or adversary proceeding in the case, unless the court determines that the failure was substantially justified or is harmless; or

(ii) award other appropriate relief, including reasonable expenses and attorney's fees caused by the failure.

ALL claimants, whether secured or unsecured, must substantially comply with the requirements of Official Form 10 as stated in Rule 3001(a). Official Form 10, the Proof of Claim form, at part 1, requires a creditor to check a box on the form if the claim includes interest or other charges

and instructs the filer to attach a statement of the charges and interest. The form of the itemization is not specified. It seems likely that courts will require this itemization to be the same as or resemble the itemization that is now required of home mortgage claimants under Rule 3001(c)(2). They must attach a new form termed Attachment A. If a lender does not know if the debtor is claiming a property as his/her homestead, the lender should err on the side of caution and utilize Attachment A. It contains a breakdown of all prepetition charges, fees and expenses. Rule 3001(c)(1) also requires the creditor to file the original or duplicate copy of the writing upon which the claim is based. Again it is unclear exactly what the writing is. Is it the credit card agreement that the debtor signed at the issuance of the card? Is it the original note, if the claim involves a debt based on a note? What about assignments of the note or debt? If it is a mortgage, must the mortgage be attached? As discussed below, the cases are not consistent. A creditor must know the policies in the district.

If the creditor holds a mortgage on the debtor's homestead, Rule 3001(c)(2) applies. The Rule does not change Rule 3001(c)(1) as to the fact that a copy or duplicate of the writing that is the basis of the claim be attached. As stated above, a new form, Attachment A, is provided that fulfills most of the itemization requirements of Rule 3001(c)(2), if fully completed. The form lists 14 different categories of fees, expenses, and charges.

The Rule also requires the attachment of an escrow account statement to the proof of claim that is accurate as of the date of the petition filing. The statement must be in a form "consistent with applicable nonbankruptcy law." This is likely to mean that the form should comply with the RESPA requirements. 12 U.S.C. § 2601, et seq. The form should look like the yearly escrow statement a homeowner receives detailing what was received, what the funds were used for and what funds remain. This statement should not indicate that a payment increase is

necessary, if that is the case. Another form, Supplement 1, discussed below, is the proper form through which a lender will notify a debtor of a payment change.

The Rule was effective on December 1, 2011. The Rule does not make clear whether it applies to pending cases or only to new bankruptcy cases filed after December 1, 2011. However, it would seem prudent to assume the rule applies to all filings made after December 1, 2011. The only disadvantage to the lender is that it may mean more work is required in preparing a proof of claim. However, with the sanctions available to the debtor if the improper information is provided, it is not worth the risk of nondisclosure.

Rule 3001(c)(2)(D) provides that failure to provide the required information may result in inability to provide the information later at a hearing on the claim. This may result in disallowance of the claimed amount for fees, charges and expenses not specifically listed and disclosed. To avoid the penalty for noncompliance, the court must find that the lender's failure to provide the information was "substantially justified." Substantial justification would require more than a response that the creditor forgot or that the information was not readily available. "Substantial justification" is a term already used in the Rules at Fed. R. Civ. P. 37(a)(5)(B) and Fed. R. Bankr. P. 7037 (a)(5)(B) and in the Bankruptcy Code at section 523(d) and in the Equal Access to Justice Act at 28 U.S.C. § 2412(d)(1)(A).

Substantial justification means that an action is justified to a degree that could satisfy a reasonable person. "A request for discovery is 'substantially justified' under [Rule 26(g)(2)] if reasonable people could differ as to whether the party requested must comply." *Reygo Pacific Corp. v. Johnston Pump Co.*, 680 F.2d 647, 648 (9th Cir. 1982). When a dispute involves differing interpretations of governing law, opposition is substantially justified unless it involves an unreasonable, frivolous or completely unsupportable reading of the law. *Bowne of New York*

City, Inc. v. AmBase Corp., 161 F.R.D. 258, 265 (S.D.N.Y. 1995). Cases involving § 523(d) have stated that establishment of "substantial justification" requires proof of 3 criteria: "(1) a reasonable basis in law for the theory it propounds; (2) a reasonable basis in truth for the facts alleged; and (3) a reasonable connection between the facts alleged and the legal theory advanced." *In re Walker*, 439 B.R. 854 (Bankr. W.D. Pa. 2010) (citing *In re Ritter*, 404 B.R. 811, 832 (Bankr. E.D. Pa. 2009)); *FIA Card Services, N.A., v. Flowers (In re Flowers)*, 391 B.R. 178 (M.D. Ala. 2008); *First Deposit National Bank v. Mack (In re Mack*), 219 B.R. 311 (Bankr. N.D. Fla. 1998).

B. Attachment of note and mortgage to proofs of claim.

Rule 3001(c)(1) states that a proof of claim "based on a writing" must have the original or a duplicate of the writing attached to the claim. The instructions for Official Form 10 at part 4 state that, if a claim is secured, "attach copies of lien documentation." This rule and the instructions do not make clear what must be attached. Is it the original note and mortgage? Is it the original note and mortgage and all of the assignments and endorsements? If the loan is securitized, does it include the Pooling and Servicing Agreement and other related trust documents? In a University of Texas law review article, Katherine Porter found that 41.1% of mortgage creditors failed to attach the note to their claims. A mortgage or deed of trust showing lien perfection was attached 80.4% of the time. Katherine Porter, *Misbehavior and Mistake In Bankruptcy Mortgage Claims*, 87 Tex. L. Rev. 121, 145-146 (November 2008). In *In re Smoak*, No. 09-30421, 2011 WL 4502596 (Bankr. S.D. Ohio. September 28, 2011), the creditor attached the mortgage and a note with an allonge that reflected 3 assignments and the loan servicer could enforce the documents. *In re Bailey*, 2011 WL 2971907 (Bankr. N.D. Ga. 2011), held that a lender who failed to attach to its proof of claim the endorsements or assignments of the note and

mortgage that would put ownership in the hands of the party requesting chapter 13 plan payments could not be paid. *In re Borrows*, No. 10-22788, 2011 WL 721842 (Bankr. W.D. Wash. 2011) is a case in which the UST objected to the claim of a lender because the note attached to the claim did not have assignments or endorsements showing ownership of the note by the lender filing the claim. *See In re Romas*, 458 B.R. 275 (Bankr. D.S.C. 2011) (same issue).

In *Bryant v. HSBC Mortgage Services, Inc. (In re Bryant)*, 452 B.R. 876 (Bankr. S.D. Ga. 2011), a debtor sued her alleged mortgage holder for damages and a declaratory judgment at the same time the mortgage holder moved for relief from stay. The Court held that the mortgagee was able to prove the validity of its claim, even though it had failed to attach proper documentation to its proof of claim. The claim was therefore not prima facie valid, but the mortgagee was able to establish the validity of the claim through testimony and evidence provided at the hearing. In another Georgia case, *Pursley v. eCast Settlement Corp. (In re Pursley)*, Nos. 10-40882, 10-40958, 09-40967, 2011 WL 2489989 (Bankr. M.D. Ga. June 20, 2011), the court described in detail what documents must be provided to properly file a credit card claim. The discussion of what attachments are required for assigned claims could be applicable to mortgage claims as well. The case states that "[b]ankruptcy courts are [] 'split on the documentation required of an assignee to establish a prima facie case' under Rule 3001(f)." *Id.* at *5 (citing *In re O'Brien*, 440 B.R. 654, 661 (Bankr. E.D. Pa. 2010) (quoting *In re Minbatiwalla*, 424 B.R. 104, 113 (Bankr. S.D.N.Y. 2010)). "Some courts require no documentation of assignments." *Id.* at *10. Fed.R.Bankr.P. 3001(e) deals with transferred claims. It states at (e)(1) that if a claim is sold before the proof of claim is filed, no evidence of the transfer need be filed with the claim. However, Rule (e)(2) requires that the transferee of a sold claim provide evidence of the transfer if the claim is transferred after the initial proof of

claim is filed. The rule would seem to allow claimants of sold mortgages to file a proof of claim that does not include documentation of all of the prior transfers, unless the sale occurs after the seller/claimant has filed a proof of claim. However, other courts require some evidence of the transfers. Why? Because of the language of Official Form 10 that requires "proof of lien documentation" and a copy of the writing upon which the claim is based. Another recent Georgia case, *Dewberry v. Bank of America, et al. (In re Dewberry)*, No. 10-60155, 2010 WL 4882016 (Bankr. N.D. Ga. October 21, 2010), involved a debtor who objected to a proof of claim filed by EMC Mortgage. The proof of claim had a copy of a note endorsed in blank attached to the claim as well as a copy of a Security Deed to MERS and a copy of an assignment of the Security Deed from MERS to Bank of America. The assignment was not recorded until after the proof of claim was filed. The court held that BOA had a claim with prima facie validity based upon the claim and attachments. In Georgia, a bearer note is entitled to be enforced by the holder under the Georgia Code's version of the UCC.

In *In re Minbatiwalla*, 424 B.R. 104 (Bankr. S.D.N.Y. 2010), the court decided what documents must be filed with a mortgage proof of claim. Courts "generally require that the claimant attach a copy of the promissory note and the mortgage, or, at least, an explanation as to why the note is not provided." *Id.* at 113. The court also stated "Where there is an assignment, some courts additionally require the claimant to attach all writings on which the alleged assignment is based, including any modification agreements and assignments. . . . Other courts similarly require evidence of the entire chain of custody of the mortgage and note." *Id.* The court then decided that

> [I]n the mortgage context, the creditor may initially attach only a summary of its claim, containing the debtor's name, account number, the prepetition account balance, interest rate, and a breakdown of the interest charges, finance charges and other fees

> that make up the balance of the debt. If the creditor is an assignee, it must also provide an affidavit attesting to the assignment of the note and mortgage. Upon request of the debtor, the creditor has an obligation to provide additional documentation underlying its summary and affidavit (such as the original note and mortgage, or a written assignment), within two weeks after dispatch or communication of such request, or the debtor can file an objection based on a lack of adequate documentation.

Id. at 117.

As of December 1, 2011, a mortgage creditor must file Attachment A instead of the summary indicated above. However, the affidavit as to creditor status would still be applicable. The *Feinberg v. Bank of New York (In re Feinberg)* case, 442 B.R. 215 (Bankr. S.D.N.Y. 2010), followed the *Minbatiwalla* decision. The creditor did not file an affidavit attesting to its assignee status, but the court did not disallow the claim. The debtor and trustee never asked for supporting documentation before commencing a lawsuit against the mortgagee. The court allowed the mortgagee to put on evidence of its ownership of the note after holding that the claim did not have prima facie validity due to its lack of documentation. In *Brown v. Ameriquest Funding II, LLC, et al. (In re Brown)*, 431 B.R. 309 (Bankr. D. Mass. 2010), the court allowed a mortgage creditor to amend its claim to correct deficiencies. It had referenced three exhibits in the proof of claim, a note, deed of trust and certificates of an officer, none of which were attached to the claim. The proof of claim was filed by AMC Mortgages Services, Inc. as loan servicer for Argent Mortgage Company, LLC. A relief from stay motion filed less than 4 months later was filed by Deutsche Bank on the same mortgage debt. This raised questions for the debtor. The court allowed the creditor to amend the claim under § 502(j). However, the court also awarded the debtor reasonable attorney's fees and costs due to Deutsche Bank's "thread of sloppiness and inattention to detail." *Id.* at 315.

C. The chain of title dilemma inherent in securitized and transferred mortgages.

The issues raised by securitized mortgages are the issues discussed above in section B writ large. A securitized mortgage is created as follows. A borrower takes out a mortgage loan on his homestead through a lender known as the originator. The "mortgage" consists of a promissory note and a mortgage or deed of trust (the mortgage). The originator sells the note and mortgage to an aggregator, or sponsor. This entity is a special purpose entity (the SPE) that has no assets or liabilities except the mortgages and notes it buys. The SPE is often an affiliate of a bank or other large financial institution. The sponsor starts the securitization process by transferring the loans to a depositor. The depositor is another SPE. The depositor transfers the mortgages to another SPE, typically a trust. The trust holds the mortgages for the parties who invest in the trust. These investors hold bonds designating their interest in the trust. The investors do not hold title to any individual mortgages. The bonds may vary in yield, duration and payment priority and thus have different credit ratings. The trust is governed by a Pooling and Servicing Agreement that actually creates the trust and sets forth the obligations and authority of the servicer. The PSA also contains rules about procedures for sales and transfers of the mortgages and notes from the originator to the trust. The PSA normally contains language that states that the trustee has received from the depositor as to each loan the original note (or a lost note affidavit) that has all intervening endorsements (or is endorsed in blank). The PSA states

> To the extent that there is no room on the face of any Mortgage Note for an endorsement, the endorsement may be contained on an allonge, unless state law does not so allow and the Trustee is advised by the Responsible Party that state law does not so allow. If the Mortgage Loan was acquired by the Responsible Party in a merger, the endorsement must be by "[last endorsee], successor by merger to [name of predecessor]". If the Mortgage Loan was acquired or originated by the last endorsee while doing business

> under another name, the endorsement must be by "[last endorsee], formerly known as [previous name]"

The depositors warrant to the trustee, in the PSA and sale documents, that there is "a complete chain of endorsements from the originator to the last endorser" for each note. The trust must file verified reports that it in fact holds all of the documents to confirm that true sales occurred at each link in the chain of title. O. Max Gardner III, *The Alphabet Problem and the Pooling and Servicing Agreements*, Credit Slips, August 14, 2009, *available at* http://www.creditslips.org/creditslips/2009/08/the-alphabet-problem-and-the-pooling-and-servicing-agreements.html (last visited January 13, 2012).

The problem in many of the cases that have arisen about "chain of title" issues in securitized mortgage cases is that the servicer or lender who is asking for mortgage foreclosure or relief from the stay cannot or has not proven an unbroken chain of title at the time it commences an action. The cases are not consistent and do not follow any one clear pattern in dealing with these chain of title issues. In part, this is due to interpretations of state law. In part, it is due to differences of opinion on judges' parts as to the issues and the law. In part, it is due to attorneys for lenders and debtors not fully presenting the facts. A recent law review article collected many of these cases and concluded that there were two themes in them. One set of cases has dismissed foreclosure actions and relief from stay motions, usually without prejudice, if documentation was not complete. The other line of cases allowed a lender to amend the faulty chain of title during the proceeding. David R. Greenberg, Comment, *Neglected Formalities in the Mortgage Assignment Process and the Resulting Effects on Residential Foreclosures*, 83 Temp. L. Rev. 253 (Fall 2010).

A recent case from the 9th Circuit Bankruptcy Appellate Panel, *Veal v. American Home Mortgage Servicing, Inc. (In re Veal)*, 450 B.R. 897 (B.A.P. 9th Cir. 2011) contains an excellent

analysis of the issue of standing in mortgage cases. The case also discusses the applicability of the UCC to the negotiability and transferability of notes.

Two very recent cases from the Alabama Court of Civil Appeals also highlight the problems that lenders face when their documentation is shoddy or incomplete. In *Sturdivant v. BAC Home Loans Servicing, LP*, 2011 WL 6275697 (Ala. Civ. App. December 16, 2011), the Court held, in a 3-2 decision, that BAC, the servicer of the loan, did not have standing to eject the mortgagor post-foreclosure when the mortgage assignment to BAC did not occur until after the servicer had demanded payment and published the notice of foreclosure. BAC only obtained title, according to the evidence, on the date it obtained the deed to the property following foreclosure.

Sturdivant was followed by *Perry v. Federal National Mortgage Association*, 2011 WL 6848485 (Ala. Civ. App. December 30, 2011). Fannie Mae sought to eject Perry from his home after foreclosure. The original mortgage note had been executed in favor of RBMG and the mortgage was executed in the name of MERS, as nominee for RBMG. Both the note and mortgage were transferred to EverHome Mortgage Company. Before the foreclosure action was commenced, EverHome conveyed its interest in the property to Fannie Mae by special warranty deed. MERS assigned the mortgage to EverHome after the deed to Fannie Mae. EverHome purchased the property at foreclosure and sent Perry a demand to vacate the premises. After that, EverHome filed the assignment of the mortgage and the deed to Fannie Mae in the Probate Court records. Fannie Mae then filed a complaint to eject Perry from the property asserting its ownership of the home by virtue of the deed from EverHome. Fannie Mae moved for summary judgment against Perry and submitted an affidavit with the note, mortgage, EverHome's foreclosure deed, and Fannie Mae's special warranty deed attached. The affidavit was signed by

a custodian of EverHome's records. The note attached to the affidavit was endorsed in blank by RMBG. The affiant stated that EverHome had acquired "its interest in the note on or about July 2, 2007." The Court held that the affidavit was insufficient evidence of when EverHome received possession of the note. "Aside from [the affiant's] general assertion that he had reviewed EverHome's books and records and that he had personal knowledge of the contents of those books and records, [the affiant] did not state (and Fannie Mae did not attach documentation to demonstrate) how [the affiant] had gained his knowledge of the date on which EverHome had acquired possession of the note." *Id.* at *5. The court ruled the portion of the affidavit discussing the date of acquisition of possession of the note inadmissible. Therefore, Fannie Mae could not prove that EverHome had a right to foreclose on the property or transfer title to Fannie Mae.

Georgia courts have refused to allow challenges to a foreclosure sale to be presented as a defense to an ejectment action. *E.g., Vines v. LaSalle Bank Nat'l Ass'n*, 302 Ga. App. 353, 691 S.E.2d 242 (Ga. Ct. App. 2010).

D. Payment changes arising from escrow account and interest rate adjustments and the need for timely notice and an opportunity for objection

New Fed.R.Bankr.P. 3002.1 provides that, in chapter 13 cases, a creditor of a debtor that has a mortgage on the debtor's homestead must serve Supplement 1 to Official Form 10 on the debtor, debtor's counsel and the chapter 13 trustee when a mortgage payment increase is necessary. The increase can be due to an increase in interest rates or escrow payments. The form is filed as a supplement to the creditor's proof of claim. The form must be filed no later than 21 days before the first increased payment is due. If the district is not a district that pays the mortgage payment through the plan, so the creditor does not file a proof of claim for the

mortgage debt, there is no established procedure yet for how to file Supplement 1. Some districts are having the form filed in the main case; others are having the form filed in the claims register. If the case is not a chapter 13 case, it is unclear what the creditor is to file. It may be advisable to file the form if an increase is needed and the debtor is in chapters 7, 11 or 12 as well. There is no real risk involved in filing the form (or a modified version of it). There may be risk to NOT filing some notification of the change. The question may also arise as to whether the form needs to be filed only in cases filed after December 1, 2011 or whether it applies to pending cases. Again, there is no real risk involved in filing the form, but there is a risk of sanctions if the form is not filed and the court believes it should have been filed.

The sanctions that a court can impose on a creditor for failure to file the required Supplement 1 include two forms of relief. A court can "preclude the holder from presenting the omitted information, in any form, as evidence in any contested matter or adversary proceeding in the case, unless the court determines that the failure was substantially justified or is harmless." Fed.R.Bankr.P. 3002.1(i)(1). Therefore, the creditor risks being unable to prove that an increase is necessary, at least until the form is correctly filled out and filed. This could mean that a creditor will have been deemed to have waived any increase until the form is properly filed. The second sanction that can be imposed is "reasonable expenses and attorney's fees caused by the failure." Fed.R.Bankr.P. 3002.1(i)(2). It is unclear what "reasonable expenses" may be. Unlike section 362(k), the rule does not provide for "actual damages." The rule does not use the term "costs" as in Rule 8014. Rule 9011(c)(2) uses the term "reasonable attorney's fees and other expenses incurred as a direct result of the violation." This may be the type of expenses that Rule 3002.1 contemplates. It is possible that a reasonable expense may include the amount of any month's increased payment as well as lost wages for attending court and meeting with counsel,

gas or mileage for traveling to court and any telephone charges or time spent resolving billing errors resulting from any violation. However, arguably "reasonable expenses" encompasses fewer losses than "actual damages." "Expenses" may assume actual out of pocket costs only and not emotional distress, time spent meeting with attorneys, time spent making telephone calls to the creditor, etc.

If a creditor files a notice at least 21 days before the increase is to go into effect, what are the debtor's rights if he/she objects? The Rule does not address this issue. It would seem logical that a debtor would file an emergency or expedited motion to decrease or deny the increase that a court would hear as soon as possible. The debtor or creditor should also request escrow of any payment increase until the court rules on the motion. A creditor should argue that a debtor should not be able to delay paying the increase by filing a delaying motion.

The same considerations apply to Supplement 2, the supplement that must be filed when fees, expenses or charges are added to a debtor's mortgage debt. The form must be filed within 180 days after the fee is incurred. The debtor or trustee has 1 year after the filing to object to the fees, expenses and charges. The risks are the same.

Presumably, if a payment increase is appropriate, the debtor will modify his/her chapter 13 plan to increase the payment or the trustee will do so, depending upon the practice in the district. If fees are added to the mortgage, the debtor will have the fees added to the chapter 13 payments by modification of the plan or by the filing of a proof of claim by the creditor that contains the amount of the fees, charges or expenses approved by the court.

E. End-of-Case determination of mortgage default cure and related bar on evidence

Rule 3002.1(f) also provides a new procedure for insuring that there is no mortgage default at the end of the case, or, if there is, that the debtor is aware of it. Within 30 days after a

debtor completes all payments the chapter 13 trustee must send the debtor, debtor's counsel and the holder of the mortgage claim, a notice that states that the debtor has paid in full the amount required to cure any default on the mortgage claim. If the trustee does not send the notice, the debtor may file and serve it. It is unclear from the language of Rule 3002.1 whether the debtor must file his/her notice within the 30 day period allowed to the trustee, or whether the debtor has an additional period of time to serve the notice.

Once the notice of Final Cure Payment is filed and served upon the mortgage claim holder, the claimant must file and serve a statement that indicates whether the claimant agrees that the debtor has cured any default on the claim and whether the debtor is current on all payments consistent with § 1322(b)(5) of the Bankruptcy Code. If the creditor asserts that the mortgage debt is not current, the creditor must itemize the necessary cure amounts that are not paid. The creditor's statement should be filed as a supplement to the creditor's proof of claim.

If the parties are in disagreement as to the cure being accomplished, the debtor or trustee may file a motion within 21 days after service of the statement of the creditor that says there is a remaining default. The motion will ask the court to determine what the cure amount is, if any.

Several issues are not clear at this point. How does the debtor then cure any default? Must it be done outside the plan, after discharge? Is the debtor to be given any time before the discharge is entered to cure the default? Is the debtor's only alternative the filing of another case? The rule does not address what the court can do if the debtor or trustee does not file the Notice of Final Cure Payment in a timely manner. Can it be filed late? If not done timely and discharge is entered, can a debtor still bring an adversary case asserting a discharge violation?

F. MERS, Robo-signing, and other foreclosure-related issues in the Automatic Stay context

MERS is Mortgage Electronic Registration System. MERS is owned by MERSCORP, Inc. Twenty-three companies own MERSCORP. They include American Land Title Association, Bank of America, CCO Mortgage Corporation, Chase Home Mortgage Corporation of the Southeast, CitiMortgage, Inc., Commercial Mortgage Securities Association, CoreLogic, Corinthian Mortgage Corporation, EverHome Mortgage Company, Fannie Mae, First American Title Insurance Corporation, Freddie Mac, GMAC Residential Funding Corporation, Guaranty Bank, HSBC Finance Corporation, MGIC Investor Services Corporation, Mortgage Bankers Association, PMI Mortgage Insurance Company, Stewart Title Guaranty Company, SunTrust Mortgage, Inc., United Guaranty Corporation, Wells Fargo Bank, N.A., and WMC Mortgage Corporation.[12] The sole purpose of MERS, a wholly owned subsidiary of MERSCORP, Inc., is "to streamline the mortgage process by using electronic commerce to eliminate paper."[13] MERS accomplishes this goal by acting as the mortgagee of record and/or nominee for the beneficial owners of mortgage loans.

The "MERS issue" in bankruptcy cases arises most often as a question of whether MERS can prosecute a motion for relief from the automatic stay in a case. The earliest cases looked at whether MERS was a "real party in interest" in the case at the time it filed the motion. They also looked at whether MERS had standing to prosecute the motion. There is an excellent article explaining the title issues encountered by courts with MERS. David P. Weber, *The Magic of the Mortgage Electronic Registration System: It is and It Isn't,* 85 AM. BANKR. L.J. 239 (2011). Some of the cases found that standing and real party in interest status were different concepts. *In*

[12] http://www.mersinc.org/about/shareholders.aspx, last visited December 22, 2011
[13] http://www.mersinc.org/about/index.aspx, last visited December 22, 2011

re Kang Jin Hwang, 396 B.R. 757 (Bankr. C.D. Cal. 2008), *rev'd and remanded on other grounds*, 438 B.R. 661 (C.D. Cal. 2010); *In re Maisel*, 378 B.R. 19 (Bankr. D. Mass. 2007); *In re Jacobson*, 402 B.R. 359 (Bankr. W.D. Wash. 2009); *In re Sheridan*, No. 08-20381, 2009 WL 631355 (Bankr. D. Idaho. March 12, 2009); *In re Wilhelm*, 407 B.R. 392 (Bankr. D. Idaho. 2009); *In re Mitchell*, No. BK–S–07–16226, 2009 WL 1044368 (Bankr. D. Nev. March 31, 2009), *aff'd on other grounds*, 423 B.R. 914 (D. Nev. 2009). Other cases did not distinguish between the two concepts, but found that MERS had no standing or had no ability to assign a mortgage to another to give that entity standing. *In re Agard*, 444 B.R. 231 (Bankr. E.D.N.Y. 2011) (citing numerous New York state court cases and federal cases holding MERS had no standing or agency relationship). Later cases have been allowing parties to proceed with relief from stay motions even in the face of defective or deficient chains of title if the party seeking relief from stay merely established a "colorable" claim. The relief from stay motion is not a foreclosure action. What may need to be provided under state law for a foreclosure does not need to be in place at the time of relief from stay. *In re Weisband*, 427 B.R. 13 (Bankr. D. Ariz. 2010); *In re Lopez,* 446 B.R. 12 (Bankr. D. Mass. 2011); *Bryant v. HSBC Mortgage Services, Inc. (In re Bryant),* 452 B.R. 876 (Bankr. S.D. Ga. 2011).

Another issue that has been raised in motion for relief from stay litigation is "robo-signing." Robo-signing allegations assert that mortgage processors and servicers produce documents, including affidavits, en masse with little or no review prior to signature or approval. This alleged practice resulted in class action cases and defense to relief from stay motions on the basis that the documents were incorrect and not able to be trusted. As to affidavits provided in relief from the stay litigation, the allegation is that the affidavits are incorrect in some way or are false or, because the affidavit has not been properly reviewed before signature, the information

contained is suspect. *Woodruff v. Chase Home Finance LLC (In re Woodruff)*, No. 09–8014, 2010 WL 386209 (Bankr. M.D. Ala. January 27, 2010); *Brannan v. Wells Fargo Home Mortgage, Inc. (In re Brannan)*, 04–01037, 2011 WL 5331601 (Bankr. S.D. Ala. November 7, 2011). In affidavits in support of relief from stay motions, the financial information in the affidavit may actually be correct, but the notarization is defective or there is a mistake in the name of the affiant or the date of the affidavit predates the information provided in the affidavit, etc. The debtor then seeks to have the entire motion for relief denied or seeks to have the fees charged by the party seeking relief from stay lowered or denied due to the shoddy quality of the affidavit. This relief may be sought as a defense to the stay motion, or as a sanction, or for "fraud on the court." *See Brannan*, 2011 WL 5331601, at *5-*6.

G. Role of the Chapter 13 Trustees and the United States Trustee

Trustees have taken up the mortgage issue with mixed results. The U.S. Trustee's office has taken up the issue of mortgage abuse in at least 3 published cases. In *Walton v. Countrywide Home Loans, Inc.*, No. 08-23337, 2009 WL 1905035 (S.D. Fla. 2009), a Florida District Court held that the U.S. Trustee could pursue an injunction action against Countrywide in which the Trustee was seeking to require Countrywide to "ensure the accuracy of its motions and pleadings" in bankruptcy courts. The Trustee asserted that the mortgage company had repeatedly filed inaccurate and misleading pleadings. In *McDermott v. Countrywide Home Loans (In re McNeal)*, Adv. No. 08-5031, Doc. 84 (Bankr. N.D. Ohio May 1, 2009) (unreported but discussed in *Harker v. Wells Fargo Bank, N.A. (In re Krause)*, 414 B.R. 243, 266 n.21 (Bankr. S.D. Ohio 2009)), the U.S. Trustee asserted that Countrywide had filed an improper proof of claim.

In *In re Davis*, 452 B.R. 610 (Bankr. E.D. Mich. 2011), the U.S. Trustee sought and was granted the right to take a 2004 examination of a proper officer of Countrywide Home Loans to investigate whether Countrywide's actions in a case were an abuse of process. The debtor had to file two motions to have his mortgage arrears correctly determined due to perceived problems on Countrywide's part. On June 7, 2010, the U.S. Trustee program, together with the Federal Trade Commission, announced a settlement with Countrywide that was to pay $108 million to settle charges that the lender "inflated fees [], made false or unsupported claims about amounts owed by homeowners [], and attempted to collect fees from borrowers that were not disclosed until after the borrower's bankruptcy case was closed."[14] A November 27, 2010 story in the New York Times stated that the U.S. Trustee also filed motions in the Northern District of Georgia asserting that JPMorgan Chase and Wells Fargo had filed relief from stay motions in debtors' cases in which the lender did not possess proper title.[15]

H. Impact of amended Bankruptcy Rules 3001(c) and 3002.1 and standing orders and local rules and governmental actions, investigations, and settlements on bankruptcy and default servicing

Amended rule 3001(c) and new rule 3002.1 of the Rules of Bankruptcy Procedure will dramatically impact mortgage claims and their resolution in bankruptcy—at least in chapter 13 cases. It is now clear that notices to debtors about payment changes on their mortgages are NOT violations of the stay. *See Gordon v. Taylor et al. (In re Taylor)*, 430 B.R. 305, 311 (Bankr. N.D. Ga. 2010) (holding that providing a debtor with payoff information about her loan did not violate the stay and citing other cases on topic). In fact, such notices are required and, if not

[14] Gail Geiger and Sandra Rasnak, USTP Actions Against Mortgage Fraud and Abuse Are Part of Financial Fraud Enforcement Task Force Sweep, http://www.justice.gov/ust/eo/public_affairs/articles/.../abi_201007.pdf , last visited December 22, 2011.

[15] Gretchen Morgenstern, "Don't Just Tell Us, Show Us That You Can Foreclose," New York Times, November 27, 2010.

filed, may arguably result in waiver of any increase in payments. Rule 3001 now makes clear that a mortgage claim cannot be disallowed solely because of a failure to attach proper documentation. It states that the remedy is to deny admission of omitted information at any hearing on the claim. The failure to attach documentation may result in disallowance but the issue must be tried or settled. Rule 3002.1 will also require a determination as to whether a mortgage has been fully reinstated by the end of a chapter 13 case. This rule will probably result in more hearings about added fees and charges. If fees, expenses or other charges are added to a mortgage, a debtor will need to amend his/her plan after each determination of charges to insure that the arrearage is paid during the plan term.

If lenders do not comply with the new rules, debtors will likely bring actions or defend against added charges and fees by asserting that they cannot be added to a loan later due to waiver or estoppel.

Courts will need to work through issues with the new rules that may require new standing orders or local rules. The new rules are drafted in a manner that makes them most appropriate for districts in which mortgages are paid through debtors' chapter 13 plans. For "direct pay" districts, districts in which the debtors pay their own mortgage payments except for arrearage claims, there are some issues. For instance, since mortgage proofs of claim are not filed for the mortgage itself, only arrearages, if there is no prepetition arrearage on the mortgage, how does a mortgage lender file a Supplement 1 or 2 to the proof of claim? At the completion of payments in a case, the chapter 13 trustee cannot state that the debtor has made all regular monthly mortgage payments because the trustee has not made them. All that the trustee can state is that he/she has paid all arrearage claims filed in the case. Do both the trustee and debtor need to file a Notice of Final Cure Payment?

Federal Reserve Board. On April 13, 2011, the Federal Reserve Board took formal enforcement actions against 10 banking organizations "to address a pattern of misconduct and negligence related to deficient practices in residential mortgage loan servicing and foreclosure processing."[16] The 10 banks must take steps "to establish mortgage loan servicing and foreclosure processes that treat customers fairly, are fully compliant with all applicable law, and are safe and sound."[17] The banks must improve oversight of their loan servicing and foreclosure operations. The 10 banks are Bank of America Corporation, Citigroup Inc., Ally Financial Inc., HSBC North America Holdings, Inc., JPMorgan Chase & Co., MetLife, Inc., The PNC Financial Services Group, Inc., SunTrust Banks, Inc., U.S. Bancorp, and Wells Fargo & Company.

The FRB is going to sanction the banks monetarily as well. No report of the amount of the sanctions is available at this time. The actions the banks must take include

> (1) strengthen coordination of communications with borrowers by providing borrowers the name of the person at the servicer who is their primary point of contact;
>
> (2) ensure that foreclosures are not pursued once a mortgage has been approved for modification, unless repayments under the modified loan are not made;
>
> (3) establish robust controls and oversight over the activities of third-party vendors that provide to the servicers various residential mortgage loan servicing, loss mitigation, or foreclosure-related support, including local counsel in foreclosure or bankruptcy proceedings;
>
> (4) provide remediation to borrowers who suffered financial injury as a result of wrongful foreclosures or other deficiencies identified in a review of the foreclosure process; and
>
> (5) strengthen programs to ensure compliance with state and federal laws regarding servicing, generally, and foreclosures, in particular.

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[16] Press Release, http://www.federalreserve.gov/newsevents/press/enforcement/201104 , last visited December 22, 2011.
[17] *Id*.

Debtors may have the right to take action against the banks if they violate the plans established. The plans of the banks are to specifically discuss how the banks will deal with issues surrounding MERS and its use.

Office of the Comptroller of the Currency. The OCC is monitoring the banks' compliance with the FRB consent orders discussed above. On November 22, 2011, the OCC reported that the banks have commenced work on compliance. "While much of the work to correct identified weaknesses in policies, operating procedures, control functions and audit processes will be substantially complete in the first part of 2012, other longer term initiatives will continue through the balance of 2012."[18] The consent orders require that banks insure that their mortgage servicers have "an easily accessible and reliable single point of contact for each borrower throughout loan modification and foreclosure processes" and have a manner of letting the borrower know who that contact is. The servicers and banks must have deadlines for responding to borrowers' requests for loan modifications that are as responsive as the timelines under HAMP. Lenders must stop all foreclosure action during a trial modification, unless the borrower defaults. Servicers can no longer "dual-track" loans which allowed loan modification requests and foreclosure procedures to occur at the same time. Payments, even partial payments, must be credited promptly "to the extent permissible under the terms of applicable legal instruments." (Does this mean no more "suspense payments?")

The consent orders require servicers to deal with MERS in a structured manner as follows:

> Must have processes to ensure that all mortgage assignments, endorsements, and all other actions with respect to mortgage loans serviced or owned by the servicer out of MERS' name are

[18] Jann Swanson, OCC Issues Interim Report on Servicer Compliance with Consent Orders, http://www.mortgagenewsdaily.com/11222011_mortgage_servicers.asp , last visited December 22, 2011.

> executed only by a certifying officer authorized by MERS and approved by the servicer;
>
> Must have processes to ensure that the servicer maintains up-to-date corporate resolutions from MERS for all servicer employees and third-parties who are certifying officers authorized by MERS, and up-to-date lists of MERS certifying officers;
>
> Must have processes to ensure compliance with all MERS requirements and with the requirements of the MERS Corporate Resolution Management System;
>
> Must have processes to ensure the accuracy and reliability of data reported to MERSCORP, including monthly system-to-system reconciliations and daily capture of all reports of problems with registrations, transfers, and status updates on open-item aging reports; and
>
> Must have an appropriate MERS quality assurance work plan and annual independent tests of the control structure of the system-to-system reconciliation process, the error correction process, and adherence to the servicer's MERS Plan.

Interim Report, pp. 12-13.

In conjunction with the issues discussed above, the OCC is allowing borrowers at certain banks to request review of their loan files if they believed they suffered financial injury "as a result of errors, misrepresentations, or other deficiencies in foreclosure actions on their primary residences between January 1, 2009 and December 31, 2010."[19] The loan must have been serviced by one of the servicers listed below:

America's Servicing Company	Countrywide	National City
Aurora Loan Services	EMC	PNC
Bank of America	Everbank/Everhome	Sovereign Bank
Beneficial	GMAC Mortgage	SunTrust Mortgage
Chase	HFC	U.S. Bank
Citibank	HSBC	Wachovia
CitiFinancial	IndyMac Mortg. Services	Washington Mutual

[19] Office of the Comptroller of the Currency, Interim Status Report: Foreclosure-Related Consent Orders, November 2011, http://www.scribd.com/doc/73522210/OCC-INTERIM-REPORT-NOV-2011-ON-THE-FORECLOSURE-REVIEWS-AND-THE-CONSENT-ORDERS, last visited December 23, 2011.

CitiMortgage Metlife Bank Wells Fargo

The loan must have actively been in the foreclosure process between 1/1/2009 and 12/31/2010. If a debtor meets the criteria, the debtor can file a claim request at www.IndependentForeclosureReview.com or call 1-888-952-9105. Besides the claims review process for loans that meet the specified criteria, the OCC is also having auditors review a sampling of other loan files as well. The files to be reviewed will be assessed in some areas that concern bankruptcy attorneys as well. The areas include a review of whether fees, penalties and charges against the loans were reasonable and customary or were excessive and whether HAMP and private bank loan modification requirements were followed.

The FDIC tracks mortgage servicing issues as well. In a speech to a Congressional Committee on July 7, 2011, the Director of the Division of Depositor and Consumer Protection stated that "borrowers in approximately 90,000 foreclosure actions have taken steps to forestall foreclosure."[20] The FDIC is tracking the following cases: "(1) borrower class actions – 67 pending class-action suits in 23 states challenging foreclosures based upon robo-signing, defective assignments, reliance upon the MERS, or the misapplication of payments; (2) class action cases related to the HAMP – 57 class actions in 25 states alleging impropriety in processing loan modifications regarding HAMP, as well as another 24 class actions in 18 states alleging misconduct under non-HAMP modification programs; (3) investor actions – 21 investor suits in 12 states alleging foreclosure and securitization misconduct that seek to "put back" defaulted loans to the loan originator and damages based upon failure to properly form the

[20] Statement of Mark Pearce, Director, Division of Depositor and Consumer Protection, Federal Deposit Insurance Corporation on Mortgage Servicing: *An Examination of the Role of Federal Regulators In Settlement Negotiations and the Future of Mortgage Servicing Standards Before the Subcommittees on Financial Institutions and Consumer Credit, and Oversight and Investigations Committee on Financial Services*; U.S. House of Representatives; Washington, D.C July 7, 2011, *available at* http://www.fdic.gov/news/news/speeches/chairman/spjul0711.html, last visited January 13, 2012.

securitization trusts, misrepresentation regarding underwriting and other misrepresentations, robo-signing, or the use of MERS; and (4) Attorney General initiated suits – three suits brought by the Attorney General of Ohio against GMAC, and the Attorneys General of Nevada and Arizona against Countrywide and Bank of America." Finally, the new Consumer Financial Protection Bureau began accepting complaints from borrowers about their mortgages as of December 1, 2011. There is a form on the Bureau's website for borrowers' use. The form says it is for complaints as the loan application process, for receiving a credit offer, for closing and settlement procedure issues, for payment issues and for loan modification, collection and foreclosure issues. The form gives the borrower a tracking number so that the complaint's progress can be followed. It is unclear what the result of a complaint might be. The CFPB clearly intends to establish a dialogue between lender and borrower. As to whether the Bureau will provide any real remedies remains to be seen.