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Securitization and Servicing of Mortgage Loans
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Honorable Frank J. Santoro
United States Bankruptcy Judge
Eastern District of Virginia, Norfolk and Newport News Divisions[1]

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I. Securitization of Loans

Historically, lending institutions (banks, savings and loan associations, etc.) originated home mortgage loans so that borrowers could acquire a house and own a part of the American dream. The originating institution would hold and service the paper. However, this model (i.e., origination, holding, servicing, work out etc. residing in the same institution) has changed dramatically--- and this change has important ramifications for bankruptcy practitioners. This paper addresses, in summary fashion, some of the changes and their impact on bankruptcy practice.

Loan securitization originated, in part, as a market response to the S&L crisis of the late 1980's and early 1990's. With the demise of the S&L industry in the wake of 1986's amendments to the Internal Revenue Code, rudimentary loan securitization began to take hold.

Loan securitization may be described, albeit simplistically, as follows. A loan is originated and closed. When a sufficiently large number of loans have closed, they are bundled together and sold as part of a pool. Capital to fund the purchase is raised via the sale of a security or series of securities; the resulting money is used to buy the pool of loans. Since this is an investment vehicle, there is a need to hire a specialty company to manage (service) the loan pool. This means collecting payment, paying real estate taxes and insurance, releasing deeds of trust or mortgages, initiating foreclosure etc. Because the loan pool is sufficiently large in number, and valid statistical tools exist for the assessment and management of risk with large numbers of inputs, the "value' and "assessment of risk" are performed on a statistical or mathematical basis. This enables traders to price and transfer the loan instruments as something like commodities. The problem associated with loan securitization may be summarized as disconnecting the upside and downside of the transactions------ the originator makes profit on the front end of the transaction and has no further involvement with the loan, leaving all of the downside risk of default and collection with the entity that holds the pooled mortgage loans. This disconnect between risk and reward has in large measure resulted in the imbalance in the current market environment.

Given the climate of selling mortgages as investment vehicles, and the need for a third party servicing entity, there has been a notable increase in the number and type of documents and pleadings submitted by servicers on behalf of mortgagees and noteholders with bankruptcy courts. Servicers have experienced a number of pitfalls throughout the bankruptcy process, including:

(a) the failure to correct the loan on its books upon the filing of the bankruptcy so that it no longer is keyed as being in arrears;
(b) application of post-petition payments to pre-petition arrearages;
(c) application of pre-petition arrearage payments received from trustee against post-petition charges;
(d) the failure to properly list fees in proofs of claim;
(e) seeking double recovery of fees paid on behalf of the debtors, through increasing mortgage payments and filing proofs of claim;
(f) failure to notify the debtor of any change in mortgage payments;

(g) the use of suspense accounts, which result in other default events that will trigger other charges;
(h) charging of fees for services not performed;
(i) failure to notify credit reporting agencies that the mortgage is current following the entry of the discharge;
(j) charging debtors for loss mitigation services;
(k) filing of false affidavits with the court;
(l) filing of motions with the court, containing false allegations;
(m) inability to create an accurate mortgage payment history;
(n) failure of counsel for servicers to review, sign and verify court pleadings;
(o) inclusion of vague disclaimer language in proofs of claim related to expense reimbursement practices;
(p) the failure to provide accurate pay-offs; and
(q) failure to timely credit payments.

II. Servicers and Motions for Relief from Automatic Stay

A. Standing

In order to seek relief from the automatic stay, any party, including (or especially) a servicer, must have standing. According to the United States Supreme Court, "[t]o qualify for standing, a claimant must present an injury that is concrete, particularized, and actual or imminent; fairly traceable to the defendant's challenged behavior; and likely to be redressed by a favorable ruling."[2] To get relief in federal court, a party must meet the standing requirements and be a real party in interest. Given the relationship between a servicer and mortgagee, a servicer should make sure to name the noteholder in the motion, and should properly allege all facts which give rise to relief, including the chain of title of the note and how the servicer and the noteholder may seek relief, if they wish to be granted relief from the automatic stay.

There have been a number of decisions related to the standing issue as it pertains to servicers. A few bankruptcy courts have held that mortgage servicers have standing to pursue relief from the stay based upon the pecuniary interests in collecting payments under the terms of the note and/or mortgage.[3] These courts reason that the servicers have contractual obligations to collect money and foreclose mortgages in the event of default by the borrowers and thus should have standing to seek relief from the automatic stay from bankruptcy courts in order to fulfill their duties as servicers.

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[2] *Davis v. Fed. Election Comm'n*, *** U.S. ***, 128 S.Ct. 2759, 2768, 171 L.Ed.2d 737 (2008).

[3] *Bankers Trust (Delaware) v. 236 Beltway Inv.*, 865 F.Supp. 1186, 1191 (E.D.Va. 1994); *In re O'Dell*, 268 B.R. 607, 618 (N.D.Ala. 2001); *In re Miller*, 320 B.R. 203, 206 n.2 (Bankr. N.D. Ala. 2005); *In re Woodberry*, 383 B.R. 373 (Bankr. D. S.C. 2008).

Other courts have held to the contrary, concluding servicers do not have standing.[4] In *Jacobson*, the Bankruptcy Court for the Eastern District of Washington denied relief from the automatic stay to the servicer, based upon the servicer failing to establish that it had the authority to act for the noteholder. The court concluded that the moving party could not establish its standing by simply stating that it was the servicer.[5] The servicer failed to either establish an interest in the note or the authority to enforce the note or even that it had the authority to file the motion on behalf of the noteholder.[6] No document was attached to the motion to establish the servicer's right to enforce the note, nor did counsel for the movant present any evidence at the hearing showing the servicer's authority, such as business records. Instead, attached to the motion was a declaration of a bankruptcy specialist, which sets out the same allegations as the motion, or *vice versa*.[7]

In reaching its decision, the *Jacobson* court noted that "for a federal court to have jurisdiction, the litigants must have constitutional standing, which requires an injury fairly traceable to the defendant's allegedly unlawful conduct and likely to be redressed by the requested relief."[8] In addition, a party must have "prudential standing".[9] Thus, in order to have standing, a servicer needs to establish its authority to act for the noteholder. Stating it has the authority to act does not establish standing. Simply put, the rule seems to be that a servicer must establish its legal authority to act for or on behalf of the note holder in pursuing rights and remedies under the instrument. These would appear to be necessary allegations in any well-pleaded lift stay motion.

B. Real Party In Interest

Even if the servicer has standing, the bankruptcy court may still deny the relief being sought by the servicer if it concludes the servicer is not a real party in interest.[10] USB AG, the servicer who filed the relief from stay motion in *Jacobson*, was held not to be a real party in interest

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[4] *In re Jacobson*, 402 B.R. 359 (Bankr. W.D. Wash. 2009);*In re Morgan*, 225 B.R. 290 (Bankr. E.D.N.Y. 1998); *In re Scott*, 376 B.R. 285 (Bankr.D. Idaho 2007). The Bankruptcy Court for the District of Idaho has also held that an assignee of mortgage may also fail to establish standing for stay relief. *In re Sheridan*, Case No. 08-20381-TLM (Bankr. D. Idaho March 12, 2009), the Bankruptcy Court for the District of Idaho sustained the chapter 7 trustee's objection to the motion for relief from stay filed by MERS, since the motion failed to state who MERS was acting as a nominee for, failed to establish that it had the authority to enforce the note, and failed to establish it had any interest in the note. Counsel for MERS argued that since it was named as a beneficiary under the deed of trust, it clearly had standing to pursue the relief being sought. The court rejected this argument, especially since no documents were produced or offered establishing the party's interest or standing.

[5] *Jacobson*, 402 B.R. at 368.

[6] *Id*.

[7] *Id*. at 362-63.

[8] *Id*. at 366 (*citing United Food & Commercial Workers Union Local 751 v. Brown Group, Inc*., 517 U.S. 544, 551, 116 S.Ct. 1529, 134 L.Ed.2d 758 (1996)).

[9] *Id*. at 367 (citations omitted).

[10] *See id*. at 366.

because it did not have a beneficial interest in the note and the court could not conclude that it could enforce the note, since no evidence was presented showing these items. Even if the servicer had the right to enforce the note, "it is the holder, rather than the servicer, which must be the moving party, and so identified in the papers and in the electronic docketing done by the moving party's counsel."[11]

The Bankruptcy Court for the Eastern District of New York reached the same decision, concluding that to the extent that "a justiciable controversy exists … with debtors, it exists solely with the holders of the mortgages, and the servicing agents, because it is only the holders of the mortgages and the mortgagors in these cases who have a 'personal stake in the outcome' of the proceeding."[12]

Recently, the Bankruptcy Court for the Central District of California concluded that the real party in interest is the trustee of the securitization trust, and not the servicing agent.[13] Typically, when a loan is securitized, a trust is created, a trustee is appointed, a transfer to the trust of thousands of secured real estate notes occurs, and there is a sale of interests in the trust to a large number of investors.[14] Because only the trustee is authorized to act under the trust, only the trustee should be joined as the owner of the note. An agent, such as a servicer, for the owner, "does not convert the noteholder's agent into a real party in interest."[15] The court held that a servicer may file a motion for relief from stay only if it joins the noteholder to the motion, or has received <u>specific authority</u> from the owner to bring the motion.[16] "Absent joinder or ratification, the noteholder must substitute into the servicer's place, and prosecute the motion on its own."[17] Presumably, a copy of the relevant portion of the loan servicing agreement, indicating authority to act on behalf of the note holder would be sufficient.

In reaching its decision, the *Hwang* court turned to whether a party seeking relief is a real party in interest, as required by Rule 17 of the Federal Rules of Civil Procedure, made applicable in bankruptcy cases pursuant to Rule 7017 of the Federal Rules of Bankruptcy Procedure. This rule states that "[a]n action must be prosecuted in the name of the real party in interest." The rule goes on to provide that while a court may not dismiss an action for failing to prosecute in the name of the real party in interest, unless, after an objection is filed, a reasonable time has been allowed for the real party in interest to ratify, join, or be substituted in the action, and the real

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[11] *Id*.

[12] *Morgan*, 225 B.R. 290, 293 (citing *Baker v. Carr*, 369 U.S. 186, 204, 82 S.Ct. 691, 703, 7 L.Ed.2d 663 (1962)).

[13] *In re Hwang*, 396 B.R. 757, 766 (Bankr. C.D. Cal. 2008) (*citing LaSalle Bank N.A. v. Nomura Asset Capital Corp*., 180 F.Supp.2d 465, 469-71 (S.D.N.Y. 2001); *accord, LaSalle Bank N.A. V. Lehman Bros. Holdings, Inc*., 237 F.Supp.2d 618, 631-34 (D.Md. 2002)).

[14] *Id*. at 767 (citation omitted).

[15] *Id*.

[16] *Id*. at 772 (emphasis added).

[17] *Id*. (*citing* Fed. R.Civ.P. 17(a)(3)).

party is not added or joined to the suit. If, on the other hand, the real party in interest does join or is substituted, then the suit may proceed as if it had originally commenced the suit.
As previously stated, once a loan is securitized, the real party in interest is or may be the trustee of the securitization trust. Thus it is arguable that the motion for relief from stay should be styled to name the securitization trustee as party to the suit, and if not done so initially, the motion should be amended to include the trustee as it is the owner of the note at issue before the court. The *Hwang* court noted, "'[a]s a general rule, a person who is an attorney-in-fact or an agent solely for the purpose of bringing suit is viewed as a nominal rather than a real party in interest and will be required to litigate in the name of his principal rather than in his own name.'"[18]

In bankruptcy, the term party in interest (as opposed to a real party in interest) is very broadly interpreted to include the debtor, creditors, officers of a corporation and professionals active in a case, and trustees. Often, a party in interest is seen as anyone who may express a view to the court as to a matter currently before the court. As previously noted, several courts have held that servicers fall into this category with respect to enforcing the terms of a note, and thus may seek relief against debtors and other parties.

The servicer may, but does not always have the authority, as the agent of the noteholder, to forbear, modify or grant relief to distressed borrowers, especially if it has the authority to seek relief from the automatic stay. A typical servicing agreement provides that the servicer with the full power and authority, acting alone, to do or cause to be done any thing in connection with servicing and administration of the mortgage loan to be serviced. Thus, the servicer may take such action it deems in the best interest of its principal when dealing with a defaulted loan, including negotiating forbearance or modification of the loan. Please note that in some circumstances, especially in the chapter 7 context, servicers do not have the ability/authority to negotiate loan modifications or agree to a forbearance of the loan terms for a period of time, making it impossible for debtors to get any meaningful relief. Instead, the debtors are simply given a telephone number of a customer service agent with the appropriate noteholder and told to contact this person in order to discuss forbearance terms or to discuss modification to the underlying loan terms. Unfortunately, when the debtors call the number, the customer service agent is not in a position to negotiate in any meaningful way, being authorized only to send out either a loan modification request or a hardship request. It has been suggested that if the servicer has the authority to participate in bankruptcy, it should also be the entity with which the debtors can deal with in negotiating forbearances, modifications or other matters. The reality often does not comport with this standard.

C. Obtaining the Relief Sought – Automatic Stay

After establishing that the movant may seek relief from the automatic stay in order to pursue its state court remedies with respect to the property, in order for a court to grant the relief being sought in the motion for relief from the automatic stay, the servicer or other moving party must

[18] *Id*. at 767 (quoting 6A Wright §1553).

establish a *prima facie* case for relief.[19] If the movant fails to meet its initial burden to demonstrate that cause exists to grant relief from the automatic stay, relief should be denied.[20] The movant has to establish that it has “a factual and legal right to the relief that it seeks.”[21] Only after making this initial showing does the burden then shift to the debtor, who has the burden of proof on all issues, except equity in the property.[22]

If the moving party, again, typically the servicer, fails to allege proper chain of title to a mortgage instrument, or establish that it is the proper movant it may not be entitled to the relief it seeks. Similarly, if a servicer fails to provide any documents in support of conclusory allegations made in the motion to lift stay, including but not limited to a copy of the deed of trust, note, assignment of note, allonge to note, or other similar document, it cannot establish standing or a *prima facie* case that it is entitled to the relief being sought. In order to avoid situations like this, counsel should allege, in its motions for relief from the automatic stay, an accurate chain of title or endorsements/assignments, along with the appropriate documents establishing the chain, so that the court, and any party reading the pleadings, may determine the standing of the moving party.

When involved with relief from stay motions, either as the moving party or as counsel for the defense/debtor, several items must be established including:

(a) Standing of the moving party;
(b) Amounts claimed owed and account status;
(c) Signature of the debtor or other defendant on the note;
(d) Assignments and Endorsements;
(e) Chain of Title; and
(f) Payment History.

Keep in mind that “a hearing on a motion for relief from stay is a summary proceeding and is not a proceeding where the bankruptcy court adjudicates substantive rights.”[23] It is simply a “summary proceeding of limited effect ….”[24] When deciding whether to grant relief from the automatic stay, at least according to the First Circuit Court of Appeals, the only thing to determine is:

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[19] *Unnamed Citizens A Thru E and Certain Minor Children v. White (In re White)*, 410 B.R. 195, 201(Bankr. W.D. Va. 2008)(citations omitted); *Mazzeo v. Lenhart (In re Mazzeo)*, 167 F.3d 139, 142 (2nd Cir. 1999).

[20] Schneiderman v. Boddanovich (In re Boddanovich), 292 F.3d 104, 110 (2nd Cir. 2002).

[21] *In re Elmira Litho, Inc*., 174 B.R. 892, 902 (Bankr. S.D.N.Y. 1994).

[22] 11 U.S.C. §362(g).

[23] *In re Roberts*, 367 B.R. 677, 686 (Bankr. Colo. 2007).

[24] *Id*. (*citing Grella v. Salem Five Cent Say. Bank*, 42 F.3d 26, 33 (1st Cir. 1994)).

> whether the party seeking relief has a colorable, claim to property of the estate. The statutory and procedural schemes, the legislative history, and the case law all direct that the hearing on a motion to lift the stay is not a proceeding for determining the merits of the underlying substantive claims, defenses, or counterclaims. Rather, it is analogous to a preliminary injunction hearing, requiring a speedy and necessarily cursory determination of the reasonable likelihood that a creditor has a legitimate claim or lien as to a debtor's property. If a court finds that likelihood to exist, this is not a determination of the validity of those claims, but merely a grant of permission from the court allowing that creditor to litigate its substantive claims elsewhere without violating the automatic stay.[25]

By seeking for relief from the stay, the movant is asking the court to determine whether grounds exist under §362 to grant the relief sought. If the stay is lifted, the movant is free to proceed to seek a determination of their rights under state law, including going forward with a foreclosure. Any issues involving ownership of real property, the rights of the parties as to the loan transaction and the rights of the parties as to a foreclosure action, remain issues to be decided under applicable state law, for the appropriate state court to consider. A bankruptcy court may not alter the rights of the parties, although some debtors may wish the court to do so. Thus, if the motion for relief is denied, for example, because the movant fails to establish it has standing to pursue the relief requested, this does not mean that the debtor owns the house free and clear of any liens. It only means that the bankruptcy court has not allowed the movant relief from the automatic stay, during the pendency of the bankruptcy case, to pursue its state law remedies.

III. Errors in Proofs of Claim

Errors in proofs of claim, filed by servicers and other parties, have also been on the rise. Rule 3001(f) of the Federal Rules of Bankruptcy Procedure provides that a proof of claim executed and filed in accordance with the rules of procedure constitute *prima facie* evidence of the amount and validity of the claim. The burden then shifts to the opposing party to object to the claim. In the absence of a properly documented claim under Fed. R. Bankr. P. 3001(c), however, the *prima facie* presumption as to validity and amount may not be applicable.[26] The absence of the Rule 3001(f) presumption, however, does not mean that a filed proof of claim is automatically disallowed. The grounds for disallowance of a proof of claim are specifically provided for in 11 U.S.C. §502. If the only basis for disallowing the claim is for lack of documentation, such disallowance may not be justified or appropriate.[27] As more clearly explained in *In re Simms*[28], the debtor must also assert a grounds for disallowance under §502. In *Simms*, the Bankruptcy Court for the Northern District of West Virginia overruled the debtor's objection that the creditor

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[25] *Id*. (citing *Grella*, 42 F.3d at 33-34).

[26] *E.g., In re Tran*, 369 B.R. 312, 317 (S.D. Tex. 2007).

[27] *See, e.g., Perron v. eCAST Settlement Corp. (In re Perron)*, 2006 Bankr. LEXIS 2639 at *12 (BAP 6th Cir. Oct. 13, 2006) (holding that "[t]he mere failure to comply with the rules concerning the form and content of a proof of claim is not justification under the Bankruptcy Code to judicially invalidate a creditor's otherwise lawful claim."); *Dove-Nation v. eCast Settlement Corporation (In re Dove-Nation)*, 318 B.R. 147 (B.A.P. 8th Cir. 2007); *Heath v. American Express Travel Related Company (In re Heath)*, 331 B.R. 424 (B.A.P. 9th Cir. 2005).

[28] Case No. 06-1206 (Bankr. N.D. W. Va. 12/17/2007).

failed to properly document its proof of claim because, “even if the Debtor’s objection to lack of proper documentation is proper under Rule 3001(c), the Debtor has not raised any legal or factual dispute regarding the validity or amount of eCAST’s claim under §502(b).”[29]

A proof of claim lacking sufficient documentation may nevertheless become *prima facie* evidence of a claim when considered in conjunction with the debtor’s schedules, reasoning that while the proof of claim may not establish the *prima facie* case, the schedules signed under oath and under penalty of perjury by the debtor would.[30] In addition, if the claimant does not get the presumption, its claim may still be allowed by proving its claim by a preponderance of the evidence.[31] “[L]ack of proper supporting documentation does not, in and of itself, result in a claim’s disallowance; rather, it strips it of any *prima facie* validity, requiring the creditor to offer the supporting documentation to carry its burden of proof in the face of an objection.”[32]

Given the growth of the mortgage market, including the securitizing and servicing of these loans by affiliates of lending institutions and/or independent loan servicers, there has been an inevitable increase in problematic claim filings. Some mortgage companies, or their agents, have filed proofs of claim without proper documentation, or have filed proofs of claim, but another mortgage company, or its agent, has filed a motion for relief against the same debtor for the same property. For example, in *In re Hayes*[33], the debtor executed a note and mortgage for property with Argent Mortgage Company, LLC (“Argent”), as the lender. AMC Mortgage Services, Inc. (“AMC”), not Argent, filed a proof of claim in the debtor’s bankruptcy case, as loan servicer for Argent. The debtor objected, claiming that the fees sought were unreasonable and excessive, and that AMC failed to attach a copy of the note or mortgage. One month later, Deutsche Bank filed its motion for relief, as trustee of Argent Mortgage Securities, Inc. In the motion, Deutsche Bank alleged it was the current holder of the mortgage, that the Debtor failed to stay current on post-petition mortgage payments, there was little to no equity in the property, and that the property was unnecessary for a successful reorganization. The debtor objected to the motion, asserting she did not have sufficient information to either admit or deny the allegation that she had failed to make post-petition payments and objected to Deutsche’s standing to bring the motion.

AMC responded to the claim objection and attached was a copy of the note and mortgage, along with a loan history. Approximately 16 months later, an attorney filed a transfer of claim other than for security, related to this claim, whereby AMC attempted to transfer the claim it filed on behalf of Argent to Citi Residential Lending, Inc., as loan servicer for the secured creditor Deutsche Bank National Trust Company, as trustee, in trust for the registered holders of Argent Securities, Inc. One can understand the confusion surrounding this sequence of events.

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[29] *Id*. at 5.

[30] *In re Jorczak*, 314 B.R. 474 (Bankr. D. Conn. 2004).

[31] *In re Porter*, 374 B.R. 471, 483 (Bankr. D. Conn. 2007); *In re Tran*, 369 B.R. 312, 317 (Bankr. S.D. Tex. 2007).

[32] *In re Armstrong*, 320 B.R. 97, 104-05 (Bankr. N.D. Tex. 2005).

[33] 393 B.R. 259 (Bankr. Mass. 2008).

The bankruptcy court consolidated the hearings on the objections to the claim and motion. At trial, Deutsche Bank actually presented a witness, a bankruptcy specialist with Citi Residential Home Lending, Inc. With respect to the claim issue, the court held that there was insufficient evidence presented to establish that the claim could be traced from Argent to AMC and then from AMC to Argent Securities Inc. it disallowed the claim and denied the motion for relief.[34]

On the other end of the spectrum, some servicers or mortgage companies have filed proofs of claim even though at the time of filing, they are not owed anything by the debtor. In a recent case before the Northern District of Ohio, Countrywide Home Loans referred a loan account to a law firm to file a proof of claim and objection to confirmation of the debtor's chapter 13 plan, although the property in question had been sold in a short sale prior to the bankruptcy filing.[35] Countrywide provided to the firm a copy of the note and mortgage, but not the payment history, or notes for the file. According to the proof of claim filed, the debtor owed approximately $88,000, all of which was secured.[36] It should be noted that the mortgage and note had been entered into with Ameriquest Mortgage Company, not Countrywide, and the proof of claim failed to attach any assignment or other transfer documents from Ameriquest to Countrywide. The debtor responded to the objection to confirmation and objected to the claim, alleging that she had sold the property in a short sale prior to the filing of her bankruptcy case, with Countrywide's permission. The court sustained the objection to the proof of claim, but, unfortunately for Countrywide, that was not the end of the story. Given the circumstances of the case, the Office of the U.S. Trustee argued that Countrywide was guilty of abusing the court process, acting recklessly and in bad faith.[37] Given what transpired in the case, the court determined that sanctions were appropriate, given the violations of Rule 9011 of the Federal Rules of Bankruptcy Procedure and 11 U.S.C. §105, and also "other sanctions sufficient to deter repetition of this conduct or comparable conduct by others" and scheduled another trial with respect to the appropriate level of sanctions.[38]

Similarly, in *In re Wells*[39], the chapter 13 debtors objected to a mortgage arrearage proof of claim. The debtors, in their schedules, listed Aegis Mortgage Corp. as a secured creditor, holding a claim for $96,000, secured by their residence, and identified Ocwen as an additional party to receive notice. U.S. Bank National Association ("U.S. Bank"), as Trustee for the Registered Holders of Aegis Asset Backed Securities Trust Mortgage Pass-Through Certificates, Series 2005-4 filed a proof of claim, secured by the debtors residence, and listed Ocwen to receive notices. The claim was signed by an individual in the Quality Control, Bankruptcy

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[34] *Id*. at 270.

[35] *In re O'Neal*, Case No. 07-51027 (Bankr. N.D. Ohio May 1, 2009). The debtor, given the short sale, did not list Countrywide or any other mortgage company in her schedules, nor did she list the property as being an asset.

[36] *Id*. at 15.

[37] *Id*. at 18.

[38] *Id*. at 22-23.

[39] 407 B.R. 873 (Bankr. N.D. Ohio 2009).

Department, without identifying for whom she filed it. The claim did not have a power of attorney designation or attachment. Other documents, including an itemization of the claim, payoff information, expense breakdown, mortgage and note, were attached to the proof of claim form. U.S. Bank did not attach any document evidencing the transfer of the note from Aegis to it, although there were assignments provided. The mortgage identified MERS as the mortgagee, as nominee for the lender. Later, U.S. Bank provided copies of two assignments of the note and mortgage. The first assignment was from MERS as nominee for Aegis Lending Corporation to U.S. Bank, Successor-in-Interest to Wachovia Bank, National Association, as Trustee for the Registered Holders of Aegis Asset Bank Securities Trust Mortgage Pass-Through Certificates, Series 2005-4, and the second assignment was made by U.S. Bank for Wachovia, to U.S. Bank, as Trustee for the Registered Holders of Aegis Asset Backed Securities Trust Mortgage Pass-Through Certificates, Series 2005-4. While the second assignment was dated August 23, 2007, it was notarized on March 24, 2009 and filed on April 3, 2009, well after the proof of claim was filed. In Ohio, notes cannot be assigned, and therefore the assignments failed with respect to the note.

The *Wells* court sustained the objection of the debtors, concluding that the claim was filed by U.S. Bank, the documents attached only establish that Aegis Lending Corporation as the lender and MERS as the mortgagee as nominee for the lender, and following the objection, U.S. Bank failed to establish it was a secured creditor of the debtors, and thus the claim was disallowed.[40]

Even if the claimant is the right party, that fact does not alleviate other important proof of claim issues, including claiming the appropriate amounts as being owed. If the amounts alleged as being owed in the proof of claim are unclear or incorrect, bankruptcy courts may order damages to be paid by the filing party. For example, the Bankruptcy Court for the Eastern District of Louisiana ordered Wells Fargo to pay $10,000.00 in damages to the debtor, plus $12,350.00 in legal fees, "for the abusive imposition of unwarranted fees and charges…."[41] In *Stewart*, Wells Fargo was held accountable for unwarranted fees and charges, imposition of fees, the negligent imposition of fees and costs not due, the improper calculation of escrow payments, the misapplication of fees, the failure to notify the debtor of fees and charges, and the improper payment of unnoticed fees and charges during the bankruptcy case.[42] The court also ordered Wells Fargo to audit every proof of claim filed on or after April 13, 2007, and to include a loan history with each claim.[43] In addition, the court ordered Wells Fargo to review proofs of claim already filed, and to amend, where necessary.

Wells Fargo, in a separate case, also before the Eastern District of Louisiana, admitted that there were irregularities in how it accounted for payments on its claims, including: (a) application of trustee payments to post-petition charges rather than payments towards the prepetition debt they were remitted to satisfy; (b) applying debtor payments to prepetition arrearages although

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[40] *Id*. at 883.

[41] *In re Stewart*, 391 B.R. 327, 357 (Bankr. E.D. La. 2008).

[42] *Id*.

[43] *Id*.

intended for current mortgage payments; (c) failure to notify borrowers of charges; (d) postpetition imposition of professional (attorney) fees without prior court approval; and (e) imposition and payment of postpetition fees from estate funds without disclosure.[44] Wells Fargo further admitted that these practices occurred in every case filed in the United States.[45] Wells Fargo contended that, although it suggested that it had systemic problems in every bankruptcy case, every debtor should have to make a challenge, by separate suit, to the proofs of claim filed by Wells Fargo.[46]

There are multiple potential problems associated with this position, including the simple fact that Wells Fargo may have admitted presenting incorrect information in proofs of claim in contravention of specific statutes warning against and perhaps criminalizing such behavior. The idea that this conduct is acceptable as long as it remains unchallenged with regard to each specific claim is problematic. "Wells Fargo's position also requires the Court to participate in its egregious conduct…. Because Wells Fargo takes a 'scream or die' approach to judicial review, it would require this Court to not only honor, but enforce collection on illegally imposed debt."[47] As a result, the court ordered injunctive relief directing Wells Fargo to account for all postpetition payments received as professional fees and to verify that estate funds were not being used in a manner in conflict with the provisions of plans and confirmation order.

Attorneys who file either proofs of claim or motions for relief on behalf of mortgagees or servicers should keep in mind that by signing, filing, or arguing in support of a pleading, they have a duty to the court to tell the truth and are to be held accountable for mistakes and may be the person sanctioned for a violation. If a court finds that a party has violated Rule 9011 of the Federal Rules of Bankruptcy Procedure, the attorney may be held accountable. Every attorney is under a duty to make a reasonable investigation before filing a document or submitting a document with the court for consideration. When preparing proofs of claim, it may not be wise solely to rely on information supplied by a client, without further inquiry.

While errors in proofs of claim, filed by, or on behalf of mortgage companies, may mean the creditor does not get paid any arrearages owed during the life of the case, it does not mean that the debtor owns the house free and clear of any liens, as seen in the recent case, *In re Eads*[48], decided by the Bankruptcy Court for the Eastern District of Texas, Sherman Division. In Eads, Litton Loan Servicing, L.L.P. ("Litton"), as servicer, filed a claim on behalf of Homecomings Financial Network, Inc. ("Homecomings"). The debtor objected to the claim, no response was filed to the objection, and the bankruptcy court entered a default order, sustaining the debtor's objection.[49] The debtor then argued that the default order entitled her to her house, free and clear

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[44] *In re Jones*, Case No. 03-16518, Section A, 14 (Bankr. E.D. La. Oct. 1, 2009).

[45] *Id*.

[46] *Id*. at 14-15.

[47] *Id*. at 16 - 17.

[48] Case No. 05-42356 (Bankr. E.D. Tex. Sept. 18, 2009).

[49] *Id*. at 8.

of any liens. The court disagreed, and reversed its earlier decision, concluding that the objection had not been properly served to the extent it sought to avoid the lien on the debtor's house. A separate proceeding with heightened notice and due process considerations is generally required to strip or avoid a lien.

IV. Post Discharge Foreclosures

In *In re Janssen*[50], the Bankruptcy Court for the Eastern District of Pennsylvania considered a case involving a post-discharge dispute between a former chapter 13 debtor and his mortgage company. The mortgage company was attempting to conduct a foreclosure sale after the granting of a discharge, based upon the debtor's alleged failure properly to pay his mortgage. The debtor filed a motion to reopen his bankruptcy case and also filed an adversary proceeding against Chase, the mortgage company attempting to conduct the foreclosure.

The court framed the issue as follows:

> does the bankruptcy court have jurisdiction under 28 U.S.C. §1334(b) to reopen a bankruptcy case to determine whether a chapter 13 debtor cured a prepetition default by fully performing his plan payment obligations under 11 U.S.C. §1322(b)(5) both to the trustee and to the creditor on account the obligations arising postpetition.[51]

Chase, for its part, argued that the bankruptcy court lacked subject matter jurisdiction because the dispute did not relate to chapter 13 plan payments, but instead to payments made directly by the debtor to Chase for post-petition payments, and because these payments were not made under the plan, the court was precluded from making any determination. The court disagreed, noting that curing a prepetition default under §1325(b)(5) requires the debtor to make the plan payments to provide for the curing of the default, and also to provide for "'maintenance of payments while the case is pending.'"[52] The court held that it had subject matter jurisdiction to determine whether the debtor performed his obligations under the chapter 13 plan. Chase also argued that the court lacked jurisdiction because the other aspect of the dispute between the parties involved payments due post-discharge, which the Debtor offered evidence such payments were in fact made. The Debtor contended the dispute involved application of plan payments or payments made to Chase directly during the life of the plan.

The court determined it had jurisdiction over the claims alleged by the debtor in the adversary proceeding, and that it could determine whether the post-discharge foreclosure was appropriate, under the circumstances.[53] In deciding to grant the motion to reopen, the court noted that such

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[50] 396 B.R. 624 (Bankr. E.D.Pa. 2008).

[51] *Id*. at 632.

[52] *Id*. at 631 (*quoting In re Venuto* 343 B.R. 120, 132-33 (Bankr. E.D. Pa. 2006)).

[53] *Id*. at 634.

decision is within the discretion of the court.[54] 11 U.S.C. §350(b) allows the reopening of the case in order to administer assets, to accord relief to the debtor or for other cause. The party seeking to reopen a case bears the burden of showing circumstances justifying the reopening.[55]

In deciding whether to grant a motion to reopen, courts consider several factors including:

(a) how long the case has been closed;
(b) whether another forum, such as state court, has the ability to determine the issue in question;
(c) whether prior bankruptcy litigation implicitly determined that a state court would be an appropriate forum to determine the issue in question;
(d) whether any parties would be prejudiced if the case were/were not opened;
(e) whether it is clear at the time of the motion being considered that the debtor would not be entitled to any relief; and
(f) the extent of the benefit which the debtor seeks to achieve by reopening.[56]

In *Janssen*, the court reasoned:

> [i]f proven, the Debtor's claim is tied directly to the bankruptcy court's claims allowance and distribution processes in chapter 13 cases. The bankruptcy system has a substantial interest in protecting the integrity of these processes and in enforcing the principle set forth in 11 U.S.C. §1327 that the provisions of a confirmed plan bind the debtor and each creditor.[57]

Accordingly, if post-discharge a mortgage company initiates foreclosure proceedings, and there is a legitimate factual argument that the foreclosure relates to plan payments or payments made by a chapter 13 debtor during the life of the plan, the debtor may wish to reopen his bankruptcy case and have the bankruptcy court determine whether the mortgage company is entitled to conduct a foreclosure.

V. Role of the U.S. Trustee in Mortgage Servicing Disputes

While it is more often that the Office of the U.S. Trustee participates in matters involving fee applications, prosecuting motions to convert or dismiss cases, objecting to disclosure statements and plans of reorganizations, and show causes issued against debtors, recently, the Office of the U.S. Trustee has participated in a number of suits involving mortgage companies and their agents.[58]

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[54] *Id*. (*citing In re Zinchiak*, 406 F.3d 214, 223 (3d Cir. 2005).

[55] *Id*. (*citing In re Otto*, 311 B.R. 43, 47 (Bankr. E.D.Pa. 2004)).

[56] *Id*. at 634-35 (*citing Otto*, 311 B.R. at 47; *In re Antonious*, 373 B.R. 400, 405-06 (Bankr. E.D.Pa. 2007)).

[57] *Id*. at 636.

[58] *See, e.g.*, *In re Parsley*, Case No. 05-90374 (Bankr. S.D.Tex. Mar. 5, 2008); *In re Wilson*, 2009 WL 304672 (Bankr. E.D. La. Feb. 6, 2009).

Typically, mortgagees and loan servicers have either argued that the Office of the U.S. Trustee does not have standing to participate in matters involving their conduct or that there is no subject matter jurisdiction to consider the claims made, courts have disagreed.[59] In support of allowing the participation of the Office of the U.S. Trustee, courts have relied upon statutory law, case law, and legislative history. For instance, 11 U.S.C. §307 provides "[t]he United States trustee may raise and appear and be hard on any issue in any case or proceeding under this title but may not file a plan pursuant to section 1121(c) of this title." If nothing else, they may object to protect the integrity of the system.[60] Please note the implications of this position with reference to the standing discussion above.

Currently, the Office of the U.S. Trustee has assigned the Philadelphia office to lead a national team of offices in an investigation into the conduct of Lender Processing Services, Inc., f/k/a Fidelity National Information Services ("LPS") in bankruptcy cases.[61] The concern of the Office of the U.S. Trustee involves LPS's preparation of proofs of claim, accounting for payments received from debtors, imposition of fees and costs on debtors and preparing stay relief motions for noteholders. In *Taylor*, LPS argued that the court lacked subject matter jurisdiction to consider the Office of the U.S. Trustee's concerns because the motion for relief from stay had been resolved, the objection to the claim it filed on behalf of HSBC had been settled and the plan had been confirmed, resulting in the revesting of the property from the estate to the debtors. Fidelity, prior to becoming LPS, also took this position in *Wilson*, a bankruptcy case out of the Eastern District of Louisiana, arguing that after the motion for relief from stay was denied, the court no longer had jurisdiction to grant the Office of the U.S. Trustee's motion for discovery. The Bankruptcy Court disagreed, noting that "it maintained jurisdiction to consider collateral matters that emanate from the Motions as well as the administration of the case."[62] The impact of these decisions and those similar to it on the well-established case or controversy requirement in federal jurisprudence is not clear.

In approximately three hundred cases pending in the Western District of Pennsylvania, the chapter 13 trustee filed motions to compel Countrywide Home Loans, Inc., f/k/a Countrywide Funding Corp. to provide loan histories and for sanctions.[63] In ten of those cases, the U.S. Trustee filed motions seeking to examine Countrywide under Rule 2004 of the Federal Rules of Bankruptcy Procedure and for turnover of certain documents, and pointed to behavior by Countrywide which raised issues or concerns related to the integrity of the bankruptcy system.[64]

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[59] *See, e.g., Id.*; *In re Taylor*, 407 B.R. 618 (Bankr. E.D. Pa. 2009).

[60] *In re Dow Corning Corp.*, 194 B.R. 147 (Bankr.E.D. Mich. 1996).

[61] *Taylor*, 407 B.R. at 631.

[62] *Wilson*, 2009 WL 304672 at *3 (Bankr. E.D. La. Feb. 6, 2009).

[63] *In re Countrywide Home Loans, Inc.*, 384 B.R. 373, 377 (Bankr. W.D. Pa. 2008).

[64] *Id.*

As was the case in the other cases discussed above, Countrywide objected, arguing that the U.S. Trustee lacked standing to conduct the examination or review the documents being sought, that the examination exceeds the statutory scope of its powers and duties.[65] In deciding the issue, the Bankruptcy Court for the Western District of Pennsylvania first considered the history of the Office of the United States Trustee.

Prior to the enactment of the Bankruptcy Reform Act of 1978 (the "1978 Act"), all administrative and judicial functions were handled by the bankruptcy judges. The 1978 Act separated the administrative and judicial aspects of bankruptcy, creating a pilot program U.S. Trustee, scheduled originally to run through 1984, later extended to 1986.[66] The pilot program continued for a number of years, until Congress made the program permanent part of the bankruptcy system, through the enactment of the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986 (the "1986 Act").[67] This act added §307 which provides that the United States trustee may raise and may appear on any issue in a case or proceeding, other than to file a plan under 11 U.S.C. §1121.

Countrywide pointed to 28 U.S.C. §586(a) in support of its argument, which lays out a list of duties of the Office of the U.S. Trustee, and reasoned that the U.S. Trustee is limited to these items to pursue and investigate. The court disagreed, based upon the statutory language, concluding that under §307, the Office of the U.S. Trustee had the authority to conduct 2004 examinations of Countrywide under the circumstances of the case. The court reasoned that the better view is to allow a broad view of the powers of the U.S. Trustee, and relied upon a number of cases in support of this premise.[68]

Given the current status of the situation involving the securitization of the mortgages, and the current state of the economy, it is fair to expect that the Office of the U.S. Trustee will continue to monitor cases involving mortgage companies and their servicers, especially if they are repeat offenders of the bankruptcy rules.

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65 *Id*. at 379.

66 *Id*. at 380.

67 *Id*. at 381.

68 *Id*. at 387-89 (*citing U.S. Trustee v. Price Waterhouse*, 19 F.3d 138 (3d Cir. 1994); *In re Columbia Gas Systems, Inc*., 33 F.3d 294 (3d Cir. 1994); *In re Revco D.S., Inc*., 898 F.2d 498 (6th Cir. 1990); *In re Plaza de Diego Shopping Center, Inc.*, 911 F.2d 280 (1st Cir. 1990); *In re Clark*, 927 F.2d 793 (4th Cir. 1991)).