MESSING WITH MORTGAGES: CONTINUING CONSUMER AND CREDITOR CONFUSION

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This portion of the materials will provide readers with a sampling of bankruptcy cases that illustrate the recent trends that have emerged, by the courts sua sponte, by novel arguments of practitioners and by innovative investigations by the trustees, to address or at the least delay, the soaring number of foreclosures resulting from the "mortgage mess".

Make Sure Your Pleading Contains Accurate Information Regarding The Identity Of The Real Party In Interest

On April 25, 2008, Judge Rosenthal issued an memorandum of decision regarding an order to show cause why sanctions should not be imposed in the matter of Nosek v. Ameriquest Mortgage Company, 2008 Bankr. LEXIS 1251 (Bankr. D. Mass. 2008). Ameriquest had maintained throughout a prior adversary proceeding and bankruptcy case that it was the "holder" of the note and mortgage. When the debtor filed a second adversary proceeding requesting trustee process from two Chapter 13 Trustees to collect payment on the judgment issued in the prior case, Ameriquest argued that it was merely the servicer of the loans and that it was not the owner of the funds sought to be collected. The court noted that Ameriquest and its attorneys had made misrepresentations to the court throughout the prior proceedings regarding its status as noteholder. Wells Fargo, NA as Trustee for Amresco Residential Securities Corp. Mortgage Loan Trust, Series 1998-2 was the real holder of the note. The Court issued a Notice to Show Cause why sanctions should not be imposed on account of the misrepresentations made to the Court and to determine if the misrepresentations were "indicative of very sloppy practice at best

or an intentionally deceptive practice at worst". A hearing on the matter was held. The Court dismissed Ameriquest's arguments that the Debtor had knowledge of the real noteholder as the assignment of mortgage was recorded with the Registry of Deeds, that it was industry practice for an original noteholder to take back a note when a borrower defaulted and that it, as servicer, was allowed to proceed in its name pursuant to the Pooling and Servicing Agreement. Ameriquest was sanctioned $250,000 for its mispresentations. The local law firm and one of its partners was each sanctioned $25,000 as the firm had institutional knowledge of the actual identity of the holder of note on account of previous filings within the Debtor's earlier bankruptcy cases. Ameriquest's national counsel was sanctioned $100,000 for its failure to probe the information given to it by the lender. Finally, Wells Fargo was sanctioned $250,000. The Court stated that a note holder cannot hide behind the Pooling and Servicing Agreement and try to "bifurcate the benefits of the note, namely its right to receive repayment of the loan, from all responsibilities associated with servicing and collecting payments".

Make Sure Your Pleading Contains Accurate Financial Information or Fed. R. Bankr. P. 9011 May Be Imposed

Along with the drastic increase in foreclosures and bankruptcy filings came an influx of motions for relief from the automatic stay. Judge Bohm asked counsel why a motion from relief from stay was being withdrawn. The lawyer's answer resulted in the judge issuing two show cause orders in In re Parsley, 2008 Bankr. LEXIS 593 (Bankr. S.D. Texas 2008). The real answer should have been that the motion for relief was filed in error on account of an erroneous payment history. Unfortunately, counsel misrepresented to the court that it was a "good motion" and that set off an explosion, leading to evidence of other misrepresentations.

In this case, Countrywide Home Loans referred a motion for relief from stay to its national counsel who in turn referred the matter to local counsel. Testimony of associates

employed by the national counsel revealed confusion amongst themselves over who the actual client was and who the attorney in charge was. Further investigation revealed that only national counsel was permitted to speak to Countrywide but that national counsel was not required to monitor post-petition payments. The Court expressed concern that local counsel could not comply with Fed. R. Bankr. P. 9011 with respect to checking the financial information contained in the motion under this arrangement.

The Court also inquired about the passing along of legal fees to the borrower in situations where the motion for relief was improperly filed. Countrywide testified that a review of fees would be done at the time of the bankruptcy discharge to classify whether the fees were recoverable or non-recoverable. The judge expressed disdain for this procedure and had high doubts that the classification would ever take place. Testimony also revealed that the payment histories were prepared by paralegals and were not reviewed by any attorneys. Countrywide did not review the loan histories either. No one was catching the errors under this system. Judge Bohm wrote "what kind of culture condones its lawyers lying to the court and then retreating to the office hoping that the Court will forget about the whole matter." Ultimately, no sanctions were imposed by the Court as the firms and Countrywide vowed to "mend their broken practices."

In an earlier matter, also in the Southern District of Texas, the Court sanctioned a law firm in the amount of $75,000 for filing an objection to plan and subsequent withdrawal of the objection that was deemed to be "gibberish." <u>In re Allen</u>, 2007 Bankr. LEXIS 2063 (Bankr. S.D. Texas 2007). It was clear to the Court that the pleadings were not being reviewed by an attorney after being generated by a computer as the objection listed reasons that were completely unrelated or blatantly opposite of the contents of the Chapter 13 plan filed by the debtor. The

Court's decision recited a string of prior instances of violations of Fed. R. Bankr. P. 9011 with the law firm and had even imposed a previous sanction of $65,000. Undeterred, the Court imposed the $75,000 sanction, reducing it from $150,000 due to significant measures undertaken by the law firm to prevent the mistakes from reoccurring.

On April 10, 2008, Judge Morris, a bankruptcy court judge for the Southern District of New York, issued a decision in the case of In re Schuessler, 2008 Bankr. LEXIS 1000 (Bankr. S.D. NY. 2008) regarding an order to show cause why Chase Home Finance, LLC should not be sanctioned for submitting pleadings that were misleading and that had no factual support. Chase filed a motion citing minimal payment defaults with no recitation of the large equity cushion in the real estate. The motion also left out pertinent facts regarding Chase's refusal to accept a payment at a branch office. The Court stated that the decision was "intended to serve as a warning to all creditors that the conduct of the mortgage servicer constituted an abuse of process" and that a "creditor's inattentiveness can be just as abusive as an intentional act of misconduct". Id. The order did not impose monetary sanctions on Chase, other than payment of the debtor's legal fees and the disallowal of any charges to the debtor's account resulting from the motion to lift stay. The Court also denied a motion to lift stay. The Court warned that the sanction was an extremely mild one and that the exercise in restraint by the Court should not limit the Court's ability to impose greater sanctions on any mortgage servicer in future cases of this nature. Id.

Standing Challenges: Make Sure The Company Bringing The Action Has The Legal Right To Do So

Another trend is to challenge a creditor's standing or right to file pleadings within a bankruptcy case. The court said in In re Schwartz, 366 BR 265 (Bankr. D. Mass. 2007) that

parties who do not hold the note or mortgage and who do not service the mortgage do not have standing to pursue motions for relief or other actions arising out of the mortgage obligation. In Schwartz the creditor was seeking relief to pursue an eviction action following a foreclosure sale. The assignment of mortgage into the foreclosing mortgagee was executed four days *after* the foreclosure sale took place. The Court stated that while the term "mortgagee", as used in M.G.L. c. 244 §1, "has been defined to include assignees of a mortgage, there is nothing to suggest that one who expects to receive the mortgage by assignment may undertake any foreclosure activity." Id. at 269. The motion for relief was denied.

The Schwartz Court also decided In re Maisel, 378 B.R. 19 (Bankr. D. Mass. 2007). A creditor filed a motion for relief from the automatic stay and produced an assignment of mortgage dated four days after the motion for relief from stay was filed. The creditor argued that standing should be assessed from the time of the entry of an order granting relief from stay and argued that Saffron v. Novastar Mortgage, Inc., No. 07-40257, slip op. (D. Mass. Oct. 18, 2007) stood for that proposition. Judge Rosenthal distinguished Saffron from the facts present in Maisel as Novastar was always the holder of the note, regardless of the date of the assignment of mortgage. He further remarked that Saffron did not hold that standing is assessed at the time of entry of the order granting relief from stay. The Court reiterated the language contained within Fed. R. Bankr. P. 9011 (b)(3), and called upon parties filing pleadings with the court to ensure that the "allegations and other factual contentions (recited in a motion presented to the Court) have evidentiary support" at the time the motion is filed. Maisel at 22.

The Bankruptcy Court in South Carolina recently addressed the issue of standing in In re Woodberry, 383 B.R. 373 (Bankr. D.S.C. 2008). In Woodberry, America's Servicing Co. as servicer for US Bank National Association, as Trustee for the Structured Asset Investment Loan

Trust, 2005-8, and its successors and/or assigns ("ASC"), filed a motion for relief from the automatic stay. The Debtor challenged ASC's right to file the pleading. The Court required the creditor to prove that it was a party in interest at the time the motion was filed. In this case, ASC was able to prove ownership of the note and mortgage by producing the original documents and introducing them into evidence at an evidentiary hearing on the issue. South Carolina state law did not require that a creditor have a written assignment of mortgage to prove ownership.

While not a bankruptcy court case, a United States District Court case worthy of inclusion in this section is In re Foreclosure Cases, 2007 WL 3232430 (N.D. Ohio 2007). The District Court issued an order covering numerous foreclosure cases that were pending in the state. The creditor was ordered by the Court to produce evidence that the named plaintiff was the holder and owner of the note and mortgage as of the date the foreclosure complaint was filed. The court dismissed the foreclosure complaints when the lenders were unable to produce the assignments.

How Many Times Can A Lender Continue a Foreclosure Sale?

For several years since 2001, the continuation of a foreclosure sale upon the filing of a bankruptcy petition was essentially unchallenged by the debtors' bar largely on account of Judge Hillman's decision in In re Heron Pond, LLC, 258 B.R. 529 (Bankr. D. Mass. 2001). In conjunction with Judge Feeney's decision in Hart v. GMAC Mortgage Corp., 246 B.R. 709 (Bankr. D. Mass. 2000), the consensus in the courts was that there was no absolute rule regarding the continuation or postponement of a foreclosure sale by a creditor. Each case would have to evaluated on a case-by-case basis although the general directive was that "one" postponement by a creditor would be blessed by the court. Practitioners are once again challenging the repeated postponement of foreclosure sales by creditors. The Massachusetts Bankruptcy Courts have addressed this issue twice in 2008. The first case was In re Soderman, 2008 Bankr. LEXIS 384

(Bankr. D. Mass. 2008). In Soderman the court recited the "one-time" postponement blessing in order to seek relief from stay but that repeated continuances may be a violation of the automatic stay. The repeated continuances will be deemed a violation of the stay if the postponements are made in order to harass the debtor, gain an advantage for the creditor or renew the financial strain that led the debtor to file for bankruptcy protection. Id. One month after the decision in Soderman was released, Judge Hillman also ruled that repeated continuances of a foreclosure sale was a violation of the automatic stay. In re Lynn-Weaver, 2008 Bankr. LEXIS 1101 (Bankr. D. Mass 2008). In Lynn-Weaver, the sale was continued twice before the lender filed a motion for relief from the automatic stay. The motion for relief from stay was denied since the debtor was only delinquent for one post-petition payment. The sale was continued three more times after the relief from stay denial was entered. The Court ruled that "on the undisputed and uncontroverted facts, the Defendant's five continuances were, as a matter of law, violations of the automatic stay." Id.

Challenging the Assessment of Mortgage Fees to a Loan and the United States Trustee's Office's Investigation of Countrywide Home Loans, Inc.

In an unprecedented move, Judge Agresti of the Pennsylvania Bankruptcy Court, in April 2008, approved the Justice Department's further investigation of Countrywide due to widespread allegations that the lender is filing false or inaccurate claims, misapplying funds, assessing unreasonable fees to borrowers' accounts or ignoring the discharge injunction and other court orders. Countrywide Homes Loans, Inc. f/k/a Countrywide Funding Corp., 2008 Bankr. LEXIS 1023 (Bankr. W.D. PA. 2008).

This matter was precipitated by a Standing Chapter 13 Trustee in Pennsylvania originally filing for sanctions against Countrywide Home Loans, Inc. due to her experience with the lender

not cashing disbursement checks exceeding $500,000 that her office had sent to Countrywide for application to various borrowers' accounts. She surmised that the lender would have assessed late charges and legal fees to the borrowers' account since the accounts would appear to be delinquent.

During the investigation of the Standing Chapter 13 Trustee in the matter of In re Hill, Docket #01-22574, Chapter 13 (Bankr. W.D. PA 2007), Countrywide produced letters that indicated an escrow change in the debtor's payments, which led to the debtor owing money to the lender at the conclusion of her Chapter 13 plan. Unfortunately for Countrywide, the dated letter listed a mailing address for Debtor's counsel for office space that he would not move into for another year. Countrywide ultimately testified that it "recreated" the letters to show the amount of the mortgage payment that would have been due at various times during the Chapter 13 case and was not admitting the letters as evidence that the letters had actually been sent. The Hill case was one of hundreds of cases in Pennsylvania demonstrating that the Standing Chapter 13 Trustee had legitimate concerns regarding Countrywide's practices.

The Pennsylvania matters have led the United States Trustee's Office to file similar suits in Georgia[1] and Ohio[2] seeking to investigate the servicing practices of Countrywide. Various subpoenas have also been served by the United States Trustee's office upon Countrywide in Florida regarding the assessment of fees on borrower's accounts.

ALL LENDERS ARE FAIR GAME

[1] The United States Trustee's Office filed a complaint on February 28, 2008 styled as Walton v. Countrywide Home Loans, Inc.,08-06092-mhm in the Northern District of Georgia. The related bankruptcy case is In re Atchley, 05-79232-mhm. In Atchley, the homeowners eventually sold their home to avoid foreclosure but believe the payoff amount cited by Countrywide contained excessive fees and that Countrywide continued to accept trustee payments after the loan paid off.

[2] The United States Trustee's Office filed a complaint on February 28, 2008 styled as Fokkena v. Countrywide Homes Loans, Inc., 08-05031-mss in the Northern District of Ohio. The related bankruptcy case is In re O'Neal, 07-51027. In O'Neal, Countrywide filed a proof of claim and objection to plan when it had already accepted a short sale on the property prior to the bankruptcy filing.

Other lenders are also assessing fees to borrowers' account without telling the borrowers. In reaction to the assessment of unwarranted fees and charges to an elderly debtor's loan in the matter of In re Dorothy Stewart Chase, Docket 07-11113, Chapter 13 (Bankr. E.D. LA 2008), Judge Magner issued a 49 page decision on April 10, 2008 which ordered Wells Fargo to audit every proof of claim it filed in the district since April 13, 2007 and to provide a complete loan history on every account. If the audits reveal additional concerns, the judge reserved the right to appoint experts to do forensic accountings at the expense of Wells Fargo. She also ruled that Wells Fargo was negligent in the loan servicing of Ms. Chase's loan and assessed damages of $10,000, legal fees of $12,350 and sanctioned Wells Fargo $5,000 for filing a consent order that did not reflect the agreement of the parties and for filing erroneous proofs of claim.

The decision in Chase was on the heels of Judge Magner's earlier decision in In re Jones, 2007 Bankr. LEXIS 2984 (Bankr. E.D. LA. 2007). In Jones, Judge Magner sanctioned Wells Fargo $67,202.45 for violating the order of confirmation and the automatic stay by improperly assessing the debtor's loan with fees in the amount of $16,852.01 and diverting payments made by the Chapter 13 trustee and the Debtor to satisfy fees that had not been authorized by the Court. The judge stated that the Jones case would provide guidance in the post-petition administration of home mortgage loans to a degree that, until this decision issued, had been lacking in the industry. In order to avoid additional monetary sanctions, Wells Fargo agreed to revise its post-petition practice in all loans administered in the Eastern District of Louisiana and was ordered to implement and use accounting procedures set for in the decision. That accounting procedure sets forth in detail the procedure to be followed in order to assess and collect post-petition fees post-discharge. Of particular note, Wells Fargo has to file with the Court a yearly statement of any post-petition charges it seeks to assess to a loan. A debtor or

other party can object to the statement and a hearing on the matter will be held to determine the appropriateness of the assessment. While the bankruptcy case is pending, Wells can only collect the amount approved by the court if the debtor voluntarily submits separate payment for the charges. Reimbursement of taxes and insurance follows a slightly different noticing procedure. If no statement of charges is filed, the charges are deemed uncollectible post-discharge.

Finally in April of 2008, the Bankruptcy Court for the District of Delaware heard In re Steven E. Watson, 2008 Bankr. LEXIS 1011 (Bankr. D. DE 2008). The decision addressed issues common in several debtors' cases where the proposed Chapter 13 Plan included provisions requiring that notice be provided to debtors of costs and fees that were being assessed against them by their residential mortgage holders. The plans provided that lenders who failed to notify debtors of assessed fees, were consequently prohibited from collection of those costs under forfeiture provisions. Lenders objected to the plans, arguing that the forfeiture and disallowance provisions violated protections afforded to the mortgage lenders by 11 U.S.C. section 1322(b)(2), a provision of the Code prohibiting modification of mortgage lender's contractual rights.

The Court held that the proposed plans, which contained procedures for timely notice of fees and charges, application of payments and adjudication of claim disputes by the bankruptcy court, may be confirmed without violating section 1322(b)(2). In his reasoning, Judge Shannon, addressing the concept that mortgage lenders who fail to give notice of post-confirmation fees and charges are thereby compromising the purpose of the bankruptcy system, stated, "If the Court and the Chapter 13 Trustee fully administer a case through completion of a 60-month Chapter 13 plan, only to have the debtor promptly re-file on account of accrued, undisclosed fees

and charges on her mortgage, it could fairly be said that we have all been on a fool's errand for five years." Id at 26.

CONCLUSION

The mortgage industry and how it functions will continue to evolve as more decisions regarding its conduct are released by the courts. Stay tuned…

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