# THE SUFFOLK LAWYER

PUBLICATION OF THE SUFFOLK COUNTY BAR ASSOCIATION

DEDICATED TO LEGAL EXCELLENCE SINCE 1908 Vol. 25 No.1 September 2008


CONSUMER BANKRUPTCY

# Litigating Against Abusive Mortgagees

## *Your Author Scores a Big Win Against Mortgagee Who Filed Frivolous Motion*

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A review of United States bankruptcy litigation during the past year shows an incredible increase in the number of proceedings brought against mortgagees and their attorneys who initiated frivolous proceedings, filed incorrect documents or sought unreasonable attorneys fees. In my April 2008 column in the *Suffolk Lawyer*, I discussed efforts of the United States Trustee to pursue mortgagee companies and their counsel who engaged in such improper conduct.

Since then, there have been even more highly publicized cases, especially involving the poster-child of bad-boy bankruptcy practices, Countrywide Mortgage Company. Not only has the U.S. Trustee brought suit against Countrywide in a host of cases around the country, but a number of State Attorneys General have sued them as well for deceptive practices.

**Why Mortgagee Litigation is on the Rise.** I previously wrote that in the past, if a mortgage company violated the rules -- by bringing a frivolous motion to lift the stay or filing an incorrect proof of claim – then invariably the worst punishment it would receive would be little more than a slap on the wrist – a token sanction in a nominal amount.

In the past year, with increased attention towards mortgage companies engaging in sloppy bankruptcy practices, and problems created by the sub-prime mortgage meltdown, the Office of the U.S. Trustee said enough is enough. In doing so, the U.S. Trustee developed a new policy to police and punish those mortgage companies and their attorneys who flout their obligations to follow the rules.

In addition, since such conduct can be considered "bankruptcy abuse," the Courts have been more open-minded towards sanctioning abuse, especially considering that the official name of the 2005 Bankruptcy Amendment Act is "the Bankruptcy Abuse Prevention and Consumer Protection Act" (often referred to as "BAPCPA").

**In the Past, Mortgagees Were Not Deterred by Sanctions.** In prior years, if a mortgagee engaged in frivolous litigation or filed an erroneous proof of claim, debtors' bankruptcy counsel, including myself, would be hesitant to litigate for several reasons.

First, the debtor rarely had sufficient funds to cover the cost of doing so. Second, the Courts seemed reluctant to sanction the mortgagee sufficiently to cover the attorney's billable time. Finally, on the rare occasions when mortgagees were sanctioned, the amounts were often so low, that the mortgagees chalked up the sanctions as a small cost of doing business, and were not deterred at all from improper future practices.

For these reasons, the most common approach was to work out a non-litigious disposition that did not necessarily result the fairest outcome to the debtor.

**A Perfect Example of Mortgagee Abuse Falls in My Lap.** In 2004, I filed a routine Chapter 13 proceeding for my client, Walter C. Schmidt. His Chapter 13 plan was confirmed, and for years, the debtor made regular and timely payments to the trustee and mortgagee. Schmidt was a great client – always personable, responsible and cooperative. He is also a paraplegic and confined to a wheelchair, having been catastrophically disabled with Multiple Sclerosis from Agent Orange exposure after serving our country in Vietnam.

In December 2007, more than three years after the petition was filed, the debtor's mortgagee, Bayview Financial, brought a typical motion to lift the stay. They argued that the debtor neglected to pay his real estate taxes which had come due two months earlier, and for this reason, the stay should be vacated. This was quite a surprise because it was the mortgagee, not the debtor, who was obligated to pay the real estate taxes.

The debtor had the same mortgage for over twenty years and every single payment to the mortgagee included an escrow component for the purpose of the mortgagee paying the real estate taxes. Since it was the mortgagee's obligation to pay the real estate taxes, their position in the motion to lift the stay was totally erroneous and therefore frivolous and abusive. For some reason, the mortgagee made an unbelievably sloppy mistake.

It thus seemed that not only did the debtor have a perfect defense to the motion to lift the stay, but he also had a great case for bringing a cross-motion seeking sanctions for bringing a frivolous motion. Whereas in the past I would have been hesitant to vigorously pursue sanctions, I thought the time was now ripe to do so.

**The Mortgagee was Guilty of Violating Other Statutes.** Upon reviewing the situation further with the debtor, I learned that the mortgagee often paid the real estate taxes late resulting in penalties. I then spent even more time pouring through the debtor's documents and inquiring about the debtor's history with the mortgagee. I learned that the mortgagee had filed to provide debtor with post-petition annual escrow disclosure statements. Apparently, the last time the debtor received an annual escrow disclosure statement was in November 2004. This violated federal law.

The Real Estate Settlement and Procedures Act of 1974 ("RESPA") is a federal consumer protection statute that, among other things, requires mortgage servicers who collect escrow to conduct an escrow account analysis each year to determine the borrower's monthly escrow account payments for the next year. Upon completing an escrow account analysis, the servicer must provide an annual escrow account disclosure statement to the borrower.

For each and every year from 2005 to the present, the lender failed to adhere to its federally-mandated obligation to provide the debtor with the annual escrow account disclosure statement. There is no exception that gives mortgage servicers a vacation from this requirement while the borrower is in a Chapter 13 bankruptcy proceeding.

RESPA provides that a servicer's failure to provide the borrower with the annual escrow account disclosure statement is a violation of the statute. RESPA also gives individuals a private right of action against mortgagees who violate such provisions.

Seeking Sanctions Against the Mortgagee. In drafting my cross-motion for sanctions, I also argued that the mortgagee's egregious conduct was abusive under BAPCPA. As with any application for sanctions, I also sought costs and attorney's fees as well.

Under BAPCPA, all parties including creditors are held to a higher standard to provide accurate information to the Court.

The purpose of BAPCPA is to protect the integrity of the bankruptcy system and that requires taking action against creditors and mortgage servicing companies who carelessly and sloppily file incorrect and frivolous proceedings.

The mortgagee though its new counsel, conceded to me that it had made an egregious mistake and blamed it on their old bankruptcy counsel. We spent a number of months hammering out a settlement which resulted in a $32,000+ package for the debtor. This included giving the debtor a $10,000

cash payment, reducing the proof of claim by about $12,000, waiving escrow arrears in the approximate sum of $9,000, and accepting slightly-reduced mortgage payments for a period of time, worth a minimum of $1,700.

In addition to bringing a frivolous motion to lift the stay, the mortgagee also violated certain RESPA provision by failing to provide the debtor with annual escrow accounting statements. In addition, the mortgagee conceded that it had neglected to make all of the necessary real estate tax payments that it was required to make, and that some of the payments that it did make were late, resulting in penalties and interest.

One of the reasons that it took so long to work out a settlement is because the mortgagee was so disorganized that it had great difficulty ascertaining the exact amount of payments that it had received, and also had difficulty calculating the amount of disbursements that it had made over the course of the mortgage. I was amazed that the mortgagee, who was responsible for hundreds of millions of dollars worth of mortgages, could not quickly get this information and had to rely on its employees to calculate everything by hand.

Prior to BACPA, the courts in the E.D.N.Y. seemed hesitant to seriously sanction mortgagees for sloppy work or practices. However, I was successful in persuading the mortgagee in this case that under BACPA their conduct would be considered abusive and would be viewed much more harshly. It also helped that Countrywide was being criticized and sanctioned in courts across the country for similar conduct.

With my case, the mortgagee's attorneys also wanted to avoid a hearing where the sole issue would be the amount of sanctions that the Court should impose against them.

**Bankruptcy Reform involving creditors is needed.** The 2005 Bankruptcy Act primarily reformed the law as it applied to consumers and made the entire bankruptcy procedure stricter for them. What we still need are laws that protect consumers from creditors and mortgagees who engage in poor and sloppy bankruptcy practices. Many mortgagees file incomplete claims with vaguely identified fees. Mortgagee's attorneys often seek to lift the stay with information that is incorrect and unverified.

Professor Porter concluded that the existing system is insufficient to ensure the integrity of the bankruptcy system and its home-saving purpose. Systematic reform of mortgage servicing is needed to protect all homeowners – inside and outside of bankruptcy – from overreaching or illegal behavior. Hopefully the recent efforts of the U.S. Trustee will be the first step in this direction.

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