

BANKRUPTCY UPDATE

NACCT Annual Conference 2016

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The National Association of Chapter Thirteen Trustees (NACCT) held its annual conference in Philadelphia this past July. Mortgage issues continued to be a hot topic at the conference, with several educational panels addressing them. There was also much useful dialogue among mortgage industry representatives, mortgage servicing attorneys, and Chapter 13 trustees. Highlighted here are a few events of interest to the mortgage servicing industry.

NACCT Presentations and Educational Panels

Director of the Administrative Office of the U.S. Trustee program, Clifford J. White III, provided opening remarks for the conference. The Office of the U.S. Trustee (UST) falls under the Department of Justice and is responsible for overseeing the administration of bankruptcy cases and private trustees. In a departure from previous years, Director White's remarks seemed somewhat softened toward the mortgage servicing industry. He was gratified by servicer responses to UST initiatives toward improved servicing in bankruptcy over the prior year, with self-reporting a welcome outgrowth of prior enforcement actions. Instead of centering on mortgage servicers, his remarks addressed other issues that the UST is focusing on — starting with security for trustees' meetings of creditors (perhaps due to recent terrorist violence). Security for the meetings is a challenging task because of the numerous sites (more than 400) in which the meetings are held. The UST's budget has earmarked an additional \$2.2 million to enhance security, including providing a list of "secure sites" in federal locations, authorizing the use of U.S. Marshalls for security in "emergency situations" (instead of the usual private security), and establishing a "call threat center" phone number to allow for identification of any threat to security.

In addition to the security concern, another current focus of the UST is underperforming consumer bankruptcy practitioners, in particular (but not limited to) large consumer debtor law firms operating across judicial district lines. Director White said that the UST would be targeting attorneys for substandard performance, unauthorized practice of law, fee sharing in violation of state professional conduct rules, and any other unethical attorney practices. He asked the trustees to help the UST in policing such conduct by informing his office of any questionable attorney practices observed in their day-to-day practice. Finally, the UST will be increasing scrutiny on the practices of unsecured creditors, including the robo-signing of proofs of claim (POCs) by debt buyers and the practice of filing POCs for unsecured debt that is unenforceable under state law due to the statute of limitations ("stale" claims).

Educational sessions included: the annual Chapter 13 case update; the aftermath of the National Mortgage Servicing Settlement, plus the winding down of the Home Affordable Mortgage Program; the treatment of long-term mortgage claims and discharge issues; as well as an overview of the Consumer Financial Protection Bureau and how it interfaces with bankruptcy.

Chapter 13 Case Update — The panel highlighted reported and unreported decisions in Chapter 13 cases handed down since the prior year’s conference. Included were cases of interest to the mortgage servicing industry. Among them, the continuing debate over whether a debtor may surrender a property in her bankruptcy plan and, at the same time, vest the property in the mortgagee upon confirmation of the plan. While it appears that the majority of courts have decided that this is impermissible, some courts have allowed this plan treatment. The court in *HSBC Bank, N.A. v. Zair*, 2016 WL 1448647 (E.D.N.Y. Apr. 12, 2016), sided with the majority view and held that such treatment was not permitted, while the court in *In re Brown*, 14-12357, slip op. (Bankr. D. Mass. Mar. 4, 2016), held that a plan can satisfy the requirements for confirmation in surrendering the property coupled with vesting the property in the mortgagee. This continued debate warrants monitoring and proactive responses if mortgage servicers wish to avoid unwanted consequences of creative Chapter 13 plans.

A reminder to servicers on the importance of observing bankruptcy deadlines came from *In re Wells*, 536 B.R. 264 (Bankr. E.D. Ark. Aug. 2015). In *Wells*, the mortgagee had completed a foreclosure sale on the property prior to the filing of the debtor’s Chapter 13 petition. Notwithstanding the completion of the sale, the debtor scheduled payments to the mortgagee under the plan, which was confirmed without the mortgagee’s objection. The court held that the debtor’s possession of the property at the time he filed his petition, coupled with the confirmed plan that paid rent, gave rise to a tenancy at sufferance that was property of the estate and, as a result, the mortgagee was bound to accept payments for the duration of the plan.

Another notable case was *HSBC Bank USA, NA v. Blendheim (In re Blendheim)* 803 F.3d 477, (9th Cir. Oct. 1, 2015), in which the Ninth Circuit Court of Appeals held that a Chapter 13 petition filed after discharge but before the closing of the prior Chapter 7 case was not *per se* prohibited by the Bankruptcy Code. The *Blendheim* court also held that a mortgage servicer who actually files a claim, and has that claim disallowed, may have its lien avoided under 11 U.S.C. § 506(d). The servicer in *Blendheim* filed a timely proof of claim in the Chapter 13 case reflecting its first-lien position on the debtors’ residence. The debtors objected to the claim on the basis that the servicer had not produced a copy of the promissory note and that a prior copy of the note appeared to bear a forged signature. The servicer did not respond and an order disallowing the claim was entered. In a subsequent adversary proceeding, the bankruptcy court held that the lien was void and cancelled upon completion of the Chapter 13 plan. The Ninth Circuit, on appeal, held that under a “plain reading” of § 506(d), the bankruptcy court properly voided the lien because the secured claim was disallowed. Under general principles of bankruptcy, a secured creditor may choose to not participate in a bankruptcy case and its lien will ride through the bankruptcy unaffected. *Blendheim* illustrates that mortgage servicers should carefully consider whether filing a POC in a Chapter 13 case may be the wrong strategy in the cases in which there may be issues with proving the claim. These were but a few of the noteworthy cases covered by the distinguished panel.

“Life after the National Mortgage Servicing Settlement” — Discussed by the panel was the state of mortgage serving in bankruptcy since the sunset of the National Mortgage Servicing Settlement (NMSS) and during this period of the wind-down of the Home Affordable Mortgage Program (HAMP) and Home Affordable Refinance Program (HARP).

Regarding servicing standards post-NMSS, the panel pointed out that while the five servicers subject to the NMSS are no longer bound by the consent judgments, other servicers have entered consent judgments with the Department of Justice and the states' attorneys general that are still in effect. The NMSS had a substantial spillover impact on non-covered servicers who voluntarily followed the NMSS standards and continue to do so.

The substantial investment in compliance by servicers and the improvement of the quality of servicing loans in default have led most servicers to leave most, if not all, levels of review in place. To a large degree, multiple levels of quality control review regarding proofs of claim and motions for relief from stay continue because of the benefits to servicers in making sure that they get their claims right. While time will tell how stringently the NMSS standards will carry on, it appears that those standards will continue for the foreseeable future.

As for HAMP and HARP, regulators will continue to urge servicers, investors, and housing finance agencies to maintain affordable and sustainable loss mitigating programs, including loan modification programs. On August 25, 2016 the Federal Housing Finance Agency directed Fannie Mae and Freddie Mac to extend HARP through September 30, 2017 (in light of a new refinance offering that will not be available to borrowers until October 2017). On the same day, the Federal Housing Authority announced new procedures to streamline the process that servicers use to evaluate borrowers for FHA-HAMP.

Meeting of Trustees, Servicers, and Attorneys

In a continuation of the "Gateways to Communication" Chapter 13 Roundtable started in Little Rock, Arkansas in 2004, trustees, mortgage servicer representatives, and mortgage servicer attorneys met to share ideas to improve mortgage servicing in Chapter 13 cases. During this meeting, the trustees were asked to convey their top issues related to current mortgage servicing practices in bankruptcy. While the trustees generally said that those practices have improved, their biggest concern relates to being able to effectively communicate with servicers about loan-level issues. In particular, incorrect servicer contact information on mortgage POCs hampers trustee staff in trying to address mortgage issues with servicers. An effort is being made by this group to maintain a list of servicer contact information through the National Data Center (NDC), an adjunct to the NACTT, so that trustees know who to contact. Servicers who want to be added to the list may contact the NDC (www.ndc.org) or this author (jgiddens@wilson-assoc.com).

In addition to communication matters, trustees said that their main concerns were: transfers of loan servicing without providing new servicer information; untimely or incomplete POCs, or the failure to file one; as well as the withdrawal, or improper amendment, of POCs after loan modification agreements. The trustees added that the next area of bankruptcy litigation may be over incorrect notices of payment change (NOPC). Specifically, the trustees are targeting those first post-petition NOPCs that include an escrow shortage as a component of the payment because these are viewed as a practice of "double-dipping." Servicers should be mindful that trustees and the UST are scrutinizing NOPCs closely, and they need to make sure that the NOPCs are being completed accurately and with sufficient oversight.

Conclusion

Once again, the conference proved to be a valuable experience for bankruptcy practitioners and mortgage servicers — a place to come together to discuss the issues impacting our world.