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Litigation of Mortgage Claims

Selected Case Summaries from the Ninth, Tenth, Eleventh And D.C. Circuits

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To follow is a general overview of recent bankruptcy decisions in the 9th, 10th, 11th and D.C. Circuits involving mortgages. The cases have been separated into categories as follows:

Affect of Confirmed Plan on Mortgagee's Rights

1. **In re Bateman, 331 F.3d 821 (11th Cir. 2003).** In this case, the Eleventh Circuit held that a timely filed proof of claim by a first mortgagee trumped the confirmed plan. The secured creditor, which held a first mortgage on debtor's property, timely filed a proof of claim showing an arrearage amount of approximately $49,000. The debtor did not object to the proof of claim, but rather filed a plan which showed an arrearage due to the mortgagee of approximately $21,000. The mortgagee did not object to the debtor's plan and the plan was thereafter confirmed. Approximately one year later, the Trustee noticed the discrepancy between the proof of claim and the plan and notified the debtor thereof. Shortly thereafter, the debtor filed an objection to the proof of claim. The bankruptcy court sustained the debtor's objection giving the debtor's plan *res judicata* effect pursuant to Section 1327 of the Code and holding that the mortgagee had waived its right to contest the amount of arrearage and was bound by the amount in the plan. The district court affirmed the bankruptcy court's order.

On appeal, the Eleventh Circuit found that the mortgagee did not have an obligation to object to the plan even though it provided for an arrearage which was less than the mortgagee's proof of claim. The court held that because the mortgagee timely filed its proof of claim and the debtor failed to object to the proof of claim prior to confirmation of the plan, the mortgagee's proof of claim was "deemed allowed" pursuant to Section 502(a) of the Code. Further, the court stated that the filing of a plan which set forth an arrearage amount that was less than the amount owed the mortgagee did not constitute an objection to the proof of claim. Accordingly, the court reversed the bankruptcy and district court's order holding that the mortgagee's claim was unaffected by the confirmed plan and would survive until it was satisfied in full. Thus, if the mortgagee's claim was not satisfied as of the date the bankruptcy was terminated, the mortgagee would be entitled to exercise its rights under the mortgage, including its right to proceed with foreclosure.

2. In re Scott, 295 B.R. 686 (M.D. Ga. 2003). In Scott, the debtors filed a plan which stated that the amount due the second mortgagee was in dispute and would not be paid through the plan. Further, the plan stated that upon completion of the plan and discharge, the second mortgage would be deemed satisfied. The mortgagee filed a proof of claim, but did not object to the plan. The plan was confirmed and thereafter the debtors were discharged. After the debtors were discharged, the mortgagee filed a state court action seeking a declaration that the mortgage was valid and unaffected by the debtors'

discharge. The debtors reopened their bankruptcy case and removed the state court action to the bankruptcy court.

Relying on Bateman, the court held that although the parties were bound to the terms of the plan under Section 1327 of the Code, the mortgagee's secured claim for arrearage survived the plan and the mortgagee retained its rights under the mortgage until the claim was satisfied in full. Further, the court stated that if the mortgage was not satisfied after the discharge was entered and the automatic stay was lifted, the mortgagee was entitled to exercise its rights under the mortgage.

3. **In re Bilal, 296 B.R. 828 (Bankr. D. Kan. 2002).** In Bilal, the court explored whether debtors may rescind their mortgage merely by providing for rescission in the plan. The debtors in Bilal filed a chapter 13 plan that included a provision which declared that they were rescinding the first mortgage on their property on the ground that one of the debtors was not provided with his own copy of the TILA right of rescission notice. The plan further provided that confirmation of the plan would constitute a finding that the transaction was rescinded and that the mortgage was void. The mortgagee did not object to the plan and the plan was confirmed. When the mortgagee refused to release the mortgage, the debtors filed an adversary proceeding seeking a declaration that they validly rescinded the transaction and that the mortgage was therefore void.

The mortgagee contended that the debtor was required to file an adversary proceeding in order to challenge the validity of the mortgagee's lien and could not rescind the lien through the filing of the plan. Relying on the Tenth Circuit's decision in Anderson v. UNIPAC-NEBHELP (In re Anderson), 179 F.3d 1253 in which the court held that the a confirmed plan which stated that the debtor's student loan debt would be discharged upon confirmation had *res judicata* effect on the issue, the court rejected the mortgagee's argument holding that if a creditor fails to object, a bankruptcy plan can provide relief that the debtor would otherwise be able to obtain only through an adversary proceeding. Further, the court found that given that (1) the mortgagee had filed a proof of claim in the bankruptcy and therefore was aware that the bankruptcy had been filed; and (2) there was no evidence that the plan was not served on the mortgagee, the creditor should have filed an objection to the plan if it wanted to challenge the debtor's rescission of the mortgage. Consequently, the court held that the confirmation of the plan constituted rescission of the mortgage and the mortgagee was barred under the doctrine of *res judicata* from asserting that the mortgage was still in effect.

4. **In re Davis, 286 B.R. 793 (Bankr. W.D. Okla. 2002).** In this case, the court held that a debtor cannot transform secured debt into unsecured debt merely by identifying it as such in her plan. The debtor stated in her plan that the creditor's lien, which was secured by the debtor's homestead, was to be treated as unsecured and discharged upon completion of the plan. Further, in debtor's

schedules she stated that she had a TILA claim against the mortgagee. The plan was confirmed. Thereafter, the mortgagee filed an adversary proceeding seeking a judgment that its lien was valid, enforceable and unaffected by debtor's treatment of the lien in the confirmed plan. Relying on Section 1322(b)(2) of the Code which states that a plan may not modify a homestead mortgagee's claim and Rule 7001(2) which states that a debtor must bring an adversary proceeding to challenge the validity of a lien secured by the debtor's property, the court stated that the debtor was not permitted to morph the status of a secured claim into an unsecured lien by simply stating it is so in the plan. Rather, the court held that if debtor had a good faith basis to contest the validity of the mortgagee's lien, it would be up to the debtor to commence an adversary lien avoidance proceeding. Interestingly, unlike the Bilal decision, the court in Davis distinguished Anderson from the case at hand because the loan in Anderson was unsecured student loan debt, whereas the debt at issue in Davis (as well as Bilal) was secured by a lien on debtor's homestead.

5. In re Jean, 306 B.R. 708 (S.D. Fla. 2004). In Jean, the bankruptcy court considered an objection by the debtor to the proof of claim filed by a junior mortgagee on the ground that the lien securing the mortgagee's claim had been stripped off by an order confirming the plan in the debtor's prior Chapter 13 case. In debtor's prior bankruptcy case, debtor had filed a plan which stated that the mortgagee's lien would be stripped off and that the value of the mortgagee's claim was $0.00. The predecessor to the mortgagee was sent notice that the bankruptcy was filed. Thereafter, the mortgagee's predecessor filed a proof of claim and did not object to the plan. The plan was confirmed. Thereafter, the bankruptcy was converted to a chapter 7 case and the debtor was discharged. After the completion of the first bankruptcy, debtor filed a new Chapter 13 case. The mortgagee filed a secured proof of claim and the debtor objected to the claim.

The court held that in order for the confirmed plan to accomplish a strip off of the mortgage, the plan must be served on the mortgagee pursuant to the requirements set forth in Rule 7004(b). In addition, the court stated that the filing of a proof of claim by an agent of the mortgagee who is not qualified to accept service under Rule 7004 of a contested matter does not indicate sufficient participation in the case to prove that the creditor had actual and sufficient notice of the strip off. Accordingly, the court overruled the debtor's objection. In interesting dicta, the court stated that a lien stripped off with proper notice in a Chapter 13 case is not reinstated upon conversion of the case to one under Chapter 7.

6. **In re Taylor, 280 B.R. 711 (Bankr. S.D. Ala. 2001).** This case is illustrative of what happens when a mortgagee misidentifies the nature of its claim. The debtors in Taylor filed a proof of claim which stated that all debts were to be paid in full and that holders of allowed secured claims would retain the lien securing such claim. Despite the fact that the mortgagee held a first

mortgage on the debtors' homestead, the mortgagee filed a proof of claim which listed the debt due the mortgagee as an unsecured nonpriority claim. The creditor did not object to the plan and thereafter the plan was confirmed. Almost five years after filing its original proof of claim and three months before the debtors were to complete the plan, the mortgagee filed an amended proof of claim which set forth additional monies purportedly due the mortgagee and stated that the mortgagee's claim was secured by the debtor's property. The debtors objected to the amended proof of claim.

The court stated that the debtor's plan did not violate Section 1322 of the Code because it provided that all claims were to be paid in full. Also, the court stated that what the mortgagee was to be paid depended entirely on what the mortgagee provided in its proof of claim. Thus, the debtor's plan did not prevent the mortgagee from being paid its full claim. Rather, the mortgagee's own proof of claim did. Further, the court held that because the mortgagee's new proof of claim stated that the mortgagee was a secured creditor, it constituted an entirely new proof of claim instead of a amended claim. Because the deadline for filing proofs of claim had long since passed, the court disallowed the mortgagee's amended proof of claim. Accordingly, given that the mortgagee had designated its claim as unsecured and its new proof of claim was untimely, the court held that the mortgagee had waived its secured status and the lien would no longer exist upon the debtors' completion of the plan.

7. In re Sernaque, 2004 WL 1494562 (Bankr. S.D. Fla. June 14, 2004). In this case, the court addressed whether a confirmed plan which provided that a junior mortgage be "stripped off" could be enforced against the mortgagee. The debtor filed a plan which sought to value the second mortgage on the debtor's property under Section 506 of the Code, "stripped off" the mortgage and treated the mortgagee's entire claim as unsecured. The mortgagee filed a secured claim but did not object to the plan. Likewise, the debtor did not object to the mortgagee's proof of claim. Thereafter, the plan was confirmed. The court held that an order confirming a plan which strips off a mortgage after due notice to the secured creditor is enforceable, whether or not the debtor separately filed an objection to the creditor's proof of claim. The court distinguished Bateman on the ground that Bateman addressed the *amount* of the claim whereas the case at issue addressed the *value* of the collateral securing the mortgagee's claim. Further, the court stated that a debtor has three vehicles through which to value the collateral securing a claim. First, a debtor may file an objection to the proof of claim under Rule 3007. Second, the debtor may filed an adversary complaint to determine the amount, validity and priority of a lien under Rule 7001(2). Finally, as the debtor did in the instant case, the debtor may value the lien as part of the plan process under Section 506 and Rule 3012.

Challenges to Fees and Other Charges in Proofs of Claim

1. **In re Atwood, 293 B.R. 227 (9th Cir. B.A.P. 2003).** In this case, the mortgagee filed a proof of claim which included attorneys fees in the amount of $450.00 for the preparation and filing of the proof of claim. The debtor objected to inclusion of the attorneys fees in the proof of claim on the ground that the fee was incurred post petition and should be included in the calculation of the arrearage due the mortgagee. The bankruptcy court overruled the debtor's objection stating that the attorneys fees were incurred as a consequence of the bankruptcy and could be included in the proof of claim because under the terms of the mortgage, the mortgagee was entitled to reimbursement for such fees.

On appeal, the B.A.P., held that the mortgagee was entitled to assert its right to the attorneys fees at issue through the proof of claim and was not required to file a fee application. However, the court stated that the mortgagee was required to show that such fees were "reasonable". The mortgagee did not provide the court with a specific hourly breakdown of the fees. Moreover, the mortgagee did not advise the court as to whether the mortgagee pays the fees if it they are not paid through the plan or whether such fees are comparable to what other similarly situated lenders pay. Accordingly, the court held that the mortgagee had failed to meet its burden of demonstrating that the fees at issue were reasonable and therefore reversed the bankruptcy court.

2. In re Powe, 281 B.R. 336 (S.D. Ala. 2001). Although this case does not involve a mortgage it is instructive on the issue of whether a creditor may include attorneys fees for preparation of the proof of claim in the claim. In this case, the creditor, which held a secured lien in the debtor's vehicle, filed a proof of claim which included a $225.00 charge for attorneys fees presumably incurred for the preparation and filing of the proof of claim. The court concluded that if a creditor wants to collect such charge through the plan it is required to either file a fee application or file a proof of claim which specifically sets forth a breakdown and explanation of such fee.

3. **In re Nolettou, 280 B.R. 868 (Banrk. S.D. Ala. 2001).** This case involves a class action to recover damages for a mortgagee's allegedly improper conduct in including in its proofs of claim a $125.00 attorneys fee for preparing the proofs of claims. The decision mainly addressed issues of standing and class certification. However, in addressing the plaintiffs motion for summary judgment on the issue of punitive damages, the court cited In re Allen, 215 B.R. 503 (Bankr. N.D. Tex. 1997) in which the court stated that "[t]he preparation of a claim is a ministerial act for which no attorney's fees should be charged against a debtor. Certainly, a creditor is free to have an attorney to prepare the claim, but the cost of that preparation cannot be passed on to the debtor without specific authorization from the court." The court stated that a genuine issue of material fact existed as to whether the plaintiffs were entitled to punitive damages.

4. In re Tomasevic, 275 B.R. 86 (Bankr. M.D. Fla. 2001). In this case, the mortgagee had received a state court foreclosure judgment which set forth in itemized detail the amount due under the mortgage and scheduled a foreclosure sale for a date shortly after the judgment was entered. Prior to the sale, the debtor filed bankruptcy and thereafter objected to the mortgagee's amended proof of claim which included amounts set forth in the state court judgment as well as post petition attorneys fees and costs incurred by the mortgagee. The court held that the state court judgment had *res judicata* effect and the debtor was therefore precluded from challenging any charges which were part of the state court judgment. In addition, the court held that because the amended proof of claim was filed after the plan was confirmed and included post petition attorneys fees and costs which were not part of the original proof of claim and not part of the confirmed plan, the mortgagee was not entitled to the payment of such attorneys fees and costs through the plan.

5. In re Harris, 280 B.R. 724 (S.D. Ala. 2001). In this case, the court held that the inclusion of attorneys fees in the proof of claim for preparation of the claim did not constitute a violation of the automatic stay. However, the court stated that if a mortgagee *posts* such fees to the debtor's account without giving the debtor the opportunity to object to the fees, such action may constitute a violation of the stay.

Violations of the Automatic Stay

1. **In re Dawson, 2004 W.L. 1094432 (9th Cir. May 18, 2004).** In this case, the Ninth Circuit addressed whether a debtor could recover emotional damages for a creditor's violation of the automatic stay. The court found that the first mortgagee had violated the automatic stay by filing a state court action after the debtor filed a Chapter 7 petition. The state court action was filed 21 days after the debtor filed bankruptcy and 7 days after the mortgagee received notice of the filing. The mortgagee dismissed the state court action 15 days after it was filed. The debtor sought emotional distress damages arising out of the mortgagee's initiation of the state court action during the automatic stay. The court, however, held that pursuant to Section 362(h) of the Code, the debtor could only recover "actual damages" for willful violation of the automatic stay. The court stated that actual damages are damages relating to economic harm and do not include damages for emotional distress. Quoting Aiello v. Providian Financial Corp., 239 F.3d 876 (7th Cir. 2001), the court stated the protection afforded by the automatic stay is "financial in character; it is not protection of peace of mind." Further, the court directed the debtor to state court if he chose to pursue his claim for emotional damages.

2. **In re Henry, 266 B.R. 457 (Bankr. C.D. Cal. 2001).** In this case, the debtors filed chapter 7 bankruptcy and the mortgagee received notice of the bankruptcy filing on several occasions. Specifically, (1) immediately after the bankruptcy was filed, the mortgagee was sent notice of the filing by the

Bankruptcy Noticing Center; (2) one of the debtors called a collector in the mortgagee's office on two occasions to advise that she had filed bankruptcy and that the mortgagee should communicate with her bankruptcy counsel; and (3) the mortgagee received a report from the credit bureau that contained information about the debtors' bankruptcy case. Apparently, the mortgagee did not have a standard procedure for recording when a mortgagor had filed bankruptcy in order to bring this information to the attention of the agent responsible for collecting the account. Accordingly, despite the fact that the mortgagee had received adequate notice of the bankruptcy filing shortly after the case was filed, the mortgagee attempted to contact or did contact the debtor approximately 90 times over the seven months immediately following the filing about the debt at issue. The mortgagee made telephone calls to the debtors both at home and at work, left telephone messages, threatened action if the debtors did not make payments, and sent delinquency letters. In addition, even though the debtors were represented by counsel, the mortgagee made no attempts to contact their counsel.

The court held that the mortgagee's collection activities constituted a willful violation of the automatic stay. The court found that the debtors were entitled to compensatory damages in the amount of all payments made by the debtors during the automatic stay. In addition, the court awarded the debtor $65,700.00 in punitive damages because of the utter lack of procedures the mortgagee had in place to deal with a mortgagor who had filed bankruptcy.

Remedies Available in TILA Cases

1. **Quenzer v. Advanta Mortgage Corporation USA, 288 B.R. 884 (D. Kansas 2003).** In this case, the chapter 13 debtors brought an adversary proceeding to rescind a mortgage on their property on the ground that the mortgagee provided them with the wrong Notice of Right to Cancel Form which extended the time to rescind the mortgage to three years and that debtors had exercised their right to rescind within such time period. The mortgagee admitted that it inadvertently provided the debtors with a copy of a form designed to inform borrowers of their rights in refinancing transactions, rather than a copy of the proper notice relating to an initial mortgage transaction. The bankruptcy court held that provision of the wrong right to cancel form constituted a violation of TILA and that the mortgage was void because the debtors had properly rescinded the mortgage. Further, the court held that because the mortgage was void, the mortgagee became a mere unsecured creditor.

The mortgagee appealed the bankruptcy court's decision to treat the mortgagee as an unsecured creditor. The district court stated that rescission is an equitable doctrine and that the rendering of the mortgagee's debt as completely unsecured based on the mortgagee's inadvertent error would be completely inequitable and would exact a penalty entirely disproportionate to the mortgagee's offense. The court therefore reversed the bankruptcy court's

decision and held that the appropriate remedy was to require the debtor to return the original principal amount of the mortgage as a condition to rescission.

2. In re Smith, 289 F.3d 1155 (9th Cir. 2002). In Smith, the debtor filed an adversary proceeding against the mortgagee claiming that mortgagee had violated TILA by failing to disclose and define "finance charge" and "annual percentage" at the closing. The bankruptcy court found that the mortgagee had violated TILA, but held that the mortgagee was only liable for statutory damages and not actual damages. The Ninth Circuit affirmed the decision holding that in order to recover actual damages for a violation of TILA, a debtor is required to establish detrimental reliance. Because the debtor was unable to demonstrate either that she would have gotten a better interest rate or would have foregone the loan at issue completely, the court found that the debtor was not entitled to actual damages.

Miscellaneous

1. **A debtor may strip down a wholly unsecured mortgage even where such mortgage is secured only by the debtor's homestead.** In **In re Samala, 295 B.R. 380 (Banrk. N.M. 2003)** there were four mortgages against the debtor's residence. The value of the homestead was $190,000 and the outstanding balance of the first two mortgages against the property was $206,000. Accordingly, there was no value in the property to which the third and fourth mortgages could attach. The debtors filed an objection to the claims filed by the third and fourth mortgagee (which was the same entity) and also filed a motion to value the collateral under Section 506(a) and a motion to avoid the third and fourth mortgages. Following the majority of courts which had addressed the issue, the bankruptcy court held that because the mortgages at issue were wholly unsecured, the debtors were entitled to "strip off" the mortgages even though the mortgages were secured only by a security interest in the debtor's homestead. In keeping with Nobleman, 508 U.S. 324, 113 S. Ct. 2106, 124 L. Ed. 2d. 228 (1993), the court stated that if a mortgage has some secured portion, Section 1322(b)(2) of the Code comes into play. In that situation, the court stated, the debtors would not be entitled to "strip down" the mortgagee's lien.

2. **Proof of claim is deemed "filed" when it is physically delivered to clerk's office for docketing, regardless of whether it is properly docketed, lost or misplaced. In re Graham, 290 B.R. 424 (N.D. Ga. 2003)** does not involve a mortgage, but it addresses an interesting issue which can arise when a creditor attempts to file a proof of claim at or near the deadline for filing claims. In Graham, the counsel for a creditor mailed a proof of claim on behalf of the creditor approximately one month before the deadline for filing proofs of claim. However, the proof of claim was never docketed. After discovering approximately four months later that the proof of claim had not been docketed, counsel filed a new proof of claim that was docketed. Debtors objected to the proof of claim on the ground that it was not docketed prior to the deadline for

filing claims. In response, creditor's counsel produced to the court a copy of his filing letter and original proof of claim which both contained a date approximately one month prior to the deadline for filing claims. The court found that the "mailbox rule" applied to the filing of proofs of claims. Specifically, the court held that the undisputed evidence produced by the creditor which showed that the proof of claim had been mailed prior to the deadline established a rebuttable presumption that the clerk's office received it. The absence of the docketing of the proof of claim did not rebut the presumption. Further, the court found that receipt of a document by the clerk's office, and nothing more, constitutes "filing" of the document. Accordingly, because the debtors were unable to overcome the presumption that the clerk's office received the proof of claim, the court held that the proof of claim was timely filed.

3. Debtor is bound by the arrearage amount due a mortgagee set forth in a confirmed plan and cannot object to mortgagee's claim even where such claim includes an improper charge. In In re Swanson, 307 B.R. 306 (Bankr. M.D. Fla. 2004), the mortgagee filed a proof of claim which improperly included post petition foreclosure attorneys fees and costs. The debtor did not object to the proof of claim and instead filed a plan which provided that the mortgagee would be paid in full including the improper attorneys fees and costs. After the plan was confirmed, the debtor objected to the mortgagee's proof of claim. The court acknowledged that the attorneys fees and costs at issue were improper, but overruled the debtor's objection on the ground that the plan was res judicata as to payment amounts set forth therein.