Misbehavior and Mistake in Bankruptcy Mortgage Claims

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Abstract

The greatest fear of many families in serious financial trouble is that they will lose their homes. Bankruptcy offers a last chance for families to save their homes by halting a foreclosure and by repaying any default on their mortgage loans over a period of years. Mortgage companies participate in bankruptcy by filing claims with the court for the amount of the mortgage debt. To retain their homes, bankruptcy debtors must pay these amounts. This process is well-established and, until now, uncontroversial. The assumption is that the protective elements of the federal bankruptcy shield vulnerable homeowners from harm.

This Article examines the actual behavior of mortgage companies in consumer bankruptcy cases. Using original data from 1700 recent Chapter 13 bankruptcy cases, I conclude that mortgage companies frequently do not comply with applicable law. A majority of mortgage claims are missing one or more of the required pieces of documentation for a bankruptcy claim. Furthermore, fees are often poorly identified, making it impossible to verify if such charges are legally permissible or accurate. In nearly all cases, debtors and mortgage companies disagree on the amount of outstanding mortgage debt.

Despite these irregularities, mortgage claims in bankruptcy are infrequently contested. Imposing unambiguous legal rules does not ensure that a system will actually function to safeguard the rights of parties. The findings of this Article are a chilling reminder of the limits of formal law to protect consumers. Observing that laws can underperform has crucial implications for designing legal systems that will function as intended and for evaluating the appropriate scope of consumer protection.

Misbehavior or mistake by mortgage servicers can have grave consequences. Undocumented or bloated claims jeopardize a family's ability to save its home. Beyond bankruptcy, poor or abusive mortgage servicing undermines America's homeownership policies by exposing families to risks of overpaying or unjustified foreclosures. This Article's findings offer an empirical measure of whether consumers can trust mortgage companies to adhere to applicable laws.

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MISBEHAVIOR AND MISTAKE IN BANKRUPTCY MORTGAGE CLAIMS

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INTRODUCTION

Families in serious financial trouble are under great stress. The telephone rings with repeated calls from debt collectors, each paycheck is at risk of garnishment, and the next knock on the door could be a process server or a repo agent. Yet, for many families, the greatest fear is losing their home to foreclosure. A home is not only most families' largest asset, but also a tangible marker of their financial aspirations and middle-class status. A threatened or pending foreclosure can signal the end of a family's ability to struggle against financial collapse and an unrecoverable tumble down the socioeconomic ladder.

Bankruptcy offers these families one last chance to save their homes. A bankruptcy filing halts a pending foreclosure and gives families the right under federal law to cure any defaults on mortgage loans over a period of years.[1] The bankruptcy system offers refuge from the vagaries of state foreclosure law, substituting the protections of a federal court system and uniform legal rules to ensure that families get one final opportunity to preserve their homes.

But this protection comes at a cost. Mortgage companies file proofs of claim with the bankruptcy court for the amount of the mortgage debt. In turn, bankrupt debtors must pay these claims or lose their homes. The balance between the family and the mortgage lender is clearly spelled out in the bankruptcy laws, which specify the manner in which the amount owed is to be established and obligate both the homeowner and the mortgage company to disclose information accurately.

[1] Raisa Bahchieva, Susan Wachter & Elizabeth Warren, *Mortgage Debt, Bankruptcy, and the Sustainability of Homeownership*, *in* CREDIT MARKETS FOR THE POOR 73 (Patrick Bolton & Howard Rosenthal eds., 2005) (stating that Chapter 13 bankruptcy is frequently used by families who face foreclosure).

This claims process is well-established and, until now, uncontroversial. Homeowners—backed up by lawyers, policymakers, and news reporters—assume that bankruptcy functions according to the official rules and, by following these rules, that bankruptcy provides a realistic opportunity for families to save their homes. The data revealed in this Article suggest, however, that mortgage companies often disobey the law and that the legal system does not substantiate the amounts that lenders assert that consumers owe. These problems can cripple a family's efforts to save its home and undermine policies of sustainable homeownership.

This Article examines the actual behavior of mortgage companies in the consumer bankruptcy system. Using original data from 1700 recent Chapter 13 bankruptcy cases, I conclude that mortgagees' behavior significantly threatens bankruptcy's purpose of helping families save their homes. Despite unambiguous federal rules designed to protect homeowners and to ensure the integrity of the bankruptcy process,[2] mortgage companies frequently fail to comply with the laws that govern bankruptcy claims. A majority of mortgage claims lack the required documentation necessary to establish a valid debt. Fees and charges on bankruptcy claims often are identified poorly and sometimes do not appear to be legally permissible. On an aggregate level, mortgage creditors assert that bankrupt families owe them at least one billion dollars more than the families who file bankruptcy believe they owe. Although infractions are frequent and irregularities are sometimes egregious, the bankruptcy system routinely processes mortgage claims that do not comply with legal procedures. Far from serving as a significant check against mistake or misbehavior, the bankruptcy system routinely processes mortgage claims that cannot be validated and are not, in fact, lawful.

These findings are important because they offer a rare glimpse into the high-stakes world of mortgage servicing. Whether a bankrupt family can save its home turns on the family being able to find the dollars to cure its mortgage arrearage. The data on missing documentation, unsubstantiated fees, and discrepancies in recordkeeping, combined with the growing body of case law sanctioning mortgage servicers for their conduct, raise the specter that many families may be overcharged or may unfairly lose their homes. Such realities undermine bankruptcy's goal of helping families save their homes.

The misbehavior or mistakes of mortgage servicers identified in the bankruptcy data are not specific to the bankruptcy process. Indeed, the reliability of mortgage servicing may be worse for ordinary, non-bankrupt Americans. When such families face foreclosure, they lack the safeguards of the bankruptcy system such as specific and uniform federal laws, bankruptcy trustees, specialized federal courts, and representation by counsel, to ensure that mortgage servicers are complying with consumer protection laws. This Article's findings suggest that flawed mortgage servicing practices are a key contributor to the current crisis in the home mortgage market. Crafting an effective policy response to help homeowners requires regulators and policymakers to recognize how poor mortgage servicing threatens families' efforts to save their homes.

The evidence of unreliable mortgage servicing also provides a powerful lesson on the limits of formal law. The procedures for bankruptcy claims were thoughtfully designed to balance the concerns of consumers and industry. The written law contains clear

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[2] *See, e.g.*, *In re* Matus, 303 B.R. 660, 675 (Bankr. N.D. Ga. 2004) ("The [bankruptcy] statutes are designed to insure that complete, truthful and reliable information is put forward at the outset of the proceedings, so that decisions can be made by the parties in interest based on fact rather than fiction.").

instructions, and parties are given the opportunity to object to inappropriate conduct. Indeed, the claims system has functioned for decades without generating calls for reform. Yet, reality is far from the ideal suggested by these external markers of system reliability. The data show that there are significant defects in the bankruptcy system, a chilling reminder that imposing unambiguous legal rules does not ensure that a system will actually function to protect the rights of parties. In the context of consumer transactions, where individuals are not repeat players or institutional actors, observing that laws underperform has crucial implications that echo far beyond bankruptcy policy. An effective legal system requires more than merely putting words into law and relying on silence as an indication of acceptable and just behavior. These data suggest that effective enforcement mechanisms or structural incentives for industry compliance can be as important as the rigor of the substantive rules.

Part I of this Article examines the incentives for mortgage servicers to comply with applicable laws and describes reported incidences of abusive servicing. Part II describes the study's methodology. Part III presents original data on the legality and accuracy of mortgage claims. These data show a high incidence of unreliable servicing behavior, even in the context of the heightened procedural protections in bankruptcy. Part IV develops the policy implications of the findings and proposes structural solutions to reduce the risks that poor mortgage servicing imposes on homeowners and the legal system. Without improved procedures and enforcement activity, homeowners in financial trouble—both inside and outside bankruptcy—remain vulnerable to mortgagees' misbehaviors and mistakes.

I. STATEMENT OF PROBLEM

Americans pursue homeownership to build wealth and to improve their financial position. The explosion of subprime lending and the rapid maturation of the securitization market for mortgages have fueled occasional criticisms of mortgage servicers, who are intermediaries between consumers and mortgage holders.[3] Consumers have complained of overcharges and difficulty in obtaining accurate loan information. Increasingly, these problems are erupting into litigation, most frequently in bankruptcy courts. Although policymakers have focused on loan origination,[4] consumers can suffer dire harms from poor mortgage servicing. Errors or overcharges increase the cost of homeownership and expose families to the risk of wrongful foreclosure. This part explains the serious consequences of mortgage servicing and collects the scattered reports of servicing abuse. This review highlights the need for a systematic examination of the reliability of mortgage servicing.

A. The Structure and Function of Mortgage Servicing

Mortgage servicing is the collection of payments from borrowers and the disbursement of those payments to the appropriate parties such as lenders, investors, taxing authorities, and

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[3] In this Article, I refer only to servicers, but lenders who service their own loans may engage in similar behavior to third-party servicers.

[4] *See, e.g.*, Press Release, Iowa Attorney General, States Settle with Household Finance: Up to $484 Million for Consumers (Oct. 11, 2002), *available at* http://www.state.ia.us/government/ag/latest_news/releases/oct_2002/Household_Chicago.html (reporting that settlement with Household Finance for misrepresentation and disclosure violations at loan origination was the largest-ever direct restitution settlement).

insurers.[5] The rise of servicing as a distinct industry results from the widespread use of securitization in the mortgage market.[6] Put simply, securitization is the process of creating debt instruments (usually bonds) by pooling mortgage loans, transferring those obligations to a trust, and then selling investors fractional interests in the trust's pool of mortgages.[7] These investors receive periodic payments on their investments. Servicers act as intermediaries between the borrower and the other parties to the securitization. A pooling and servicing agreement sets out the servicer's responsibilities for collecting and remitting the mortgage payments. The participation of servicers complicates the borrower-lender relationship and limits flexibility in loss mitigation and default situations.

Mortgage servicers do not have a customer relationship with homeowners; they work for the investors who own the mortgage-backed securities.[8] Borrowers cannot shop for a loan based on the quality of the servicing, and they have virtually no ability to change servicers if they are dissatisfied with the servicers' conduct.[9] The only exit strategy is refinancing the mortgage, and even then, the homeowner may find the new loan assigned to its prior servicer. Because their customers are the trustees who hire them to collect on behalf of investors, servicers have few reputational or financial constraints to work to satisfy homeowners with their performance.[10]

In fact, servicers have a financial incentive to impose additional fees on consumers. Mortgage servicers earn revenue in three major ways. First, they receive a fixed fee for each loan. Typical arrangements pay servicers between .25% and 1.375% of the note principal for each loan.[11] Second, servicers earn "float" income from accrued interest between when consumers pay and when those funds are remitted to investors. Third, servicers often are permitted to retain all, or part, of any default fees, such as late charges, that consumers pay.[12] In this way, a borrower's default can boost a servicer's profits.[13] A significant fraction of servicers' total revenue comes from retained fee income.[14] Because of this structure, servicers' incentives upon default may not align with investors' incentives.[15] Servicers have incentives to make it difficult for consumers to cure defaults.

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[5] Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers*, 15 HOUSING POLICY DEBATE 753, 755 (2004).

[6] Statement of Sheila C. Bair, Testimony before U.S. House Comm. on Financial Services (Apr. 17, 2007) ("Prior to the widespread use of securitization, home finance typically involved a bank or savings institution granting a loan to a borrower. The lending institution would make the decision to grant credit, fund the loan, and collect payments.").

[7] *See generally* STEVEN L. SCHWARCZ, BRUCE A. MARKELL & LISSA L. BROOME, SECURITIZATION, STRUCTURED FINANCE, AND CAPITAL MARKETS (2004) (providing an introduction to securitization and examining the legal issues relevant to securitized transactions).

[8] Lenders do have a customer relationship with borrowers and may want to retain them as repeat customers. Some lenders retain the servicing obligations when they sell loans on the secondary market, but the active market for servicing contracts means that very few customers will find their loan is serviced by the originating lender.

[9] Jack Guttentag, *Why is Mortgage Servicing So Bad?*, Feb. 3, 2003, http://www.mtgprofessor.com/A%20-%20Servicing/why_is_servicing_so_bad.htm.

[10] *Id*.

[11] NAT'L CONSUMER LAW CENTER, FORECLOSURES 23 (2006 Supp.) [hereinafter Nat'l Consumer Law Center].

[12] Eggert, *supra* note 5, at 758 (explaining that servicers' conventional fee is a percentage of the total value of the loan but that servicers typically have the right to retain any default fees).

[13] NAT'L CONSUMER LAW CENTER, *supra* note 11 at 13.

[14] Some information can be gleaned from the securities filings of public companies that service mortgages. Late charges account for approximately 11% of revenues for Ocwen's residential mortgage servicing division in 2006. *See* Ocwen Financial Corp., Annual Report (Form 10-K), at 30 (Mar. 16, 2007). *Cf.* RONALD MANN, CHARGING AHEAD 23 (2006) (reporting that credit card issuers earn 9% of their revenue from penalty fees).

[15] Statement of Sheila C. Bair, *supra* note 6, at 9.

A consumer is only obligated to pay charges if the charges are permitted by the terms of the mortgage and by state and federal law. To validate such charges, consumers must know how the servicer calculated the amount due and whether such fees are consistent with their loan contract. A lending industry representative has admitted that "[m]ost people don't understand the most basic things about their mortgage payment."[16]Mortgage servicers can exploit consumers' difficulty in recognizing errors or overcharges by failing to provide comprehensible or complete information. In fact, poor service to consumers can actually maximize servicers' profits.[17] Indeed, it appears that servicers fail to satisfy customers. A study of consumer satisfaction with business services found that only 10% of borrowers are happy with their mortgage servicer.[18]

Spiking foreclosure rates and pressure from Wall Street may exacerbate problems with mortgage servicing.[19] Falling real estate prices have changed the profit calculus of foreclosure, encouraging lenders to reach out to delinquent borrowers. Facing political and financial pressure, lenders and servicers are struggling to develop cost- and time-effective strategies for loss mitigation.[20] However, cash-strapped lenders have fewer resources than ever to devote to loan servicing. Just as more borrowers risk losing their homes, servicers may have to lay off employees, skimp on procedural safeguards, or reduce investment in technology. These changes do not portend well for borrowers in high-cost loans or those seeking loan modifications.[21] Mortgage servicing is a crucial part of the homeownership process that must be part of any response to the rising foreclosure rate and downturn in the mortgage market.

B. Homeowners in Bankruptcy

Most consumers who file Chapter 13 bankruptcy cases are homeowners.[22] The requirements of the Bankruptcy Code impose new burdens on mortgage servicers. In turn, these complexities create new opportunities for mortgage servicing abuse. The harms of poor mortgage servicing are heightened in bankruptcy, a refuge for families trying to save their homes.

When a borrower files bankruptcy, the creditor is barred by the automatic stay from pursuing other legal action to collect the debt.[23] Pending foreclosures may not proceed against the debtor's home, unless the court grants the creditor permission to do so.[24] Many homeowners

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[16] *Lenders Look for Way to Avoid Bankruptcy Maze*, NAT'L MORTGAGE NEWS, Aug. 30, 2004.
[17] Guttentag, *supra* note 9.
[18] Press Release, J.D. Powers and Associates, Customer Service and Attention to Detail Drive Home Mortgage Satisfaction (Nov. 26, 2002), http://www.jdpower.com/corporate/news/releases/pressrelease.aspx?ID=2002144.
[19] Posting of Tara Twomey to *Credit Slips* blog, Subprime Servicing Getting Worse, http://www.creditslips.org/creditslips/2007/03/subprime_servic.html (Mar. 19, 2007).
[20] Ruth Simon, *Digging Out of Delinquency*, WALL ST. J., Apr. 11, 2007, at D1 ("The sharp rise in delinquencies in recent months is straining mortgage companies' ability to respond quickly to borrowers, with such solutions as new repayment plans or modifications to loan agreements."); Carrick Mollenkamp, *Faulty Assumptions*, WALL ST. J., Feb. 8, 200, at A1 (describing HSBC's expanded loss mitigation efforts).
[21] *See* Kurt Eggert, *What Prevents Loan Modifications*, 18 HOUSING POLICY DEBATE 279 (2007) (documenting barriers that servicers face in loan modifications).
[22] TERESA SULLIVAN, ELIZABETH WARREN, JAY LAWRENCE WESTBROOK, THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT 202 (2000) (half of all bankruptcy debtors are homeowners); Bahchieva, Wachter & Warren, *supra* note 1, at 104–05 (explaining that homeowners disproportionately choose Chapter 13 because Chapter 7 does not protect home equity).
[23] 11 U.S.C. § 362(a).
[24] 11 U.S.C. § 362(b).

are in default on their mortgage loans when they seek bankruptcy relief.[25] Because families typically struggle for months before filing bankruptcy,[26] their mortgage accounts at the time of bankruptcy may be loaded with default charges, penalty fees, and foreclosure costs. To retain their homes in bankruptcy, Chapter 13 requires debtors to pay, in full, these arrearage amounts (including any regular monthly payments that were not made before the bankruptcy.)[27]

To establish the arrearage amount that must be cured, creditors usually file proofs of claim.[28] Even if a loan is not in default, many mortgagees will file a claim to establish the amount of outstanding principal. While liens on a debtor's property pass unaffected through bankruptcy,[29] barring a specific challenge based on special bankruptcy avoidance powers, [30] creditors who wish to receive distributions from trustee must file claims.[31] Liens on debtor's property pass through bankruptcy unaffected, unless there is a specific challenge based on special bankruptcy avoidance powers. However, creditors who wish to receive distributions from the trustee must file claims. Trustees normally pay arrearage amounts to servicers from debtors' Chapter 13 payments. In some jurisdictions, trustees also collect and transmit the regular ongoing mortgage payments to servicers.[32]

A claims process is incorporated into every bankruptcy case to determine how much each creditor is owed and to adjudicate any disputes about the debt. These proofs of claims are bankruptcy's alternative mechanism to a separate lawsuit by each creditor to collect a debt. In the mortgage context, a proof of claim functions similarly to a complaint to foreclose and collect a deficiency judgment. That is, the claim should establish a creditor's interest in the debtor's home as a mortgagee and the amount owed on the mortgage note. The debtor has the opportunity to "answer," by objecting to the claim. The bankruptcy court then has authority to fix the claim. Because proofs of claim are the most common interaction between debtors and creditors in the

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[25] Bahchieva, Wachter & Warren, *supra* note 1, at 104 (finding that bankrupt homeowners are about 50 percent more likely to file Chapter 13 than Chapter 7 and attributing this preference to Chapter 13's special protections for home owners in default.).

[26] The median bankruptcy filer reported that they seriously struggled with debts for more than one year before filing bankruptcy. This query was posed to Chapter 7 and Chapter 13 debtors in telephone interviews one year after the respondent filed bankruptcy. N=585 (17 missing from total respondent sample of 602). 2001 Consumer Bankruptcy Project (data on file with author).

[27] 11 U.S.C. § 1322(b)(5).

[28] Creditors are not required to file proofs of claim. *See* David Gray Carlson, *Proofs of Claim in Bankruptcy: Their Relevance to Secured Creditors*, 4 J. BANKR. L. & PRAC. 555 (1995).

[29] Marianne B. Culhane & Michaela M. White, *Debt After Discharge: An Empirical Study of Reaffirmation*, 73 AM. BANKR. L.J. 709, 712 (1999).

[30] 11 U.S.C. §§ 544, 547.

[31] *See* ELIZABETH WARREN & JAW LAWRENCE WESTBROOK, THE LAW OF DEBTORS AND CREDITORS 219 (5th ed. 2005) ("[T]o receive any distribution, each chapter 7 or chapter 13 creditor must submit a proof of claim.")

[32] Practices on paying mortgage creditors in Chapter 13 cases vary. In some jurisdictions, ongoing mortgages are paid "outside the plan," meaning that the debtor continues to make the ongoing principal and interest payments directly to the mortgage servicer without trustee involvement. Even in these jurisdictions, the trustee usually collects the debtor's payment of any arrearages on the mortgage loan. In other districts, the trustee collects both the arrearage amounts and the ongoing mortgage payments. These practices are yet another example of the well-documented phenomena of "local legal culture" in bankruptcy cases. *See* Lynn M. LoPucki, *Legal Culture, Legal Strategy, and the Law in Lawyers' Heads*, 90 NW. U. L. REV. 1498 (1996); Teresa A. Sullivan, Elizabeth Warren & Jaw Lawrence Westbrook, *The Persistence of Local Legal Culture: Twenty Years of Evidence From the Federal Bankruptcy Courts*, 17 HARV. J.L. & PUB. POL'Y 801 (1994); Jean Braucher, *Lawyers and Consumer Bankruptcy: One Code, Many Cultures*, 67 AM. BANKR. L.J. 501 (1993).

bankruptcy system,[33] they offer an excellent mechanism for examining the behavior of mortgage servicers in bankruptcy cases.

C. The Harms of Abusive Servicing

Mortgage servicing abuse can take several forms. The Federal Trade Commission believes that poor servicing can be a serious problem for homeowners and has identified several abusive practices, including the imposition of unwarranted late fees, unnecessary force-placed insurance, and illegal fees.[34] Two cases illustrate the problems that incorrect or inaccurate mortgage servicing imposes on borrowers. In *Rawlings v. Dovenmuehle Mortgage, Inc.*,[35] the servicer repeatedly asserted that the homeowners had failed to make payments, imposed late fees, and sent notices of default. Consumers spent over seven months to resolve the servicers' error in applying the payments to the wrong account. In another instance, borrowers refinanced but the prior servicer continued to threaten to foreclose on their home and to report adverse information to credit bureaus.[36] This year, the *Boston Globe* reported that mortgage companies typically include projected foreclosure costs in payoff amounts given to borrowers in default.[37] These fees are estimates for anticipated services that may never be incurred. While a consumer advocate described the practice as a "license to steal from homeowners," an industry representative conceded that it was "pretty much industry standard."[38]

The likelihood that such practices translate to concrete harms is sharpened because consumers report serious difficulty in communicating with mortgage servicers when they perceive an error or overcharge has occurred.[39] Consumers allege that they have to speak with dozens of representatives to address servicing mistakes or to receive basic information such as a payment history. These problems are exacerbated when a borrower defaults on a loan, in part because the loan is often transferred to the loss mitigation department or sold to a different servicer who specializes in troubled loans.

Abusive servicing can push a homeowner into default or can make it hard or impossible for a homeowner to climb out of trouble. Research has shown that the quality of loan servicing can affect the incidence of loan default.[40] Servicers may alter their practices and delay foreclosure to drive up their profits because they do not have incentives to care about preventing foreclosure.[41] While preventive servicing can reduce loss severities, abusive servicing can

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[33] While claims are the most common creditor activity in bankruptcy cases, claims are not filed by every creditor. *See* 1 KEITH M. LUNDIN, CHAPTER 13 BANKRUPTCY § 67.1 (3d ed. 2000 & Supp. 2004) (stating that numerous creditors fail to file proofs of claim).

[34] Federal Trade Commission, *Mortgage Servicing: Making Sure Your Payments Count*, *at* http://www.ftc.gov/bcp/conline/pubs/homes/mortgserv.htm.

[35] 64 F. Supp. 2d 1156 (M.D. Ala. 1999).

[36] Islam v. Option One Mortgage Corp., 432 F. Supp. 2d 181 (D. Mass. 2006).

[37] Sacha Pfeiffer, *Hidden Legal Fees Push Some Into Foreclosure*, BOSTON GLOBE Jan. 18, 2007.

[38] *Id.*

[39] *See, e.g.*, S.P. Dinnen, *Mortgage Complaints Can Take Extra Effort*, DES MOINES REGISTER, May 2, 2004; A. Pesquera, *Paper Trail of Problems: Some Fairbanks Clients Report Nightmare Errors*, SAN ANTONIO EXPRESS-NEWS, Aug. 9, 2002.

[40] Anthony Pennington-Cross & Giang Ho, *Loan Servicer Heterogeneity &The Termination of Subprime Mortgages* (Federal Reserve Bank of St. Louis, Working Paper No. 2006-024A, 2006, *available at* http://research.stlouisfed.org/wp/2006/2006-024.pdf (finding that individual servicer affected chance of default to substantial degree among large sample of subprime mortgages).

[41] Yingjin Gan & Christopher Mayer, *Agency Conflicts, Asset Substitution, and Securitization* (Nat'l. Bur. of Econ. Res., Working Paper No. 12359 2006), *available at* http://www.nber.org/papers/w12359.

heighten them.[42] Without servicers' reaching out to consumers and spending the necessary time and money, sensible loan modification opportunities will be missed. Families who could have saved their homes with a repayment plan or modification will lose their homes, and investors will suffer unmitigated losses.[43]

The harms of servicing abuse may be even higher for families in bankruptcy, who often file Chapter 13 in a final effort to save their homes. If bankruptcy claims contain illegal fees, debtors face increased burdens in confirming repayment plans and are forced to find extra income to make bloated payments. Even if the servicing harm is limited to informational problems, debtors suffer harms. As one bankruptcy court recognized, mistakes by creditors, who are in control of the accounts, impose additional costs to sort out such problems on debtors, the party that can least afford such expense.[44] Servicing problems also jeopardize the ability of courts and trustees to administer bankruptcy cases correctly and fairly. Other creditors are harmed if mortgage companies wrongly divert money that should be available to pay unsecured creditors and increase the administrative costs of bankruptcy. If servicing abuse is routine, an additional harm is to our collective confidence in the integrity of the bankruptcy system and the power of law to balance the rights of consumers and businesses.

D. Litigation on Mortgage Servicing Practices

Mortgage servicing abuse is a nascent legal issue.[45] Depending on the type of misbehavior, consumers may have federal and state claims and both common law and statutory remedies.[46] While the case law is growing, there are still relatively few adjudicated decisions on mortgage servicing problems. Several explanations exist. Consumers may not be aware of their rights or be able to afford an attorney. The relative youth of mortgage servicing as an industry means that few attorneys or judges understand the legal and factual issues. Regulatory authority for mortgage servicing is fractured. The paucity of decisions suggests that many consumers may respond to mortgage claims by "lumping it," rather than seeking any formal redress.[47] Consumers who litigate these disputes face all the challenges of typical consumer protection litigation, including limited access to attorneys, expensive and complicated evidentiary issues, and insufficient remedies to justify such suits.[48]

Most litigation against mortgage servicers has occurred in the context of bankruptcy cases.[49] Bankruptcy changes the dynamic between borrowers and servicers. The vast majority of consumers hire an attorney to represent them in their bankruptcy.[50] Without counsel, consumers

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[42] MICHAEL A. STEGMAN, ET. AL., *Preventive Servicing Is Good for Business and Affordable Homeownership Policy*, 18 HOUSING POLICY DEBATE 243 (2007).
[43] Eggert, *supra* note 21, at 282.
[44] Williams v. Fairbanks Capital Corp. (*In re* Williams), 2001 WL 1804312, at *2 (Bankr. D.S.C. 2001) (awarding punitive damages to debtor as a result of actions and misrepresentations of creditor).
[45] NAT'L CONSUMER LAW CENTER, *supra* note 11, at 23.
[46] *Id*.
[47] Marc S. Galanter, *Reading the Landscape of Disputes: What We Know and Don't Know (And Think We Know) About Our Allegedly Contentious and Litigious Society*, 31 UCLA L. REV. 4, 14 (1983) ("Even where injuries are perceived, a common response is resignation, that is, 'lumping it.').
[48] *See* JOHN A. SPANOGLE ET. AL., CONSUMER LAW 772 (3d ed. 2007) (discussing barriers to consumer litigation).
[49] *See Lenders Look for Way*, *supra* note 16, (quoting employee of servicer remarking that "[b]ankruptcy is becoming a fertile ground for a lot of loopholes and a lot of lawsuits and a lot of costs to servicers").
[50] TERESA SULLIVAN, ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA 22–23 (1989) (finding only 4% of debtors in a sample of 1529 cases filed *pro se* petitions).

may be unable to raise such claims. They may also have trouble identifying an attorney who is familiar with such issues or willing to take such a suit on a stand-alone basis. As part of the bankruptcy case, the attorney may find it difficult to obtain the cooperation of the mortgage servicer and litigation may be necessary to fulfill their duty of representation. While bankruptcy is the context for most servicing disputes, the problems are identified in bankruptcy cases often originated months or years earlier and are equally likely to occur when a borrower is in default but does not file bankruptcy.[51]

Bankruptcy courts have repeatedly expressed frustration with mortgagees' failure to provide complete and accurate information.[52] Courts and litigants have struggled to obtain comprehensible records from servicers. *In re Maxwell*, the court described the creditor's pleadings. "Thus, Fairbanks, in February 2000, represented that the Debtor owed it $48,691.36 *less* than what it demanded of the Debtor in April of 1998 and $192,963.64 *more* than it demanded of her on July 13, 1999."[53] The court found that "Fairbanks, in a shocking display of corporate irresponsibility, repeatedly fabricated the amount of the Debtor's obligation to it out of thin air." The court held that this behavior violated both federal and state law. After the court's ruling on liability, the debtor settled the case for a full discharge of her mortgage, $50,000 in damages, and attorney's fees.

Other courts have identified a similar pattern of confusing or incomplete recordkeeping as evidenced by servicers' proofs of claim. Unable to decipher a servicer's records, even after ordering further document production, one court finally resorted to creating its own amortization table. The judge stated that "[t]he poor quality of papers filed by Fleet to support its claim is a sad commentary on the record keeping of a large financial institution. Unfortunately, it is typical of record-keeping products generated by lenders and loan servicers in court proceedings."[54] In some instances, mortgagees apparently are unable to offer any accounting to support their claim. In *Litton Loan Servicing v. Garvida,* when the servicer failed to respond to a court order to provide information, Bankruptcy Appellate Panel affirmed that a downward adjustment of the mortgagee's claim was an appropriate remedy.[55] Another court reduced a mortgagee's claim under the equitable theory of recoupment after finding that the servicer violated the Real Estate Settlement Procedures Act in failing to respond to the debtor's requests for an account balance. The opinion's first sentence reveals the court's frustration: "Is it too much to ask a consumer mortgage lender to provide the debtor with a clear and unambiguous statement of the debtor's default prior to foreclosing on the debtor's house?"[56] In one egregious case, a mortgage company filed a proof of claim for more than $1 million when the principal balance on the note was $60,000.[57] The inaccuracy stemmed from the claimants' mistake in reporting the cost of the

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[51] E-mail from the Honorable Keith M. Lundin (June 9, 2003) (on file with author) (describing session at Nat'l. Ass'n. of Chapter 13 trustees meeting on mortgage issues in Chapter 13). The grievances aired were: servicers are unable to prepare correct pre-petition claims in Chapter 13 cases; creditors file proofs of claim without balances or that are bloated with illegal and fraudulent fees sometimes totaling several thousand dollars; irreconcilable and unexplained balances appear on amended proofs of claim; servicers provide no contact information; and servicers refuse to provide loan payment histories.

[52] Henry R. Hildebrand III, *The Sad State of Mortgage Service Providers*, 22 AM. BANKR. INST. L. REV. 10 (2003) (describing mortgage servicers' inability or lack of effort to make their records match the debtor's plan or to comply with the requirements of the Bankruptcy Code such as disclosing fees and costs).

[53] Maxwell v. Fairbanks Capital Corp. (*In re* Maxwell), 281 B.R. 101, 114 (Bankr. D. Mass. 2002).

[54] *In re* Wines, 239 B.R. 703, 709 (Bankr. D.N.J. 1999).

[55] *In re* Garvida, 347 B.R. 697 (9th Cir. B.A.P. 2006).

[56] *In re* Thompson, 350 B.R. 842, 844–45 (Bankr. E.D. Wis. 2006).

[57] The proof of claim was filed in a Northern District of Texas Chapter 13 case and is on file with the author.

insurance policy that the servicer forced on the debtor after the debtor's insurance lapsed. These problems led a prominent Chapter 13 trustee to conclude that mortgage servicing in bankruptcy is in a "sorry state."[58]

Mortgagee servicing problems have surfaced in other procedural contexts besides proofs of claims. The nature of this misconduct is rarely due to the posture of the case, however, and similar problems may infect mortgage claims or non-bankruptcy servicing. For example, bankruptcy motions for relief from stay put debtors at direct risk of losing their home in a state law foreclosure action. This context may spur debtors and their attorneys to respond to confront servicing inaccuracies that went unidentified in proofs of claim. Several courts have complained about unsubstantiated or patently false allegations in mortgagees' motions for relief from the stay. Courts have lamented mortgage servicers' practice of filing motions to vacate the automatic stay based on poor accounting practices or non-existent records, rejecting what one court termed the mortgage servicers' "dog ate my homework excuses" for such problems.[59] These courts have emphasized two main harms: damage to the judicial process when a court is asked to rule on incorrect or baseless facts and a danger that a family would lose its home without just cause and in violation of the Bankruptcy Code.

In *Jones v. Wells Fargo Home Mortgage*, the court identified a variety of accounting errors and impermissible behavior by a mortgage company, including miscalculations of both prepetition and postpetition obligations and attempts to collect impermissible fees.[60] Wells Fargo also applied payments in violation of the debtor's confirmed Chapter 13 plan—a practice that increased the interest charged above what was actually due.[61] The court noted that Wells Fargo's actions resulted in "such a tangled mess that neither Debtor, who is a certified public accountant, nor Wells Fargo's own representative could fully understand or explain the accounting offered."[62] In another protracted dispute, a court that initially was concerned about whether a creditor lacked a basis for a motion for relief from stay or may have misapplied plan payments eventually heard hours of evidence on the propriety of servicers' and attorneys' practices in bankruptcy cases.[63] The participation of the U.S. Trustee program in the litigation was hotly contested,[64] but undoubtedly changed the character of the litigation to focus on whether servicers engage in a pattern of misconduct, an issue usually relevant to crafting an appropriate sanction for misbehavior.

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[58] *See* Hildebrand, *supra* note 52.
[59] *In re* Gorshtein, 285 B.R. 118, 126 (Bankr. S.D.N.Y. 2002).
[60] *In re* Jones, No. 03-16518, 2007 WL 1112047 (Bankr. E.D. La. 2007). Perhaps most egregiously, Wells Fargo charged the debtor for sixteen property inspections during the bankruptcy case but its representative "could not list a single reason why an inspection would have been ordered postpetition, nor could she detail any reason why continuous monitoring of the property was necessary or reasonable." *Id.* at *11.
[61] *Id.* at *3.
[62] *Id.* at *4. As a remedy, the court imposed a sanction award of $67,202.45 and ordered Wells Fargo to implement an accurate accounting system for cases in the court's jurisdiction. Michael L. Jones v. Wells Fargo Home Mortgage (*In re* Jones), Case. No. 03-16518; Adv. No. 06-01093. Supplemental Memorandum Opinion (Aug. 29, 2007).
[63] Order Requiring Countrywide Home Loans, Inc. to Appear and Show Cause Why It Should Not Be Sanctioned for Filing a Motion for Relief From Stay Containing Inaccurate Debt Figures and Inaccurate Allegations Concerning Payments Received From the Debtor, *In re* Parsley, No. 05-90374 (Bankr. S.D. Tex. Feb. 12, 2007).
[64] Order Granting in Part and Denying in Part Motion of Barrett Burke Wilson Castle Daffin & Frappier, L.L.P. to Strike or, In the Alternative, Limit Issues and/or Continue Show Cause Hearing, *In re* Parsley, No. 05-90374 (Bankr. S.D. Tex. Mar. 6, 2007) (finding that U.S. Trustee has standing to participate under 11 U.S.C. § 307 and finding that Federal Rule of Bankruptcy Procedure 2004 permitted requested discovery).

Some courts also have targeted the creditors' law firms for misbehavior.[65] A New Jersey law firm was fined for filing 250 court pleadings in which the signature page had been pre-signed before review by the servicer.[66] The court's opinion sternly reminds servicers and attorneys that technological "advances" do not absolve the responsible humans of their duty to the court.[67] Another court has observed "instances in which attorneys representing alleged mortgagees or their servicing agents did not know whether the client was a mortgagee or a servicing agent, or how their client came to acquire its role."[68] In addition, several class-action lawsuits have been filed based on allegedly inappropriate efforts to collect attorneys' fees in bankruptcy.[69]

When problems are systemic, private lawsuits may be an ineffective solution. The Federal Trade Commission joined the National Consumer Law Center in bringing a class-action lawsuit against a large servicer, Fairbanks Capital Corporation, for alleged violations of consumer protection laws. The lawsuit settled in 2003 after Fairbanks agreed to pay $47 million, including funding a $5 million foreclosure-redress fund for consumers who lost their homes in part due to unwarranted charges or difficulties in obtaining information from Fairbanks.[70] Despite this victory, the FTC has not pursued any other major enforcement activities against servicers. The Department of Housing and Urban Development also has authority to address servicing misbehavior. It enforces the Real Estate Settlement Procedures Act, which obligates mortgage servicers to provide certain information to homeowners upon receiving a "qualified written request."[71] While a failure to respond to a qualified written request can give rise to a private right of action, there is no empirical evidence on how frequently this law is used to help consumers.[72] Forty percent of consumer complaints to HUD concern servicing issues,[73] yet HUD does not routinely investigate these complaints or collect data from servicers on compliance issues.

The anecdotal reports of mortgage servicing abuse are growing, and the cited decisions are quite recent. However, regulatory enforcement remains weak, and cases outside of bankruptcy are exceedingly rare. Given the millions of consumer who may face foreclosure in the next few years, and the hundreds of thousands of homeowners who annually file Chapter 13 bankruptcy to save their homes, there is a definite need to probe the reliability of mortgage

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[65] *See, e.g.*, *In re* Allen, Memorandum Opinion regarding Sanction of Creditor's Attorneys, Case No. 06-60121 (Jan. 9, 2007) (finding that large creditor's firm had filed erroneous and unsubstantiated objection to plan confirmation).
[66] *In re* Rivera, 342 B.R. 435 (Bankr. D.N.J. 2006).
[67] *Id.* at 467. *See also In re* Allen, *supra* note 65 (describing the close relationship between servicers and their "outside" counsel, who receive some pleadings "set up" with data from the servicer's computer system).
[68] *In re* Schwartz, No. 06-42476JBR, 2007 WL 1188348 (Bankr. D. Mass. Apr. 19, 2007). In that case, the "creditor" claimed to have foreclosed before the bankruptcy filing but was ultimately unable to show that it had the right to undertake any foreclosure activity.
[69] *See In Re* Harris, No. 96-14029-MAM, 00-11321-MAM, Adv. No. 99-1144 (Bankr. S.D. Ala. Jan. 13, 2005); *In Re* Slick, No. 98-14378-MAM, Adv. No. 99-1136 (Bankr. S.D. Ala. Nov. 22, 2002). In Nevada, a proposed class-action was filed to challenge Ocwen Federal Bank's practice of including a "proof of claim fee" in claims filed in Chapter 13 cases. The case was transferred to the Panel on Multidistrict Litigation and remains pending. *In re* Ocwen Federal Bank FSB Mortgage Servicing Litigation, 04-CV-2714, MDL-1604, N.D. Ill.
[70] Fairbanks Capital Corporation settlement documents, http://www.consumerlaw.org/initiatives/mortgage_servicing/index.shtml.
[71] 12 U.S.C. § 2605.
[72] Consumers themselves or their attorneys (including bankruptcy attorneys) may not be aware of the law. Also consumers often do not hire attorneys until foreclosure is imminent, at which time a qualified written request and its sixty-day response window may not be an expedient option.
[73] Guttentag, *supra* note 9.

servicing. The harms from poor servicing carry severe consequences, and empirical data can help draw attention to the need to consider how servicing contributes to failed homeownership.

II. METHODOLOGY

The Mortgage Study is a large, multi-state study of the home loans of families in financial distress. Its principal objective was to create an original database to facilitate new research on the intersection of mortgage lending and bankruptcy. Tara Twomey[74] and I are the principal investigators in the Mortgage Study, which was funded by the National Conference of Bankruptcy Judge's Endowment for Education.[75]

The Mortgage Study sample contains 1733 Chapter 13 bankruptcy cases filed by homeowners. The sample includes cases from forty-four judicial districts in twenty-four states, which represented 61% of all Chapter 13 cases filed in 2006.[76] The sample captures variations in local bankruptcy practice and ensures that all large mortgage lenders and servicers are represented. In each district, the sample was constructed by selecting every fifth case filed in April 2006 in which the debtor owned a home.[77] If a case was converted from another chapter or the debtor did not own a home, that case was excluded and the next case that met the selection criteria was included in the sample. Thus, the sample roughly reflects the proportional size of Chapter 13 filings among all judicial districts in the sample.[78]

The sample is not representative of all homeowners in bankruptcy for two reasons. First, the sample includes only Chapter 13 bankruptcy cases and excludes Chapter 7 cases. Prior studies have confirmed that the percentage of homeowners in Chapter 13 bankruptcy is much higher than in Chapter 7 bankruptcy.[79] The exclusive focus on Chapter 13 enhances the data's usefulness to examine bankruptcy as a home-saving device.[80] Chapter 13 is particularly attractive to homeowners who are in default on their mortgage loans because it permits them to retain their home by curing arrearages over time through repayment plans.[81] Although the data are only from

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[74] When the study began, Tara Twomey was a clinical instructor at Harvard Law School. She is currently a Lecturer in Law at Stanford Law School and a consultant for the National Association of Consumer Bankruptcy Attorneys and the National Consumer Law Center. Neither organization had any involvement in this research.

[75] The Endowment for Education is a non-profit and non-partisan organization. In funding the grant, the Endowment does not endorse or express any opinion about the methodology utilized, or any conclusions, opinions, or results contained in this Article or any other findings based on the research funded by the Endowment.

[76] American Bankruptcy Institute, *Annual Non-business Filings by Chapter (2000-2006)*, http://www.abiworld.org/AM/AMTemplate.cfm?Section=Home&CONTENTID=47461&TEMPLATE=/CM/ContentDisplay.cfm (last visited Jan. 19, 2008).

[77] All homeowners were included in the sample, regardless of whether they had mortgages. In the sample, 96% of homeowners had outstanding mortgage debt when they filed bankruptcy.

[78] For example, in a district with few Chapter 13 filings, such as Wyoming, only two cases are in the sample. At the other extreme, the sample contains 164 cases from the Northern District of Georgia because that district has a large number of Chapter 13 cases filed.

[79] Consumer Bankruptcy Project III (CBP) data indicate that homeownership is much more prevalent among Chapter 13 debtors than Chapter 7 debtors. In the CBP's core sample of 1250 cases filed in 2001 in five judicial districts, 30% of Chapter 7 cases were filed by homeowners. In contrast, 75% of Chapter 13 debtors owned their homes when they filed bankruptcy (data on file with author).

[80] Scarce data exist on how homeowners fare in bankruptcy. *See* Melissa B. Jacoby, *Bankruptcy Reform and Homeownership Risk*, 1 ILL. L. REV. 323, 352 (2007) ("Although scholars of mortgage debt and foreclosure generally may be aware that some homeowners with housing problems file for bankruptcy, chapter 13's specific mortgagor protection feature has not received sufficient discrete and sustained scholarly attention."). The most extensive study to date was conducted based on cases filed in 2001 and did not rely on proofs of claim or home loan documents. *See* Bahchieva, Wachter, & Warren, *supra* note 1, at 74.

[81] *See* 11 U.S.C. §§ 1322(b)(3) and (b)(5), 1325(a)(5) and 362(a).

Chapter 13 cases, the rules and procedures to ensure accurate bankruptcy claims are identical for Chapter 7 cases. However, mortgage claims are much less frequently filed in Chapter 7 cases because there are fewer homeowners who file Chapter 7 and because Chapter 7 does not offer the remedies to homeowners in default that Chapter 13 does.

Second, the sample was drawn only from districts where the applicable state law permits non-judicial foreclosures of debtors' principal residences.[82] We limited the sample in this way because the more favorable remedies available to mortgagees in non-judicial foreclosure states may reduce servicers' incentives to negotiate with consumers after default. That is, because non-judicial foreclosure is faster and less expensive than judicial foreclosure,[83] debtors may have a greater need to file bankruptcy in non-judicial foreclosures states to contest a foreclosure. Sampling states that permit non-judicial foreclosure probably boosted the proportion of homeowners in default on mortgage loans in the sample. Because bankruptcy law is uniform nationally on the requirements for proofs of claims and the rights of homeowners with mortgages in default,[84] a random national sample (including judicial foreclosure states) may not produce different data.[85]

Data were drawn from the public court records filed in each case.[86] Like other leading studies of consumer bankruptcy, [87] we coded data from debtors' schedules. Filed under penalty of perjury, these schedules may provide more complete and reliable evidence of debtors'

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[82] Our sample represents 49% of the judicial districts in the United States. The twenty-four states in the sample are: Alabama, Arkansas, California, Colorado, District of Columbia, Georgia, Idaho, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, New Hampshire, North Carolina, Rhode Island, South Dakota, Tennessee, Texas, Utah, Virginia, West Virginia, and Wyoming.

[83] GRANT NELSON & DALE WHITMAN, REAL ESTATE FINANCE LAW 635 (2002); BARLOW BURKE, REAL ESTATE TRANSACTIONS 336 (2006) ("[Power of sale foreclosure] is cheaper than judicial foreclosure and takes less time."). Judicial foreclosure procedures vary depending on state law. Typically these steps include the filing of a lawsuit and a judgment, followed by a court order authorizing a judicial sale conducted pursuant to statutory procedures. *Id.* at 334. Non-judicial foreclosure typically proceeds under a deed of trust that permits a third-party trustee, upon default, to sell the property in a private sale. Although some public notice is required by all states, a non-judicial foreclosure, as its name suggests, does not require court supervision or the filing of a lawsuit. *Id.* at 337.

[84] Notwithstanding the law's uniformity, practices in bankruptcy do vary in remarkable ways, often due to "legal culture." *See generally* sources cited in note 32, *supra*.

[85] For those cases in which a foreclosure was filed before bankruptcy, it is possible that in judicial foreclosure states the lender was more likely to have retained an attorney before the bankruptcy than in non-judicial foreclosure states. It is unclear if such attorney involvement would result in more complete or accurate bankruptcy pleadings.

[86] Most documents were obtained from PACER. We thank the Chief Judges of each district in the Mortgage Study (with the sole exception noted below) for granting us a research waiver of PACER fees. The Southern District of Texas denied the application for a fee waiver, stating that it had a blanket policy against such waivers, notwithstanding the written policy of the Judicial Conference of the United States that individual researchers associated with educational institutions are eligible for waivers if they can show cause. *See* Electronic Public Access Fee Schedules, http://pacer.psc.uscourts.gov/documents/epa_feesched.pdf (last visited Sept. 9, 2006). When PACER did not appear to contain complete court files, we obtain paper records. For example, in the Eastern and Middle Districts of North Carolina, proofs of claim are not made available on PACER. We thank Edward Boltz of the Law Offices of John T. Orcutt and Reid Wilcox, Clerk of the Bankruptcy Court for the Middle District of North Carolina, for their help in obtaining these documents.

[87] Teresa Sullivan, Elizabeth Warren & Jay Lawrence Westbrook, *Less Stigma or More Financial Distress: An Empirical Analysis of the Extraordinary Increase in Bankruptcy Filings*, 59 STAN. L. REV. 213 (2006); Scott Norberg & Andrew J. Velkey, *Debtor Discharge and Creditor Repayment in Chapter 13*, 39 CREIGHTON L. REV. 473 (2006); Marianne B. Culhane & Michaela M. White, *Debt After Discharge: An Empirical Study of Reaffirmation*, 73 AM. BANKR. L.J. 709, 712 (1999).

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financial situations than survey or interview methods.[88] For each case, we coded a debtor's income, the debtor's valuation of her home, and any information about mortgage obligations on the debtor's principal residence,[89] including total debt, any arrearages, and the amount of monthly payments.[90]

The innovation of the Mortgage Study was to code mortgage creditors' proofs of claim and supporting documentation. These files give more information on home loans than is available from debtors' schedules. Data came from four documents, when available: the proof of claim itself, an itemization of the amount claimed; a copy of the mortgage that secured the obligation, and a copy of the note evidencing the debt. From these documents, we coded the type and terms of each loan; the names of the mortgagee, originating lender, and servicer; the amount of the initial mortgage debt; and the amount of mortgage debt, including arrearages, when the bankruptcy was filed. We also coded any objections to mortgage creditors' proofs of claim and any amended claims. For a case with only one mortgage loan, we coded 152 data points; when debtors had more loans, there were more data points to capture.[91] Combining data from creditors' and debtors' pleadings, the Mortgage Study database offers a rich and detailed picture of bankrupt families' mortgages.

Data were coded into a specially designed database. We deployed several standard procedures to ensure the data's accuracy. First, if the initial coding six months after the cases' filing did not locate a mortgagee proof of claim or an objection to any filed proof of claim, we rechecked the court records a year later to locate any records that were filed later or missed in the initial coding. These were added to the database. To reduced concerns about coding reliability, we used only three coders, each of which either had law degrees or prior experience on academic bankruptcy projects. All coders received individual training on practice cases to develop consistent coding practices. Coders referred to a written manual while coding and noted any unusual situations or questions. We individually reviewed the coding in each of these flagged cases. We also performed two types of error checks on the data. First, we ran error traps to improve the accuracy of the database,[92] and corrected any identified errors. Second, a random sample of 10% of the cases (approximately 175 cases) was recoded blind, without reference to the prior coding. We then compared each variable of each case between the initial coding and the recoding, noted any discrepancies, and checked for mistakes in the initial coding. The data were 99% accurate, and no systematic errors were identified between coders.[93]

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[88] RONALD J. MANN, CHARGING AHEAD 61 (2006) (noting problems with the Federal Reserve's Survey of Consumer Finance data); David B. Gross & Nicholas S. Souleles, *Do Liquidity Constraints and Interest Rates Matter for Consumer Behavior? Evidence From Credit Card Data*, 117 Q. J. ECON. 149, 151, n.2 (2001) ("SCF households substantially underreport their bankcard debt.").

[89] Real property that was not the debtor's principal residence was ignored, as were any corresponding proofs of claim for such properties. No debtor was permitted to have more than one principal residence.

[90] We coded data from the docket, petition, Schedules A, C, D, I, and J, Form B22, and the Chapter 13 plan. These documents were available and complete in over 99% of sampled cases; there are very few missing observations. We coded only the original version of the schedules, including any separately or later-filed schedules that were not included in the original schedules. We did not code amendments to schedules because we were interested in the debtors' initial abilities to gauge the amounts of their mortgage debts.

[91] The exact number of data points actually coded varied with each case based on several factors, including the number of home loans, the type of loan, and the quantity of documentation attached to the proof of claim.

[92] Two examples illustrate this type of check: we reviewed any proof of claim dates before April 2006 when the cases were filed; we checked for any dollar figures that began with a decimal point or exceeded one million dollars.

[93] The error rate was 1.04%. To calculate the error rate, we compared the original coding and the recoding and determined the number of errors in the initial coding, and divided this number by the number of data points.

The final data were transferred to Microsoft Excel and SPSS for Windows for analysis. All dollar figures are presented as reported in court records without adjustment for inflation.

III. FINDINGS

The Mortgage Study data permit multiple analyses of the reliability of mortgage claims. The overall pattern of findings is disturbing. Many creditors do not comply with applicable law governing claims. Routinely, fees are not identified with specificity, making it impossible to determine if these charges are legal. In most instances, mortgagees believe the debt is greater than debtors do; these differences typically represent thousands of dollars. Yet, creditors are rarely called to task for these behaviors. The vast majority of all claims (96%) pass undisturbed through the bankruptcy system without objection. Attorneys do not aggressively enforce their clients' rights against mortgage companies because the costs are too high and the incentives are too low in the current system. The combination of widespread deficiencies in claims and the lack of objections weakens the integrity of the bankruptcy process and can harm both debtors and other creditors by skewing distributions in favor of mortgage creditors.

A. Required Documentation for Mortgage Claims

Mortgage creditors who want to receive distributions from the bankruptcy estate for mortgage arrearages must file a proof of claim. Claims also establish the amount of the debtor's future mortgage payment during the bankruptcy case. In the Chapter 13 cases in the sample, mortgage creditors filed proofs of claim to correspond with 81.7% of the home loans that debtors listed on their bankruptcy schedules.[94]

Creditors who file claims are required to use Official Form 10 or a similar document that substantially conforms to the form.[95] Form 10 directs creditors to attach an itemized statement if their claim "includes interest or other charges" in addition to the principal amount.[96] This requirement would apply to nearly all typical mortgage claims, as these obligations bear interest. Federal Rule of Bankruptcy Procedure 3001 imposes two additional evidentiary requirements on proofs of claim:[97] a copy of the writing if one evidences the claim;[98] and evidence of perfection if the creditor asserts a security interest in the property of the debtor. [99]

Requiring this trio of documentation (itemization, note and mortgage) permits all parties in a bankruptcy case—debtor, trustee, other creditors—to ensure the accuracy and legality of the claim. Without documentation, parties cannot verify that the claim is correctly calculated and that it reflects only amounts due under the terms of the note and mortgage and permitted by other

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[94] As noted in Part II (Methodology), *supra*, we checked at two points (six months after each case's filing date and over one year after the cases' filing date) to ensure the completeness of the proof of claim data. *See also* text near notes 28–33, *supra*, for mortgagees' incentives to file claims.

[95] Fed. R. Bankr. P. 3001(a).

[96] Official Form 10, *available at* http://www.uscourts.gov/bankform/formb10new.pdf.

[97] It is possible that a single integrated document could perform the function of both the note and the mortgage in creating the parties' rights and obligations in the transaction. We did not identify such instances in the sample. Because consumer home loans are typically intended for sale on the secondary market, separation of the note and the mortgage helps ensure that the note is a negotiable instrument that will be subject to the holder-in-due-course defense upon transfer.

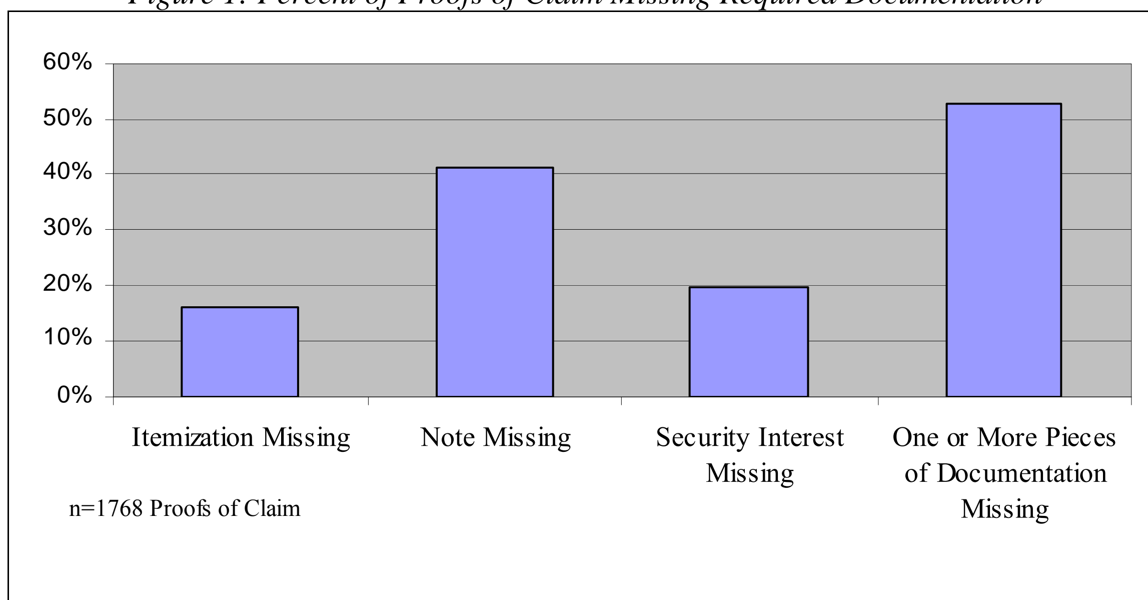
[98] Fed. R. Bankr. P. 3001(c) ("When a claim, or an interest in property of the debtor securing the claim, is based on a writing, the original or a duplicate shall be filed with the proof of claim.").

[99] Fed. R. Bankr. P. 3001(d) ("If a security interest in property of the debtor is claimed, the proof of claim shall be accompanied by evidence that the security interest has been perfected.").

applicable law.[100] A lack of documentation hampers efforts to ensure that any payments on mortgage claims are made in accord with the Bankruptcy Code.

The documentation requirements for mortgage proofs of claim are unambiguous and long-standing. Nevertheless, these laws were not consistently respected. A majority of claims (52.77%) lacked one or more required attachments. Figure 1 illustrates the findings for mortgagees' proofs of claim on loans secured by a debtor's home.[101] The data show that in a majority of instances mortgagees to not provide the required documentation.

Figure 1: Percent of Proofs of Claim Missing Required Documentation



A majority of claims (83.9%) had the itemization attached to them. Despite the applicable, clear instruction on Form 10, the remaining fraction (16.1%) did not have any itemization attached. For the one in six claims that was not supported by an itemization, the debtor and other parties are unable to discern the specific bases for a creditor's asserted right to be paid the total amount of the claim. Further, as discussed in Part B, *infra*, the usefulness of these itemizations varied greatly.

The most fundamental piece of evidence to support a claim is a copy of the promissory note or instrument establishing the existence and terms of the debt. A note is necessary to establish the existence of a debt, its key terms, and the creditor's standing to collect the debt. Despite its importance, a note was not attached to 41.1% of claims.

The finding that four of ten claims were not supported by a note is troubling for several reasons. First, the note is not easily available from another source. Unlike mortgages, notes are not recorded in public records. If the debtor does not have a copy of the note, and the servicer

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[100] For example, some states have specific laws that govern foreclosure costs and fees. *See, e.g.*, Mich. Comp. Laws Ann. 600.2431 (West 2000) (capping attorneys' fees in a non-judicial foreclosure at no more than $75 if the mortgage does not specifically contract for such attorneys' fees).

[101] These data come from the proof of claim initially filed in each case and do not reflect any attachments that may have been added if mortgagees filed amended claims. The purpose here is to measure compliance with the clear obligations of the rules in the first instance, not whether creditors responded if a party objected or requested information.

does not provide one, the servicer has an informational advantage, which the rule was presumably designed to eliminate. Next, the promissory note or other debt instrument is absolutely necessary to enable the debtor, trustee, and other creditors to verify that the amount asserted to be owed on the proof of claim is correct. The note contains the initial account balance, the applicable interest rate, and the terms that govern the mortgagee's ability to charge fees upon default.[102] In subprime loans, such terms are non-standard and may vary widely, increasing the importance of having a copy of the note. Finally, Rule 3001(c)'s requirement that a copy of a writing be attached applies widely. Nearly all debts are evidenced by writing in today's commercial economy. Yet, even when the claim is for a large debt such as a mortgage, creditors do not comply with the proof of claim rules. The mortgage data hint that compliance with Rule 3001(c) may be even worse for smaller claims evidenced by a writing, such as credit-card debts.[103]

Creditors were more diligent about attaching documentation to prove a valid security interest in the debtor's home. A perfected security interest such as a copy of a recorded mortgage or deed of trust accompanied 80.4% of mortgagees' proofs of claim. As shown in Figure 1, 19.6% of claims were not supported by a security interest to document the creditor's lien in the debtor's home. In light of the dismal compliance on attachment of notes, it may be tempting to view the security interest data as a relative success that may not merit policy attention. However, several risks are created when creditors do not prove a valid security interest.

The first potential harm is to the integrity of the bankruptcy system. The data show that nearly one in five mortgagees ignores a clear disclosure rule when they participate in a bankruptcy case. With much less evidence of misbehavior by debtors,[104] Congress imposed audits on debtors' schedules to ensure full disclosure of assets and permitted dismissal of debtors' cases as a penalty for failing to provide documentation.[105] These laws evidence Congress' belief that bankruptcy is a serious and important process and that full disclosure is necessary to preserve the system's integrity. Creditors who make affirmative filings to a court, such as a proof of claim, also affect public confidence in the integrity of the bankruptcy

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[102] In most instances, the note contains broad language on charges and costs. For example, the Fannie Mae uniform instrument gives the note holder a "right to be paid back by [the borrower] for all of its costs and expenses in enforcing this Note to the extent not prohibited by applicable law. Those expenses include, for example, reasonable attorneys' fees." *See* Fannie Mae, Multistate Fixed Rate Note—Single Family, 6e, https://www.efanniemae.com/sf/formsdocs/documents/notes/pdf/3200.pdf. Even under this broad language, debtors may have challenges to the mortgagees' claim. For example, they could contest the "reasonableness" of asserted attorneys' fees or argue that the language on "costs and expenses" is modified by "enforcing this Note" so that costs such as fax fees cannot be justified by this provision.

[103] John Rao, *Debt Buyers Rewriting of Rule 3001: Taking the "Proof" Out of the Claims Process*, 23 AM. BANKR. INST. L. REV. 16 (July/Aug. 2004).

[104] *See* Steven W. Rhodes, *A Preview of "Demonstrating a Serious Problem with Undisclosed Assets in Chapter 7 Cases*", 5 NORTON BANKR. L. ADVISER 1 (May 2002) (finding in a one district sample that 41% of asset cases—a small fraction of all Chapter 7 cases generally—contained inaccuracies in debtors' lists of assets and valuations); Recommendations for Reform of Consumer Bankruptcy Law by Four Dissenting Commissioners, REPORT OF THE NAT'L BANKRUPTCY REVIEW COMMISSION, ch. 5, at 14. ("The Commission repeatedly heard testimony that the information reported in the debtors' schedules is unreliable.").

[105] Bankruptcy Abuse Prevention and Consumer Protection Act (hereinafter "BAPCPA"), Pub. L. No. 109-8, § 603, 119 Stat. 23, 122 (authorizing random audits of debtors); Pub. L. No. 109-8, §316, 119 Stat. 23, 92 (codified at 11 U.S.C. § 521(i)) (Supp. V. 2005) (automatically dismissing bankruptcy case if debtor does not provide required information, such as payment advices).

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system.[106] The failure of approximately twenty percent of creditors to attach security interests to their claims damages the structural integrity of the process to ensure that claims are accurate and all assets are distributed according to bankruptcy law and procedure.

The second reason that the finding on attachment of mortgages is troubling results from the serious distributional consequences to all parties in a bankruptcy if a mortgagee cannot prove it holds a valid security interest. Under bankruptcy law, a mortgage that is not properly perfected can be avoided.[107] Avoidance typically relegates the obligation to unsecured status in bankruptcy and dramatically reduces the debtor's obligation to pay the full amount of the debt.[108] Even a credible threat of avoidance can cause an allegedly secured party to lower its claim to prevent litigation risk of its secured status. Thus, the ability to challenge whether a mortgage is properly perfected redounds to the benefit of both the debtor and to all unsecured creditors, whose distributions from the bankruptcy estate will be higher if the mortgage is not entitled to treatment as a secured claim. In light of these very powerful benefits, the rate of non-compliance is alarming. The failure to attach a security interest should serve as a red flag that prompts scrutiny of the claim. While some trustees or debtors may themselves be checking the public records to determine if the creditor holds a valid mortgage, this state of affairs effectively reflects creditors' ability to shift the burdens of their disclosure duties on to other parties in the system. The law requires creditors to prove that they are entitled to preferential treatment as secured creditors; their failure to do so creates a risk that some creditors who may not in fact have valid mortgages will receive higher payments than those to which the law entitles them.[109]

Finally, the security interest is necessary for the same reasons as the note: it contains the terms that bear on the calculation of the amount owed. Further, the mortgage usually contains provisions on how a loan should be serviced. For example, the model Fannie Mae instrument requires the lender to either apply or refund partial payments within a "reasonable period of time."[110] Based on this language, a debtor could challenge a servicer's practice of holding payments in suspense accounts for extended periods.

Mortgagees' compliance with the documentation requirements for claim varied among judicial districts. Figure 2 shows the variation among districts for the three types of claims documentation.[111] The boxes in Figure 2 demarcate the middle two quartiles of documentation

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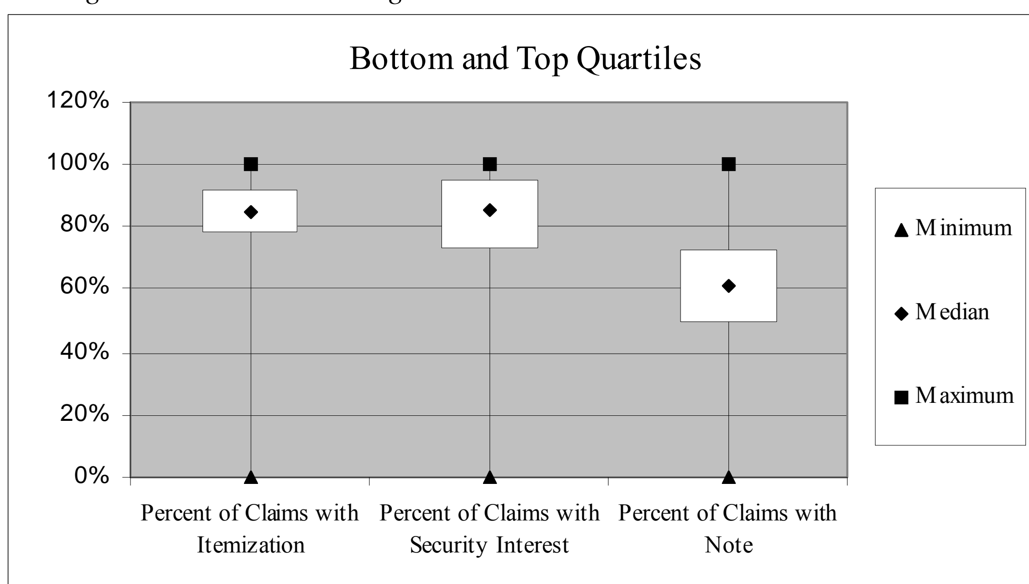
[106] Because debtors almost always affirmatively seek bankruptcy relief, it may be fair to impose increased burdens for disclosure on them as the "moving party." Nonetheless, creditors who participate in cases also submit themselves to federal process and should be required to comport with the rules that govern their actions in bankruptcy cases.
[107] 11 U.S.C. §§ 544, 548. These provisions are commonly called the "strong arm" powers, because they empower the trustee or other party in interest to "knock off" security interests that are not properly perfected under state law to defeat certain other types of creditors.
[108] Without a security interest, the mortgage is an unsecured obligation and the house is owned free and clear. This not only frees up the house as an asset for the debtor to borrow against in the future, it permits the debtor to discharge any remaining obligation on the mortgage claim after committing all disposable income for the applicable commitment period in the Chapter 13 case.
[109] In addition to failure to have properly perfected the mortgage by complying with state recording statutes, some trustees who routinely demand and scrutinize mortgage documents have identified other errors that invalidate a mortgage (such as the failure for a notary to witness the mortgage, for example).
[110] Fannie Mae/Freddie Mac Uniform Instrument (standard), *available at* https://www.efanniemae.com/sf/formsdocs/documents/secinstruments/#standard.
[111] The top and bottom of the lines in Figure 2 show that there was at least one district in which no claims (0%) had a required type of documentation and at least one district in which all claims (100%) had a required type of documentation. These findings largely result from the presence of some districts in the sample with very few cases. Because the addition of a single case could dramatically change the compliance rate, the absolute range of

compliance. The bottom of each box shows the percent of attached documentation in the district that was at the first quartile (25% of districts had worse compliance). The top of each box shows the percent of attached documentation in the district that was at the top quartile (75% of districts had worse compliance). The diamond in the middle of each box shows the rate of attached documentation in the median district.

The relatively small height of the boxes in Figure 2 indicates that most jurisdictions do not approach full compliance with documentation requirements. The overall pattern of findings is not driven by outlying districts with very poor compliance. Even in the districts that boast compliance that is better than the other three quartiles of districts, the fraction of claims without documentation is significant. The problem is particularly acute with respect to mortgagees' failure to attach notes. Among the districts with the worst compliance (those in the bottom quartile), the percentage of claims with a note attached was 50 percent or below, ranging all the way to zero complying claims. In these jurisdictions, a majority of claims will not be supported by a copy of the note.

Figure 2: Variation among Judicial Districts in Attached Documentation



The variation among districts reinforces concerns about uniformity, a feature of bankruptcy law that is explicit in the U.S. Constitution's bankruptcy clause.[112] While uniformity challenges to bankruptcy law have had little success,[113] the variations in claims documentation reveal systematic differences based on where a debtor files bankruptcy. While the law is identical, the realities of compliance vary among judicial districts. Proofs of claim are another example of a "local legal culture" effect in bankruptcy.[114] To the extent that uniformity is crucial to ensure the integrity of the bankruptcy system, creditors' inconsistent compliance with claims

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compliance is not very useful. Thus, the data on inter-district variation are best used to observe a general pattern as shown by the quartile findings.

[112] U.S. CONST. art. I, § 8, cl. 4; Erwin Chemerinsky, *Constitutional Issues Posed in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 571, 592–94 (2005).

[113] *See id*. (cataloguing unsuccessful challenges under the uniformity clause).

[114] *See* sources cited in note 32, *supra* (describing other examples of local legal culture phenomenon in bankruptcy).

procedures is troubling. Depending on place of residence, debtors and their counsel receive varying amounts of information about mortgage obligations.

The data on proofs of claim show that in at least one important respect creditor behavior is not uniform, and that the reality of practice does not match the clear requirements of the law. Despite long-standing and unambiguous documentation rules that apply in all bankruptcy cases, most mortgage proofs of claim lack one or more pieces of documentation. This pattern of noncompliance undermines the purpose of the proof of claim rules and effectively shifts the burden to debtors or trustees to verify the accuracy of claims. Undocumented or insufficiently documented claims create obstacles to ensuring that mortgage creditors are paid in accordance with the law. At worst, creditors' failure to provide documentation can manipulate the bankruptcy system to overpay on these obligations, harming the debtor and all other creditors.[115] The requirements for claims documentation should be consistently respected and enforced to prevent these harms.

B. Default Fees in Mortgage Claims

Itemizations were the most common documentation attached to claims. The prevalence of itemizations, however, is a misleading cue as to their usefulness in ensuring the accuracy of mortgage claims. Two major problems undermined the itemizations as a tool to evaluate the propriety of a creditor's claim. First, there is no standard form for itemizations. Even among a single servicer or attorney, the itemization format and amount of detail varied.[116] Without a standard format, itemizations cannot be reviewed using a semi-automated or routine process. In high-volume system such as consumer bankruptcy, the result is to dramatically limit the scrutiny of claims. For a debtor to afford a bankruptcy, the consumer attorney has to employ standardized procedures that can be applied in hundreds of cases a year. Trustees are similarly bound by cost and efficiency concerns. The wide variation in the form of itemizations means that debtors and trustees will be severely hampered in reviewing and objecting to claims. The result is a system that does not ensure that even obvious mistakes or overcharges in claims will be reviewed and objections filed, if appropriate.

The second, and related, problem is tremendous variation in the quantity of detail provided on itemizations. Some "itemizations" contain so little detail as to be a perversion of the proof of claim form's use of that term to describe the attachment. In a few instances, the itemization simply consisted of a break-out of the amount of arrears that was part of the creditor's total claim. Since the proof of claim form itself already requires that information, the itemization added nothing to the one-page claim form itself. Other creditors merely listed three categories: the total amounts of principal, interest, and "other/miscellaneous."

To analyze the variation in detail, the Mortgage Study coded all the itemization detail into several categories based on the types of charges that debtors allegedly owe.[117] Despite using

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[115] *See* Opinion Resolving Show Cause Order Entered on March 8, 2007, *In re* Wingerter, No. 06-50120 (Oct. 1, 2007) ("A policy of filing a proof of claim without having possession of the supporting documents, but withdrawing the claim if the debtor subsequently files an objection to the claim's validity smacks of gamesmanship and creates an unacceptable risk that distributions to other creditors will be unfairly reduced.").

[116] In some districts, the variation was obviously due to the differing practices of the attorney hired to represent the servicer. In other instances, however, the same attorney filed proofs of claim in several different formats, probably reflecting the fact that the servicer itself is preparing the proof of claim and merely transmitting it to the attorney for review and filing with the court.

[117] Each charge was categorized as one of the following: principal, interest, escrow, late charges, foreclosure fees or costs, non-sufficient funds charges, property inspection fees, broker price opinions or appraisals, corporate

the servicing industry's own categories,[118] 43% of itemizations either made reference to fees that did not fit one of the dozen specific categories or proffered an aggregate sum of many types of varying charges that could not be separated. One common technique was the use of a temporal category that did not provide any legal basis for the permissibility of the charges. For example, several itemizations labeled charges only as "pre-petition," without identification of whether these amounts resulted from missed payments, default charges, or accrued interest.[119] Among claims with debt identified only as "pre-petition," the average of this type of debt was $1651, a fairly substantial sum without any specific basis. Another common label was "prior/previous servicer," which again does not pinpoint the basis for the charges or permit any examination of whether the amount claimed is correct. Perhaps most egregiously, some amounts were labeled merely "other" or included in a column of summed figures with absolutely no description at all.[120] These vague or temporal descriptions do not meet the requirement of Form 10 to "detail" any additional charges and do not permit meaningful review of the accuracy or legality of the servicer's calculation of the debt.

The itemizations were plagued another troubling feature: the use of laundry-list descriptions. The most common such label in the sample was "Inspection, Appraisal, NSF, and other charges." Over thirty proofs of claim used that recitation (with the words in that order and no additional breakdown of fees in that line item). For this description to be literally accurate, the servicer should have actually conducted an inspection and an appraisal, one or more of the debtor's payments should have been returned for non-sufficient funds, and the debtor should have engaged in some other behavior that resulted in a permissible charge. While plausible, the laundry-list description with its inclusion of "other charges" suggests that servicers are taking shortcuts in describing the actual fees that debtors owe.

The poor quality of itemizations has real harms. First, confidence in the bankruptcy system is undermined when the quality of information provided does not satisfy the rules designed to ensure fair claims distribution. Vague or laundry-list descriptions do not satisfy the instructions on the proof of claim form, which were written to balance the rights and needs of debtors and creditors. Second, without a true itemization that identifies the nature of each fee, parties cannot verify that a mortgage claim is correctly calculated. The service could have made a mistake when aggregating fees and charges. Alternatively, the servicer could be overreaching and charging fees that are not permitted by law or the terms of the contract. The case law described in Part I, *infra*, shows that when courts scrutinize the nature of mortgage claims, they frequently find evidence of servicer misbehavior. Yet, the itemizations do not provide sufficient information to permit a review of the charges' legality. Individual debtors would need to engage in extensive discovery to verify the permissibility of the servicer's calculations. This reality makes it equally impossible to use the Mortgage Study data to apply systematic analyses to determine if servicers are actually charging illegal fees. The available bankruptcy court records

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advances, post-petition fees, suspense funds, or other. The last category was residual and used when the charge did not fit another category or the fees were not broken out into one of the above categories.

[118] The categories set forth in note 117, *supra*, are consistent with those on the Model Proof of Claim itemization developed by a joint committee of Chapter 13 trustees and mortgage servicers. *See* Model Proof of Claim Attachment, NAT'L ASS'N OF CHAPTER THIRTEEN TRUSTEES, REPORT OF MORTGAGE COMMITTEE (June 28, 2007) (on file with author).

[119] Charges or amounts labeled merely as pre-petition were identified in 63 claims, fewer than 5% of all claims. This count excludes any fees labeled pre-petition attorneys' fees.

[120] For example, one claim's "itemization" listed $5391 described only as "other." CDCA 12. Another claim requested $3023 for "delinquency expenses." NDGA 146.

simply do not provide the necessary information. Indeed, the courts that have adjudicated disputes over mortgage claims have needed dozens of hours of evidentiary testimony to decipher the basis for the total amount claimed by mortgage servicers. This, in fact, is the key point. By obscuring the information needed to determine the alleged basis for the charges, servicers thwart effective review of mortgage claims. The system can only function as intended if complete and appropriate disclosures are made.

Notwithstanding the limitations of the servicers' itemizations, I attempted to conduct an individual review of claims that were merely categorized as "other." Given that the categories used to code the claims data (e.g., "foreclosure costs") were deliberately broad to encompass all likely charges, these charges seemed *per se* suspicious. I identified dozens and dozens of claimed fees that appeared to be impermissible, or at minimum, should have been challenged to ensure that the creditor had a basis for such unusual charges. Table 1 gives a few examples of causes for concern.

Table 1: Actual Fees from Mortgagees' Claims

Description	**Id. No.**	**Fee amount**
Attorney's fees	WDVA 4	$31,273
Bankruptcy fees & costs	NDGA 56	$2275
Broker price opinion fee	ED AR 18	$1489
Demand fee	DMA 18	$145
Overnight delivery	EDMI 91	$137
Payoff statement fee	SDCA 7	$60
Fax fee	EDVA 21	$50

The law constrains the charges that debtors must pay in several ways. On their face, the fees in Table 1 appear vulnerable to legal challenge. Yet, none of these claims were objected to by any party in the bankruptcy. The law's various limits on fees were never invoked to test the validity of these charges.

The first legal constrain on fees and charges is private contract law. The note and mortgage themselves are agreements that limit the parties' obligations.[121] Most mortgage notes only obligate the borrower to pay the lender for "reasonable" costs incurred to collect on the debt or enforce the security interest.[122] The standard mortgage permits the lender, upon default (including a bankruptcy filing) to "do and pay for whatever is reasonable or appropriate" to protect the lender's interest in the property and rights under the security agreement.[123] While this

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[121] This point reinforces the problems created when claims are not supported by this documentation, particularly for subprime loans, which do not conform to Fannie Mae/Freddie Mac standards.

[122] For example, one of the mortgages MDTN 44 contains the following language: "COSTS OF COLLECTION AND ATTORNEYS' FEES—I agree to pay you all reasonable costs you incur to collect this debt or realize on any security. This includes, unless prohibited by law, reasonable attorneys' fees."

[123] *See* Fannie Mae/Freddie Mac Uniform Instrument (standard), *available at* https://www.efanniemae.com/sf/formsdocs/documents/secinstruments/#standard ("If [Borrower defaults including

language is quite broad, it is not unlimited. For example, at least one court has held that payoff fees are impermissible because they constitute a non-reimbursable expense under the terms of the note.[124] The typical amount of a fax fee ($50) could also be challenged as unreasonable. Such requests are apparently handled automatically by fax-back technology at minimal cost to the servicer.[125] Thus, some of the fees shown in Table 1 may be neither reasonable nor permitted by contract. Paying such claims would distort the claims distribution process and impose unfair burdens on debtors in making bankruptcy payments.

State or federal statutes also limit the fees that debtors must pay. Certain charges appear on proofs of claim simply are not legal. Some states prohibit the pyramiding of late fees[126] or have promulgated specific rules about the use of suspense accounts to hold partial payments in abeyance.[127] Because mortgage servicers operate on a national basis, they may be unaware of these state laws. Alternatively, servicers may apply the same fees to all loans covered by a securitization agreement, despite the fact that varying state law actually applies. The propriety of fees may be impossible to verify without a payment history for the loan, which almost never was attached to the proof of claim.[128] For example, the payment history may show that the servicer imposed late charges on the homeowner, despite the homeowner's check clearing the bank before the payment was due,[129] or that the servicer held funds in "suspense accounts" without application to the amount due.[130]

Some servicing practices may constitute consumer abuse. For example, the Federal Trade Commission alleged that Fairbanks Capital Corporation had engaged in an unfair or deceptive practice by repeatedly and unnecessarily assessing property preservation fees, which usually

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by filing bankruptcy], then Lender may do and pay for whatever is reasonable or appropriate to protect Lender's interest in the Property and rights under this Security Instrument, including protecting and/or assessing the value of the Property, and securing and/or repairing the Property. Lender's actions can include, but are not limited to: (a) paying any sums secured by a lien which has priority over this Security Instrument; (b) appearing in court; and (c) paying reasonable attorneys' fees to protect its interest in the Property and/or rights under this Security Instrument, including its secured position in a bankruptcy proceeding.").

[124] *See, e.g.*, Ga. Code Ann. § 7-6A-3(4) (prohibiting payoff fee or limiting fee to $10 if borrower requests a faxed copy of payoff amount or has other recent payoff requests); Dougherty v. N. Fork Bank, 753 N.Y.S.2d 130 (N.Y. App. Div. 2003) (holding that payoff quote fee of $100 was not permissible under state law).

[125] *See* Michael LaCour-Little, *The Evolving Role of Technology in Mortgage Finance*, 11 J. OF HOUSING RESEARCH 173, 192 (2000) ("Payoff requests can be handled by incorporating the related fax-back technology, in which printed payoff statements (as would be required for a refinance loan) can be automatically faxed back to a telephone number entered during the same automated telephone transaction.").

[126] The Fannie Mae note seems to prohibit pyramiding late fees, stating that the borrower will pay a late charge "only once on each late payment." *See* Fannie Mae, Multistate Fixed Rate Note—Single Family, 6a, *available at* https://www.efanniemae.com/sf/formsdocs/documents/notes/pdf/3200.pdf. Some transactions used different notes (and thus, it is important that a copy of the note accompany the proof of claim), and some servicers may not honor the terms of the notes, either intentionally or inadvertently.

[127] JOHN RAO, ODETTE WILLIAMSON & TARA TWOMEY, NATIONAL CONSUMER LAW CENTER, FORECLOSURES: DEFENSES, WORKOUTS, AND MORTGAGE SERVICING 154–55 (2d. ed. 2007).

[128] The instruction on the proof of claim form says that the claimant "must attach to this proof of claim form copies of documents that show the debtor owes the debt claimed." This arguably requires not just the note to show the existence of the original debt, but a current payment history that supports that the debtor actually owes the amount of the claim.

[129] *See In re* Ocwen Fed. Bank F.S.B. Mortgage Servicing, 2006 WL 794739 (N.D. Ill. Mar. 22, 2006) (denying motion to dismiss a multi-district litigation suit that alleged, *inter alia*, that servicer misapplied payments and improperly imposed late fees).

[130] Most loan instruments specify how payments are to be applied, and a violations of this language is a potential breach of contract.

means an agent drove by the property to determine its condition. The settlement enjoined the assessment of such fees more frequently than every thirty days and permitted such charges only if Fairbanks was unable to contact the borrower or had determined that the property was vacant.[131] Recently, one bankruptcy court stated that it was "done allowing lenders reimbursement for property preservation fees," unless the lenders can show "that those property inspections actually happened and that they're worthwhile."[132] If the fees cannot meet these criteria, they may not legally be charged. Imposing such fees could give rise to a counterclaim against the servicer for engaging in an unfair or deceptive practice. The amount of the property preservation fees in the sampled itemizations varied greatly, suggesting either that many of these fees resulted from multiple inspections or that a few servicers may be charging an unreasonable amount for a single inspection service.[133] The "broker price opinion" charge in Table 1 would grossly exceed the standard cost for this type of property inspection, which is essentially an abbreviated appraisal. If the $1489 sum represents several inspections, the servicer should have separated these charges in its detail of fees.

Another limitation on charges is found in the general law of contracts. Even if the parties' agreement does not contain a "reasonableness" requirement for default fees, egregious charges could be challenged as unconscionable as a matter of contract law. For example, the overnight delivery charge of $137 in Table 1 may meet this standard. A court could rule that this charge violated public policy. It is quite possible, of course, that the $137 represents the sum of many charges, rather than one mailing. Alternatively, perhaps it reflects a data entry error and should have been $13, or $17, or $37. The crucial problem is that the bankruptcy system did not flag this item as a potential cause for concern and seek to determine if this charge was legally permissible.

Federal bankruptcy law imposes additional legal constraints on the charges that debtors must pay their mortgage companies. Many claims in the sample included a flat "bankruptcy fee" in the proof of claim.[134] The propriety of this practice is unclear. Some courts have held that, to the extent these fees are for creditors' attorneys' fees, it is impermissible to include them in a claim.[135] Instead, creditors must file a fee application pursuant to Federal Rule of Bankruptcy Procedure 2016.[136] Other courts have reached a contrary conclusion and permitted attorneys' fees in claims.[137] Some courts have modified this approach, requiring that the disclosure of the

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[131] Order Preliminarily Approving Stipulated Final Judgment and Order as to Fairbanks Capital and Fairbanks Capital Holding Corp., United States v. Fairbanks Capital Corp., No. 03-12219 (D. Mass. Nov. 21, 2003), *available at* www.ftc.gov/os/2003/11/0323014order.pdf.
[132] Transcript of Hearing at 3, *In re* Waring, No. 06-40614 (Bankr. D. Mass. July 27, 2007).
[133] In addition to the example given in Table 1, two different proofs of claim requested payment of property preservation fees of $105, NDTX 69, NDTX 75; another property preservation fee was $240, SDGA 56. As discussed in the text accompanying notes 143–144, inspection and appraisal were frequently combined in a laundry list of fees, making it impossible to determine whether the inspection or appraisal parts of these charges were reasonable.
[134] In the remainder of this Section, I use the term "bankruptcy fee" as shorthand to describe these fees. I did not include any fees that were identified as related to actual post-petition litigation, such as a motion for relief from the stay or an objection to confirmation.
[135] *See, e.g.*, Tate v. NationsBanc Mortgage Corp., 253 B.R. 653 (Bankr. W.D.N.C. 2000) (ruling that creditor cannot "hide" attorneys' fees for preparing a proof of claim in the claim itself without court approval).
[136] *Id.* at 665; *In re* Ezzell, 07-34780 (Bankr. S.D. Tex. Jan. 14, 2008) (disallowing attorneys fees for failure to comply with Rule 2016).
[137] *See, e.g.*, *In re* Atwood, 293 B.R. 227, 232 (B.A.P. 9th Cir. 2003).

attorneys fees be "specific"[138] or ruling that while including fees is prima facie permissible, a fee application will be required if the debtor objects to the fees.[139] These inconsistent rulings make it more difficult for both servicers and attorneys to know how to handle these charges in preparing a bankruptcy claim.

The amounts of attorneys fee disclosed in the claims varied considerably. The data revealed several clusters of bankruptcy fees; the most common amounts were $125, $150, $250, $275, and $500. On a dollar basis, the difference in these amounts is small. On a percentage basis, however, many mortgagees charge two or three times as much as other mortgagees.[140] Because the fees varied within judicial districts, the discrepancy does not seem to be attributable merely to regional cost differences.[141] The consistency of such fees also suggests that many servicers use a flat fee, rather than a lodestar method based on hourly rate, which is required in some jurisdictions. Given the non-existent or minimal scrutiny of most mortgage claims,[142] the system appears to permit mortgagees to effectively make their own determinations of what constitutes reasonable attorneys' fees for a routine Chapter 13 bankruptcy.

A related problem is that one cannot discern from a flat bankruptcy fee whether such charges actually represent an actual expense for attorneys. Some creditors use such a bankruptcy fee to collect a "monitoring" fee due to the purported additional burden of having to service a loan in bankruptcy.[143] In other instances, servicers may seek to impose a bankruptcy fee for the purported administrative costs of preparing a proof of claim.[144] If such work is performed by internal employees and not by licensed attorneys, the corresponding fee cannot be claimed under the "reasonable attorneys' fees" provision of the security agreement or note. Arguably such expenses are mere costs of servicing a mortgage that the servicer was previously compensated for by the owners of the note.[145] Without better disclosure, bankruptcy courts cannot even ensure that creditors are respecting the bankruptcy law that governs attorneys' fees.

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[138] *In re* Madison, 337 B.R. 99, 103–04 (Bankr. N.D. Miss. 2006); *see also In re* Powe, 281 B.R. 336, 347 (Bankr. S.D. Ala. 2001).

[139] *In re* Plant, 288 B.R. 635, 644 (Bankr. D. Mass. 2003).

[140] A review of the data suggests that in May 2006, when the claims in the Mortgage Study were filed, the bankruptcy fee of Bank of America was $250. Yet, Chase Home Finance, LLC imposed a bankruptcy fee of half that amount, $125. These lenders are large, national institutions, and presumably their actual costs for preparing a proof of claim would be quite similar. Nevertheless, the data show a disparity. It appears that debtors whose mortgage is held by Bank of America must pay $125 more than debtors whose mortgage is held by Chase Home Finance, LLC in order to complete their plan.

[141] For example, in the Eastern District of Arkansas, bankruptcy fees ranged from $125 to $800.

[142] *See infra* Part III.D.

[143] The lodestar versus flat fee issue was apparently a point of contention in the work of the National Association of Chapter 13 Trustees' committee on proofs of claim. The servicers wrote separately on this issue to argue that a flat fee should be permissible, analogizing to the flat "no-look" fee that some courts permit for Chapter 13 representation to avoid debtors' counsel having to file a fee application pursuant to Rule 2016 in each case. *See* Notes by Mortgage Servicers on Mortgage Servicing during a Chapter 13 Bankruptcy at 3–4, Appendix to NAT'L ASS'N OF CHAPTER THIRTEEN TRUSTEES, REPORT OF MORTGAGE COMMITTEE (June 28, 2007) (on file with author).

[144] This may be particularly true when the charge was described as "POC prep fee" or "plan review" fee. Neither of the prior-quoted activities is strictly necessary to "defend the mortgage," nor are they costs from "prosecut[ing] all necessary claims and actions to prevent or recover for any damage to or destruction of the property." Further, the preparation or filing of a proof of claim and the review of a proposed Chapter 13 plan may not constitute an "appearance" by the lender, which is a required prerequisite to the borrower being obligated to pay the lenders' costs and expenses. Yet, these conditions are incorporated in standard mortgage documents upon which lenders rely to collect a bankruptcy fee.

[145] *See* JOHN RAO, ODETTE WILLIAMSON & TARA TWOMEY, NAT'L CONSUMER LAW CENTER, FORECLOSURES: DEFENSES, WORKOUTS, AND MORTGAGE SERVICING 177 (2d. ed. 2007) ("If all the lender is doing is "monitoring"

Delinquency and default fees can be a substantial source of profit for servicers.[146] The requirement that an itemization be attached to a bankruptcy claim could be a valuable check to the financial incentives of mortgage servicers to overreach and to charge unreasonable or illegal fees. However, the itemizations suffer two fatal defects—a lack of standardization and a lack of detail—that inhibit any meaningful review of the amount of mortgagees' claims. By describing charges in vague generalities, creditors can eviscerate the purpose of the proof of claim process, which is to ensure that creditors offer evidence of their debt.

Individualized review of "other" fees on claims highlights some instances of suspicious fees. While the data admittedly do not permit concrete findings of servicer misconduct, courts that have conducted evidentiary hearings to determine the validity of servicing fees have invalidated charges similar to these and sanctioned creditors for misbehavior.[147] The key point that can be substantiated by the itemization data is that servicers fail to provide the necessary information to allow debtors or trustees to review the claims. The resulting situation permits servicers to overcharge debtors without fear of challenge. These problems suggest that the bankruptcy system may be harboring mortgage servicing abuse, rather than functioning as a system to protect homeowners from impermissible charges.

Anecdotal reports suggest that creditors proffer similarly vague itemizations to borrowers facing state law foreclosure.[148] Indeed, given the additional safeguards inherent in the bankruptcy process, the data may understate the difficulty that nonbankrupt homeowners face in reviewing default or foreclosure costs. Inside or outside of bankruptcy, the law does not appear to be functioning as intended to ensure that creditors must satisfy the evidentiary burden to show that charges are permissible under applicable law.

C. Discrepancies between Debtors' Schedules and Mortgagees' Claims

The proof of claim process is the mechanism for fixing the amount of the debtor's obligation. When they file Chapter 13 bankruptcy, most homeowners are in default on their mortgages.[149] Thus, most claims seek to establish both the amount of the arrearage and the amount of the outstanding principal remaining on the loan. These amounts are treated differently in Chapter 13 cases. To retain their homes, debtors must "cure any default within a reasonable time,"[150] normally by making payments over the period of the Chapter 13 plan (three to five years) or a shorter period as fixed by the bankruptcy court.[151] Any regular mortgage payments also continue to be due as set forth in the note. Debtors must pay both the arrearages and their ongoing mortgage payments to retain their homes and receive a discharge of remaining unsecured debt.[152] Thus, part of the pre-bankruptcy calculus that debtors and their attorneys

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the bankruptcy . . . then these activities do not constitute the practice of law and should not be compensable as an attorney fee. These routine administrative services are generally not compensable under any reading of typical mortgage provisions." (citations omitted)).

[146] *See* Gretchen Morgenson, *Can These Mortgages Be Saved?*, N.Y. TIMES, Sept. 30, 2007 ("Borrower advocates fear that fees imposed during periods of delinquency and even foreclosure can offset losses that lenders and servicers incur.").

[147] *See* Part I.D., *supra* (discussing *Jones v. Wells Fargo* and *In re* Parsley cases).

[148] *See* Morgenson, *supra* note 146 (reporting that a payoff demand statement that Countrywide provided to a borrower had line items identified only as "fees due" and "additional fees and costs" that totaled $8525).

[149] *See* note 25, *supra*.

[150] 11 U.S.C. § 1322(b)(5).

[151] 2 KEITH LUNDIN, CHAPTER 13 BANKRUPTCY § 133.1 (3d ed. 2000) ("It is astonishing and baffling that a significant portion of listed claims are never filed in Chapter 13 cases.").

[152] 11 U.S.C. § 1328(a).

should consider in determining whether a debtor can save their home in bankruptcy is whether the debtor will have sufficient income to both payments.[153] To weigh the viability of Chapter 13 and consider alternatives such as Chapter 7 bankruptcy or surrendering the home, debtors and their attorneys need a fairly accurate estimate of the amount of the outstanding arrearage and the amount of the total mortgage debt.

This section analyzes data to measure whether debtors and creditors agree on the amount of the mortgage debt. The goal was to determine if either party had a substantial misunderstanding of the amount of the debt. For this analysis, I matched each home loan listed on a particular debtor's schedule to its corresponding proof of claim.[154] I then measured the direction and extent of the gap between debtors' and mortgagees' calculations of the mortgage debt.[155] If the amount on the claim exceeded the mortgage debt on the debtor's schedule, I termed the gap in the "creditor's favor." In these instances, the creditor is asserting that more dollars are owed in the mortgage debt than the debtor believed was owed. Conversely, if the scheduled amount of mortgage debt exceeded the amount on the mortgagee's claim, I termed the gap in the "debtor's favor." Here, the gap between the schedule and the claim resulted from the debtor overreporting the amount of mortgage debt.

Figure 3 shows what fraction of claims fell into each of three categories based on the existence of a discrepancy between the claim and the scheduled amount of debt. Debtors and creditors agreed on the amount owing for only 74 of 1675 loans (4.4%). For the vast majority of loans (95.6%), the debtor and mortgagee did not agree on the amount of mortgage debt. In about one-quarter of instances (25.2%), the debtor's scheduled amount exceeded the mortgagee's claim. However, the majority of claims exceeded the debtor's calculation. Seven in ten (70.4%) claims asserted that the mortgage debt was greater than what the debtor listed on the schedule.

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[153] Melissa Jacoby, *Consumer Bankruptcy and Credit in the Wake of the 2005 Act: Bankruptcy Reform and Homeownership Risk*, 2007 U. ILL. L. REV. 323, 337 (2007) (arguing that failure of debtors' lawyers to screen their clients for ability to complete a Chapter 13 repayment plan results in more unsuitable debtors in Chapter 13).

[154] It was not possible to perform this matching for every home loan. Among the 2164 home loans in the sample, only 1768 proofs of claim were filed.

[155] For the gap analysis, some loans and their corresponding claims had to be eliminated. First, loans were eliminated if the Schedule D or the proof of claim had a zero or a blank entry for the amount of the debt. These are usually placeholders, akin to listing the debt as "unknown." Second, loans were eliminated if the schedules and claims were not attempting to calculate the same thing. This usually occurred because one party listed only the arrearage amount and the other calculated the entire outstanding mortgage debt, both arrearage and principal. These cases were excluded from the gap analysis because the disagreement was in large part a result of the parties not trying to communicate the identical debt. In a very small number of instances, when both the creditor and the debtor clearly provided only the arrearage amount, the cases were used in gap analysis because the discrepancy in calculation can be fairly compared. Finally, twelve loans were removed as outliers. Two criteria were used to identify these situations. Six loans were eliminated because the gap between the claim and the scheduled debt exceeded 200% of the amount of the scheduled debt. An additional six loans were deemed outliers because the gap exceeded $100,000 in absolute dollars and the gap was greater than 50% of the amount of the scheduled debt.

Figure 3: Percent of Claims by Type of Gap Between Claim and Scheduled Debt

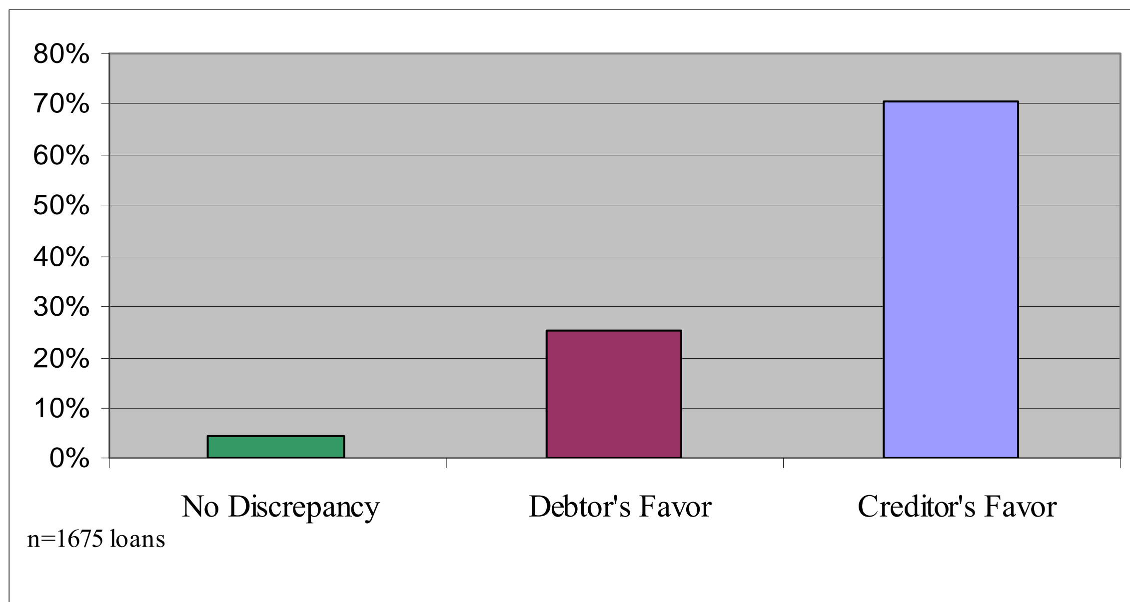

Figure 3 shows that as an initial matter the debtor and creditor do not agree on the amount of the debt in a vast majority of cases. The mere existence of discrepancies is not itself alarming. The findings in Figure 3 could merely reflect minor differences in recordkeeping. Alternatively, the claims could consistently be larger because of the addition of modest and explainable post-bankruptcy charges such as accrued interest.[156] I explore these explanations with additional analyses, ultimately concluding that the data do not suggest that either reason can fully explain the discrepancies in creditors' and debtors' calculations.

The first indication that the disagreements may be genuine and serious comes from evidence on the dollar size of the gaps. Among all loans, the median claim exceeded its corresponding scheduled debt by $1366. The average difference between a claim and its scheduled debt was $3533.[157] In the typical bankruptcy, a mortgage creditor asserts that it is owed a significantly larger amount than the debtor believed was the home debt. These errors are too large to reflect small recordkeeping situations, such as a single late charge imposed since the debtor's most recent mortgage statement or a post-bankruptcy property inspection.

The second indication that post-bankruptcy charges cannot explain most of the differences in debtors' and creditors' calculations is the existence of claims in which the debtor overestimated the amount of the debt. Post-bankruptcy charges can only explain discrepancies in favor of creditors. Debtors do not know whether such charges will be imposed and cannot include them in their schedules. The debtor's favor gaps suggest that the disagreement occurs for a different reason, at least in many instances.

Further analysis reinforces the conclusion that the gaps between claims and scheduled debts reflect a serious misunderstanding. Figure 4 shows the distribution of the size of the gap

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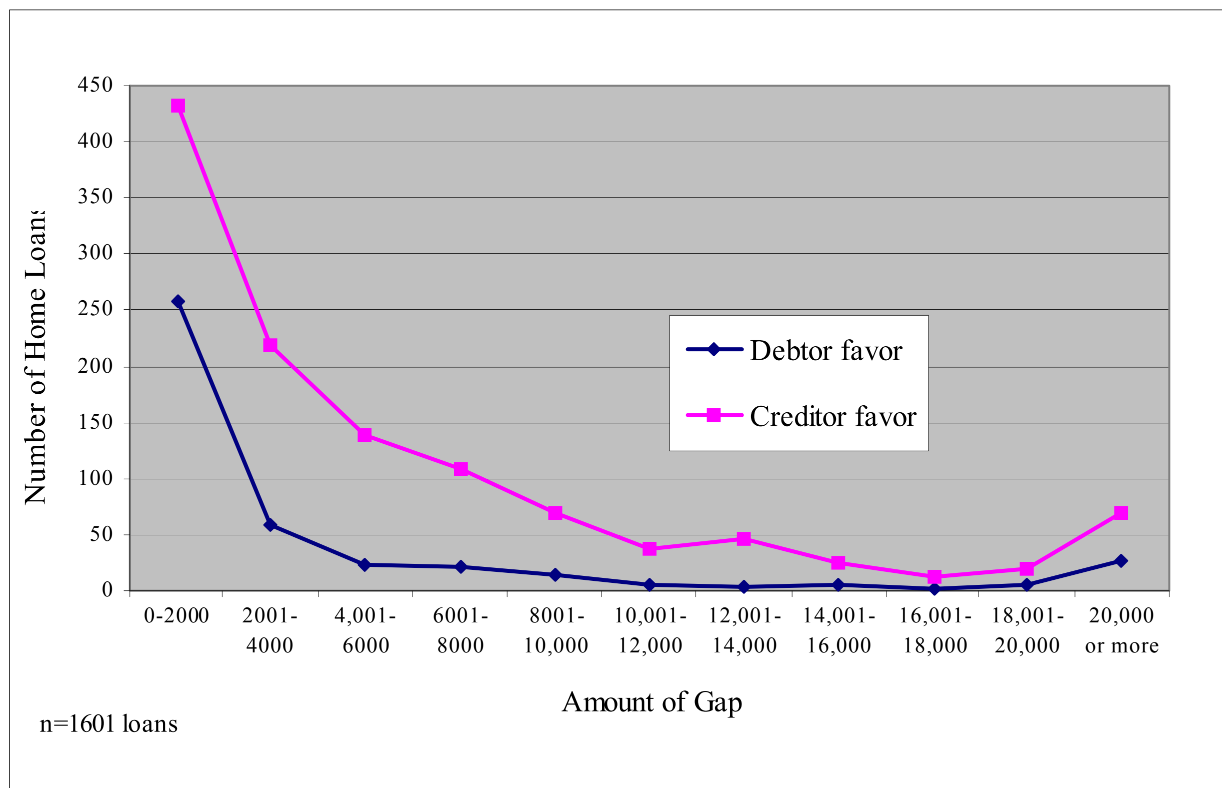
[156] The debtors' schedules should only reflect the amount due at the time of the bankruptcy. The proof of claim form should be identical, as the instructions specify that the amount should be the "Total Amount of Claim at Time Case Filed." However, some creditors ignored this instruction and listed charges that arose after the bankruptcy was filed and before the claim was filed (a period of usually less than sixty days).

[157] N=1675. The analysis included those loans in which the claim and scheduled amount were identical (no gap). The standard deviation for the entire sample was 11,480.

amounts between claims and the corresponding scheduled debt. At every interval, the number of loans in which the creditor's claim exceeded the scheduled amount was greater than the number of times in which debtors estimated a higher debt. While the disagreements go in both directions (with debtors and creditors each reporting a higher amount of debt in some instances), creditor more frequently charge more than debtors think is owed.

Figure 4: Gap Between Proofs of Claim and Schedule D Amounts



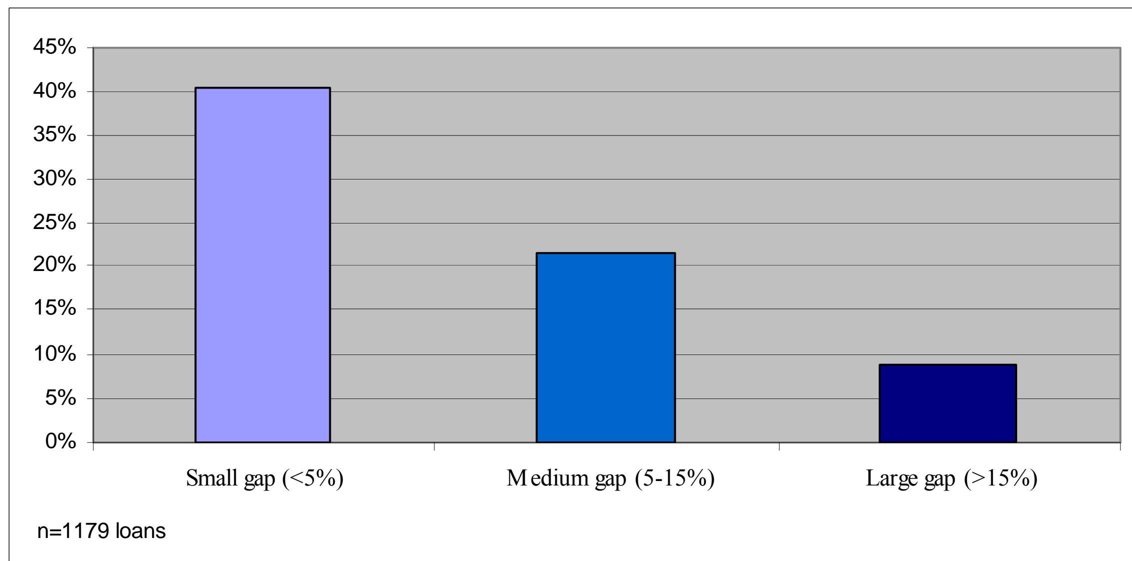
Creditor-favor gaps were consistently larger than debtor-favor gaps. The median gap for loans in which the claim exceeded the scheduled amount (creditor's favor) was $3311. The average creditor's favor gap was $6309. The size of the typical gap in the debtor's favor was much less. The median was $1090, less than one third of the gap for creditor's favor loans ($3311).[158] The bottom line in Figure 4 shows that debtor-favor gaps were of modest amounts, with the vast majority of such differences in calculations less than $2000. The top line in Figure 4, however, shows that very large gaps were much more common when the creditor's calculation exceeded the debtor's calculation. Many creditors requested payment on the proof of claim of several thousand more dollars than debtors thought they owed.

Of course, mortgage debts are relatively large in absolute size. It is difficult to articulate an exact standard for a "minor" versus "major" disagreement and to know at what point the gaps are sufficiently large that the bankruptcy process is undermined if these discrepancies are not being identified and resolved. An alternative to measuring the gaps in absolute dollars large is to

[158] The average gap among the debtors' favor claims was $5376. As with the creditors' favor claims, the size of the average reflects a substantial number of claims with very large gaps. The standard deviation of the debtors' favor claims was 13,704. The standard deviation for the creditors' favor claims was 9143.

consider the size of the gaps in relation to the amount of the claims. For this analysis, I calculated the percentage size of each gap in relation to the amount of the debtor's scheduled debt. For example, if a debtor's schedule listed an outstanding mortgage obligation of $100,000 and the corresponding proof of claim was for $110,000, the gap is $10,000. As a percentage of the amount of scheduled debt, the gap is 10%. I grouped these percentage-size data into categories as shown in Figure 5 for creditor's favor claims (70.6% of all loans). About four in ten (40.4%) of all loans in the Mortgage Study sample had a mortgage claim that exceeded the corresponding debtor's scheduled amount by less than 5%. The more alarming findings concern the portion of claims in which the creditor's claim was much higher than the debtor's amount. The gap was between 5 and 15% of the debtor's calculation of the mortgage debt for 21.4% of all loans in the sample. Another 8.8% of loans had mortgage claims that were more than 15% higher than the amount of debt as calculated by the debtor on their schedules. Given their size, it seems implausible these discrepancies resulted from valid post-bankruptcy charges amounts or an underestimation by debtors relying on the prior month's mortgage statement to complete the bankruptcy schedules. Instead, the magnitude of these differences suggests a real misunderstanding between debtors and creditors about the amount of mortgage debt.

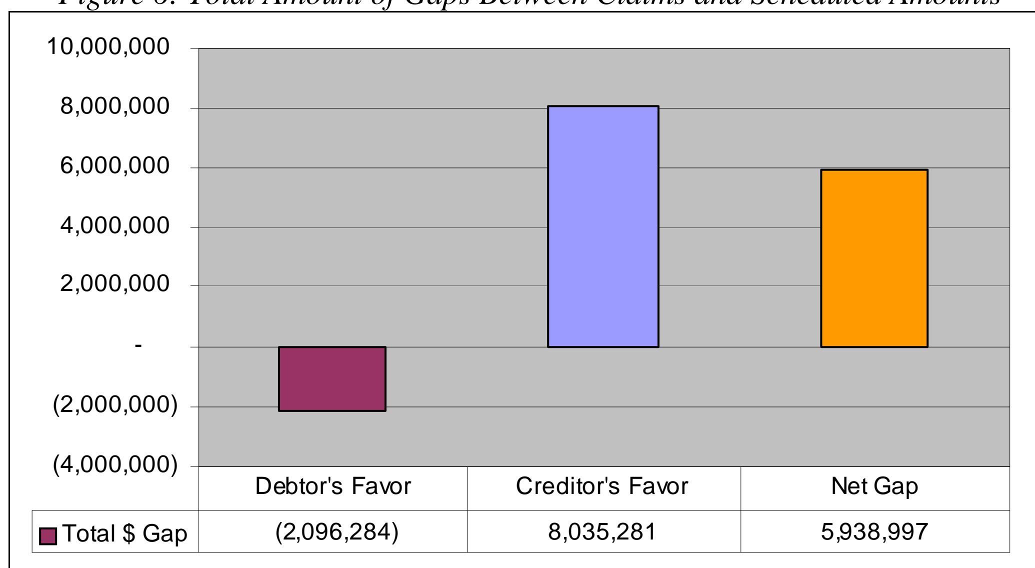
Figure 5: Frequency of Creditors' Favor Gaps, Calculated as Percentage of Claimed Amount



Unfortunately, the data do not permit an analysis of what portion of the disagreement about the debts relate to arrearage and what fraction, if any, is due to differing calculations of outstanding principal. Creditors and debtors were not consistent enough in separating these amounts to make any systematic comparison. Given that the outstanding principal appears on each mortgage statement that a debtor receives, it seems likely that at least some fraction of the disagreement is attributable to default charges and fees. These costs cannot be easily calculated by debtors, who may only take into account missed payments in determining the arrearage amount. To the extent the gaps between claims and scheduled amounts represent default fees, they offer a powerful reminder of how quickly mortgage debt can mushroom and how difficult it can be for debtors to find the income to cure arrearages.

A final rebuttal to the assertion that the gap data indicate the existence of only minor misunderstandings comes from a system-wide analysis. On an aggregate basis, the disagreements between debtors and mortgagees are a multi-billion dollar problem. Based solely on the Mortgage Study sample of approximately 1700 loans, millions of dollars are at risk of misallocation. Figure 6 shows the total of all debtor's favor claims (scheduled amount exceeded claim) and all creditor's favor claims (claim exceeded scheduled amount). When viewed from a systems standpoint,[159] the cumulative effect of the discrepancies is enormous. Mortgage creditors requested nearly six million dollars more on proofs of claims than the debtors reflected on their schedules. The mismatch between debtors' and creditors' calculations tilts sharply in favor of creditors.

Figure 6: Total Amount of Gaps Between Claims and Scheduled Amounts



Extrapolating this finding beyond the Mortgage Sample shows the scope of the problem for the entire bankruptcy system. About 400,000 homeowners have filed Chapter 13 bankruptcy in recent years.[160] Multiplying the six million dollar gap from the sample of 1700 cases to the total homeowners in Chapter 13 indicates that each year mortgagees claim over one billion dollars more than debtors believed was owed. If even a small fraction of this billion dollar aggregate sum represents creditors overreaching in their claims, the damage to the bankruptcy process is tremendous. Debtors are surprised after filing bankruptcy by the burden of paying their mortgage debt, and distributions to other creditors could be unfairly skewed.

The substantial number of cases with large discrepancies shows that debtors and creditors operate in bankruptcy with very different understandings of the amount of mortgage debt. The most likely explanation for this phenomenon may be that debtors and creditors simply have different records or lack reliable records. The finding that debtors overestimate their obligations in just over one quarter of loans is consistent with this hypothesis. Debtors get no benefit from inflating their mortgage debt on their bankruptcy schedules. In most cases, neither debtors nor

[159] Lynn M. LoPucki, *The Systems Approach to Law*, 82 CORNELL L. REV. 479 (1997).

[160] American Bankruptcy Institute, *Quarterly Non-Business Filings by Chapter (1994–2007)*, http://www.abiworld.org/AM/AMTemplate.cfm?Section=Home&CONTENTID=49785&TEMPLATE=/CM/ContentDisplay.cfm (last visited Feb. 8, 2008).

their attorneys appear to confirm the amount of the mortgage debt with the creditor at the time of the bankruptcy filing.[161] The data strongly suggest that many debtors file bankruptcy without knowing how much their mortgage creditors thinks is owed. The problem could reflect a different phenomenon. Creditors' claims may themselves be bloated and overstate the accurate amount of the debt. Such problems could result from servicers' practices of loading claims with default fees that are not disclosed to debtors, or because of mistaken calculations of the amount due in preparing the proof of claim; case law has documented both effects.[162]

Regardless of which party's calculation is correct, and even assuming all parties' behavior is unintentional, serious policy consequences occur from the system's failure to resolve these discrepancies. If the mortgagee is actually owed a smaller amount than the debtor thought was due, the counseling process regarding the advisability of bankruptcy was based on misinformation. If the arrearages were significantly less than the debtor believed, viable alternatives could have existed to Chapter 13 bankruptcy. Perhaps the debtor could have borrowed the amount necessary to cure the default in one payment. Or perhaps the debtor would have tried asking the servicer for a repayment plan outside of bankruptcy.

The creditor-favor gaps raise equal, or more serious, harms. Additional amounts of mortgage debt have meaningful effects on families in bankruptcy. If creditors are overreaching by even half of the amount suggested by either the absolute dollar or percentage analysis, they are imposing a hefty burden on debtors' disposable income and diverting money from unsecured creditors. Claims that are bloated by default fees or enlarged due to a servicer's miscalculations diminish bankruptcy's potential as a home-saving device.

To prevent the harms from either type of gap, two changes are needed. Debtor's attorneys should obtain an up-to-date statement of their client's mortgage obligations from the creditor before counseling a debtor to file Chapter 13. Then, after a bankruptcy is filed, attorneys and debtors should verify the accuracy and reasonableness of mortgagees' claims, examining the source of any discrepancy between the claim and the scheduled amount. To enable this latter practice, creditors must be held to the evidentiary standard for proofs of claims and must produce complete and clear documentation of their calculations. Without these changes, the functioning of the bankruptcy process is impaired.

D. Claims Objections

The findings in the prior parts of the Article offer a trio of indicia that undermine confidence in the claims system. Mortgagees often presented claims without required documentation; many claims contained requests for suspicious fees; and mortgagees' claims and debtors' records were rarely identical. The proof of claim process has an existing, internal mechanism to address such problems. Under section 502(a) of the Bankruptcy Code, any party in interest may object to a claim.[163] If such an objection is made, "the court, after notice and hearing, shall determine the amount of such claim."[164]

Despite these procedures, mortgage creditors are rarely called to task for the widespread deficiencies in their claims. Objections were identified to correspond with only 67 of the 1768

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[161] Servicer practices may deter debtors from getting such information. As explained above in Part I.A, servicers have no reputational concern about poor customer service response, and so many servicers make it time-consuming and difficult for a debtor to reach them. Additionally, the industry practice of imposing a "payoff" fee or a "statement fee" discourages debtors from making an account inquiry.

[162] *See supra* text accompanying notes 60–64.

[163] 11 U.S.C. § 502(a).

[164] 11 U.S.C. § 502(b).

proofs of claim in the sample. In other words, objections were filed in response to only 4% of all claims. Debtors, trustees, and other creditors simply do not object to mortgagees' claims—even when such claims do not meet the standard for prima facie validity because the claims did not comply with the unambiguous requirements of Rule 3001;[165] even such claims contained vague or suspicious fees; and even when such claims exceeded the debtors' calculation of the debt by thousands of dollars. A debtor's attorney who has developed a training program to educate attorneys about mortgage servicing issues has concluded "that the vast majority of Chapter 13 debtors and their attorneys do little or nothing about these illegal fees and charges."[166]

Among the objections that were filed, there were no observable patterns. The objections came from a variety of districts.[167] While many districts had only one objection, no district had more than seven objections. It appears that no jurisdiction has a strong local practice of reviewing and objecting to claims that would distinguish it from national norms.

Debtors filed more than two thirds of all objections (44 objections); Chapter 13 trustees filed the remaining objections. Debtors' objections usually alleged substantive problems with the claims. The most common basis for objection was a disagreement about the amount of the claim. These situations alleged a variety of wrongs: the claim contained excessive fees; the escrow amount was incorrect; the attorney fees were not itemized; or the mortgagee double-charged for property tax. In a few instances, the debtor contested the inclusion of any arrearages in the claim because the debtor believed the loan was current. Chapter 13 trustees typically focused on procedural problems with claims. The trustees' most frequent basis for objection was simply that a claim was a duplicate of a previously filed claim. Trustees' other objections were for egregious or facial errors. The sample contains trustee objections because a claim was for a borrower other than the bankruptcy debtor or because the claim was filed after the bar date for filing claims. The tiny number of objections makes it difficult to develop any useful model of why objections were filed in these cases and not in other claims with documentation deficiencies, unidentified fees, or discrepancies with debtors' schedules.

Neither the few high profile cases about mortgage servicing abuse nor the anecdotal allegations of widespread problems with the reliability of mortgage claims appear to have sparked more scrutiny of claims. The formal objection process for deficient or incorrect claims is largely dormant. The written law that governs claims does not appear in reality to translate into a functional check on mortgage servicing abuse. Many mortgage claims fail to comply with the bankruptcy rules and procedures, request unidentified or suspicious fees, or reflect a serious discrepancy between debtors' and creditors' records. Yet, no objection was filed in response to 96% of all claims, despite these problems. While Congress has emphasized the importance of a reliable bankruptcy system that garners the public's trust,[168] creditors face no meaningful consequences when they disregard the law and this public policy and submit incomplete or unsubstantiated claims for judicial approval.

The number of formal objections could understate the scrutiny that claims receive. Parties could be informally working out disagreements about claims. This hypothesis, however, is incongruent with the rare incidence of amended claims. Amended claims were located to

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[165] Fed. R. Bankr. Proc. 3001(f) ("A proof of claim executed and filed in accordance with these rules shall constitute prima facie evidence of the validity and amount of the claim.").

[166] O. Max Gardner III, *Mortgage Securitization, Servicing, and Consumer Bankruptcy*, 2 GP Solo Law Trends & News (Sept. 2005), http://www.abanet.org/genpractice/newsletter/lawtrends/0509/business/mortgagesecuritization.html.

[167] Twenty-five of the forty-four judicial districts had at least one claims objections.

[168] *See supra* text accompanying notes 105–06.

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correspond with only 9.7% of all mortgagees' initial claims. If creditors were being called to task through informal processes like phone calls from debtors' counsel or negotiations at plan confirmation hearings, the result in most of such situations should be an amended claim.[169] Further, my interviews with dozens of consumer attorneys before beginning this study revealed only a few practitioners have a regular practice of reviewing all mortgage claims.[170] The high-volume nature of consumer practice undoubtedly explains this situation, but does not excuse it. The missing documentation and the lack of standardized and detailed itemizations only heighten the financial and time costs to review claims.

The data offer a cautionary tale about relying on the formal law to actually function as intended to protect parties. Very few mortgage claims meet the ideal of the bankruptcy process; a majority of claims lack documentation and reflect a sizeable discrepancy in recordkeeping between the debtor and creditor. Unambiguous law exists to address such problems. For decades, the system has relied on these procedures to safeguard the integrity of bankruptcy distributions. Yet, the paucity of objections shows a collective failure of the system to identify even patently defective claims.

Verifying that debtors only pay amounts to which creditors are legally entitled should be a routine part of bankruptcy representation. This is a reasonable burden to impose on attorneys given the large size of mortgage claims and the requirement that a debtor must pay all mortgage arrearage debt in full to save their home. Similarly, trustees have a statutory obligation to object to improper claims,[171] yet rarely do so. The current system fails to offer sufficient incentives to encourage attorneys and trustees to obtain the additional information necessary to ensure that the amounts paid to mortgagees are correct. Similarly, the current system suggests that creditors can operate with the knowledge that their claims will not be reviewed or challenged. Combined with the financial incentives of servicers to overreach and the anecdotal evidence of servicing abuse,[172] there is a serious risk that overreaching or errors by servicing is imposing unfair burdens on families trying to save their homes. The evidence from the bankruptcy courts calls into question the ability of consumers to trust their mortgage servicers to accurately and fairly account for their payments and assess charges.

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[169] Another possibility is that the plan confirmation process serves as a check on the accuracy of claims. In their proposed Chapter 13 repayment plans, debtors may be relying on their calculations of the amounts due, rather than using the amount of the mortgagee's claim as the basis for the required repayment. If the creditor does not object to the plan, the order confirming the plan would trump the claim for purposes of the required payment in bankruptcy. Conversely, creditors may be objecting to the amount of mortgage debt in the plan and if the objections are sustained, the plans would be conformed to the creditors' claims. The extent to which confirmed Chapter 13 plans reflect the creditors' claims or the debtors' scheduled amounts or some compromise between these discrepant numbers is an empirical question. The difficulty in testing this hypothesis is that in most districts, the plan contains only the amount of prepetition arrearage. Yet, some claims did not specify the arrearage or combined prepetition and postpetition amounts. Thus, despite my efforts to do so, it is impossible to compare either the total claim or the total arrearage between confirmed plans and the proofs of claim in any significant fraction of cases.

[170] O. Max Gardner III is the most prominent example of a debtor's counsel who always reviews mortgage claims. Indeed, he has developed a "boot camp" to train other attorneys on this practice. ABC Nightline, *Bankruptcy Bootcamp*, Dec. 14, 2007, http://abcnews.go.com/Business/RealtyCheck/story?id=4002397&page=1 (last visited Feb. 8, 2008).

[171] 11 U.S.C. § 704(a)(5).

[172] *See* Part I.A and D, *supra.*

IV. IMPLICATIONS

The systemic failure of the claims process to ensure that mortgage creditors are collecting only what they are legally owed harms debtors, other non-mortgage creditors, and the integrity of the bankruptcy system. Yet, the most distressing implication may be the data's suggestion that mortgage servicing abuse may be even more prevalent beyond bankruptcy.

A. Proof of Claim Process

The problems with mortgage claims are structural. Creditors should comply with federal law if they expect to receive distributions in bankruptcy. Debtors and their attorneys also must bear responsibility for ensuring accurate payments. Objections to claims do not appear with sufficient frequency to police claims, even with regard to large debts such as mortgages. The current claims process is malfunctioning.

Mortgagees' failure to satisfy Rule 3001 should not be dismissed as a mere technicality. The rules governing claims were implemented to prevent substantive harm. Without documentation of the debt, the debtor and other creditors cannot verify the legitimacy or accuracy of claims, each of which cuts into the limited dollars available for distribution. Poor compliance with the claims rules effectively deflects creditors' obligations onto cash-strapped bankrupt families, who must choose between the costs of filing an objection or the risks of overpayment. Deficiencies in the claims process can permit unmeritorious or excessive claims to dilute the participation of legitimate creditors and prevent the just administration of bankruptcy estates.[173] Further, from a systems standpoint, it is hard to discern the benefit of allowing parties to "opt-out" of rules at will. Reforms to the claims process will protect the integrity of the bankruptcy system.

Mortgagees' frequent failure to comply with Rule 3001 results from weaknesses in the current rules, which do not deter creditors from disregarding the documentation requirements. While the rules themselves use mandatory language, phrased in terms of "shall,"[174] the reality is that some creditors treat them as aspirations—or ignore them entirely. In most instances, there is no negative consequence to the mortgagee from its failure to attach the required documentation. Under the current system, the main tool to fight improper claims is Federal Rule of Bankruptcy Procedure 9011, which requires all factual contentions in pleadings to have evidentiary support.[175] While courts have sanctioned creditors for filing unsubstantiated claims,[176] Rule 9011 was not designed to correct the systematic failure of other rules. Rule 3001(f) provides a "carrot" to encourage compliance by granting prima facie validity to claims that are executed and filed in compliance with Rule 3001.[177] Yet, as a practical matter, all claims receive this treatment if

[173] Gardner v. State of N.J., 329 U.S. 565, 573 (1947).

[174] Fed. R. Bankr. P. 3001(c)–(d). The proof of claim form (B10) also contains a sheet of instructions, which states, in relevant parts, that "[y]ou must attach to this proof of claim form copies of documents that show the debtor owes the debt claimed or, if the documents are too lengthy, a summary of those documents. If the documents are not available, you must attach an explanation of why they are not available" and "[y]ou must . . . attach copies of the documentation of your lien, and state the amount past due on the claim as of the date the bankruptcy case was filed." Instructions for Proof of Claim Form, Office Form 10[9/97], *available at* http://www.uscourts.gov/bankform/formb10new.pdf.

[175] Fed. R. Bankr. P. 9011.

[176] *See, e.g., In re* Cassell, 254 B.R. 687 (B.A.P. 6th Cir. 2000) ("Proofs of claim must meet the standards of [Rule 9011.]"; *In re* Berghoff, 2006 WL 1716299 (Bankr. N.D. Ohio. 2006) (finding that mortgage lender violated Rule 9011 by including certain fees in claim that were not warranted by existing law).

[177] Fed. R. Bankr. P. 3001(f).

neither the debtor nor another party in interest objects to the claim. Creditors can rely on the lack of scrutiny to validate their claims and sidestep the burdens of Rule 3001.

The consequences of disregarding Rule 3001 needs to be sharpened. Even when an objection is filed, there is typically no sanction for missing documentation. Some courts have concluded that failure to comply with Rule 3001 is not a permissible basis for disallowing a claim,[178] because this behavior is not listed in section 502(b) of the Bankruptcy Code, which governs claims allowance. A few jurisdictions have taken a different approach and ruled that incomplete claims documentation can be a basis for disallowing a claim.[179] The majority rule seems to be that a claim that does not comply with Rule 3001 loses its prima facie evidentiary effect, which shifts the burden to mortgagees to prove their claim. However, courts usually require the debtor to advance some evidence that disputes the claim and not merely point to noncompliance with the rule.[180] If the servicer is uncooperative, and for example, refuses to promptly provide a complete and comprehensible payment history, the debtor may have a difficult time actually forcing the creditor—the party in control of the records—to meet the burden that the rules impose upon it. An affidavit from the debtor may suffice in such cases, and the courts seem to be increasingly sympathetic to debtors' frustrations with obtaining information from mortgage servicers.[181]

The simplest route to boosting the reliability of mortgage claims is to revise section 502(b) to include the failure to provide the attached documentation as a basis for claims disallowance. This reform would ratchet up the consequences for failing to attach a note or security interest. In effect, a creditor, who could not validate the existence of the purported debt with a note (or could not adequately explain why a note was unavailable), could not receive more in bankruptcy than it would have been entitled to had it been put to its proof in a judicial-foreclosure lawsuit. In this way, the bankruptcy process would be at least as rigorous as the foreclosure scheme outside of the federal system.

Another strategy is to squarely impose the burden of reviewing mortgage claims on trustees. The Bankruptcy Code already states that a trustee shall "if a purpose would be served, examine proofs of claims and object to the allowance of any claim that is improper."[182] Many trustees apparently believe that no purpose would be served by objecting to claims without the

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[178] *See, e.g.*, *In re* Stoecker, 5 F.3d 1022 (7th Cir. 1993); *In re* Heath, 331 B.R. 424 (B.A.P. 9th Cir. 2005); *In re* Gurley, 311 B.R. 910 (Bankr. M.D. Fla. 2001). *See also* Alane A. Becket, *Proofs of Claims: A Look at the Forest* 23 AM. BANKR. INST. L. REV. 10 (Dec./Jan. 2005) (concluding that disallowance on Rule 3001 grounds is not within a court's statutory authority because bankruptcy rules are not supposed to abridge, enlarge or modify substantive rights under 28 U.S.C. § 2075).

[179] *See, e.g.*, *In re* Shaffner, 320 B.R. 870 (Bankr. W.D. Mich. 2005); *see also* WESTLAW BANKRUPTCY LAW MANUAL § 6:4 (5th ed. 2007) ("There is a split of authority on whether the failure to comply with Rule 3001(c) requires disallowance of the claim."). *Cf. In re McLaughlin*, 05-63927 (Ct. Aug. 31, 2007) (disallowing claims filed by trustee pursuant to Rule 3004 because trustee did not reasonably investigate claims and provide documentation to support the claims.).

[180] *In re* Campbell, 336 B.R. 430, 434 (B.A.P. 9th Cir. 2005) (holding that a proof of claim that lacks documentation required by Rule 3001(c) is not disallowed unless the debtor's claim objection contests the amount of the debt and not merely the rule violation).

[181] *See In re* Heath, 331 B.R. 424, 437 (B.A.P. 9th Cir. 2005) ("Moreover, a creditor's lack of adequate response to a debtor's formal or informal inquiries in itself may raise an evidentiary basis to object to the unsupported aspects of the claim, or even a basis for evidentiary sanctions, thereby coming within Section 502(b)'s grounds to disallow a claim." (citations omitted)).

[182] 11 U.S.C. § 704(a)(5).

documentation required by law. For example, while notes were missing from forty percent of claims, trustees filed only one or two objections that raised that issue.

The U.S. Trustee Program could mandate mortgage claims review as an official duty of panel and standing trustees in their program handbook, and trustees could be evaluated, in part, on their fulfillment of this duty. This solution is informal, requiring no legislative reform. The proposal merely posits that the U.S. Trustee Program would ensure that trustees carry out the statutory mandate in a rigorous fashion. This solution eliminates the need to create incentives for debtors' attorneys to make claims objections in the first instance. The U.S. Trustee Program could use standards and procedures that parallel those used when auditing debtors' schedules. If the Chapter 13 trustees' examinations revealed serious or systematic misconduct, the problems could be referred to the U.S. Trustee for enforcement activity. In 2007, the U.S. Trustee took a step in this direction by becoming involved in litigation over alleged wrongdoing by mortgage servicers.[183]

A complementary tactic to these enforcement strategies would improve the clarity of claims. The varying formats and level of detail in the itemizations dramatically increase the costs in reviewing claims, rendering it prohibitively expensive and inefficient for the high-volume consumer bankruptcy system. If itemizations were standardized, it would be easier to train legal assistants and junior attorneys to review claims. Standardization would also facilitate the development of computer programs to analyze the creditors' calculations for items such as escrow accounts and arrearage payment streams. A model itemization attachment was promulgated by a committee of mortgage industry representatives and Chapter 13 trustees and mortgage servicers.[184] The model attachment would require servicers to provide details such as the type of the loan, its interest rate, and any payment adjustment dates. It also sets out a standardized format for servicers to break out the amount of any pre-petition arrearages, categorize each charge, and report how many times each type of charge had been imposed. The Advisory Committee on Bankruptcy Rules should review the model itemization and consider incorporating it into the Official Form 10 and Rule 3001(a), at least for mortgage claims. Voluntary adoption seems unlikely as the form has not yet been adopted, despite its existence for many months. Notably, the participation of industry representative in creating the model itemization does reflect some willingness by servicers to admit that their bankruptcy procedures need improvement.

The solutions outlined here would systematically improve mortgage claims.[185] Given the empirical evidence of widespread problems with mortgage claims, these approaches may be the most efficient solution. The realities of consumer bankruptcy practice may dictate structural solutions that do not rely on the voluntary participation of individual actors. While such reforms

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[183] *See* Statement of the United States Trustee Regarding This Court's Order Requiring Countrywide Home Loans, Inc. [and Barrett Burke Wilson Castle Daffin & Frappier, L.L.P. Attorneys and Personnel] to Appear and Show Cause Why [They] Should Not Be Sanctioned for Filing a Motion for Relief From Stay Containing Inaccurate Debt Figures and Inaccurate Allegations Concerning Payments Received From the Debtor, *In re* Parsley, No 05-90374, (Bankr. S.D. Tex. Mar. 3, 2007).

[184] Model Proof of Claim Attachment, NAT'L ASS'N OF CHAPTER THIRTEEN TRUSTEES, REPORT OF MORTGAGE COMMITTEE (June 28, 2007) (manuscript on file with author). The model attachment would also require the creditor to provide the MERS number for the loan, the real property tax number and parcel number, and a contact person for the servicer (and not just the servicer's attorney).

[185] *Cf. In re* Coates, 292 B.R. 894, 899–900 (Bankr. C.D. Ill. 2003) (noting that frequent appearance of attorneys' fees and expenses in mortgage claims justifies a systematic approach to this aspect of Chapter 13 cases).

would modestly increase the administrative burdens, the benefits of increased reliability in mortgage claims justify these policy changes.

B. Bankruptcy as a Home-saving Device

Mortgage claims are a key determinant of the outcome of consumer bankruptcy cases. A core function of Chapter 13 bankruptcy is helping families save their homes,[186] which the Bankruptcy Code effectuates by permitting debtors to cure arrearages on mortgages over time.[187] Because mortgage creditors are most Americans' largest creditor, their actions in bankruptcies heavily influence debtors' success in saving their homes from foreclosure.[188] A family's ability to confirm a Chapter 13 plan or cure a default may turn on the amount fixed as owing to the mortgage creditor.[189] Debtors cannot easily generate additional disposable income if alleged obligations to mortgagees magically increase or if fees multiply without justification. The debtor's ability to pay mortgage arrearages, as a practical matter, determines the success of a case. Not only does plan confirmation turn on this issue, if the debtor misses any plan payments, the mortgage creditor frequently will seek relief from the stay to proceed with a foreclosure and the debtor's bankruptcy may be dismissed. Thus, the amounts of mortgage proofs of claim have direct effects on bankruptcy's usefulness as a home-saving device.

Miscalculations about mortgage debt have grave consequences for families at nearly every point in the bankruptcy system. From the outset, debtors may be harmed if they make the bankruptcy filing decision without accurate knowledge of their mortgage debts. If debtors underestimate the amount of their outstanding obligations to mortgagees, which the data show occurs in the majority of cases, their attorneys may misadvise them about the feasibility of confirming a Chapter 13 plan and the likelihood that they can cure their mortgage default. Conversely, if debtors overestimate the arrearage, they could file bankruptcy without pursuing other types of relief, such as borrowing from families or friends, seeking forbearance from the mortgagee, or selling an asset. Debtors' inability to report their mortgage debt with reasonably accuracy indicates a serious shortcoming in the pre-bankruptcy counseling process. The data suggest that attorneys who do not verify the mortgage debt may give suboptimal advice to their clients about the advisability of Chapter 13 bankruptcy. This situation could be one factor that contributes to the low success rate of debtors completing Chapter 13 repayment plans.[190]

After families file bankruptcy, discrepancies in debtors' and creditors' records of the amount of mortgage debt and incomplete mortgagee proofs of claim lead to either of two undesirable consequences. In most instances, the data show that debtors do not verify the amount requested on the mortgagees' claim and risk overpaying that creditor. In so doing, debtors increase their burden in confirming and completing a Chapter 13 plan. This outcome, however,

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[186] *See* 1 KEITH LUNDIN, CHAPTER 13 BANKRUPTCY, § 129.1 (3d ed. 2000) ("[I]t is not unusual for rehabilitation of a home mortgage to be the principal reason for filing a Chapter 13 case.").

[187] *See* 11 U.S.C. § 1325(b)(5).

[188] Bahchieva, Wachter & Warren, *supra* note 1, at 74. ("Our results also suggest that rising mortgage debt has important consequences for federal bankruptcy policy.").

[189] *In re* Coates, 292 B.R. 894, 899 (Bankr. C.D. Ill. 2003) ("A debtor's obligation to cure the prepetition mortgage arrearage is enforceable as a condition of confirmation. A plan that fails to provide for a complete cure is not confirmable over the objection of the mortgagee. Most of the Chapter 13 cases filed in this District involve the cure of a prepetition mortgage arrearage.").

[190] *See*, *e.g.*, Scott Norberg, *Consumer Bankruptcy's New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13*, 7 AM. BANKR. INST. L. REV. 415, 439 (1999) (finding that approximately one-third of Chapter 13 debtors complete their plans).

saves the debtor the litigation and negotiation costs of seeking clarification from the mortgagee. When mortgagees' claims are challenged, the debtor faces increased costs for their attorneys' time in this work. Proofs of claim with unexplained or impermissible fees, or without adequate documentation, drive up the expense of bankruptcy relief, a consequence that financially-strapped families can ill afford.

Despite these costs, debtors may benefit substantially from challenging mortgage claims. Bloated claims make it more difficult for a family to confirm repayment plans. Because arrearages must be paid in full, every dollar of savings is a direct benefit to a family who would have to dismiss their Chapter 13 case and surrender its home if the original arrearage amount were allowed to stand. Improved accuracy by mortgage servicers in bankruptcy cases could save litigation costs in response to motions for relief from stay that are based on incorrect accounting.

Scrutinizing the proof of claim to ensure that only valid fees are included in arrearage claims can help reduce the burdens that debtors face in making all required Chapter 13 plan payments. Reduced arrearages could improve the success rate of debtors in completing Chapter 13 plans and receiving a discharge. Better outcomes in Chapter 13 could help encourage more debtors to consider this alternative, and boost recovery to all creditors. Further, ensuring that the mortgagees' accounting is accurate at the time of the confirmation can help prevent disputes about the amount of mortgage debt that remains to be paid after the bankruptcy case is complete.

Debtors would benefit substantially if consumer bankruptcy attorneys incorporated a routine review of mortgage claims in the scope of their representation. Given the recent escalation in attorneys' fees that occurred after BAPCPA,[191] it is discouraging to suggest that the solution lies in passing the costs of claims review along to debtors. The structural changes suggested in the prior section would reduce the costs of claims review in various ways, and in some instances they would change the incentives of debtors' attorneys to monitor the accuracy of claims.

Taking those suggestions a step further, debtors' attorneys need to be educated about the potential benefits to their practice of challenging mortgage claims. While challenging a claim does not *per se* generate revenue for an attorney, claims review can reveal other causes of action. Most obviously, if consumer attorneys request information from mortgage servicers and receive no response or an inadequate response, the servicer may have violated the Real Estate Settlement Procedures Act ("RESPA"). If successful, these claims entitle plaintiffs to actual damages and the costs of reasonable attorneys' fees.[192] An objection may also generate evidence of a practice that can be challenged under a state's unfair or deceptive practices act, which typically also permits the recovery of attorneys' fees if the plaintiff is successful.[193] In some instances, review of mortgage claims can reveal causes of action that allege violations in how the loan was originated. For example, a review of the Truth-in-Lending disclosure can give rise to a claim for actual or statutory damages, or even rescission of the loan under some circumstances.[194] The Truth in Lending Act also is fee-shifting so that mortgage companies may be ordered to pay the

[191] In 2001, the Consumer Bankruptcy Project found that the median attorneys' fee for a Chapter 13 case among five judicial districts was $1550 (in 2001 dollars; no inflation adjustment) (data on file with author). A recent survey suggests that on a national basis, Chapter 13 fees are nearly twice the 2001 amount, with many districts having a presumptively permissible fee of $3000 or more. Nat'l Ass'n of Consumer Bankruptcy Attorneys, Survey of Presumptive Chapter 13 Fees (Apr. 22, 2007) (on file with author).
[192] 12 U.S.C. § 2605(f)(3).
[193] DOUGLAS J. WHALEY, PROBLEMS AND MATERIALS ON CONSUMER LAW 482 (3d. ed. 2002).
[194] 15 U.S.C. §§ 1635 & 1640.

attorneys' fees and costs of successful actions.[195] These examples show how bankruptcy can be the locus for identifying a variety of illegal lending activity. Reviewing mortgage claims should be merely the first step in helping a family stop a foreclosure or untangle itself from the harm of an inappropriate or predatory home loan.

The data provide systematic evidence that mortgage servicers do not adequately document their claims and may be engaged in overreaching in assessing fees and calculating outstanding obligations. The current state of mortgage claims puts debtors at risk. Each time a family loses its home based on an inaccurate claim, the bankruptcy system fails. Inflated mortgage claims undercut a core bankruptcy policy of helping families in financial trouble save their homes and right themselves financially.

C. Sustainable Homeownership Policy

The findings on the unreliability of mortgagees' claims have implications beyond bankruptcy. All families who are trying to pay off a home loan are put at risk if subject to poor or predatory mortgage servicing. Most families rely on their mortgage servicer to credit payments, calculate pay-off balances, and apply fees only when justified. Most families do not and cannot separately verify the servicers' accounting. Bankruptcy data provide a lens for examining whether Americans should trust servicers to carry out these tasks and whether the servicing industry is adequately regulated.

It seems likely that default by a borrower may exacerbate servicing problems because default triggers the imposition of fees, and sometimes a transfer to a loss mitigation department or even to a new servicer. Nonetheless, the reality is that most defaults and pending foreclosures occur outside the bankruptcy system.[196] Thus, most families in default on their mortgages lack the protections—albeit, the existing weak protections—of the bankruptcy claims process to shield them from impermissible or unreasonable default fees. Indeed, servicers' accounting should be better inside the bankruptcy system than outside it because, at least in theory, a bankruptcy is a check on mortgage overreaching. If a Chapter 13 case is filed, the servicer usually hires an attorney who is supposed to review the claim for accuracy and illegality, and the servicer knows that homeowners usually have retained an attorney to represent them. Not only are mortgagees' misbehavior or mistakes probably not confined to bankruptcy debtors, the frightening prospect is that servicing problems among non-bankrupt families who are behind on their mortgages may be even worse than the bankruptcy data reveal.

Very recent case law lends legitimacy to this fear. In late 2007, two federal courts in Ohio dismissed dozens of foreclosure lawsuits on standing grounds because the plaintiffs could not

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[195] 15 U.S.C. § 1640(a)(3).

[196] Foreclosure filings appear to outnumber bankruptcy cases filed by homeowners by a ratio of four to one. In 2006, there were 597,965 non-business bankruptcy filings. *See* Administrative Office of the U.S. Courts, *Bankruptcy Filings Plunge in Calendar Year 2006* (Apr. 26, 2007), http://www.uscourts.gov/Press_Releases/bankruptcyfilings041607.html. The best available data, the 2001 Consumer Bankruptcy Project, indicate that about 52.5% of all families in bankruptcy are homeowners. *See* Bahchieva, Wachter & Warren, *supra* note 1, at 92. Accordingly, about 300,000 bankruptcy cases were filed by homeowners. In the same year (2006), there were 1,259,118 foreclosure filings. *See More Than 1.2 Million Foreclosure Filings Reported in* 2006, REALTY TRAC, Jan. 25, 2007, http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=1855&accnt=64847. *See also* Dennis R. Capozza and Thomas A. Thomson, *Subprime Transitions: Lingering or Malingering in Default?* 33 J. OF REAL EST. FIN. & ECON. 241–58 (2006) (reporting that only 11% of subprime borrowers in default by ninety days or more subsequently filed bankruptcy in the preceding eight months).

prove they were the record owner of the mortgage and note.[197] Two class action lawsuits are pending that allege that consumers pay bloated, illegal fees for default charges.[198] Mortgage servicers are increasingly being fingered as the primary party who is frustrating homeowners' efforts to obtain modifications of unaffordable loans.[199]

Poor mortgage servicing is an assault on America's policy of promoting sustainable homeownership. If families are hit with unreasonable fees and cannot understand what is owed on their mortgage loan, they are at risk of foreclosure. Servicing abuse can begin before bankruptcy, but may ultimately drive some families into bankruptcy as a last resort for trying to address this issue. The current policy debate on homeownership is focused on loan origination issues, such as whether mortgage brokers or lenders placed families in appropriate loans.[200] Servicing problems may be less visible, but no less harmful. Research shows that the quality of preventive servicing affects the incidence and outcome of default.[201] The rising foreclosure rate will only escalate the number of families who must struggle to understand the amount of their arrearage and who are at risk of having to pay unreasonable default costs to save their home.[202] Policies that aim to protect families from foreclosure should address the weaknesses in mortgage servicing, and not just alter the process for loan origination. For families who are already trapped in unaffordable loans, other relief will come too late. Improving mortgage servicing would provide immediate protection to families facing foreclosure.

Paying a mortgage is most families' most important financial obligation. Unreliable servicing can cause ordinary families to overpay, even for those who avoid default and bankruptcy. For example, inaccurate pay-off balances can penalize families when they refinance a home loan. Even families who try to get ahead on their mortgage may lose such benefits if servicers fail to credit additional payments to principal, instead holding them in suspense or treating them as prepayments despite instructions to the contrary from the borrower. These practices create a needless barrier to homeownership.

Under the current regime, consumers have no choice in servicers. Any market exists solely based on the needs of lenders and bond issuers, whose concerns are distinct—if not opposed—to borrowers. Jack Guttentag, emeritus professor at the Wharton School of Business, has suggested that consumers be allowed to "fire" their servicer, essentially receiving a one-time option to choose a different servicer.[203] He postulates that servicers would compete for this

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[197] *In re* Foreclosure Cases, 07CV2282 (N.D. Ohio. Oct. 31, 2007) (Boyko, J.); *In re* Foreclosure Cases, 07CV043 (S.D. Ohio Nov. 15, 2007) (Rose, J.).

[198] *Harris v. Fidelity Nat'l Information Serv*., No. 03-44826, Complaint (Bankr. S.D. Tex. Jan. 16, 2008) (class action suit alleging that default servicers had impermissible and undisclosed arrangements with attorneys to retain portion of fees); *Trevino v. MERS*, 07-568, Complaint (D. Del. Nov. 6, 2007) (class action alleging that MERS overcharges borrowers).

[199] Eggert, *supra* note 21 at 282.

[200] Home Mortgage Disclosure Act Data and FTC Lending Enforcement Before the H. Comm. on Financial Services, 110th Cong. 1, 5–9 (2007), *available at* http://www.ftc.gov/os/testimony/P064806hdma.pdf (describing FTC collection of data on pricing of subprime mortgages marketed to consumers).

[201] Anthony Pennington-Cross & Giang Ho, *Loan Servicer Heterogeneity and the Termination of Subprime Mortgages* (Fed. Res. Board of St. Louis, Working Paper No. 2006-024A 2006).

[202] *See generally Foreclosure Activity Up Over 55% in First Half of 2007*, REALTYTRAC, July 30, 2007), http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=2932&accnt=64847; Danielle Reed, *Rising Foreclosure Rates Point to a Normalizing Market*, REAL ESTATE JOURNAL.COM, Apr. 17, 2006, http://www.realestatejournal.com/buysell/markettrends/20060417-reed.html?refresh=on.

[203] Jack Guttentag, *Borrowers Should Be Able to Fire Mortgage Servicers*, Feb. 2, 2004, http://www.mtgprofessor.com/A%20-%20Servicing/borrowers_should_be_able_to_fire_servicers.htm.

additional business, driving up quality, and balancing servicers' incentives between lenders and borrowers. Another policy response to concerns about mortgage servicing is to step up enforcement action. However, single actions against egregious servicers may not produce systematic reform, as the Mortgage Study data suggest that servicing issues are industry-wide. A bigger problem may simply be focusing the Department of Housing and Urban Development ("HUD") on its duties to enforce RESPA and to police mortgage servicers. HUD's website for complaints does not even mention mortgage servicing,[204] and the Federal Trade Commission, rather than HUD, has taken the lead in recent actions against servicers.

The Mortgage Study data suggest that policymakers who focus on promoting homeownership need to concern themselves with mortgage servicing, which is a crucial aspect to enabling families to achieve homeownership. Mortgage servicing abuse weakens families' efforts to manage their mortgages successfully and can result in families being wrongfully deprived of their homes through foreclosure or unsuccessful outcomes in bankruptcy. Mortgagees' failure to honor the terms of their loans and applicable law weakens America's homeownership policies and threatens families' financial well-being.

The findings are a tangible reminder that merely enacting a law does not ensure its success. Without the correct structural incentives and without robust safeguards, a law can fail to deliver its promised protections. In the consumer context, this observation has particular power. Consumers face disadvantages to industry in a legal system: consumers are not repeat players; they have fewer resources; and they do not have institutional incentives to shape the system. The bankruptcy claims process exemplifies the difficulty in developing and monitoring an effective legal system. The findings should caution policymakers and advocates from blindly trusting in the written law as a decontextualized instrument to shape behavior.

CONCLUSION

Hundreds of thousands of Americans file Chapter 13 bankruptcy each year hoping to save their homes from foreclosure. Reliable claims are crucial to the success of the bankruptcy system because the claims mechanism implements the two core goals of bankruptcy policy: to help debtors obtain a fresh start by paying their debts and to ensure that creditors receive a fair share of debtors' assets. From external indicia, the claims process in consumer bankruptcy cases may seem like an exemplar of a well-designed legal system that balances the interests of debtors and creditors. The claims rules are unambiguous; all parties typically are represented by attorneys; the federal judicial system brings uniformity to the procedures; and specialized actors such as bankruptcy judges and trustees police the system.

Yet, despite these reassuring features, the empirical data establish the widespread, current practice of mortgagees' filing incomplete claims with vaguely identified fees. This hinders any effective scrutiny of whether servicers are only charging the correct amounts to struggling homeowners. The existing system is insufficient to ensure the integrity of the bankruptcy system and its home-saving purpose. The problems with mortgagees' calculations are likely to be even worse outside of bankruptcy, where the rules are less clear and the procedural safeguards are fewer. Systematic reform of mortgage servicing is needed to protect all homeowners—inside and outside of bankruptcy— from overreaching or illegal behavior. The findings on the unreliability of mortgage servicing are a high-stakes reminder of the challenges of designing a legal system that actually functions to protect consumers.

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[204] U.S. Dept. of Housing and Urban Dev. Complaints, http://www.hud.gov/complaints/ (last visited Sept. 11, 2007).