<u>Foreclosure Servicing and Mortgage-Related Lender Liability</u>

Lance E. Olsen, Esq.
Routh Crabtree Olsen, P.S.
(425) 586-1905
lolsen@rcolegal.com

A. Actions related to the Discharge Injunction

1. What Actions by a Servicer/Lender Constitute a Violation of the Discharge Injunction and/or Automatic Stay Provisions of the Bankruptcy Code?

In the case of In re Canning, 442 B.R. 165 (Bankr. D. Me. 2011) aff'd, 462 B.R. 258 (Bankr. App. 1st Cir. 2011), the debtors brought an adversary proceeding against defendant mortgagee alleging that the mortgagee violated the discharge injunction of 11 U.S.C. §524(a)(2) by sending the debtors a collection letter and refusing to foreclose against the debtors' real property which the debtors surrendered to the mortgagee.

In Canning, both the Bankruptcy and Bankruptcy Appellate Panel held that the collection letters sent to the debtors by their servicer nine weeks post discharge violated the permanent injunction.

Under 11 U.S.C. §524(a)(2), a discharge injunction operates as an injunction against the commencement or continuation of an action, the employment of process, or an act to collect, recover, or offset any such debt as a personal liability of the debtor. A party will be found liable for a "willful violation" of the discharge injunction when it is proved that the violator (1) has knowledge of the discharge and (2) had general intent to commit acts forbidden by 11 U.S.C. §524 (a)2 and (a)3. In re Canning, 442 B.R. 165 (Bankr. D. Me. 2011) aff'd, 462 B.R. 258 (Bankr. App. 1st Cir. 2011.

Knowledge: Despite the servicer having received notice of the Cannings' discharge, it sent a letter to the Cannings nine weeks post-discharge stating that the Cannings' "still have a financial obligation … to repay the money they borrowed under their loan and that (the lender) "reserved all rights and remedies." In re Canning, 442 B.R. 165 (Bankr. D. Me. 2011) aff'd, 462 B.R. 258 (Bankr. App. 1st Cir. 2011). The servicer's claim that the Cannings "still have a

financial obligation to repay … money borrowed" violates 11 USC § 524 because it had knowledge that the Cannings' debt was discharged.

Intent: The facts indicate that the lender sent a Dunning letter to the Cannings on August 3, 2009. Therefore, the servicer had a general intent to commit the acts forbidden by 11 USC §524(a)(2) and (a)3. As such, both elements have been met. The Dunning letters sent by a servicer to a debtor post discharge violate 11 U.S.C. §524(a)2 and (a)3.

In contrast to Canning, the court in In re Brown, 481 B.R. 351 (Bankr. W.D. Pa. 2012) found that simply contacting a debtor is not sufficient communication by servicer to constitute a violation of the discharge injunction. In re Brown, servicer contacted the debtor via phone to offer the Browns' foreclosure assistance.

The court held that when a servicer sends letters to a debtor accompanied with payment coupons, it can constitute a violation of the discharge injunction. However, general informational letters and notices in which no demand for payment is made do not constitute a violation of the discharge injunction. Id. While it was unclear whether the servicer or the Browns' initiated the calls, the court reached its decision based on the non-threatening nature of the calls.

Similarly, the court in In re Ogunfiditimi, 09-34778PM, 2011 WL 2652371 (Bankr. D. Md. 2011) held that an offer of foreclosure assistance without mention of the debtor's discharge or liability is non-threatening and therefore does not rise to a level of an "act to collect" as provided under 11 USC §524(a)2 and (3).

A secured creditor will not violate a discharge injunction when it refuses to foreclose its interest or release its lien when a debtor complies with 11 U.S.C. §521(a)(2)(A) and surrenders property, unless the circumstances indicate that the creditor stands on its state law right to be paid in full before creditor the releases its lien.

In re Ogunfiditimi, the facts indicate that Deustche Bank after being granted relief from stay refused to foreclose its interest on debtor's property. Here, the debtors instituted this action asserting that Deutsche Bank's refusal to institute foreclosure proceedings constituted a violation of the discharge injunction. The court determined that the termination of the automatic stay, combined with the debtor's 11 U.S.C. §521(a)(2)(A) statement of intention to surrender property burdened by a security interest does not impose an affirmative duty upon the creditor to take any action. In re Canning, 442 B.R. 165 (B.C.Me.2011); In re Pratt, 462 F.3d 14 (CA1 2006).

While relief from the automatic stay permits a lender to institute foreclosure proceedings or to repossess collateral, the automatic stay does not require a lender to foreclose on its interest. However, a lender's refusal to take possession of surrendered collateral or their refusal to release their lien could be violation of the discharge injunction because to do so might have the effect of depriving a debtor of her right to a "fresh start." In re Ogunfiditimi, 09-34778PM, 2011 WL 2652371 (Bankr. D. Md. 2011) (citing *to In re Pratt*, 462 F.3d at 19-20).

In re Pratt, after the debtors surrendered his "worthless" vehicle to his secured creditor the creditor refused to possess the vehicle or release its lien. This refusal was held to be a violation of the discharge injunction because of its effect on the debtors. The court *In re* Pratt reached its decision on the issue of "effect" by stating:

> The debtors were faced with "the grim prospect of retaining indefinite possession of a worthless vehicle unless they paid the loan balance, together with all the attendant costs of possessing, maintaining, insuring, and/or garaging the vehicle.

In re Pratt, 462 F.3d at 19-20

2. What Remedies Exist for a debtor when a Lender/Servicer Violates the Discharge Injunction/Automatic Stay?

The automatic stay provision of the Bankruptcy Code provides a private right of action for a debtor against a lender when that lender violates 11 U.S.C. §362(k)(1). While many courts have yet to sufficiently address the issue of whether 11 U.S.C. §524 implies a private right of action, either alone or through 11 U.S.C. §105(a), the Third Circuit concluded In re Brown, 481 B.R. 351 (Bankr. W.D. Pa. 2012) that 11 U.S.C. §524 does not imply a private right of action.

Courts have determined that the remedy available for a debtor when a lender is held liable for a violation of the discharge injunction is a civil contempt proceeding pursuant to 11 U.S.C. §105(a).In re Brown, 481 B.R. 351 (Bankr. W.D. Pa. 2012) (citing to *In re Bonnano*, Adv. No. 08-7035 BM, 2009 WL 8556815, at *3, 2009 Bankr. LEXIS 5544, at *7).

B. Actions Related to Alleged Failures to Modify Loans

During the first year of the Home Affordable Modification Program ("HAMP") program, only 170,000 borrowers had received permanent modifications - - fewer than 15 percent of the 1.4 million homeowners who had been offered trial plans. Wigod v. Wells Fargo Bank, 2012 WL 727646, at *2 (7th Cir. 2012). Fewer than projected home modifications under HAMP have

lead to increased HAMP related litigation. Borrowers have raised three theories of liability: (1) Rights under HAMP; (2) Borrower's claims as third party beneficiaries under HAMP's Service Participation Agreements (SPA's); and, (3) Breach of Contract claim under the terms of the Trial Participation Program Agreement (TPP). Only the latter theory has prevailed. Thomas v. U.S. Bank Nat. Ass'n, 474 B.R. 450 (D.N.J. 2012); Healey v. Fargo, 2012 WL 994564

1. Private Right of Action under HAMP Theory

In Thomas v. U.S. Bank Nat. Ass'n, 474 B.R. 450 (D.N.J. 2012), the Lender was granted relief from stay to foreclose on debtor's residence. Subsequently, debtor/borrower submitted a Motion for Reconsideration asserting that American Servicing Company, a servicer of U.S. Bank, moved for relief without granting debtor a modification on their loan. The debtor asserted that U.S. Bank violated HAMP and because of this violation U.S. Bank should not have been granted relief from the stay. The court disagreed with this assertion and determined that nothing in the Act required a lender/servicer to modify a debtor's loan, especially, when a modification is to the detriment of the lender/servicer. It was held that HAMP does not provide for a private right of action. Thomas v. U.S. Bank Nat. Ass'n, 474 B.R. 450 (D.N.J. 2012) (citing to *Wigod,* 673 F.3d at 555; *O'Connor v. First Alliance Home Mtg*. Civil Action no. 12-111, 2012 WL 762351 (D.NJ. Mar. 6, 2012); *Cave*, 2012 WL 1957588).

In deciding this case, the court referenced the Supreme Court's 2011 decision in Astra USA, Inc. v. Santa Clara County, —– *U.S. ——, 131 S.Ct. 1342, 179 L.Ed.2d 457 (2011).*

In Astra, the court held that:

> An agreement designed to implement a federal program, whereby drug manufacturers opted into the program by executing the agreement, could not be enforced by beneficiaries of the program because, to rule otherwise, would obviate Congress' decision not to provide a private right of action to those beneficiaries.

In short, a borrower should not rely on the ability to establish a private right of action for the failure of a lender / servicer to engage in loan modification discussions.

2. Breach of Contract Claim Theory

In Healey v. Wells Fargo, 2012 WL 994564, the homeowner entered into a Trial Period Payment Agreement ("TPP") with Servicer. Under the terms of the Agreement the borrower would automatically qualify for a permanent loan modification should they comply with all terms of the agreement at which time the homeowner would receive an executed copy of a permanent modification agreement. Here, borrower complied with all terms of the Agreement but did not receive the executed copy of the permanent modification agreement. To maintain a cause of action for breach of contract the homeowner needed to establish: (1) the existence of an agreement, including its essential terms; (2) a breach of a duty imposed by that agreement; and (3) damages resulting from the breach. In order for an enforceable contract to be formed, there must be an offer, acceptance, and exchange of consideration,.

The court determined that when the borrowers forwarded their signed TPP Agreement to the servicer, and the servicer signed and returned a copy to the borrowers, offer and acceptance had been achieved. Further, the return of the signed TPP Agreement to the servicer, together with the promises to perform therein, acted as an exchange of consideration. Therefore, the borrower could maintain a cause of action against the servicer for breach of contract.

C. Actions related to alleged violations of the Servicemember's Civil Relief Act?

1. No cause of action if borrower was in active service at time of origination

A borrower of a home loan may not prevent foreclosure under SCRA when that member entered into that obligation during his/her military service. Coward v. JP Morgan Chase Bank, Nat. Ass'n, 2:11-CV-03378-GEB, 2012 WL 2263359 (E.D. Cal. 2012).

In Coward, borrower and his wife entered into a home loan after borrower, a member of the armed services, entered military service. In this case, borrower and his wife asserted that servicer breached its duty when it failed to evaluate her husband for assistance under SCRA. Because servicer breached its duty, it is alleged that the Coward's home was wrongfully foreclosed.

The court denied plaintiff's claim for two reasons: (1) Plaintiff failed to cite to a provision of SCRA that affirms such a duty and (2) SCRA is only applicable to obligations and interest arising before borrower entered military service. 50 U.S.C. §533 (West). Therefore, if a

member of the armed services or his wife enters into an obligation prior to that member entering active duty then that member, his spouse, or their representative must file an affidavit with the court requesting relief under SCRA to prevent a lender from foreclosing on their property. Further, no language in 50 U.S.C. §501-597 implies a duty on the part of a lender to evaluate a borrower for assistance under SCRA.

D. Lender Liability under FCRA

A court will find that a borrower/discharged debtor has sufficiently alleged a claim on which relief can be granted when a lender fails to timely investigate a complaint by borrower that lender erroneously reported to a credit reporting agency (CRA) an improper delinquency in payment. Moreover, a person who negligently violates the FCRA § 1681*o* is liable in an amount equal to the sum of any actual damages sustained by the consumer as a result of that violation plus costs and attorney's fees. A plaintiff may base his allegations on willful non compliance or negligent compliance. King v. Bank of Am., N.A., C-12-04168 JCS, 2012 WL 4685993 (N.D. Cal. 2012).

To make a claim under the FCRA, Plaintiff must aver: (1) she contacted the CRA; (2) the CRA pursued the claim and; (3) the CRA contacted Defendant(s) regarding the dispute thus triggering the Defendant's duty to investigate.

In King v. Bank of Am., N.A., C-12-04168 JCS, 2012 WL 4685993 (N.D. Cal. 2012), plaintiff/borrower/discharged debtor sent written communication to Experian disputing improper delinquencies in payment that Bank of America reported to Experian. Under FCRA, Experian reported this dispute to Bank of America. Subsequently, Bank of America verified that it received notice and continued to erroneously report the delinquencies in payment.

Therefore, under FCRA, a court will likely find that plaintiff has adequately claimed that Defendant's conduct, if not willful, was negligent and plaintiff suffered actual harm as a result.

In re Gilliland, 07-11392-DWH, 2011 WL 4760040 (Bankr. N.D. Miss. 2011).

A court may deny a debtor's Motion for Summary Judgment (with respect to *Complaints* listed below) if a creditor establishes that it has implemented procedures to safeguard against erroneous reporting of customer information.

Complaints:

Count 1: A willful violation of the discharge injunction

Count II: Filing a false proof of claim

Count III: A violation of the Rule 3001, Federal Rules of Bankruptcy Procedure

Count IV: A violation of the Fair Debt Collection Practices Act

In Gilliland, the debtor received a discharge in 2001. Among the debts discharged was an obligation to Capitol One. In 2007, debtor filed another petition listing Capitol One as creditor. In the 2007 proceeding, Capitol One submitted erroneous proof of claims (later withdrawn by Capitol One) that reflected amounts discharged in debtor's 2001 case. Capitol One contends that it implemented a procedure to safeguard against erroneous reporting of customer accounts by requiring that before any case could be marked to reflect a discharge several parameters had to match exactly. In Capitol One's system, hundreds of names matched debtor's name. While the social security number of the discharged debtor matched - the address did not. The court denied debtor's Motion for Summary Judgment in favor of an evidentiary hearing to determine what, if any, damages resulted and whether Capitol One took reasonable steps to prevent such events.

E. Lender Liability under the Trust in Lending Act ("TILA")

A court will likely dismiss a borrower's complaint when an agent of a lender/servicer has allegedly falsified information on a loan application and debtor does not file a suit to exercise his Right of Rescission within the requisite time period. In re Salazar, BKR. 10-10165-TJC, 2011 WL 1237648 (Bankr. D. Md. 2011).

In this case, debtor's loan transaction closed on November 20, 2006. On November 19, 2009 debtor's attorney sent to First Residential Mortgage Servicer a Notice of Rescission. While the parties do not dispute that the requisite period for rescission is 3 years, the court held that the debtor's complaint was untimely because a suit needed to be filed and not a Notice of Rescission. The court dismissed debtors' complaint without prejudice, subject to the outcome of *DeCosta v. U.S. Bancorp,* 2010 WL 3824224 (D.Md.2010).

The court stated the following to support its position:

> This precise issue was recently addressed by the United States District Court for the District of Maryland in *DeCosta v. U.S. Bancorp,* 2010 WL 3824224 (D.Md.2010), *appeal docketed,* No. 10–2212 (4th Cir. Oct. 28, 2010). There,

> Chief Judge Chasanow determined that, where the borrowers mailed a rescission notice within the three year period but filed their lawsuit after the period ran, the borrowers' rescission suit was untimely under § 1635(f). This Court adopts the rationale of *DeCosta* and concludes that the Plaintiffs' TILA claim for rescission is untimely.[3]
>
> The Court recognizes, however, that the issue is not free from doubt. *See DeCosta,* 2010 WL 3824224, at *4 ("The issue of what constitutes a timely claim for rescission has perplexed courts and produced a variety of approaches."); *see also,*12 C.F.R. § 226.23(a)(2) (Requiring that "[t]o exercise the right to rescind, the consumer shall notify the creditor of the rescission by mail, telegram or other means of written communication."); *Jones v. Saxon Mortgage Inc.,* 537 F.3d 320, 325 (4th Cir.1998) (per curiam) ("[T]o exercise the right to rescind, a borrower must notify the creditor of the rescission by mail, telegram or other means of written communication.") Accordingly, the Court will dismiss the TILA rescission claim without prejudice subject to being reasserted as appropriate upon the Fourth Circuit's resolution of the *DeCosta* appeal.

F. New Government Oversight Over Mortgage Lenders

1. Creation of the Consumer Financial Protection Bureau

The Consumer Financial Protection Bureau ("CFPB") was established under Dodd Frank as enacted on July 21, 2010. Specifically, the CFPB is an independent bureau of the Federal Reserve System created to regulate the offering and provision of consumer financial products or services under the Federal consumer financial laws. 12 U.S.C.A. § 5491 (West).

The CFPB has just started the process of establishing jurisdiction, rules, penalties and enforcement action. As time progresses, more will come available on the topic.

2. Fallout from the Office of Comptroller of Currency Consent Orders and the Global Settlement with the United States and 49 Attorneys General.

a. Fallout from the April 2011 OCC and FRB Consent Orders

In April 2011, federal regulators mandated that an independent firm review the foreclosure actions of servicers. The independent review, hereinafter referred to as, Independent Review, included an evaluation of the foreclosure processes utilized in foreclosing on borrowers in 2010 and 2011. To be a part of the review, borrowers were able to request a review. The review period ended December 31, 2012.

According to the Office of Comptroller of Currency (OCC), 495,000 borrowers requested a review. Rather than continued with the review process, several mortgage servicing companies

agreed in principle to "pay" a total of $8.5 billion in "penalties" associated with the alleged conduct. The agreement indicated that $3.3 billion would be in direct cash payments to 3.8 million eligible borrowers and $5.2 billion would be in additional assistance to these borrowers. It is unclear what the $5.2 billion in assistance entails for borrowers. Office of Comptroller of Currency, *Correcting Foreclosure Practices,*http://www.occ.gov/topics/consumer-protection/foreclosure-prevention/correcting-foreclosure-practices.html

Regulators and industry leaders agreed that this plan of redress was best for borrowers to receive compensation more quickly. The OCC indicated that the agreement included the following servicers/banks: Aurora, Bank of America, Citibank, JP Morgan Chase, MetLife Bank, PNC, Sovereign, SunTrust, U.S. Bank, and Wells Fargo. The Independent Review continues for Ally, Everbank, HSBC, and OneWest.

The OCC indicated borrowers will not waive any of their legal claims against a servicer for receiving payments beginning at the end of March 2013.

b. April 2012 Settlement with the United States and 49 Attorneys General

The OCC initiated Independent Review is distinct from the Settlement with the United States and the Attorneys General.

In February 2012, the 49 state attorneys general working group announced a historic joint state-federal settlement with the nation's five largest mortgage servicers: Ally/GMAC, Bank of America, Citi, JPMorgan Chase, and Wells Fargo. National Mortgage Settlement, *About the Settlement, http://www.nationalmortgagesettlement.com/about (accessed on January 16, 2013).*

The settlement will provide up to $25 billion in relief to distressed borrowers and states who signed on to the settlement. Settlement payments will also be made to the federal government. According to the National Mortgage Settlement organization, an agency administering the settlement:

> It's the largest consumer financial protection settlement in US history. The agreement settles state and federal investigations finding that the country's five largest mortgage servicers routinely signed foreclosure related documents outside the presence of a notary public and without really knowing whether the facts they contained were correct. Both of these practices violate the law.

Key provisions of the settlement include:

- Immediate Aid to homeowners need loan modifications now
- Immediate Aid to borrowers who are current, but whose mortgages currently exceed their home's value
- Payments to borrowers who lost their homes to foreclosure
- Immediate payments to signing states
- First ever nationwide reforms to servicing standards
- State AG oversight of national banks for the first time

National Mortgage Settlement, *About the Settlement*,
http://www.nationalmortgagesettlement.com/about