

Misbehavior and Mistake in Bankruptcy Mortgage Claims

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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 proofs of claim with the court for the amount of the mortgage debt. To retain their homes, bankruptcy debtors must pay these claims. This process is well established and, until now, has been uncontroversial. The assumption is that the protective elements of federal bankruptcy shield vulnerable homeowners from harm.

This Article examines the actual behavior of mortgage companies in consumer bankruptcy cases. Using original data from 1,700 recent Chapter 13 bankruptcy cases, I conclude that mortgage companies frequently do not comply with bankruptcy law. A majority of mortgage claims are missing one or more of the required pieces of documentation for a bankruptcy claim. Furthermore, fees and charges on claims often are poorly identified, making it impossible to verify if such fees 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 contested infrequently. 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. The observation that laws can underperform has crucial implications for designing legal systems that function as intended and for evaluating the appropriate scope of consumer protections.

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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 the United States' home-ownership policies by exposing families to the risks of overpaying or suffering unjustified foreclosure. This Article's findings offer an empirical measure of the validity of concerns about whether consumers can trust mortgage companies to adhere to applicable laws.

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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 homes 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 begin an unrecoverable tumble down the socioeconomic ladder.

Bankruptcy offers these families one last chance to save their homes.¹ 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.² The bankruptcy system offers refuge from the vagaries of state foreclosure law, substituting the protections of the federal court system and uniform legal rules to ensure that these families get one final opportunity to preserve their homes.

But this protection comes at a cost. Mortgage companies file proofs of claim with bankruptcy courts for the amount of mortgage debts. 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.³

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

This Article examines the actual behavior of mortgage companies in the consumer bankruptcy system. Using original data from 1,700 recent Chapter 13 bankruptcy cases, I conclude that mortgagees' behavior significantly threatens bankruptcy's purpose of helping families save their homes. Despite

1. See Raisa Bahchieva et al., *Mortgage Debt, Bankruptcy, and the Sustainability of Homeownership*, in CREDIT MARKETS FOR THE POOR 73, 104 (Patrick Bolton & Howard Rosenthal eds., 2005) (explaining that Chapter 13 bankruptcy is frequently used by families facing foreclosure).

2. ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, *THE LAW OF DEBTORS AND CREDITORS* 306 (5th ed. 2006).

3. *Id.* at 143; see FED. R. BANKR. P. 9011 (requiring that all petitions, pleadings, motions, and other papers filed with the court in a bankruptcy action have factual support).

unambiguous federal rules designed to protect homeowners and ensure the integrity of the bankruptcy process,⁴ mortgage companies frequently fail to comply with the laws that govern bankruptcy claims. A majority of mortgage companies' proofs of claim lack the 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 \$1 billion more than the families who file bankruptcy believe they owe.⁵ 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.

The data revealed here 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's being able to find the money to cure its mortgage arrearage. The data on missing documentation, unsubstantiated fees, and discrepancies in record keeping, combined with the growing body of case law penalizing mortgage servicers for their conduct in bankruptcy cases, raise the specter that many bankrupt families may be overcharged or may unfairly lose their homes. Such realities undermine bankruptcy's core purpose of helping financially distressed families save their homes.⁶

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

The evidence that unreliable mortgage servicing is pervasive 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

4. See, e.g., *In re Matus*, 303 B.R. 660, 675 (Bankr. N.D. Ga. 2004) ("The [bankruptcy] statutes are designed to insure 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." (quoting *In re Bratcher*, 289 B.R. 205, 218 (Bankr. M.D. Fla. 2003))).

5. See *infra* text accompanying note 224.

6. See WARREN & WESTBROOK, *supra* note 2, at 306 (explaining that nearly every state had granted some level of protection from creditors by the end of the nineteenth century).

industry.⁷ The written law contains clear instructions, and parties are given the opportunity to object to inappropriate conduct.⁸ Indeed, the claims system has functioned for decades without generating calls for reform. Yet these data show that reality is far from the ideal suggested by these external markers of system reliability. These 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—the observation 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 then relying on silence as an indication of acceptable and just behavior. These data show that effective enforcement mechanisms or structural incentives for industry compliance can be as important as the rigor of 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 of bankruptcy—remain vulnerable to mortgagees' misbehavior and mistakes.

I. Statement of the Problem

Americans pursue home ownership to build wealth and to improve their financial positions. The explosion of subprime lending and the rapid maturation of the securitization market for mortgages have fueled occasional criticisms of mortgage servicers, who are the intermediaries between consumers and mortgage holders.⁹ Consumers have complained of overcharges and difficulty in obtaining accurate loan information. Increasingly, these problems erupt into litigation, most frequently in bankruptcy courts. Although policy makers have focused on loan origination,¹⁰ consumers can

7. See MARGARET HOWARD, *BANKRUPTCY: CASES AND MATERIALS* 44 (4th ed. 2005) (noting that bankruptcy law attempts to protect the interests of both debtors and creditors).

8. See *infra* notes 228–29 and accompanying text.

9. In this Article, I refer only to servicers, but lenders who service their own loans may behave similarly to third-party servicers.

10. See, e.g., Press Release, Iowa Attorney Gen., 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 the multistate settlement with mortgage lender Household Finance Corp., for its misrepresentation and disclosure violations

suffer dire harms from poor mortgage servicing. Errors or overcharges increase the cost of home ownership 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 insurers.¹¹ The rise of servicing as a distinct industry resulted from the widespread use of securitization in the mortgage market.¹² 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 to investors fractional interests in the trust's pool of mortgages.¹³ These investors receive periodic payments on their investments.¹⁴ Servicers act as intermediaries between the borrower and the other parties to the securitization.¹⁵ A pooling-and-servicing agreement sets out the servicer's responsibilities for collecting and remitting the mortgage payments.¹⁶ The participation of servicers complicates the borrower-lender relationship and limits flexibility in loss mitigation and default situations.¹⁷

Mortgage servicers do not have a customer relationship with homeowners; they work for the investors who own the mortgage-backed securities.¹⁸ Borrowers cannot shop for a loan based on the quality of the

at the loan origination phase, was the largest direct- restitution settlement ever in a state or federal case).

11. Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers*, 15 HOUSING POL'Y DEBATE 753, 755 (2004).

12. See *Possible Responses to Rising Mortgage Foreclosures: Hearing Before the H. Comm. on Fin. Servs.*, 110th Cong. app. at 97 (2007) (statement of Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation) ("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.").

13. See STEVEN L. SCHWARCZ ET AL., *SECURITIZATION, STRUCTURED FINANCE, AND CAPITAL MARKETS 2* (2004) (providing an introduction to securitization and examining the legal issues relevant to securitized transactions).

14. *Id.*

15. *Id.* at 15.

16. See *Hearing*, *supra* note 12, app. at 101–02 (statement of Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation) (explaining that a servicer must comply with the relevant securitization documents).

17. See *id.* app. at 102–06 (describing the conflicts of interest faced by servicers when managing mortgagees).

18. *Id.* app. at 103. However, lenders do have a customer relationship with borrowers and may want to retain them as repeat customers. SCHWARCZ ET AL., *supra* note 13, at 15. 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 that their loans are serviced by the

servicing, and they have virtually no ability to change servicers if they are dissatisfied with the servicers' conduct.¹⁹ The only exit strategy for a dissatisfied borrower is refinancing the mortgage, and even then, the homeowner may find the new loan assigned to the prior servicer.²⁰ Because their customers are the trustees who hire them to collect on behalf of investors, servicers have few reputational or financial constraints pushing them to work to satisfy homeowners with their performance.²¹

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 0.25% and 0.50% of the note principal for each loan.²² Second, servicers earn "float" income from interest accrued between when consumers pay and when those funds are remitted to investors.²³ Third, servicers often are permitted to retain all, or part, of any default fees, such as late charges, that consumers pay.²⁴ In this way, a borrower's default can boost a servicer's profits. A significant fraction of servicers' total revenue comes from retained-fee income.²⁵ Because of this structure, servicers' incentives upon default may not align with investors' incentives.²⁶ Servicers have incentives to make it difficult for consumers to cure defaults.

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 contracts. A lending industry representative has admitted that "[m]ost people don't understand the

originating lender. See Jack M. Guttentag, *A Mortgage Servicing System for Borrowers?*, http://www.mtgprofessor.com/A%20-%20Servicing/a_servicing_system_for_borrowers.htm ("The great majority of loans today are serviced by firms that don't own them.").

19. Jack M. Guttentag, *Why Is Mortgage Servicing So Bad?*, http://www.mtgprofessor.com/A%20-%20Servicing/why_is_servicing_so_bad.htm (last modified Dec. 13, 2004) (explaining that borrowers cannot easily choose a servicer based on the quality of servicing, nor can they fire a servicer for poor servicing).

20. See *id.* (describing borrowers' inability to select their mortgage servicers).

21. *Id.*

22. NAT'L CONSUMER LAW CTR., *FORECLOSURES* 148 (2d ed. 2007).

23. Kurt Eggert, *Comment on Michael A. Stegman et al.'s "Preventive Servicing Is Good for Business and Affordable Homeownership Policy": What Prevents Loan Modifications?*, 18 HOUSING POL'Y DEBATE 279, 286 (2007).

24. Eggert, *supra* note 11, at 758.

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

26. See *Hearing*, *supra* note 12, at 9 (describing the conflicting interests of the participants in a securitization).

most basic things about their mortgage payment[s].”²⁷ 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.²⁸ 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 servicers.²⁹

Spiking foreclosure rates and pressure from Wall Street may exacerbate problems with mortgage servicing.³⁰ Falling real-estate prices have changed the profit calculus of foreclosure, encouraging lenders to reach out to delinquent borrowers.³¹ Facing political and financial pressure, lenders and servicers are struggling to develop cost- and time-effective strategies for loss mitigation.³² However, cash-strapped lenders have fewer resources than ever to devote to loan servicing.³³ 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.³⁴ Mortgage servicing is a crucial part of the home-ownership process that must be part of any response to the rising foreclosure rate and downturn in the mortgage market.

27. *Lenders Look for Way to Avoid Bankruptcy Maze*, NAT’L MORTGAGE NEWS, Aug. 30, 2004, at 23 [hereinafter *Lenders Look*], available at <http://www.nationalmortgagenews.com/premium/archive/?id=147519>.

28. See Guttentag, *supra* note 19 (arguing that the normal financial incentives to provide quality service do not exist within the current structure of the loan-servicing industry).

29. Press Release, J.D. Power & Assocs., Customer Service and Attention to Detail Drive Home Mortgage Satisfaction 1 (Nov. 26, 2002) (on file with the Texas Law Review).

30. See Posting of Tara Twomey to Credit Slips, http://www.creditslips.org/creditslips/2007/03/subprime_servic.html (Mar. 19, 2007, 23:32 PDT) (“Financial troubles, staff layoffs and potentially higher servicing costs on defaulting loans have led to concerns that servicing quality may decline.”).

31. See, e.g., Carrick Mollenkamp, *Faulty Assumptions: In Home-Lending Push, Banks Misjudged Risk*, WALL ST. J., Feb. 8, 2007, at A1 (discussing mega-bank HSBC’s recent efforts to work with troubled borrowers, including hiring more employees to work out payment plans and implementing a top-down overhaul of its entire mortgage-services branch).

32. See *id.* (describing HSBC’s expanded loss-mitigation efforts); 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.”).

33. See Simon, *supra* note 32, at D1 (describing the heightened strains on servicers as the volume of default increases).

34. See Eggert, *supra* note 23, at 284–92 (documenting barriers that servicers face in loan modifications).

B. Homeowners in Bankruptcy

Most consumers who file Chapter 13 bankruptcy cases are homeowners.³⁵ 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 supposed refuge for families trying to save their homes.

When a borrower files for bankruptcy, the creditor is barred by the automatic stay from pursuing other legal action to collect the debt.³⁶ Pending foreclosures may not proceed against the debtor's home, unless the court grants the creditor permission to do so.³⁷ Many homeowners are in default on their mortgage loans when they seek bankruptcy relief.³⁸ Because families typically struggle for months before filing bankruptcy,³⁹ 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 these arrearage amounts in full (including any regular monthly payments that were not made before the bankruptcy).⁴⁰

To establish the arrearage amount that must be cured, creditors usually file proofs of claim.⁴¹ Even if their loans are not in default, many

35. See TERESA SULLIVAN ET AL., *THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT* 202 (2000) (stating that half of all bankruptcy debtors are homeowners); Bahchieva et al., *supra* note 1, at 104–05 (explaining that although most debtors prefer Chapter 7, homeowners disproportionately choose Chapter 13 because Chapter 7 does not protect home equity).

36. 11 U.S.C. § 362(a) (2006).

37. See *id.* § 362(b) (setting out the exceptions to the automatic stay).

38. See Bahchieva et al., *supra* note 1, at 73, 104 (finding that bankrupt homeowners are about 50% more likely to file Chapter 13 than Chapter 7, and attributing this preference to Chapter 13's special protections for homeowners in default).

39. The median family that files for bankruptcy reports seriously struggling 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 for bankruptcy. See Robert M. Lawless et al., *Did Bankruptcy Reform Fail? An Empirical Study of Consumer Debtors*, 82 AM. BANKR. L.J. 349, 381–82, 382 fig.12 (2008) (reporting data from telephone surveys of families in bankruptcy).

40. See 11 U.S.C. § 1322(b)(2) (2000) (providing that the Chapter 13 bankruptcy plan may “modify the rights of holders of secured claims, other than a claim secured by a security interest in real property that is the debtor's principal residence”) (emphasis added); § 1322(b)(5) (providing that “notwithstanding paragraph (2) of this subsection,” the bankruptcy plan may “provide for the curing of any default within a reasonable time”); see also Mark S. Scarberry & Scott M. Reddie, *Home Mortgage Strip Down in Chapter 13 Bankruptcy: A Contextual Approach to Sections 1322(b)(2) and (b)(5)*, 20 PEPP. L. REV. 425, 431 (1993) (“Most homeowners in Chapter 13 must, as a practical and ultimately a legal matter, use § 1322(b)(5) to cure their defaulted home mortgages if they wish to keep their homes.”).

41. See Official Bankruptcy Form 10 (2007), available at http://www.uscourts.gov/rules/BK_Forms_1207/B_010_1207f.pdf (instructing secured creditors to list the amount of any arrearage as of the time that the case is filed). See generally David Gray Carlson, *Proofs of Claim in Bankruptcy: Their Relevance to Secured Creditors*, 4 J. BANKR. L. & PRAC. 555 (1995) (describing the reasons why secured creditors file proofs of claim).

mortgagees will file claims to establish the amount of outstanding principal. While liens on a debtor's property pass unaffected through bankruptcy⁴² barring a specific challenge based on special bankruptcy avoidance powers,⁴³ creditors who wish to receive distributions from the trustee must file claims.⁴⁴ Trustees normally pay arrearage amounts to servicers from debtors' Chapter 13 payments.⁴⁵ In some jurisdictions, trustees also collect and transmit the regular ongoing mortgage payments to servicers.⁴⁶

42. See 11 U.S.C. § 524(a) (stating that discharge "voids any judgment at any time obtained, to the extent that such judgment is a determination of the *personal liability* of the debtor") (emphasis added); *Johnson v. Home State Bank*, 501 U.S. 78, 83 (1991) (noting that discharge extinguishes *only* the personal liability of the debtor and that a creditor still has the right to foreclose on a mortgage); Marianne B. Culhane & Michaela M. White, *Debt After Discharge: An Empirical Study of Reaffirmation*, 73 AM. BANKR. L.J. 709, 714 (1999) ("Valid liens on collateral survive the discharge.").

43. See 11 U.S.C. §§ 544, 547 (2006) (establishing the powers of the trustee and allowing avoidance of a transfer when several conditions are satisfied).

44. See FED. R. BANKR. P. 3002 (providing that, with certain exceptions, an "unsecured creditor or an equity security holder must file a proof of claim or interest for the claim or interest to be allowed"); FED. R. BANKR. P. 3021 (providing that distribution under the plan will be made to creditors whose claims have been allowed and to certain others); see also WARREN & WESTBROOK, *supra* note 2, at 219 ("To receive any distribution, each Chapter 7 or Chapter 13 creditor must submit a proof of claim.").

45. See 11 U.S.C. § 1326(c) ("Except as otherwise provided in the plan or in the order confirming the plan, the trustee shall make payments to creditors under the plan."); see also Henry E. Hildebrand III, *The Sad State of Mortgage Service Providers*, AM. BANKR. INST. J., Sept. 2003, at 10, 10 (explaining that trustees are required by the terms of confirmed Chapter 13 plans to make arrearage payments to mortgage companies).

46. See Scott F. Norberg & Nadja Schreiber Compo, *Report on an Empirical Study of District Variation, and the Roles of Judges, Trustees and Debtors' Attorneys in Chapter 13 Bankruptcy Cases*, 81 AM. BANKR. L.J. 431, 446 (2007) (reporting that in three of the seven bankruptcy districts surveyed in the article, the practice was for Chapter 13 debtors to make mortgage payments through the trustee). Practices for 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. See *id.* (finding three other bankruptcy districts where the practice was for Chapter 13 debtors to make mortgage payments directly to the creditor); see also Timothy D. Moratzka, *Commission-Free: Chapter 13 Debtor as Dispersing Agent*, AM. BANKR. INST. J., Oct. 2007, at 14, 14 (presenting cases from jurisdictions where the debtors were allowed to make mortgage payments "outside the plan"). 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. See Hildebrand, *supra* note 45, at 40 ("More and more chapter 13 trustees are being required by the terms of confirmed plans to make not only the arrearage payments to mortgagees, but also the payments to maintain the regular monthly payments.").

These practices are yet another example of the well-documented phenomena of "local legal culture" in bankruptcy cases. See generally Jean Braucher, *Lawyers and Consumer Bankruptcy: One Code, Many Cultures*, 67 AM. BANKR. L.J. 501 (1993) (contrasting the cultures of bankruptcy practices in different locations); Lynn M. LoPucki, *Legal Culture, Legal Strategy, and the Law in Lawyers' Heads*, 90 NW. U. L. REV. 1498 (1996) (using examples of local bankruptcy practices to explain the nature and evolution of law); Teresa A. Sullivan et al., *The Persistence of Local Legal Culture: Twenty Years of Evidence from the Federal Bankruptcy Courts*, 17 HARV. J.L. & PUB. POL'Y 801 (1994) (using examples of the differing bankruptcy practices in various locales to stress the importance of "local legal culture").

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 claim are bankruptcy's alternative mechanism to separate lawsuits 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 bankruptcy system,⁴⁷ 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 (FTC) 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.⁴⁸ Two cases illustrate the problems that incorrect or inaccurate mortgage servicing imposes on borrowers. In *Rawlings v. Dovenmuehle Mortgage, Inc.*,⁴⁹ the servicer repeatedly asserted that the homeowners had failed to make payments even though the servicer itself had erred by applying the payments to the wrong account.⁵⁰ After the servicer sent notices of default and imposed late fees, the homeowners spent over seven months attempting to resolve the servicer's error.⁵¹ In another instance, *Islam v. Option One Mortgage Corp.*,⁵² the borrowers refinanced, but the prior servicer continued to threaten to foreclose on the borrowers' home and to report adverse information to credit bureaus.⁵³ This year, the *Boston Globe* reported that mortgage companies typically include projected foreclosure costs in payoff amounts given to borrowers in default.⁵⁴ These fees are estimates for anticipated services, which may never be rendered.

47. 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).

48. DIV. OF CONSUMER & BUS. EDUC., FED. TRADE COMM'N, MORTGAGE SERVICING: MAKING SURE YOUR PAYMENTS COUNT 3 (2008), available at <http://www.ftc.gov/bcp/edu/pubs/consumer/homes/real10.pdf>.

49. 64 F. Supp. 2d 1156 (M.D. Ala. 1999).

50. *Id.* at 1159–60.

51. *Id.*

52. 432 F. Supp. 2d 181 (D. Mass. 2006).

53. *Id.* at 183–84.

54. Sacha Pfeiffer, *Hidden Legal Fees Push Some into Foreclosure*, BOSTON GLOBE, Jan. 18, 2007, at D1.

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.”⁵⁵

The likelihood that such practices translate into concrete harms is sharpened because consumers report serious difficulty in communicating with mortgage servicers when they perceive that an error or overcharge has occurred.⁵⁶ 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.⁵⁷ 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 that specializes in troubled loans.⁵⁸

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.⁵⁹ Servicers may alter their practices and delay foreclosure to drive up their profits because they do not have incentives to care about preventing foreclosure.⁶⁰ While preventive servicing can reduce loss severities,⁶¹

55. *Id.*

56. *See, e.g.*, S.P. Dinnen, *Mortgage Complaints Can Take Extra Effort*, DES MOINES REG., May 2, 2004, at 1D (detailing scenarios in which consumers had to repeatedly argue with their mortgage servicers over the servicers’ accounting mistakes); Adolfo Pesquera, *Paper Trail of Problems: Some Fairbanks Clients Report Nightmare Errors*, SAN ANTONIO EXPRESS-NEWS, Aug. 9, 2002, at 1E (reporting repeated complaints that Fairbanks Capital Corporation does not properly record payments and then holds its customers responsible for the errors).

57. *See* Posting of Ben Popken to The Consumerist, <http://consumerist.com/5047947/12-confessions-of-a-home-mortgage-collector> (Sept. 10, 2008, 12:36 EDT) (reporting that mortgage-servicing employees frequently hang up or transfer homeowners back into queue in order to avoid work); Posting of Katie Porter to Credit Slips, <http://www.creditslips.org/creditslips/2008/07/the-really-sad.html> (July 15, 2008, 10:01 PDT) (providing a transcript of a debtor’s call to his mortgage servicer in which he was transferred and put on hold and was unable to learn the reason for a charge).

58. *See* Popken, *supra* note 57 (“The Loss Mitigation department has NO CLUE what they are doing.”); *see also* *Policing Lenders and Protecting Homeowners: Is Misconduct in Bankruptcy Fueling the Foreclosure Crisis? Hearing Before the Subcomm. on Admin. Oversight and the Courts of the S. Comm. on the Judiciary*, 110th Cong. (2008) (statement of Robin Atchley), available at http://judiciary.senate.gov/hearings/testimony.cfm?id=3327&wit_id=7158 (testifying that while her account was in bankruptcy, no person with Countrywide could ever give her clear information on what they claimed was owed or why that amount was owed).

59. *See* Anthony Pennington-Cross & Giang Ho, *Loan Servicer Heterogeneity and the Termination of Subprime Mortgages* 19, 19–20 (Fed. Reserve Bank of St. Louis, Working Paper No. 2006-024A, 2006), available at <http://research.stlouisfed.org/wp/2006/2006-024.pdf> (finding “strong evidence” that the identity of the individual mortgage servicer substantially affected the chance of default among a large sample of subprime mortgages).

60. *See* Yingjin Hila Gan & Christopher Mayer, *Agency Conflicts, Asset Substitution, and Securitization* 19–20 (Nat’l Bureau of Econ. Research, Working Paper No. 12,359, 2006), available at <http://www.nber.org/papers/w12359> (finding that mortgage servicers often delay foreclosure proceedings so that they can avoid the costs associated with foreclosure and collect additional fees while the loan spends time in special servicing).

abusive servicing can heighten them. Without servicers' reaching out to consumers and spending the necessary time and money, sensible loan modification opportunities will be missed.⁶² Families who could have saved their homes with a repayment plan or modification will lose their homes, and investors will suffer unmitigated losses.⁶³

The harms of servicing abuse may be even higher for families in bankruptcy, which often file Chapter 13 in a final effort to save their homes. If bankruptcy claims contain illegal fees, debtors will face increased burdens in confirming repayment plans and be 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 on debtors—the parties who can least afford such expense—to sort out such problems.⁶⁴ 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, this also weakens 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.⁶⁵ Depending on the type of misbehavior, consumers may have both federal and state claims and both common law and statutory remedies.⁶⁶ While the case law is growing, there are still relatively few adjudicated decisions on mortgage-servicing

61. See Michael A. Stegman et al., *Preventive Servicing Is Good for Business and Affordable Homeownership Policy*, 18 HOUSING POL'Y DEBATE 243, 246 (2007) (presenting data that show that effective preventive-servicing strategies increase dollars collected, reduce overall operating costs, and slow the rate at which mortgages progress into delinquency).

62. See Eggert, *supra* note 23, at 282 (recounting a 2007 statement from a federal regulatory authority encouraging mortgage servicers to use loan modification and other loss-mitigation techniques to keep borrowers in their homes).

63. See *id.* at 284 ("Effective loan modifications, which can result from preventive servicing, can both reduce borrowers' payments, helping to keep them in their homes, and save investors from credit losses that result from foreclosure.").

64. See *Williams v. Fairbanks Capital Corp.* (*In re Williams*), Case No. 00-00770-W, Adv. No. 01-80105-W, 2001 WL 1804312, at *1-2 (Bankr. D.S.C. Nov. 19, 2001) (awarding punitive damages to the debtor after the debtor incurred substantial attorneys fees, other costs, and lost wages responding to inaccurate court documents filed by the creditor due to errors in its records).

65. NAT'L CONSUMER LAW CTR., *supra* note 22, at 147 n.1 (citing recently published authorities describing the growing problem of mortgage-servicing abuse).

66. See *id.* at 179 (explaining that, in addition to federal claims brought under the Real Estate Settlement Procedures Act, 15 U.S.C. §§ 2601-2617 (2006), consumers often may bring claims under state unfair-and-deceptive-trade-practices acts and common law breach-of-contract, breach-of-fiduciary duty, and tort claims).

problems.⁶⁷ Several explanations exist. Consumers may not be aware of their rights or be able to afford attorneys.⁶⁸ The relative youth of mortgage servicing as an industry means that few attorneys or judges understand the legal and factual issues involved.⁶⁹ Regulatory authority for mortgage servicing is fractured.⁷⁰ The paucity of decisions suggests that many consumers may respond to mortgage claims by “lumping it” rather than seeking any formal redress.⁷¹ 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.⁷²

Most litigation against mortgage servicers has occurred in the context of bankruptcy cases.⁷³ Bankruptcy changes the dynamic between borrowers and servicers. The vast majority of consumers hire attorneys to represent them in their bankruptcies.⁷⁴ Without counsel, consumers may be unable to raise such claims. They may also have trouble identifying attorneys who are familiar with such issues or willing to take such suits 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,⁷⁵ and litigation may be necessary to fulfill the attorney’s duty of representation.⁷⁶ While bankruptcy is the context for most servicing disputes, the problems identified in bankruptcy

67. See generally Gretchen Morgenson, *Dubious Fees Hit Borrowers in Foreclosure*, N.Y. TIMES, Nov. 6, 2007, at A1 (chronicling several ongoing lawsuits alleging serious misconduct by mortgage-servicing providers).

68. See Eggert, *supra* note 11, at 768 (arguing that most borrowers are unable to enforce their legal rights because they rarely read their mortgage-loan contracts and usually cannot afford to retain an attorney to pursue litigation under consumer-protection statutes).

69. See, e.g., NAT’L CONSUMER LAW CTR., *supra* note 22, at 201–03 (documenting conflicting decisions in the federal courts regarding mortgage servicers’ claims that the requirements of the Fair Debt Collection Practices Act (FDCPA) and Real Estate Settlement Procedures Act (RESPA) are preempted by the Bankruptcy Code).

70. See Eggert, *supra* note 11, at 774–75 (expressing concern that legislation passed by several states to curb servicer abuses may be subject to federal preemption).

71. See Marc 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.’”).

72. See JOHN A. SPANOGLE ET AL., CONSUMER LAW: CASES AND MATERIALS 772 (3d ed. 2007) (discussing the barriers to consumer litigation).

73. See *Lenders Look*, *supra* note 27 (quoting an employee of a servicer remarking that “[b]ankruptcy is becoming fertile ground for a lot of loopholes and a lot of lawsuits and a lot of costs to servicers”).

74. See TERESA SULLIVAN ET AL., AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA 22–23 (1989) (finding that only 4% of debtors in a sample of 1,529 bankruptcy cases filed pro se petitions).

75. See Hildebrand, *supra* note 45, at 10 (describing mortgage servicers’ inability or lack of effort to make their records match debtors’ plans or to comply with the requirements of the Bankruptcy Code, such as disclosing fees and costs).

76. See MODEL RULES OF PROF. CONDUCT pmb. para. 2 (2007) (“As advocate, a lawyer zealously asserts the client’s position under the rules of the adversary system.”).

cases often originate months or years earlier and are equally likely to occur when a borrower is in default but does not file for bankruptcy.⁷⁷

Bankruptcy courts have repeatedly expressed frustration with mortgagees' failure to provide complete and accurate information.⁷⁸ Courts and litigants have struggled to obtain comprehensible records from servicers. In *Maxwell v. Fairbanks Capital Corp.*,⁷⁹ 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."⁸⁰ 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."⁸¹ The court held that this behavior violated both federal and state law.⁸² After the court's ruling on liability, the debtor settled the case for a full discharge of her mortgage and \$125,000 in damages and attorneys fees.⁸³

Other courts have identified a similar pattern of confusing or incomplete record keeping 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.⁸⁴ The judge stated, "The poor quality of the 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 the products generated by lenders and loan servicers in court proceedings."⁸⁵ In some instances, mortgagees apparently are unable to offer any accounting to support their claims. In *Litton Loan Servicing v. Garvida*,⁸⁶ when the servicer failed to respond to a court order to provide information, the bankruptcy appellate panel affirmed that a downward adjustment of the mortgagee's claim was an appropriate

77. Email from Keith M. Lundin, Bankr. Judge, U.S. Bankr. Court for the Middle Dist. of Tenn., to Henry J. Sommer (July 12, 2004) (on file with the Texas Law Review) (recounting the discussion at a session on mortgage-servicing problems in Chapter 13 cases, which occurred at a 2004 National Association of Chapter 13 Trustees meeting). The grievances aired were: (1) servicers are unable to prepare correct pre-petition claims in Chapter 13 cases; (2) proofs of claim are filed without balances or are bloated with illegal and fraudulent fees sometimes totaling several thousand dollars; (3) irreconcilable and unexplained balances appear on amended proofs of claim; (4) servicers provide no contact information; and (5) servicers refuse to provide loan payment histories. *Id.*

78. See Hildebrand, *supra* note 45, at 40 (describing judges' critical responses to mortgagees' "deplorable records").

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

80. *Id.* at 114.

81. *Id.* at 117.

82. *Id.* at 120, 132.

83. Agreement for Judgment at 2, *In re Maxwell*, 281 B.R. 101 (No. 00-142383) (on file with the Texas Law Review).

84. *In re Wines*, 239 B.R. 703, 706 (Bankr. D.N.J. 1999).

85. *Id.* at 709.

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

remedy.⁸⁷ Another court reduced a mortgagee's claim under the equitable theory of recoupment after finding that the servicer violated the Real Estate Settlement Procedures Act⁸⁸ (RESPA) by failing to respond to the debtor's requests for an account balance.⁸⁹ 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 explanation of the debtor's default prior to foreclosing on the debtor's house?"⁹⁰ In some instances, creditors have paid the price for their attorneys' poor record keeping. In *In re Hight*,⁹¹ the court disallowed the portion of a mortgagee's claim that pertained to attorneys fees because neither the creditor nor its law firm could provide evidence of the legal work, such as the hourly rate or the time spent.⁹² 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 \$60,300.03.⁹³ The inaccuracy likely stemmed from the claimant's mistake in reporting the cost of the insurance policy that the servicer forced on the debtor after the debtor's insurance lapsed. These types of problems led a prominent Chapter 13 trustee to conclude that mortgage servicing in bankruptcy is in a "sad state."⁹⁴

Mortgage-servicing problems have surfaced in other procedural contexts besides proofs of claim. The nature of this misconduct is rarely due to the posture of the case, however, and similar problems may infect mortgage claims or nonbankruptcy servicing. For example, bankruptcy motions for relief from the automatic stay put debtors at direct risk of losing their homes in a state-law foreclosure action. This context may spur debtors and their attorneys to respond by confronting 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.⁹⁵ Courts have lamented mortgage servicers' practice of filing motions to vacate the automatic stay based on nonexistent records or inaccurate information stemming from poor accounting practices, and have

87. *Id.* at 707–08.

88. 12 U.S.C. § 2617(c)(1) (2006).

89. *See In re Thompson*, 350 B.R. 842, 852 (Bankr. E.D. Wis. 2006) (explaining that the debtors could reduce the amount of the claim via recoupment even though RESPA does not explicitly authorize it).

90. *Id.* at 844–45.

91. No. 07-36683, 2008 WL 3539802 (Bankr. S.D. Tex. Aug. 13, 2008).

92. *Id.* at *13.

93. Proof of Claim, *In re Farmer*, No. 04-35273 (Bankr. D. Mass. June 1, 2004) (on file with the Texas Law Review).

94. *See Hildebrand, supra* note 45, at 10.

95. *See, e.g., In re Schuessler*, 386 B.R. 458, 492–93 (Bankr. S.D.N.Y. 2008) (imposing sanctions requiring the creditor to pay the debtors' attorneys fees and costs caused by the filing of an unsubstantiated motion for relief from the stay); *In re Parsley*, 384 B.R. 138, 180 (Bankr. S.D. Tex. 2008) (finding that an attorney's misrepresentation of the stay-relief motion was conducted in bad faith, but declining to impose sanctions).

rejected what one court termed the mortgage servicers' "dog ate my homework" excuses for such problems.⁹⁶ These courts have emphasized two main harms: (1) damage to the judicial process when a court is asked to rule on incorrect or baseless facts, and (2) the danger that a family will lose its home without just cause and in violation of the Bankruptcy Code.

In *Jones v. Wells Fargo Home Mortgage*,⁹⁷ the court identified a variety of accounting errors and impermissible behavior by a mortgage company, including miscalculations of both pre-petition and post-petition obligations and attempts to collect impermissible fees.⁹⁸ Wells Fargo also applied payments in violation of the debtor's confirmed Chapter 13 plan, which increased the interest charged above what was actually due.⁹⁹ 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."¹⁰⁰ In another protracted dispute, a court that initially was concerned about whether Countrywide lacked a basis for a motion for relief from the stay or may have misapplied plan payments eventually heard hours of evidence on the propriety of servicers' and attorneys' practices in bankruptcy cases.¹⁰¹ The court stated that it was "very disheartened" by the conduct of Countrywide and its attorneys, and emphasized that the court's determination that the standard for sanctions had not been met should not be interpreted as its condoning the servicing practices evidenced in the case.¹⁰²

The misapplication of plan payments purportedly results from the operation of servicers' computer software rather than human intent. Nonetheless, courts have held that the failure to comply with an order of a

96. *In re Gorshtein*, 285 B.R. 118, 126 n.4 (Bankr. S.D.N.Y. 2002).

97. 366 B.R. 584 (Bankr. E.D. La. 2007).

98. *Id.* at 591–98. 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 post-petition, nor could she detail any reason why continuous monthly monitoring of the property was necessary or reasonable." *Id.* at 598, 597–98.

99. *Id.* at 589.

100. *Id.* at 590–91. 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. *Jones v. Wells Fargo Home Mortgage (In re Jones)*, Case No. 03-16518, Adv. No. 06-01093, 2007 WL 2480494, at *8 (Bankr. E.D. La. Aug. 29, 2007) (supplemental memorandum opinion).

101. *See In re Parsley*, 384 B.R. 138, 181–82 (Bankr. S.D. Tex. 2008) (criticizing the practices of the servicer and its attorneys but determining that the standard for sanctions had not been met); *In re Parsley*, No. 05-90374, slip op. at 1 (Bankr. S.D. Tex. Feb. 12, 2007) (order requiring Countrywide to appear and show cause) (finding that the servicer and its attorneys failed to sufficiently review the debtor's payment history before filing its motion for relief from the stay, and ordering that representatives of the servicer and its attorneys appear to show cause for why they should not be sanctioned).

102. *Parsley*, 384 B.R. at 183.

bankruptcy court confirming a plan cannot be excused by the failure to develop appropriate technology.¹⁰³

Some courts also have targeted the creditors' law firms for misbehavior.¹⁰⁴ 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.¹⁰⁵ The court's opinion sternly reminds servicers and attorneys that technological "advances" do not absolve the responsible humans of their duties to the court.¹⁰⁶ 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 serving agent, or how their client came to acquire its role."¹⁰⁷ In addition, several class action lawsuits have been filed based on allegedly inappropriate efforts to collect attorneys fees in bankruptcy.¹⁰⁸

When problems are systemic, private lawsuits may be an ineffective solution. The Federal Trade Commission (FTC) 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.¹⁰⁹ The lawsuit settled in 2003 after Fairbanks agreed to pay

103. *See, e.g.*, *Payne v. Mortgage Elec. Registration Sys. (In re Payne)*, 387 B.R. 614, 625 (Bankr. D. Kan. 2008) (focusing on the fact that the creditor did not change its accounting when a homeowner filed bankruptcy, and describing how the creditor misapplied the debtor's Chapter 13 plan payments); *Nosek v. Ameriquist Mortgage Co. (In re Nosek)*, 363 B.R. 643, 650 (Bankr. D. Mass. 2007) (rejecting computer-software shortcomings as an excuse for failing to correctly apply the debtors' payments).

104. *See, e.g.*, *In re Allen*, No. 06-60121, slip op. at 7–8 (Bankr. S.D. Tex. Jan. 9, 2007) (finding that a large creditor's law firm had filed an erroneous and unsubstantiated objection to a plan's confirmation).

105. *In re Rivera*, 342 B.R. 435, 463–64 (Bankr. D.N.J. 2006).

106. *Id.* at 467; *see also Allen*, No. 06-60121, slip op. at 7 (describing the close relationship between servicers and their "outside" counsel, who receive some pleadings "set up" with data from the servicer's computer system).

107. *In re Schwartz*, 366 B.R. 265, 266 (Bankr. D. Mass. 2007). In *Schwartz*, 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. *Id.* at 269.

108. *See Harris v. First Union Mortgage Corp. (In re Harris)*, Case Nos. 96-14029-MAM & 00-11321-MAM-13, Adv. No. 99-1144, 2002 Bankr. LEXIS 771, at *10, *13, *30 (Bankr. S.D. Ala. May 10, 2002); *Slick v. Norwest Mortgage Inc. (In re Slick)*, Case No. 98-14378-MAM, Adv. No. 99-1136, 2002 Bankr. LEXIS 772, at *11–12, *25 (Bankr. S.D. Ala. May 10, 2002) (both refusing to award attorneys fees to a mortgagee for proof-of-claim-preparation fees that were not fully disclosed to the mortgagor). In Nevada, a proposed class action suit 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. *See In re Dunlap*, Case No. 03-14317, Adv. No. 03-1429, slip op. at 1–4 (Bankr. D. Nev. Jan. 26, 2005) (describing the facts of the case).

109. The National Consumer Law Center's Web site lists the *Fairbanks Capital Corp.* case as one of its recent successes and provides the pertinent case documents. Nat'l Consumer Law Ctr., Examples of NCLC's Litigation, http://www.consumerlaw.org/action_agenda/cocounseling/eamples_litigation.shtml#fairbanks; *see also* Complaint for Permanent Injunction and Other Equitable Relief and Monetary Civil Penalties at 1–2, *United States v. Fairbanks Capital Corp.*, No. 03-12219 (D. Mass. Nov. 12, 2003), available at <http://www.consumerlaw.org/initiatives/>

\$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.¹¹⁰ Despite this victory, the FTC did not pursue any other major enforcement activities against servicers for several years until it reached a settlement with EMC Mortgage Corporation and its parent company, Bear Stearns, about mortgage-servicing practices that allegedly violated several consumer-protection laws.¹¹¹ The U.S. Department of Housing and Urban Development (HUD) also has authority to address servicing misbehavior. It enforces RESPA, which obligates mortgage servicers to provide certain information to homeowners upon receiving a “qualified written request.”¹¹² 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.¹¹³ Forty percent of consumer complaints to HUD concern servicing issues,¹¹⁴ yet HUD does not routinely investigate these complaints or collect data from servicers on compliance issues.¹¹⁵

In 2007 and 2008, the U.S. Trustee filed several complaints against Countrywide for alleged wrongdoing in servicing bankruptcy cases.¹¹⁶

mortgage_servicing/content/ftc_complaint.pdf (claiming that Fairbanks Capital engaged in “unfair or deceptive acts or practices” in violation of the Federal Trade Commission Act, the Fair Debt Collection Practices Act, and the Fair Credit Reporting Act); First Amended and Consolidated Class Action Complaint at 3, *Curry v. Fairbanks Capital Corp.*, No. 03-10895 (D. Mass. Dec. 1, 2003), available at http://www.consumerlaw.org/initiatives/mortgage_servicing/content/Consolidated_Class_Complaint.pdf (“Fairbanks has engaged in a nationwide scheme of illegal, unfair, unlawful, and deceptive practices that violate both federal and state law.”).

110. See Settlement Agreement and Release at 12, 25–27, *Curry v. Fairbanks Capital Corp.*, No. 03-10895 (D. Mass. Nov. 14, 2003), available at http://www.consumerlaw.org/initiatives/mortgage_servicing/content/settlement.pdf (providing for the creation of a \$40-million-dollar Redress Fund and for additional benefits to class members).

111. *Bear to Pay \$28 Million to Settle Loan Complaint*, N.Y. TIMES, Sept. 10, 2008, at C4; see also *Fed. Trade Comm’n v. EMC Mortgage Corp.*, No. 4:08-CV-338 (E.D. Tex. Sept. 9, 2008) (stipulated final judgment and order).

112. 12 U.S.C. § 2605 (2006).

113. 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.

114. Guttentag, *supra* note 19.

115. For example, on its Web site, HUD lists eight categories of complaints that consumers can file. None of the categories include mortgage servicing. U.S. Dep’t of Housing and Urban Dev., Complaints, <http://www.hud.gov/complaints> (last updated Oct. 6, 2006) [hereinafter U.S. Dep’t of Housing and Urban Dev., Complaints]. In addition, HUD does not make available any data sets on mortgage-servicing abuse. See U.S. DEP’T OF HOUSING AND URBAN DEV., DATA SETS AVAILABLE FROM HUD USER 4–10, available at <http://www.huduser.org/Datasets/datasets06.pdf> (describing the data sets that are available from HUD).

116. See Peg Brickley, *Countrywide Deal with Critic is Disputed*, WALL ST. J., Aug. 11, 2008, at A3 (reporting that the Justice Department has brought actions in Pittsburgh, Atlanta, Ohio, and Florida for purported misbehavior by Countrywide in consumer bankruptcy cases); Carrie Teegardin, *Couple Lose Home in Countrywide Dispute, but May Yet Win*, ATLANTA J.–CONST.,

However, the U.S. Trustee may have limited powers to pursue such remedies. A court has dismissed one of the actions that the U.S. Trustee filed against a mortgage servicer, ruling that the agency does not have the authority to bring legal action to request monetary sanctions against creditors that have engaged in abusive practices.¹¹⁷ The court also refused to grant the injunction that the U.S. Trustee requested.¹¹⁸ This decision may undermine the potential of the U.S. Trustee to protect bankruptcy debtors, although other courts have affirmed the right of the U.S. Trustee to participate in litigation that could result in sanctions against creditors for abusive practices.¹¹⁹ Clearly, the U.S. Trustee does not have regulatory authority to investigate or challenge mortgage-servicing abuse outside the bankruptcy system.

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 consumers who may face foreclosure in the next few years,¹²⁰ and the hundreds of thousands of homeowners who file for Chapter 13 bankruptcy to save their homes each year,¹²¹ there is a definite need to probe the reliability of mortgage 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 home ownership.

II. Methodology

The Mortgage Study is a large, multistate study of the home loans of families in financial distress. Its principal objective is to create an original database to facilitate new research on the intersection of mortgage lending and bankruptcy. Tara Twomey¹²² and I are the principal investigators in the

Mar. 30, 2008, at 1E (describing the U.S. Trustee's involvement in a Georgia bankruptcy case after the debtor lost her home to foreclosure despite filing for bankruptcy).

117. See, e.g., *Walton v. Countrywide (In re Sanchez)*, Case No. 01-042230, Adv. No. 08-1176, slip op. at 5 (Bankr. S.D. Fla. Oct. 2, 2008) (memorandum opinion and order granting Countrywide's motion to dismiss) (holding that the U.S. Trustee does not have authority to "pursue punitive sanctions on behalf of the public by way of an adversary proceeding").

118. *Id.*

119. See, e.g., *In re Parsley*, 384 B.R. 138, 145-47 (Bankr. S.D. Tex. 2008) (finding that the U.S. Trustee acted within its authority in participating in show-cause proceedings against a mortgage servicer and its attorneys); see 11 U.S.C. § 307 (2006) (granting wide authority to the U.S. Trustee in bankruptcy cases).

120. Press Release, Pew Charitable Trusts, 1 in 33 Homeowners Projected to Be in Foreclosure Within the Next Two Years (Apr. 16, 2008), available at http://www.pewtrusts.org/news_room_detail.aspx?id=37950.

121. Ben Rooney, *Bankruptcy Filings Surge to 1 Million—Up 29%*, CNNMONEY.COM, Aug. 27, 2008, <http://money.cnn.com/2008/08/27/news/economy/bankruptcy/>.

122. 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.

Mortgage Study, which was funded by the National Conference of Bankruptcy Judges' Endowment for Education.¹²³

The Mortgage Study sample contains 1,733 Chapter 13 bankruptcy cases filed by homeowners. The sample includes cases from forty-four judicial districts in twenty-three states and the District of Columbia, which represented 61% of all Chapter 13 cases filed in 2006.¹²⁴ The sample captures variations in local bankruptcy practices and represents all large mortgage lenders and servicers. In each district, the sample was constructed by selecting every fifth case filed in April 2006 in which the debtor owned a home.¹²⁵ If a case was converted from another chapter or if 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.¹²⁶

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.¹²⁷ The exclusive focus on Chapter 13 enhances the data's usefulness to examine bankruptcy as a home-saving device.¹²⁸ Chapter 13 is particularly attractive to homeowners who are in default on their mortgage loans because it permits them to retain their homes by curing arrearages over time through repayment plans.¹²⁹ Although the data are only

123. The Endowment for Education is a nonprofit and nonpartisan organization. In funding the grant, the Endowment does not endorse or express any opinion about the methodology utilized, any conclusions, opinions, or results contained in this Article, or any other findings based on the research funded by the Endowment.

124. Am. Bankr. Inst., Annual Non-business Filings by Chapter (2000–2006), <http://www.abiworld.org/AM/AMTemplate.cfm?Section=Home&CONTENTID=47461&TEMPLATE=/CM/ContentDisplay.cfm>.

125. 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.

126. For example, the sample contains only two cases from Wyoming, a district with few Chapter 13 filings. 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.

127. Data from the Consumer Bankruptcy Project III (CBP) indicate that home ownership is much more prevalent among Chapter 13 debtors than Chapter 7 debtors. In the CBP's core sample of 1,250 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. The CPB data are on file with the author.

128. Scarce data exist on how homeowners fare in bankruptcy. See Melissa B. Jacoby, *Bankruptcy Reform and Homeownership Risk*, 2007 U. ILL. L. REV. 323, 345 ("Although scholars of mortgage debt and foreclosure generally are aware that some bankruptcy filers own homes, chapter 13's specific anti-foreclosure function has not received sufficient scholarly attention."). The most extensive study to date was based on cases filed in 2001 and did not rely on proofs of claim or home-loan documents. See Bahchieva et al., *supra* note 1, at 94 (detailing the sources of data collected for the 2001 study).

129. See 11 U.S.C. § 1322(b)(3), (b)(5) (2006) (providing for a bankruptcy-repayment plan to cure a default on a debtor's primary residence).

from Chapter 13 cases, the rules and procedures to ensure accurate bankruptcy claims are identical for Chapter 7 cases.¹³⁰ However, mortgage claims are much less frequently filed in Chapter 7 cases because there are fewer homeowners who file Chapter 7, and also because Chapter 7 does not offer the remedies to homeowners in default that Chapter 13 does.¹³¹

Second, the sample was drawn only from districts where the applicable state law permits nonjudicial foreclosures of debtors' principal residences.¹³² We limited the sample in this way because the more favorable remedies available to mortgagees in nonjudicial-foreclosure states may reduce servicers' incentives to negotiate with consumers after default. That is, because nonjudicial foreclosure is faster and less expensive for creditors than judicial foreclosure,¹³³ debtors may have a greater need to file bankruptcy in nonjudicial-foreclosure states to contest a foreclosure. Restricting sampling to states that permit nonjudicial foreclosure probably boosted the proportion of homeowners in default on mortgage loans in the sample. Nevertheless, because bankruptcy law is uniform nationally on the requirements for proofs of claim and the rights of homeowners with mortgages in default, a random national sample, including judicial-foreclosure states, may not produce different data.¹³⁴

130. *See, e.g.*, FED. R. BANKR. P. 3001 (describing the procedures for claims, without differentiation for various chapters of bankruptcy relief).

131. *See* Jacoby, *supra* note 128, at 327–28 (reviewing the additional legal tools available to defaulting mortgage borrowers filing under Chapter 13 as compared to Chapter 7).

132. Our sample represents 49% of the judicial districts in the United States. The sample includes twenty-three states in addition to the District of Columbia: Alabama, Arkansas, California, Colorado, 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.

133. *See* BARLOW BURKE, REAL ESTATE TRANSACTIONS 336 (4th ed. 2006) (discussing nonjudicial power-of-sale foreclosure and stating that it is both cheaper and faster than judicial foreclosure); GRANT NELSON & DALE WHITMAN, REAL ESTATE FINANCE LAW 636 (5th ed. 2007) (characterizing the rationale of power-of-sale foreclosure as removing the “substantial additional burdens” of judicial foreclosure). 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. BURKE, *supra*, at 334. Nonjudicial foreclosure typically proceeds under a deed of trust that permits a third-party trustee, upon default, to sell the property in a private sale. *See id.* at 336 (identifying the deed of trust as “the more commonly used form of security instrument” in a power-of-sale foreclosure, and noting that the individual conducting the sale under this system will usually be a trustee). Although some public notice is required by all states, a nonjudicial foreclosure, as its name suggests, does not require court supervision or the filing of a lawsuit. *See id.* at 337 (describing how a power-of-sale foreclosure relieves mortgagees of the burden of initiating litigation to enforce a lien).

134. For those cases in which a foreclosure was filed before bankruptcy, it is possible that in judicial-foreclosure states the lenders were more likely to have retained attorneys before the bankruptcy than in nonjudicial-foreclosure states. It is unclear if such attorney involvement would result in more complete or accurate bankruptcy pleadings.

Data were drawn from the public court records filed in each case.¹³⁵ Like other leading studies of consumer bankruptcy, we coded data from debtors' schedules.¹³⁶ Filed under penalty of perjury, these schedules may provide more complete and reliable evidence of debtors' financial situations than survey or interview methods.¹³⁷ For each case, we coded the debtor's income; the debtor's valuation of the home; and any information about mortgage obligations on the debtor's principal residence,¹³⁸ including total debt, any arrearages, and the amount of monthly payments.¹³⁹

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: (1) the proof of claim itself; (2) an itemization of the amount claimed; (3) a copy of the mortgage that secured the obligation; and (4) 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

135. Most documents were obtained from the Public Access to Court Electronic Records (PACER) service. 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 our 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 U.S. Judicial Conference, Electronic Public Access Fee Schedules, (effective Mar. 11, 2008), available at http://pacer.psc.uscourts.gov/documents/epa_feesched.pdf. When PACER did not appear to contain complete court files, we obtained paper records. For example, in the Eastern and Middle Districts of North Carolina, proofs of claim are not 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.

136. See Culhane & White, *supra* note 42, at 767 (mentioning that their study data included information from debtors' Schedule I and J filings); Scott F. Norberg & Andrew J. Velkey, *Debtor Discharge and Creditor Repayment in Chapter 13*, 39 CREIGHTON L. REV. 473, 486 n.25 (2006) (identifying their data as collected from debtors' Schedule I filings); Teresa A. 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, 219 (2006) (describing financial data used in the study as drawn from "schedules filed with the court").

137. See MANN, *supra* note 25, at 61 (suggesting that one of the problems with the Federal Reserve's Survey of Consumer Finance data is that those surveyed often underreport their spending); 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) (asserting that a 1995 survey understates household borrowing on bankcards because survey participants "substantially underreport their bankcard debt").

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

139. We coded data from each debtor's docket; petition; Schedules A, C, D, I, and J; Form B22; and 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 separate 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 ability to gauge the amount of their mortgage debts.

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 cases with only one mortgage loan, we coded 152 data points; when debtors had more loans, there were more data points to capture.¹⁴⁰ 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, which occurred six months after a case's filing, did not locate a mortgagee's 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 were missed in the initial coding. These were added to the database. To reduce concerns about coding reliability, we used only three coders, each of whom either has a law degree 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 and corrected any identified errors.¹⁴¹ Second, a random sample of 10% of the cases—approximately 175 cases—was recoded blindly, 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.¹⁴²

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

140. The exact number of data points actually coded varied across cases 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.

141. Two examples illustrate this type of check: (1) we reviewed any proof of claim dated before April 2006, when the cases were filed; and (2) we checked for any dollar figures that began with a decimal point or exceeded \$1 million.

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

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 the 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.¹⁴³ 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.¹⁴⁴

Creditors who file claims are required to use Official Form 10 or a similar document that substantially conforms to the form.¹⁴⁵ Form 10 directs creditors to attach an itemized statement if their claim "includes interest or other charges" in addition to the principal amount.¹⁴⁶ 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:¹⁴⁷ (1) a copy of the writing if one evidences the claim,¹⁴⁸ and (2) evidence of perfection if the creditor asserts a security interest in the property of the debtor.¹⁴⁹

143. See Official Bankruptcy Form 10 (2007), *supra* note 41 (requiring a creditor who fills out a proof of claim for a secured claim to state the value of property that is collateral for the debt, attach copies of documentation of the lien, and state the amount past due on the claim (the arrearage) as of the date the bankruptcy case was filed). Note that the proof-of-claim form has been amended slightly and that the new version will go into effect in December 2008. See Official Bankruptcy Form 10 (2008), available at http://www.uscourts.gov/rules/BK_Forms_Pending_2008/B10_Form10_1208.pdf.

144. As noted in Part II (Methodology), we checked for proofs of claim at two points—six months after each case's filing date and over one year after each case's filing date—to ensure the completeness of the proof-of-claim data. For a discussion of mortgagees' incentives to file claims, see *supra* text accompanying notes 41–46.

145. FED. R. BANKR. P. 3001(a).

146. Official Bankruptcy Form 10 (2007), *supra* note 41.

147. 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.

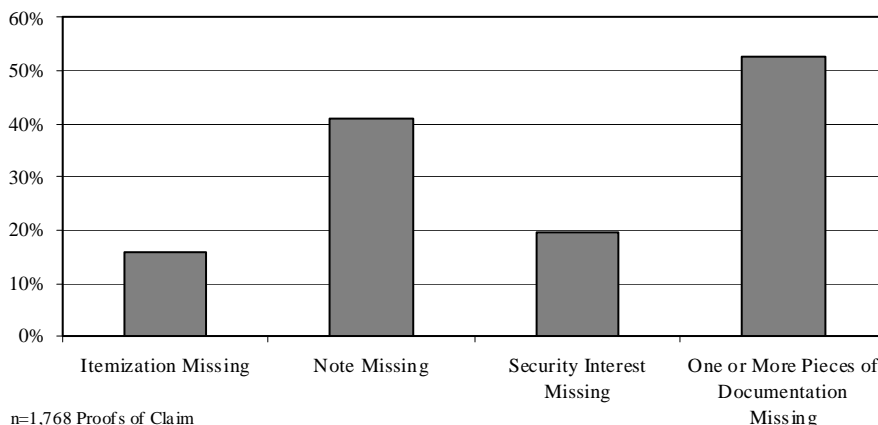
148. FED. R. BANKR. P. 3001(c) ("When a claim, or an interest in property of the debtor securing the claim, is based on a writing, the original or a duplicate shall be filed with the proof of claim.").

149. *Id.* 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.").

Requiring this trio of documentation (itemization, note, and mortgage) permits all parties in a bankruptcy case—debtor, trustee, and 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 applicable law.¹⁵⁰ 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.¹⁵¹ Nevertheless, these laws are not consistently respected. A majority of claims (52.8%) lacked one or more required attachments. Figure 1 illustrates the findings for mortgagees' proofs of claim on loans secured by a debtor's home.¹⁵² The data show that in a majority of instances mortgagees do not provide the required documentation.

Figure 1: Percentage 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 claims (16.1%) did not have any itemization attached. For the one in six claims not

150. For example, some states have specific laws that govern foreclosure costs and fees. *See, e.g.*, MICH. COMP. LAWS § 600.2431 (2007) (capping attorneys fees in a nonjudicial foreclosure at no more than \$75 if the mortgage does not specifically contract for such attorneys fees).

151. *See, e.g.*, FED. R. BANKR. P. 3001 advisory committee's notes (indicating that the requirements for mortgage proofs have remained largely identical since at least 1983).

152. 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 to determine whether creditors responded if a party objected or requested information.

supported by an itemization, the debtor and other parties are unable to discern the specific bases for the creditor's asserted right to be paid the total amount of the claim. Further, the usefulness of these itemizations varied greatly.¹⁵³

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 out 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 does not provide one, the servicer has an informational advantage, which Rule 3001 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 as 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.¹⁵⁴ In subprime loans, such terms are nonstandard and may vary widely, increasing the importance of having a copy of the note. Third, a copy of the note is necessary to trace the ownership of the obligation and to ensure that a creditor has standing to bring an action to collect from a debtor. As an avalanche of securitized home loans have entered default in the last year, courts have become frustrated at the difficulty in determining the chain of title of the note.¹⁵⁵ 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.

153. See *infra* subpart III(B).

154. In most instances, the note contains broad language on charges and costs. For example, the Fannie Mae uniform instrument gives the noteholder 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." Fannie Mae, Multistate Fixed-Rate Note—Single Family 1 (instrument revised Jan. 2001), available at <https://www.efannie.com/sf/formsdocs/documents/notes/pdf/3200.pdf>. Even under this broad language, debtors may have challenges to the mortgagees' claims. 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.

155. See *Nosek v. Ameriquest Mortgage Co. (In re Nosek)*, 386 B.R. 374, 383–85 (Bankr. D. Mass. 2008) (imposing monetary sanctions on Ameriquest, Wells Fargo, and several attorneys for misrepresenting the identity of the holder of the note in bankruptcy proceedings); see also *In re Foreclosure Cases*, 521 F. Supp. 2d 650, 654 (S.D. Ohio 2007) (dismissing foreclosure cases for lack of standing when ownership of the note was not established).

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.¹⁵⁶

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 this finding on security interests 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,¹⁵⁷ Congress imposed audits on debtors' schedules to ensure full disclosure of assets¹⁵⁸ and permitted dismissal of debtors' cases as a penalty for failing to provide documentation.¹⁵⁹ These laws evidence Congress's 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 system.¹⁶⁰ The failure of approximately 20% of creditors to attach security interests to their claims damages the structural integrity of the process to ensure that claims are accurate and that 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

156. See John Rao, *Debt Buyers Rewriting of Rule 3001: Taking the "Proof" Out of the Claims Process*, AM. BANKR. INST. J., July–Aug. 2004, at 16, 16 (stating that Rule 3001 supporting documents are not provided to purchasers of credit-card debt).

157. See Steven W. Rhodes, *A Preview of "Demonstrating a Serious Problem with Undisclosed Assets in Chapter 7 Cases"*, NORTON BANKR. L. ADVISER, May 2002, at 1, 1–2 (finding in a one-district sample that 70% of asset cases—a small fraction of all Chapter 7 cases generally—contained undisclosed or undervalued assets in the debtors' lists of assets and valuations); see also Edith H. Jones & James I. Shepard, *Recommendations for Reform of Consumer Bankruptcy Law by Four Dissenting Commissioners*, in REPORT OF THE NATIONAL BANKRUPTCY REVIEW COMMISSION 1029, 1057–58 (1997), available at <http://govinfo.library.unt.edu/nbrcreport/24commvi.pdf> ("The Commission repeatedly heard testimony that the information reported in the debtors' schedules is often unreliable.").

158. Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005, Pub. L. No. 109-8, § 603, 119 Stat. 23, 122 (codified at 11 U.S.C. §§ 521, 727 and 28 U.S.C. § 586 (2006)) (authorizing random audits of debtors).

159. *Id.* § 316, 119 Stat. at 92 (codified at 11 U.S.C. § 521(i)) (automatically dismissing a bankruptcy case if the debtor does not provide required information, such as payment advices).

160. 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.

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.¹⁶¹ Avoidance typically relegates the obligation to unsecured status in bankruptcy and significantly reduces the debtor's obligation to pay the full amount of the debt.¹⁶² Even a credible threat of avoidance could cause an allegedly secured party to lower its claim to prevent the risk of litigating 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 noncompliance 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 onto other parties in the system. The law requires creditors to prove that they are entitled to preferential treatment as secured creditors;¹⁶³ their failure to do so creates a risk that some creditors who may not in fact have valid mortgages will receive higher payments than they are entitled to under the law.¹⁶⁴

Finally, the security interest is necessary for the same reason 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, in most states the model Fannie Mae instrument requires the lender to either apply or refund partial payments within a

161. 11 U.S.C. § 544 (2006). This provision is commonly called the "strong arm" power because it permits the trustee to "knock off" security interests that are not properly perfected under state law to defeat certain other types of creditors.

162. See WARREN & WESTBROOK, *supra* note 2, at 478 (explaining that a creditor in an avoidance action "may face the loss of its security interest or an order requiring it to pay back amounts it received from the debtor shortly before bankruptcy"); *id.* at 285 ("Just as secured creditors in Chapter 7 enjoy enhanced status and are entitled to greater repayment than unsecured creditors, the secured creditor in Chapter 13 enjoys substantially better protection than the unsecured creditor."). Without a security interest, the mortgage is an unsecured obligation. Thus, the house is immediately available to the debtor as an asset to use as collateral. After committing all disposable income for the applicable commitment period in the Chapter 13 case, a debtor then may discharge any remaining obligation on the mortgage claim because it is an unsecured debt. The combination of avoiding a security interest and completing a Chapter 13 plan results in the debtor owning the house free and clear.

163. FED. R. BANKR. P. 3001(d).

164. In addition to the failure to properly perfect 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 of a notary to witness the mortgage). See, e.g., *In re Fisher*, 320 B.R. 52, 65 (E.D. Pa. 2005) (holding that a bankruptcy trustee may avoid a mortgage under 11 U.S.C. § 544 on the basis that it was improperly proved and recorded); *In re Marsh*, 12 S.W.3d 449, 454 (Tenn. 2000) (ruling that, under Tennessee law, a deed of trust that lacks a notary seal acknowledging execution is invalid as a lien).

“reasonable period of time.”¹⁶⁵ Based on this language, a debtor could challenge a servicer’s practice of holding payments for extended periods, usually by placing the funds in “suspense accounts” and by not applying the payment to the debtor’s obligation.

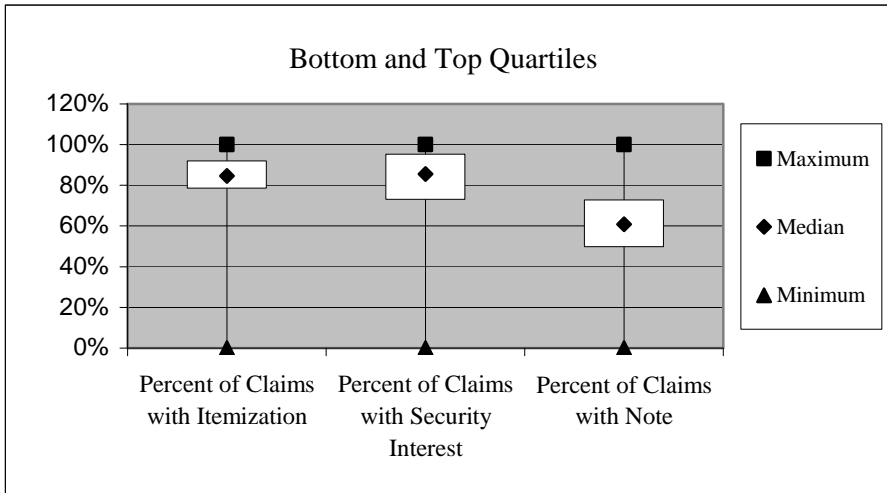
Mortgagees’ compliance with the documentation requirements for claims varied among judicial districts. Figure 2 shows the variation among districts for the three types of claims documentation.¹⁶⁶ The boxes in Figure 2 demarcate the middle two quartiles of documentation compliance. The bottom of each box shows the percentage of attached documentation in the district that was at the first quartile (i.e., 25% of districts had worse compliance). The top of each box shows the percentage of attached documentation in the district that was at the top quartile (i.e., 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 heights of the boxes in Figure 2 indicate 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% or lower, ranging all the way to zero complying claims. In these jurisdictions, a majority of claims will not be supported by copies of the notes.

165. To access the Fannie Mae/Freddie Mac uniform instruments for each state, see Fannie Mae, Legal Documents—Security Instruments, <https://www.efanniemae.com/sf/formsdocs/documents/secinstruments/#standard> [hereinafter Fannie Mae Standard Instruments]. To access the standard instrument for a particular state, follow the hyperlink in the *Standard.doc* column in the *Standard Instruments* table. Note that the standard instrument for Maine does not include “reasonable period of time” language, and the standard instrument for New Jersey requires the lender to immediately apply any payments it accepts. *Id.*

166. The top and bottom of the vertical 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 in the sample of some districts with very few cases. Because the addition of a single case could dramatically change the compliance rate in those districts, the absolute range of compliance is not very useful. Thus, the data on interdistrict variation are best used to observe a general pattern, as shown by the quartile findings.

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.¹⁶⁷ While uniformity challenges to bankruptcy law have had little success,¹⁶⁸ the variations in claims documentation reveal systematic differences based on where a debtor files for 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.¹⁶⁹ To the extent that uniformity is crucial to ensure the integrity of the bankruptcy system, creditors' inconsistent compliance with claims procedures is troubling. Depending on the 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 verify the accuracy of claims to debtors or

167. See U.S. CONST. art. I, § 8, cl. 4 (stating that Congress has the power "to establish . . . uniform laws on the subject of bankruptcies throughout the United States"). See generally 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) (discussing the effect of the uniformity requirement in the Bankruptcy Clause and the judicial interpretations of what constitutes uniformity).

168. See Chemerinsky, *supra* note 167, at 592–94 (cataloging unsuccessful challenges under the uniformity requirement).

169. See *supra* note 46 (describing other local-legal-culture effects in bankruptcy).

trustees. 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.¹⁷⁰ 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 form of 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' use as a tool to evaluate the propriety of a creditor's claim. First, there is no standard form for itemizations. Even with a single servicer or attorney, the itemization format and amount of detail varied.¹⁷¹ Without a standard format, itemizations cannot be reviewed using a semiautomated or routine process. In high-volume systems such as the consumer bankruptcy system, the result is to dramatically limit the scrutiny of claims. To make affordable services available to debtors, 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.¹⁷² 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 will be filed, if appropriate.

The second, and related, problem is the 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 breakout of the amount of arrears that was part of the

170. See *In re Wingerter*, No. 06-50120 (Bankr. N.D. Ohio Oct. 1, 2007) (opinion resolving a show-cause order) ("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.").

171. In some districts, the variation was obviously due to the differing practices of the attorneys 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.

172. See 11 U.S.C. § 704(1) (2006) (prescribing that the trustee shall "close such estate as expeditiously as is compatible with the best interests of parties in interest"). A trustee is potentially subject to liability to the creditors for failing to close an estate in a cost-efficient manner. See *In re C. Keffas & Son Florist, Inc.*, 240 B.R. 466, 474 (Bankr. E.D.N.Y. 1999) ("If the trustee fails to make this necessary cost-benefit analysis, then the trustee will necessarily breach the statutory mandate under 11 U.S.C. § 704(1), and incur a liability for the damages unjustifiably imposed upon the creditors . . .").

creditor's total claim. Since the proof-of-claim form itself already requires that information,¹⁷³ 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.¹⁷⁴ Despite using the servicing industry's own categories,¹⁷⁵ 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.¹⁷⁶ Among claims with debt identified only as pre-petition, the average of this type of debt was \$1,651, 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.¹⁷⁷ These vague or temporal descriptions do not meet the requirement of Form 10 to itemize any additional charges and do not permit meaningful review of the accuracy or legality of servicers' calculations of debt.

The itemizations were plagued by another troubling feature: the use of laundry-list descriptions. The most common such label in the sample was "Inspection, Appraisal, NSF, and other charges."¹⁷⁸ 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

173. Official Bankruptcy Form 10 (2007), *supra* note 41.

174. Each charge was categorized as one of the following: principal, interest, escrow, late charges, foreclosure fees or costs, nonsufficient funds charges, property inspection fees, broker price opinions or appraisals, corporate 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.

175. The categories set out above, *supra* note 174, are consistent with those on the Model Proof of Claim itemization developed by a joint committee of Chapter 13 trustees and mortgage servicers. See NAT'L ASS'N OF CHAPTER 13 TRUSTEES MORTGAGE COMM., MODEL PROOF OF CLAIM ATTACHMENT 2-3 (2007) [hereinafter MODEL PROOF OF CLAIM ATTACHMENT]. This model proof of claim attachment was included in a 2007 report issued by the National Association of Chapter 13 Trustees Mortgage Committee. NAT'L ASS'N OF CHAPTER 13 TRUSTEES, REPORT OF MORTGAGE COMMITTEE (2007) [hereinafter REPORT] (on file with the Texas Law Review).

176. Charges or amounts labeled merely as pre-petition were identified in sixty-three claims, fewer than 5% of all claims. This count excludes any fees labeled as "pre-petition attorneys' fees."

177. For example, one claim's "itemization" listed \$5,391 described only as "other." Another claim requested \$3,023 for "delinquency expenses."

178. "NSF" stands for nonsufficient funds.

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 nonsufficient 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 causes 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 servicer 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 by the terms of the contract. The case law described in Part I shows that when courts scrutinize the nature of mortgage claims, they frequently find evidence of servicer misbehavior.¹⁷⁹ 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 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 enough 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.

179. *See supra* Part I.

Table 1: Actual Fees from Mortgagees' Claims

<i>Description</i>	<i>District</i>	<i>Fee Amount</i>
Attorneys fees	Western District of Virginia	\$31,273
Bankruptcy fees & costs	Northern District of Georgia	\$2,275
Broker price-opinion fee	Eastern District of Arkansas	\$1,489
Demand fee	District of Massachusetts	\$145
Overnight delivery	Eastern District of Michigan	\$137
Payoff-statement fee	Southern District of California	\$60
Fax fee	Eastern District of Virginia	\$50

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

The first legal constraint on fees and charges is private contract law. The note and mortgage themselves are agreements that limit the parties' obligations.¹⁸⁰ 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.¹⁸¹ 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.¹⁸² While this language is quite broad, it is not

180. This point reinforces the problems created when claims are not supported by this documentation, particularly for subprime loans that do not conform to Fannie Mae's or Freddie Mac's standards.

181. For example, one of the notes from a Tennessee case included in the Mortgage Study sample 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."

182. See Fannie Mae Standard Instruments, *supra* note 165. In almost all states, the Fannie Mae standard instrument provides:

If [Borrower defaults (including 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

unlimited. For example, at least one court has held that payoff fees are impermissible because they constitute a nonreimbursable expense under the terms of the note.¹⁸³ Another court ruled that a servicer could not charge a homeowner for property inspections because it had failed to give the debtor notice of the inspections as required by the note.¹⁸⁴ 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.¹⁸⁵ 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 that appear on proofs of claim simply are not legal. Some states prohibit the “pyramiding” of late fees¹⁸⁶ or have promulgated specific rules about the use of suspense accounts to hold partial payments in abeyance.¹⁸⁷ 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 one securitization agreement, despite the fact that varying state law actually applies to the loans. 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.¹⁸⁸ For example, the

attorneys’ fees to protect its interest in the Property and/or rights under this Security Instrument, including its secured position in a bankruptcy proceeding.

Id. The standard instruments of Georgia, New York, and Wisconsin include substantially similar language. *Id.* Maine’s standard instrument provides that the lender may “do and pay for whatever is necessary to protect the value of the Property and Lender’s rights in the Property.” *Id.*

183. *See, e.g.,* *Dougherty v. N. Fork Bank*, 753 N.Y.S.2d 130, 131 (N.Y. App. Div. 2003) (holding that the payoff-quote fee of \$25 was not permissible under state law); *see also* GA. CODE ANN. § 7-6A-3(4) (2004) (generally prohibiting a payoff fee but allowing a limited fee of \$10 if the borrower requests a faxed copy of the payoff amount or has made other recent payoff requests).

184. *In re Stewart*, 391 B.R. 327, 344–45 (Bankr. E.D. La. 2008).

185. *See* Michael LaCour-Little, *The Evolving Role of Technology in Mortgage Finance*, 11 J. HOUSING RES. 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.”).

186. The standard Fannie Mae note seems to prohibit the pyramiding of late fees, stating that the borrower will pay a late charge “only once on each late payment.” *See* Fannie Mae Standard Instruments, *supra* note 165. Some transactions use different notes (and thus, it is important that a copy of the note accompanies the proof of claim), and some servicers may not honor the terms of the notes, either intentionally or inadvertently.

187. *See* JOHN RAO ET AL., NAT’L CONSUMER LAW CTR., FORECLOSURES: DEFENSES, WORKOUTS, AND MORTGAGE SERVICING 154–55 (2d ed. 2007) (discussing the use of suspense accounts).

188. 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.” Official Bankruptcy Form 10 (2007), *supra* note 41. This arguably requires not just the note to show the existence of the original debt, but also a current payment history that supports that the debtor actually owes the amount of the claim.

payment history may show that the servicer imposed late charges on the homeowner, despite the fact that the homeowner's check cleared the bank before the payment was due,¹⁸⁹ or that the servicer held funds in suspense accounts without application to the amount due.¹⁹⁰

Some servicing practices may constitute consumer abuse. For example, the FTC alleged that Fairbanks Capital Corporation had engaged in an unfair or deceptive practice by repeatedly and unnecessarily assessing property-preservation fees, which usually means an agent drove by the property to determine its condition.¹⁹¹ 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.¹⁹² Nonetheless, servicers continue to be faulted for conducting an unreasonable number of inspections.¹⁹³ One bankruptcy court has stated that it is "done allowing lenders reimbursement for property inspections," unless the lenders can show "that those property inspections actually happened and that they're worthwhile."¹⁹⁴ 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.¹⁹⁵ 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 \$1,489 sum represents several inspections, the servicer should have separated these charges in its detail of fees.

189. See, e.g., *In re Ocwen Fed. Bank FSB Mortgage Servicing Litig.*, Case No. 04-CV-2714, MDL-1604, 2006 WL 794739, at *1 (N.D. Ill. Mar. 22, 2006) (denying a motion to dismiss a multidistrict litigation suit that alleged, *inter alia*, that the servicer misapplied payments and improperly imposed late fees).

190. Most loan instruments specify how payments are to be applied, and violations of this language are potential breaches of contract.

191. See *United States v. Fairbanks Capital Corp.*, No. 03-12219, 2004 WL 3322609, at *1 (D. Mass. May 12, 2004) (approving the settlement agreement of the FTC's deceptive-trade claims against Fairbanks Capital Corporation).

192. *United States v. Fairbanks Capital Corp.*, No. 03-12219 (D. Mass. Nov. 21, 2003) (order preliminarily approving stipulated final judgment), available at www.ftc.gov/os/2003/11/0323014_order.pdf.

193. See *In re Stewart*, 391 B.R. 327, 343-45 (Bankr. E.D. La. 2008) (criticizing a servicer for inspecting the debtor's property on average every fifty-four days after default, notwithstanding that every inspection reported the property to be in good condition).

194. Transcript of Hearing at 3, *In re Waring*, No. 06-40614 (Bankr. D. Mass. July 27, 2007).

195. In addition to the example given in Table 1, two different proofs of claim from the Northern District of Texas requested payment of property-preservation fees of \$105; another property-preservation fee from the Southern District of Georgia was \$240. 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. See *supra* notes 176-78 and accompanying text.

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.¹⁹⁶ 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.¹⁹⁷ 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 claims.¹⁹⁸ Instead, creditors must file fee applications pursuant to Federal Rule of Bankruptcy Procedure 2016.¹⁹⁹ Other courts have reached a contrary conclusion and permitted attorneys fees in claims.²⁰⁰ Some courts have modified this approach, requiring that the disclosure of the attorneys fees be "specific,"²⁰¹ or ruling that while including fees is *prima facie* permissible, a fee application will be required only if the debtor objects to the fees.²⁰² These inconsistent rulings make it more difficult for both servicers and

196. See generally U.C.C. § 2-302 (2004) (acknowledging the authority of courts to void unconscionable portions of a contract).

197. In the remainder of this subpart, 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.

198. See, e.g., *Tate v. NationsBanc Mortgage Corp.*, 253 B.R. 653, 655–56 (Bankr. W.D.N.C. 2000) (ruling that a creditor cannot "hide" attorneys fees for preparing a proof of claim in the claim itself without court approval).

199. See *In re Ezzell*, No. 07-34780, slip op. at 5–6 (Bankr. S.D. Tex. Jan. 14, 2008) (disallowing attorneys fees for failure to comply with Rule 2016); *Tate*, 253 B.R. at 665 (ruling that a creditor's attempts to claim attorneys fees under a proof of claim is a violation of Rule 2016); see also FED. R. BANKR. P. 2016 (setting forth the application requirements for an entity seeking compensation for services from the bankruptcy estate).

200. See, e.g., *Atwood v. Chase Manhattan Mortgage Co. (In re Atwood)*, 293 B.R. 227, 232 (B.A.P. 9th Cir. 2003) (rejecting *Tate's* reasoning and holding that a proof of claim satisfies the due process requirements for recovering attorneys fees).

201. See, e.g., *In re Madison*, 337 B.R. 99, 103, 103–04 (Bankr. N.D. Miss. 2006) ("[T]he attorney fees, costs and charges must be itemized so that any interested party may object if so desired."); *Powe v. Chrysler Fin. Corp. (In re Powe)*, 281 B.R. 336, 347 (Bankr. S.D. Ala. 2001) (concluding that fees labeled "attorneys fee" or "atty fee" were not specific enough to provide the requisite notice of the nature of the fee).

202. See, e.g., *In re Plant*, 288 B.R. 635, 644 (Bankr. D. Mass. 2003) (holding that there is no need for a creditor to incur the time and expense of preparing a fee application absent a challenge by a debtor).

attorneys to know how to handle these charges in preparing bankruptcy claims.

The amounts of attorneys fees 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.²⁰³ Because the fees varied within judicial districts, the discrepancy does not seem to be attributable merely to regional cost differences.²⁰⁴ 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.²⁰⁵ Given the nonexistent or minimal scrutiny of most mortgage claims,²⁰⁶ 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 bankruptcy fees to collect “monitoring” fees due to the purported additional burden of having to service a loan in bankruptcy.²⁰⁷ In other instances, servicers may seek to impose bankruptcy fees for the purported administrative costs of preparing proofs of claim.²⁰⁸ If such work

203. A review of the claims in the Mortgage Study shows that the bankruptcy fee of Bank of America was \$250. Yet, Chase Home Finance, LLC imposed a bankruptcy fee of half that amount, or \$125. Because these lenders are large, national institutions, 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 mortgages are held by Bank of America must pay \$125 more than debtors whose mortgages are held by Chase Home Finance, LLC in order to complete their plans.

204. For example, in the Eastern District of Arkansas, bankruptcy fees ranged from \$125 to \$800.

205. *See, e.g., In re Boddy*, 950 F.2d 334, 337 (Bankr. W.D. Ky. 1991) (holding that a lower court abused its discretion by employing a “normal and customary” standard, rather than a lodestar analysis, to calculate the fee award).

206. *See infra* subpart III(D).

207. 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. NAT’L ASS’N OF CHAPTER 13 TRUSTEES MORTGAGE COMM., NOTES BY MORTGAGE SERVICERS ON MORTGAGE SERVICING DURING A CHAPTER 13 BANKRUPTCY 3–4 (2007) (included in REPORT, *supra* note 175).

208. This may be particularly true when the charge was described as “POC prep fee” or “plan review” fee. Arguably, neither of the prior-quoted activities is strictly necessary to “defend th[e] 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,” although such language commonly appears in the standard mortgage documents upon which lenders rely to collect bankruptcy fees. *See* RAO ET AL., *supra* note 187, at 176 (reproducing a provision contained in standard mortgages that a large loan-servicing company relies on to impose bankruptcy-monitoring fees). Further, the preparation or filing of a proof of claim and the review of a proposed Chapter 13 plan may not

is performed by internal employees and not by licensed attorneys, the corresponding fees cannot be claimed under the “reasonable attorneys fees” provision of the security agreements or notes.²⁰⁹ Arguably such expenses are mere costs of servicing a mortgage that the servicer was previously compensated for by the owners of the note.²¹⁰ Without better disclosure, bankruptcy courts cannot even ensure that creditors are respecting the bankruptcy law that governs attorneys fees.

Delinquency and default fees can be a substantial source of profit for servicers.²¹¹ 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 debts.

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.²¹² 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 imper-missible charges.

Anecdotal reports suggest that creditors proffer similarly vague itemizations to borrowers facing state-law foreclosure.²¹³ Indeed, given the additional safeguards inherent in the bankruptcy process, the data may understate the difficulty that nonbankrupt homeowners face in reviewing

constitute an “appearance” by the lender, which is a prerequisite to the borrower’s becoming obligated to pay the lender’s costs and expenses. *Id.*

209. *See id.* at 177 (“If all the lender is doing is ‘monitoring’ the bankruptcy, that is, receiving court notices, reading them, keeping them, and so forth, then these activities do not constitute the practice of law and should not be compensable as an attorney fee.”).

210. *See id.* (concluding that routine administrative services are generally not compensable under any reading of typical mortgage provisions that permit the recovery of costs).

211. *See* Gretchen Morgenson, *Can These Mortgages Be Saved?*, N.Y. TIMES, Sept. 30, 2007, § 3, at 1 (“Borrower advocates fear that fees imposed during periods of delinquency and even foreclosure can offset losses that lenders and servicers incur.”).

212. *See supra* subpart I(D) (discussing the *Jones v. Wells Fargo* and *In re Parsley* cases).

213. *See* Morgenson, *supra* note 211, at 8 (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 \$8,525).

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.²¹⁴ Thus, most claims seek to establish both the amounts of the arrearages and the amounts of the outstanding principal remaining on the loans. These amounts are treated differently in Chapter 13 cases. To retain their homes, debtors must "cur[e] any default within a reasonable time,"²¹⁵ 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 courts.²¹⁶ 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 discharges of remaining unsecured debt.²¹⁷ Thus, part of the pre-bankruptcy calculus that debtors and their attorneys should consider in determining whether debtors can save their homes in bankruptcy is whether they will have sufficient income to make both payments.²¹⁸ To weigh the viability of Chapter 13 bankruptcy 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 subpart analyzes data to measure whether debtors and creditors agree on the amount of 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.²¹⁹ I then measured the direction and extent of the gap between the debtor's and mortgagee's calculations of the mortgage debt.²²⁰ If the amount on the claim exceeded the mortgage debt on the

214. See *supra* note 38 and accompanying text.

215. 11 U.S.C. § 1322(b)(5) (2006).

216. See 2 LUNDIN, *supra* note 47, § 133.1 (noting that several bankruptcy courts have formulated factor tests for the reasonableness determination and citing decisions that permitted the curing of defaults for a wide variety of time periods).

217. See 11 U.S.C. § 1328(a) (requiring the debtor to complete all payments under the plan before the court may discharge debts provided thereunder).

218. See Jacoby, *supra* note 128, at 337 (arguing that the failure of debtors' lawyers to screen their clients for their ability to complete a Chapter 13 repayment plan results in more unsuitable debtors in Chapter 13 bankruptcy).

219. It was not possible to perform this matching for every home loan. Among the 2,164 home loans in the sample, only 1,768 proofs of claim were filed.

220. 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

debtor's schedule, I termed the gap in the "creditor's favor." In these instances, the creditor was asserting that more dollars were owed in the mortgage debt than the debtor believed were 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's overreporting the amount of mortgage debt.

Figure 3 shows what fraction of claims fell into each of three categories—creditor's favor, debtor's favor, and no discrepancy—based on the existence of discrepancies between the claims and the scheduled amounts of debt. Debtors and creditors agreed on the amounts owed for only 74 of 1,675 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.

Figure 3: Percentage of Claims by Type of Gap

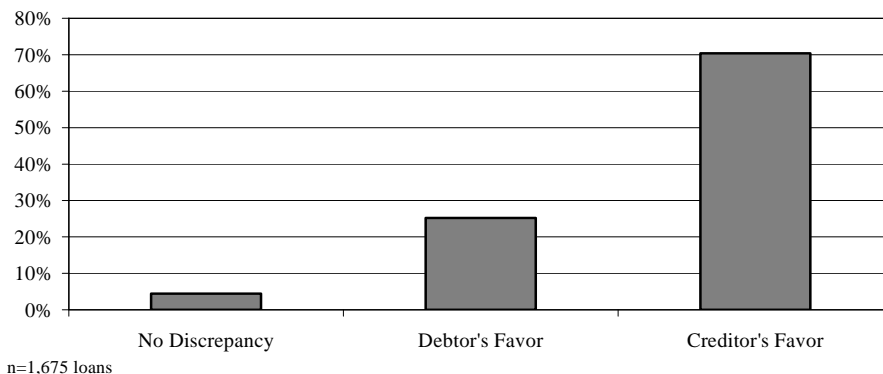


Figure 3 shows that, as an initial matter, the debtor and creditor do not agree on the amount of the debt in the vast majority of cases. The mere

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 same 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 the 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.

existence of discrepancies is not itself alarming. The findings in Figure 3 could merely reflect minor differences in record keeping. Alternatively, the claims could consistently be larger because of the addition of modest and explainable postbankruptcy charges such as accrued interest.²²¹ 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 \$1,366. The average difference between a claim and its scheduled debt was \$3,533.²²² In the typical bankruptcy, a mortgage creditor asserted that it was owed a significantly larger amount than the debtor believed was the home debt. These errors are too large to reflect small, record-keeping situations, such as a single late charge imposed since the debtor's most recent mortgage statement or a postbankruptcy property inspection.

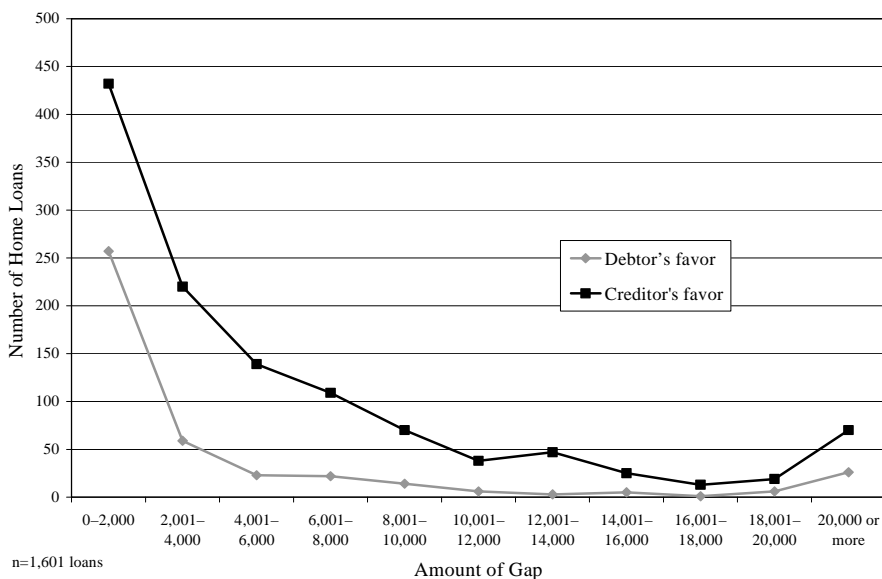
The second indication that postbankruptcy charges cannot explain most of the differences in debtors' and creditors' calculations is the existence of claims in which the debtor overestimated the amount of the debt. Postbankruptcy charges can only explain discrepancies in favor of creditors. Debtors do 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 amounts between claims and the corresponding scheduled debt. At every interval, the number of times in which the creditor's claim exceeded the scheduled amount was greater than the number of times in which the debtor 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), creditors more frequently charge more than debtors think is owed.

221. The debtors' schedules should only reflect the amount due at the time of the bankruptcy. The proof-of-claim forms should be identical, as the instructions specify that the amount should be the "Amount of Claim as of Date Case Filed." Official Bankruptcy Form 10 (2007), *supra* note 41. 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).

222. The sample size was 1,675. The analysis included those loans in which the claim amount and the scheduled amount were identical (no gap). The standard deviation for the entire sample was \$11,480.

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



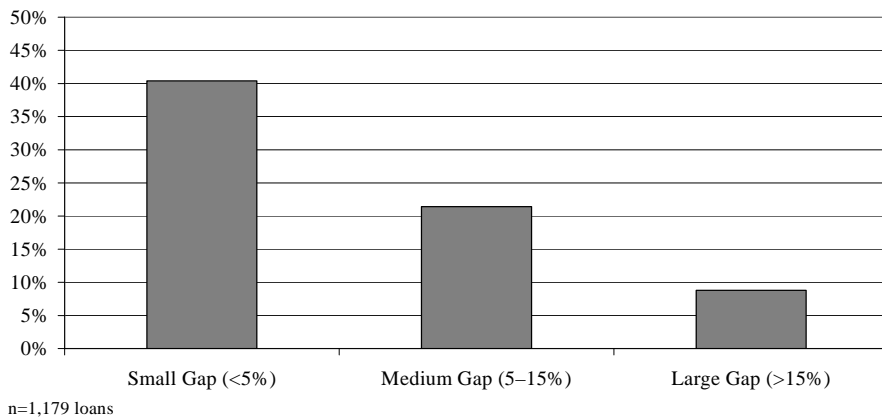
Creditor's-favor gaps were consistently larger than debtor's-favor gaps. The median gap for loans in which the claim exceeded the scheduled amount (creditor's favor) was \$3,311. The average creditor's-favor gap was \$6,309. The size of the typical gap in the debtor's favor was much less. The median was \$1,090, less than one-third of the gap for creditor's-favor loans.²²³ The bottom line in Figure 4 shows that debtor's-favor gaps were of modest amounts, with the vast majority of such differences calculated at less than \$2,000. 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 is to 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

223. The average gap among the debtor's-favor claims was \$5,376. As with the creditor's-favor claims, the size of the average reflects a substantial number of claims with very large gaps. The standard deviation of the debtor's-favor claims was \$13,704. The standard deviation for the creditor's-favor claims was \$9,143.

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 debtors on their schedules. Given their size, it seems implausible that these discrepancies resulted from valid postbankruptcy charges or an underestimation by debtors relying on the prior month's mortgage statements to complete the bankruptcy schedules. Instead, the magnitude of these differences suggests a real misunderstanding between debtors and creditors about the amounts of mortgage debt.

Figure 5: Frequency of Creditor's-Favor Gaps, Calculated as Percentage of Claimed Amount

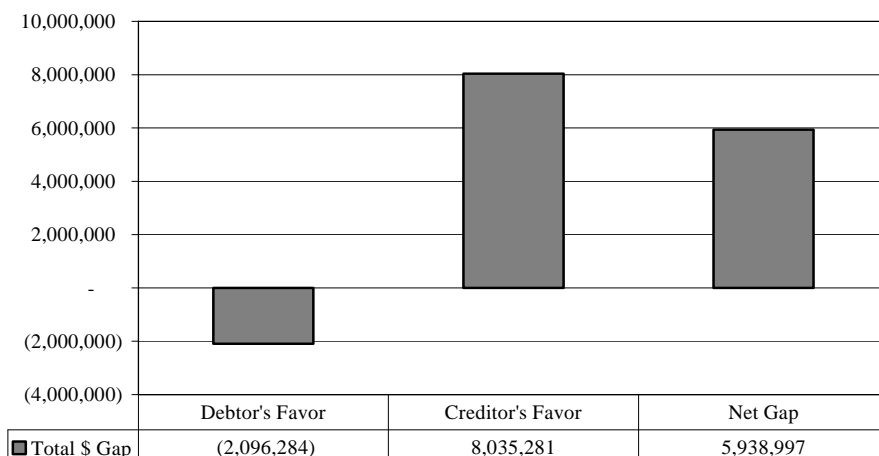


Unfortunately, the data do not permit an analysis of what portion of the disagreement about the debts relate to arrearage and what fraction, if any, is due to differing calculations of outstanding principal. Creditors and debtors were not consistent enough in separating these amounts to make any systematic 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 amounts. To the extent the

gaps between claims and scheduled amounts represent default costs, 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 multibillion-dollar problem. Based solely on the Mortgage Study sample of approximately 1,700 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,²²⁴ the cumulative effect of the discrepancies is enormous. Mortgage creditors in the sample requested nearly \$6 million more on proofs of claim than the debtors reflected on their schedules. The mismatch between debtors' and creditors' calculations tilts sharply in favor of creditors.

Figure 6: Aggregate Gap Between Claims and Scheduled Amounts



Extrapolating this finding beyond the Mortgage Study sample shows the scope of the problem for the entire bankruptcy system. About 400,000 homeowners per year have filed Chapter 13 bankruptcy in recent years.²²⁵ Multiplying the \$6 million gap from the sample of 1,700 cases to the total homeowners in Chapter 13 indicates that each year mortgagees claim over \$1

224. See Lynn M. LoPucki, *The Systems Approach to Law*, 82 CORNELL L. REV. 479, 481 (1997) (describing systems analysis as a methodology developed to manage complexity).

225. Am. Bankr. Inst., *Quarterly Non-business Filings by Chapter (1994–2008)*, <http://www.abiworld.org/AM/AMTemplate.cfm?Section=Home&CONTENTID=49785&TEMPLATE=/CM/ContentDisplay.cfm>.

billion more than debtors believed was owed. If even a small fraction of this 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 debts, 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 amounts 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 their attorneys appear to confirm the amount of the mortgage debt with the creditors at the time of the bankruptcy filing.²²⁶ The data strongly suggest that many debtors file bankruptcy without knowing how much their mortgage creditors think is owed. The problem could reflect a different phenomenon. Creditors' claims may themselves be bloated and overstate the accurate amounts of debt. Such problems could result from servicers' practices of loading claims with default fees that are not disclosed to debtors, or from mistaken calculations of the amounts due in preparing the proofs of claim. Case law has documented both effects.²²⁷

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 was 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 to Chapter 13 bankruptcy could have existed. 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's-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 analysis or the percentage analysis, they are imposing a hefty burden on debtors' disposable incomes and diverting money from unsecured creditors. Claims that are bloated by

226. Servicer practices may deter debtors from getting such information. As explained above in subpart 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 "payoff" or "statement" fees discourages debtors from making account inquiries.

227. See *supra* text accompanying notes 86–91.

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. Debtors attorneys should obtain up-to-date statements of their clients' mortgage obligations from creditors before counseling debtors to file Chapter 13. Then, after a bankruptcy is filed, attorneys and debtors should verify the accuracy and reasonableness of the mortgagees' claims, examining the source of any discrepancies between the claims and the scheduled amounts. To enable this latter practice, creditors must be held to the evidentiary standard for proofs of claim 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 three Parts of this Article offer a trio of indicia that undermine confidence in the claims system. Mortgagees often presented claims without required documentation;²²⁸ many claims contained requests for suspicious fees;²²⁹ and mortgagees' claims and debtors' records were rarely identical.²³⁰ The proof-of-claim process has an existing, internal mechanism to address such problems. Under § 502(a) of the Bankruptcy Code, any party in interest may object to a claim.²³¹ If such an objection is made, "the court, after notice and a hearing, shall determine the amount of such claim."²³²

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 1,768 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 did not object to mortgagees' claims—even when such claims did not meet the standard for prima facie validity because the claims did not comply with the unambiguous requirements of Rule 3001;²³³ even when such claims contained vague or suspicious fees; and even when such claims exceeded the debtors' calculations of their debts by thousands of dollars. A debtors attorney who has developed a training program to educate attorneys about mortgage-servicing issues²³⁴ has

228. *See supra* text accompanying notes 149–54.

229. *See supra* text accompanying notes 173–74, 209–11.

230. *See supra* subpart III(C).

231. 11 U.S.C. § 502(a) (2006).

232. *Id.* § 502(b).

233. FED. R. BANKR. P. 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.").

234. *See infra* note 238.

concluded “that the vast majority of Chapter 13 debtors and their attorneys do little or nothing about these illegal fees and charges.”²³⁵

Among the objections that were filed, there were no observable patterns. The objections came from a variety of districts.²³⁶ 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 (forty-four 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 attorneys 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 and because a 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; many also 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, creditors face no meaningful consequences when they disregard the law and this public policy and submit incomplete or unsubstantiated claims for judicial approval.

235. 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>.

236. Twenty-five of the forty-four judicial districts had at least one claim objection.

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 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.²³⁷ Further, my interviews with dozens of consumer attorneys before beginning this study revealed that only a few practitioners regularly review all mortgage claims.²³⁸ The high-volume nature of consumer practice undoubtedly explains this situation, but it 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 record keeping between debtors and creditors. 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 the 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 debtors must pay all mortgage arrearage debt in full to save their homes. Similarly, trustees have a statutory obligation to object to improper claims,²³⁹ yet rarely do so. The current system fails to

237. 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 own calculations of the amounts due, rather than using the amounts of the mortgagees' claims 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 amounts of mortgage debt in the plans, 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 pre-petition arrearage. Yet, some claims did not specify the arrearage at all, while other claims reflect only the combination of pre-petition and post-petition amounts. Thus, despite my efforts to do so, it is impossible to compare either the total claims or the total arrearages contained in confirmed plans to those contained in the proofs of claim in any significant fraction of cases.

238. See also Vicki Mabrey & Ely Brown, *Playing the Odds*, ABCNEWS.COM, Dec. 14, 2007, <http://abcnews.go.com/Business/RealtyCheck/Story?id=4002397&page=1> (interviewing Max Gardner about the "bankruptcy boot camp" that he developed to train attorneys on mortgage issues in bankruptcy cases).

239. 11 U.S.C. § 704(a)(5) (2006).

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,²⁴⁰ there is a serious risk that mortgage servicers' overreaching and errors are imposing unfair burdens on families trying to save their homes. It is also possible that creditors' claims for nonmortgage debt are plagued with problems similar to those that exist in mortgage claims.²⁴¹ Indeed, because such debts are usually for smaller amounts, they may be subject to even less scrutiny for their accuracy. The evidence from the bankruptcy courts calls into question the ability of consumers to trust creditors to accurately and fairly account for their payments and assess charges.

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 nonmortgage 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 provide adequate procedures to help parties identify claims for which a valid objection may exist, thus ensuring the accurate payment of claims.²⁴² Without documentation of the debt, the debtor and other creditors cannot

240. See *supra* subparts I(A), I(D).

241. The U.S. Trustee recently settled a complaint against Capital One that alleged that the credit-card issuer had filed claims and accepted payments in bankruptcy cases for debts that had been discharged in debtors' prior bankruptcies. Complaint of the U.S. Trustee Phoebe Morse for a Permanent Injunction & Other Equitable Relief at 3, *Morse v. Capital One Bank (In re Galley)*, No. 06-12142-JNF (Bankr. D. Mass. Oct. 2, 2008); see also Amir Efrati, *Capital One in Settlement Over Card Debt*, WALL ST. J., Oct. 3, 2008, at B3 (announcing the settlement between Capital One and the U.S. Trustee).

242. See Alane A. Becket, *Proofs of Claims: A Look at the Forest*, AM. BANKR. INST. J., Dec.–Jan. 2005, at 10, 53 (describing how the rules governing claims are designed to give parties information and evidence to use in determining whether to object to the claim).

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 to prevent the just administration of bankruptcy estates.²⁴³ 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,"²⁴⁴ the reality is that some creditors treat them as aspirations—or ignore them entirely. In most instances, there is no negative consequence when a mortgagee fails 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.²⁴⁵ While courts have sanctioned creditors for filing unsubstantiated claims,²⁴⁶ 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 3001.²⁴⁷ Yet, as a practical matter, all claims receive this treatment if 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 need to be sharpened. Even when an objection is filed, there is typically no sanction for missing

243. See *Gardner v. New Jersey*, 329 U.S. 565, 573 (1947) (acknowledging the deleterious effects of unmeritorious or excessive claims on participation by legitimate bankruptcy claimants).

244. FED. R. BANKR. P. 3001(c)-(d). The proof-of-claim form also contains the following instructions:

You 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.

Official Bankruptcy Form 10 (2007), *supra* note 41.

245. FED. R. BANKR. P. 9011(b)(3).

246. See, e.g., *In re Cassell*, 254 B.R. 687, 691 (B.A.P. 6th Cir. 2000) ("Proofs of claim must meet the standards of [Rule 9011.]"); *In re Berghoff*, No. 06-10375, 2006 WL 1716299, at *2 (Bankr. N.D. Ohio June 30, 2006) (finding that a mortgage lender violated Rule 9011 by including in a claim certain fees that were not warranted by existing law).

247. FED. R. BANKR. P. 3001(f).

documentation.²⁴⁸ Some courts have concluded that failure to comply with Rule 3001 is not a permissible basis for disallowing a claim²⁴⁹ because this behavior is not listed in § 502(b) of the Bankruptcy Code, which governs the allowance of claims.²⁵⁰ A few jurisdictions have taken a different approach and ruled that incomplete claims documentation can be a basis for disallowing a claim.²⁵¹ 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 creditors to prove their claims.²⁵² However, courts usually require the debtor to advance some evidence that disputes the claim rather than merely pointing to noncompliance with the rule.²⁵³ 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.²⁵⁴

The simplest route to boosting the reliability of mortgage claims is to revise § 502(b) to include the failure to provide the attached documentation

248. *But see In re Prevo*, No. 08-30815, 2008 WL 4425799, at *3-4 (Bankr. S.D. Tex. Aug. 7, 2008) (issuing a show-cause order to determine whether the creditor should be required to pay the debtor's attorneys fees for objecting to a mortgage claim that was disallowed for failure of the creditor to meet its evidentiary burden).

249. *See, e.g., In re Stoecker*, 5 F.3d 1022, 1028 (7th Cir. 1993); *In re Heath*, 331 B.R. 424, 431-32 (B.A.P. 9th Cir. 2005); *In re Gurley*, 311 B.R. 910, 915-16 (Bankr. M.D. Fla. 2001) (all holding that the failure to comply with Rule 3001 either can be fixed by amending the claim or is not a valid objection); *see also* Becket, *supra* note 242, at 53 (concluding that disallowance on Rule 3001 grounds is not within a court's statutory authority because, under 28 U.S.C. § 2075, the bankruptcy rules are not supposed to "abridge, enlarge, or modify substantive rights").

250. 11 U.S.C. § 502(b) (2006).

251. *See, e.g., In re Shaffner*, 320 B.R. 870, 879 (Bankr. W.D. Mich. 2005) (permitting a trustee to refuse to administer the proof of claim as filed); *see also* NANCY H. DREHER & JOAN N. FEENEY, *BANKRUPTCY LAW MANUAL* § 6:4 (5th ed. 2008) ("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*, No. 05-63927, 2007 WL 2571943, at *4 (Bankr. N.D. Ohio Aug. 31, 2007) (disallowing claims filed by a trustee pursuant to Rule 3004 because the trustee did not reasonably investigate the claims or provide documentation to support them).

252. *In re Gilbreath*, No. 08-32404-H4-13, 2008 WL 4569965, at *76 (Bankr. S.D. Tex. Oct. 14, 2008) (ruling that proofs of claim that failed to comply with Rule 3001 are not prima facie valid, and disallowing such claims when the creditor did not meet its burden of proof to prove the claims).

253. *See, e.g., In re Campbell*, 336 B.R. 430, 434 (B.A.P. 9th Cir. 2005) (holding that a proof of claim lacking documentation required by Rule 3001(c) is not disallowed unless the debtor's objection to the claim contests the amount of the debt and not merely the violation of the Rule); *In re Stewart*, No. 07-11113, 2008 WL 2676961, at *9 n.15 (Bankr. E.D. La. Apr. 10, 2008) (shifting the burden of proof onto the creditor because the debtor had objected and presented sufficient evidence to overcome the presumption of the claim's validity).

254. *See, e.g., In re Heath*, 331 B.R. 424, 437 (B.A.P. 9th Cir. 2005) (stating that a creditor's failure to provide information or to support its claim "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 the claim" (internal citations omitted)).

as a basis for the disallowance of claims. 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.²⁵⁵ In this way, the bankruptcy process would be at least as rigorous as the state-law foreclosure schemes.

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.”²⁵⁶ Many trustees apparently believe that no purpose would be served by objecting to claims without the documentation required by law. For example, while notes were missing from 40% of claims, trustees filed only one or two objections that raised that issue.²⁵⁷

The U.S. Trustee Program could, in its program handbook, mandate the review of mortgage claims as an official duty of panel and standing trustees, 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.²⁵⁸

A complementary tactic to these enforcement strategies would improve the clarity of claims. The varying formats and levels of detail in the itemizations dramatically increase the costs of 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

255. See *supra* note 154 and accompanying text.

256. 11 U.S.C. § 704(a)(5) (2006).

257. See *supra* text accompanying note 152.

258. See, e.g., Statement of the U.S. Tr. 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*, 384 B.R. 138 (Bankr. S.D. Tex. 2008) (No. 05-90374) (evidencing the United States Trustee’s willingness to become involved in litigation). However, the U.S. Trustee may have limited authority to pursue creditors for abusive claims practice because its powers are circumscribed by statute. See *supra* notes 116–18 and accompanying text.

legal assistants and junior attorneys to review claims. Standardization would also facilitate the development of computer programs to analyze creditors' calculations for items such as escrow accounts and arrearage payment streams. Indeed, creditors themselves have identified variations in local practice as an obstacle to accurate servicing.²⁵⁹ A model itemization attachment was promulgated by a committee of mortgage-industry representatives, Chapter 13 trustees, and mortgage servicers.²⁶⁰ The model attachment would require servicers to provide details such as the type of the loan, its interest rate, and any payment-adjustment dates.²⁶¹ 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 representatives 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.²⁶² 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 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 outcomes of consumer bankruptcy cases. A core function of Chapter 13 bankruptcy is helping families save their homes,²⁶³ which the Bankruptcy Code effectuates by

259. *Hearing, supra* note 58, at 5 (statement of Steve Bailey, Chief Executive for Loan Administration, Countrywide Financial Organization), available at http://judiciary.senate.gov/pdf/08-05-06Steve_%20Bailey_Testimony.pdf (testifying that, as a result of variations across jurisdictions in the rules governing bankruptcy, bankruptcy-loan servicing is a borrower-by-borrower process that requires manual input of data unique to each borrower, and that this type of processing can occasionally result in mistakes).

260. MODEL PROOF OF CLAIM ATTACHMENT, *supra* note 175, at 2–3.

261. The model attachment would also require the creditor to provide the Mortgage Electronic Registration System (MERS) number for the loan, the real property tax number and parcel number, and a contact person for the servicer (not just the servicer's attorney).

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

263. *See* 1 LUNDIN, *supra* note 47, § 129.1 (“[I]t is not unusual for rehabilitation of a home mortgage to be the principal reason for filing a Chapter 13 case.”).

permitting debtors to cure arrearages on mortgages over time.²⁶⁴ Because mortgage creditors are most Americans' largest creditor, their actions in bankruptcies heavily influence debtors' success in saving their homes from foreclosure.²⁶⁵ A family's ability to confirm a Chapter 13 plan or cure a default may turn on the amount fixed as being owed to the mortgage creditor.²⁶⁶ 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. Plan confirmation turns on this issue. What is more, 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 their bankruptcy-filing decisions 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 defaults. Conversely, if debtors overestimate their arrearages, 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 debts with reasonable accuracy indicates a serious shortcoming in the prebankruptcy 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.²⁶⁷

After families file for 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 amounts requested on

264. See 11 U.S.C. § 1322(b)(5) (2006) (providing debtors with the right to cure mortgage arrearages within a reasonable time).

265. See Bahchieva et al., *supra* note 1, at 74 ("Our results also suggest that rising mortgage debt has important consequences for federal bankruptcy policy.")

266. See *In re Coates*, 292 B.R. at 899 ("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.")

267. See, e.g., Scott F. 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).

mortgagees' claims and consequently risk overpaying those creditors. In so doing, debtors increase their burdens in confirming and completing their Chapter 13 plans. This outcome, however, saves debtors the litigation and negotiation costs of seeking clarification from the mortgagees. When mortgagees' claims are challenged, debtors face 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 by 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 its 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 the stay that are based on incorrect accounting.

Scrutinizing proofs of claim to ensure that only valid fees are included in arrearage claims can help reduce the burdens that debtors face in making all payments required to complete their Chapter 13 plans. Reduced arrearages could improve the success rate of debtors in completing Chapter 13 plans and receiving discharges. Better outcomes in Chapter 13 could help encourage more debtors to consider this alternative, which could in turn boost recovery to all creditors. Further, ensuring that the mortgagee's 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 the Bankruptcy Abuse Protection and Consumer Protection Act (BAPCPA),²⁶⁸ 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 subpart 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, attorneys need to be educated about how challenging mortgage claims can potentially benefit their practices. While challenging a claim does not per se generate revenue for an attorney, claims review can reveal other causes of action. Most obviously, if

268. GOV'T ACCOUNTABILITY OFFICE, DOLLAR COSTS ASSOCIATED WITH THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005, at 25, 26 fig.7 (2008) (reporting analysis that showed that the Chapter 13 standard fee had increased after BAPCPA in nearly all judicial districts for which information was collected).

debtors attorneys request information from mortgage servicers and do not receive responses or receive inadequate responses, the servicers may have violated RESPA.²⁶⁹ If successful, these claims entitle plaintiffs to actual damages and the costs of reasonable attorneys fees.²⁷⁰ 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.²⁷¹ 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 a loan's statutorily required Truth in Lending disclosure can give rise to a claim for actual or statutory damages, or even rescission of the loan under some circumstances.²⁷² The Truth in Lending Act²⁷³ also is fee-shifting so that mortgage companies may be ordered to pay the attorneys fees and costs of successful actions.²⁷⁴ 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—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 servicers to credit payments, calculate payoff 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

269. See 12 U.S.C. § 2605(e) (2006) (detailing the proper response to a borrower's request).

270. *Id.* § 2605(f)(3).

271. DOUGLAS J. WHALEY, PROBLEMS AND MATERIALS ON CONSUMER LAW 481 (3d ed. 2002).

272. 15 U.S.C. §§ 1635, 1640 (2006).

273. *Id.* §§ 1601–1667f.

274. *Id.* § 1640(a)(3).

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.²⁷⁵ 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 of 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 and 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 prove they were the record owners of the mortgage and note.²⁷⁶ Two class action lawsuits are pending that allege that consumers paid bloated, illegal fees for default charges.²⁷⁷ Mortgage servicers are increasingly being fingered as the primary parties who are frustrating homeowners' efforts to obtain modifications of unaffordable loans.²⁷⁸

275. Foreclosure filings appear to outnumber bankruptcy cases filed by homeowners by a four-to-one ratio. In 2006, there were 597,965 nonbusiness bankruptcy filings. Press Release, Admin. Office of the U.S. Courts, Bankruptcy Filings Plunge in Calendar Year 2006 (Apr. 26, 2007), available at http://www.uscourts.gov/Press_Releases/bankruptcyfilings041607.html. The best available data, which is from the 2001 Consumer Bankruptcy Project, indicate that about 52.5% of all families in bankruptcy are homeowners. Bahchieva et al., *supra* note 1, at 92. In 2006, there were 1,259,118 foreclosure filings. Press Release, RealtyTrac, More Than 1.2 Million Foreclosure Filings Reported in 2006 (Jan. 25, 2007), available at <http://www.realtytrac.com/Content/Management/pressrelease.aspx?ChannelID=9&ItemID=1855&acct=64847>; see also Dennis R. Capozza & Thomas A. Thomson, *Subprime Transitions: Lingerin' or Malingering in Default?*, 33 J. REAL ESTATE FIN. & ECON. 241, 241–58 (2006) (reporting that in a study of borrowers who were identified as ninety-days delinquent on their loans, only 11% had filed for bankruptcy eight months later).

276. See, e.g., *In re* Foreclosure Cases, 521 F. Supp. 2d 650, 654 (S.D. Ohio 2007) (giving plaintiffs thirty days to submit evidence proving that they had standing to file the complaint); *In re* Foreclosure Cases, No. 07CV2282, 2007 WL 3232430, at *3 (N.D. Ohio Oct. 31, 2007) (finding that plaintiffs could not show proof of ownership of the note or mortgage).

277. See *In re* Harris, No. 03-44826, 2008 WL 924939, at *1 (Bankr. S.D. Tex. Jan. 16, 2008) (alleging that default servicers had impermissible and undisclosed arrangements with attorneys to retain a portion of the fees); Complaint at 2, *Trevino v. Merscorp, Inc.*, No. 07-568 (D. Del. Nov. 6, 2007) (alleging that Merscorp note overcharged and extracted improper fees from mortgage borrowers).

278. See Eggert, *supra* note 23, at 286–87 (describing servicers' self-interest as a barrier to loan modification); Larry Cordell et al., *The Incentives of Mortgage Servicers: Myths and Realities* 3 (Fed. Reserve Bd., Fin. and Econ. Discussion Series, Paper No. 2008-46, 2008) (reporting that available evidence suggests that the inadequate loss-mitigation capacity of mortgage servicers and certain servicing practices are factors contributing to avoidable disclosures).

Poor mortgage servicing is an assault on America's policy of promoting sustainable home ownership. If families are hit with unreasonable fees and cannot understand what is owed on their mortgage loans, 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 home ownership is focused on loan-origination issues, such as whether mortgage brokers or lenders placed families in appropriate loans.²⁷⁹ 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.²⁸⁰ The rising foreclosure rate will only escalate the number of families who must struggle to understand the amounts of their arrearages and who are at risk of having to pay unreasonable default costs to save their homes.²⁸¹ 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 payoff balances can penalize families when they refinance a home loan. Even families who try to get ahead on their mortgages 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 borrowers. These practices create a needless barrier to home ownership.

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 servicers, essentially receiving a one-

279. See *Prepared Statement of the Federal Trade Commission on Home Mortgage Disclosure Act Data and FTC Lending Enforcement: Hearing Before the H. Comm. on Fin. Servs.*, 110th Cong. 5–9 (2007) (statement of Lydia B. Parnes, Director of the Bureau of Consumer Protection, Federal Trade Commission), available at <http://www.ftc.gov/os/testimony/P064806hdma.pdf> (describing the FTC's collection of data on the pricing of subprime mortgages marketed to consumers).

280. See Pennington-Cross & Ho, *supra* note 59, at 19 (finding that the probability of loan default varied widely by loan servicer, even after controlling for loan-, housing-, and labor-market conditions).

281. See generally Press Release, RealtyTrac, Foreclosure Activity Up Over 55% in First Half of 2007 (July 30, 2007), available at http://www.realtytrac.com/ContentManagement/press_release.aspx?ChannelID=9&ItemID=2932&acct=64847 (summarizing the results of a mid-year foreclosure-market report showing dramatic increases in foreclosure filings nationwide); Danielle Reed, *Rising Foreclosure Rates Point to a Normalizing Home Market*, WALL ST. J. ONLINE, Apr. 17, 2006, <http://www.realestatejournal.com/buysell/markettrends/20060417-reed.html> (discussing rising foreclosure rates and mortgage delinquencies in the United States in the first half of 2006).

time option to choose a different servicer.²⁸² He postulates that servicers would compete for this additional business, driving up quality, and balancing servicers' incentives between lenders and borrowers.²⁸³ 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 HUD on its duties to enforce RESPA and to police mortgage servicers. HUD's Web site for complaints does not even mention mortgage servicing,²⁸⁴ and the FTC, rather than HUD, has taken the lead in recent actions against servicers.²⁸⁵

The Mortgage Study data suggest that policy makers who focus on promoting home ownership need to concern themselves with mortgage servicing, which is a crucial aspect to enabling families to achieve home ownership. 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 home-ownership 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 claims process in bankruptcy exemplifies the difficulty in developing and monitoring an effective legal system. The findings should caution policy makers and advocates from blindly trusting in the written law as a decontextualized instrument to shape behavior.

V. 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

282. Jack Guttentag, Borrowers Should Be Able to Fire Mortgage Servicers, http://www.mtgprofessor.com/A%20%20Servicing/borrowers_should_be_able_to_fire_servicers.htm.

283. *Id.*

284. See U.S. Dep't of Housing and Urban Dev., Complaints, *supra* note 115 (handling complaints for housing discrimination; landlord-tenant disputes; manufactured-housing issues; land sales; deceptive contractors; and fraud, waste, and abuse).

285. See DIV. OF CONSUMER & BUS. EDUC., *supra* note 48 (describing what consumers should expect of mortgage servicers and the process for filing complaints against servicers).

share of debtors' assets. From external indicia, the claims process in consumer bankruptcy cases seems like an exemplar of a well-designed legal system that balances the interests of consumers and industry. The claims rules are unambiguous; all parties typically are represented; the process is uniform; the federal judicial system brings gravitas to the procedures; and specialized actors such as bankruptcy judges and trustees are present to police the system.

Yet, despite these reassuring features, the empirical data show that many mortgagees fail to comply with applicable law. The data establish a widespread, current practice of filing incomplete claims with vaguely identified fees. This hinders any meaningful or effective scrutiny of whether mortgage companies are only charging the correct amounts to struggling homeowners. The structural incentives are insufficient to uphold bankruptcy's potential as a home-saving device and to ensure the integrity of the bankruptcy system. 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 the mortgage-servicing industry 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.