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Upcoming Changes to the Federal Rules of Bankruptcy Procedure[1]

On December 1st, 2011, assuming Congress approves (through inaction), dramatic changes to the federal rules of bankruptcy will go into effect. These changes will significantly increase the amount of work for mortgage servicers during the course of a bankruptcy case (including pending cases filed before December 1st, 2011), as well as the amount of paperwork that must be filed with the bankruptcy court. Furthermore, in addition to establishing requirements and deadlines for compliance, the new rules include a punitive component for non-compliance.

As U.S. Bankruptcy Judge Ray Lyons explained it at the American Legal and Financial Network (ALFN) Conference in July, 2011, these rule changes are the product of his conversations with fellow U.S. Bankruptcy Judge Eugene Wedoff several years ago after the NACTT Mortgage Committee adopted its Best Practices for Trustees and Mortgage Servicers in Chapter 13 (herein, “Best Practices”). The new forms that accompany the rule changes are intended to replace the forms attached to Best Practices. However, as pointed out by the NACTT Mortgage Committee’s Draft of “Suggested Practices for Trustees and Mortgage Servicers” (herein, “Suggested Practices”) regarding the rule changes and proposed forms, except as they are supplemented or amended by amended Rule 3001 and Rule 3002.1, the Best Practices still provide guidance on many practice issues in Chapter 13.

The rule changes are also intended to standardize the various local rules, standing orders and plan provisions that govern mortgage servicers during the course of a bankruptcy case, especially those provisions which direct how and when a mortgage servicer is to give notice of a payment change or post-petition fees, expenses, or charges. In theory at least, when these rule changes go into effect on December 1st, any conflicting local rules or standing orders will have to give way to the new federal rules and at least one judge anticipates seeing many jurisdictions repealing their local provisions. It remains to be seen how well this will happen in practice and how quickly jurisdictions that worked hard to implement their own rules will be willing be to give them up. Until that happens, the recommendation is for servicers to attempt to comply with both the local and federal rules as best as possible.

The changes brought about by the federal rules can be broken down into the following categories:

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- Changes to Rule 3001 and the new requirements for filing a proof of claim
- Adoption of Rule 3002.1 and the requirements for
    - Providing notice of payment changes
    - Providing notice of post-petition fees, expenses and charges
    - Responding to the trustee's notice of final cure

Rule 3001 Changes – The Original Proof of Claim

To begin with, Rule 3001 has been amended to provide that in a bankruptcy case in which the debtor is an individual, the proof of claim must include an itemized statement of any prepetition interest, fees, expenses or charges included in the claim, and a statement of the amount necessary to cure any default as of the petition date (if a security interest is claimed in the debtor's property).

If the subject property is the debtor's principal residence, the new Mortgage Proof of Claim Attachment (Form B10 (Attachment A)) must be filed with the proof of claim. Furthermore, if the loan is escrowed, an escrow statement, prepared as of the petition date, and in a form consistent with applicable nonbankruptcy law (i.e., RESPA), shall be filed with the Mortgage Proof of Claim Attachment (herein, "Attachment").

The instructions on the new Attachment and the plain language of the amended Rule 3001 only require use of the new form where the subject property is the debtor's principal residence. However, since the information contained in two (2) sections of the Attachment is required even where the property is not the debtor's principal residence (i.e., an itemized statement of any prepetition interest, fees, expenses or charges included in the claim, and a statement of the amount necessary to cure any default as of the petition date), servicers may wish to consider using the Attachment for all claims. Finally, since there are sometimes issues determining if the subject property is the debtor's principal residence, servicers again may wish to consider using the Attachment in all cases to avoid the punitive components of amended Rule 3001.

It is worth noting that there are several issues with the Attachment. To begin with, there is nowhere on the Attachment for the servicer to put the property address or the amount of the first post-petition payment. Similarly, there is no area to add post-petition amounts, and of course debtors often put post-petition mortgage payments into the plan.

Consequences for Non-Compliance

If the holder of a claim fails to provide any of the information required by amended Rule 3001, the court may, after notice and hearing, take either or both of the following actions:

- preclude the hold from presenting the omitted information, in any form, as evidence in any contested matter (e.g., an objection to claim or a motion for relief from the automatic stay) or adversary proceeding in the case, unless the court determines that the failure was substantially justified or is harmless; or

- award other appropriate relief, including reasonable expenses and attorney's fees caused by the failure.

The present version of this section of amended Rule 3001 is actually less harsh than the original draft. The words "shall be precluded" were changed to "may, after notice and hearing, take either or both" after the Rules Committee carefully considered all of the comments and testimony during the public comment period. In addition, the Committee Note clarifies that Section 502 of the U.S. Bankruptcy Code, 11 U.S.C. § 101, *et. seq.* (herein, "Code") govern the grounds for disallowance of a claim and that inadequate documentation, by itself, is not a basis for disallowing a claim. Moreover, the bankruptcy court retains jurisdiction to allow amendment to a proof of claim under appropriate circumstances. Nevertheless, the only thing clear about what constitutes "substantially justified" or "harmless" is that the decisions will likely vary greatly across the country.

Revised Form B10

A new section 3B is added to the form to allow the reporting of uniform claim identifier. This identifier, consisting of 24 characters, is used by some creditors to facilitate payments by means of electronic funds transfer from Chapter 13 trustees. However, creditors are not required to use a uniform claim identifier.

The annual interest rate applicable at the time the bankruptcy case was filed must be reported in Section 4. In addition, there are checkboxes to indicate whether the interest rate is fixed or variable. These two (2) boxes may not be sufficient, however, as some servicers have loan products which are more complex than a simple "fixed" or "variable" designation.

Section 7 of Form B10 has been revised to clarify that documents to support the perfection of a security interest must be attached to the PoC (see also the instructions to section 4). If the documents are not available, the filer must provide an explanation for their absence. Of course, Rule 3001 already contains the same requirement for the "writing" upon which the claim is based (e.g., the promissory note).

Section 8, the date and signature box, has probably received the most discussion. Section 8 has been revised to include a declaration, under penalty of perjury, that the information provided in the claim is true and correct to the best of the filer's knowledge, information and reasonable belief.

Section 8 of Form B10 also requires the filer to provide identifying information (e.g., name, title, company, address, telephone, e-mail). According to the Committee Notes that accompany the amended Rule 3001, the "provision of this additional information does not affect any requirements for serving or providing official notice to the claimant."

The person filing the claim must also indicate in what capacity he or she is filing the proof of claim (e.g., as authorized agent). When a servicer files a proof of claim, the individual completing Form B10 must sign it; provide his or her own name, and the name of the company that is the servicing agent. It is important to note that at the annual conference for the National Conference of Bankruptcy Judges

(NCBJ) in Tampa in October, 2011, Judge Wedoff explained there would be no instance where a mortgage creditor would ever check the creditor box since even an employee signing and filing a proof of claim on behalf of a servicer would be acting as an authorized agent.

The form and instructions to Section 8 of Form B10 also ask for a power of attorney "(if any)." Therefore, servicers should expect their attorneys to be making requests for a copy of the pertinent power of attorney that documents its authority to file the proof of claim. Of course the better practice would be to include the power of attorney with the proof of claim referral wherever possible. However, Judge Wedoff and John Rao with the National Consumer Law Center (NCLC) clarified at the October NCBJ conference that nothing in the Code or the Federal Rules of Bankruptcy Procedure requires an attorney appearing on behalf of his or her client to have a power of attorney. See Fed. R. Bankr. P. 9010.

Rule 3002.1

This new rule governs the notice of:

- Payment changes
- Post-petition fees, expenses and charges
- final cure (by the trustee – or by the debtor, should the trustee does not file the notice).

This rule only applies:

- in Chapter 13 cases
- to claims secured by the debtor's principal residence; and
- to claims provided for under Section 1322(b)(5) of the Code (i.e., where the debtor's plan provides for the curing of a long term debt).

Notice of Mortgage Payment Change

Notice of payment changes must be provided to the debtor, the debtor's attorney and the trustee at least 21 days before the new payment amount is due. In addition, the notice shall be filed as a supplemental claim using the new official Form B10 (Supplement 1) instead of on the docket.

The form is to be filed by itself (i.e., without the use of Form B10 as a cover page). In addition, supporting documentation must be attached, depending on the reason for the payment change, including:

- Part 1 – escrow change – attach escrow analysis
- Part 2 – interest rate change – attach payment change letter
- Part 3 – other – (e.g., loan modification – attach a copy of the loan modification and any court order approving the loan modification).

Again, as with the Mortgage Proof of Claim Attachment under amended Rule 3001, the person filing the Notice of Mortgage Payment Change must provide identifying information (i.e., name, company, address, telephone number, e-mail address), identify the capacity in which the Notice is being filed (i.e.,

as the creditor or authorized agent), and sign a declaration that the information provided is true and correct to the best of his or her knowledge, and reasonable belief.

Interestingly, Rule 3002.1 does not provide the debtor or the trustee with an opportunity to object to a Notice of Mortgage Payment Change filed by a mortgage servicer.

There is no accommodation or exception for HELOCs or other types of loans where the payment changes on a monthly basis (or otherwise frequently) despite vociferous objection and comments by servicers, attorneys and scholars during the public comment period that ran between August, 2009 and February, 2010. So far the response has been for servicers to deal with these loans on a case by case basis by either contacting the trustee or debtor's counsel to discuss alternative methods of interest calculation, at least during the course of the bankruptcy case, including by modifying the loan to a fixed rate loan. Keep in mind, however, that many debtors will likely be proposing to strip off or avoid the liens on these HELOCs due to a lack of equity. Therefore, since the debtor's plan will not be providing for a cure, the requirement to provide payment change notices under Rule 3002.1 should not apply. In my opinion, this would especially hold true where a stipulation has been entered between the debtor and the servicer acknowledging there is no equity in the property, but providing that the debtor does not get the benefits of the strip off until all payments have been made under the plan. To be safe, however, I would recommend any stipulation going forward with respect to a strip off include language providing that it is not necessary for the servicer to comply with Rule 3002.1 in that particular case and with respect to that particular loan and property.

<u>Notice of Postpetition Mortgage Fees, Expenses and Charges</u>

If there are post-petition fees, expenses and charges that the claim holder asserts are recoverable against the debtor or against the debtor's principal residence, a notice that itemizes said amounts must be provided to the debtor, debtor's attorney and the trustee. This notice must be served no later than 180 days after the fee, expense or charge is incurred. In addition, as was the case with payment changes, this notice must be filed as a supplemental claim using the new official Form B10 (Supplement 2). I have heard several attorneys recommend and several representatives from various servicers discuss the possibility of filing these notices on a quarterly basis out of an abundance of caution. At least one trustee has also requested and that servicers stagger the filing and serving of these notices evenly over the course of a calendar year instead of mailing them for their entire portfolios at the same time. This recommendation also appears in Suggested Practices.

Suggested Practices also recommends debtors include plan provisions that provide for payment of any notice of fees, expenses and charges (as well as a notice of payment change).

The debtor or trustee has one year to object (much longer than the 30 day period under Best Practices). If there is an objection, the bankruptcy court will determine if payment is required by the underlying agreement or applicable nonbankruptcy law.

It is important to note that the Notice of Postpetition Mortgage Fees, Expenses and Charges does not receive the same presumption of prima facie validity as does the original claim.[2] Considering this, plus the fact the debtor has one year to object to any fees or costs contained on the Notice. Considering this, servicer may wish to consider marking any fees or costs contained on Notice as non-recoverable until the court makes a determination that the fees or costs are recoverable.

Notice of Final Cure Payment and Completion of Payments Under Plan

Subdivisions (f), (g) and (h) of Rule 3002.1 govern the trustee's giving notice that the debtor has cured the arrears claim and completed all payments under the plan.

Subdivision (f) of Rule 3002.1 provides that within 30 days after the debtor completes all payments under the plan, the trustee shall file and serve on the holder of the claim, the debtor, and the debtor's counsel a notice stating that the debtor has paid in full the amount required to cure any default on the claim. This notice shall also inform the holder of its obligation to file and serve a response within 21 days as required by subdivision (g). If for some reason the trustee does not file and serve this notice of final cure, the debtor may file and serve the notice.

Again, within 21 days after service of the Notice of Final Cure Payment and Completion of Payments Under Plan, the holder shall file and serve on the debtor, debtor's counsel, and the trustee and statement indicating whether:

1. it agrees (i.e., a response is mandatory) that the debtor has paid in full the amount required to cure the default on the claim, and
2. the debtor is otherwise current on all payments consistent with Section 1322(b)(5) of the Code.

The response shall itemize the required cure of postpetition amounts, if any, that the holder contends remain unpaid "as of the date of the response." Again, the response is to be filed as a supplement to the proof of claim. It is recommended that any postpetition amounts listed on the response be consistent with any prior notices regarding postpetition fees, expenses, and charges.

The debtor or trustee can file a motion within 21 days after service of the response by the holder (or servicer) under subdivision (g), and after notice and hearing, determine whether the debtor has cured the default and paid all required postpetition amounts. The rule does not indicate what happens if neither the debtor nor the trustee files a motion, or whether the holder can file a motion to seek a determination under this part of Rule 3002.1. Although members of the Rules Committee opined at the NCBJ Conference in October that a motion by the creditor under these circumstances is not necessary, some servicers may choose to seek an order so there is a final determination about which fees, costs or other amounts are recoverable before the case is closed.

[2] Fed. R. Bankr. P. 3001(f) provides: "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."

Consequences for Failing to Notify Under Rule 3002.1

As is the case under amended Rule 3001, subdivision (i) provides for penalties should the holder of a claim fail to provide any of the information as required by subdivisions (b), (c), or (g) of the rule, i.e., with respect to payment change notices; a notice of fees, expenses and charges; or a Notice of Final Cure and Completion of Payments Under the Plan. Specifically, subdivision (i) provides that the Court, after notice and hearing may take either or both of the following actions:

- Preclude the holder from presenting the omitted information as evidence in any contested matter or adversary proceeding in the case, unless the court determines the failure was substantially justified or harmless
- Award other appropriate relief, including reasonable expenses and attorney's fees caused by the failure.

Conclusion

The proposed rule changes and proposed forms will undoubtedly change the playing field for mortgage servicers after December 1st and significantly increase the work involved with notifying debtors of payment changes and fees, expenses and charges. Even though the changes have not been approved by Congress yet, because of the punitive component and the fact the rules apply to pending cases filed before December 1st, 2011, it is recommended that servicers update their policies and procedures as soon as possible so they can be compliant by the effective date.[3]

On a final note, debtors, creditors and bankruptcy practitioners should also be aware that at the same time the above changes to the federal bankruptcy rules are scheduled to go into effect, changes to the Federal Rules of Evidence also go into effect. Although all the rules are affected, the changes are intended to be stylistic rather than substantive.

[3] All rules, proposed amendments, and committee reports are available at http://www.uscourts.gov//RulesandPolicies/FederalRuleMaking/Overview.aspx.