09-BK-140

February 16, 2010

Mr. Peter G. McCabe
Secretary, Committee on Rules of Practice and Procedure
Thurgood Marshall Federal Judiciary Building
Washington, DC 20544

Re: **Proposed Revisions to Bankruptcy Rule 3001 and the Creation of Bankruptcy Rule 3002.1: Issues for Mortgage Servicers**

Dear Mr. McCabe:

As the Committee considers proposed revisions to Bankruptcy Rule 3001 and the creation of the new Bankruptcy Rule 3002.1, the undersigned trade associations, representing America's mortgage servicing industry, submit the following comments.

There are several areas of particular concern to the mortgage servicing industry:

- The proposed revisions appear to upset the balance of burdens and responsibilities for the claims process that Congress clearly established in 11 USC 502, in violation of the constraints contained in the Rules Enabling Act;

- In particular, the proposed sanctions under both Rule 3001 and proposed Rule 3002.1 are unduly severe, are not supported by statutory authority, and reverse the presumption of validity that attaches to timely filed proofs of claim;

- Any revisions that require creditors to provide new documentation to support the proof of claim or an adjustment to a proof of claim should be accompanied by nationwide model forms to increase certainty and compliance, for the benefit of all parties; and

- The timing deadlines in the new notification scheme contained in proposed Rule 3002.1 must be modified to create more realistic deadlines for mortgage servicers.

The Proposed Sanctions Scheme Conflicts with 11 U.S.C. 502 and Exceeds the Judiciary's Authority Under The Rules Enabling Act

Our analysis of the proposed revisions begins with the grant of statutory authority to establish bankruptcy rules given to the Judicial Conference under the Rules Enabling Act ("REA"). *See* 28 U.S.C. 2075. Section 2075 of the REA specifically and unequivocally states that the power granted to the Judicial Conference to "prescribe by general rules...the practice and procedures in cases under title 11...shall not abridge, enlarge, or modify any substantive right." *See also* Semtek Int'l Inc. v. Lockheed Martin Corp., 531 U.S. 497, 504 (2001). In our view, Congress created a detailed and specific scheme for addressing proofs of claim (and objections to proof of claim) by enacting 11 U.S.C. 502. Under Section 502(a), a proof of claim timely filed "is *deemed allowed*, unless a party in interest...objects." (emphasis added)

The plain language of Section 502 could not be clearer: all timely filed proofs of claim are presumptively valid.[1] Thus, creditors have a statutorily-guaranteed, substantive right to rely on this presumption and, under the REA, any rules of bankruptcy procedure must respect this right.[2] In a similar context, courts have invalidated local rules that contradicted substantive law. *See* Sunahara v. Burchard In re Sunahara, 326 B.R. 768 (B.A.P. 9th Cir. 2005); Steinacher v. Rojas In re Steinacher, 283 B.R. 768 (9th Cir. BAP 2002); In re Adams, 734 F.2d 1094 (5th Cir. Tex. 1984).

Based on any fair reading, the proposed sanctions scheme in Rule 3001 and proposed Rule 3002.1 runs afoul of the Rules Enabling Act by "modifying" and "diminishing" a mortgage servicer's statutory right to rely on a presumption of validity for timely-filed proofs of claim. This is most evident when Rule 3001(c)(1)(D) would impose sanctions on a mortgage servicer and/or prevent a mortgage servicer from using certain documentary evidence of the validity of a claim "in any form" if there is a later objection to that claim. In fact, under Rule 3001(c)(1)(D) as presently drafted, it appears the court may award attorney's fees and other "relief" even if there has been no objection filed by a debtor.

Proposed Rule 3002.1 essentially mirrors the sanctions provision of revised Rule 3001 and similarly conflicts with Section 502. Under 11 U.S.C. 1305, mortgage servicers have a substantive right to file postposition proofs of claim for consumer debts and such proofs of claim "shall be allowed or disallowed under Section 502." Thus, the sanctions in proposed Rule 3002.1 "modify" and "diminish" the rights of servicers, in violation of the REA. The sanctions are unduly severe, will penalize mistakes rather than intentional misconduct, and should therefore be eliminated.[3] Rule 3002.1, which establishes a new notification scheme in Chapter

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[1] Importantly, the Committee note accompanying Rule 3001(c) as revised, make clear that the proposed rules are not attempting to modify what constitutes a proof of claim. Instead, the revisions "prescribe with greater specifics the supporting information *required to accompany* certain proofs of claim." (emphasis added)

[2] Given the plain language of Section 502, there can be no doubt that there is a substantive right for creditors to file presumptively valid proofs of claim. As the Tenth Circuit stated, "[s]ubstantive rules 'are directed at individuals and government and tell them to do or abstain from certain conduct on pain of some sanction." *See* Sims v. Great Am. Life Ins. Co. , 469 F.3d 870, 882 (10th Cir. 2006). Under current law, if creditors do not file timely proofs of claim, they may be estopped from collecting against the debtor during the bankruptcy proceeding.

[3] It should be noted that, because a secured creditor need not file a proof of claim in any bankruptcy case, the creation of harsh, unfair penalties may create an incentive for certain mortgage servicers to bypass the bankruptcy

13 cases involving mortgage claims whereby certain payment and other notices must be filed "as a supplement to the holder's proof of claim," also expressly violates Section 502, because the proposed rule specifies that these supplements are not to be presumed valid under Rule 3001(f). This clearly contravenes the letter and spirit of Section 502 and, as we have noted, seems to conflict with 11 U.S.C. 1305.

The sanctions structure for Rule 3001 and Rule 3002.1 clearly undermines and conflicts with Section 502, which unambiguously establishes a different claims process, because all proofs of claim (including mortgage proofs of claim) are effectively no longer presumed valid, unless accompanied by extraneous materials. The threat of sanctions for not providing, in advance of any objection, detailed information to support a proof of claim, renders the presumption of validity moot.

The proposed sanctions for non-compliance with Rule 3001 should be eliminated to avoid undermining the Congressionally-created claims process established under Section 502. At a minimum, if the sanctions scheme in Rule 3001 and proposed Rule 3002.1 are not eliminated, as we believe they must be, we suggest that the Committee narrow the circumstances in which sanctions are permitted to actions by a creditor that intentionally and willfully violate the new filing requirements.

We understand that it was suggested in the Committee's recent hearing on Rule 3001 and proposed Rule 3002.1 that the Committee may have power to create substantive bankruptcy rules under 11 USC 105. We believe that Section 105 is intended to empower bankruptcy courts to issue necessary orders as to particular cases. *See* In re Dow Corning, 280 F.3d 648, 656 (6th Cir. 2002) (Section 105 empowers courts to "take appropriate equitable measures needed *to implement* other sections of the Code.") (emphasis added). Furthermore, even if Section 105 were read broadly enough to grant bankruptcy courts the power to issue general rules outside the context of a particular bankruptcy case, Section 105 has been interpreted as not granting judicial power to override substantive provisions of the Bankruptcy Code. *See* In re Combustion Engine Inc., 391 F.3d 190 (3rd Cir. 2004). As we discussed above, Section 502 creates substantive rights for filers of proofs of claim and, accordingly, Section 105 cannot serve as the basis for Rule 3001 or 3002.1.

Compliance Issues with Proposed Rule 3002.1

As drafted, proposed Rule 3002.1 presents a myriad of practical, compliance-related issues that must be addressed before the Rule is released in final form. As an initial matter, where future mortgage payments are made outside of Chapter 13, which frequently occurs, the provisions of Rule 3002.1 should not apply. In such cases, issues related to payment adjustments and late fees would be handheld informally between the servicer and the borrower and would not implicate the terms of a Chapter 13 plan.

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court altogether. *See, e.g.*, Firemans Fund vs. Hobdy, B.R. 318, 321 (9th Cir. BAP 1991) (where a secured creditor such as a mortgage servicer does not file a proof of claim, the residence is still encumbered by the lien, including the arrearages). Thus, Rue 3002.1 could actually reduce bankruptcy court oversight of mortgage servicers for Chapter 13 debtors.

It is unclear under the Rule whether notice of payment change must be provided for variable rate loans that adjust frequently. We believe the Rule should not apply to loans where the interest rate adjusts more frequently than once every six months. In addition, where the rate of interest varies on a mortgage, the rate will sometimes adjust according to a published rate (such as *The Wall Street Journal* prime rate) and the servicer itself does not receive 30 days notice of the change. Thus, we suggest that the servicer be required to provide notice as soon as possible for changes dependant on published rates.

Rule 3002.1(c) should be revised to permit fees and charges that are valid if "allowed" in the underlying agreement or are otherwise approved by the debtor (e.g., speed pay fees). The current construction of the Rule could be read to disallow charges and fees that are not "required" in the mortgage contract. Thus, if any portion of the contract permits a servicer to waive any such fee, the Rule could be interpreted as disallowing the fee, even if the debtor admits his or her conduct could permit a fee (e.g., a debtor acknowledges a late payment but argues that the servicer has discretion not to charge the fee and thus the fee is not "required.")

The Need for Uniformity and Consistency

Should the Committee insist on proceeding with all or part of the proposed Rule 3002.1 or Rule 3001(c)(2), we strongly urge the Committee to develop standard forms to be used by mortgage creditors. As experience with the post-2005 reaffirmation forms show, allowing each district to modify Judicial Conference forms on an ad hoc basis creates needless compliance difficulties for creditors. This experience should not be replicated with mortgage servicers. In particular, we note that the requirement in Rule 3001 that mortgage servicers file an "escrow account statement" with its proof of claim. However, there is no definition of an escrow account statement provided. We believe that such a definition should be provided and should specify that the mere act of advancing payment for delinquent taxes or insurance by a servicer does not create an escrow for an account. Finally, we believe the Committee should make clear that notices required under the Rule may be filed by non-attorney employees of mortgage servicers.

The Need to Adjust Time Deadlines and Other Changes

Finally, we recommend the following deadlines in proposed Rule 3002.1 be modified. The following chart lists our recommendations:

MORTGAGE SERVICER ISSUES SUMMARY	PROPOSED REVISIONS
3001	Exempt HELOC loans from requirements that last account statement accompany proof of claim.
3001(c)(2)	Create standard form for providing itemized statement and "escrow account statement."

MORTGAGE SERVICER ISSUES SUMMARY	PROPOSED REVISIONS
3002.1(a): For principal residence debt involving a security instrument in a Chapter 13, 30 days' prior written notice of any payment change served to debtor, debtor's counsel and trustee file a supplemental Proof of Claim reflecting the payment change.	Revise timing to "at least 25, but no more than 120 calendar days, prior to the due date of the new payment amount" to follow TILA ARM rate change notice; provide flexibility where payment change due to variable rate
3002.1(c): For principal residence debt involving a security instrument in a Chapter 13, serve debtor, debtor's counsel and trustee notice that itemizes all fees, expenses or charges incurred in connection with the claim after the bankruptcy case was filed and holder assets are recoverable against the debtor or against the residence. Notice shall be filed in a supplemental Proof of Claim within 180 days after such fees accrued. Debtor will have a year after filing of supplemental Proof of Claim to object to fees via a motion. After notice and hearing, court shall determine whether payment of fees is necessary to cure a default or maintain payments under the plan.	Revise "180 days" to "a year" and "a year" to "90 days."
3002.1(e): Holder then has 21 days after service of the notice under 3002.1(d) to file and serve on debtor, debtor's counsel and trustee submit a supplemental Proof of Claim stating whether it agrees with or denies the trustee's claim, and if it denies, it must provide an itemization of amounts needed to bring the loan current.	Revise "21 days" to "90 days."

Thank you for considering the views of the undersigned trade associations. Please contact John McMickle at 202-282-5833 if you have any questions or require further information.

Respectfully submitted:

The Housing Policy Council
The Financial Services Roundtable
The American Bankers Association
The Mortgage Bankers Association