In Light of Current Mortgage Crisis, Errors in Proofs of Claim on the Rise

by Kelly M. Barnhart

Newspaper headlines scream out the news: "Foreclosures at All-time High," "Bankruptcies on the Rise." More and more consumers are filing for bankruptcy relief under Chapter 13, Title 11, of the U.S. Bankruptcy Code in an effort to save their homes and to catch up their mortgages.

The holders of the mortgages, in order to be paid, must file a proof of claim in the bankruptcy proceeding. However, errors in proofs of claim filed by servicers and other parties have been on the rise.

Rule 3001(f) of the Federal Rules of Bankruptcy Procedure provides that a proof of claim executed and filed in accordance with the rules of procedure constitute prima facie evidence of the amount and validity of the claim. The burden then shifts to the opposing party to object to the claim.[1] In the absence of a properly documented claim under Fed. R. Bankr. P. 3001(c), however, the prima facie presumption as to validity and amount may not be applicable.[2] But the absence of the Rule 3001(f) presumption does not mean that a filed proof of claim is automatically disallowed.[3] The grounds for disallowance of a proof of claim are specifically provided for in 11 U.S.C. § 502. If the only basis for disallowing the claim is for lack of documentation, such disallowance may not be justified or appropriate.[4] As more clearly explained in both *In re Fleming*[5] and *In re Simms*[6], the debtor must also assert a grounds for disallowance under § 502. In *Simms*, the bankruptcy court for the Northern District of West Virginia overruled the debtor's objection that the creditor failed to properly document its proof of claim because, "even if the Debtor's objection to lack of proper documentation is proper under Rule 3001(c), the Debtor has not raised any legal or factual dispute regarding the validity or amount of eCAST's claim under § 502(b)."[7]

A proof of claim that lacks sufficient documentation may nevertheless become prima facie evidence of a claim when considered in conjunction with the debtor's schedules, based on the reasoning that while the proof of claim may not establish the prima facie case, the schedules signed under oath and under penalty of perjury by the debtor would.[8] In addition, if the claimant does not get the presumption, its claim may still be allowed by proving its claim by a preponderance of the evidence.[9] "[L]ack of proper supporting documentation does not, in and of itself, result in a claim's disallowance; rather, it strips it of any prima facie validity, requiring the creditor to offer the supporting documentation to carry its burden of proof in the face of an objection."[10]

Given the growth of the mortgage market, including the securitizing and servicing of these loans by affiliates of lending institutions or independent loan servicers, there has been an inevitable increase in problematic claim filings. Some mortgage companies or their agents have filed proofs of claim without proper documentation. Some have filed proofs of claim while another mortgage company or its agent has filed a motion for relief against the same debtor for the same property.

For example, in *In re Hayes*[11], the debtor executed a note and mortgage for property with Argent Mortgage Company LLC (Argent), as the lender. AMC Mortgage Services Inc. (AMC), not Argent, filed a proof of claim in the debtor's bankruptcy case, as loan servicer for Argent. The debtor objected, claiming that the fees sought were unreasonable and excessive, and that AMC failed to attach a copy of the note or mortgage. One month later, Deutsche Bank filed its motion for relief, as trustee of Argent Mortgage Securities Inc. In the motion, Deutsche Bank alleged it was the current holder of the mortgage, that the debtor failed to stay current on post-petition mortgage payments, that there was little to no equity in the property, and that the property was

unnecessary for a successful reorganization. The debtor objected to the motion, asserting she did not have sufficient information to either admit or deny the allegation that she had failed to make post-petition payments and objected to Deutsche Bank's standing to bring the motion.

AMC responded to the claim objection and attached a copy of the note and mortgage, along with a loan history. Approximately sixteen months later, an attorney filed a related transfer of claim other than for security whereby AMC attempted to transfer the claim it filed on behalf of Argent to Citi Residential Lending Inc., as loan servicer for the secured creditor Deutsche Bank National Trust Company, as trustee, in trust for the registered holders of Argent Securities Inc. One can understand the confusion surrounding this sequence of events.

The bankruptcy court consolidated the hearings on the objections to the claim and motion. At trial, Deutsche Bank actually presented a witness, a bankruptcy specialist with Citi Residential Home Lending Inc. The court held that there was insufficient evidence presented to establish that the claim could be traced from Argent to AMC and then from AMC to Argent Securities Inc. It disallowed the claim and denied the motion for relief.[12] The facts of this case demonstrate why "it is axiomatic that in federal courts a claim may only be asserted by the real party in interest."[13]

On the other end of the spectrum, some servicers or mortgage companies have filed proofs of claim even though at the time of filing, they are not owed anything by the debtor. In a recent case before the Northern District of Ohio, Countrywide Home Loans referred a loan account to a law firm to file a proof of claim and objection to confirmation of the debtor's Chapter 13 plan, although the property in question had been sold in a short sale prior to the bankruptcy filing.[14] Countrywide provided to the firm a copy of the note and mortgage, but not the payment history or notes for the file. According to the proof of claim filed, the debtor owed approximately $88,000, all of which was secured.[15] It should be noted that the mortgage and note had been entered into with Ameriquest Mortgage Company, not Countrywide, and the proof of claim failed to attach any assignment or other transfer documents from Ameriquest to Countrywide. The debtor responded to the objection to confirmation and objected to the claim, alleging that she had sold the property in a short sale prior to the filing of her bankruptcy case, with Countrywide's permission. The court sustained the objection to the proof of claim, but, unfortunately for Countrywide, that was not the end of the story. The Office of the U.S. Trustee argued that Countrywide was guilty of abusing the court process, acting recklessly and in bad faith.[16] Given what transpired in the case, the court determined that sanctions were appropriate, given the violations of Rule 9011 of the Federal Rules of Bankruptcy Procedure and 11 U.S.C. § 105, and also "other sanctions sufficient to deter repetition of this conduct or comparable conduct by others" and scheduled another trial with respect to the appropriate level of sanctions.[17]

Similarly, in *In re Wells*[18], the Chapter 13 debtors objected to a mortgage arrearage proof of claim. The debtors, in their schedules, listed Aegis Mortgage Corp. as a secured creditor, holding a claim for $96,000, secured by their residence, and identified Ocwen Financial Corporation as an additional party to receive notice. U.S. Bank National Association (U.S. Bank), as Trustee for the Registered Holders of Aegis Asset Backed Securities Trust Mortgage Pass-Through Certificates, Series 2005-4, filed a proof of claim, secured by the debtors residence, and listed Ocwen to receive notices. The claim was signed by an individual in the quality control, bankruptcy department, without identifying for whom she filed it. The claim did not have a power of attorney designation or attachment. Other documents, including an itemization of the claim, payoff information, expense breakdown, mortgage, and note, were attached to the proof-of-claim form. Nothing was attached evidencing the transfer of the note to U.S. Bank. Later, U.S. Bank provided copies of two assignments of the note and mortgage. The first assignment was from MERS as nominee for Aegis Lending Corporation to U.S. Bank, Successor-in-Interest to Wachovia Bank, National Association, as Trustee for the Registered Holders of Aegis Asset Bank Securities Trust Mortgage Pass-Through Certificates, Series 2005-4. The second assignment was made by U.S. Bank for Wachovia, to U.S. Bank, as Trustee for the Registered Holders of Aegis Asset Backed Securities Trust Mortgage Pass-Through Certificates, Series 2005-4. While the second assignment was dated August 23, 2007, it was notarized on March 24, 2009, and filed on April 3, 2009 — well after the proof of claim was filed.

The *Wells* court sustained the objection of the debtors, concluding that the claim was filed by U.S. Bank, and the documents attached did not

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establish it was a secured creditor of the debtors; and therefore, the court disallowed the claim.[19]

Even if the claimant is the right party, that fact does not alleviate other important proof of claim issues, including claiming the appropriate amounts as being owed. If the amounts alleged as being owed in the proof of claim are unclear or incorrect, bankruptcy courts may order damages to be paid by the filing party. For example, the Bankruptcy Court for the Eastern District of Louisiana ordered Wells Fargo to pay $10,000 in damages to the debtor, plus $12,350 in legal fees, "for the abusive imposition of unwarranted fees and charges."[20] In *Stewart*, Wells Fargo was held accountable for unwarranted fees and charges, imposition of fees, the negligent imposition of fees and costs not due, the improper calculation of escrow payments, the misapplication of fees, the failure to notify the debtor of fees and charges, and the improper payment of unnoticed fees and charges during the bankruptcy case.[21] The court also ordered Wells Fargo to audit every proof of claim filed on or after April 13, 2007, and to include a loan history with each claim.[22] In addition, the court ordered Wells Fargo to review proofs of claim already filed and to amend, where necessary.

Wells Fargo, in a separate case also before the Eastern District of Louisiana, admitted that there were irregularities in how it accounted for payments on its claims, including application of trustee payments to postpetition charges rather than payments towards the prepetition debt they were remitted to satisfy; applying debtor payments to prepetition arrearages although intended for current mortgage payments; failure to notify borrowers of charges; postpetition imposition of professional (attorney) fees without prior court approval; and imposition and payment of postpetition fees from estate funds without disclosure.[23] Wells Fargo further admitted that these practices occurred in every case filed in the United States.[24] Wells Fargo contended that, although it suggested that it had systemic problems in every bankruptcy case, every debtor should have to make a challenge, by separate suit, to the proofs of claim filed by Wells Fargo.[25]

There are potential problems associated with this position, including the fact that Wells Fargo may have admitted presenting incorrect information in proofs of claim in contravention of specific statutes warning against and perhaps criminalizing such behavior. The idea that this conduct is acceptable as long as it remains unchallenged with regard to each specific claim is problematic. "Wells Fargo's position also requires the Court to participate in its egregious conduct …. Because Wells Fargo takes a 'scream or die' approach to judicial review, it would require this Court to not only honor, but enforce collection on illegally imposed debt."[26] As a result, the court ordered injunctive relief directing Wells Fargo to account for all postpetition payments received as professional fees and to verify that estate funds were not being used in a manner in conflict with the provisions of plans and confirmation order.

Attorneys who file either proofs of claim or motions for relief on behalf of mortgagees or servicers should keep in mind that by signing, filing, or arguing in support of a pleading, they have a duty to the court to tell the truth and are to be held accountable for mistakes and may be the person sanctioned for a violation. If a court finds that a party has violated Rule 9011 of the Federal Rules of Bankruptcy Procedure, the attorney may be held accountable. Every attorney is under a duty to make a reasonable investigation before filing a document or submitting a document with the court for consideration. When preparing proofs of claim, it may not be wise solely to rely on information supplied by a client, without further inquiry.

Endnotes:

1 *In re Fleming*, 2008 Bankr. LEXIS 4021, * 2 (Bankr. E.D. Va. Oct. 15, 2008).
2 *In re Andrews*, 394 B.R. 384 (Bankr. E.D.N.C. 2008); *In re Tran*, 369 B.R. 312, 317 (S.D. Tex. 2007).
3 *See, e.g., In re Herron*, 381 B.R. 184, 190 (Bankr. D. Md. 2008).
4 *See, e.g., Perron v. eCAST Settlement Corp. (In re Perron)*, 2006 Bankr. LEXIS 2639 at *12 (BAP 6th Cir. Oct. 13, 2006) (holding that "[t]he mere failure to comply with the rules concerning the form and content of a proof of claim is not justification under the Bankruptcy Code to judicially invalidate a creditor's otherwise lawful claim."); *Dove-Nation v. eCast Settlement Corporation (In re Dove-Nation)*, 318 B.R. 147 (B.A.P. 8th Cir. 2007); *Heath v. American Express Travel Related Company (In re Heath)*, 331 B.R. 424 (B.A.P. 9th Cir. 2005).
5 *Fleming*, 2008 Bankr. LEXIS 4021, at *2 (Bankr. E.D. Va. Oct. 15, 2008).
6 Case No. 06-1206 (Bankr. N.D. W. Va. 12/17/2007).
7 *Id.* at 5.
8 *In re Jorczak*, 314 B.R. 474 (Bankr. D. Conn. 2004).
9 *In re Porter*, 374 B.R. 471, 483 (Bankr. D. Conn. 2007); *In re Tran*, 369 B.R. 312, 317 (Bankr. S.D. Tex. 2007).
10 *In re Armstrong*, 320 B.R. 97, 104-05 (Bankr. N.D. Tex. 2005).
11 393 B.R. 259 (Bankr. Mass. 2008).
12 *Id.* at 270.
13 *In re Smith*, 41 B.R. 622, 628 (Bankr. E.D.Va. 2008).
14 *In re O'Neal*, Case No. 07-51027 (Bankr. N.D. Ohio May 1, 2009). The debtor, given the short sale, did not list Countrywide or any other mortgage company in her schedules, nor did she list the property as being an asset.
15 *Id.* at 15.
16 *Id.* at 18.
17 *Id.* at 22-23. *See also, In re Varona*, 388 B.R. 705, 717 (Bankr. E.D. Va. 2008) (explaining, "Despite the availability of other statutory or rule-based remedies, the Court's power to remedy and punish for the filing of a false or fraudulent claim is within the strictures of its authority pursuant to 11 U.S.C. §105.").
18 407 B.R. 873 (Bankr. N.D. Ohio 2009).
19 *Id.* at 883.
20 *In re Stewart*, 391 B.R. 327, 357 (Bankr. E.D. La. 2008).
21 *Id.*
22 *Id.*
23 *In re Jones*, Case No. 03-16518, Section A, 14 (Bankr. E.D. La. Oct. 1, 2009).
24 *Id.*
25 *Id.* at 14-15.
26 *Id.* at 16-17.