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# Misbehavior and Mistake in Bankruptcy Mortgage Claims

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# Misbehavior and Mistake in Bankruptcy Mortgage Claims

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Abstract

*The greatest fear of many families in serious financial trouble is that they will lose their homes. Bankruptcy offers a last chance for families save their houses 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 claims with the court for the amount of the mortgage debt. In turn, bankruptcy debtors pay these claims to retain their homes. This process is well-established and, until now, uncontroversial. The assumption is that the protective elements of the federal bankruptcy shield vulnerable homeowners from harm.*

*This Article examines the actual behavior of mortgage companies in consumer bankruptcy cases. Using original data from 1700 recent Chapter 13 bankruptcy cases, I conclude that mortgage servicers 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 claims. Fees and charges on claims often are poorly identified and do not appear to be reasonable. The bankruptcy data reinforce concerns about the overall reliability of the mortgage service industry to charge homeowners only the correct and legal amount of the debt and to comply with applicable consumer protection laws. Mistakes or misbehavior by mortgage servicers can have grave consequences. Bloated claims can jeopardize a family's ability to save their home in bankruptcy. On a system level, mistakes or misbehavior by mortgage servicers undermine America's homeownership policies for all families trying to buy a home.*

*The data also reinforce concerns about whether consumers can trust financial institutions to adhere to applicable laws. The findings are a chilling reminder of the limits of formal law to protect consumers. Imposing unambiguous legal rules does not ensure that a system will actually function to safeguard the rights of parties. Observing the reality that laws can underperform or even misfire has crucial implications for designing legal systems that produce acceptable and just behavior.*

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## INTRODUCTION

Families in financial distress 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. For many families, the greatest fear is losing their home 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 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. The bankruptcy system offers refuge from the vagaries of state law foreclosure, substituting the protections of a 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 the bankruptcy court for the amount of the mortgage debt. 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, specifying the manner in which the amount owed is to be established and obligating both the homeowner and the mortgage company to disclose information accurately.

This claims process is well-established and, until now, uncontroversial. Homeowners—backed up by lawyers, policymakers, and news reporters—assume that bankruptcy functions according to the official rules and, by following these rules, that it provides a realistic opportunity for families to save their homes. The data revealed in this Article suggest, however, that home mortgage lenders often disobey the law and overreach in calculating the mortgage obligations of consumers. Such actions can cripple a family's efforts to save its home and undermine policies to promote sustainable homeownership.

This Article examines the actual behavior of mortgage companies in the consumer bankruptcy system. Using original data from 1700 recent Chapter 13 bankruptcy cases, I conclude that mortgagees' behavior significantly threatens bankruptcy's potential to help families save their homes. Despite unambiguous federal rules designed to protect homeowners and to ensure the integrity of the bankruptcy process,[2] mortgage companies frequently fail to comply with the laws that governs bankruptcy claims. A majority of mortgage companies' proofs of claim lack the required documentation necessary to establish a valid debt. Fees and charges on bankruptcy claims often are identified poorly and sometimes do not appear to be reasonable. Each year, mortgage creditors assert that bankrupt families owe them an aggregate of at least one billion dollars more than the families themselves believe are their outstanding mortgage debts. Although infractions are frequent and irregularities are sometimes egregious, the bankruptcy system routinely

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

[2] *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.").

processes mortgage claims that are not lawful. Far from serving as a significant check against mistake or misbehavior, the bankruptcy system routinely processes mortgage claims that clearly are not lawful.

The data revealed here are important because they offer a rare glimpse into the billion-dollar world of mortgage servicing. Many of the overcharges and unreliable calculations identified in the bankruptcy data are not specific to bankruptcy. Instead, they raise the specter of poor recordkeeping, failure to comply with consumer protection laws, and massive, consistent overcharging. If mortgage companies frequently fail to comply with federal bankruptcy law and do not deal honestly with bankruptcy courts, trustees, and bankrupt families (most of whom are represented by attorneys), the problems may be worse for ordinary, non-bankrupt Americans, who have none of those safeguards operating in their favor. These data suggest a widespread problem in the American home mortgage market. Instead of focusing exclusively on loan origination, these data suggest that regulators and policymakers should broaden their vision to consider how poor mortgage servicing can threaten families' efforts at homeownership throughout the country.

The evidence that unreliable mortgage servicing is flourishing also 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 industry. All parties usually are represented by attorneys. A specialized federal bench and neutral bankruptcy trustees are appointed specifically to police misbehavior. The 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. The findings are a chilling reminder that imposing unambiguous legal rules does not ensure that the system will actually function to safeguard the rights of parties. In a consumer context in particular, where individuals are not repeat players or institutional actors, observing the reality of laws that underperform or even misfire has crucial implications that echo far beyond the bankruptcy scheme. An effective legal system requires more than merely putting words in a statute or relying on silence as an indication of acceptable and just behavior. These data show that effective enforcement mechanisms or structural incentives for compliance can be as important as the substantive rules themselves.

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 methodology of the Mortgage Study. Part III presents original data on the legality and accuracy of mortgage claims. These data show that even in the context of the heightened procedural protections in bankruptcy, the incidence of unreliable servicing behavior is high. Part IV analyzes the policy implications of my findings and proposes structural solutions to reduce the risks to homeowners created by poor servicing. Without improved procedures and enforcement activity, families struggling with homeownership—both inside and outside bankruptcy—remain vulnerable to mortgagees' mistakes and misbehavior.

## I. STATEMENT OF PROBLEM

Many Americans pursue homeownership as a step to build wealth and to improve their financial position. As the volume of mortgage lending has mushroomed and the secondary mortgage market has matured, there have been occasional criticisms of mortgage servicing.[3]

[3] Some lenders service their own loans. For purposes of this paper, I refer only to servicers, but lenders who service their own loans may engage in similar behavior to third-party servicers.

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Consumers have complained of overcharges or difficulty in obtaining accurate loan information. Friction between mortgagors and mortgagees (and their agents) has sometimes erupted into litigation, most frequently in bankruptcy courts. Although policymakers' focus has been on loan origination,[4] consumers also are harmed if they are overcharged while they are paying their mortgage. Mortgage servicing errors that lead to overcharges increase the cost of homeownership and expose families to the risk of wrongful foreclosure. Scattered reports reveal a range of possible mortgage servicing abuse and highlight the need for a systematic examination of such behavior.

**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, governments, and insurers.[5] The rise of servicing as a distinct industry results from the widespread use of securitization in the mortgage market.[6] Put simply, securitization is the process of creating debt instruments (usually bonds) by assembling a group of mortgage loans into a pool of similar transactions, transferring the obligations to a trust, and then selling investors fractional interests in the trust's pool of mortgages.[7] These investors receive periodic payments on their investments in the pool of loans. Servicers act as intermediaries between the borrower and the other parties to the securitization. A pooling and servicing agreement sets out the servicer's responsibilities for collecting and remitting the mortgage payments and the permissible responses that the servicer may employ if a borrower defaults on a loan. The participation of servicers complicates the borrower-lender relationship and limits flexibility in loss mitigation and default situations.[8]

Borrowers cannot shop for a loan based on the quality of the servicing, and they have virtually no ability to change servicers.[9] The servicer works on behalf of the bond issuer, and by extension the investors who owned the mortgage-backed securities. The servicer does not have a customer relationship with the borrower.[10] When they enter into a mortgage transaction, borrowers cannot specify that a particular servicer will be responsible for their loan. If their servicer provides poor or even abusive service, the borrower has no exit strategy other than

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[4] *See, e.g.*, Iowa Attorney General, Press Release, 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 settlement with Household Finance for misrepresentation and disclosure violations at loan origination was largest-ever direct restitution settlement).

[5] Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers*, 15 HOUSING POLICY DEBATE 753, 755 (2004); Michael LaCour-Little, *The Evolving Role of Technology in Mortgage Finance*, 11 J. OF HOUSING RESEARCH 173, 186 (2000).

[6] Statement of Sheila C. Bair, Testimony before U.S. House Comm. on Financial Services, (April 17, 2007) ("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.").

[7] *See generally* Steven L. Schwarcz, Bruce A. Markell, & Lissa L. Broome, SECURITIZATION, STRUCTURED FINANCE, AND CAPITAL MARKETS (2004) (providing an introduction to securitization and examining the legal issues relevant to a securitized transaction).

[8] *Id.* at 9.

[9] Jack Guttentag, *Why is Mortgage Servicing So Bad?*, http://www.mtgprofessor.com/A%20-%20Servicing/why_is_servicing_so_bad.htm.

[10] Lenders do have a customer relationship with borrowers and may want to retain them as repeat customers. 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 loan is serviced by the originating lender.

refinancing the loan. Even then, there is no guarantee that the refinanced loan will not be assigned to the same servicer. Consumers cannot seek redress by complaining about the quality of the servicing because the servicer's reputation among borrowers is not a concern for issuers. Neither the servicer nor the bond issuer has a financial incentive to care about service to a borrower.[11]

While servicers are limited in their actions by their contracts with the trust for the bond holders, servicers have a financial incentive to overcharge consumers. Mortgage servicers earn revenue in three major ways. First, they receive a fixed fee for each loan. Typical arrangements pay servicers between .25% and 1.375% of the note principal for each loan.[12] Second, servicers earn "float" income from accrued interest between when consumers pay servicers and when the servicers remit those funds to their clients. Third, servicers often are permitted to retain all, or part, of any additional charges that consumers pay.[13] Servicers boost their profits when they charge excessive fees, impose late charges, or create hurdles for borrowers who are trying to cure defaults and stop a cascade of fees.[14] The head of the Federal Deposit Insurance Corporation has noted that because of this structure, the servicers' incentives upon default may not align with bondholders' incentives.[15] A borrower's default can present a servicer with an opportunity for additional profit. A significant fraction of servicers' total revenue appears to come from retained fee income.[16]

A consumer is only obligated to pay charges if they are permitted by the terms of the mortgage and by state and federal law. To ensure the accuracy and legality of such charges, consumers must understand how the servicer calculated the amount purported to be due and whether such fees are consistent with their loan contract. Mortgage servicers may exploit consumers' difficulty in recognizing errors or overcharges by providing poor service that maximizes their profits.[17] A lending industry representative has admitted that "[m]ost people don't understand the most basic things about their mortgage payment."[18]

The Federal Trade Commission has identified mortgage servicing abuse as a serious problem for homeowners and urged consumers to keep careful records to ensure that their mortgage account is being properly credited.[19] Among the specific practices that the Commission has flagged are the imposition of unwarranted late fees; unnecessary force-placed insurance; and illegitimate or unexplained fees. Despite these alleged problems, the Commission has not targeted any particular servicer or servicing practice for enforcement activity in the last few years. Another federal agency, the Department of Housing and Urban Development, has potential authority to address servicing misbehavior. Forty percent of consumer complaints to the

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[11] *Id.*
[12] Nat'l Consumer Law Center, FORECLOSURES 23 (2006 Supp.).
[13] Eggert, *supra* note 15,. at 758 (explaining that servicers' conventional fee is a percentage of the total value of the loan but that servicers typically have the right to retain any default fees).
[14] Nat'l Consumer Law Center, *supra* note __, at 23.
[15] Statement of Sheila C. Bair, *supra* note ___, at 9.
[16] Some information can be gleaned from the securities filings of public companies that service mortgages. Late charges account for approximately 11% of revenues for Ocwen's residential mortgage servicing division in 2006. *See* Ocwen Financial Corp., Annual Report (Form 10-K), at 30 (Mar. 16, 2007). *Cf.* RONALD MANN, CHARGING AHEAD 23 (2006) (reporting that credit card issuers earn 9% of their revenue from penalty fees).
[17] *See* Jack Guttentag, *Why is Mortgage Servicing So Bad?*, http://www.mtgprofessor.com/A%20-%20Servicing/why_is_servicing_so_bad.htm (Feb. 3, 2003; updated Dec. 13, 2004).
[18] Lenders Look for Way to Avoid Bankruptcy Maze, NAT'L MORTGAGE NEWS, Aug. 30, 2004.
[19] Fed'l Trade Comm'n, Mortgage Servicing: Making Sure Your Payments Count, *available at* http://www.ftc.gov/bcp/conline/pubs/homes/mortgserv.htm.

Department of Housing and Urban Development concern servicing issues,[20] and a study of consumer satisfaction with business services found that only 10% of borrowers are happy with their mortgage servicer.[21] Yet, litigation outside of the bankruptcy context alleging mortgage servicing abuse is sparse. The paucity of lawsuits could have several explanations, including that consumers are not aware of their rights with regard to servicers, that attorneys are not willing to bring such lawsuits, or that most disputes are resolved without the need for litigation.

Mortgage servicing abuse is a nascent legal issue. Because mortgage servicing is a relatively new industry, the law has generally lagged behind emerging issues.[22] The Real Estate Settlement Procedures Act is the main federal law that governs mortgage servicers.[23] The thrust of that law is to obligate servicers to communicate certain information to borrowers.[24] Consumers may submit a "qualified written request" to obtain information about the servicing of their mortgages, and servicers are obligated to respond to the request within sixty days.[25] There is no empirical evidence of how frequently consumers invoke this law to aid them in their disputes with servicers, or whether consumer attorneys are aware of the potential of the Real Estate Settlement Procedures Act to aid clients struggling with mortgage servicing abuse.[26]

Newspapers have featured the difficulties that consumers face in resolving disputes with mortgage servicers.[27] 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. 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. This year, the *Boston Globe* reported that mortgage companies include projected foreclosure costs in payoff amounts given to borrowers in default.[28] These fees are estimates for anticipated services that may never be incurred. 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."[29]

Two cases illustrate the harms that incorrect or inaccurate mortgage servicing can impose on borrowers. In *Rawlings v. Dovenmuehle Mortgage, Inc.*,[30] the servicer repeatedly asserted that the homeowners had failed to make payments, imposed late fees, and sent notices of default. It took the consumers over seven months to resolve its error in applying the consumers' payments to another borrower's account. In *Islam v. Option One Mortgage Corp.*,[31] the prior servicer continued to contact borrowers who had refinanced their mortgage loan, threatened to foreclose

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[20] *See* Jack Guttentag, *Why is Mortgage Servicing So Bad?*, http://www.mtgprofessor.com/A%20-%20Servicing/why_is_servicing_so_bad.htm (Feb. 3, 2003; updated Dec. 13, 2004) (reporting that two in five complaints to the Department of Housing and Urban Development involve servicing issues).

[21] Press Release, J.D. Powers and Associates, *Customer Service and Attention to Detail Drive Home Mortgage Satisfaction* (Nov. 26, 2002), http://www.jdpower.com/corporate/news/releases/pressrelease.aspx?ID=2002144.

[22] Nat'l Consumer Law Center, *supra* note ___, at 23.

[23] 12 U.S.C. § 2605.

[24] For example, if the loan is being transferred to a different servicer, the consumer must receive timely notification of the transfer. 12 U.S.C. § 2605(b).

[25] 12 U.S.C. § 2605(e).

[26] One challenge may be that consumers do not seek counsel until foreclosure is imminent, at which time, a qualified written request and its sixty-day response window may not seem like an expedient option.

[27] *See, e.g.*, S.P. Dinnen, Mortgage Complaints Can Take Extra Effort, DES MOINES REGISTER, May 2, 2004; A. Pesquera, Paper Trail of Problems: Some Fairbanks Clients Report Nightmare Errors, SAN ANTONIO EXPRESS-NEWS, Aug. 9, 2002.

[28] Sacha Pfeiffer, *Hidden Legal Fees Push Some Into Foreclosure*, BOSTON GLOBE (Jan. 18, 2007).

[29] *Id.*

[30] 64 F. Supp. 2d 1156 (M.D. Ala. 1999).

[31] 432 F. Supp. 2d 181 (D. Mass. 2006).

on their home, and did not report to credit bureaus that the loan was paid off. The consumers struggled for more than a year to get the servicer to change its practices. These cases highlight the burden that consumers face in resolving disputes without resorting to litigation. Yet, the paucity of reported opinions suggests that many consumers may respond to mortgage claims by "lumping it," rather than seeking any formal redress.[32]

When problems are systematic, individual consumer action may be an ineffective solution. The Federal Trade Commission 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. The lawsuit settled in 2003 after Fairbanks agreed to pay $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.[33]

Spiking foreclosure rates and pressure from Wall Street may exacerbate problems with mortgage servicing.[34] Falling real estate prices have changed the profit calculus of foreclosure, encouraging lenders to reach out to delinquent borrowers. Facing political and financial pressure, lenders and servicers are struggling to develop cost- and time-effective strategies for loss mitigation.[35] However, cash-strapped lenders have fewer resources than ever to devote to loan servicing. 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. Research has shown that the quality of loan servicing can affect the incidence and degree of loan default.[36] Poor mortgage servicing can increase loss severities and deprive families and even investors of sensible loan modification opportunities. Mortgage servicing is a crucial piece of sustainable homeownership policy that should be evaluated for policy reform as part of the response to the rising foreclosure rate.

**B. Mortgage Servicing in Bankruptcy Cases**

Most consumers who file Chapter 13 bankruptcy cases are homeowners who are in default on their mortgage at the time of their bankruptcy filing.[37] The pre-bankruptcy default usually means that the mortgage accounts of bankruptcy debtors reflect servicer activity, such as

[32] Marc S. 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.").

[33] Fairbanks Capital Corporation settlement documents, http://www.consumerlaw.org/initiatives/mortgage_servicing/index.shtml. Fairbanks is now named Selected Portfolio Servicing.

[34] Posting of Tara Twomey, Subprime Servicing Getting Worse, to *Credit Slips* blog, http://www.creditslips.org/creditslips/2007/03/subprime_servic.html (Mar. 19, 2007).

[35] Ruth Simon, *Digging Out of Delinquency*, WALL ST. J. April 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."); Carrick Mollenkamp, *Faulty Assumptions*, WALL ST. J. Feb. 8, 2007 (describing HSBC's expanded loss mitigation efforts).

[36] Anthony Pennington-Cross & Giang Ho, *Loan Servicer Heterogeneity &The Termination of Subprime Mortgages*, Federal Reserve Bank of St. Louis Working Paper No. 2006-024A (April 2006), *at* http://research.stlouisfed.org/wp/2006/2006-024.pdf (finding that presence of individual servicer affected chance of default to substantial and meaningful degree among large sample of subprime mortgages).

[37] TERESA SULLIVAN, ELIZABETH WARREN, JAY LAWRENCE WESTBROOK, THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT, 202 (2000) (half of all bankruptcy debtors are homeowners); Bahchieva, Wachter & Warren, *supra* note ___, at 104–05 (explaining that homeowners disproportionately choose Chapter 13 because Chapter 7 does not protect home equity).

imposing penalty fees (such as late charges), sending default letters, or implementing other loss mitigation strategies, that add to the amount that a debtor must pay to cure the default. The requirements of the Bankruptcy Code increase the complexity of the default situation. A bankruptcy filing imposes new burdens on mortgage servicers, including compliance with the automatic stay and with the rules regarding proofs of claim.

When a borrower in default files bankruptcy, the creditor is barred by the automatic stay from pursuing other legal action to collect the debt.[38] Pending foreclosures may not proceed against the debtor's home, unless the court grants the creditor relief from the stay to continue that action.[39] The proof of claim process that is incorporated into every bankruptcy serves as an alternative venue for adjudicating any disputes about the debt and for facilitating repayment to the creditor. In the mortgage context, the filing of a proof of claim functions in a similar manner to a complaint seeking a judgment of foreclosure. The debtor has the opportunity to "answer," by contesting the claim. Because of the expansive definition of a bankruptcy claim[40] and a bankruptcy court's equitable powers,[41] the bankruptcy process can resolve issues regarding whether the debtor actually is obligated on the debt, the amount of outstanding debt, and the nature of the obligation (for example, secured versus unsecured or contingent versus presently due).

Creditors are not required to file proofs of claim, but must do so to be eligible to receive distributions from the bankruptcy estate.[42] Barring a specific challenge based on bankruptcy law,[43] liens on the debtor's property pass unaffected through a bankruptcy.[44] Thus, a valid mortgage remains on the debtor's home, even if the mortgagee does not file a bankruptcy claim. In Chapter 13 cases, creditors usually file proofs of claim as a vehicle for establishing the amount of the outstanding arrearage, which is usually a key element in determining whether a debtor's proposed Chapter 13 plan is feasible. Additionally, a proof of claim is usually necessary if creditors wish to have the trustee collect and disburse the ongoing mortgage payments.[45] No

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[38] 11 U.S.C. § 362(a).
[39] 11 U.S.C. § 362(b).
[40] 11 U.S.C. § 101(5) ("The term 'claim' means—right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.").
[41] 11 U.S.C. § 105.
[42] 11 U.S.C. § 501(a) ("A creditor or an indenture trustee may file a proof of claim."); *see also* David Gray Carlson, *Proofs of Claim in Bankruptcy: Their Relevance to Secured Creditors*, 4 J. BANKR. L. & PRAC. 555 (1995).
[43] 11 U.S.C. §§ 544, 547 (2005).
[44] Marianne B. Culhane & Michaela M. White, *Debt After Discharge: An Empirical Study of Reaffirmation*, 73 AM. BANKR. L.J. 709, 712 (1999).
[45] *See* ELIZABETH WARREN & JAW LAWRENCE WESTBROOK, THE LAW OF DEBTORS AND CREDITORS 219 (5th ed. 2005) ("[T]o receive any distribution, each chapter 7 or chapter 13 creditor must submit a proof of claim."). This seemingly simple statement is complicated in Chapter 13 when a debtor may be making up past debts (arrearages) and making ongoing obligations as scheduled in the original loan. *See infra* note 130. The practices for paying mortgages during a Chapter 13 case vary across districts, yet another example of the well-documented phenomena of local legal culture in bankruptcy cases. *See* Teresa A. Sullivan, Elizabeth Warren & Jaw Lawrence Westbrook, *The Persistence of Local Legal Culture: Twenty Years of Evidence From the Federal Bankruptcy Courts*, 17 HARV. J.L. & PUB. POL'Y 801 (1994); Jean Braucher, *Lawyers and Consumer Bankruptcy: One Code, Many Cultures*, 67 AM. BANKR. L.J. 501 (1993). In many jurisdictions, mortgages are paid "outside the plan," meaning that the debtor continues to make the ongoing principal and interest payments directly to the mortgage servicer, just as before the bankruptcy. Even in these instances, however, the trustee usually collects the debtor's payment of any arrearages on the mortgage loan. Some Chapter 13 trustees require the debtor to make their regular mortgage payments to the trustee, along with the arrearage payments, because they believe that this practice reduces confusion or error and increases the chance that the debtor successfully completes the Chapter 13 plan. Whether a trustee charges a fee to

prior data seem to exist on how frequently creditors in general or mortgagees in specific actually file proofs of claim.[46] The Mortgage Study identified and examined all filed proofs of claim that corresponded to the home loans that debtors reported on their bankruptcy court schedules.[47] Proofs of claim are the most common way in which mortgage servicers interact with the bankruptcy system and may be the best mechanism for examining the overall reliability of mortgage servicing within the bankruptcy context.

A prominent Chapter 13 trustee has concluded that mortgage servicing in bankruptcy is in a "sorry state."[48] Anecdotes reinforce the aptness of this description. 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 $60,000.[49] The inaccuracy stemmed from the claimants' mistake in reporting the cost of the insurance policy that the servicer forced on the debtor after the debtor's insurance lapsed.

While such a glaring error would hopefully always cause a debtor or trustee to object, more modest errors risk passing through the bankruptcy system without notice or resolution. A debtor's attorney who has developed a training program to educate attorneys about mortgage servicing issues has concluded "that the vast majority of Chapter 13 debtors and their attorneys do little or nothing about these illegal fees and charges."[50]

Mistakes or misbehavior by mortgage servicers also burden bankruptcy trustees who are responsible for ensuring accurate payments to all creditors in all cases. At a meeting of the National Association of Chapter 13 Trustees a few years ago, attendees discussed problems with mortgage servicing in Chapter 13 cases. A laundry list of grievances was aired: servicers are unable to prepare correct pre-petition claims in Chapter 13 cases; proofs of claim are filed without balances or are bloated with illegal and fraudulent fees sometimes totaling several thousand dollars; irreconcilable and unexplained balances appear on amended proofs of claim; servicers provide no contact information; and servicers refuse to provide loan payment histories.[51] Loan servicers have complained of the heightened litigation risk that they face in bankruptcy,[52] presumably because consumers have attorneys and bankruptcy courts require evidentiary hearings before granting stay relief.[53]

In early 2005, industry representatives and Chapter 13 trustees formed a "Mortgage Committee" to address how to improve the existing bankruptcy procedures that apply to

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the estate for collecting and disbursing regular mortgage payments also varies between different judicial districts and affects the proof of claim practice.

[46] *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).

[47] *See infra* Part II.

[48] Henry E. Hildebrand III, *The Sad State of Mortgage Service Providers*, 22 AM. BANKR. INST. L. REV. 10 (2003).

[49] The proof of claim is on file with Katherine Porter. It was made in a Northern District of Texas Chapter 13 case.

[50] 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.

[51] Email communication from the Honorable Keith M. Lundin dated June 9, 2003 describing session on mortgage issues in Chapter 13 (on file with author).

[52] National Mortgage News, *Lenders Look for Way to Avoid Bankruptcy Maze* (Aug. 30, 2004) (quoting employee of servicer remarking that "[b]ankruptcy is becoming a fertile ground for a lot of loopholes and a lot of lawsuits and a lot of costs to servicers.").

[53] When judicial foreclosure is required, a state court judge should also scrutinize the lenders' pleadings. However, only about half of states require judicial foreclosure, and in many others, no deficiency is permitted against a debtor's principal residence. This latter rule reduces a court's incentive to ensure that the amount alleged to be due is correct because the foreclosure can proceed if any substantial default exists.

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mortgage claims. Notably, the committee's representatives do not appear to have included any consumer debtors, other than those Chapter 13 trustees who may represent debtors as part of their private practice.[54] As of June 2007, the committee had developed a number of proposed practices. Its subcommittee on proofs of claim drafted a model proof of claim attachment. That form would supplement the identification fields that exist on the standard proof of claim.[55] The model attachment would require servicers to provide a detailed profile of the terms of the loan, including the type of the loan, its interest rate, and adjustment dates. Most importantly, it presents a 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 subcommittee does not report how close servicers' current practices are to the proposed model attachment and whether any servicers have voluntarily adopted the model form. The formation of such a committee and the obvious effort expended in developing its proposals reflect that mortgage servicers themselves recognize that their procedures in bankruptcy cases need improvement.

### C. Bankruptcy Litigation of Mortgage Claims

Bankruptcy changes the dynamic between borrowers and servicers. The vast majority of consumers hire an attorney to represent them in their bankruptcy.[56] The consumer's retention of counsel may partially explain why most mortgage-servicing litigation occurs in bankruptcy and may suggest that attorneys or consumers are not willing to raise such claims outside of bankruptcy. As part of the bankruptcy case, the attorney may find it difficult to obtain the cooperation of the mortgage servicer and may find it necessary to litigate with the servicer to represent the debtor in the bankruptcy. Bankruptcy is the context for most servicing disputes, but the problems that bankruptcy courts have identified frequently concern servicing activity that occurred well before the bankruptcy.

In recent years, bankruptcy courts have issued opinions faulting mortgagees for providing inaccurate information and ignoring applicable laws and procedures.[57] Courts and litigants have struggled to obtain comprehensible records from servicers or lenders. A leading decision is *In re Maxwell*.[58] Tara Twomey, the co-principal investigator of the Mortgage Study, represented the debtor. The court described the discrepancies in the servicer's court filings. "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."[59] 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." The court noted that

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[54] As of June 2007, the National Association of Chapter 13 Trustees Mortgage Committee was comprised of Chapter 13 trustees, mortgage servicers, and their attorneys. *See, e.g.*, NAT'L ASS'N OF CHAPTER THIRTEEN TRUSTEES, REPORT OF MORTGAGE COMMITTEE (June 28, 2007) (manuscript on file with author).

[55] *Id.* The model "Attachment to Chapter 13 Proof of Claim" would require the creditor to provide the 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).

[56] TERESA SULLIVAN, ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA, 22–23 (1989) (finding only 4% of debtors in a sample of 1529 cases filed *pro se* petitions).

[57] *See* Hildebrand, *supra* note 21 (describing mortgage servicers' inability or lack of effort to make their records match the debtor's plan or to comply with the requirements of the Bankruptcy Code such as disclosing fees and costs.).

[58] Maxwell v. Fairbanks Capital Corp. (In re Maxwell), 281 B.R. 101 (Bankr. D. Mass. 2002).

[59] *Id.* at 114.

criminal penalties exist for presenting a fraudulent claim. The court held that Fairbanks violated the Fair Debt Collection Practices Act, the Real Estate Settlement Procedures Act, the Massachusetts Consumer Credit Cost Disclosures Act, and that the terms of the loan were unconscionable. After the court's decision, the debtor settled the case for a full discharge of her mortgage, $50,000 in damages, and attorney's fees.

Other courts have identified a similar pattern of servicer behavior to that described in *Maxwell*. Unable to decipher a servicer's records, even after ordering further document production, one court finally resorted to creating its own amortization table. The judge stated that "[t]he poor quality of 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 record-keeping products generated by lenders and loan servicers in court proceedings."[60] In some instances, mortgagees apparently are unable to offer any documentation. In *Litton Loan Servicing v. Garvida*, the bankruptcy court ordered the servicer to provide an accounting of the loan balance after the debtor asserted that a lesser amount was due.[61] The servicer failed to do so, and the Bankruptcy Appellate Panel affirmed that an adjustment of the mortgagee's claim was an appropriate remedy.

Mortgagees' accounting has created problems in bankruptcy contexts other than proofs of claim. The nature of the errors is rarely due to the procedural posture of the case, however, so these cases may well indicate that similar problems pervade mortgage claims. In the situations below, debtors and their counsel may be forced to confront servicing inaccuracies that may go unidentified in proofs of claim because attorneys and debtors may not scrutinize the claims. Motions for relief from the stay, for example, put debtors at direct risk of losing their home, spurring debtors and their attorneys to respond to the servicers' pleadings. Several courts have complained about unsubstantiated or patently false allegations in mortgagees' motions for relief from the stay. The Bankruptcy Court for the Southern District of New York has lamented mortgage servicers' practice of filing motions to vacate the automatic stay based on poor accounting practices or non-existent records.[62] The court rejected what it termed the mortgage servicers' "dog ate my homework excuses,"[63] emphasizing the damage to the judicial process that occurs when a court is asked to rule on incorrect or baseless facts. It also noted that in each of the three separate cases at issue, the mortgage servicer's actions had created a danger that a family would lose its home without just cause and in violation of the Bankruptcy Code.

Other cases that question the reliability of servicers' accounting arise after a bankruptcy is filed at the time when a debtor is trying to complete a confirmed Chapter 13 plan. In *Jones v. Wells Fargo Home Mortgage*, the debtor filed an adversary proceeding when he was unable to obtain an accounting from Wells Fargo after he refinanced his loan during bankruptcy.[64] Upon examination of all the servicer's actions, the court identified a variety of accounting errors and impermissible behavior, including miscalculations of both prepetition and postpetition obligations and attempts to collect impermissible fees.[65] Wells Fargo also applied payments in

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[60] *In re* Wines, 239 B.R. 703, 709 (Bankr. D.N.J. 1999).
[61] *In re* Garvida, 347 B.R. 697 (9th Cir. BAP 2006).
[62] *In re* Gorshtein, 285 B.R. 118 (Bankr. S.D.N.Y. 2002).
[63] *Id.* at 126.
[64] *In re* Jones, No. 03-16518, 2007 WL 1112047 (Bankr. E.D. La. 2007).
[65] Perhaps most egregiously, Wells Fargo charged the debtor for sixteen property inspections during the pendency of the bankruptcy case but its representative "could not list a single reason why an inspection would have been ordered postpetition, nor could she detail any reason why continuous monitoring of the property was necessary or reasonable." *Id.* at *11.

violation of the plan—a practice that increased the interest charged above what was actually due.[66] 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."[67] The court imposed a sanctions award of $67,202.45 and ordered Wells Fargo to implement an accurate accounting system for post-petition mortgage payments in all cases in its district.[68] Another court reduced a mortgagee's claim under the equitable theory of recoupment after finding that the servicer violated the Real Estate Settlement Procedures Act in failing to respond to the debtor's requests for clarification of the account balance. 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 statement of the debtor's default prior to foreclosing on the debtor's house?"[69]

Some courts have targeted the law firms retained by mortgagees or servicers. Judge Steen found that a large creditor's firm had filed an erroneous and unsubstantiated objection to plan confirmation on behalf of its client, Countrywide Home Loans.[70] Judge Morris Stern fined a New Jersey law firm for filing 250 court pleadings in which the signature page had been pre-signed before review by the servicer.[71] His opinion sternly reminds servicers and attorneys that technological "advances" do not absolve the responsible humans of their duty to the court.[72] 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 servicing agent, or how their client came to acquire its role."[73]

Bankruptcy courts have occasionally been the venue for class-action lawsuits based on mortgage servicing abuses. Purported wrongdoing by mortgage lenders sparked two cases in the Southern District of Alabama. One class-action case alleged that a lender had failed to file fee applications to recover attorneys' fees included in proofs of claim, and later the lender simply stopped disclosing the fees but continued charging them to debtors' accounts. The court ordered that the lender return the disputed fees to all class members.[74] A separate class-action suit complained about the lenders' practice of charging a "proof of claim fee" or "bankruptcy fee." The court approved a settlement that required the lenders to credit each class member's loan account in the amount of the fees.[75] 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

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[66] *Id.* at *3.
[67] *Id.* at *4.
[68] *Michael L. Jones v. Wells Fargo Home Mortgage* (*In re Jones)*, Case. No. 03-16518; Adv. No. 06-01093. Supplemental Memorandum Opinion (Aug. 29, 2007). The court believed that "it would be more productive and effective to accept Well Fargo's offer to modify its practices" than to impose a "large monetary fine." Slip op. at 13.
[69] *In re* Thompson, 350 B.R. 842, 844–45 (Bankr. E.D. Wis. 2006).
[70] *In re* Allen, Memorandum Opinion regarding Sanction of Creditor's Attorneys, Case No. 06-60121 (Jan. 9, 2007), http://www.nacba.org/files/email/Hamm-Memorandum_Opinion_re_Sanctions_v_Barrett_Burke.pdf; *see* Order Sanctioning Barrett, Burke, Wilson, Castle, Daffin & Frappier, *In re* Allen, No. 06-60121 (Bankr. S.D. Tex. June 18, 2007) (fining the law firm $75,000).
[71] *In re* Jenny Rivera, 342 B.R. 435 (Bankr. D.N.J. 2006).
[72] *Id.* at 467. *See also* Allen, *supra* note 38 (describing the close relationship between servicers and their "outside" counsel, who receive some pleadings "set up" with data from the servicer's computer system.).
[73] *In re* Schwartz, No. 06-42476JBR, 2007 WL 1188348, (Bankr. D. Mass. April 19, 2007). In that case, 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.
[74] *In Re* Slick, No. 98-14378-MAM, Adv. No. 99-1136 (Bankr. S.D. Ala. Nov. 22, 2002).
[75] *In Re* Harris, No. 96-14029-MAM, 00-11321-MAM, Adv. No. 99-1144 (Bankr. S.D. Ala. Jan. 13, 2005).

Chapter 13 cases.[76] This case was transferred by the Judicial Panel on Multidistrict Litigation to the Northern District of Illinois and apparently remains pending.[77] Servicers have not changed their practices based on these isolated cases, despite the breadth of relief granted or requested for each class.

In general, disputes about mortgage servicing have been two-party contests between debtors and mortgage servicers. Just this year, that situation changed. The U.S. Trustee Program participated in litigation over an order to a leading mortgage servicer (Countrywide) and its prominent creditor's counsel (Barrett Burke) to show cause why they should not be sanctioned for filing a motion for relief from the stay that was allegedly inaccurate.[78] On its own volition, the Office of the United States Trustee submitted a statement in response to the show cause order.[79] The U.S. Trustee suggested that it conduct further examination and discovery pursuant to Federal Rule of Bankruptcy Procedure 2004 to determine whether Barrett Burke and Countrywide were aware of ongoing problems with the accuracy of their pleadings and what those parties were doing to address these problems.[80] At that point, Barrett Burke retained outside counsel to represent it, who filed a motion to strike or limit the U.S. Trustee's motion for discovery,[81] but the court denied the motion.[82] The court later affirmed that the U.S. Trustee had standing to appear and be heard on matters raised in show cause orders and had the authority to conduct discovery under Bankruptcy Rule 2004.[83] A final order has not yet been issued on the show-cause hearing. The issues of the propriety and amount of sanctions remain pending. Undeniably, however, the participation of the U.S. Trustee changed the character of the litigation and exposed servicers and their attorneys to having their mortgage accounting and pleading

[76] *In re* Dunlap, No. 03-14317-LBR, Adv. No. 03-1429, (Bankr. Nev. Jan. 26, 2005); Nevada judge green-lights class action against mortgage provider, CONSUMER BANKRUPTCY NEWS, Feb. 17, 2005 at 2. T.

[77] *In re* Ocwen Federal Bank FSB Mortgage Servicing Litigation, 04-cv-2714, MDL-1604, N.D. Ill.

[78] Order Requiring Countrywide Home Loans, Inc. to Appear and Show Cause Why It 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, No. 05-90374 (Bankr. S.D. Tex. Feb. 12, 2007).

[79] Statement of the United States Trustee 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, No 05-90374, (Bankr. S.D. Tex. Mar. 3, 2007). In addition to briefing the relevant legal issues and asking the court to permit it to conduct additional discovery, the U.S. Trustee set forth evidence of prior litigation asserting that Barrett Burke had been accused of filing inaccurate pleadings. These cited cases included *In re* Allen, 2007 WL 115182 at 5–6 (Bankr. S.D. Tex.) and *In re* Thompson, 01-10399-RLJ-13 (Bankr. N.D. Tex. 2003) (imposing sanction against Barrett Burke and its client CitiFinancial Mortgage).

[80] Fed. R. Bank. Proc. 2004(b) (establishing an expansive examination into "the acts, conduct, or property or to the liabilities and financial condition of the debtor").

[81] Motion of Barrett Burke Wilson Castle Daffin & Frappier, L.L.P. to Strike or, In the Alternative, Limit Issues and/or Continue Show Cause Hearing (Docket #29), *In re* Parsley, No. 05-90374 (Bankr. S.D. Tex. Mar. 5, 2007).

[82] Order Granting in Part and Denying in Part Motion of Barrett Burke Wilson Castle Daffin & Frappier, L.L.P. to Strike or, In the Alternative, Limit Issues and/or Continue Show Cause Hearing, *In re* Parsley, No. 05-90374 (Bankr. S.D. Tex. Mar. 6, 2007).

[83] Findings of Fact and Conclusions of Law Regarding Barrett Burke, Countrywide Home Loan, Inc., and McCalla Raymer, LLC's Emergency Motions for Protective Order, *In re* Parsley, No. 05-90374 (June 6, 2007) (citing 11 U.S.C. § 307 as the basis for the U.S. Trustee's standing and stating that Countrywide and Barrett Burke "must comply with the production requests of the U.S. Trustee."). Indeed, another judge in the same judicial district (Southern District of Texas) specifically requested that the U.S. Trustee participate in litigation before that court about the accuracy of Barrett Barke's mortgage claim-related pleadings. Request for Participation by US Trustee, *In re* Allen, No. 06-60121 (Bankr. S.D. Tex. Mar. 9, 2007).

practices in Chapter 13 cases scrutinized on a more systematic basis than in prior single-case litigation.

Mistakes or misconduct by mortgage companies 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. Such overpayment harms debtors because it increases their burden in confirming and completing repayment plans. As one bankruptcy court recognized, mistakes by creditors, who are in control of the accounts, impose additional costs to sort out such problems on debtors, the party that can least afford such expense.[84]

## II. METHODOLOGY

The Mortgage Study is a large, multi-state study of the home loans of Chapter 13 debtors. Tara Twomey and I are the principal investigators in the Mortgage Study.[85] The National Conference of Bankruptcy Judge's Endowment for Education, a non-profit and non-partisan organization that funds basic research and education about bankruptcy, provided financial support for the Mortgage Study.[86] The Endowment for Education is not responsible for the data or findings, which are solely my responsibility. No other entity or organization provided funding or participated in the research.

The Mortgage Study's principal objective was to create a new, original database that would improve researchers' ability to examine the intersection of mortgage lending and bankruptcy. The final sample contains 1733 Chapter 13 bankruptcy cases filed by homeowners. The sample was constructed using the case report feature on PACER and includes cases from forty-four judicial districts in twenty-four states.[87] The sample was constructed by selecting every fifth case filed between April 1, 2006, and April 30, 2006, in which the debtor reported owning a home, regardless of whether any liens encumbered their homes.[88] If a case was converted from another chapter or 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.[89]

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

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[84] *Williams v. Fairbanks Capital Corp. (In re Williams)*, 2001 WL 1804312, *2 (Bankr. D.S.C. 2001) (awarding punitive damages to debtor as a result of actions and misrepresentations of creditor).

[85] 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. They provided no funding and have no access to the data.

[86] More information about the National Conference of Bankruptcy Judges' Endowment for Education is available on its website: http://www.ncbj.org/education.php3 (last visited Sept. 7, 2007).

[87] We thank the Chief Judges of each district in the Mortgage Study (with the sole exception noted below) for granting a waiver of PACER fees for this research. The Southern District of Texas denied the 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* Electronic Public Access Fee Schedules (Sept. 9, 2006), http://pacer.psc.uscourts.gov/documents/epa_feesched.pdf.

[88] To be included in the sample, a debtor must have been a homeowner. Ninety-six percent of homeowners had outstanding mortgage debt when they filed bankruptcy.

[89] For example, in a district with few Chapter 13 filings, such as Wyoming, only two cases are in the sample. At other extreme, the sample contains 164 cases from the Northern District of Georgia because that district has a large number of Chapter 13 cases filed.

studies have confirmed that the percentage of homeowners in Chapter 13 bankruptcy is much higher than in Chapter 7 bankruptcy.[90] Sampling only Chapter 13 cases made it easier to construct a sample of homeowners in bankruptcy because it eliminated the need to examine thousands of Chapter 7 cases to find those filed by homeowners. The exclusive focus on Chapter 13 also enhances the usefulness of the Mortgage Study's data to examine bankruptcy as a home-saving device.[91] Chapter 13 is particularly attractive to homeowners who are in default on their mortgage loans because it permits them to retain their home and cure arrearages over time through their repayment plans.[92] The rules and procedures that govern the proof-of-claim process apply equally in Chapter 7 and Chapter 13 cases. Mortgagee claims are much less important in Chapter 7 because Chapter 7 does not provide a remedy to debtors who are in default on their home loans.

The other limitation of the sample was the choice of where to sample. By design, the sample only contains bankruptcy cases filed in districts where the applicable state law permits non-judicial foreclosures of debtors' principal residences.[93] Non-judicial foreclosure is faster and less expensive than judicial foreclosure.[94]

The more favorable remedies of non-judicial foreclosure reduce the willingness of mortgage lenders in states with such laws to negotiate upon default and increase the debtors' need to file bankruptcy to create a forum to contest the foreclosure and restructure the home loan. Limiting the sample to states that permit non-judicial foreclosure increased the proportion of homeowners in default on mortgage loans in the sample. The forty-four judicial districts in the sample capture variations in local bankruptcy practice and ensure that all of the nation's largest mortgage lenders and servicers are represented. The bankruptcy claims process should not differ between judicial and non-judicial foreclosure states, but instead may vary by local rule imposed in a given judicial district.

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[90] Consumer Bankruptcy Project III (CBP) data indicate that homeownership is much more prevalent among Chapter 13 debtors than Chapter 7 debtors. In the CBP's core sample of 1250 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 (data on file with author).

[91] Scarce data exist on how homeowners fare in bankruptcy. *See* Melissa B. Jacoby, *Bankruptcy Reform and Homeownership Risk*, 1 ILL. L. REV. 323, 352 (2007) ("Although scholars of mortgage debt and foreclosure generally may be aware that some homeowners with housing problems file for bankruptcy, [c]hapter 13's specific mortgagor protection feature has not received sufficient discrete and sustained scholarly attention."). The most extensive study to date was conducted based on cases filed in 2001 and did not rely on proofs of claim or home loan documents. *See* Raisa Bahchieva, Susan Wachter, and Elizabeth Warren, *Mortgage Debt, Bankruptcy, and the Sustainability of Homeownership*, in CREDIT MARKETS FOR THE POOR 74 (Patrick Bolton & Howard Rosenthal, eds. 2005).

[92] *See* 11 U.S.C. §§ 1322(b)(3) and (5), 1325(a)(5) and 362(a).

[93] The following twenty-four states permit non-judicial foreclosure of residential mortgages: Alabama, Arkansas, California, Colorado, District of Columbia, Georgia, Idaho, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Mississippi, Montana, New Hampshire, North Carolina, Rhode Island, South Dakota, Tennessee, Texas, Utah, Virginia, West Virginia, and Wyoming. There are forty-four judicial districts in these states, so our sample represents 49% of the judicial districts in the United States.

[94] *See* GRANT NELSON & DALE WHITMAN, REAL ESTATE FINANCE LAW 635 (2002); BARLOW BURKE, REAL ESTATE TRANSACTIONS 336 (2006) ("[Power of sale foreclosure] is cheaper than judicial foreclosure and takes less time."). Judicial foreclosure procedures vary depending on state law. Typically these steps include: 1) summons, complaint, answer, motion for summary judgment and a trial; 2) appointment of a referee to compute the debt and to search the title; 3) referee report; 4) court order authorizing the sale; 5) sale advertisement; 6) sale; and 7) judgment confirming the sale. *Id.* at 334. Non-judicial foreclosure typically proceeds under a deed of trust that permits a third-party trustee, upon default, to sell the property in a private sale. Although some public notice is required by all states, a non-judicial foreclosure, as its name suggests, does not require court supervision or the filing of a lawsuit. *Id.* at 337.

All data were drawn from the public court records filed in each case.[95] The debtor files schedules that provide detailed information on debts, assets, and income at the time of the bankruptcy. These schedules are filed under penalty of perjury,[96] and may provide more complete and reliable evidence of debtors' financial situations than survey or interview methods.[97] Other leading studies of consumer bankruptcy typically rely on debtors' schedules as their primary source of information about debtors' financial situations.[98] From the schedules, we coded debtors' incomes, current home-related expenses, their valuations of their homes, any relevant exemptions claimed in real property, and any other information the debtor provided about loans that encumbered their home, including total debt, arrearages, and monthly payments.[99]

The major methodological innovation of the Mortgage Study was to use mortgagees' proofs of claim and supporting documentation to collect more detailed information on home loans than was available from the schedules.[100] We drew data primarily from four documents: the proof of claim itself and, when attached to the proofs of claim: any itemization or detail of the amount claimed; a copy of the security interest that pertained to the loan; and a copy of the note that evidenced the obligation. Relying on these documents, we coded the type and terms of each loan; the amount and nature of any arrearages; the names of the mortgagee, originating lender, and servicer; and the outstanding obligation at origination and at the time of the bankruptcy. We also coded any objections to mortgagees' proofs of claim[101] and any amended claims. If a case had only one mortgage loan, we coded 152 data points for that case; when

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[95] Most documents were obtained from PACER, but paper records were consulted if necessary. When documents were initially missing, we rechecked the PACER docket ten months after the initial collection to see if the documents had been added. 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 paper court records. We were shocked to learn that in the Eastern and Middle Districts of North Carolina, the debtor's attorney is not sent a copy of the proofs of claim and that they are not made available on PACER for easy review.

[96] Teresa 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, 218 (2006).

[97] RONALD J. MANN, CHARGING AHEAD 61 (2006) (noting problems with Federal Reserve's Survey of Consumer Finance data); 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) ("SCF households substantially underreport their bankcard debt."). To date, the Mortgage Study has not surveyed or interviewed debtors. Demographic information about homeowners is available from the Consumer Bankruptcy Project III (2001) and the ongoing Consumer Bankruptcy Project IV (2007), which use surveys and interviews.

[98] *See* Sullivan, Warren & Westbrook, *Less* Stigma, *supra* note ___, at 213; Scott Norberg & Andrew J. Velkey, *Debtor Discharge and Creditor Repayment in Chapter* 13, 39 CREIGHTON L. REV. 473 (2006); Marianne B. Culhane & Michaela M. White, *Debt After Discharge: An Empirical Study of Reaffirmation,* 73 AM. BANKR. L.J. 709, 712 (1999).

[99] We drew this information from the following documents in each case: docket, petition, Schedules A, C, D, I, and J, Form B22, and the Chapter 13 plan. These documents were available and complete in well over 99% of all cases in our sample; there are very few missing observations. We coded only the original version of the schedules, including any separately and later filed schedules that were not included in the debtors' original pleadings. We did not code information from the amended schedules because we were interested in the debtors' initial ability to gauge the amount owing on their mortgage debts.

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

[101] The initial coding revealed very few objections to proofs of claim. To ensure that these data were reliable, we checked both the docket and the claims register of each case a second time. We include as data any objections identified upon either the first or the second review.

debtors had more loans, there were more data points to capture.[102] With its combination of data from creditors' pleadings and debtors' pleadings, the Mortgage Study database offers a rich and detailed picture of the home loans of families in bankruptcy.[103]

Data were coded into a specially designed database. We used only three coders, which reduced concerns about intercoder consistency. Two coders had law degrees, and the third coder has prior experience in coding bankruptcy data for academic research. All coders received individual training on practice cases to reduce errors and improve the reliability of data coding. Coders referred to a written codebook during the coding process and noted any unusual situations. We reviewed the coding in each of the cases that coders flagged as unusual to ensure that these cases were coded correctly.

To improve the reliability of the data, we deployed two standard procedures. First, we ran error traps to verify the quality of data entry and improve the accuracy of the database. Two examples illustrate the types of checks that we used: we reviewed any proof of claim dates that were entered as being before April 2006, when the cases were filed; and we checked for any dollar figure entries that began with a decimal point or exceeded one million dollars. When we identified errors, we corrected the database. Second, a random sample of 10% of the cases (approximately 175 cases) was recoded blind—without reference to the prior coding and without knowledge that an initial coding existed. We compared each variable of each case between the initial coder and the recoder, noted any discrepancies, and checked for mistakes in the initial coding. The data were 99% accurate, and no systematic errors were identified between coders.[104]

The final data were transferred to Microsoft Excel and SPSS for Windows for analysis. All dollar figures are presented as found 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 the rules of the bankruptcy system, and a significant fraction of claims appear to request impermissible, unreasonable or inaccurate charges. Yet, the vast majority of all claims pass undisturbed through the bankruptcy system, potentially skewing distributions to all creditors and weakening the integrity of the Chapter 13 process.

### A. Required Documentation for Mortgage Claims

Creditors who want to receive bankruptcy distributions must file a proof of claim using the official form or something that substantially conforms to the form.[105] A proof of claim should either consist of a completed Official Form 10 or a similar document. Form 10 directs creditors to attach an itemized statement if their claim "includes interest or other charges" in addition to the principal amount.[106] This requirement would apply to all typical mortgage claims, as nearly all of these obligations bear interest. The itemization permits the collective parties in a

[102] The exact number of data points actually coded (as opposed to left blank because they did not apply) varied with the case 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.
[103] In total, approximately 200 data points were coded for each case, making the Mortgage Study useful for studying other hypotheses about bankruptcy and homeownership.
[104] The error rate was 1.04%. To calculate the error rate, we compared the original coding and the recoding and determined the number of errors in the initial coding, and divided this number by the number of data points.
[105] Fed. R. Bankr. P. 3001(a).
[106] Official Form 10, *available at* http://www.uscourts.gov/bankform/formb10new.pdf.

bankruptcy—debtor, trustee, other creditors—to ensure that the total amount claimed consists of sums that are permitted under the terms of the note and mortgage.

Federal Rule of Bankruptcy Procedure 3001 imposes two additional evidentiary requirements on proofs of claim:[107] a copy of the writing if one evidences the claim;[108] and evidence of perfection if the creditor asserts a security interest in the property of the debtor. [109] These rules permit debtors, trustees, and courts to evaluate the accuracy of claims and ensure that all payments are made in accord with the Bankruptcy Code and applicable nonbankruptcy law. Without documentation, parties cannot ensure that the creditors' claims correctly reflect the terms of the loan and all payments made, and comply with applicable law.

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.[110] The documentation requirements for these mortgage proofs of claim are unambiguous and long-standing. Nevertheless, these laws were not consistently respected. A substantial fraction of claims lacked one or more required attachments. Figure 1 illustrates the findings for all proofs of claim in the sample that relate to a loan secured by a debtor's home.[111]

A majority of claims (83.9% of all proofs of claim in the sample) had the itemization attached to them.[112] Despite the instruction on Form 10, the remaining fraction (16.1%) did not have an itemization attached. In the sample, about one in six claims was not supported by an itemization. Part B, *infra*, discusses the quality of these itemizations.

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[107] It is possible that a single 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 any instances in which the note was incorporated into the mortgage. For consumer home loans, nearly all of which are intended for resale on the secondary market as part of mortgage-backed securities, separation of the note and the mortgage helps ensure that the note is a negotiable instrument under law that will be subject to the holder-in-due-course defense upon sale.

[108] 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.").

[109] Fed. R. Bankr. P. 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.").

[110] A proof of claim was filed to correspond with over 90% of the home loans listed on the debtors' schedules. To boost the completeness of the Mortgage Study database, in each case in which a proof of claim was not initially located to correspond with a home loan, a second check was conducted approximately eighteen months after the case was filed to ensure that all available proofs of claim were incorporated into the database.

[111] These data come from only the original proofs of claim, and do not reflect any attachments that may have been added by mortgagees when they filed amended proofs of claim. However, note that the number of amended claims was relatively small. Only 9.7% of all claims had an amended claim associated with them.

[112] N= 1768 proofs of claim. Itemizations were attached to 1484 of these proofs of claim.

*Figure 1: Percent of Proofs of Claim Missing Required Documentation*


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. Yet, four of ten claims were missing this crucial evidence. A note was not attached to 41.1% of claims. Only 58.9% of proofs of claim filed by mortgagees had a writing attached to evidence the debt.

Given the importance of a note to establish the principal amount of debt, the interest rate, and other key terms, it was surprising that the note was more frequently missing from claims than a copy of the security interest. The higher likelihood that a claim will not have a note attached is troubling for several reasons. First, the note is not easily available from another source. Unlike the security interest, notes are not recorded in the public records. If the debtor has lost the note, and the servicer does not provide one, the servicer has an informational advantage, which the rule was presumably designed to eliminate. Second, 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 produce instruments or contracts in compliance with the proofs of claim rules. The lack of notes in the Mortgage Study hints that this aspect of Rule 3001 compliance may be even worse for smaller claims evidenced by a writing, such as credit-card debts.[113] Third, the promissory note or other debt instrument is absolutely necessary to enable the debtor, trustee, and other creditors to verify that the amount asserted to be 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.[114]

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[113] John Rao, *Debt Buyers Rewriting of Rule 3001: Taking the "Proof" Out of the Claims Process*, 23-AUG AM. BANKR. INST. L. REV. 16 (July/Aug. 2004).

[114] A few states have specific laws that govern foreclosure costs and fees. *See, e.g.*, Mich. Comp. Laws Ann. 600.2431 (West 2000) (capping attorneys' fees in a non-judicial foreclosure at no more than $75 if the mortgage does not specifically contract for such attorneys' fees). In most instances, the note contains broad language on

Creditors were more diligent about attaching documentation to show they hold 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 prior finding on promissory notes, it is tempting to view Rule 3001(d)'s requirement of attaching a security interest as a relative success that may not merit policy attention. However, the fact remains that one in five creditors ignores required federal law when they participate in a bankruptcy case. With much less evidence of clear misbehavior by debtors,[115] Congress imposed audits on debtors' schedules to ensure full disclosure of assets and permitted dismissal of debtors' cases for failure to provide required documentation in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.[116] These actions evidence Congress' belief that bankruptcy is a serious and important process and that compliance with the technical process is necessary to preserve the system's integrity. To be sure, there could be reasons to have different standards for debtors and creditors. In the vast majority of instances, debtors are the party seeking bankruptcy relief. Thus, it may be fair to impose an increased burden on debtors as the "moving" party in bankruptcy cases. Nonetheless, creditors who choose to participate in bankruptcy cases also submit themselves to federal process. Viewed from this perspective, the nearly twenty percent (19.6%) of proofs of claim without security interests represents a structural weakness in the integrity of bankruptcy procedures. Creditors should be required to comport with the rules that govern their responsibilities to debtors, courts, and other creditors.

Creditors' compliance with the rule requiring the attachment of evidence of a valid security interest likely results from the practice of a few Chapter 13 trustees of objecting to claims if the security interest is missing. Further, security interests are publicly available from local land records if the obligation was properly recorded. Thus, while loan documentation may get lost in the shuffle between lenders and servicers or between servicers if the obligation is transferred, this problem can be remedied by relying on public records. In contrast, the parties cannot rely on a neutral third-party to maintain a readily accessible copy of the promissory note.

These factors may combine to make mortgagees fear that failure to attach a security interest is a red flag that the obligation was not, in fact, properly perfected, and is subject to

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charges and costs. For example, the Fannie Mae uniform instruments gives the note holder 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." *See* Fannie Mae, Multistate Fixed Rate Note—Single Family, 6e, https://www.efanniemae.com/sf/formsdocs/documents/notes/pdf/3200.pdf. Particularly in the subprime market or for refinance loans, a uniform instrument might not be used. However, even the Fannie Mae language permits borrowers to raise defenses in some situations. For example, it puts a "reasonableness" limitation on attorneys' fees. Also, the language on "costs and expenses" is modified by "enforcing this Note." Costs that are not necessary to enforce the Note—for example, fax fees, arguably cannot be justified by this provision.

[115] *See* Steven W. Rhodes, *A Preview of "Demonstrating a Serious Problem with Undisclosed Assets in Chapter 7 Cases"* 2002 5 NORTON BANKR. L. ADVISER 1 (May 2002) (finding in a one district sample that 41% of asset cases (a small fraction of all Chapter 7 cases generally) contained inaccuracies in debtors' list of assets and valuations); Recommendations for Reform of Consumer Bankruptcy Law by Four Dissenting Commissioners, REPORT OF THE NAT'L BANKRUPTCY REVIEW COMMISSION, ch. 5 at 14 n. ("The Commission repeatedly heard testimony that the information reported in the debtors' schedules is unreliable.").

[116] BAPCPA, Pub. L. No. 109-8, § 603, 119 Stat. 23, 122 (authorizing random audits of debtors); Pub. L. No. 109-8, §316, 119 Stat. 23, 92 (to be codified at 11 U.S.C. § 521(i)) (automatically dismissing a debtor's bankruptcy case if required information, including payment advices, are not filed).

avoidance under the Bankruptcy Code.[117] In the context of a mortgage, avoidance typically relegates the obligation to unsecured status in bankruptcy and dramatically reduces the debtor's obligation to pay the full amount of the debt.[118] Such a mistake also redounds to the benefit of unsecured creditors, whose distributions are higher if the mortgage can be paid pro rata with other unsecured claims. While most mortgages probably are recorded correctly in the public records, a few enterprising trustees may discover other errors in the mortgage process such as inadequate witnesses to the obligation that subject the claim to avoidance. Attaching evidence that the creditor has a valid security interest may defer any further scrutiny of the mortgage and weaken the likelihood that these problems are identified. Most trustees simply do not look beyond whether a security interest is attached, and indeed, the data suggest that in at least a modest fraction of instances, the trustees do not even care if the security interest is missing entirely.

The security interest, however, is also useful for reasons beyond validating the perfection of the lien. The deed of trust or mortgage typically has provisions that bear on the propriety of the servicer's accounting. For example, most model Fannie Mae instruments require the lender to either apply or refund partial payments within a "reasonable period of time."[119] Based on this language, a debtor could challenge a servicer's practice of holding amounts in suspense accounts for several consecutive months. When a claim is not supported by the required documentation, debtors, trustees, and other parties in interest cannot readily validate the claim against the terms of the obligation.

Compliance with the documentation requirements varied among claims filed in different judicial districts. In some districts, there are very few observed cases because Chapter 13 filings are infrequent. Because there were only a few claims in the sample from judicial districts with few bankruptcy filings, the percentage of claims with documentation attached could change dramatically with the addition of a single case in these jurisdictions. Thus, these data are best used to observe a general pattern of variation, rather than as robust measures of compliance in any individual district.

As shown by the top and bottom of the lines in Figure 2, there was at least one district in which no claims had a required type of documentation and at least one district in which all claims had a type of documentation. The boxes in Figure 2 represent the districts whose compliance was in the middle two quartiles of the variation. The bottom of each box shows the rate of compliance in the district that was at the first quartile (25% of districts had worse compliance). The top of each box shows the rate of compliance in the district that was at the top quartile (75% of districts had worse compliance). The diamond in the middle of each box shows the rate of compliance in the median district.

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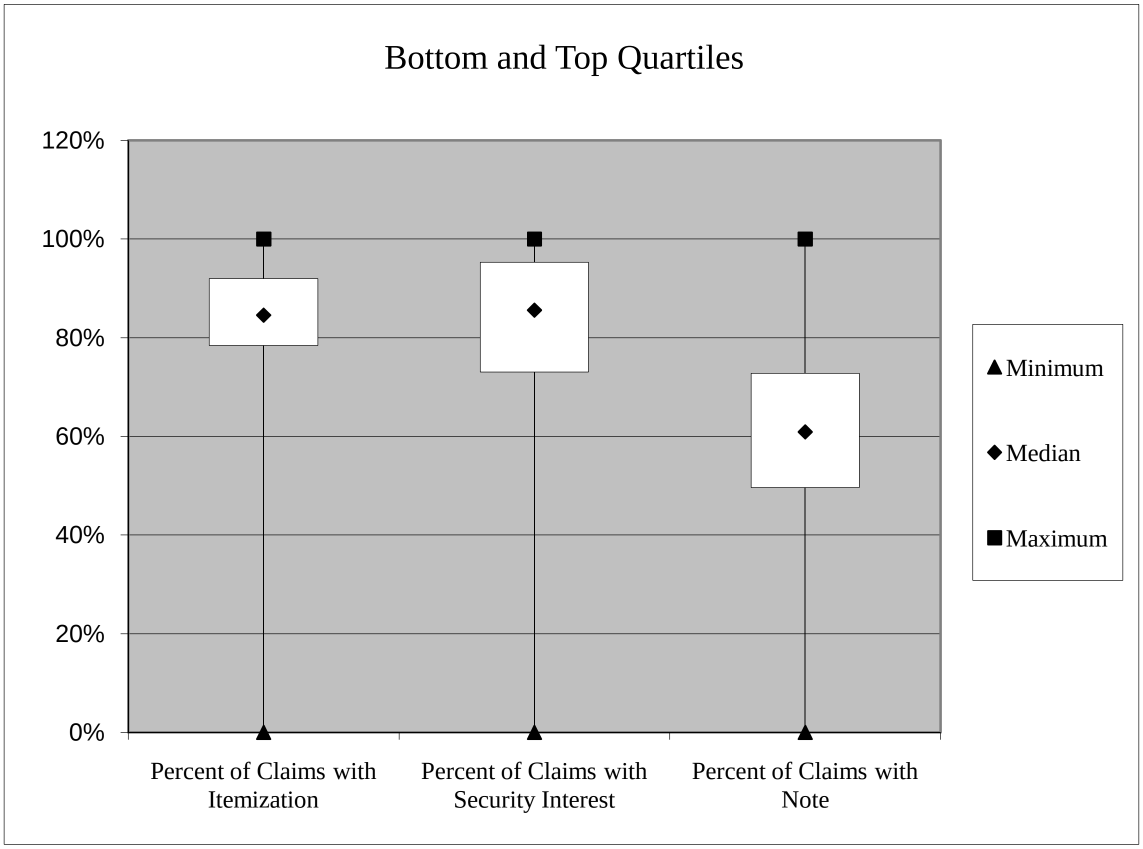
[117] 11 U.S.C. §§ 544 and 548. These provisions are commonly called the "strong arm" powers, because they empower the trustee or other party in interest to "knock off" security interests that are not properly perfected under state law to defeat certain other types of creditors.

[118] Without a security interest, the mortgage is an unsecured obligation and the house is owned free and clear. This not only frees up the house as an asset for the debtor to borrow against in the future, it permits the debtor to discharge any remaining obligation on the mortgage claim after committing all disposable income for the applicable commitment period in the Chapter 13 case.

[119] Fannie Mae/Freddie Mac Uniform Instrument (standard), https://www.efanniemae.com/sf/formsdocs/documents/secinstruments/#standard.

*Figure 2: Variation among Judicial Districts in Attached Documentation*




The least inter-district variation occurred with respect to whether itemizations were attached to claims. While there were outlier districts at both extremes (0% of claims had itemizations and 100% of claims had itemizations), most districts had itemizations attached to between 80 and 90% of the claims. In one in five districts, every claim (100%) had an itemization attached. This was the most consistent compliance rate among the districts, as shown by the relatively short height of the itemization box in Figure 2.

There was greater variation between districts with regard to Rule 3001 compliance. In seven judicial districts, every single claim had a security interest attached. However, in one-fourth of all districts, fewer than 75 percent of all claims had security interests attached. A similar pattern of variation was identified for the attachment of notes to proofs of claims. The major difference was that notes were simply less likely to be attached in the entire sample of districts. Among the districts with the worst compliance with Rule 3001(c)'s requirement that a writing be attached (those in the bottom quartile), the percentage of claims with a note attached was 50 percent or below, ranging all the way to zero complying claims.

The variation among districts reinforces concerns about uniformity, a feature of bankruptcy law that is explicit in the U.S. Constitution's provision permitting a federal bankruptcy law.[120] While uniformity challenges to bankruptcy law have had little success,[121] the variations in proofs of claim reinforce concerns about systematic differences based on where the debtor files bankruptcy. Several academics have observed the effects of "local legal culture" in

[120] U.S. CONST. art. I, § 8, cl. 4; 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).
[121] *See id.* (cataloguing unsuccessful challenges under the uniformity clause).

other aspects of bankruptcy practice;[122] practices with respect to disbursing payments to mortgagees are one example of differences in judicial districts.[123] The proof of claim data reinforce the existence of the existence of the local legal culture phenomenon because compliance with the documentation requirements varies among judicial districts. To the extent that uniformity is a crucial aspect of ensuring the integrity of the bankruptcy system, creditors' inconsistent compliance with claims procedures hinders this goal. Depending on place of residence, debtors and their counsel receive varying amounts of information about mortgage obligations.

The data on proofs of claim show that, at least in one important respect, creditor behavior is not uniform and consistent. Despite clear requirements for documentation that apply in all bankruptcy cases, mortgage proofs of claims do not consistently adhere to applicable law. A majority of claims 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 debtors to verify the accuracy of claims. Undocumented or insufficiently documented claims create obstacles to ensuring that families only pay their mortgage creditors what is actually owed and may permit creditors to manipulate the bankruptcy process.[124] The requirements for valid claims should be enforced against creditors to prevent these harms.

**B. Default Fees in Mortgage Claims**

Itemizations were the most common documentation attached to claims. The prevalence of itemizations, however, is misleading. Examination of the itemizations revealed large discrepancies in the quantity of detail provided. No standard format exists for itemizations. Even among servicers, the claims differed in some instances depending on the attorney who was hired to file the proof of claim.[125] The same attorney sometimes filed proofs of claim in several different formats, which could reflect that the servicer itself is preparing the proof of claim and merely transmitting it to the attorney for review and filing with the court.

Inconsistencies in the itemization undermined their usefulness. The itemizations can be a valuable source of information about the nature of the mortgage arrearage that debtors must pay to save their home in bankruptcy. Shortcomings in the detail of information on the itemizations prevent the development of semi-automated or consistent processes for reviewing the charges.

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[122] *See* Lynn M. LoPucki, *Legal Culture, Legal Strategy, and the Law in Lawyers' Heads*, 90 NW. U. L. REV. 1498 (1996); Teresa A. Sullivan, Elizabeth Warren & Jaw Lawrence Westbrook, *The Persistence of Local Legal Culture: Twenty Years of Evidence From the Federal Bankruptcy Courts*, 17 HARV. J.L. & PUB. POL'Y 801 (1994); Jean Braucher, *Lawyers and Consumer Bankruptcy: One Code, Many Cultures*, 67 AM. BANKR. L.J. 501 (1993).

[123] In many jurisdictions, mortgages are paid "outside the plan," meaning that the debtor continues to make the ongoing principal and interest payments directly to the mortgage servicer, just as before the bankruptcy. Even in these instances, however, the trustee usually collects the debtor's payment of any arrearages on the mortgage loan. Some Chapter 13 trustees require the debtor to make their regular mortgage payments to the trustee, along with the arrearage payments, because they believe that this practice reduces confusion or error and increases the chance that the debtor successfully completes their Chapter 13 plan. Whether a trustee charges a fee to the estate for collecting and disbursing regular mortgage payments also varies between different judicial districts and affects the proof of claim practice.

[124] *See* Opinion Resolving Show Cause Order Entered on March 8, 2007, *In re Wingerter*, No. 06-50120 (Oct. 1, 2007) ("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.")

[125] In some districts, one or two creditors' counsel dominate local consumer practice, and those firms' itemizations forms seem to be a kind of de facto standard.

For analysis, the Mortgage Study employed several categories for the types of charges that debtors owe,[126] and the fees and charges on each itemization were individually coded in the appropriate category.

Forty-three percent of the 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. We coded these fees, and the mortgagees' description of the nature of the charges, in an "other" category. These "other" fees were often substantial in amount, but poorly identified.[127] At least three separate concerns appeared from analysis of the fees mortgagees' asserted to be owed in their claims. First, some creditors appear to be overreaching or engaging in unfair practices by asking for patently unreasonable fees. Second, many "itemizations" contain so little detail as to be a perversion of Form 10's use of that term. Third, many proofs of claim requested payment of a "bankruptcy fee," but the permissibility of such a charge is often unclear. Each of these issues is discussed in turn below.

Fees that did not fit an expected category were *per se* suspicious because the categories were deliberately broad (such as "foreclosure costs" and "post-petition") to encompass all common charges that delinquent borrowers incur. As part of the analysis, each of the "other" fees was considered individually. This review revealed dozens and dozens of attempts to collect fees that are likely impermissible, if not illegal. Some of these fees are not "reasonable" as required by the note or state law, are unconscionable as a matter of contract law, or would not withstand an objection by the debtor. Table 1 gives a few examples of causes for concern:

*Table 1: Actual Fees from Mortgagees' Claims*

| **Description** | **Id. No.** | **Fee amount** |
|---|---|---|
| Attorney's fees | WDVA 4 | $31,273 |
| Bankruptcy fees & costs | NDGA 56 | $2275 |
| Broker price opinion fee | ED AR 18 | $1489 |
| Demand fee | DMA 18 | $145 |
| Overnight delivery | EDMI 91 | $137 |
| Payoff statement fee | SDCA 7 | $60 |
| Fax fee | EDVA 21 | $50 |

[126] Each charge was categorized as one of the following: principal, interest, escrow, late charges, foreclosure fees or costs, non-sufficient 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. Our confidence in these categories was bolstered by the recent release of the Model Proof of Claim itemization developed by a joint committee of Chapter 13 trustees and mortgage servicers. *See* Model Proof of Claim Attachment, NAT'L ASS'N OF CHAPTER THIRTEEN TRUSTEES, REPORT OF MORTGAGE COMMITTEE (June 28, 2007) (manuscript on file with author).

[127] For example, one claim's "itemization" listed $5391 described only as "other." (CDCA 12). Another claim requested $3023 for "delinquency expenses." (NDGA 146).

The key point about these suspicious fees is that the proof of claim documentation is frequently inadequate to permit a determination of whether the fees are accurate and legal. In some instances the terms of the transaction may be critically important. For example, at least one court has held that payoff fees are impermissible because they constitute a non-reimbursable expense under the terms of the note.[128] The typical amount of a fax fee ($50) could also be challenged as unreasonable. Such requests are apparently handled autotmatically by fax-back technology at minimal cost to the servicer.[129]

Some notes only obligate the borrower to pay the lender for "reasonable" costs incurred to collect on the debt or enforce the security interest.[130] The standard Fannie Mae/Freddie Mac security interest usually empowers 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.[131] The security interest language is quite broad, and makes clear that the listed examples are non-exhaustive. Nonetheless, the fees shown in Table 1 may be neither reasonable nor appropriate; the cited language certainly gives the debtor a basis for investigating the propriety of such fees. The explosion of subprime and alternative loans means that more homeowners have non-standard terms, which has exacerabated the problems created by the lack of claim documentation. Moreover, these fees may be impossible to verify without a payment history for the loan, which almost never was attached to the proof of claim.[132] For example, late charges can be challenged if the payment history shows that they were imposed despite the debtor's check clearing the bank at a prior date.[133]

[128] *See, e.g.*, Ga. Code Ann. § 7-6A-3 (4) (prohibiting payoff fee or limiting fee to $10 if borrower requests a faxed copy of payoff amount or has other recent payoff requests); Dougherty v. N. Fork Bank, 753 N.Y.S.2d 130 (App. Div. 2003) (holding that payoff quote fee of $100 was not permissible under state law).
[129] LaCour, *supra* note 15, at 192 ("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.")
[130] For example, one of the mortgage proofs of claim for a case in the Mortgage Study database, MDTN 44, contains the following language, which even specifies that it shall govern any bankruptcy claims filed by the lender: "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. This provision also shall apply if I file a petition or any other claim for relief under any bankruptcy rule or law of the United States, or if such person or other claim for relief is filed against me by another."
[131] *See* Fannie Mae/Freddie Mac Uniform Instrument (standard), *available at* https://www.efanniemae.com/sf/formsdocs/documents/secinstruments/#standard ("If (a) Borrower fails to perform the covenants and agreements contained in this Security Instrument, (b) there is a legal proceeding that might significantly affect Lender's interest in the Property and/or rights under this Security Instrument (such as a proceeding in bankruptcy, probate, for condemnation or forfeiture, for enforcement of a lien which may attain priority over this Security Instrument or to enforce laws or regulations), or (c) Borrower has abandoned the Property, 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 attorneys' fees to protect its interest in the Property and/or rights under this Security Instrument, including its secured position in a bankruptcy proceeding.").
[132] The instruction on the proof of claim form (Official Form 10) that says that the claimant "must attach to this proof of claim form copies of documents that show the debtor owes the debt claimed" arguably requires not just the note that shows the debtor is in fact obligated on the principal, but the payment history that supports that the debtor actually owes the additional charges.
[133] *See In re Ocwen Federal Bank F.S.B. Mortgage Servicing*, 2006 WL 794739 (N.D. Ill. Mar. 22, 2006) (denying motion to dismiss a multi-district litigation suit that alleged, *inter alia*, that servicer misapplied payments and improperly imposed late fees.).

In other situations, servicers may impose fees repeatedly within a very short time frame. If done without cause and in an unreasonable manner, the imposition of these fees can constitute servicing abuse that may be an unfair or deceptive practice. From the information creditors provided in many itemizations, it was unclear whether the fees represent aggregate costs or single charges. The overnight delivery charge reported in Table 1 illustrates this concern. While it is remotely possible that a debtor could incur a total of $137 in overnight delivery charges over a period of several months, it is exceedingly difficult to determine what bulky and heavy item would incur those charges if they resulted from a single mailing or even how many different mailings must have been made overnight to accumulate $137 in charges. Perhaps the charge reflects a data entry error, and should have been $13, or $17, or $37. The relevant point is that the bankruptcy system did not flag this item as a potential cause for concern and resolve this problem.

Certain charges that may appear on proofs of claim simply are not legal. Some states have regulated the imposition of fees, such as prohibiting the pyramiding of late fees,[134] and promulgated specific rules about the use of suspense accounts to hold partial payments in abeyance.[135] 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 a securitization pooling agreement, despite the fact that the loans are governed by varying state law. Unless debtors and their counsel object to these claims or obtain a payment history from the servicer to verify these charges, patently unreasonable or illegal fees can pass through the proof-of-claim process and become fixed obligations that debtors must pay to comply with their Chapter 13 plans.

Recently, one bankruptcy court implemented a policy that a certain type of default charge in mortgage claims is not allowed unless the creditor requests an evidentiary hearing and carries its burden. The Honorable Henry Boroff, Chief Judge of the United States Bankruptcy Court of Massachusetts, stated on the record that he is "done allowing lenders reimbursement for property preservation fees," unless the lenders can show "that those property inspections actually happened and that they're worthwhile."[136] Property inspections are the most common type of "property preservation fees;" the other frequent charge is for a broker price opinion, which is essentially an abbreviated appraisal. If the transaction is governed by a standard Fannie Mae/Freddie Mac security instrument, the lender may be limited to making "reasonable" entries or inspections.[137] Presumably, this limitation governs the frequency, as well as the cause, for such activity. The court's presumption against property preservation charges apparently stems from concern that property preservation activity is often unnecessary or unjustified, or that lenders sometimes impose such charges without the occurrence of any actual inspection or appraisal. The Federal Trade Commission's settlement with Fairbanks Capital Corporation

[134] The Fannie Mae note seems to prohibit pyramiding late fees, stating that the borrower will pay a late charge "only once on each late payment." *See* Fannie Mae, Multistate Fixed Rate Note—Single Family, 6a, *available at* https://www.efanniemae.com/sf/formsdocs/documents/notes/pdf/3200.pdf. Some transactions used different notes (and thus, it is important that a copy of the note accompany the proof of claim), and some servicers may not honor the terms of the notes, either intentionally or inadvertently.

[135] JOHN RAO, ODETTE WILLIAMSON & TARA TWOMEY, NATIONAL CONSUMER LAW CENTER, FORECLOSURES: DEFENSES, WORKOUTS, AND MORTGAGE SERVICING 154–55 (2d. ed. 2007).

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

[137] *See* Fannie Mae/Freddie Mac Uniform Instrument (standard), *available at* https://www.efanniemae.com/sf/formsdocs/documents/secinstruments/#standard ("Lender or its agent may make reasonable entries upon and inspections of the Property.").

explicitly addressed this type of servicing abuse. The settlement enjoined the assessment of property preservation 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.[138] The amount of the property preservation fees found in the Mortgage Study proofs of claim 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.[139]

Fees imposed during delinquency or in the initial stages of foreclosure can be a substantial source of profit for servicers.[140] The itemizations attached to bankruptcy claims could provide a partial check on this form of servicing abuse, but the lack of a standard form for itemizations inhibits routine review of these charges. The data reveal that suspicious fees do appear on bankruptcy claims. The lack of a note or security interest, both of which are needed to verify the legality of these charges, to accompany the proofs of claims only heightens concern that the bankruptcy system is harboring mortgage servicing abuse, rather than functioning as a system to protect homeowners from impermissible charges.

The second troubling feature of itemizations was the paucity of detail provided. Some itemizations were so minimal as to hardly seemed worthy of that label. In a few instances, the itemization simply consisted of a break-out of the amount of arrears that was part of the creditor's total claim. Since the proof of claim form itself already requires that information, the itemization added nothing to the one-page claim form itself. Other creditors merely listed the total amounts of principal, interest, and "other" or "miscellaneous."

The failure to provide sufficient detail occurred frequently enough to undermine the usefulness of routine inspection of itemizations. More than 40% of claims with itemizations attached listed fees that had to be coded as "other" because the creditors' labels were generic or did not fit any reasonable category.[141] An example of a charge categorized as an "other" fee was the use of the term "pre-petition," without identification of whether these amounts resulted from missed payments, default charges, or accrued interest.[142] This super-generic term does not separate what portion, if any, of the requested amount stems from missed payments and what portion relates to fees and charges. Without a more complete breakdown, a debtor cannot verify that the servicer's claim is correct. A servicer may have misapplied payments,[143] or may

[138] *See supra* Part II.A. Order Preliminarily Approving Stipulated Final Judgment and Order as to Fairbanks Capital and Fairbanks Capital Holding Corp., United States v. Fairbanks Capital Corp., No. 03-12219 (D. Mass. Nov. 21, 2003), *available at* www.ftc.gov/os/2003/11/0323014order.pdf.

[139] In addition to the example given in Table 1, two different proofs of claim requested payment of property preservation fees of $105 (NDTX 69 and NDTX 75); another property preservation fee was $240 (SDGA 56). As discussed in the text near notes ____, 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.

[140] *See* Gretchen Morgenson, *Can These Mortgages Be Saved?* N.Y. TIMES (Sept. 30, 2007) ("Borrower advocates fear that fees imposed during periods of delinquency and even foreclosure can offset losses that lenders and servicers incur.")

[141] In the sample of 1484 proofs of claim with itemizations in the Mortgage Study database, 626 claims had amounts that were coded as "other" because no other category applied or the creditor collapsed fees without itemizing the amounts. In addition to the "pre-petition" label, attributes were sometimes made merely to "prior/previous servicer," or simply to "other." In some instances, the amounts were included in a column of summed figures with absolutely no description at all.

[142] Charges or amounts labeled merely as pre-petition were identified in 63 claims, fewer than 5% of all claims. This count excludes any fees labeled to be pre-petition attorneys' fees.

[143] Most loan instruments include language that specifies how payments are to be applied. In Fannie Mae/Freddie Mac Single-family loans, payments should go first to interest and principal before such money is applied to fees.

currently be holding funds in suspense without application to the amount due; either situation inflates the amount of the arrearage. The average amount of debt identified merely as "pre-petition" was $1651, a fairly substantial sum without any specific basis. Further, because any charges that servicers labeled as pre-petition will be included in the determination of the amount of outstanding arrearage that the debtor must pay to cure the default on the mortgage, it is important that the parties verify the veracity and propriety of such charges.

Many itemizations contained laundry-list descriptions, in lieu of one super-generic category. In the Mortgage Study data, the most common such label was "Inspection, Appraisal, NSF, and other charges." Over thirty proofs of claim used that recitation (with the words in that order and no additional fees in that line item). For this description to be 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 non-sufficient funds, and the debtor should have engaged in some other behavior that resulted in a permissible charge. It is certainly plausible that each of those situations occurred in a single case, but the laundry-list description, particularly the inclusion of "other charges," suggests that servicers are taking shortcuts in describing the actual costs that they bore as a result of the debtor's delinquency.

Anecdotal reports suggest that servicers proffer similarly vague itemizations to borrowers facing state law foreclosure[144]. Given the additional procedural requirements for proofs of claims, the bankruptcy data may understate the information available to nonbankrupt borrowers who want to examine the foreclosure costs that servicers are assessing. The problem may be particularly acute in states that permit non-judicial foreclosure because the creditor does not retain an attorney, who in theory acts as an independent reviewer of the legitimacy of charges.

The final practice of concern was the frequent inclusion of a flat "bankruptcy fee" in the proof of claim.[145] The propriety of this practice is unclear. Some jurisdictions have held that, to the extent these fees are for creditors' attorneys' fees, it is impermissible to include these fees in a proof of claim.[146] These courts require the attorneys for mortgage servicers to file a fee application pursuant to Federal Rule of Bankruptcy Procedure 2016.[147] Other courts have reached a contrary conclusion and permit creditors to include attorneys' fees in proofs of claim.[148] These rulings are inconsistent in their justification, however, leading to further confusion. One court held that Rule 2016 does not apply because the mortgagee's attorneys were not paid directly by the bankruptcy estate but by the mortgage servicer.[149] This approach ignores the reality that promissory notes for residential home loans nearly always obligate mortgagors to pay mortgagees for reasonable attorneys' fees incurred to protect the mortgagor's interest or rights under the security agreement.[150] Other courts have ruled that servicers may disclose attorneys' fees in "most routine circumstances" in a proof of claim, but that the disclosure must

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[144] *See* Morgenson, *supra* note 146 (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 $8525).

[145] In the remainder of this section, 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.

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

[147] *Id.* at 665.

[148] *See, e.g.*, *In re* Atwood, 293 B.R. 227, 232 (9th Cir. B.A.P. 2003).

[149] *In re* Electra D. Rice-Ethlerly v. Bank One, 336 B.R. 308, 315 (Bankr. E.D. Mich. 2006).

[150] *See supra* Part II.B.

be "specific."[151] Some courts have upheld the prima facie inclusion of attorneys' fees in proofs of claim, but ruled that a fee application is required if the debtor contests the amount or validity of the fees.[152]

If allowed, the issue of what constitutes "reasonable" attorneys fees for a mortgagee in a routine Chapter 13 bankruptcy case applies regardless of whether the fees are included in a proof of claim or disclosed in a Rule 2016 fee application. Several clusters of bankruptcy fees were present; 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.[153] Some of this discrepancy could be due to regional differences in attorneys' fees, but the fees seem to vary within judicial districts.[154] Given the minute number of objections to mortgagees' claims,[155] the system appears to permit mortgagees to effectively make their own determinations of what constitutes reasonable attorneys' fees for a routine Chapter 13 bankruptcy filing by a borrower.

Perhaps more disturbingly, a flat bankruptcy fee in a proof of claim may not even represent an actual cost that the mortgagee incurred for hiring counsel to represent it in the debtor's bankruptcy. That is, not only is it unclear what constitutes a "reasonable" fee, these charges may not be for work performed by an attorney. Notably, the claimant did not specify that these fees were "attorney charges" for bankruptcy representation; they could be a "monitoring" fee imposed due to the purported additional burden of having to service a loan for a borrower in bankruptcy. This ambiguity about the source of the expense should be construed against the claimant because it has the information about the charges and has the burden of ultimately proving the amount due. Obscuring the nature of bankruptcy fees worsens the confusion regarding whether disclosure of this fee in a proof of claim is adequate, and does not squarely raise the issue of whether a flat fee, rather than a lodestar fee based on an hourly rate, is a permissible method to calculate the creditor attorneys' fees in a bankruptcy.[156] In some instances, servicers appear to have imposed a bankruptcy fee for the purported administrative costs of preparing a proof of claim.[157] If such work is performed by internal employees and not by

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[151] *In re* Madison, 337 B.R. 99, 103–04 (Bankr. N.D. Miss. 2006); *see also In re* Powe, 281 B.R. 336, 347 (Bankr. S.D. Ala. 2001).

[152] *In re* Plant, 288 B.R. 635, 644 (Bankr. D. Mass. 2003).

[153] A review of the data suggests that in May 2006, when the claims in the Mortgage Study were filed, the bankruptcy fee of Bank of America was $250. Yet, Chase Home Finance, LLC imposed a bankruptcy fee of half that amount, $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 mortgage is held by Bank of America must pay $125 more than debtors whose mortgage is held by Chase Home Finance, LLC in order to complete their plan.

[154] For example, in the Eastern District of Arkansas, bankruptcy fees ranged from $125 and $800.

[155] *See infra* Part III.D.

[156] 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 lodestar 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. *See* Notes by Mortgage Servicers on Mortgage Servicing during a Chapter 13 Bankruptcy at 3–4, Appendix to NAT'L ASS'N OF CHAPTER THIRTEEN TRUSTEES, REPORT OF MORTGAGE COMMITTEE (June 28, 2007) (manuscript on file with author).

[157] This certainly seems to be the situation where the charge was described as "POC prep fee" or "plan review" fee, as was done in a handful of claims. Neither of the prior-quoted activities is strictly necessary to "defend the 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." Further, the preparation or filing of a proof of claim and the review of a

licensed attorneys, the corresponding fee cannot be claimed under the "reasonable attorneys' fees" provision of the security agreement or note. Indeed, such expenses can sometimes be characterized as the mere costs of servicing a mortgage that are already compensated for by the issuer's percentage-of-principal payments.[158]

In a modest fraction of cases, mortgagees did not even feel compelled to observe the instruction to attach an itemization to support the total amount they wish to be paid. The more widespread problem, however, is the wide variation in the quality of itemizations. The procedural rule that an itemization be attached to a bankruptcy claim can be a valuable check to the financial incentives of servicers to bloat claims with unreasonable or illegal fees, a phenomenon that has been documented by several courts. Such charges in claims are an affront to the integrity of the bankruptcy system because when payments are made on these amounts through the bankruptcy system, the servicing abuse receives the imprimatur of approval from the bankruptcy court and the trustee program. The requirement of an itemization is meaningless if what is produced cannot be examined in a cost-effective and consistent manner. Without a standard format for itemizations, parties are hobbled in their efforts to assess the propriety of the amount requested in mortgagees' claims.

**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. For homeowners in default when they file Chapter 13 bankruptcy, mortgagees normally seek to establish both the amount of the arrearage and the amount of the outstanding principal owed on the loan. These amounts are treated differently in Chapter 13 cases. To retain their homes and enjoy the protection of the automatic stay during the Chapter 13 bankruptcy, debtors must "cure any default within a reasonable time,"[159] normally by making payments over the period of the Chapter 13 plan (three to five years) or a shorter period as fixed by the court in the order confirming the Chapter 13 plan.[160] Any regular mortgage payments on a loan secured by the debtor's principal residence also continue to be due as set forth by the terms of the note. Debtors must have the funds to pay both of these amounts to complete their Chapter 13 plan and receive a discharge of any remaining amounts of unsecured debt.[161] Thus, part of the pre-bankruptcy calculus that debtors and their attorneys should consider in determining whether bankruptcy could permit a debtor to save a home is whether the debtor will have sufficient income to make the Chapter 13 payments.[162] Adequately weighing the viability of Chapter 13 and considering alternatives such as filing Chapter 7 bankruptcy or surrendering the home

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proposed Chapter 13 plan may not constitute an "appearance" by the lender, which is a required prerequisite to the borrower being obligated to pay the lenders' costs and expenses. Yet, these conditions are incorporated in standard mortgage documents upon which lenders rely to collect a bankruptcy fee.

[158] *See* JOHN RAO, ODETTE WILLIAMSON & TARA TWOMEY, NAT'L CONSUMER LAW CENTER, FORECLOSURES: DEFENSES, WORKOUTS, AND MORTGAGE SERVICING 177 (2d. ed. 2007) ("If all the lender is doing is "monitoring" the bankruptcy . . . then these activities do not constitute the practice of law and should not be compensable as an attorney fee. These routine administrative services are generally not compensable under any reading of typical mortgage provisions.") (internal citations omitted).

[159] 11 U.S.C. § 1322(b)(5).

[160] KEITH LUNDIN, 2 CHAPTER 13 BANKRUPTCY § 133.1 (3d ed. 2000) ("It is astonishing and baffling that a significant portion of listed claims are never filed in Chapter 13 cases.").

[161] 11 U.S.C. § 1328(a).

[162] Melissa Jacoby, Symposium, *Consumer Bankruptcy and Credit in the Wake of the 2005 Act: Bankruptcy Reform and Homeownership Risk*, 2007 U. ILL. L. REV. 323, 337 (2007) (arguing that failure of debtors' lawyers to screen their clients for ability to complete a Chapter 13 repayment plan results in more unsuitable debtors in Chapter 13).

outside of bankruptcy requires debtors and their attorneys to have a fairly accurate estimate of the amount of the outstanding arrearage and the amount of the regular monthly mortgage payments.

The bankruptcy court schedules require debtors to provide the total amount of any secured debts and to specify the collateral, the name of the creditor, and the date that the debt was incurred. Based on this information, the Mortgage Study matched each home loan listed on a debtor's schedule D to the corresponding proof of claim.[163] I then measured the extent of the gap between debtors' and mortgagees' calculations of the amount due on the mortgage loan, and analyzed the size and direction of any discrepancies.[164] If the amount on the proof of claim exceeded the home loan debt on the debtor's bankruptcy schedules, I termed the gap in the "creditor's favor." The creditor is asserting that more dollars are owed on the mortgage debt than the debtor believed that she owed. Conversely, if the debt for a mortgage loan listed on a debtor's schedules exceeded the amount on the mortgagee's proof of claim, I termed the gap in the "debtor's favor." In these situations, the discrepancy between the bankruptcy schedules and the claim resulted in the debtor overstating the amount that the creditor believed was owed at the time of the bankruptcy filing.

Figure 3 shows what fraction of claims fell into each of three categories based on the existence of a discrepancy between the claim and the scheduled amount of debt. Debtors and creditors agreed on the amount owing for only 74 of 1675 loans (4.4%). For the vast majority of loans (95.6%), the debtor and mortgagee did not agree on the amount of the mortgage debt. In about one-quarter of instances, the debtor set forth an amount of debt in his bankruptcy schedules that exceeded the amount of the mortgagee's claim. These situations are in the debtor's favor, in that the debtor should have been pleasantly surprised at the amount of the creditor's claim. However, the majority of claims contained unhappy news for debtors. Approximately seven in ten (70.4%) proofs of claim asserted that outstanding debt was greater than the amount that

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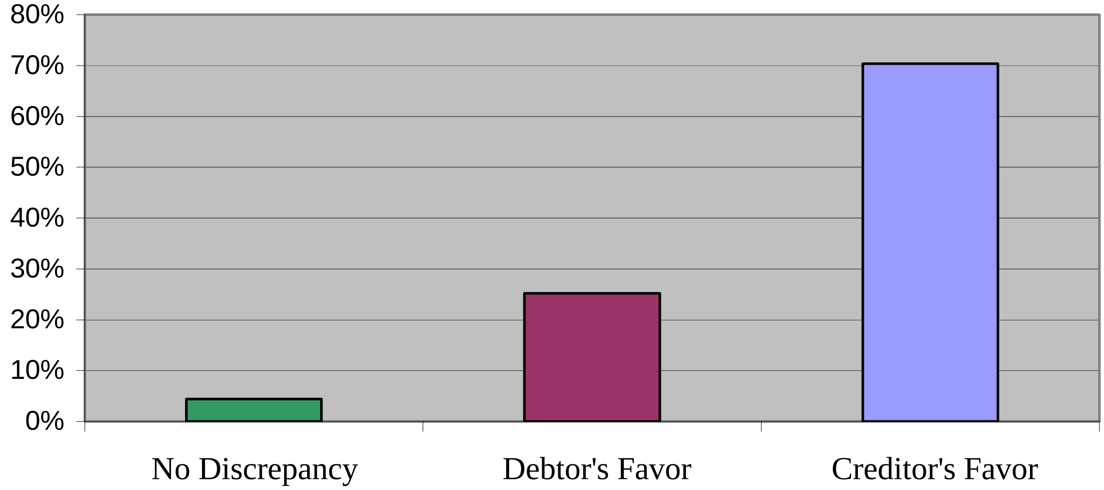
[163] It was not possible to perform this matching for every home loan. Among the 2164 home loans listed on all Schedule D cases in the sample, there were only 1768 proofs of claim filed. No corresponding proof of claim was located for 18.3% of the loans on Schedule D.

[164] For the gap analysis, further loans and their corresponding claims were eliminated from the sample. First, in some instances, the debtor only listed the amount of the arrearage on the Schedule D court record, whereas the creditor's claim was based on the total obligation, including all outstanding principal. In other cases, the opposite phenomenon occurred. The creditor's only claim was for the arrearage that was owed, but the Schedule D listed the entire obligation. Regardless of the direction of the mismatch, these cases were excluded from the gap analysis. Any discrepancy resulted not from disagreement on the actual amount but on a disagreement about what amount (principal, arrearage, etc.) should be included on the schedule or claim; the two parties did not intend to provide equivalent information. In a very, very small number of cases, where both the creditor and the debtor provided only the arrearages (often because local practice or a local claim form directs this result) and this was clear from the documents, the cases were used in this analysis because the gap between the debtor's and mortgagee's records—at least as to the arrearage—can be fairly determined (at least on a percentage basis) based on this information. Second, a small number of outliers (12 loans) were removed because the claims and loans were so discrepant that it appeared that one party was only listing the arrears, despite no actual indication that this was happening. Two criteria were applied to identify outliers. Six loans were eliminated because the gap between the claim and the scheduled debt exceeded 200% of the amount of the scheduled debt. Each of these loans had a gap in favor of the creditor because the claim was much, much larger than the debt. An additional 6 cases were eliminated as outliers because the gap exceeded $100,000 in absolute dollars *and* the gap was greater than 50% of the amount of the scheduled debt. Three of these loans had creditor's favor gaps and three of the loans had debtor's favor gaps. Finally, loans were eliminated if the Schedule D or the proof of claim had a zero or a blank entry for the amount of the debt.

debtors reported on their schedules for that mortgage loan.[165] The gap was in the creditor's favor in these instances.

*Figure 3: Percent of Claims by Type of Gap Between Claim and Scheduled Debt*




n=1675 loans

The findings in Figure 3 evidence that in a vast majority of cases, the debtor and creditor do not agree on the amount of the debt as an initial matter. The claims process provides the mechanism for identifying and reconciling these discrepancies. The mere existence of discrepancies is not itself alarming. The findings in Figure 3 could merely reflect small differences in recordkeeping. Alternatively, the claims could consistently be larger because of the addition of modest and explainable post-bankruptcy charges such as accrued interest.[166] The analysis below explores each of these explanations, ultimately rejecting them as the key reason for the discrepancy between debtors and creditors.

The first indication that the discrepancy results from a genuine and substantial problem in debtors' and creditors' records is the substantial size of the gap in dollars. Among all loans, the median proof of claim exceeded its corresponding debt as listed on Schedule D by $1366. The average proof of claim was $3533 greater than the debtor reported on Schedule D.[167] In the typical consumer bankruptcy, mortgage creditors assert that a significantly larger amount is owed than debtors report on their bankruptcy schedules for a home loan. These errors are too large to reflect small disagreements in recordkeeping, such as a single late charge imposed before the debtor received their mortgage statement.

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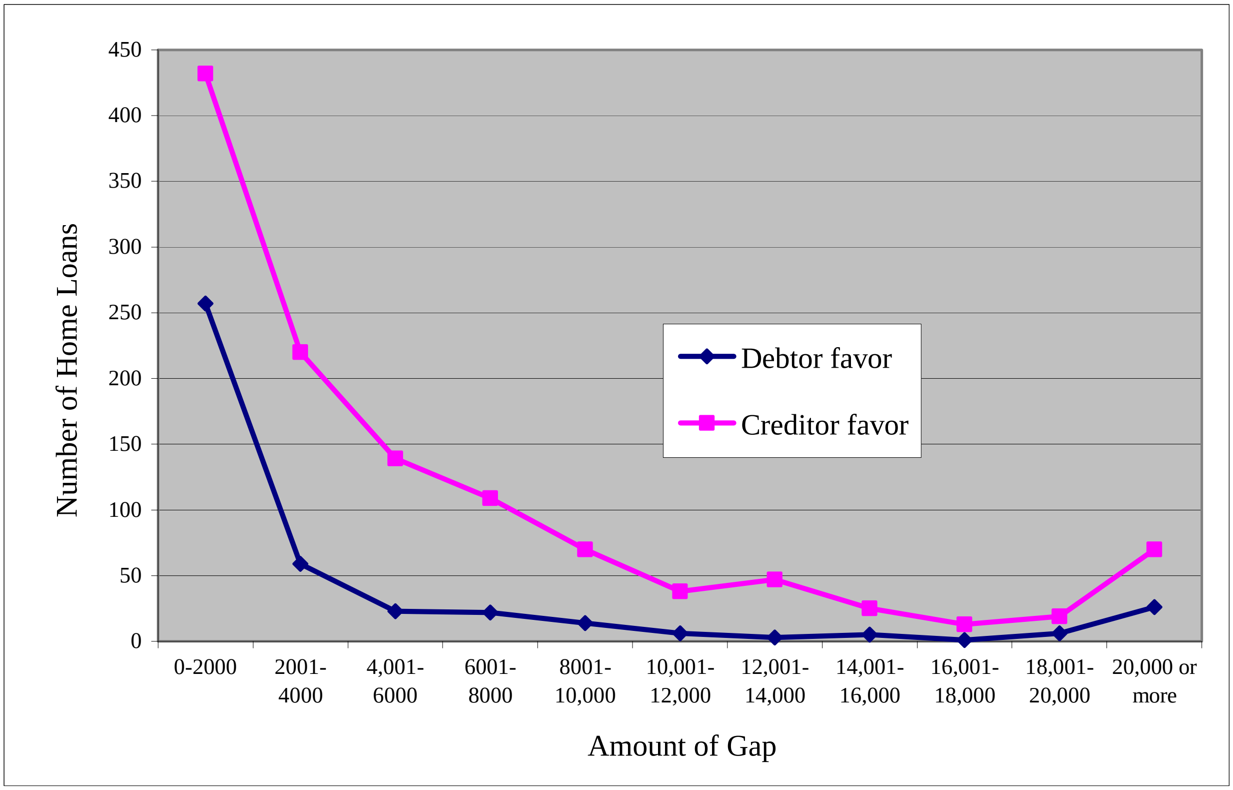
[165] For the remaining 25.2% of loans, the Schedule D listed a greater amount of outstanding mortgage debt than the proof of claim requested. These overestimations were generally more modest, but could deter debtors or their attorneys from pursuing a non-bankruptcy workout with the mortgagee.

[166] The debtor's schedules should only reflect the amount due at the time of the bankruptcy. The proof of claim form should be identical, as the form specifies that the amount listed should be the "Total Amount of Claim at Time Case Filed." However, this instruction to creditors—like those discussed in parts A and B, *infra*—appeared to be frequently ignored.

[167] These statistics are for all home loans used in the gap analysis, including those loans in which the schedule D and the claim matched exactly (gap was zero). N=1675. The standard deviation for the entire sample was 11,480.

The second indication that the discrepancies cannot be explained by minor charges or solely post-petition amounts added to claims comes from subdividing the data for further analysis. Figure 4 shows the distribution of gap amounts between proofs of claim and the corresponding scheduled debts. Postpetition charges can only explain discrepancies in favor of creditors. Debtors have neither the knowledge nor the means to include such charges on their schedules and simply cannot anticipate what these amounts will be with any accuracy.

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




Creditors frequently requested payment on the proof of claim of several thousand more dollars than debtors thought they owed. As illustrated in Figure 4, at every point in the distribution, the number of loans in which the creditor's claim exceed the scheduled amount was higher than the incidence of the reverse situation occurring. The direction of any gap between mortgage claims and the scheduled amounts is much higher in the situations when the gap is in the creditor's favor, i.e., the claim exceeds the scheduled amount.

The median gap for those loans in which the proof of claim exceeded the debtors' scheduled amount (creditor's favor) was $3311. The average gap of $6309 was nearly double the median, indicating some very large discrepancies in the creditors' favor at the tail of the sample, as shown in Figure 4.[168] While the majority of creditor's favor gaps were in an amount less than $4000, the top line in Figure 4 shows that a substantial number of gaps had much higher gaps.

[168] The average gap among the debtor's favor claims was $5376. 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 13704. The standard deviation for the creditor's favor claims was 9143.

Large gaps in absolute dollars are more frequent when the discrepancy arises from a proof of claim that exceeds the scheduled amount. When debtors overestimate the claim, the discrepancies are much smaller, rarely exceeding $4000. The median gap for the loans when the discrepancy favored the debtor was $1090, a figure less than one-third the size of median creditor's favor gap ($3311).

Given their size, it seems unlikely that the creditor gaps could result from postpetition obligations. Even if the servicer imposed a bankruptcy fee and interest continued to accrue between the bankruptcy filing and the proof of claim date, the gap is too sizeable to reflect solely postpetition charges. One possibility, discussed *supra* in Part B, is that servicers continue to impose unreasonable fees even after the bankruptcy is filed. Because creditors fail to include itemizations in some cases and provide only general breakdowns of fee categories, it is difficult, if not impossible, for parties to determine the nature of each fee and whether it was assessed prepetition or postpetition.

If the discrepancy does not relate to post-petition expenses, then 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 are not going to overcharge themselves intentionally; there is no obvious benefit to debtors who inflate the total amount of their home loans on Schedule D.

However, there are policy consequences to debtors' overestimations of even modest amounts. If the mortgagee is 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 thought, viable alternatives could have existed to Chapter 13 bankruptcy.[169] The data do seem to indicate that in many cases, neither debtors nor their attorneys confirm the amount of the mortgage obligations at or near the time of the bankruptcy filing.[170] The substantial number of cases with large discrepancies may reveal serious disagreements between debtors and creditors. These problems could emanate either from serious underestimation behavior by debtors or from inflated claims filed by mortgagees.

Figure 5 presents a different analysis of the discrepancies in the amounts of creditors' claims and the amounts for the corresponding loans on debtors' schedules. For each loan, I calculated the gap as a dollar amount by subtracting the claim and the amount listed for the corresponding loan on the debtor's bankruptcy schedules. I then considered the gap in absolute dollars relative to the amount of mortgage debt as reported on the debtor's schedules. I converted each gap amount to a percent by dividing the gap in dollars by the total amount of the scheduled debt. For example, if a 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 then grouped these data into categories based on the size of the percentage that the claim dwarfed the amount on the scheduled debt. Figure 5 displays this analysis for all creditor's favor claims (70.6% of all loans).

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[169] For example, some debtors may have family willing to loan them $500 to cure an arrearage but those same relatives could not come up with $1000 to help. Also, servicers may have greater flexibility in agreeing to workout or forbearance arrangements in situations when the arrearage is small.

[170] Of course, the practices of many servicers themselves deter debtors from getting such information. As explained above in Part I.A, servicers have no reputational concern about poor customer service response because borrowers do not choose their servicer and cannot change their servicer, and so many servicers make it time-consuming and difficult for a debtor to reach them. Additionally, the industry practice of imposing a "payoff" fee discourages debtors from making an account inquiry at the time of their bankruptcy.

Among these gaps in the creditors' favor, when the claim exceeded the scheduled debt, there were different levels of discrepancies. About four in ten (40.4%) of all loans had an amount on the proof of claim that exceeded the corresponding scheduled amount by less than 5%. To some degree, these situations could reflect postpetition charges. However, two points seem worth on this issue. First, mortgage loans are large debts in absolute dollars. Among the "small gap" claims, when the claim was less than 5% more than the amount on the debtor's schedule, the dollars at issue are still sizeable. The average claim in the small gap category exceeded the scheduled amount by $2471. As an absolute figure, this is a significant amount of money for bankruptcy debtors to have to repay, given their relatively modest incomes. A second and related point relates to the costs of default. Even if the gap stems solely from postpetition charges, the 5% additional debt is a powerful reminder of how quickly a defaulted debt can mushroom in size. Proofs of claim are usually filed within 60 days of the date of the bankruptcy filing, but even in this short time, the default charges quickly accumulate to a sizeable sum. To the extent that the claims exceed the scheduled debts due to postpetition charges and fees, the discrepancies evidence the tremendous difficulty that debtors face in curing a default without the help of bankruptcy law to let them do so over a period of years.

The more alarming findings concern the fraction of claims that exceed the scheduled amount by a sizeable fraction. Aggregating the results shown in Figure 5, more than three in ten claims (30.2%) were more than 5% above the debtors' scheduled amounts. Given their size, it seems implausible that these discrepancies resulted from postpetition amounts or an underestimation by a debtor caused by completing the schedules using the prior month's mortgage statement. The fault could come from either party. Debtors may be literally clueless about their mortgage obligations. Creditors may be loading claims with fees that are not permitted in bankruptcy or may be making servicing errors because of confusion caused by the mortgagor filing bankruptcy. Regardless of the source of the misunderstanding, the reality of these situations poses a challenge to the bankruptcy system, which should function to ensure that such disputes are resolved fairly and efficiently.

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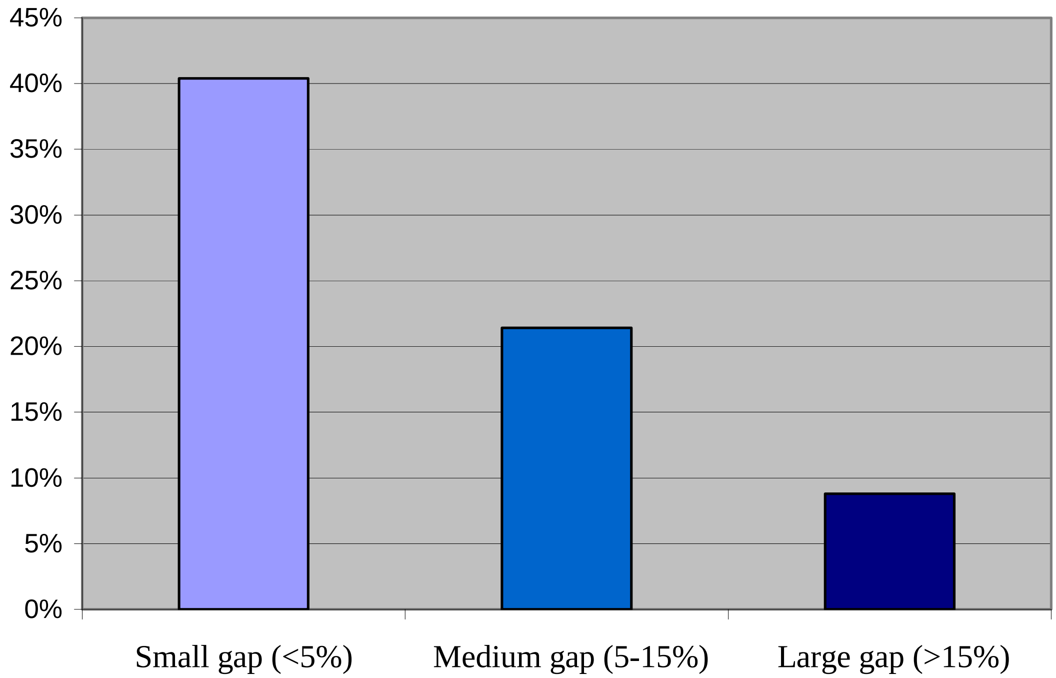
*Figure 5: Frequency of Creditors' Favor Gaps,*
*Calculated in Size as Fraction of Amount on Claim*




n=1179 loans

Whether viewed in absolute dollars or as a percentage of error, creditors' claims are boosting debtors' obligation in Chapter 13 bankruptcy beyond debtors' expectations. 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 or percentage analysis, they are imposing a hefty burden on debtors' disposable income and diverting money from unsecured creditors. Even if the proofs of claim are correct, debtors' underestimations of their mortgage debt hamper debtors' attorneys from making optimal *ex ante* determinations about the feasibility of repayment plans. These significant gaps suggest that debtors and their attorneys need to incorporate two additional actions into routine consumer practice. Before bankruptcy, attorneys should obtain an up-to-date statement of their client's mortgage obligations from the creditor before counseling the debtor to file Chapter 13. Then, after a bankruptcy is filed, attorneys and debtors should verify the accuracy and reasonableness of mortgagees' claims, examining the source of any discrepancy between the claim and the schedules.

These findings have implications for the entire bankruptcy system. On an aggregate basis, the discrepancies between debtors and mortgagees are a multi-billion dollar problem. Based solely on the Mortgage Study sample of approximately 1700 loans, millions of dollars may be overpaid to mortgagees.

*Figure 6: Total Gap in Dollars*

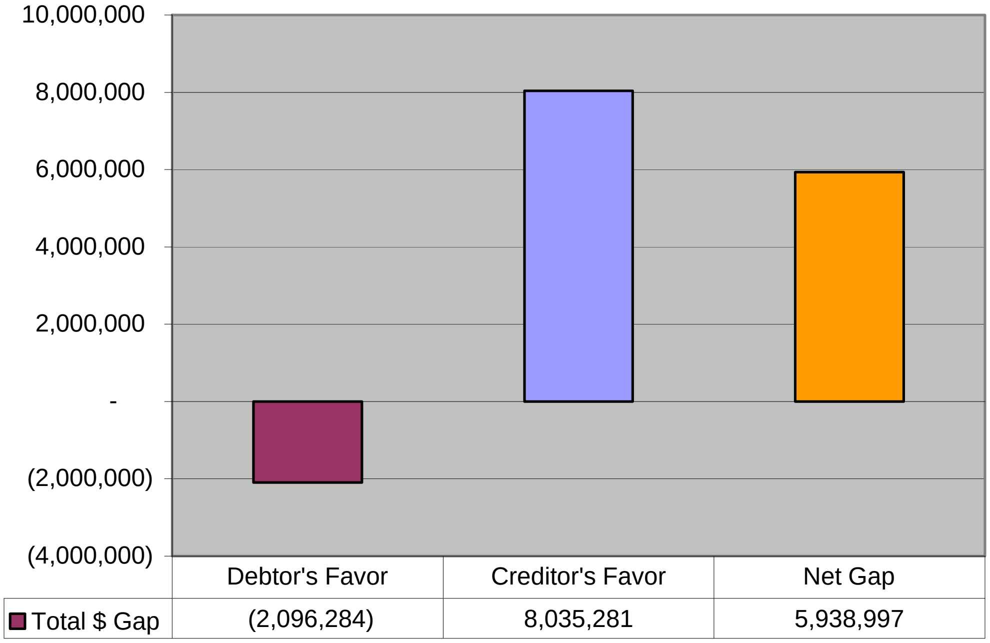



Figure 6 shows combined figures for all of the debtor's favor claims (debtor scheduled a larger amount than mortgagee asserted on the proof of claim) and all of the creditor's favor claims (creditor's proof of claim was larger than the amount of mortgage debt the debtor put on the bankruptcy schedule). When aggregated, the claims totaled millions of dollars—even for the Mortgage Study sample of approximately 1700 loans. When viewed from a systems standpoint,[171] the discrepancies are substantial.

The net effect of these discrepancies favors creditors. As shown in Figure 5, the cumulative effect is that mortgage creditors requested nearly six million dollars more on proofs of claims than the total mortgage debts listed by debtors on bankruptcy schedules. The mismatch between debtors' and creditors' understanding of what is owed tilts sharply toward creditors asserting debts that are greater than debtors believe they owe.

If even a small fraction of this six million dollar net discrepancy represents creditors overreaching in their claims, the damage to the bankruptcy process is significant. Hundreds of thousands of families file Chapter 13 bankruptcy each year and own their homes. Among all these cases, the unresolved differences between debtors' and creditors' records exceed one billion dollars each year. If these mortgage claims are inaccurate, the collective effect on bankruptcy distributions has tremendous policy implications.

Overreaching or errors by servicers impose financial burdens on families trying to buy homes. In the bankruptcy context, such behavior can doom a family's efforts to save its home. Bloated arrearage debts can prevent a debtor from confirming a Chapter 13 plan and force the family to surrender their home. The inadequate documentation of claims, the inclusion of impermissible fees in claims, and the existence of so many claims that greatly exceed the debtors' records each suggests concern about whether mortgage claims are reliable. Very few mortgage claims meet the ideal of the bankruptcy process, despite unambiguous law that is

[171] Lynn M. LoPucki, *The Systems Approach to Law*, 82 CORNELL L. REV. 479 (1997).

intended to safeguard the integrity of the claims system. The evidence from the bankruptcy courts calls into question the ability of consumers to trust their mortgage servicers to accurately and fairly account for their payments and assess charges.

**D. Claims Objections**

The data presented in the prior three parts offer multiple indicia that mortgage claims are inaccurate and unreliable. Mortgagees often presented claims without required documentation; many claims contained requests for suspicious fees; and mortgagees' claims and debtors' records were rarely identical. The proof of claim process has an existing, internal mechanism to address such problems. Under section 502(a) of the Bankruptcy Code, any party in interest may object to a claim.[172] If such an objection is made, "the court, after notice and hearing, shall determine the amount of such claim."[173] Claims objections are contested matters, in which the bankruptcy court may hear evidence and make final rulings.[174]

Despite these procedures, mortgage creditors are rarely called to task for the widespread deficiencies or inaccuracies in their proofs of claim. Objections were rarely identified to correspond with the proofs of claim in the Mortgage Study. An objection was filed in response to 4% of all proofs of claim. In numerical terms, among the 1768 proofs of claim in the sample, the total number of objections was only 67. Debtors, trustees, and other creditors simply do not object to mortgagees' claims—even when such claims do not meet the standard for prima facie validity because the claims did not comply with the unambiguous requirements of Rule 3001.[175]

This finding was depressing, but not surprising. Before beginning data collection in the Mortgage Study, Tara Twomey and I spoke to dozens of debtors' attorneys regarding their practices with mortgage claims. With the exception of one or two prominent consumer advocates, virtually no attorney has a routine practice of reviewing mortgage claims.[176] The high-volume nature of consumer practice undoubtedly explains this situation,[177] but does not excuse it. Verifying that debtors only pay amounts to which creditors are legally entitled should be part of bankruptcy representation.

Among the objections that were filed, there were no observable patterns to account for the activity. The objections came from a variety of districts. Twenty-five of the 44 judicial districts had at least one claims objections. In the remaining 19 districts, there was not a single objection to a mortgage claim in our sample. While many districts had only one objection, no district had more than seven objections. It appears that no jurisdiction has a strong local legal culture of reviewing and objecting to claims that distinguishes it from national norms.

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[172] 11 U.S.C. § 502(a).
[173] 11 U.S.C. § 502(b).
[174] Advisory Comm. Notes, Fed. R. Bankr. Proc. 9014 ("For example, the filing of an objection to a proof of claim . . . is a contested matter.").
[175] Fed. R. Bankr. Proc. 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.").
[176] O. Max Gardner III is the most prominent example of a debtors' counsel who has incorporated a review of mortgage claims into his routine bankruptcy practice. Indeed, he has developed a "boot camp" to train other attorneys on the value of this practice. Information is available on his website: http://www.maxbankruptcybootcamp.com/.
[177] A further explanation exists in a few districts, where apparently debtors or their attorneys do not even receive copies of the proofs of claim, which are submitted solely to the trustee. The potential harm of this practice is exacerbated because these districts do not make claims available through PACER, or at least do not do so within the first six months of the case.

Debtors filed more than two thirds of all objections (44 of the 67 objections); Chapter 13 trustees filed the remaining 20 objections. Chapter 13 trustees typically focused on procedural problems with claims. The trustee's most frequent basis for objection was simply that the claim at issue was a duplicate of a previously filed claim. These duplicate claims pose little risk of error in the Chapter 13 mortgage context; the mortgagees' error nearly always will be caught at the time of plan confirmation or when the trustee begins to disburse payments. Trustees tended to catch errors that were either egregious or readily observable. For example, trustees objected when attachments to the claim referenced a borrower other than the bankruptcy debtor, or the claim was filed after the claims bar date.

Debtors filed objections that alleged substantive problems with the claims. The most common 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 attorney fees were not itemized; or the mortgagee double-charged for property tax. In a few instances, the debtor contested the arrearages contained in the claim because the debtor believed that the loan was current. This fact pattern has been the source of contention in the cases challenging the creditors' affidavits to support motions for relief from stay.

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. Objections were rare in the Mortgage Study sample. The formal objection process for deficient or incorrect claims is largely dormant.

Of course, parties could be informally working out disagreements about bloated claims. To the extent this occurs, the number of objections could understate the amount of scrutiny that claims receive.[178] This hypothesis, however, is incongruent with the rare incidence of amended claims. If creditors were being called to task for inaccurate or incomplete claims through processes like phone calls from debtors' counsel or concerns raised at confirmation hearings, the result in some of these situations should be an amended claim.[179]

The current review of claims is plainly inadequate to ensure the integrity of the bankruptcy system. Sizeable discrepancies between debtors' and creditors' accountings of the amount of outstanding mortgage debt are never reconciled. To the extent that the debtor and creditor disagree on the amount owed, and yet the debtor does not object or even examine the claim, the bankruptcy process may be failing as a mechanism for ensuring the accurate distribution of the debtor's future income. Given that most consumers' mortgage is their largest debt, the claims process may be even less rigorous with regard to other smaller obligations.

The claims process also does not function as a check on mortgage servicing abuse. While this outcome is not an explicit goal of the bankruptcy system, the judicial process should not

[178] *See supra* note 118.

[179] 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 calculations of the amounts due, rather than using the amount of the mortgagee's claim 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 amount of mortgage debt in the plan 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 this discrepant numbers is an empirical question. The difficulty in testing this hypothesis is that in most districts, the plan contains only the amount of prepetition arrearage. Yet, some claims did not specify the arrearage or combined prepetition and postpetition amounts. Thus, it is impossible to compare the total claim or even the total arrearage between confirmed plans and the proofs of claim in any significant fractionof cases.

implicitly sanction illegal activity. Yet, no objection was filed in response to the claims with the suspicious fees shown in Table 1, *supra*. These claims, like 96% of others, passed undisturbed through the bankruptcy system. While Congress has emphasized the importance of a reliable bankruptcy system that garners the public's trust,[180] creditors face no meaningful consequences when they disregard the law and this public policy.

## IV. IMPLICATIONS

The current interaction between the mortgage servicing industry and the Chapter 13 bankruptcy system is distressing. Many mortgage claims fail to comply with the bankruptcy rules and procedures, assert that suspicious or impermissible fees are owed, or reflect a serious discrepancy between debtors' and creditors' records.

### 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 some responsibility for the malfunctioning of the claims process. Objections to claims do not appear with sufficient frequency to police claims, even with regard to large debts such as mortgages. Quite simply, the current claims process seems broken.

Reforms to the claims process will protect the integrity of the bankruptcy system. As the Supreme Court has recognized, deficiencies in the claims determination process can permit unmeritorious or excessive claims to dilute the participation of legitimate creditors and prevent the just administration of bankruptcy estates.[181] Mortgagees' failure to satisfy Rule 3001 should not be dismissed as a mere technicality. The rules governing claims were implemented to prevent substantive harm. Without documentation of the debt, the other parties in bankruptcy, including the debtor and unsecured creditors cannot verify the legitimacy or accuracy of claims, each of which cuts into the limited pool of dollars available for distribution. The absence of the required documentation effectively deflects creditors' obligations in the bankruptcy process onto cash-strapped bankrupt families, who must choose between the costs of filing an objection or the risks of overpayment. Further, from a systems standpoint, it is hard to discern the benefit of allowing parties to "opt-out" of rules at will.

Mortgagees' frequent failure to comply with Rule 3001 results from weakness in the current rules. Rigorous enforcement of Rule 3001 would improve the fairness and accuracy of bankruptcy payments. Current practice does not deter creditors from disregarding the requirements to attach documentation to Rule 3001. While the rules themselves use mandatory language, phrased in terms of "shall,"[182] the reality is that some creditors treat them as aspirations—or ignore them entirely. In most instances, there is no negative consequence to the mortgagee from its failure to attach the required documentation. Under the current system, the main tool to fight improper claims is Federal Rule of Bankruptcy Procedure 9011, which

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[180] *See supra* Introduction.

[181] Gardner v. State of N.J., 329 U.S. 565, 573 (1947).

[182] Fed. R. Bankr. P. 3001(c) and (d). The proof of claim form (B10) also contains a sheet of instructions, which states, in relevant parts, that "[y]ou 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." Instructions for Proof of Claim Form, Office Form 10[9/97], *available at* http://www.uscourts.gov/bankform/ formb10new.pdf.

requires all factual contentions in pleadings to have evidentiary support.[183] While courts have sanctioned creditors for filing unsubstantiated claims,[184] 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.[185] 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.

Even when an objection is filed, there is typically no sanction for disregarding Rule 3001 in the first instance. This outcome is the result of the limited legal effect of bankruptcy rules, which "shall not abridge, enlarge, or modify any substantive right."[186] Most courts have concluded that failure to comply with Rule 3001 is not a permissible basis for disallowing a claim because this behavior is not listed in section 502(b) of the Bankruptcy Code.[187] A few jurisdictions have taken a different approach and ruled that incomplete claims documentation can be a basis for disallowing a claim.[188] The majority rule seems to be that a challenged claim that does not comply with Rule 3001 loses its quality as prima facie evidence and shifts the burden to mortgagees to prove their claim. However, courts usually require the debtor to advance some evidence that disputes the claim,[189] so that even if Rule 3001 compliance is lacking, the debtor has some evidentiary burden. 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.[190]

The simplest route to boosting the reliability of mortgage claims is to revise section 502(b) to include the failure to provide the attached documentation as a basis for claims disallowance. 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

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[183] Fed. R. Bankr. Proc. 9011.

[184] *See, e.g., In re Cassell,* 254 B.R. 687 (B.A.P. 6th Cir. 2000) ("Proofs of claim must meet the standards of [Rule 9011.]"; *In re Berghoff,* 2006 WL 1716299 (Bankr. N.D. Ohio. 2006) (finding that mortgage lender violated Rule 9011 by including certain fees in claim that were not warranted by existing law).

[185] Fed. R. Bankr. Proc. 3001(f).

[186] 28 U.S.C. § 2075.

[187] *See, e.g., In re* Stoecker, 5 F.3d 1022 (7th Cir. 1993); *In re* Heath, 331 B.R. 424 (B.A.P. 9th Cir. 2005); *In re* Gurley, 311 B.R. 910 (Bankr. M.D. Fla. 2001). *See also* Alane A. Becket, *Proofs of Claims: A Look at the Forest* 23-JAN AM. BANKR. INST. L. REV. 10 (Dec./Jan. 2005) (concluding that disallowance on Rule 3001 grounds is not within a court's statutory authority).

[188] *See, e.g., In re* Shaffner, 320 B.R. 870 (Bankr. W.D. Mich. 2005); *see also* WESTLAW BANKRUPTCY LAW MANUAL § 6:4 (5th ed. 2007) ("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,* 05-63927 (Aug. 31, 2007) (disallowing claims filed by trustee pursuant to Rule 3004 because trustee did not reasonably investigate claims and provide documentation to support the claims.)

[189] *In re* Campbell, 336 B.R. 430, 434 (B.A.P. 9th Cir. 2005) (holding that a proof of claim that lacks documentation required by Rule 3001(c) is not disallowed unless the debtor's claim objection contests the amount of the debt and not merely the rule violation).

[190] *See In re* Heath, 331 B.R. 424, 437 (B.A.P. 9th Cir. 2005) ("Moreover, a creditor's lack of adequate response to a debtor's formal or informal inquiries 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 a claim.") (internal citations omitted).

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. In this way, the bankruptcy process would be at least as rigorous as the foreclosure scheme outside of the federal system.

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."[191] 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 forty percent of claims, trustees filed only one or two objections that raised that issue.

The U.S. Trustee Program could mandate mortgage claims review as an official duty of panel and standing trustees in their program handbook, 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. The Chapter 13 trustees could report their activity to the U.S. Trustee Program to generate national evidence of what, if any, problems with claims remain after their active review. This approach could generate more detailed recommendations for legislative reform or show that additional procedures beyond trustee activity are necessary to improve the reliability of claims.

A complementary tactic to these enforcement strategies would improve the clarity of claims. The varying formats and level of detail in the itemizations make it difficult for all parties in interest to make a routine review of proofs of claim. If itemizations were standardized, it would be easier to train legal assistants and junior attorneys to review claims and would facilitate the development of computer programs to help analyze the creditors' calculations for things such as escrow accounts and arrearage payment streams. A model itemization attachment was promulgated by the Chapter 13 trustees and mortgage servicers but the form has not become widely used despite its existence for more than a year.[192] 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 of a standard format seems unlikely given the current fate of the model itemization in existence. However, the participation of the servicing industry in creating the model itemization highlights the potential of the existing servicing technology to reasonably accommodate a standard claims format.

The prior solutions would systematically address the issue with mortgage claims.[193] 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.

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[191] 11 U.S.C. § 704(a)(5).

[192] Model Proof of Claim Attachment, NAT'L ASS'N OF CHAPTER THIRTEEN TRUSTEES, REPORT OF MORTGAGE COMMITTEE (June 28, 2007) (manuscript on file with author).

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

**B. Bankruptcy as a Home-saving Device**

Mortgage claims are a key determinant of the outcome of consumer bankruptcy cases. A core function of Chapter 13 bankruptcy is helping families save their homes,[194] which the Bankruptcy Code effectuates by permitting debtors to cure any arrearage on a mortgage over a reasonable time.[195] Because mortgage creditors are most Americans' largest creditor, their actions in bankruptcies heavily influence debtors' success in saving their homes from foreclosure.[196] A family's ability to confirm a Chapter 13 plan or cure a default may turn on the amount fixed as owing to the mortgage creditor.[197] 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. Not only does plan confirmation turn on this issue, 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 the bankruptcy filing decision without correct 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 default. Conversely, if debtors overestimate the arrearage, 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 debt with reasonably accuracy indicates a serious shortcoming in the pre-bankruptcy 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.[198]

After families file 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 amount requested on the mortgagees' claim and risk overpaying that creditor. In so doing, debtors increase their burden in confirming and completing a Chapter 13 plan. This outcome, however, saves the debtor the litigation and negotiation costs of seeking clarification from the mortgagee.

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[194] *See* 1 KEITH LUNDIN, CHAPTER 13 BANKRUPTCY, § 129.1 (3d ed. 2000) ("[I]t is not unusual for rehabilitation of a home mortgage to be the principal reason for filing a Chapter 13 case").

[195] *See* 11 U.S.C. § 1325(b)(5).

[196] Bahchieva, et al., *supra* note 50, at 74. ("Our results also suggest that rising mortgage debt has important consequences for federal bankruptcy policy.").

[197] *In re* Coates, 292 B.R. 894, 899 (Bankr. C.D. Ill. 2003) ("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. Most of the Chapter 13 cases filed in this District involve the cure of a prepetition mortgage arrearage.").

[198] *See*, *e.g.*, Scott 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).

When mortgagees' claims are challenged, the debtor faces 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 from 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 their 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 stay that are based on incorrect accounting. Scrutinizing the proof of claim to ensure that only valid fees are included in arrearage claims can help reduce the burdens that debtors face in making all required Chapter 13 plan payments. Reduced arrearages could improve the success rate of debtors in completing Chapter 13 plans and receiving a discharge. Better outcomes in Chapter 13 could help encourage more debtors to consider this alternative, and boost recovery to all creditors. Further, ensuring that the mortgagees' 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 BAPCPA,[199] it is discouraging to suggest that the solution lies in passing the costs of claims review along to debtors. The structural changes suggested in Part A 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, debtors' attorneys need to be educated about the potential benefits to their practice of challenging mortgage claims. While challenging a claim does not *per se* generate revenue for an attorney, claims review can reveal other causes of action. Most obviously, if consumer attorneys request information from mortgage servicers and receive no response or an inadequate response, the servicer may have violated the Real Estate Settlement Procedures Act ("RESPA"). If successful, these claims entitle plaintiffs to actual damages and the costs of reasonable attorneys' fees.[200] 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.[201] 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 the Truth-in-Lending disclosure can give rise to a claim for actual or statutory damages, or even rescission of the loan under some circumstances.[202] The Truth in Lending Act also is fee-shifting so that mortgage companies may be ordered to pay the attorneys' fees and costs of successful actions.[203] These examples show how bankruptcy can be

[199] In 2001, the Consumer Bankruptcy Project found that the median attorneys fee for a Chapter 13 case among five judicial districts was $1550 (in 2001 dollars; no inflation adjustment) (data on file with author). A recent survey suggests that on a national basis, Chapter 13 fees are nearly twice the 2001 amount, with many districts having a presumptively permissible fee of $3000 or more. Nat'l Ass'n of Consumer Bankruptcy Attorneys, Survey of Presumptive Chapter 13 Fees (April 22, 2007) (on file with author).
[200] 12 U.S.C. § 2605(f)(3) (2005).
[201] DOUGLAS J. WHALEY, PROBLEMS AND MATERIALS ON CONSUMER LAW 482 (3d. ed. 2002).
[202] 15 U.S.C. §§ 1635 & 1640 (2005).
[203] 15 U.S.C. § 1640(a)(3) (2005).

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 of 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 servicer to credit payments, calculate pay-off 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.

As noted above, most Chapter 13 debtors are in default when they file bankruptcy. It seems likely that default by a borrower may exacerbate servicing problems because default triggers the imposition of fees, and sometimes a 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.[204] Thus, most families who are behind on their home loans do not have 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 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 or 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.

Poor mortgage servicing is an assault on America's policy of promoting sustainable homeownership. If families are hit with unreasonable fees and cannot understand what is owed on their mortgage loan, 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

[204] In 2006, there were 597,965 non-business bankruptcy filings in 2006 and 1,259,118 foreclosure filings. *See* Administrative 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 (bankruptcy filings); RealtyTrac, *More Than 1.2 Million Foreclosure Filings Reported in 2006* (Jan. 25, 2007), *available at* http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=1855&accnt=64847. The best available data, the 2001 Consumer Bankruptcy Project, indicate that about 52.5% of all families in bankruptcy are homeowners. *See* Bahchieva, Wachter & Warren, *supra* note ___, at 92. Foreclosure filings appear to outnumber bankruptcy cases filed by homeowners by a ratio of four to one. *See also* Dennis R. Capozza and Thomas A. Thomson, *Subprime Transitions: Lingering or Malingering in Default?* 33 J. OF REAL EST. FIN. & ECON. 241–58 (2006) (reporting that only 11% of subprime borrowers in default by 90 days or more subsequently filed bankruptcy in the preceding eight months).

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address this issue. The current policy debate on homeownership is focused on loan origination issues, such as whether mortgage brokers or lenders placed families in appropriate loans.[205] Servicing problems may be less visible, but no less harmful. The rising foreclosure rate will only escalate the number of families who must struggle to understand the amount of their arrearage and who are at risk of having to pay unreasonable default costs to save their home.[206] 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 pay-off balances can penalize families when they refinance a home loan. Even families who try to get ahead on their mortgage 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 borrower. These practices create a needless barrier to homeownership.

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 servicer, essentially receiving a one-time option to choose a different servicer.[207] He postulates that servicers would compete for this additional business, driving up quality, and balancing servicers' incentives between lenders and borrowers. 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 the Department of Housing and Urban Development ("HUD") on its duties to enforce RESPA and to police mortgage servicers. HUD's website for complaints does not even mention mortgage servicing,[208] and the Federal Trade Commission, rather than HUD, has taken the lead in recent actions against servicers.

The Mortgage Study data suggest that policymakers who focus on promoting homeownership need to concern themselves with mortgage servicing, which is a crucial aspect to enabling families to achieve homeownership. 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 homeownership policies and threatens families' financial well-being.

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[205] Home Mortgage Disclosure Act Data and FTC Lending Enforcement Before the H. Comm. On Financial Services, 110th Cong. 1 5–9 (2007), *available at* http://www.ftc.gov/os/testimony/P064806hdma.pdf (describing FTC collection of data on pricing of subprime mortgages marketed to consumers).

[206] *See generally* RealtyTrac, *Foreclosure Activity Up Over 55% in First Half of 2007* (July 30, 2007), http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=2932&accnt=64847; Danielle Reed, *Rising Foreclosure Rates Point to a Normalizing Market*, REAL ESTATE JOURNAL.COM (Apr. 17, 2006), http://www.realestatejournal.com/buysell/markettrends/20060417-reed.html?refresh=on.

[207] Jack Guttentag, *Borrowers Should Be Able to Fire Mortgage Servicers* (Feb. 2, 2004), http://www.mtgprofessor.com/A%20-%20Servicing/borrowers_should_be_able_to_fire_servicers.htm.

[208] U.S. Dept. of Housing and Urban Dev. Complaints, http://www.hud.gov/complaints/ (last visited Sept. 11, 2007).

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 bankruptcy claims process exemplifies the difficulty in developing and monitoring an effective legal system. The findings should caution policymakers and advocates from blindly trusting in the written law as a decontextualized instrument to shape behavior.

## 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 addressing their debts and to ensure that creditors receive a fair 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 and, in fact, may be collecting unreasonable or illegal fees in the context of the bankruptcy claims process. These problems damage the integrity of the bankruptcy system and hinder families' efforts to save their homes. The structural incentives in the current system are insufficient to uphold bankruptcy's potential as a home-saving device and to ensure the integrity of the bankruptcy system. 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 showing the unreliability of mortgage servicing are a high-stakes reminder of the challenges of designing a legal system that actually functions to protect consumers.

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