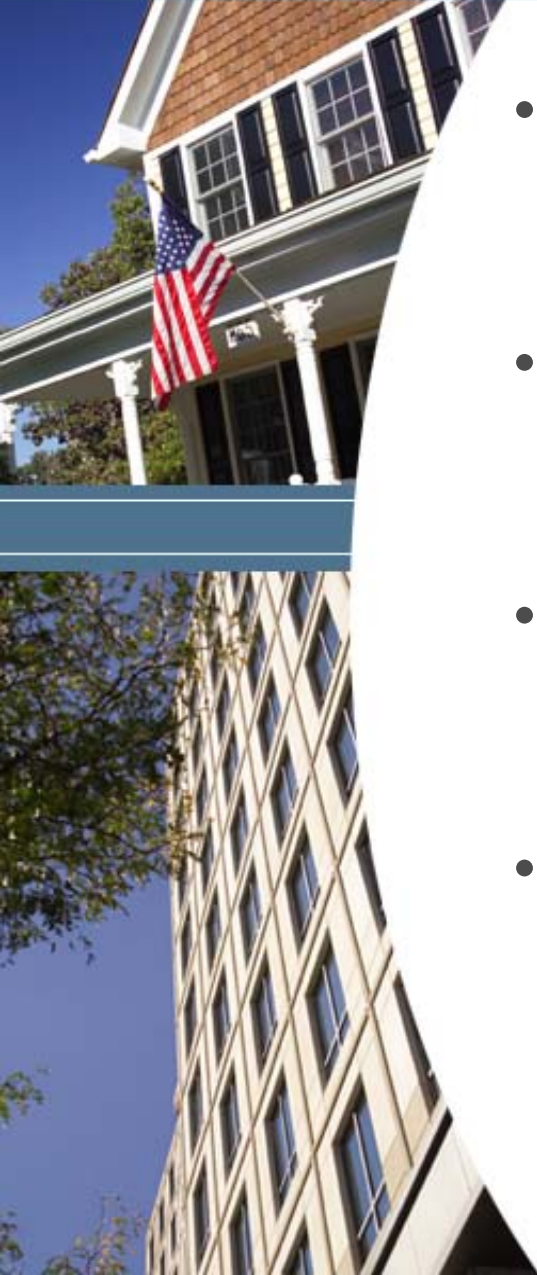


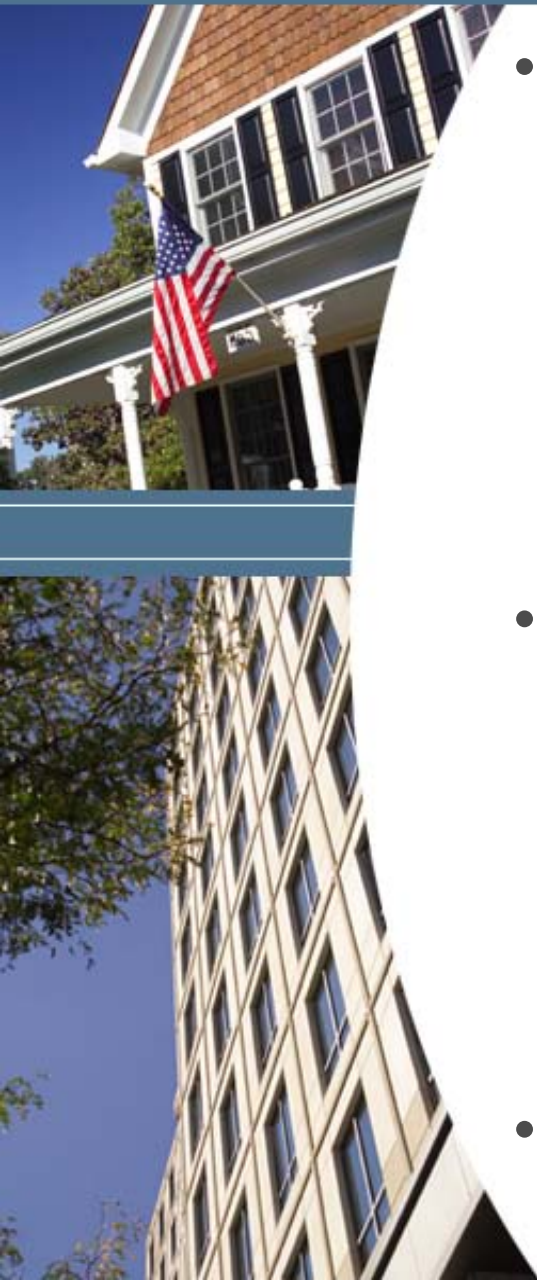


Judicial Attacks on Standard Mortgage Servicing Practices

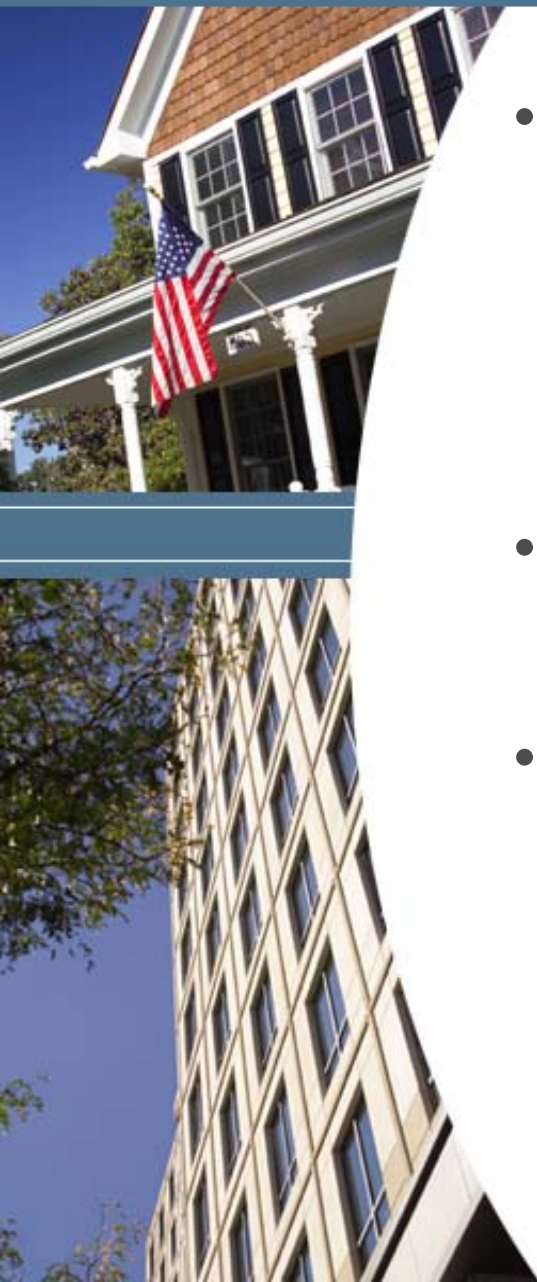
Bennet S. Koren
McGlinchey Stafford PLLC

The Cases Typically Start the Same Way – The Borrower Defaults

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- Chapter 13 Bankruptcies Soaring Because They Enable Borrowers to Keep their Houses and Cure their Delinquencies Over a 3 – 5 Year Period.
 - Chapter 13 Bankruptcies Require the Creditor to File a Proof of Claim Detailing the Amounts Owed As of the Date of the Bankruptcy Filing.
 - Debtors' Attorneys Are Asserting Broad, Non-Specific Challenges to Fees and Charges Included in Mortgage Creditors' Proofs of Claim.
 - In Many Instances, Bankruptcy Counsel Are Not Fully Prepared to Discuss the Nuances of How Each Fee Is Assessed or the Application of Each Payment or to Defend the Legal Basis for a Specific Servicing Practice.



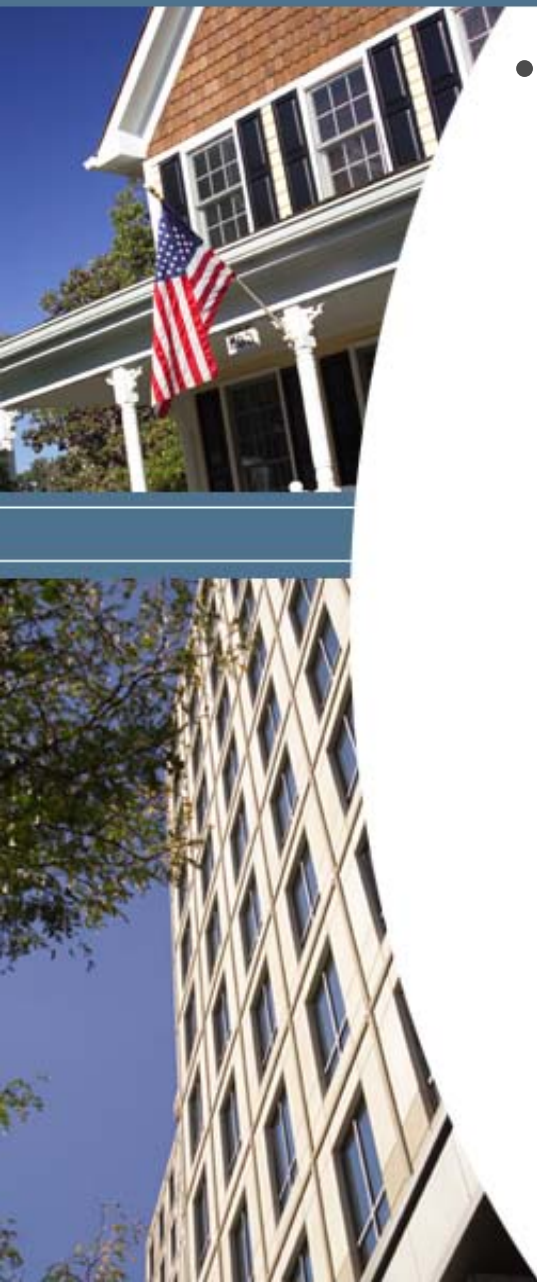
- Bankruptcy Courts Are Scrutinizing Individual Transactions From the Inception of the Loan, Not Just Amounts Listed on the Proofs of Claim
 - » Traditionally, bankruptcy courts looked only to the amounts listed on the proof of claim, not every transaction; now courts are going outside of the proofs of claim and reviewing the entire lending and servicing relationship
- Specific Servicing Issues Under Attack:
 1. Application of Payments
 2. Late Fees
 3. Inspections
 4. Broker Price Opinions (“BPOs”)
 5. Escrow Calculations
- Bankruptcy Decisions Are Yielding Class-Type Relief and Spawning Nationwide Class Actions



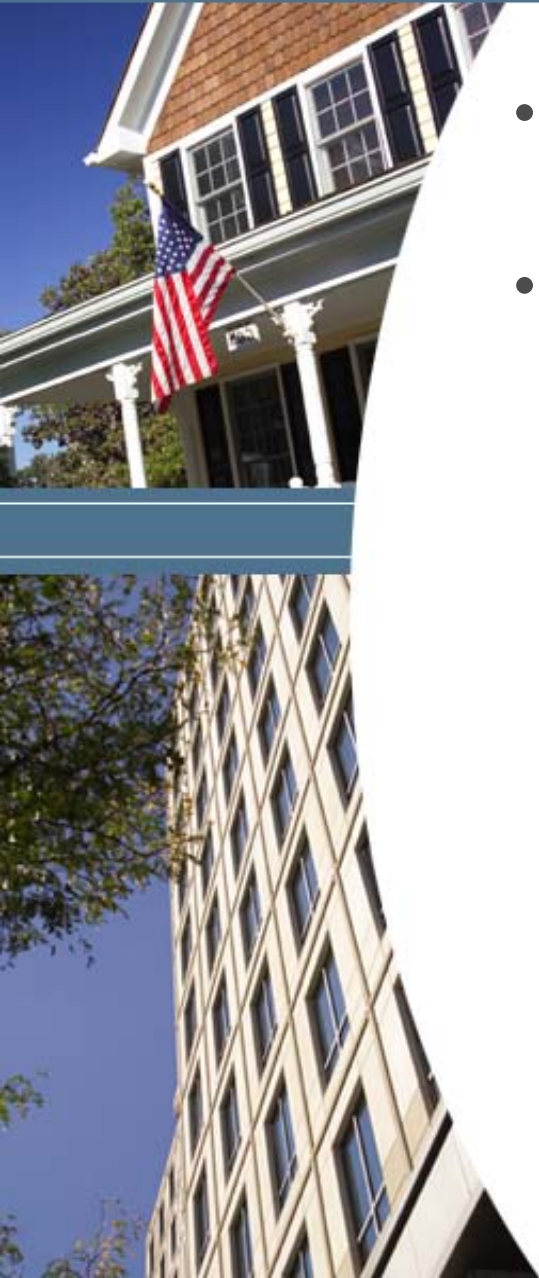
- *In re Stewart*, 391 B.R. 327 (Bkrctcy. E.D. La. 2008)
 - » Directly Spawned Three Class Actions
 - **Two in the Eastern District of Louisiana**
 - **One in the Southern District of Iowa**
 - » Cited in numerous complaints nationwide
- Appealed to the United States District Court for the Eastern District of Louisiana.
- Now On Appeal to the United States Fifth Circuit Court of Appeals



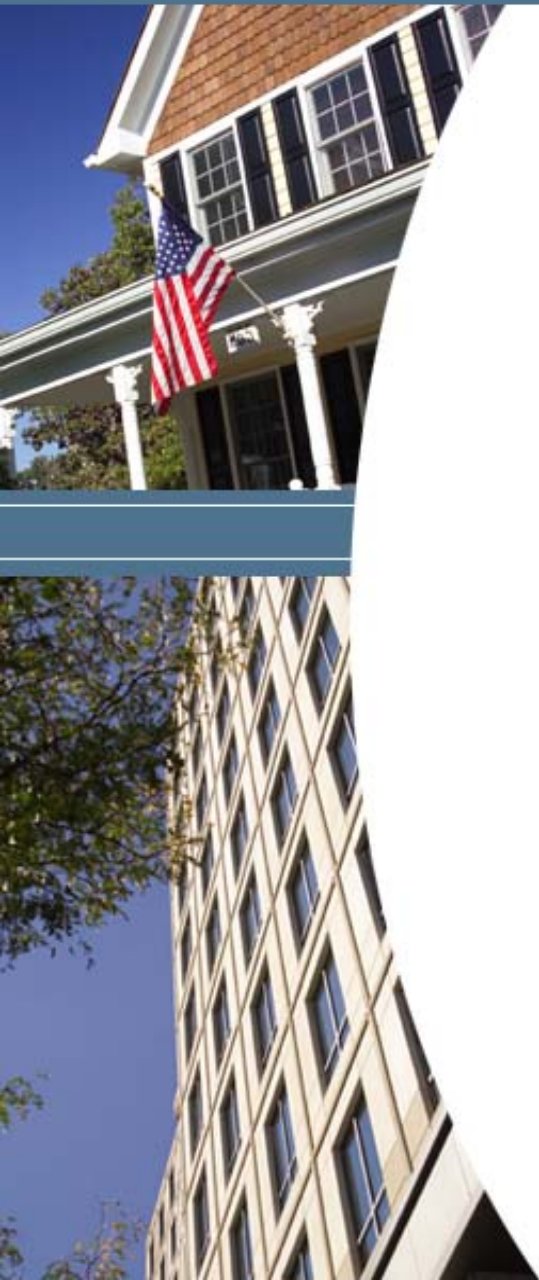
- On April 10, 2008, the bankruptcy court issued a Memorandum Opinion and Judgment disallowing or reducing certain charges and imposing a mandatory audit injunction.
 - » Found the standard Fannie Mae mortgage form to be “ambiguous” and construed it against the servicer.
 - » Disallowed a number of late charges.
 - » Disallowed a number of inspection fees.
 - » Held the servicer miscalculated the monthly escrow amount by failing to credit funds held in suspense to the total of all escrow items before calculating the monthly escrow payment.
 - » Reduced the amount the servicer could collect for each BPO charge.
 - » Issued damages and monetary sanctions.



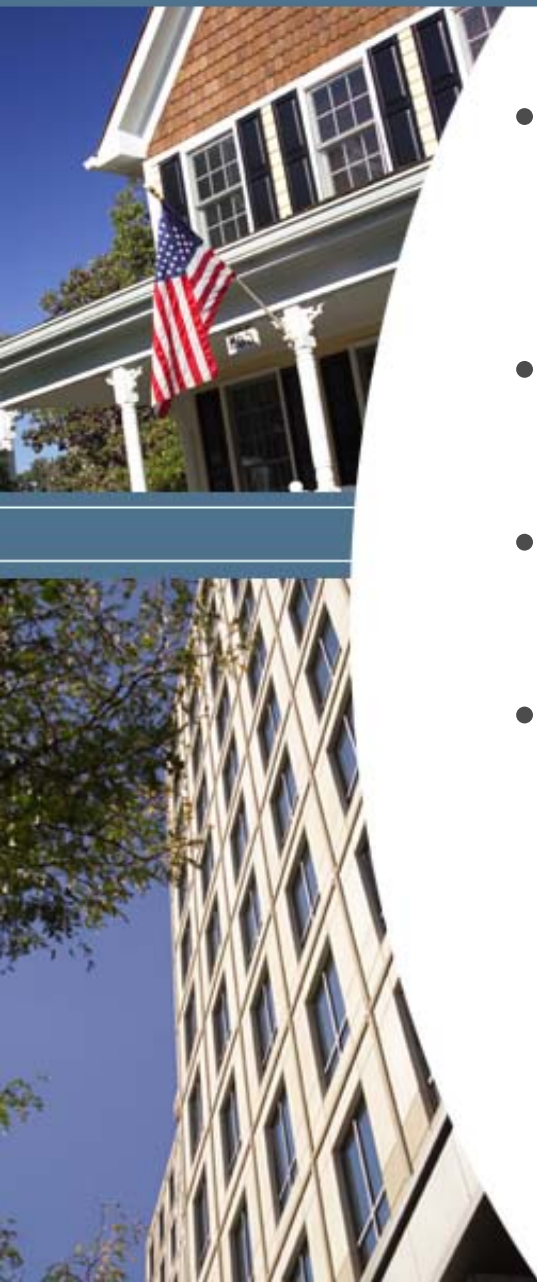
- Issued a Mandatory Audit Injunction Against the Servicer:
 - » Audit every proof of claim filed in the District and to amend proofs of claim already on file to comply with the “principles” established in this case and in another case decided by the same judge.
 - » Does not define “principles” and appears to assume that its legal conclusions, based on the specific language of Stewart’s single pre-2000 note and mortgage, are equally applicable to all other loans
 - » The audit affects hundreds of other cases, including not only those before this bankruptcy judge, but also those before the other bankruptcy judge in the Eastern District.
 - » Reserved the right to expand the injunction by creating administrative orders, appointing experts at the servicer’s expense and making “further adjustments.”



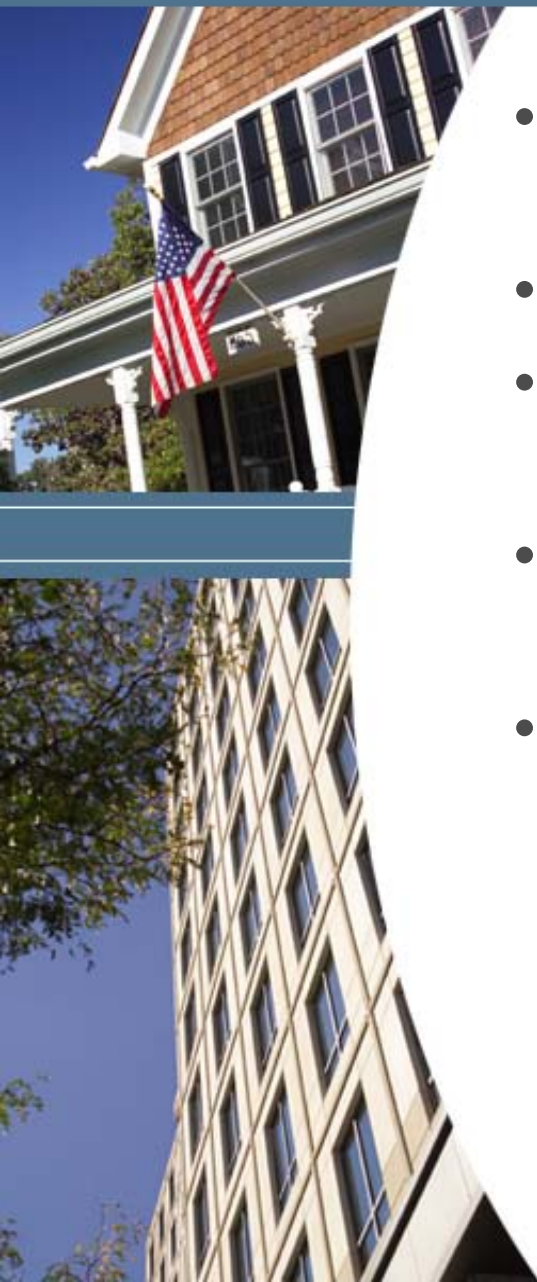
- Servicer Appealed the Bankruptcy Court Judgment to the District Court.
- August 7, 2009, the District Court Affirmed the Bankruptcy Court Judgment.
 - » Late Fees- The district court held the servicer improperly assessed late fees to the borrower's account by failing to apply a payment to the installment owed for the month in which it was received.
 - » Inspection Fees- The district court held that the mortgage establishes a reasonableness standard for each inspection and the bankruptcy court was correct in assessing the reasonableness of each inspection.



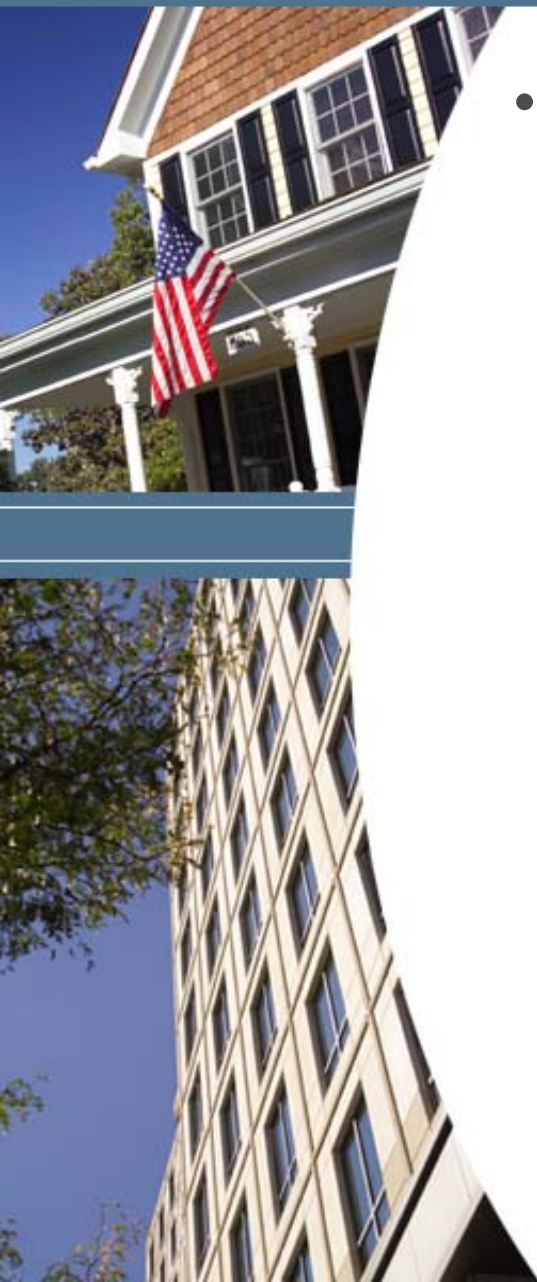
- » BPO Fees- The district court affirmed the bankruptcy court's reduction in the price of BPO charges.
- » Escrow Accounts- The district court ignored the concept of installments, read the application of payments section to require all funds received to be applied to escrow before being applied to accrued interest or principal and held that RESPA is not inconsistent with the note and does not prevent applying suspense funds to escrow amounts.
- » Mandatory Audit Injunction- The district court affirmed the audit and the district-wide remedy that it ordered.



- The Servicer Appealed the Bankruptcy Court Judgment to the United States Court of Appeals for the Fifth Circuit.
- Briefs Have Been Submitted by the Servicer and Debtor.
- The United States Trustee Filed an *Amicus Curiae* Brief.
- Waiting On Fifth Circuit To Determine Whether It Will Hear Oral Argument.

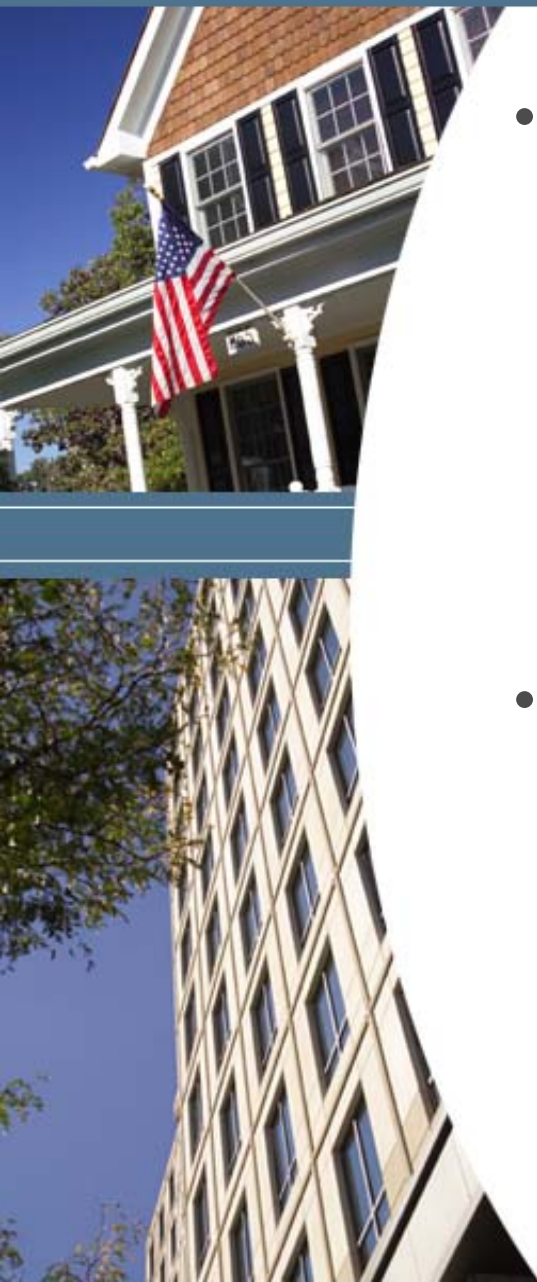


- Issues arise concerning the application of payments when the borrower makes a delinquent payment.
- The use of suspense accounts confuses the issue.
- Courts look to the language of the note and mortgage.
- Different mortgages have different language, including Fannie Mae mortgages.
- The mortgage at issue in *In re Stewart* was a standard Fannie Mae mortgage executed in 1999 with uniform covenants.

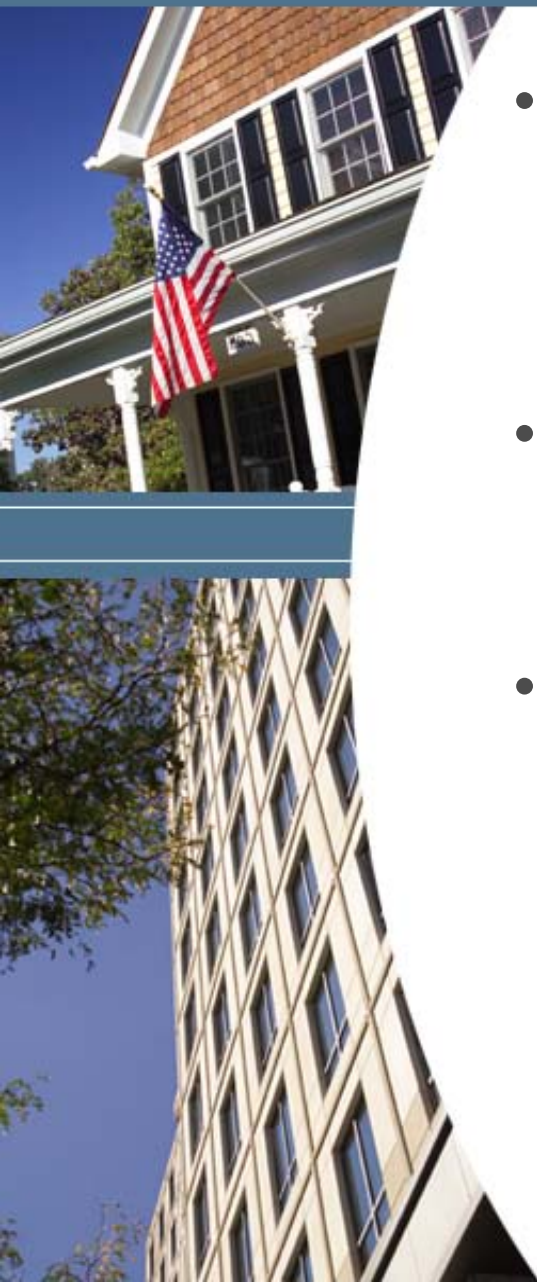
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- The Stewart mortgage provided the following payment hierarchy:

Unless applicable law provides otherwise, all payments received by Lender shall be applied:

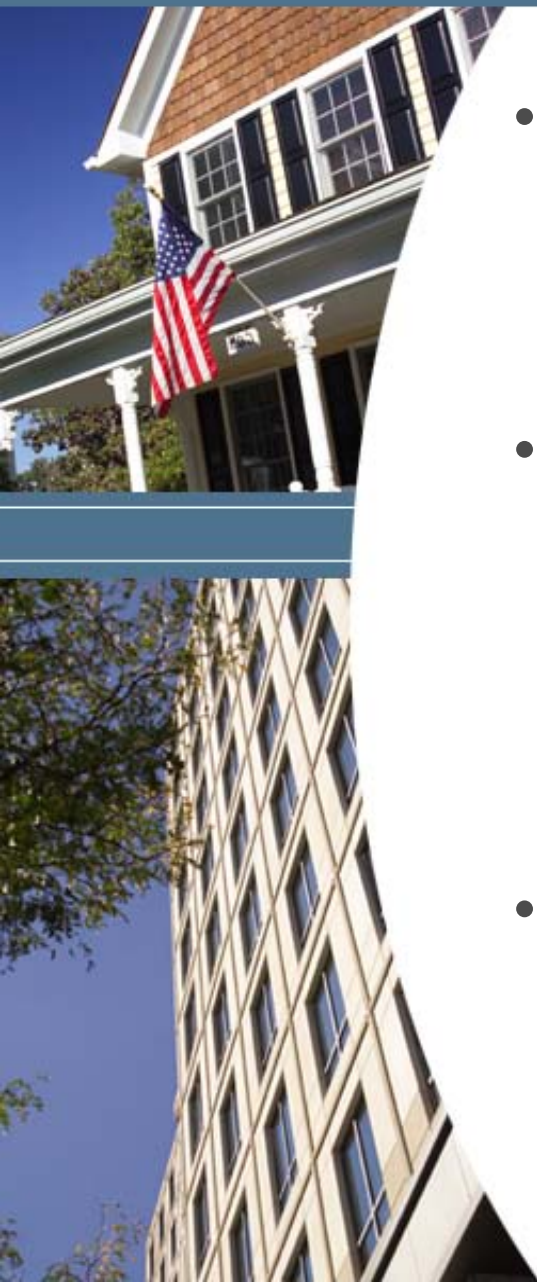
- First, to any prepayment charges due under the Note;
- Second, to amounts payable under paragraph 2 [for escrow items];
- Third, to interest due;
- Fourth to principal due; and
- Last, to any late charges due under the Note.



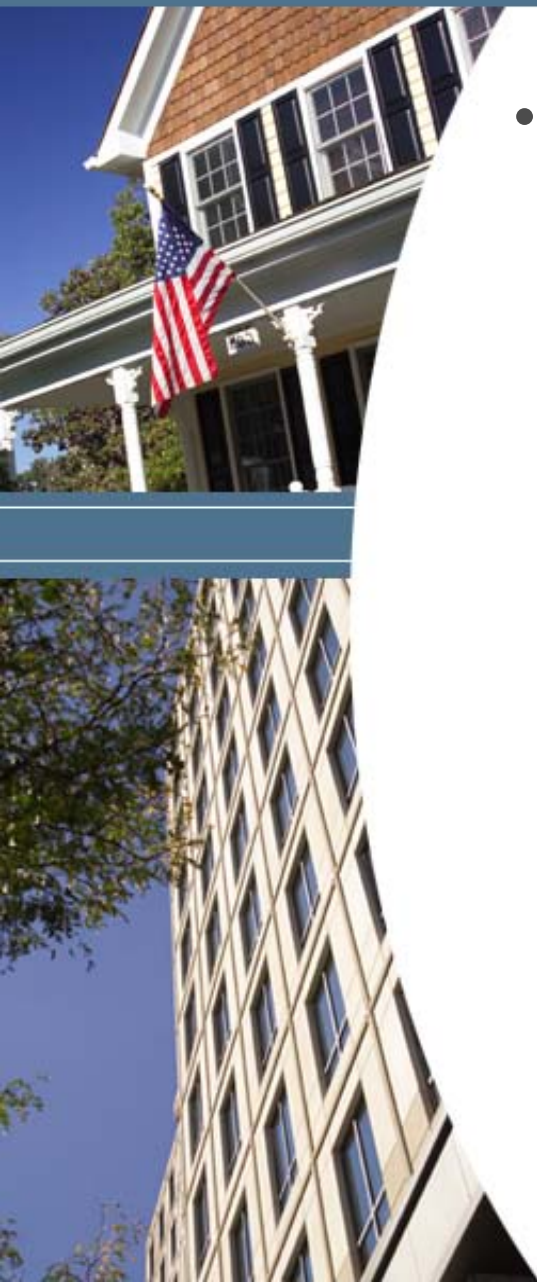
- Based on this language, the bankruptcy court held that all payments must be applied in that order, irrespective of installments.
 - » In other words:
 - All escrow amounts owed must be satisfied before any interest is collected;
 - All interest owed must be collected before any amount is applied to principal and so on.
- The court held that the servicer could not collect the delinquent installment owed in January and the late fee assessed on the delinquent January installment before applying funds to the February installment.



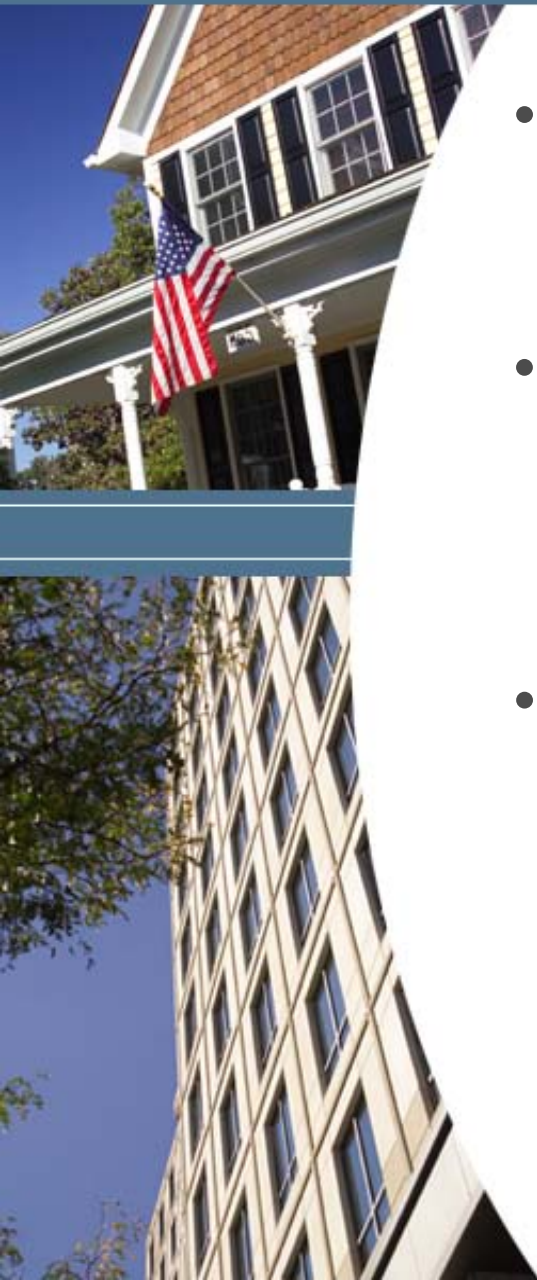
- The district court compounded the problem by holding: “The Note and Mortgage are silent as to the application of payments to past due amounts” and then looked to a Louisiana Civil Code article.
- Based on the alleged ambiguity, the court applied Louisiana Civil Law to interpret the application of payments under a standard Fannie Mae mortgage.
- The Louisiana Civil Code article provides a default rule for application of payments when the borrower owes multiple debts.
 - » This article dates back to 1870.
 - » On its face, this article does not apply because there was only one debt – the mortgage loan.



- The district court held that under the article, the borrower “has the right to impute payment to the debt [she] intends to pay,” which can be express or implied.
- Although there were no facts in the record regarding the debtor’s imputation, the court held “the circumstances known to the obligee indicate an inferred imputation to the most current debt.”
 - » This interpretation stops the assessment of additional late charges after the first one is assessed.
- Not only did the court look to state law to interpret the standard form mortgage, but its holding requires servicers to guess what the borrower intended a payment to be applied to based on the “circumstances.”



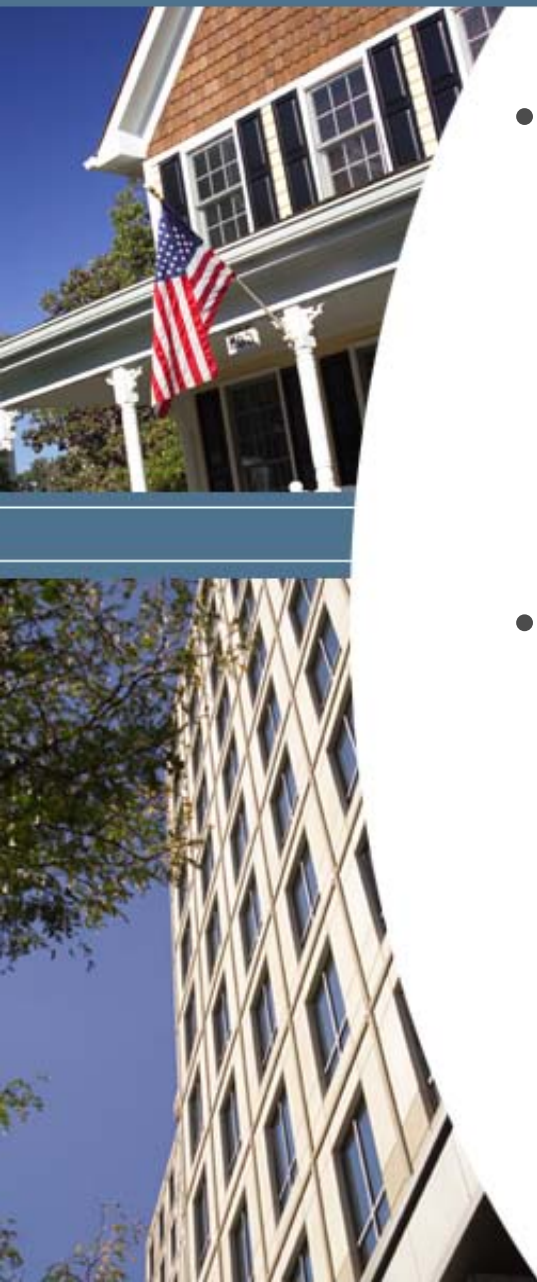
- The current version of the standard Fannie Mae mortgage is more clear on this point:
“Except as otherwise described in this Section 2, all payments accepted and applied by Lender shall be applied in the following order of priority: (a) interest due under the Note; (b) principal due under the Note; (c) amounts due under Section 3. Such payments shall be applied to each **Periodic Payment** in the order in which it became due. Any remaining amounts shall be applied first to late charges, second to any other amounts due under this Security Instrument, and then to reduce the principal balance of the Note.”



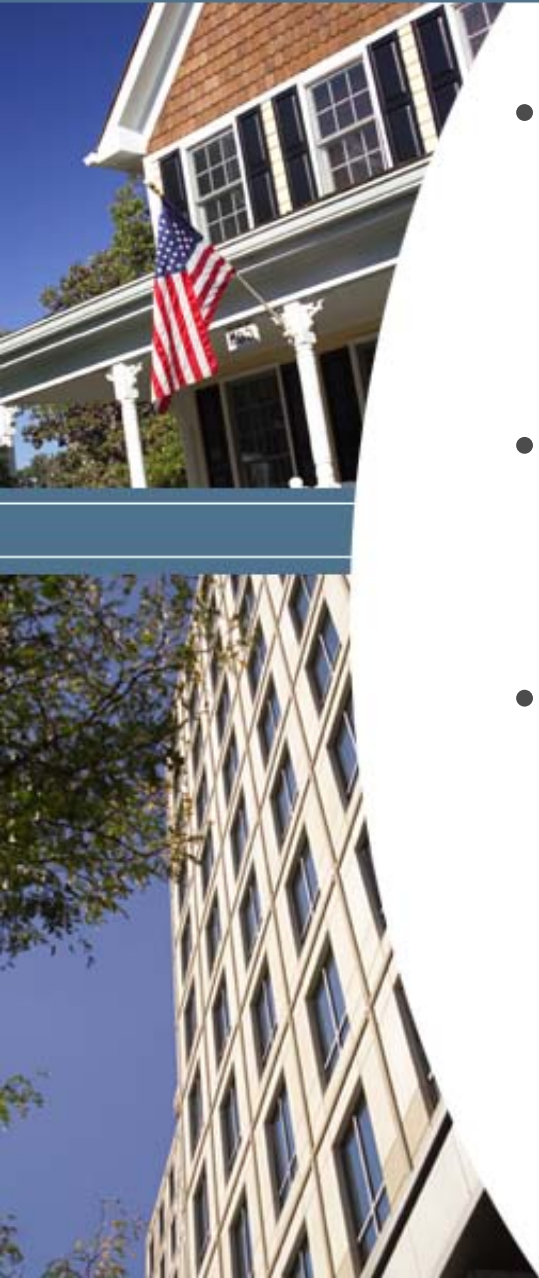
- Standard mortgage forms do not necessarily lead to standard, one-size-fits-all mortgage servicing practices.
- Even though the current version of the standard Fannie Mae mortgage may be favorable, servicers cannot rely on the new language when servicing older forms.
- Courts are scrutinizing individual mortgage forms, reading them literally and construing any ambiguity against the lender and, in some instances, applying state laws that were not designed to apply to mortgage servicing issues.



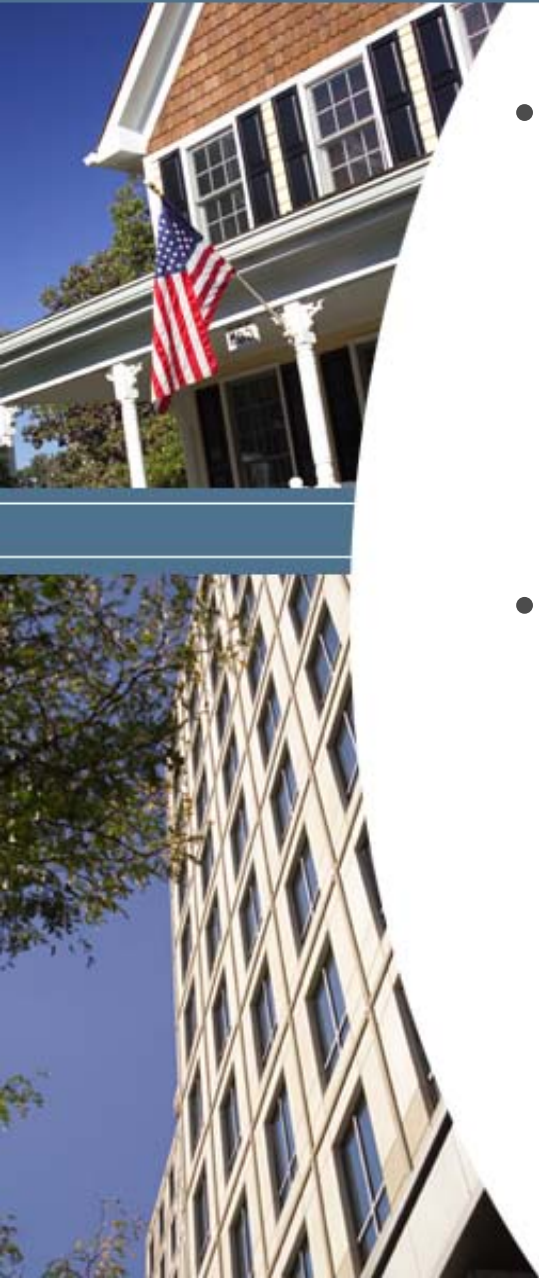
- Challenges to late fees are closely tied to the application of payments issue.
- Issue arises under the following facts:
 - » Borrower skips the January installment payment
 - » Borrower makes a payment within the grace period of the February installment, but in the amount of only one P&I payment
 - » Borrower does not make another payment in February
 - » What payment does the servicer apply the payment to? The skipped January payment or the February payment?



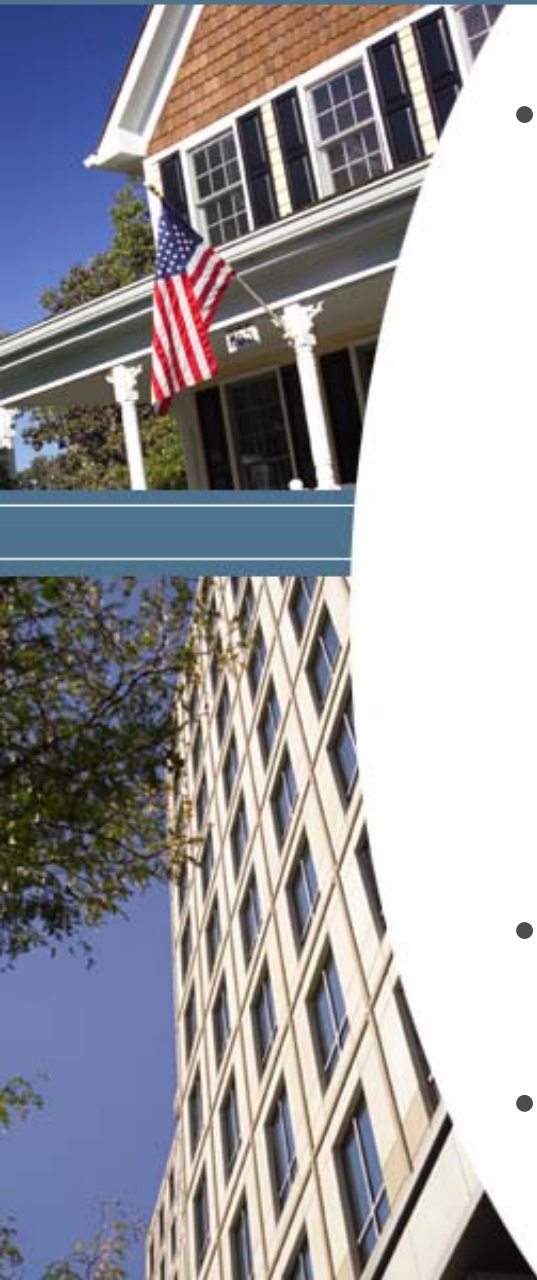
- In the *Stewart* decision, the bankruptcy court held that the servicer was required by the mortgage to apply the payment to the February installment.
 - » Result is that the January payment and the late fee assessed based on that payment are not satisfied.
 - » Servicer cannot charge a late fee for the February payment.
- The bankruptcy court based its holding on the mortgage and Regulation AA.
 - » The Bankruptcy Court acknowledged that Regulation AA does not apply to the note.
 - » The only practice prohibited is the assessment of a late fee “. . . when the only delinquency is attributable to late fees or delinquency charges assessed on earlier installments . . .”



- The bankruptcy court also focused on the issue of notice – what notice the borrower received of the late fee and of the method by which the servicer applied payments.
- The bankruptcy court held that the servicer had a corporate practice that fails to notify borrowers that fees are being assessed against their accounts.
- The bankruptcy court found this failure was contrary to the requirements of the note and mortgage.

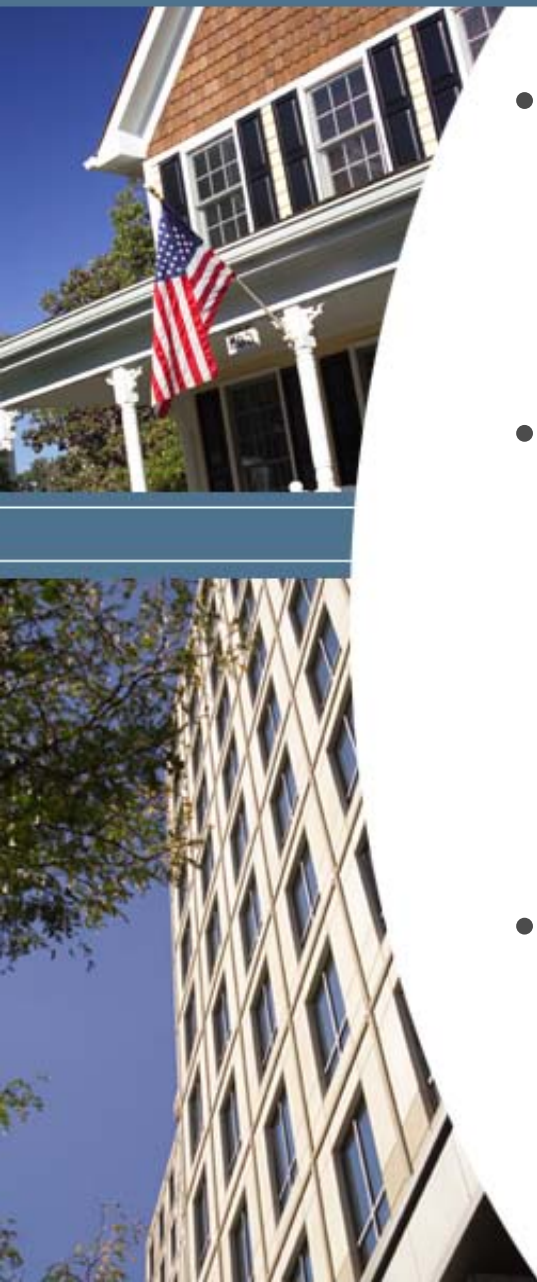


- The district court affirmed the bankruptcy court's decision on late fees and found that the servicer improperly assessed late fees to the borrower's account by failing to apply a payment to the installment owed for the month in which it was received.
- Based on the Louisiana Civil Code, the district court held that the circumstances indicated that Stewart intended to pay the most current debt, not past due amounts.
 - » Thus, her payments were not "late" and could not trigger a late fee.

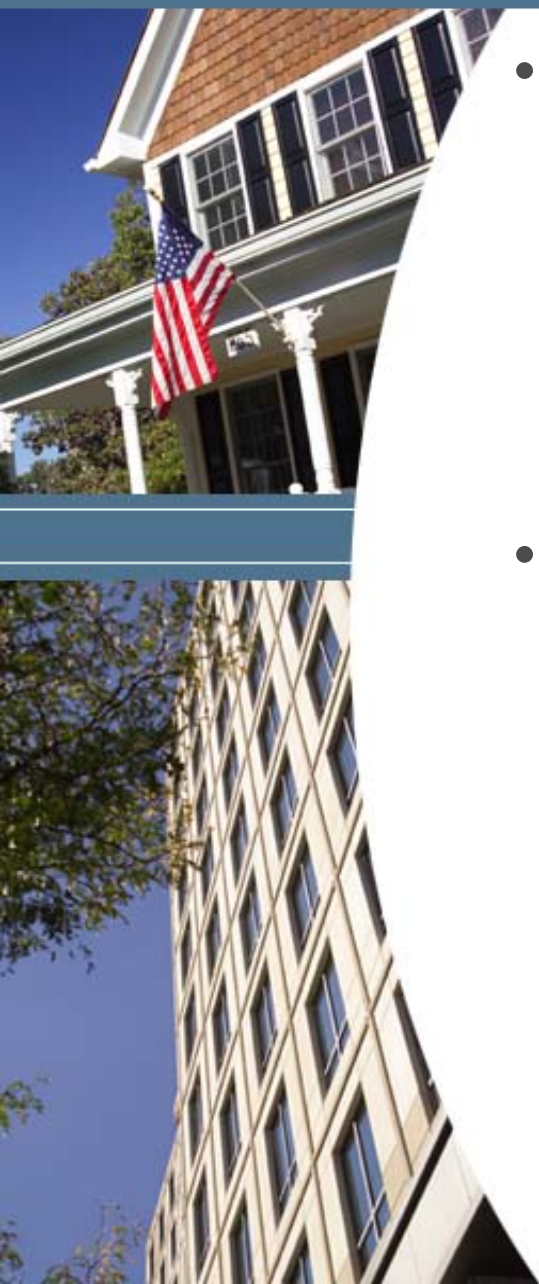


- The current Fannie Mae mortgage states:

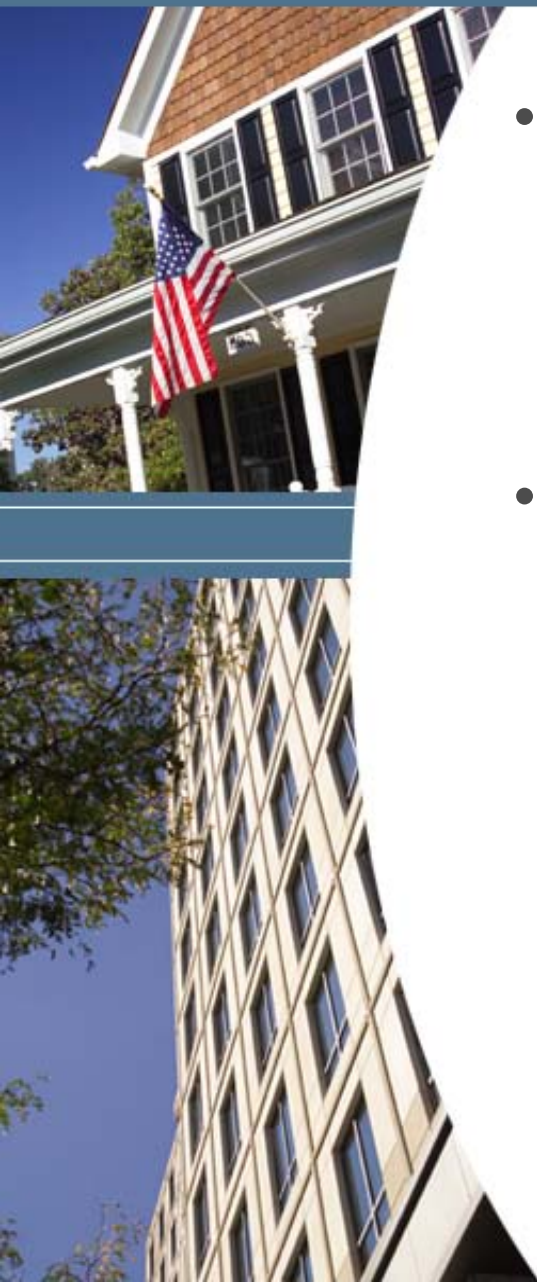
“If Lender receives a payment from Borrower for a delinquent Periodic Payment which includes a sufficient amount to pay any late charge due, the payment may be applied to the delinquent payment and the late charge. If more than one **Periodic Payment** is outstanding, Lender may apply any payment received from Borrower to the repayment of the Periodic Payments if, and to the extent that, each payment can be paid in full. To the extent that any excess exists after the payment is applied to the full payment of one or more Periodic Payments, such excess may be applied to any late charges due.”
- Different variations on this language may yield different results.
- The absence of any such language may lead to the same result as the Stewart decision.



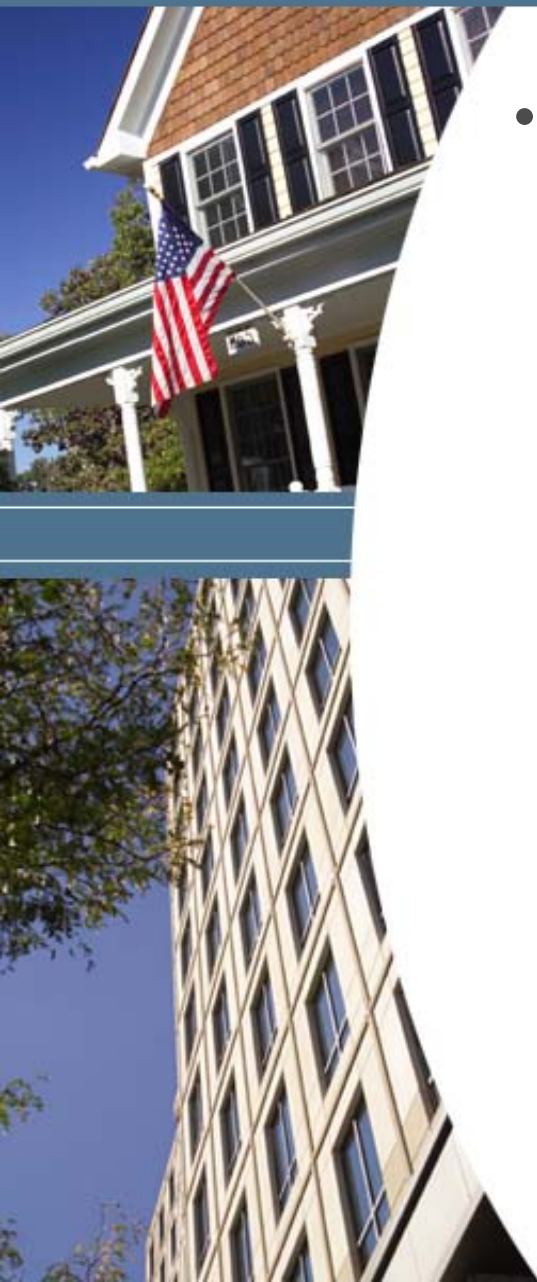
- Courts are challenging inspection fees charged to borrowers based on the reasonableness of the number and frequency of property inspections and the basis for ordering each inspection.
- The language in the standard Fannie Mae mortgage allowing a lender to “do and pay for whatever is necessary to protect Lender’s interest in the Property and rights under this Security Instrument” may not be clear enough to support the ordering of inspections in all instances.
- Allows the court to decide what is, and is not, “necessary” or “reasonable.”



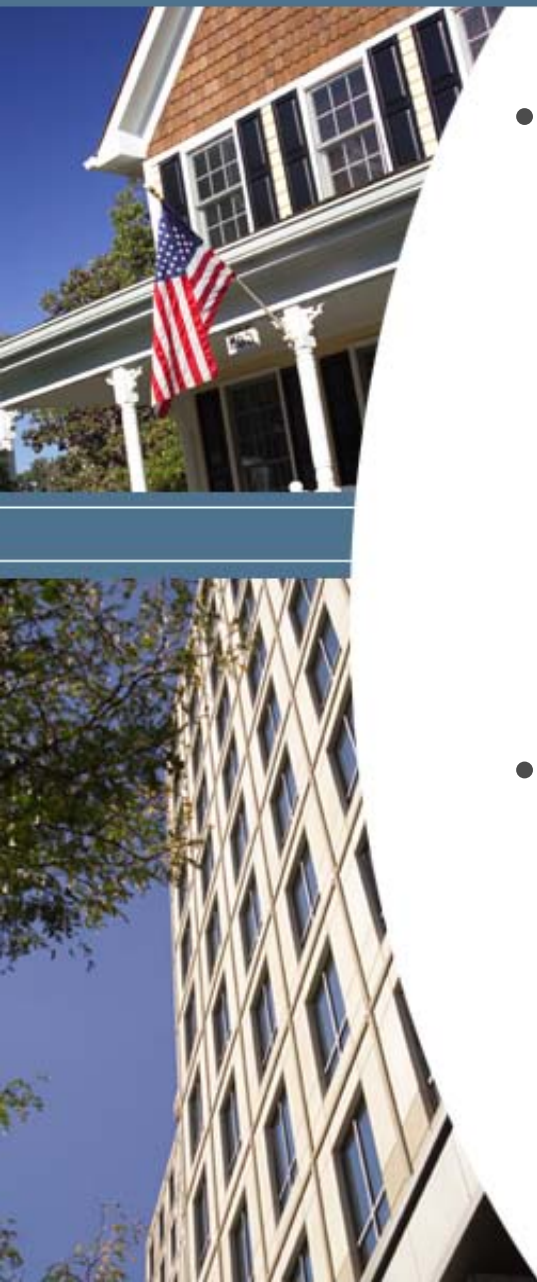
- The bankruptcy court disallowed 42 of the 43 property inspections ordered of the property.
 - » The borrower was charged \$15.00 for each inspection.
 - » Including inspections ordered after the borrower was more than one year delinquent and after Hurricane Katrina.
- The court's rationale was if “the first report reveals a property in fair to good condition, nothing justifies, without further evidence of a problem, monthly inspections thereafter.”
 - » No way to know if the property is in good condition without an inspection.
 - » No guidance on what constitutes “further evidence of a problem.”
 - » “[A] general belief that loans in default create a risk for the collateral” is insufficient to justify an inspection.



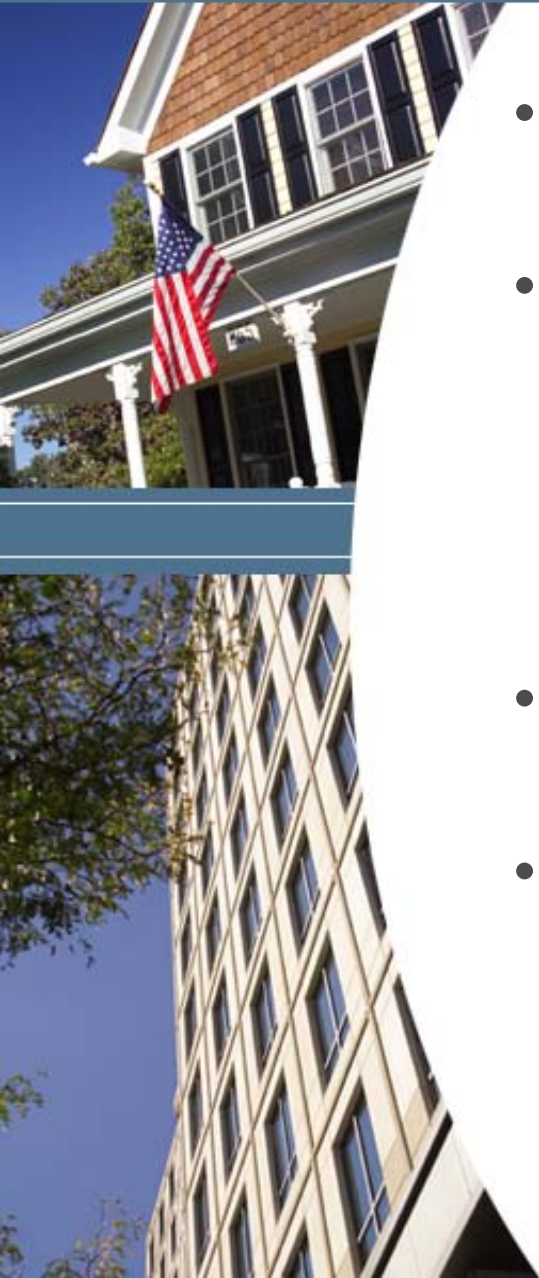
- The bankruptcy court also required notice to the borrower prior to the inspection itself and prior to the assessment of the inspection fee.
 - » Including notice to the borrower of drive-by inspections before they occur.
- The bankruptcy court based its holding on language included in a pre-2001 mortgage that states: “Lender or its agents may make reasonable entries upon and inspections of the Property. Lender shall give Borrower notice at the time of or prior to an inspection specifying reasonable cause for the inspection.”



- The district court affirmed the bankruptcy court decision regarding inspections.
 - » Held that the mortgage establishes a reasonableness standard for each inspection and the bankruptcy court was correct in assessing the reasonableness of each inspection.
 - » Focused on inconsistencies in the description of the property among the various inspection reports and that the inspection reports showed the property was occupied and well maintained and found inspections were unreasonable when the debtor was making regular payments.
 - » Rejected arguments that inspections were necessary to protect the lender's interest and that the issue involved safety and soundness standards not considered by the bankruptcy court.



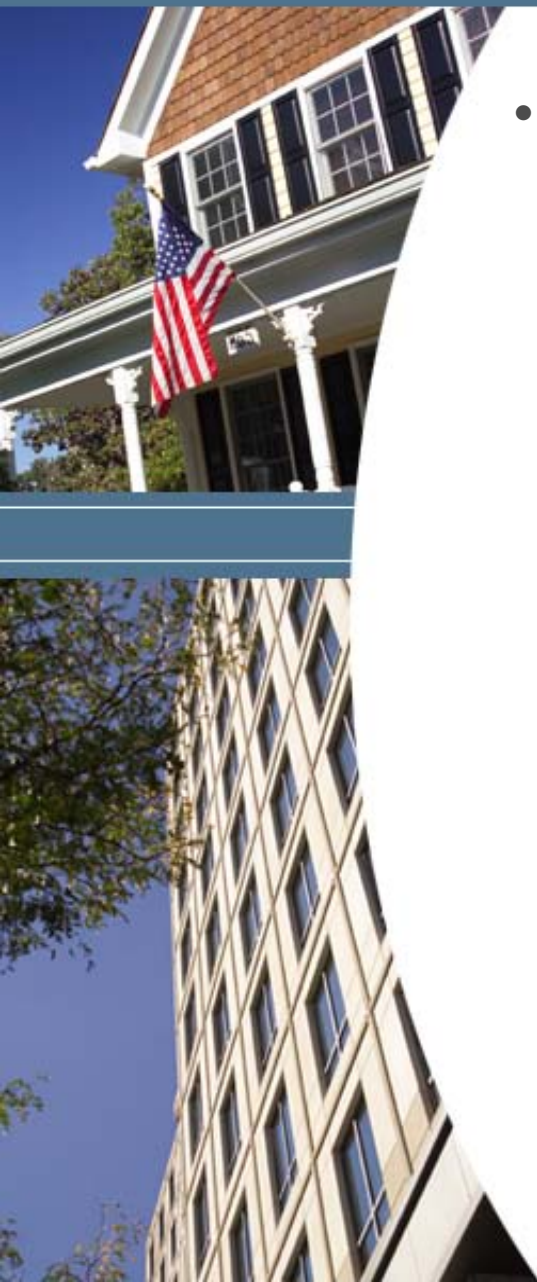
- The current version of the standard Fannie Mae mortgage states:
“Lender or its agent may make reasonable entries upon and inspections of the Property. If it has reasonable cause, Lender may inspect the interior of the improvements on the Property. Lender shall give Borrower notice at the time of or prior to such an **interior inspection** specifying such reasonable cause.”
- Although this language is more clear, it may not shield servicers from providing notice to borrowers whose mortgages do not include the same language.



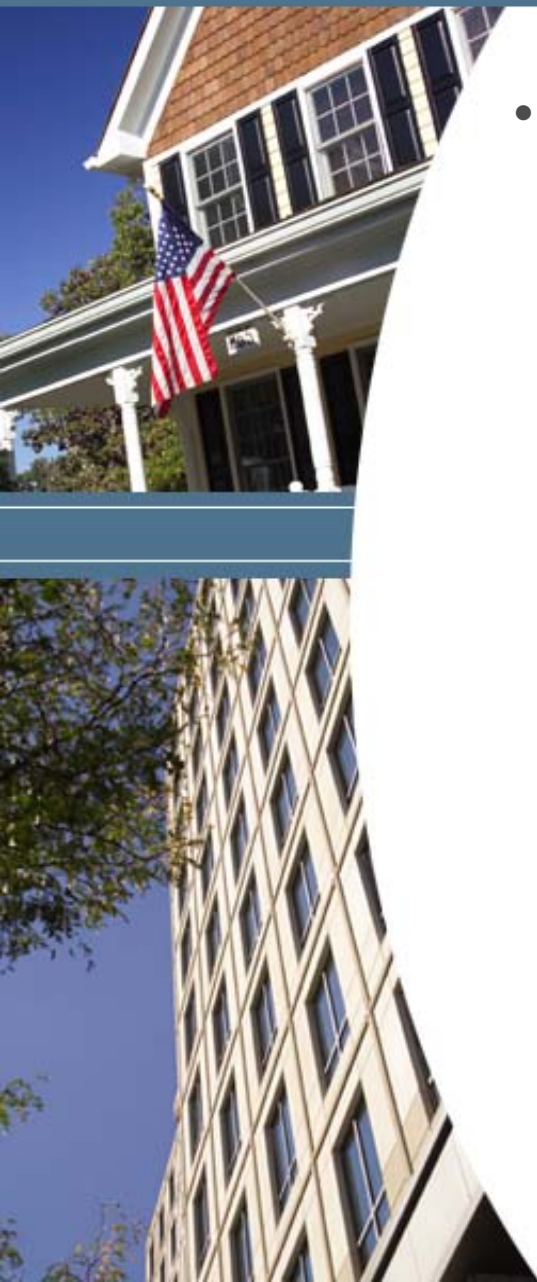
- Courts are looking to the basis for ordering the BPO and the amount of the charge.
- The bankruptcy court looked to language in the standard Fannie Mae mortgage allowing a lender to “do and pay for whatever is necessary to protect Lender’s interest in the Property and rights under this Security Instrument.”
- The bankruptcy court restricted the number and pricing of BPO charges.
- This language in the mortgage may not be clear enough to support each BPO or to support the pricing of BPOs.



- Practice Tips:
 - » Be Careful When Using Divisions, Affiliates or Subsidiaries
 - » Courts Are Scrutinizing Perceived “Profits” Built Into Charges Assessed to Borrowers
 - » Attacking Any Charge That Is Not Invoiced By a Third Party Vendor
 - » Debtors’ Counsel Are Challenging Fees On This Basis As a Matter of Course



- Whether the bankruptcy court erred, legally and procedurally, in issuing a mandatory injunction in the Stewart bankruptcy case by, among other things, ordering the servicer:
 - » (a) to conduct an audit of proofs of claim filed on its behalf in hundreds of bankruptcy court cases other than the Stewart bankruptcy case that are before other bankruptcy judges;
 - » (b) to file loan histories into the claims registries, and to amend proofs of claim already on file, in open cases other than the Stewart bankruptcy case that are before other bankruptcy judges; and
 - » (c) to deliver to the debtors, the debtors' counsel and the standing chapter 13 trustee copies of loan histories in closed cases other than the Stewart bankruptcy case that are before other bankruptcy judges?



- Whether the bankruptcy court erred in disallowing, or reducing the amount of recovery of, certain fees and costs included in the proofs of claim filed by the servicer in the Stewart bankruptcy case?
 - » Whether the uniform covenants in a standard Fannie Mae mortgage should be subject to varying interpretations in each state?
 - » Whether the note and mortgage allow a lender to impose a late fee each and every time a borrower is late with a payment?
 - » Whether the standard note and mortgage forms are ambiguous?
 - » Whether the standard Fannie Mae mortgage allows a lender to order a drive-by inspection with the borrower does not pay a monthly installment within the grace period?
 - » Whether the servicer properly calculated escrow amounts?
 - » Whether the servicer is entitled to charge a reasonable amount for BPO charges?



Questions?