

What's My Balance?: Accurate Payoffs, Reinstatements and Loan Histories

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A seemingly commonplace, but consistently problematic, area in the default servicing arena has been payoffs, reinstatements, and loan histories. Particularly from a bankruptcy perspective, these are areas where a servicer can be exposed to litigation due to inadvertent errors, improperly included fees and charges, lack of explanation or itemization, or failure to properly credit payments.

Most security documents, whether it is a deed of trust or a mortgage, provide for the reimbursement of attorneys' fees and costs and/or any additional debt that a creditor may incur to protect its rights in the property. However, many states have specific guidelines on what is collectible against the borrower, especially while that borrower is in bankruptcy. In North Carolina, attorneys' fees and costs incurred during the bankruptcy must be court-awarded before they can be assessed against a borrower's account. An example of this is the proof of claim fee. The fee paid to local counsel or a national law firm to prepare a proof of claim is typically not awarded by a bankruptcy court. In fact, in the Western District of North Carolina, an administrative order of the court specifically provides that the proof of claim fee is a non-recoverable expense of the secured creditor. Where we typically see this fee again, however, is blended in with other corporate advances or attorneys' fees on a payoff or reinstatement.

Other questionable fees and charges, depending upon the state, may include property inspection fees, property preservation fees, broker price opinions, or appraisals that were incurred while the automatic stay was in effect. While these fees are a necessary aspect of servicing a loan, not all jurisdictions allow them to be recouped from the borrower, especially if incurred during a bankruptcy. These types of improper charges have made payoffs and reinstatements a popular form of attack by debtors' attorneys. Sending out a payoff or reinstatement containing inadequately explained charges or fees, or failing to check with local counsel as to whether certain fees or charges are recoverable, could create unnecessary litigation for a servicer. By way of illustration, case law shows how overstated or confusing payoffs, as well as inaccurate payment histories, can be grounds for significant monetary penalties against the servicer.

The confirmed plan dictates what is due.

Under *In re Riser*, 289 B.R. 201 (Bankr. M.D. Fla. 2003), the court held that the servicer was bound by the confirmed plan pursuant to Bankruptcy Code Section 1327. Because the plan did not provide for the payment of an "allowable corporate advance" that the servicer had placed in a post-discharge payoff letter, the lender was not legally entitled to collect the advance. By demanding that the debtor pay the \$11,000 corporate advance, the

debtor was precluded from refinancing. Ultimately, the court sanctioned the servicer in the amount of \$11,538.14.

Itemize “recoverable corporate advances” and make sure that they are truly “recoverable.”

This point is illustrated by *In re Dougherty*, 425 F. Supp. 2d 599 (E.D. Pa. 2006). In *Dougherty*, the post-discharge payoff letter included a “recoverable corporate advance” in the amount of \$3,768.50 that was not previously disclosed to the debtor. Additionally, part of the advance was for post-petition attorneys’ fees that were not approved by the bankruptcy court. The debtor initiated a class action lawsuit against the servicer under a number of theories, including an alleged FDCPA violation of 15 U.S.C. 1692e. Section 1692e provides: “A debt collector may not use any false, deceptive, or misleading representation or means in connection with the collection of a debt.” Further, the debtor alleged that the servicer had engaged in an unfair trade practice by charging fees without approval of the bankruptcy court, and by failing to provide the debtor with prior notice of the fees.

The servicer’s motion to dismiss the complaint, while successful on some counts, was not successful on the FDCPA count or the unfair trade practice count. The court found that the debtor might have a claim under Section 1692e because “describing the contested fees as ‘recoverable corporate advances’ may be confusing and deceptive to an unsophisticated consumer.” The court further denied the servicer’s motion to dismiss the state law claim of unfair trade practice for attempting to collect fees that were not previously allowed by the bankruptcy court. Although the *Dougherty* case is pending a final decision on the merits of the debtor’s claims, it does illustrate that servicers must be diligent in scrubbing and accurately itemizing payoffs and reinstatements.

Payment histories should align with the confirmed Chapter 13 plan.

Once a plan is confirmed, a court has held that while a servicer’s contractual loan history will show all bankruptcy payments being applied to the oldest outstanding contractual obligation, a servicer must be able to produce a payoff or pencil ledger that is consistent with the plan confirmation order. The pencil ledger must account for trustee payments being applied to the pre-petition arrearage, and post-petition payments being applied to the oldest outstanding post-petition obligation. *In re Nosek*, 2006 Bankr. LEXIS 1279* (Bankr. D. Mass. 2006). In *Nosek*, the servicer was found to have placed a large number of post-petition payments into suspense, which made it look as though the debtor was severely delinquent in her post-petition mortgage payments. As a result, she alleged that she was unable to refinance her home “because she could not obtain an accurate payment history from the [servicer].”

Although the servicer also maintained a pencil ledger tracking the post-petition payments, which showed that the payments were received timely and that the debtor was post-petition current, the servicer did not supply the pencil ledger to the debtor. Instead, the debtor was sent the contractual loan history that was created by a computer loan-servicing program. The court, in finding that the servicer had — under Massachusetts’s law — violated an implied covenant of good faith and fair dealing, stated that the servicer

failed to account for and properly distinguish between pre-petition and post-petition payments made by the debtor.

The court further stated that payments “made during the pendency of the Chapter 13 plan should have been applied by [the servicer] to the current payments [then] due and owing with the arrearage amounts [received from the Chapter 13 trustee] to be applied to the back payments. [The servicer] cannot use its accounting procedures to contravene the terms of a confirmed Chapter 13 plan and the bankruptcy code.” Nosek at *47-48 quoting *In re Wines*, 239 B.R. 703, 707 (Bankr. D. N.J. 1999). Because of the violation of the implied covenant of good faith and fair dealing, the servicer was fined \$250,000.

State Statutes Dictate Time

In addition to regulating the contents of payoffs and reinstatements, several states have enacted consumer protection statutes that provide a mandatory timeframe in which payoffs must be provided. North Carolina and Connecticut are two such states. Effective October 1, 2005, North Carolina General Statute §45-36.7 specifies that a payoff must be provided within 10 days of receipt of a written request. The payoff must also contain the date on which it was prepared, the payoff amount as of that date (including the amount by type of each fee, charge, or other sum included within the payoff amount), the per diem, payment cutoff time and address. The statute further provides for actual damages and attorneys’ fees caused by a creditor’s failure to timely comply.

While the Connecticut statute does not dictate what the payoff must contain, it does require that the payoff be provided by the date the borrower requests, so long as the request date is at least 10 business days from the date of receipt of the written request. Failure to provide the payoff in a timely fashion will result in curtailed interest. [Conn. Gen. Stat. Section 49-10a.]

Practically speaking, 10 days is a scant amount of time to provide a payoff statement to a requesting party. Once the payoff is received from the servicer, local counsel will review it for any questionable items. This may entail obtaining further breakdowns from the client on certain items listed on the payoff, including specific dates as to when fees or charges were incurred, and whether they were incurred during a bankruptcy. One suggestion for trimming time from this process is for the servicer to include detailed information in the payoff. For example, if an account had several thousand dollars in outstanding corporate advances, it is helpful for those corporate advances to be broken down by type, i.e. foreclosure fees and costs, bankruptcy fees and costs, and escrow advances.

So what can lenders do to avoid the pitfalls of litigation brought on by hastily prepared payoffs or reinstatements? Here are some recommendations.

1. **Communicate with local counsel.** Have local counsel review and advise whether the payoff or reinstatement complies with that state’s statutory law and bankruptcy case law — especially if a borrower has filed for bankruptcy multiple times. Keep a record of what

is allowed and disallowed in each jurisdiction. Every state is different, and even some bankruptcy districts within each state have varying rules.

2. **Be specific.** List charges by type and be as detailed as possible. For example, what were the corporate advances for? What are “other fees and charges”? The more information, the better.

3. **Apply payments promptly and accurately.** Do not allow payments to accumulate in suspense. Also, any post-petition histories provided to the debtor must show that payments have been applied in accordance with the plan.

4. **Streamline the process.** Have a procedure in place for requesting payoffs and reinstatements, whether it is a designated email address, facsimile number, or particular option on a website.

While the cases demonstrate that servicers can have great financial exposure in providing an inaccurate payoff or reinstatement quote, with proper diligence and help from local counsel, servicers should be able to shield themselves from these substantial monetary penalties.

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