

## Residential Mortgage Lenders and Servicers Beware of Changes to Rule 3002.1

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This December, residential mortgage lenders and servicers will be required to comply with new requirements for providing notices of payment changes (PCNs) and post-petition fees, expenses, and charges (PPFNs) to mortgage borrowers in Chapter 13 bankruptcies. While the new Federal Bankruptcy Rule 3002.1 will provide much needed clarity, it will also significantly increase the number of PCNs and PPFNs that lenders will need to file.

Current Rule 3002.1 became effective December 1, 2011. It requires a creditor in a Chapter 13 case whose claim is secured by a security interest in the debtor's principal residence, and is provided for under Section 1322(b)(5) of the Code, to file PCNs 21 days before a payment in the new amount is due. In addition, creditors must file PPFNs within 180 days of incurring any fees, expenses or charges. The Rule is intended to provide greater transparency and give debtors and trustees time to amend bankruptcy plans to reflect the changes in payments.

One of the reasons the Rule is being amended is to address conflicting interpretations of the language, "provided for under Section 1322(b)(5)". Section 1322(b)(5) permits debtors to cure defaults and maintain payments while the bankruptcy case is pending. Courts' application of the Rule, however, has varied. Some courts have found the Rule only applies where there is a prepetition default, while others determined the Rule applies even if there was not a prepetition default. Courts also differ on whether notices are required when the debtor, rather than the trustee, pays the ongoing mortgage payments.

Many creditors have been caught by the lack of clarity in the Rule and have faced sanctions for failing to comply with the Rule. This can include preclusion from offering evidence if the amount of debt is contested. In addition, creditors may be required to pay expenses and attorney's fees caused by the failure. Creditors may also be ordered to credit or reimburse amounts that were not properly noticed. For example, on August 25, 2016, the U.S. Trustee and Wells Fargo Bank, N.A. (Wells Fargo), filed a modified settlement agreement whereby Wells Fargo agreed to pay an additional \$3.5 million for failing to timely file PCNs for approximately 8,000 accounts.<sup>[1]</sup> This is in addition to the \$81.6 million Wells Fargo agreed to pay at the end of 2015 in remediation for over 100,000 instances of failing to timely file PCNs.<sup>[2]</sup>

As stated in the original settlement, one of the primary issues causing Wells Fargo's non-compliance was the complexity of loan products, including calculations of daily simple interest, lines of credit, and loan modifications. Many creditors face similar challenges in timely filing the notices required by Rule 3002.1. Some creditors have even sought relief from the notice requirements where the complexity of the loan made compliance with the 21 day rule impossible. Some courts deny these requests because of the mandatory application of the rule and lack of authority to excuse creditors from the PCN and PPFN requirements.<sup>[3]</sup>

The amendments effective December 1, 2016 will not address the problems arising from complex loans.<sup>[4]</sup> Instead, the Rule is amended to replace "provided for under Section 1322(b)(5)" with "the plan provides that either the trustee or the debtor will make contractual installment payments." As a result, creditors will need to file PCNs and PPFNs regardless whether the debtor or the trustee is making the maintenance payments and even when there is no prepetition default. This means creditors will have to file notices in jurisdictions where they previously did not have to file under these circumstances. However, the intended clarity and uniformity of the Rule may outweigh the additional burden.

In order to avoid sanctions, creditors will need to adjust their filing practices to comply with the amended Rule. It should be noted, the changes to the Rule will not affect local rules and requirements. Creditors should be familiar with the local rules which can impose additional requirements, including: extending the notice requirements of the Rule to landlords<sup>[5]</sup> and real property other than the debtor's principal residence<sup>[6]</sup> or requiring PCNs be filed 60 days before the payment change.<sup>[7]</sup>

If you have questions or would like additional information regarding specific points of the proposed changes to Rule 3002.1, please contact Amy Vulpio (vulpioa@whiteandwilliams.com; 215.864.6250) or James Vandermark (vandermarkj@whiteandwilliams.com; 215.864.6857).

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[1] See *In re Green*, Bankr. D. Md., No. 11-33377 (August 25, 2016).

[2] See *id.* (November 19, 2015)

[3] See *In re Adkins*, 477 B.R. 71, (Bankr. N.D. Ohio 2012).

[4] The Advisory Committee on Bankruptcy Rules proposed additional amendments to Rule 3002.1, which specifically give courts the discretion to modify the notice requirements for a home-equity line of credit. The proposed amendment was published in August 2016 and is open for public comment until February 16, 2017.

[5] See Bankr. W.D. Pa. L.B.R. 3002-5.

[6] See Bankr. S.D. Fla. L.B.R. 3070-1; and Bankr. S.D. Ill. L.B.R. 3002.1

[7] See Bankr. D. Ariz. Standing Order (July 30, 2008)

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