Mortgage Servicer Held Liable for Damages for Sending Account Statements

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A federal bankruptcy appellate court has held a mortgage loan servicer liable for $119,000 in compensatory damages and possibly punitive damages for sending account statements and other notices to borrowers whose debts were discharged in bankruptcy, even though most of the notices contained disclaimers specifically intended to avoid such liability. This decision adds an appellate decision to a line of cases holding that sending periodic statements and/or demand letters to bankrupt borrowers can constitute an attempt to collect a debt in violation of a bankruptcy discharge order even when standard disclaimer language is included. Our previous advisory on this subject can be found here.

The case at issue is *In Re: Marino*, 2017 WL 6553691 (B.A.P. 9th Cir 2017), and was decided on December 22, 2017, by the United States Bankruptcy Appellate Panel for the Ninth Circuit. (The Ninth Circuit includes California and several western states.) The two debtors, in this case, filed a Chapter 7 bankruptcy petition in March of 2013. They agreed to surrender their property in exchange for the discharge of their mortgage loan obligations and received a Chapter 7 discharge on June 18, 2013.

Following the discharge, the debtors received numerous notices from the mortgage servicer, including account statements, force-placed insurance notices, and escrow statements. Some of these notices requested payments from the borrowers. However, most of the notices contained the following disclaimer at the end:

If you have filed for bankruptcy and your case is still active and/or if you received a discharge, please be advised that this notice is for information purposes only and is not an attempt to collect a pre-petition or discharged debt.

After approximately two years of notices and phone calls from the servicer, the debtors reopened their bankruptcy case to request sanctions against the servicer for violation of the debtors' discharge injunction.

The appellate panel held an evidentiary hearing in which they heard testimony from the debtors on how they felt humiliated, tormented, harassed and distressed by the servicer's constant letters and phone calls. The debtors also stated that constant communications took a toll on their marriage. The court noted that the service was also fully aware of the debtors' bankruptcy and discharge but still continued sending the notices.

In its review of the disclaimers in the notices, the court noted that the disclaimers were preceded by demands for payment by a certain date with conspicuous language stating "you must pay." The disclaimers only spoke of a hypothetical possibility regarding bankruptcy and discharge (i.e. "if you filed for bankruptcy" or "if you received an order of discharge.") The court indicated the notices were often contradictory — stating in the body of the letter that the debtors must pay the debt, but then disclaiming the need to pay the debt at the very end of the letter.

The court concluded that the generic disclaimers were not enough to protect the servicer from violating the discharge injunction. The court stated "[i]n this modern age of information technology, [the servicer] could and should prepare notices that are consistent with the known legal status of its borrowers." In situations where a foreclosure is pending, the underlying mortgage debt has been discharged in the borrower's bankruptcy and the borrower/debtor is still in possession, this custom tailoring will provide loan servicers with the difficult task of telling borrowers that a timely payment will forestall foreclosure without making an improper demand for payment in violation of any discharge injunction. The court responded to this problem by stating that the responsibility is on the lienholder to communicate with the discharged debtor "only to the extent necessary to preserve or enforce its lien rights" but may not attempt to induce the debtor to pay the debt.

The appellate panel affirmed the lower court's award of $119,000 in compensatory damages and remanded the case back to the bankruptcy court for the imposition of possible punitive damages. The appellate panel justified these compensatory damages based on the causal connection between the emotional distress of the debtors and the servicer's notices. This decision represents a continuation of the trend of raising the bar as to the specific content of periodic statements sent to borrowers in bankruptcy.

If you have any questions regarding this case or the issue of sending periodic statements and/or letters to borrowers in bankruptcy, please feel free to contact Joseph D. Simon at 516-357-3710 or via email at jsimon@cullenanddykman.com, Kevin Patterson at 516-296-9196 or via email at kpatterson@cullenanddykman.com, or Diana R. Acosta at 516-357-3739 or via email at dacosta@cullenanddykman.com.

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