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New York Bankruptcy Court Holds Mortgage Servicer in Contempt for Sending Periodic Statements

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A United States Bankruptcy Court in New York has found a mortgage servicer in civil contempt and subject to sanctions under the U.S. Bankruptcy Code for sending a mortgage borrower periodic statements that were viewed as seeking payment even though the borrower's personal liability on the loan had been discharged in bankruptcy.

This case presents a cautionary tale for mortgage servicers who send periodic statements to borrowers in bankruptcy. The court held for the borrower despite the fact that the servicer included a disclaimer on most of the periodic statements in question that was intended to specifically avoid liability under the Bankruptcy Code.

The case at issue is *In Re: Jeffrey Sharak,* No. 09-62928, 2017 WL 2210248 (Bankr. N.D.N.Y.), and was decided on May 18, 2017, by the United States Bankruptcy Court for the Northern District of New York. The borrower, in this case, received a discharge in bankruptcy in April 2015. Although the borrower's personal liability on the loan was discharged, the lender continued to have a lien against the mortgaged property and thus had its servicer continue the pending foreclosure action against the property. The servicer also continued to send the borrower periodic statements with respect to the mortgage, with each statement including the amount due on the loan, a notice of a potential late payment fee, a payment coupon, payment due date, and the statement that " you must pay this amount to bring your loan current."

To help protect itself from a claim that it was attempting to collect a debt discharged in bankruptcy, the servicer included the following disclaimer on four of the six periodic statements at issue: "To the extent that your obligation has been discharged or is subject to an automatic stay in bankruptcy this notice is for information purposes only and does not constitute a demand for payment or any attempt to collect such obligation." The court noted that the disclosure was "in fine print," and was "inconspicuous" in that it was located in a non-titled section on the second of three pages.

The Bankruptcy Court stated that other courts across the country have split on the issue of whether periodic statements sent to borrowers who have been discharged in bankruptcy constitute an attempt to collect a debt in violation of the discharge order. In reviewing this split, the court determined that the key issue is the specific content of the periodic statements and whether such contents evidence an attempt to collect a debt that no longer exists. Under that analysis, the court in New York found that the servicer violated the discharge injunction.

The court stated:

[the servicer]...sent six Mortgage Statements to Debtor over the course of eighteen months. Each of these Mortgage Statements includes a payment due date, past due amount, the threat of a late charge if payment is not received by a date certain, and delinquency notice that warns of both fees and foreclosure if the loan is not brought current. Only four of the Mortgage Statements include an inconspicuous disclaimer. On these facts, the Court finds that the Mortgage Statements seek payment from Debtor and therefore violate the discharge injunction...

In this case, the Debtor had vacated the property and advised the servicer that it intended to surrender the premises and not oppose the foreclosure action. The court stated that the servicer "should have more carefully tailored its correspondence to Debtor's actual circumstances and, at a minimum, included a clear and conspicuous disclaimer on each document." The court set a separate hearing date to determine what damages to impose on the servicer.

One defense that the servicer raised in this case is the regulatory requirement for the servicer to send periodic statements to consumer mortgage borrowers pursuant to federal mortgage servicing rules established under the Real Estate Settlement Procedures Act ("RESPA") and the Truth in Lending Act ("TILA"). These mortgage servicing rules generally require servicers to send consumer borrowers a periodic mortgage statement that includes, among other things, certain payment information on the loan. However, under the current mortgage servicing rules, there is an exemption to the periodic statement requirement if the borrower is in bankruptcy. As we explained in a prior advisory, that broad exemption is being significantly narrowed under amendments that take effect on October 19, 2017.

The court in *In Re: Jeffrey Sharak* acknowledged the periodic statement required under the federal mortgage servicing rules, but stated that "service is not prohibited from complying with RESPA so long as such communication is strictly for compliance purposes rather than to coerce payment of a discharged debt."

This case illustrates how carefully mortgage servicers have to navigate the periodic statement requirement under federal mortgage servicing rules while trying to avoid the prohibition on sending communications about unpaid debts to borrowers who have been discharged in bankruptcy (or who are protected by the automatic stay in bankruptcy).

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

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Attorneys

- Joseph D. Simon