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Effects on Consumer Bankruptcy Practice

An In-depth
Look at What
Changes Lay
Ahead for
Lenders and
Servicers

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The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 will have major effects on the consumer bankruptcy practices of the mortgage servicing industry. The new law does provide some consumer protection provisions; however, most of the changes to the U.S. Bankruptcy Code discourage consumer bankruptcy abuse and protect the interests of creditors. The following summary discusses some of the major changes in consumer bankruptcy cases that will affect the mortgage servicing industry.

» New Filing and Discharge Standards

Once the law takes effect Oct. 17, 2005, debtors will face tougher standards when filing a consumer case under Chapter 7, 11 or 13. More individuals will be required to repay at least a portion of their debts through Chapter 13 rather than receive a discharge of their debts under Chapter 7 due to the adoption of a means test, which provides an additional method of dismissing an abusive Chapter 7 case. Under the means test, there is a presumption of abuse if a debtor's income exceeds his or her state's median income. Creditors will now have standing to request the dismissal or conversion of a Chapter 7 case for abuse under the means test if the debtor's income exceeds the median income. The means test, however, does not apply to debtors whose income is below the median income.

Debtors will also be limited in their ability to receive a discharge under Chapter 7 and Chapter 13. They will have to wait eight years instead of six years between the filing of Chapter 7 cases in order to receive a discharge. Chapter 13 debtors will be denied a discharge if they have received a discharge in another Chapter 13 case within the preceding two years, or if they received a discharge in a Chapter 7, 11 or 12 case within the preceding four years.

» Changes in the Automatic Stay

Several changes regarding the automatic stay will protect the mortgage servicing industry against abusive or serial filers. Under provisions in the act, the automatic stay now terminates 30 days after the filing of a case if the debtor was dismissed within the previous year from a single or joint case under Chapter 7, 11 or 13, unless the new case is a Chapter 11 or 13 case filed after the dismissal of a Chapter 7. The court can issue an order continuing the automatic stay on the motion of a party in interest, if the debtor demonstrates that the new case was filed in good faith.

For multiple filers, if the debtor



» SIDEBAR

NEW NOTICE REQUIREMENTS: ARE SERVICERS READY?

The Bankruptcy Reform Act makes a host of changes to the U.S. Bankruptcy Code, but none is likely to garner more attention among default servicers than those included in a section of the act titled "Giving Creditors Fair Notice."

The Bankruptcy Reform Act requires proper notice as a condition for any monetary damages to be awarded due to a violation of the automatic stay and clarifies what constitutes proper notice, allowing for four distinct ways notice is considered given:

- » Any address used twice by the servicer within the past 90 days.
- » An address filed by the servicer with the bankruptcy court in an individual case.
- » A general address filed with the bankruptcy court, which will cover all cases filed against that creditor.
- » The creditor may designate a special group to get bankruptcy notices; and, if that creditor establishes reasonable procedures so that received notices are routed to that group, then notice is considered given when received by that group.

Sources tell *REO Magazine* that these provisions could spell real trouble for unprepared or unwary servicers, because many bankruptcies are filed hours and even minutes before a foreclosure sale or eviction lock-out. Attorneys rely on information in PACER, the Federal Judiciary's electronic source for bankruptcy court records, to protect the interests of their clients;

but for those bankruptcy filings too recent to be found there, the act's clarification of fair notice could serve to expose unprepared servicers to a new and significant source of legal liability.

At this point, overriding industry sentiment suggests that both servicers and the technology vendors that serve them are taking a wait-and-see approach to the new bankruptcy provisions in general, realizing that attempting to guess the act's eventual interpretation by the courts may mean guessing wrong. "Folks I'm talking to aren't preparing, they're kind of waiting," said Duke Olrich, CEO of DRI Management Systems. "The bottom line is that I don't think the law is as clear-cut as it seems."

Mike McKeever, partner with Goldbeck, McCafferty & McKeever in Pennsylvania and an expert on bankruptcy law, agrees. "Lenders ought to be pretty careful in exercising what they perceive to be their new rights under this statute," he said, noting that "a judge may interpret it differently, and that may have a far different outcome than the lender or creditor thought it would."

Smart servicing shops will be paying close attention to how courts rule on the new notice provisions in the months ahead—and hoping, too, that they aren't the unlucky trailblazers for a new, untested area of case law.

—PAUL JACKSON

has been dismissed from two or more cases under Chapter 7, 11 or 13 within the year preceding the filing of a new case, then the automatic stay will not go into effect. A Chapter 11 or 13 case filed after a dismissal does not count as a previous filing to be held against the debtor. The court shall enter an order confirming that no stay is in effect upon the request of a party in interest. However, the court can also issue an order imposing the automatic stay upon motion of a party in interest if the debtor dem-

onstrates that the new case was filed in good faith.

an order in a prior case prohibiting the debtor from being a debtor in another case.

» More Hurdles for Debtors

Other sections in the Code have been amended or added to provide additional hurdles for debtors in the filing of consumer cases. New provisions require debtors to receive credit counseling and debtor education within 180 days of filing bankruptcy to be eligible for relief under Chapter 7, 11 or 13. Debtors will have to meet increased filing

until their secured claim is paid pursuant to non-bankruptcy law or until the case is discharged. Therefore, a lien does not have to be released upon payment of a crammed-down secured claim.

» Potential Potholes for Creditors

Finally, creditors must be aware of the consumer protection provisions that are included in the new law. New provisions include amended procedures for reaffirmation concerning extensive disclosures by creditors in the reaffirmation agreement and the

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Other changes regarding the automatic stay include authorization for in rem relief from stay as to real property, binding on all owners of the property for two years from the date of entry of an order if properly recorded. If in rem relief is effect, the Code permits for an exception to the automatic stay. Another exception to the automatic stay includes any act to enforce a lien against or security interest in real property if the debtor is ineligible to be a debtor, or if the case was filed in violation of

requirements, especially regarding the debtors' income and federal tax returns. If a debtor under Chapter 7 or 13 does not provide the information or request additional time to provide information within 45 days after filing the petition, then the case must be dismissed on the 46th day. Creditors will be able to request that the court enter an order dismissing the case for failure to comply with the filing requirements. Additional amendments are designed to protect creditors if the debtor fails to give effective notice of the bankruptcy.

acceptance of payments before and after the filing of a reaffirmation agreement. Provisions in the act also provide that a willful failure of a creditor to apply payments in accordance with a confirmed Chapter 13 plan constitutes a violation of the discharge injunction. Mortgage servicers will need to ensure they have accurate information concerning the application of payments to prevent any such violations.

Due to the numerous changes to the Code, the mortgage servicing industry should be better protected against consumer bankruptcy abuse. However, until the courts begin to make rulings under the new law, mortgage servicers will not know the full extent of the benefits and protections seemingly afforded by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. 🏠

» **Additional Protection for Mortgagees**

For their part, mortgage holders are positioned to be better protected because the definition of "debtor's personal residence" has been amended to include mobile homes, manufactured homes and individual condominium or cooperative units. This definition will serve to limit the ability of debtors to cram down mortgages and afford greater protection to creditors. Secured creditors will be able to retain their liens,

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