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Mortgagees Holding Liens Against Chapter 13 Debtor's Primary Residence Could Be Subject to Punitive Damages for Notice Violations

*By Michelle Badolato and Deborah A. Reperowitz**

The authors discuss court decisions considering whether the Federal Rules of Bankruptcy Procedure authorize the imposition of punitive monetary sanctions against a mortgagee that fails to comply with the notice requirements of Rule 3002.1.

The U.S. Court of Appeals for the Second Circuit recently became the first circuit court of appeals to consider whether Federal Bankruptcy Rule 3002.1 authorizes punitive monetary sanctions to be imposed against a mortgagee for failure to comply with the Rule. The Second Circuit, in *In re Gravel*,¹ determined that Rule 3002.1 does not authorize the imposition of such sanctions.²

At issue in *Gravel* was the imposition of sanctions by the U.S. Bankruptcy Court for the District of Vermont in the amount of \$75,000 against a mortgagee for violation of Rule 3002.1.³ The consolidated bankruptcy court decisions that were reversed by the Second Circuit were the first to impose punitive monetary sanctions under the Rule.⁴ The *Gravel* decision includes a lengthy dissenting opinion authored by Circuit Judge Bianco.

NOTICE REQUIREMENTS

Federal Bankruptcy Rule 3002.1 imposes notice requirements on mortgagees holding a mortgage against a Chapter 13 debtor's principal residence in instances where a confirmed Chapter 13 plan requires the trustee or the debtor to make contractual installment payments to the mortgagee.

Specifically, the Rule imposes three requirements on such mortgagees.

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¹ *In re Gravel*, 6 F. 4th 503 (2d Cir. 2021).

² *Id.*, at 508.

³ *Id.*, at 503.

⁴ *In re Gravel*, 601 B.R. 873 (Bankr. D. Vt. 2019); *In re Gravel*, 556 B.R. 561 (Bankr. D. Vt. 2016).

First, the mortgagee must file and serve a notice of any change in the payment amount, including any change that results from an interest rate or escrow account adjustment, no later than 21 days before payment of the new amount is due.

Second, the mortgagee must file and serve a notice itemizing all fees, expenses or charges that were incurred in connection with the claim after the bankruptcy case was filed and that the mortgagee asserts are recoverable against the debtor or its principal residence. The notice of postpetition fees must be served within 180 days after the fees, expenses or charges are incurred.

Third, within 21 days after service of the trustee's notice of final cure payment, the mortgagee must file and serve a statement confirming whether it agrees that the debtor has paid the full amount required to cure the default on the claim and whether the debtor is otherwise current on all payments consistent with Section 1322(b)(5) of the Bankruptcy Code.

If the mortgagee fails to comply with the Rule, the Rule specifically states that the court may, after notice and hearing, take either or both of the following actions: (i) preclude the creditor from presenting the omitted information, in any form, as evidence in any contested matter or adversary proceeding in the case, unless the court determines that the failure was substantially justified or is harmless, or (ii) award other appropriate relief, including reasonable expenses and attorney's fees caused by the failure.⁵

Rule 3002.1 was adopted to prevent mortgagees from adding fees and costs to a Chapter 13 debtor's mortgage postpetition without giving notice and thereafter attempting to foreclose upon the debtor's property after all payments under the confirmed plan have been made. In such cases, the foreclosure was based on the nonpayment of unnoticed fees and costs, which were not addressed in the plan because they were unknown to the Chapter 13 debtor and the trustee.

A CONTRARY RULING

About a month after the Second Circuit's decision in *Gravel*, the U.S. Bankruptcy Court for the Southern District of Texas, relying largely upon the dissent in *Gravel*, entered a contrary ruling.

Specifically, the Texas bankruptcy court determined that the plain language of Rule 3002.1(i) coupled with the policies underlying the Bankruptcy Code

⁵ Bankruptcy Rule 3002.1(i)(2).

permits punitive damages and sanctions to be imposed against a mortgagee as “other appropriate relief” under Rule 3002.1(i)(2).⁶

Prior to the *Gravel* and *Blanco* decisions, several courts considered, at least in dicta, whether Rule 3002.1 authorizes the imposition of punitive damages.⁷ The disparity in the decisions generally stems from the court’s interpretation of the “other appropriate relief” language in the Rule. It remains to be seen if the other circuits will take up this issue and how they will rule.

CONCLUSION

A mortgagee’s failure to comply with Bankruptcy Rule 3002.1 may result in the disallowance of fees and charges, the imposition of attorneys’ fees and costs, and sanctions. In the majority of jurisdictions, no binding precedents have been established regarding whether sanctions are permissible under Bankruptcy Rule 3002.1.

To avoid monetary and other penalties for non-compliance with Rule 3002.1, mortgagees should:

- Become fully familiar with their obligations under Bankruptcy Rule 3002.1;
- Establish protocols to ensure their compliance with Bankruptcy Rule 3002.1;
- Ensure that their staff and agents are fully familiar with, and comply with, those protocols; and
- Not seek payment of any amounts they fail to properly notice in accordance with the mandates of Bankruptcy Rule 3002.1.

⁶ *In re Blanco*, 633 B.R. 714 (Bankr. S.D. Tex. 2021).

⁷ See *In re Tollstrup*, No. 15-33924 (Bankr. D. Ore. Mar. 16, 2018) (rule does not permit punitive sanctions); *In re: Beiter*, 590 B.R. 446 (Bankr. S. D. Ohio 2018) (did not rule on the sanctions issue, but noted it might decide the punitive sanction issue later); *In re Freeman-Clay*, 578 B.R. 423 (W.D. Miss. 2017) (did not find bankruptcy court decision in *Gravel* compelling).