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Practice Groups:

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Restructuring & Insolvency

Have You Noticed Your Payment Change?

Advisory Rules Committee Proposes Amendments to Bankruptcy Rule 3002.1

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The Judicial Conference Advisory Committee on Bankruptcy Rules (the "Advisory Committee") recently published proposed amendments to the Bankruptcy Rules, including Bankruptcy Rule 3002.1, which requires a secured creditor to file certain notices regarding new post-petition amounts that may become due and owing over the course of a Chapter 13 bankruptcy. The proposed amendments seek to clarify that the rule's notice requirements apply in cases where the debtor or trustee makes post-petition payments directly to the creditor without regard to whether the debtor is curing a pre-petition arrearage, but do not apply in cases where the court has granted relief from the automatic stay. The proposed amendments address the current uncertainty and conflicting case law surrounding the scope and application of Rule 3002.1's notice obligations, and this increased clarity can only be viewed as a positive development. Nonetheless, certain shortcomings in Rule 3002.1 persist, including its broad application to daily simple interest loans, home equity lines of credit, other loans with frequently changing monthly payment amounts, and loan modifications.

Background on Bankruptcy Rule 3002.1

Bankruptcy Rule 3002.1 went into effect on December 1, 2011, and was intended to provide greater transparency to debtors, trustees, and bankruptcy courts regarding debtors' ongoing mortgage payment obligations in Chapter 13 bankruptcy proceedings. Specifically, the rule requires a creditor in a Chapter 13 case whose claim is secured by a security interest in the debtor's principal residence to file certain notices with the bankruptcy court, advising of (1) any changes in the debtor's post-petition payment amount due, such as adjustments in the debtor's interest rate or escrow, (2) any costs, expenses, and fees that are incurred on a post-petition basis, and (3) the status of the debtor's account and whether the debtor's account is current or owing in response to the Chapter 13 trustee's Notice of Final Cure.

The primary purpose of Bankruptcy Rule 3002.1 is to avoid the situation in which unexpected amounts are found owing when a debtor looks to exit bankruptcy. Rule 3002.1's filings act as a supplement to the proof of claim and must be served on the debtor, debtor's attorney, and the Chapter 13 trustee. Pursuant to Rule 3002.1, if a creditor were to fail to file and serve any required notices, a bankruptcy court has the discretion to 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 harmless. Further, the bankruptcy court could award other

appropriate relief, including reasonable expenses and attorney's fees caused by the failure to comply with the rule.[1]

Conflicting Case Law Surrounding Bankruptcy Rule 3002.1

Rule 3002.1(a) applies only to claims that "are provided for under § 1322(b)(5) of the Code in the debtor's plan," and bankruptcy courts have differed in their interpretation of this provision. The proposed amendments seek to settle this conflict.

Section 1322(b)(5) of the Bankruptcy Code provides that a Chapter 13 debtor may cure any default within a reasonable time and maintain payments while the case is pending on any loan that has the last payment due after the bankruptcy is scheduled to end. As most mortgages mature after the three- or five-year bankruptcy plan period, a debtor is typically required to remain current by continuing to make payments to its mortgage creditor. Some courts, noting that section 1322(b)(5) specifically provides, in part, for the curing of defaults, have held that the notice requirements of Rule 3002.1 only apply if the debtor is curing a pre-petition arrearage through the debtor's Chapter 13 plan.[2] Several bankruptcy courts have gone even further, holding that any time the claim is being paid directly by the debtor, rather than by the trustee, Rule 3002.1 does not apply.[3] In fact, the United States Bankruptcy Court for the Southern District of Florida has adopted a local rule that not only prohibits a creditor from filing a payment change notice ("PCN") if the debtor is making direct payments to the creditor, but also opens the creditor to possible sanctions should it file an "unnecessary" PCN.[4]

Other courts, however, have taken a different approach, interpreting the requirement that the claim be "provided for under section 1322(b)(5)" to include mortgage claims where the debtor indicates in the plan that the debtor or trustee will be making continuing post-petition payments on the mortgage. In so holding, these courts have determined that PCNs are required even where there is no pre-petition arrearage to be cured through the plan.[5] Of course, debtors typically receive direct notification of payment changes by way of mailed escrow statements, interest rate adjustment letters, and monthly statements; nonetheless, a number of bankruptcy courts require additional notice of the change to be filed in the bankruptcy proceeding via a PCN pursuant to Rule 3002.1.

Another area of judicial disagreement relates to whether Rule 3002.1 continues to apply after relief from stay has been granted to foreclose on the property. Given that debtors and trustees will generally cease making payments on a mortgage loan once relief from stay to foreclose has been granted, there would appear to be no practical need for a creditor to continue to file any PCNs, because the claim is no longer provided for under section 1322(b)(5) of the Bankruptcy Code.[6] This rationale is similar to where a debtor has

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[1] Fed. R. Bankr. P. 3002.1(i).

[2] *See, e.g., In re Weigel*, 485 B.R. 327, 328 (Bankr. E.D. Va. 2012); *In re Wallett*, 2012 WL 4062657, at *2 (Bankr. D. Vt. Sept. 14, 2012).

[3] *See, e.g., In re Merino*, 2012 WL 2891112, at *1 (Bankr. M.D. Fla. July 16, 2012); *In re Garduno*, 2012 WL 2402789, at *1 (Bankr. S.D. Fla. June 26, 2012).

[4] S.D. Fla. L.B.R. 3070-1(B)(4).

[5] *See, e.g., In re Tollios*, 491 B.R. 886, 889, 891 (Bankr. N.D. Ill. 2012); *In re Cloud*, 013 WL 441543, at *2 (Bankr. S.D. Ga. Jan. 31, 2013).

[6] *See, e.g., In re Thongta*, 480 B.R. 317, 319 (Bankr. E.D. Wis. 2012) (finding that Rule 3002.1 did not apply after entry of order granting relief from stay and withdrawal of creditor's claim because the claim was no longer "provided for" under § 1322(b)(5)). Further, some bankruptcy courts have even adopted local rules making clear that Rule 3002.1 notices are no longer required after relief from stay. *See, e.g.*, E.D. Mo. LBR 3002.1(D); D.N.J. LBR 3002-1.2(a); W.D. Tex. LBR 3002.1(a).

surrendered the property as part of the bankruptcy.[7] At least one court, however, has held that Rule 3002.1 still applies up until title to the property has transferred.[8] The proposed amendment attempts to address any uncertainty created by the *Holman* ruling and encourages a uniform rule across all jurisdictions.

Proposed Amendments

In light of these conflicting interpretations, the Advisory Committee has proposed amending section (a) of Rule 3002.1 to remove reference to section 1322(b)(5) of the Bankruptcy Code, thereby clarifying the rule's application. Proposed Rule 3002.1(a) states:

> (a) IN GENERAL. This rule applies in a chapter 13 case to claims (1) that are secured by a security interest in the debtor's principal residence, and (2) for which the plan provides that either the trustee or the debtor will make contractual installment payments. Unless the court orders otherwise, the notice requirements of this rule cease to apply when an order terminating or annulling the automatic stay becomes effective with respect to the residence that secures the claim.

This proposed amendment clarifies that Rule 3002.1 is applicable anytime where the plan provides that the trustee or the debtor are to make continuing payments. As the Advisory Committee explained: "[w]hether or not there was a prepetition default, proper payment of the mortgage during the case requires accurate information about any changes in payment amounts and the assessment of any fees and charges."[9]

Further, the proposed amendments make it the default rule that the notice requirements cease upon the effective date of an order terminating or annulling the automatic stay with respect to the property. However, the proposed amendments allow the bankruptcy court discretion to order that the notice requirement continue after relief from stay is granted. We anticipate that those courts which already require that notices continue after relief from stay has been granted or which otherwise strike provisions in proposed orders on motions for relief from stay excusing continued compliance with Rule 3002.1, will adopt local rules or enter orders mandating the continuation of such notices.

Unaddressed Shortcomings of Bankruptcy Rule 3002.1

While the proposed amendments go a long way in clarifying the scope of Rule 3002.1, they still leave several important shortcomings unaddressed:

Difficulty in Calculating Timely Payment Amounts for Daily Simple Interest ("DSI") Accounts and Home Equity Lines of Credit ("HELOCs") and Burden of Filing Notices for Frequent Payment Changes: Creditors have struggled with how to timely notify courts where payment changes arise from the computation of interest on a daily simple basis. Rule 3002.1 makes no exceptions for DSI accounts or HELOCs,[10] where often monthly payment amounts vary month-to-month depending on a number of factors, such as the day of the month in which the debtor made his most recent payment and the amount of that payment. For this reason, creditors often are unable to calculate the payment change amount on DSI accounts at least 21 days before the effective date of the change. Further, filing PCNs for

[7] *Weigel*, 485 B.R. at 328.
[8] *See In re Holman*, 2013 WL 1100705, at *4 (Bankr. E.D. Ky. Mar. 15, 2013).
[9] Advisory Committee Report at 83.
[10] Many HELOCs are DSI accounts, though some HELOCs involve other methods of calculating interest.

accounts with monthly changes is administratively burdensome for creditors and, in the view of some, serves to clutter the claims registers and dockets of bankruptcy courts. Although some courts appear willing to excuse strict compliance with Rule 3002.1(b) for accounts with frequent payment changes, other courts have taken a hard line and refused to allow any exceptions to the letter of the rule.[11] At least one commenter on the proposed amendments to Rule 3002.1 has noted the burden imposed on servicers through the filing of monthly PCNs, and has recommended that creditors should be allowed to send statements to debtors advising of payment changes in lieu of PCNs filed with the court.

Difficulty in Timely Filing PCNs Arising from Loan Modifications: The model PCN form appears to contemplate that it will be filed when a loan modification agreement effects a change in the debtor's monthly payment amount. However, procedural delays in executing and approving loan modifications often make it difficult, if not impossible, to comply with Rule 3002.1's requirement that the PCN be filed at least 21 days before the effective date of the payment change. For example, some jurisdictions have waiting periods before any motion (including a motion to approve a loan modification) will be acted on. Given this passage of time, the order on any motion to approve may be entered after the effective date of the modification, thereby rendering any PCN untimely on its face. Some servicers have sought to address this issue by including language in the proposed order on the motion to approve the modification that relieves the servicer of the obligation to file a PCN. As a practical matter, this makes sense because, by way of the motion to approve the modification and the related order entering the same, the parties to the bankruptcy are presumably already on notice of the newly modified payment amount. However, procedurally, not all courts require motion practice for the approval of a loan modification, so this mechanism does not provide a universal cure-all. Other servicers have included disclaimer language in their PCNs, indicating that, by necessity, the filing was untimely as a result of procedural delays. For payment changes arising from loan modifications, creditors should be afforded some flexibility in complying with Rule 3002.1's timeliness requirements or should be otherwise excused from compliance with Rule 3002.1(b).

Conclusion

The proposed amendments help to clarify the scope of Rule 3002.1 so that creditors can better anticipate when they will be required to comply with its notice provisions. Creditors that have not filed PCNs where there are no pre-petition arrearages or where the debtors are making direct payments may have to adjust their filing practices should the amendments be adopted, in order to avoid the penal provisions of the rule. However, there are still open issues regarding the application of Rule 3002.1 that merit further consideration and amendment to the rule. The public comment period ended February 17, 2015. K&L Gates LLP will continue to monitor the proposed changes to the rule and will report on significant developments.

[11] *See, e.g., In re Adkins*, 477 B.R. 71, 73 (Bankr. N.D. Ohio 2012) (holding that a creditor who held a second mortgage based on a HELOC was not excused from compliance with Rule 3002.1 despite the potential difficulties of compliance based on the nature of the HELOC, even though the Court "sympathizes with [the creditor] and the difficulty that compliance with Rule 3002.1(b) presents under these circumstances;" "[d]espite such sympathy, however, this Court does not believe that it can excuse compliance with Rule 3002.1").

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