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JUDGE: M. A. Mahoney

PARTIES: Roland E. Harris, Betty Ann Dean, First Union Mortgage Corporation

CHAPTER: 13

ATTORNEYS: S. Olen, S. L. Nicholas, D. J. Stewart, J. N. Leach, R. J. Pope

DATE: 5/10/02

KEY WORDS:

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF ALABAMA

In Re

ROLAND E. HARRIS,
Debtor.

Case No. 96-14029-MAM

BETTY ANN DEAN
Debtor.

Case No. 00-11321-MAM-13

BETTY ANN DEAN,
Plaintiff,

Adv. No. 99-1144

v.

FIRST UNION MORTGAGE CORPORATION,
Defendant.

ORDER AWARDING JUDGMENT TO PLAINTIFFS

Steve Olen, Mobile, Alabama, Attorney for the Plaintiffs
Steven L. Nicholas, Mobile, Alabama, Attorney for the Plaintiffs
Donald J. Stewart, Mobile, Alabama, Attorney for Plaintiffs
John N. Leach, Mobile, Alabama, Attorney for the Defendants
Russell J. Pope, Towson, Maryland, Attorney for the Defendants

This matter is before the Court on defendants' motion for judgment on partial findings (at the close of plaintiffs' evidence), (2) defendant's motion for judgment as a matter of law at the close of all the evidence, and (3) trial of the case. The Court has jurisdiction to hear this matter pursuant to 28 U.S.C. §§ 157 and 1334 and the Order of Reference of the District Court. This is a core proceeding pursuant to 28 U.S.C. § 157(b) and the Court has the authority to enter a final order. For the reasons indicated below, the Court is denying defendant's motions and awarding the plaintiff class a judgment against First Union Mortgage Corp.

FACTS

A.

Betty Dean filed a chapter 13 bankruptcy case on March 20, 2000. She had a mortgage loan secured by her homestead. The mortgagee was First Union Mortgage Corporation. First Union was given notice of Ms. Dean's bankruptcy filing and it filed a proof of claim on May 4, 2000.

The proof of claim was signed by Perry Hall, an attorney employed by a law firm that did legal work for First Union. The proof of claim included in the total balance shown as owing to First Union an attorneys fee of \$150 for preparation of the proof of claim. There was no separate disclosure of the fee. Ms. Dean has continued to pay her mortgage loan debt through monthly payments to First Union during her bankruptcy case and will pay an arrearage claim of \$8,899.34 through her plan. In July 2002, Ms. Dean's lien servicing was transferred to EMC Bear Stearns.

B.

First Union's claims preparation and filing procedures changed over time. Until at least 1993, First Union prepared proofs of claim "in house" and filed the claims itself. Under this procedure, no proof of claim filing fee was charged or ever posted to debtors' accounts. First Union began outsourcing preparation of some proofs of claim in 1993 or 1994.¹ The fees that First Union paid outside counsel to prepare and file the proofs of claim were posted to debtors' accounts after their bankruptcy cases were closed or relief from stay was granted to First Union.²

¹The Court could find no evidence of an exact date when outsourcing first occurred.

²Although First Union's witnesses stated that no fees of one specific firm, the Raymer, Padrick, Cobb, Nichols & Clark, LLC firm, were charged to debtor's accounts, this contradicts the policies and procedures as to all other loans. It is also unclear if that means the fees were never reflected at all in debtors' accounts or just that debtors never actually paid the fees.

First Union instructed all of its outside counsel in writing not to disclose the proof of claim preparation fee on the proofs of claim.

In 1997 or 1998, First Union learned that one of its outside attorneys had disclosed the proof of claim preparation fee on some proofs of claim despite the established procedure. He was instructed by First Union's Delinquency Resolution Group Leader not to disclose the fees. In fact, on March 13, 1998, as a follow up to this contact, Daniel D. Phelan, an attorney at McCalla, Raymer, Padrick, Cobb, Nichols & Clark, LLC, one of First Union's primary outside counsel, was instructed to send a letter to all outside counsel stating that proof of claim preparation fees were not to be separately disclosed on the proofs of claim. That letter was sent. Most of the outside counsel have followed this directive, although in some cases the fee has been disclosed.

C.

The amounts of the preconfirmation fees charged by outside counsel have varied. The range was approximately \$150 to \$450 as best the Court could discern from the evidence and were flat rate fees. The \$450 charge was by the McCalla Raymer firm. It charged an \$800 total fee in two parts. The first installment was \$450 for mainly preconfirmation work. That work included preparation of a proof of claim and other services. The fee was not broken down into its component parts. This fee was negotiated by Fannie Mae and Freddie Mac with McCalla Raymer. It applied to all such loans serviced by First Union.³

³There may be other loans funded by quasi-governmental agencies that are included in this category as well.

D.

First Union did not monitor the charges at all so long as the charges did not exceed the guidelines established by the investors who owned the loans. First Union automatically paid the outside attorneys billings up to the limits established by the investor. For Fannie Mae and Freddie Mac loans, this limit was \$800.

If attorneys fees were unpaid, First Union did not consider the loan to be in default. However, if a debtor paid off a loan or reinstated it or reclaimed the property after a foreclosure, the fee was in the balance charged to the debtor. If the loan was foreclosed, First Union billed the investor for the fee. The debtor did not pay the fee in that case. If attorneys fees were added to a proof of claim and disclosed, and First Union received payments from the trustee, First Union credited the payments to the fees first.

The evidence showed that First Union had 6,000 to 8,000 loans involved in chapter 13 bankruptcy cases in 2000-2001. The evidence did not include an estimate of how many cases were filed from 1993 or 1994, when the procedure of having outside counsel file claims was instituted. The Court extrapolates from the 2000-2001 numbers that over 20,000 to 30,000 bankruptcy cases had to have been filed over the eight-year period.

E.

First Union sold or otherwise transferred the servicing rights to the Dean loan and almost all of its other loans on November 30, 2000 and after. The sales and transfers were part of a corporate decision to divest the company of many assets due to the declining price of its stock. This suit had no bearing on the transfers according to First Union's employees. The transfers occurred more than one year after the commencement of the suit although the decision to transfer the servicing rights was made in July 1999.

First Union no longer has the original servicing files. They were transferred to the new servicers. It does have backup data for 1999 and data from loans active in 2000 and 2001. First Union still owns many of the loans even though it no longer services them.

Some of the loan servicing transfer agreements required First Union to indemnify the new servicer for any losses resulting from First Union's servicing.

PROCEDURAL HISTORY

This suit was instituted on July 23, 1999 with Roland Harris as the proposed class representative. On December 29, 2000, the Court granted First Union's summary judgment motion and dismissed the case of Mr. Harris because he had no claim against First Union.

On February 8, 2001, the Court amended its order to allow intervention of a different plaintiff to be the class representative in the suit. Betty Ann Dean moved to intervene and this Court, by order dated August 3, 2001, granted class certification. On September 10, 2001, this Court defined the class as follows:

All bankruptcy debtors who have filed a Chapter 13 petition on or after January 1, 1994 (1) who had proofs of claim filed in their cases by the Defendant which (a) did not disclose postpetition/preconfirmation fees at all, (b) did not disclose them with sufficient specificity, or (c) did not include these fees in the arrearage claims; (2) who had these fees collected or posted to their accounts in some way by the Defendant after filing bankruptcy; and (3) in whose cases the Defendant did not file a specific application for these fees which was approved by the United States Bankruptcy Court.

LAW

The plaintiffs have the burden of proving their case by a preponderance of the evidence. That burden has been met. The Court carefully considered the defendant's motion for a judgment on partial findings pursuant to Fed. R. Bankr. P. 7054 and the defendant's motion for a

verdict at the close of the evidence. The plaintiffs met their burden at each stage of the trial and these motions are denied.

The Court has already entered numerous orders in this case and several similar cases. The Court, when appropriate, will refer to those rulings rather than repeat them. All prior rulings in this case are incorporated by reference.

The remaining sections of this opinion will be broken into 14 parts and the Court will discuss each issue in turn.

- A. Jurisdiction
- B. Class Certification
- C. Identification of the Class
- D. Fee Disclosure in Chapter 13 Cases
- E. Cases in Which Fees were Disclosed
- F. Statute of Limitations
- G. Converted and Dismissed Cases
- H. Excluded Cases
- I. Injunctive Relief
- J. Post Litigation Conduct
- K. Damages
- L. Sanctions
- M. Prejudgment Interest
- N. Attorneys Fees

A.

Jurisdiction

This Court issued a ruling on its jurisdiction to hear this type of case. *In re Noletto, et al.*, 244 B.R. 845 (Bankr. S.D. Ala. 2000). The Court incorporates that ruling by reference. The U.S. District Court of the Northern District of Alabama has recently issued a thoughtful opinion concluding that its bankruptcy court also has jurisdiction to consider a class action suit. *Bank United v. Manley (In re Manley)*, Case No. CV-00-N-2141-W, opinion dated November 29, 2001. This Court adopts its reasoning as well. This Court concludes that there is clearly no

obstacle to this Court ruling on issues involving debtors in this district. The defendant does not dispute this exercise. It is debtors' cases beyond this district as to which a question has been raised. As to those cases, the District Court certainly has jurisdiction if this Court does not. If this Court is held to be without jurisdiction over this case, the Court reports and recommends to the District Court that it adopt these findings and conclusions pursuant to Fed. R. Bankr. P. 9033.

The problem at issue in this case and several others pending in this Court and other courts needs to be addressed. Creditors should not be able to assess fees to the account of a person in bankruptcy without the person's knowledge. A bankruptcy case's purpose is to allow a debtor to get out of financial trouble. At discharge, a debtor ought to be able to expect he or she has brought his or her secured debts current and wiped out all unsecured debts not paid through a plan. Undisclosed fees prevent a debtor from paying the fees in his or her plan—an option that should not be lost simply because a creditor chooses to not list the fee and expects to collect it later. Also, secured creditors should not be able to add attorneys fees to a debtor's account during a bankruptcy when no other creditor can receive fees without approval.

B.

Class Certification

This Court has issued an opinion certifying a class in this case and a separate order defining the class. *In re Harris*, Order Granting Class Certification Motion, August 3, 2001 (Bankr. S.D. Ala. 2001) and Ordering Defining Class, September 10, 2001 (Bankr. S.D. Ala. 2001). These opinions are incorporated by reference.

C.

Identification of the Class

First Union asserts that it should not be required to identify the members of the class in this case. It relies on cases that state that the general rule is that the representative plaintiff should do so. *E.g., Oppenheimer Fund, Inc. v. Sanders*, 437 U.S. 340, 356, 98 S. Ct. 2380, 57 L. Ed. 2d 253 (1978) (“The general rule must be that the representative plaintiff should perform the task, for it is he who seeks to maintain the suit as a class action and to represent other members of his class.”). As First Union admits, there is an exception to this rule. If the defendant can perform the task with less difficulty or expense, then the defendant can be required to identify class members. *Id.* at 358-59.

First Union proved that extracting the information about class members may be difficult for either plaintiffs or First Union. Each proof of claim will have to be reviewed to determine whether the fee for filing a proof of claim was disclosed or not. According to the testimony, First Union in 2001 had files or data for loans serviced in 1999-2001. Certainly the debtors with undisclosed fees in these files can be produced more easily by First Union than the plaintiff. The information is under First Union’s control as are the computers necessary to extract it and the employees with the expertise to extract it. As to information on loans from 1993 or 1994 to 1999, the evidence is that that data are not available other than in the proof of claim themselves at courts or are in the hands of new servicers. As to identification of those plaintiffs, the burden would be equal for plaintiff or defendant to obtain the data. If the data are in First Union’s computer format, it would be easier for it to view the data and retrieve them. If the data are in proofs of claim, the plaintiff can as easily as First Union review the information.

Therefore, the Court concludes that First Union must provide a list of class members to the class from the data it has from 1999-2001. If the plaintiff class gets other information from the new servicers in a computer format that First Union can more easily read, First Union will be

required to provide a class list from these data as well. The plaintiff class will be responsible for compiling the list of all other class members. However, First Union should be able to provide a list of all bankruptcy cases from 1993 to 1998 to the plaintiff class so that the check of disclosure or not can be made. There is no checking of each proof of claim required. The cases to be disclosed include the Fannie Mae and Freddie Mac cases because the evidence is not clear whether the fees are posted to debtors' accounts or not. If they are, the fees need to be expunged from the accounts even if the debtors never actually pay them.

D.

Fee Disclosure in Chapter 13 Cases

The crux of the controversy in this case is whether First Union can charge attorneys fees to debtors' accounts at any time during a bankruptcy case without disclosure of those fees to anyone. The Court has already addressed this issue in an opinion in this case. *Harris v. First Union Mortgage Corporation*, Case No. 96-14029, Adv. No. 99-1144, Order Granting Defendant's Summary Judgment Motion and Dismissing Case Without Prejudice (as to Roland Harris) (Bankr. S.D. Ala. December 29, 2000). The evidence at trial did not alter this Court's view of the issue.

First Union, since 1993 or 1994, has outsourced its bankruptcy proofs of claim filing function. The outside firms charge a fee for the service of preparing and filing a claim. (In the case of the Fannie Mae and Freddie Mac loans, the fee is an unspecified amount of the first installment fee charged to First Union.) The fee is posted to the debtors' accounts in all non-Fannie Mae or Freddie Mac loan cases. As to the Fannie Mae and Freddie Mac loans it is unclear whether the fees are posted to the account or not. The fee is collected from non Fannie Mae and Freddie Mac loans if the loan is paid off, refinanced or the property is redeemed at

foreclosure. First Union indicated the fees were never paid by debtors with Fannie Mae or Freddie Mac loans. The fees are never disclosed to the debtors during the bankruptcy case in most instances. When they were disclosed as “bankruptcy fees and expenses” (as in the *Harris* case), they were sufficiently disclosed.

This Court has written an opinion that deals with the issue of nondisclosure and inadequate disclosure of fees. *In re Noletto*, Order Granting Defendant’s Summary Judgment Motion, dated December 29, 2000 (Bankr. S.D. Ala. 2000). That opinion is incorporated by reference.

The U.S. Supreme Court case of *Rake v. Wade*, 508 U. S. 464, 113 S. Ct. 2187, 124 L. Ed. 2d 424 (1993) and the Eleventh Circuit case of *Telfair v. First Union Mortgage Corp.*, 216 F.3d 1333 (11th Cir. 2000) *cert. denied*, 531 U.S. 1073 (2001), *reh’g denied*, 121 S. Ct. 765 (2001), speak to this issue. This ruling is consistent with their holdings.

Rake v. Wade held that a chapter 13 debtor who chose to cure a default on his or her oversecured home mortgage through a plan had to pay postpetition interest on the arrearage claim. The plan in question provided that the arrearage including interest and attorneys fees would be paid through the plan. The Supreme Court held that debtors could pay postpetition interest through the plan and be in compliance with 11 U.S.C. §§ 506(b) and 1322(b)(5). The Court commented, without disagreeing, that COLLIER ON BANKRUPTCY and the parties to the suit agreed that § 506(b) is applicable only to the effective date of the plan. 3 COLLIER ON BANKRUPTCY ¶ 506.05, pp. 506-43 and n.5c (15th ed. 1993); *Rake* at 508 U.S. 468. Thus, § 506(b) interest and fees should only be added to a claim if preconfirmation.

The *Telfair* case, *Telfair v. First Union Mortgage Corp.*, 216 F.3d 1333 (11th Cir. 2000) *cert. denied*, 531 U.S. 1073 (2001), *reh’g denied*, 121 S. Ct. 765 (2001), building upon this

ruling, held that payment of postconfirmation attorneys fees from the debtor's regular monthly mortgage payments paid postconfirmation did not violate § 506(b) or § 362 of the Bankruptcy Code.

[A]fter confirmation, only the amount required for the plan payments remained property of the estate. Telfair's regular loan payments, made outside of the plan, were therefore no longer property of the estate and First Union's application of a portion of those payments to attorneys fees pursuant to the Deed [of Trust] did not violate section 362.

Id. at 1340; and

[T]he Supreme Court has stated that interest accrues under section 506(b) "as part of the allowed claim from the petition date until the confirmation or effective date of the plan." *Rake v. Wade*, 508 U. S. 464, 471, 113 S. Ct. 2187, 2191, 124 L. Ed. 2d 424 (1993) This Court . . . can find no basis to distinguish *Rake*'s statement that section 506(b) "applies only from the date of filing through the confirmation date," 508 U.S. at 468, 113 S. Ct. at 2190, on the ground that it dealt with interest rather than attorney's fees.

Id. at 1328-29. No other circuit court has disagreed with *Telfair*. Indeed, it would be hard to do so since the ruling is based on the U.S. Supreme Court case of *Rake v. Wade*.

Telfair reasons that postconfirmation fees are *not* part of the creditor's secured claim in a chapter 13 bankruptcy case, but preconfirmation fees are. The treatment of all preconfirmation fees, therefore, must be consistent with this premise.

Since the fees are to be treated as part of First Union's secured claim, two things must happen. The proof of claim fee must be *disclosed* so that the debtor knows the fee is part of the secured claim. Second, the fee should be included in the arrearage claim portion of the debt so that debtor can pay the fee through his or her plan as allowed by 11 U.S.C. § 1322(b)(5).

In the *Slick* case, a similar class action case pending in this Court, several arguments were raised at trial as to the propriety of undisclosed attorneys fee charges:

1. The fees are not treated as "defaults" and therefore need not be cured under 11 U.S.C. § 1322(b)(5).

2. A long-term mortgage debt survives the discharge of the debtor in a chapter 13 case. It is consistent with this premise that a debtor may remain liable for some debts which cannot be or are not included in a creditor's proof of claim.

Slick v. Norwest Mortgage, Inc. (In re Slick), Adv. No.99-1136, Case No. 98-14378-MAM-13, Order Awarding Judgment to Plaintiffs (Bankr. S.D. Ala. May 10, 2002)

This Court will address these issues in this case too since they could be argued to be applicable.

The first argument relates to § 1322(b)(5) of the Bankruptcy Code that states a chapter 13 plan shall

provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due.

If failure to pay the attorneys fee is not a "default," then, according to the lender, the sum should not be added to any arrearage claim to be paid in a plan. In this case, First Union also presented evidence that failure to pay fees was not a default under the loan.

This theory will not save First Union for several reasons. First, § 506(b) clearly includes attorneys fees as part of a creditor's secured claim as made clear in *Rake v. Wade, supra*, and *Telfair, supra*. If the fee is not listed, the debtor has no way to know it exists. If the debtor does not know it exists, it cannot be a part of the secured claim and cannot be collected after discharge. Second, First Union cannot decide for the debtor what arrearage or costs the debtor may pay in his or her plan and what arrearages he may not pay in his plan by picking and choosing which § 506(b) costs to disclose. Section 1322(b)(5) is a provision of the Bankruptcy Code which gives the *debtor* options for plan formulation, not the creditor. If the debtor does not know all of his debts, he cannot exercise his options most effectively for himself. A creditor should not be able to dictate to a debtor what option he selects by its nondisclosure. First Union

failed to disclose a \$150 fee to Ms. Dean. What if it was more?⁴ One thousand dollars? Two thousand dollars? The debtor must be able to sort through his choices. Also, only “reasonable” attorneys fees are to be added to the debt. If the fees are not disclosed, no reasonableness determination can be made. As this case shows, fees have been \$150 to part of a \$450 fee.

The second argument is that since the mortgage debt rides through the plan and discharge, it does not matter if the fee is added to the arrearage. A portion of the debt will remain anyway and letting this fee ride through is consistent with that. This argument is also incorrect. As *Rake v. Wade* and *Telfair* stated, § 506(b) states that a secured claim includes all prepetition debt and all postpetition interest, fees, costs and charges to the effective date of the plan. The § 506(b) charges can be paid through the plan. If a creditor fails to disclose those charges, they cannot be added later. First Union has no choice in the matter. If the fee is not disclosed, it is discharged.

E.

Cases in Which Fees Were Disclosed

In some cases—an unknown number—attorneys did disclose on the proof of claim that a proof of claim filing fee was being charged. The Court does not have evidence of the exact manner of disclosure except that in the *Harris* case, the fee was disclosed as “bankruptcy fee” or “bankruptcy fee and expense.” In any event, the plaintiffs are not asserting that any relief is due them when there has been a disclosure. (“Based on the undisputed evidence in this case, Defendant First Union Mortgage corporation . . . consciously implemented a practice of assessing and collecting proof of claim fees from debtors with **no disclosure** of the fees. As

⁴In the Fannie Mae cases, it may have been more—up to \$450 for unspecified services.

such, Plaintiff and the class are entitled to all of the relief sought in the complaint.” (emphasis in original) (Plaintiff’s trial brief, p. 1)). Therefore, the Court assumes for purposes of this ruling, without making additional findings, that in any case in which counsel for First Union disclosed that a fee was being charged for filing a proof of claim, the disclosure was adequate. Since the disclosure was adequate, the debtors had an opportunity to challenge the fee in each of their cases. Therefore, debtors who had fees disclosed in any manner on the proof of claim are not members of the case of debtors included in this case.

F.

Statute of Limitations

On September 10, 2001, this Court certified a class that included all bankruptcy debtors who filed a chapter 13 petition on or after January 1, 1994, in which certain proofs of claim were filed. The question at issue now is whether this limitations period is appropriate. In the *In re Slick* case, Norwest Mortgage argued that a two-year statute of limitations should apply and therefore the class should be limited to debtors who filed a chapter 13 case on or after July 23, 1997 because that date is two years prior to the filing of the class action suit. The Alabama statute that would be applicable to this case sets a two-year limit. ALA. CODE § 6-2-38(j) and (e) (1975). Due process suits are limited by a two-year statute as well. ALA. CODE § 6-2-38(l) (1975). The plaintiffs assert that statutes of limitations do not control when the issue is injunctive relief. *Holmberg v. Armbrecht*, 327 U.S. 392 (1946). Also, equitable tolling should apply since the fees were undisclosed. *In re Bookout Holsteins, Inc.*, 100 B.R. 427 (Bankr. N.D. Ind. 1989). Finally, there is no statute of limitations for a violation of the stay. *E.g., In re Wills*, 226 B.R. 369 (Bankr. E.D. Va. 1998); *In re Germansen Decorating, Inc.*, 149 B.R. 517 (Bankr. N.D. Ill. 1992).

The Court concludes that the class of debtors should include all debtors who filed chapter 13 cases on or after January 1, 1994 if First Union charged but did not disclose a proof of claim filing fee in the case. The Court agrees with the plaintiffs' arguments. The fact that the fees in this case were undisclosed except as a portion of the total loan balance makes an equitable tolling argument especially appropriate. *Erie Ins. Co. v. Romano (In re Romano)*, 262 B.R. 429, 432 (Bankr. N.D. Ohio 2001) ("Equitable tolling will apply when a plaintiff, through no fault of its own and despite the exercise of due diligence, cannot determine information essential to bringing a complaint in a timely manner."). Because the primary relief to be granted is injunctive, and because of equitable tolling, the period of limitations is longer—from January 1, 1994 to date. The Court is not agreeing with plaintiffs' position that the stay has been violated and, therefore, the fact that there is no limitations period for stay violations is not adopted.

G.

Converted and Dismissed Cases

Debtors whose cases have been converted or dismissed should not be excluded from the class as finally constituted. Converted or dismissed debtors will not pay any arrearages from property of the estate; and, in converted cases, the attorneys fee claim becomes part of the prepetition claim. 11 U.S.C. § 348(d). These facts do not preclude converted and dismissed cases from being included. An undisclosed fee in a chapter 7 case, if posted or collected after filing of the case, violates the chapter 7 debtor's stay or discharge. The posting and collection of the fee is an action to collect a preconfirmation claim treated in the plan. The violation remains, even if the case is closed. Such violations can be handled without reopening each underlying case. *Singleton v. Wells Fargo Bank, N.A. (In re Singleton)*, 269 B.R. 270 (Bankr. D.R.I. 2001). As to dismissed cases, no discharge is entered so there can be no violation of it. However, each

debtor still has a cause of action to avoid the fee because it was improperly charged during the bankruptcy case. This cause of action is not extinguished by dismissal of the case because § 349 of the Bankruptcy Code specifically addresses what occurs at dismissal and extinguishment of bankruptcy causes of action is not included. The case of *Menk v. Lapaglia (In re Menk)*, 241 B.R. 896, 906 (B.A.P. 9th Cir. 1999) specifically catalogues numerous actions that are not extinguished. Among these are issues of compensation. *Id.* at 906. That is precisely the issue in this case. What is the proper compensation to be allowed to First Union, if any, for preparation of the bankruptcy proof of claim? This is an issue of bankruptcy law. It should not be dealt with in state court when a class of similar debtors is constituted in federal court. The issue is still a part of the bankruptcy case and federal court jurisdiction remains. The matter “arises under title 11.” 28 U.S.C. § 1334(b). The question is the validity and reasonability of the fee under § 506(b), a purely federal law question. Therefore, debtors in dismissed cases are included. There is also no need for these cases to be reopened. *Id.* at 906-07.

H.

Excluded Cases

First Union asserts that many cases should be excluded from the class because of local rules and general orders that describe how claims are to be filed or how claims are allowed in chapter 13 cases or when fees must be disclosed and/or approved for professionals. First, the rules provided to the Court do not relate to proofs of claim or creditors’ attorneys fees. Second, the rules and procedures do not apply to undisclosed fees. The omissions of First Union cannot be corrected by local rules or orders. Due process concerns must be addressed first. This order does not apply to any cases in which fees were disclosed so that courts and debtors could follow normal procedures. It applies only to cases in which fees were undisclosed.

I.

Injunctive Relief

First Union asserts that injunctive relief cannot be afforded to the class of debtors in this case because First Union has transferred its servicing rights on all loans to third parties.

Therefore, it cannot expunge fees from files or be enjoined from posting or collecting fees in the future. This is not the case.

First, First Union is the owner of some loans and does have control over the posting and collection of fees from those debtors. Second, the servicing rights transfer documents indicated that First Union is obligated through indemnification obligations to some new servicers for any of First Union's actions during its servicing contract. First Union will be liable to the plaintiffs for its actions.

As stated in another opinion in a related case:

The Court concludes that “a mere assignment does not release the assignor from his or her obligations to the other party under the assigned contract.” Assignments, § AM. JUR. 2d 2000; *Vetter v. Security Continental Inc. Co.*, 567 N.W. 2d 516, 521 (Minn. 1997) (“the original obligor may not divest itself of liability without the consent of the obligee”)’ *Orange Bowl Corp. v. Warren*, 386 S.E. 2d 293, 295 (S.C. App. 1989) (“an assignor remains liable to the obligor for the assignee’s defective performance, just as he would be liable for his own defective performance”); *Baker v. Weaver*, 309 S.E.2d 770 (S.C. App. 1983) (“Under settled contract law, a person may not simply delegate a duty to another and thereby extinguish his own liability to fully perform that duty.”). The treatise continues by stating:

Observation: If this were not true, obligors could free themselves of their obligations by the simple expedient of assigning them.

And so it would be in this case. NationsBank could free itself from all responsibility for the process it set in motion by simply transferring its contract midstream.

The Court concludes that the claims against NationsBank should not be dismissed. First, there has been no evidence of any transfer of the claim filed with this Court pursuant to Fed. R. Bankr. P. 3001(e) (“If a claim . . . has been transferred other than for security after the proof of claim has been filed, evidence of the transfer shall be filed by the transferee.”). Second, unless Fair consented to transfer of NationsBank’s liability for the filing of a proof of claim without disclosure of the inclusion of an

attorneys fee and consented to NationsBanc no longer being liable for the process which leads to improper posting of a fee to his account, then NationsBanc remains liable. It is NationsBanc's responsibility to see to add third party defendants who are responsible to NationsBanc for the posting and collection of the fee. This is particularly true, as seen before in these cases, a debtor, the Court and creditor are not informed of something, in this case the transfer of the claim as required by the Bankruptcy Rules. (Footnote omitted).

Noletto v. Nationsbanc Mortgage Corporation, Case No. 98-13813, Adv. No. 99-1120, Order Denying Defendant's Motion for Summary Judgment (as to John Fair) (Bankr. S.D. Ala. July 25, 2001) at pp. 5-6.

To the extent that First Union, during its servicing of the loans, abused the bankruptcy process, regardless of its transfer of its rights, it remains liable for that abuse.

J.

Post Litigation Conduct

Since the filing of this case, First Union has transferred all of its servicing rights business to other services. The evidence showed that the transfer was not done as a reaction to this suit.

First Union asserts that the transfer moots the viability of this suit against it. The Court dealt with this issue in an earlier ruling and in the prior section.

K.

Damages

The damages suffered by the plaintiffs are of two kinds. First, all of the debtors had a proof of claim filing fee posted to their accounts. Second, some of the debtors have actually paid

the fee.⁵ Those debtors that have had the fee posted to their accounts must have the fee expunged from their account records. Those who have paid the fee must have it returned.

Even if the bankruptcy case of a debtor has been dismissed or converted or relief from stay granted, the fee cannot remain on the account or be added after the bankruptcy is over. The fee was a bankruptcy attorneys fee. It should have been charged and disclosed during the bankruptcy case and the debtor given a right to contest the fee in bankruptcy court. Therefore none of the fees are collectible from a debtor. As *Telfair* stated, preconfirmation fees are part of the secured claim in the bankruptcy case and, therefore, this Court concludes that they are discharged if they are not claimed or adequately disclosed in the bankruptcy case.

The Court does not even need to reach the issue of the propriety or reasonability of a particular fee or type of fee. When an attorneys fee for filing a proof of claim is undisclosed, it simply cannot be charged.

As to the fees of Fannie Mae/Freddie Mac counsel that are not broken down as to pre- and post confirmation charges, all charges must be presumed to be preconfirmation in the first billing because the Court was given no evidence (or very little) to the contrary. The evidence indicated that the first billing was made at about the time of confirmation. Therefore, when the Court speaks of how to treat fees in its order for judgment, the entire first bill of \$450 that was posted to debtors' accounts must be expunged.

⁵The exact number that have paid the fee is unknown at present.

L.

Sanctions

Plaintiffs seek sanctions or exemplary damages for the actions of First Union under § 105 of the Bankruptcy Code. Section 105 authorizes a court to

issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

Such damages are awarded when there has been an abuse of the bankruptcy process. *Karsch v. LaBarge (In re Clark)*, 223 F.3d 859 (8th Cir. 2000). Cases have awarded damages under § 105 for attorney misconduct. *In re Rimsat, Ltd.*, 212 F.3d 1039 (7th Cir. 2000). The case of *In re Tate*, 253 B.R. 653 (Bankr. W.D.N.C. 2000) used § 105 to award damages for money collected on improperly filed claims. Cases involving issues related to § 362 stay violations, such as *Jove Engineering, Inc. v. Internal Revenue Service (In re Jove Engineering, Inc.)*, 92 F.3d 1539 (11th Cir. 1996), and violations of § 524, the discharge injunction, such as *Bessette v. Avco Financial Services, Inc.*, 230 F.3d 439 (1st Cir. 2000), have invoked § 105 to award actual damages, attorneys fees, and punitive damages too.

As stated above, actual damages in the form of an injunction and the ancillary relief of repayment of any proof of claim filing fees collected are appropriate under § 105 in this case. Attorneys fees are also warranted.

The more difficult issue is whether punitive or exemplary damages should be assessed. Courts award exemplary damages if a creditor has willfully abused the bankruptcy process or court orders. *E.g., In re Lafferty*, 229 B.R. 707 (Bankr. N.D. Ohio 1998). There are factors to consider that weigh both ways.

From 1993 or 1994 onward, First Union has had a consistent policy of not disclosing any attorneys fees charged for filing proofs of claim. It elected to outsource that function and put the cost on borrowers, but it never disclosed the cost. First Union had a choice as to whether to disclose the attorneys fees it was posting to debtors' accounts. It chose not to disclose and to wait until the bankruptcy case (or at least First Union's involvement) was over to post the fees. Every institutional creditor like First Union can certainly be charged with an awareness of bankruptcy law. Case law and treatises make clear that fees are a concern to courts.

The Court concludes that the nondisclosure should be sanctioned. First Union gave debtors no notice at all of a fee added to their accounts. An unknown amount, but probably about \$2,000,000 to \$3,000,000 in fees, has been posted to unknowing debtors.⁶ Courts are concerned about fees, as the numerous decisions about fees at all court levels attest. *E.g.*, cases cited at BANKRUPTCY SERVICE, LAWYERS EDITION, § 16:636 Sua Sponte Power of the Court (Gavin L. Phillips & Michael J. Yaworsky, eds, West 2001). Treatises discuss judges' duties in regard to fees. *E.g.*, 2 CHAPTER 11 THEORY AND PRACTICE, § 12.01 at 12:3 (James F. Queenan, Jr., et al., eds. 1994) ("The bankruptcy judge has an independent duty to examine the property and reasonableness of fees, even if no party in interest objects."). Norwest decided to not disclose its fees in the face of this knowledge. The Court concludes that debtors should be awarded \$2,000,000 in punitive damages. This sum is large enough to send a message to First Union and other lenders about the necessity of disclosing fees in bankruptcy cases.

The Court looked for cases upon which to base its award. There was only one similar case. In the *Conley v. Sears, Roebuck & Co.* case, 222 B.R. 181 (D. Mass. 1998), Sears agreed

⁶This figure is arrived at by figuring that an average fee of \$100 was charged for the 20,000 to 30,000 claims filed.

to pay 151% of 190,000 debtors' out of pocket losses or over \$165,000,000 and a finance charge waiver (18-21%) on all postpetition purchases. The actions of Sears were clear violations of the blackletter bankruptcy law. Sears' actions affected more debtors. Therefore, an exemplary award of \$2,000,000 is appropriate in this case. This is considerably less than the 151% and finance charge waiver paid in the *Sears* case to debtors. As to Fannie Mae and Freddie Mac loans, if the fees were posted to the debtors' accounts, they need to be expunged even if they were never paid by the debtors while First Union was servicer. If they are posted to the account, there is always a danger of an attempt at collection.

M.

Prejudgment Interest

The Court must look at what prejudgment interest rate is appropriate. A rate of 6% might be appropriate since it is the rate used in Alabama. ALA. CODE § 8-8-2 (1975). This Court has broad discretion in whether to award prejudgment interest. *In re Vic Bernacchi & Sons, Inc.*, 170 B.R. 647 (Bankr. N.D. Ind. 1994). The Court concludes prejudgment interest should be paid to every plaintiff who has paid some or all of the attorneys fee posted to his or her account. The debtor has been deprived of the use of that money since payment. Since this is a case based strictly on federal law and involves plaintiffs from every state, the most appropriate interest rate to use is 28 U.S.C. § 1961(a), the federal prejudgment interest statute.

N.

Attorneys Fees

The parties have agreed that attorneys fees will be determined at a later hearing.

CONCLUSION

Undisclosed proof of claim preparation attorneys fees cannot be posted to or collected from bankruptcy debtors. Such fees, if posted or collected, are improper under the Bankruptcy Code, particularly 11 U.S.C. § 506(b).

IT IS ORDERED:

1. The motions of First Union for judgment on partial findings and for a judgment at the close of the evidence are DENIED.

2. First Union is enjoined from posting all undisclosed proof of claim preparation attorneys fees to the account of any mortgagors who filed chapter 13 bankruptcy cases from January 1, 1994 to the current date.

3. First Union shall expunge from the account of any mortgagor who filed chapter 13 on January 1, 1994 to date any undisclosed proof of claim preparation attorneys fee.

4. First Union is ordered to refund to the class all undisclosed proof of claim preparation attorneys fees collected from mortgagors who filed chapter 13 cases from January 1, 1994 to date together with prejudgment interest pursuant to 28 U.S.C. § 1961(a) for the period from the date of collection to the date of refund to the debtor.

5. The plaintiffs are awarded exemplary damages of \$2,000,000 for First Union's improper, undisclosed assessment of fees to debtors' accounts.

6. First Union shall search its records for the names and last known addresses of all members of the class for the years 1999-2001 and provide that list to plaintiffs' counsel within ninety days of this order.

7. A hearing on attorneys fees to be awarded to plaintiffs' counsel shall be held on **October 22, 2002 at 1:00 p.m.** in Courtroom 2, U.S. Bankruptcy Court, 201 St. Louis Street, Mobile, AL 36602.

Dated:

MARGARET A. MAHONEY
CHIEF BANKRUPTCY JUDGE