20-1, 20-2, 20-3

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

IN RE: NICHOLAS & AMANDA GRAVEL, Debtors. (20-1)
IN RE: ALLEN & LAURIE BEAULIEU, Debtors. (20-2)
IN RE: MATTHEW & EMILIE KNISLEY, Debtors. (20-3)

PHH MORTGAGE CORPORATION,
Creditor-Appellant,
v.
JAN M. SENSENICH,
Trustee-Appellee.

Consolidated Direct Appeals from the United States Bankruptcy Court for the District of Vermont, Case Nos. 11-10112, 11-10281, & 12-10512.

BRIEF OF AMICI CURIAE NATIONAL CONSUMER BANKRUPTCY RIGHTS CENTER, NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS, NATIONAL CONSUMER LAW CENTER, LEGAL SERVICES VERMONT, INC. AND HOUSING CLINIC OF JEROME N. FRANK LEGAL SERVICES ORGANIZATION AT YALE LAW SCHOOL IN SUPPORT OF APPELLEE AND SEEKING AFFIRMANCE OF THE BANKRUPTCY COURT'S DECISION

TARA TWOMEY
NATIONAL CONSUMER BANKRUPTCY RIGHTS CENTER
1501 The Alameda, Suite 200
San Jose, CA 95126
(831) 299-0256

On brief: Geoff Walsh
August 11, 2020

RULE 26.1 CORPORATE DISCLOSURE STATEMENT

PHH Mortgage Corp. v. Sensenich, Nos. 20-1, 20-2, 20-3.

Pursuant to 2d Cir. R. 26.1, Amici Curiae, the National Association of Consumer Bankruptcy Attorneys, the National Consumer Bankruptcy Rights Center, the National Consumer Law Center, Legal Services Vermont, Inc. and the Housing Clinic of Jerome N. Frank Legal Services Organization at Yale Law School make the following disclosure:

1) Is party/amicus a subsidiary or affiliate of a publicly owned corporation? If yes, list below the identity of the parent corporation or affiliate and the relationship between it and the named party. **NO**

2) Is there a publicly owned corporation, not a party to the appeal, that has a financial interest in the outcome? If yes, list below the identity of the corporation and the nature of the financial interest. **NO**

This day of August 11, 2020.

s/ Tara Twomey
Tara Twomey
Attorney for Amici Curiae

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Rules

Legislative History

Other Authorities

INTEREST OF AMICI CURIAE

NCBRC is a nonprofit organization dedicated to preserving the bankruptcy rights of consumer debtors and protecting the bankruptcy system's integrity. NCBRC files *amicus curiae* briefs in systemically-important cases to ensure that courts have a full understanding of the applicable bankruptcy law, the case, and its implications for consumer debtors.

NACBA is also a nonprofit organization of more than 2,500 consumer bankruptcy attorneys nationwide. NACBA advocates nationally on issues that cannot adequately be addressed by individual member attorneys.

The National Consumer Law Center is a public interest, non-profit legal organization that is a national research and advocacy organization focusing specifically on the legal needs of low income, financially distressed, and elderly consumers.

Legal Services Vermont, Inc. (LSV) is a nonprofit legal services law firm based in Burlington, Vermont. LSV provides free consultation, advice and community education for low-income Vermonters with the goal of empowering individuals and families through education, advice, and other legal services.

The Housing Clinic of Jerome N. Frank Legal Services Organization at Yale Law School is a legal clinic in which law students, supervised by faculty attorneys, provide legal assistance to people who cannot afford private counsel. (Amicus briefs filed by the legal clinic affiliated with Yale Law School do not represent any institutional views of Yale Law School or Yale University.) Many of the Clinic's clients have experienced repeated mishandling of their mortgage accounts from servicers, including PHH and its predecessor Ocwen Loan Servicing, LLC.

Amici have a vital interest in the outcome of this case. PHH's practice of harvesting fees from struggling homeowners violates Bankruptcy Rules which were created specifically to prevent such conduct. The improper practice has a significant negative impact on countless consumer debtors and demonstrates contempt for the rule of law. If PHH is permitted to continue this conduct by simply returning improperly collected fees only upon request by the individual debtor or trustee, it will defeat the purpose of Bankruptcy Rule 3002.1

Amici believe the issue presented to this Court is of fundamental importance to the bankruptcy system and seek to provide the Court with additional background on the principles of law at stake in this case.

SUMMARY OF ARGUMENT[1]

PHH, one of the largest national mortgage servicers, ran a program that systematically harvested fees from homeowners while they struggled to bring their mortgages current in chapter 13 bankruptcy cases. PHH ran the program in flagrant disregard of Bankruptcy Rule 3002.1, a rule promulgated specifically to curb servicers' abusive assessment of fees in chapter 13 cases. PHH's practice also violated orders of the bankruptcy court. The bankruptcy court appropriately sanctioned PHH in order to deter it from continuing this behavior.

Although PHH acknowledged that it violated court rules and orders, it believes it should not have been sanctioned at all. PHH emphasizes three points: first the amounts of money at issue were insignificant, JA 145, 155, 443; second, it would have promptly corrected the accounts if the trustee had only asked first instead of filing motions for sanctions, PHH Brief pp.59, 62; and third, neither the trustee nor the debtors were harmed because PHH promptly corrected the accounts after the trustee filed his motions. PHH Brief p.48.

PHH urges a "no harm no foul" spin for a reason. What it wants is a green light to continue to run its fee harvesting programs during chapter 13 cases, leaving

---

[1] Pursuant to Fed. R. App. P. 29(a)(4)(E) and Local Rule 29.1(b), amici curiae affirm that no counsel for a party authored this brief in whole or in part, and no person or entity other amici and their counsel made any monetary contribution toward the preparation or submission of this brief.

it up to individual debtors and trustees to challenge the fees on a case-by-case basis. This is precisely the practice that Rule 3002.1 was promulgated to stop.

The bankruptcy court appropriately exercised its powers under 11 U.S.C. § 105(a) and its inherent powers to enforce Rule 3002.1 and its own orders. Rule 3002.1(i)(2) authorizes bankruptcy courts to impose "appropriate relief" to sanction violations of the Rule. The bankruptcy court had the full powers of the district court to impose sanctions in this instance. Congress gave the bankruptcy courts full authority to hear and determine proceedings that directly involve enforcement of essential aspects of the Bankruptcy Code. Article III of the Constitution does not limit the bankruptcy courts' powers when they make these determinations. Due process protections come into play when any federal court imposes punitive sanctions. These protections must be available in the bankruptcy court to the same extent as in the district court. In this case, the sanctions imposed on a corporation the size of PHH did not rise to a level requiring heightened due process protections applicable to substantial punitive sanctions. In the alternative, even if the sanctions are considered criminal contempt, adequate due process safeguards were available to PHH in the bankruptcy court.

ARGUMENT

I. Large financial institutions use fee harvesting programs to generate substantial revenue.

Programs that harvest default-related fees from consumers generate substantial income for financial institutions. These programs use software to assess fees automatically upon predetermined events. They have the capacity to collect from large pools of accounts with minimal cost. For example, the Consumer Financial Protection Bureau ("CFPB") estimates that consumer overdraft and NSF fee revenues total as much as $17 billion annually."[2]

In the years leading up to promulgation of Fed. R. Bankr. P. 3002.1, bankruptcy courts often saw the devastating impact that mortgage servicers' fee harvesting programs had in chapter 13 cases. When it prepared to draft Rule 3001 and Rule 3002.1, the Bankruptcy Rules Committee referred specifically to evidence coming to light in litigation in the Louisiana bankruptcy court.[3] This litigation involved two related cases.

---

[2] Consumer Financial Protection Bureau, A Closer Look: Overdraft and the Impact of Opt-In (Jan. 19, 2017) p.1 available ahttps://files.consumerfinance.gov/f/documents/201701_cfpb_Overdraft-and-Impact-of-Opting-In.pdf

[3] Memorandum of Subcommittee on Consumer Issues to Advisory Committee on Bankruptcy Rules "Mortgage Payments in Chapter 13 Cases," August 27, 2008, pp.2, 8-10, contained in Agenda Book of Advisory Committee on Bankruptcy Rules, Denver CO., Oct. 2-3, 2008. https://www.uscourts.gov/rules-policies/records-rules-committees/agenda-books.

The first of the Louisiana cases was *In re Jones,* 366 B.R. 584 (Bankr. E.D. La. 2007), *subsequent decision* 2007 WL 2480494 (Bankr. E.D. La. Aug. 29, 2007), *affirmed* 391 B.R. 577 (E.D. La. 2008). The *Jones* decisions came as the culmination of an extensive investigation by the bankruptcy court and the U.S. Trustee into systemic practices of one large mortgage servicer, Wells Fargo.

At the time he filed for chapter 13 relief, Mr. Jones owed an arrearage on his mortgage payments totaling $22,259.69. Twenty-nine months later and after extensive hearings to assess the appropriate payoff amount for the loan, the bankruptcy court concluded that Wells Fargo overcharged Mr. Jones by $24,450.65 while his chapter 13 plan was in effect. *Id.* at 604.

The overcharge in Mr. Jones' case ballooned because of systemic features of Wells Fargo's servicing program. To begin with, Wells Fargo misapplied payments between Mr. Jones' arrearage ("cure") payments and the ongoing payments he made to keep the account current. This resulted in an interest overcharge of $13,000. *Id.* at 593. In addition, Wells Fargo applied the trustee's payments to an array of pre- and post-petition fees that were unauthorized and never disclosed to the trustee or to Mr. Jones. These included charges that Wells Fargo's own witnesses could not explain. Among these were sixteen property inspection charges, some of which were incurred while the property was inaccessible due to hurricane Katrina. *Id.* at 596-98.

During the course of the *Jones* litigation Wells Fargo never disputed that the accounting practices employed in Mr. Jones' case were the same as those it used for all chapter 13 cases. The court noted that in its experience these practices were routine among all major mortgage servicers. After Wells Fargo successfully appealed the bankruptcy court's broad injunction directing it to reform its practices, the bankruptcy court assessed punitive sanctions of $2.1 million against Wells Fargo based on the conduct revealed in Mr. Jones' case. *In re Jones*, 2012 WL 1155715 (Bankr. E.D. La. April 5, 2012) *affirmed* 489 B.R. 645 (E.D. La. 2013).[4]

The same bankruptcy court focused more closely upon Wells Fargo's practices in assessing costs and fees in another chapter 13 case. *In re Stewart,* 391 B.R. 327 (Bankr. E.D. La. 2008), *affirmed* 2009 WL 2448054 (E.D. La Aug. 7, 2009), *ruling on district-wide injunctive relief vacated* 647 F.3d 553 (5th Cir. 2011).[5]

The debtor in *Stewart* challenged several categories of fees that Wells Fargo attempted to collect during her chapter 13 case. These included 49 late fees of

[4] Addressing only the issue of the breadth of injunctive relief, the Fifth Circuit reversed the bankruptcy court's injunction on standing grounds. *Wells Fargo v. Jones*, 439 Fed. Appx. 330 (5th Cir. 2011).

[5] As in *In re Jones,* discussed above, the Fifth Circuit in *Stewart* ruled that an individual debtor lacked standing to assert a claim for an order enforceable in all chapter 13 cases pending in two Louisiana districts.

$27.71 each. The bankruptcy court found that only ten of these had been properly assessed. *Stewart,* 391 B.R. at 355. The servicer's fee harvesting system automatically charged these fees to Ms. Stewart's account when it showed a payment as fifteen days overdue. In one instance a single delayed payment of $554.11 triggered 13 consecutive monthly late fees despite Ms. Stewart's having made the next 13 payments when due. *Id.* at 342. The same single late payment set off an automated program that simultaneously ordered seven property inspections, charged to the account at $15.00 each. In total, Ms. Stewart incurred fees of $465.11 due to one late payment of $554.11. *Id.* Another servicer error in the application of escrow payments inappropriately triggered 22 more late fees. *Id.* at 354. Based on a computer program tied to late payment dates Wells Fargo ordered 44 inspections of Ms. Stewart's property over a period of 79 months, charging them to her account. *Id.* at 343-44. There was no need for these inspections. No one read the reports. Several were clearly for the wrong house, with some reporting a brick home and others a wood frame structure. The servicer's witness could give no valid reason for the number or frequency of inspections.

During the same period Wells Fargo charged Ms. Stewart for nine on-site appraisals of the property (broker price opinions) at $95 to $125 each. *Id.* at 345-46. Two reports dated from a time when the property was inaccessible due to Hurricane Katrina. *Id.* The bankruptcy court learned from the testimony of Wells

Fargo's witness that the servicer ran "extremely sophisticated computer software" that maximized fee collection. *Id.* at 335. Once set in motion, these programs continued to harvest fees from pools of loans without further human intervention, until someone decided to turn a program off.

While each individual fee charged in *Stewart* did not seem significant in isolation, the bankruptcy court noted the impact of the scale of a large mortgage servicer's operations. According to the court, Wells Fargo serviced 7.7 million home mortgages at the time, "While a $15.00 inspection charge might be minor in an individual case, if the 7.7 million home mortgage loans Wells Fargo services are inspected just once per year, the revenue generated will exceed $115,000,000.00." *Id.* at 343 n.34.

Under the terms of their servicing agreements servicers are typically entitled to retain as compensation the default-related fees they collect. Late fees and other delinquency-related charges are a major source of income to mortgage servicers. *Id.* at 336. *See also* Diane E. Thompson, *Foreclosing Modifications: How Servicer Incentives Discourage Loan Modifications*, 86 Wash. L. Rev. 755, 803 (2011) (noting as an example that Countrywide Mortgage received $285 million in revenue from late fees in 2006, a relatively stable period before delinquencies skyrocketed during the foreclosure crisis).

Servicers' failures to make clear disclosures of delinquency and default fees in bankruptcy cases have been amply documented. *See* Katherine Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*, 87 Tex. L Rev. 121, 152-161 (2008). The Porter study was based on reviews of claims filed in bankruptcy courts before the appearance of the current Rules 3001 and 3002.1 in 2011. The study found that servicers routinely used vague "laundry list" aggregations of fees, often totaling more than $1,500 at a time. The descriptions made it impossible to ascertain the nature of the charges, highlighting the need for clear disclosures:

> Indeed, the courts that have adjudicated disputes over mortgage claims have needed dozens of hours of evidentiary testimony to decipher the basis for the total amount claimed by mortgage servicers. This, in fact, is the key point. By obscuring the information needed to determine the alleged basis for the charges, servicers thwart effective review of mortgage claims. The system can only function as intended if complete and appropriate disclosures are made.

Id. at 154. The economies of scale described above apply to PHH. As of October 2018, PHH became a wholly owned subsidiary of Ocwen Financial Corp. Upon completion of the acquisition, the combined PHH/Ocwen company serviced 1.562 million home loans with a total unpaid principal balance valued at $256 billion.[6]

[6] Ocwen Financial Corporation Form 10-K year ending December 31, 2018 p.5. https://www.annualreports.com/HostedData/AnnualReportArchive/o/NYSE_OCN_2018.pdf

According to its annual reports filed with the SEC, PHH's income from "late fees and other ancillary servicing revenue" totaled $62 million in 2012[7] and $35 million in 2015.[8]

A. The trustee acted appropriately to stop PHH's continuing unlawful operation of a fee harvesting program during the chapter 13 cases.

When Trustee Sensenich appeared for the sanctions hearing on July 27, 2016, the bankruptcy court asked his counsel why she had not simply written to PHH and asked that they withdraw the improper fees. JA 504. After all, PHH's counsel acknowledged the error and indicated PHH would have withdrawn the fees as soon as the trustee brought the matter to the servicer's attention. JA 506. In response, the Trustee and his counsel patiently explained why they had not taken this approach. JA 504-505. On May 25, 2016, PHH had sent out three statements to three different chapter 13 debtors, each statement listing similar unauthorized fees. In each case PHH had sent the debtor dozens of similar statements claiming similar fees that had not been disclosed as required by Rule 3002.1. There was clearly a pattern here. This could only be the product of a systemic practice that

---

[7] PHH Corporation Annual Report 10K 2012 at p.40 https://www.sec.gov/Archives/edgar/data/77776/000110465913015794/a12-27694_110k.htm

[8] PHH Corporation Annual Report 10K 2015 at p.40 https://www.sec.gov/Archives/edgar/data/77776/000007777616000007/phh2015123110-k.htm

routinely violated the rules and orders of the court. JA 504-505. In the Trustee's view, a systemic problem required a systemic response. Reliance on a case-by-case approach would place on the trustee and debtors the responsibility to implement Rule 3002.1. The Trustee pointed out that a different bankruptcy court had rejected precisely the same suggestion from PHH—that courts rely on its promise voluntarily to remove fees on a case-by-case basis as a substitute for compliance with Rule 3002.1. JA 516. (referring to *In re Owens,* 2014 WL 184781 (Bankr. W.D.N.C. Jan. 15, 2014)).

The Trustee had other grounds for skepticism about PHH's adherence to a system of voluntary compliance absent his filing a motion. Before he filed a contempt motion against PHH in Mr. Gravel's case in 2014, the trustee had written multiple letters to PHH seeking to resolve the account errors without litigation. JA 730-31. When PHH's attorney appeared at the sanctions hearing in 2014, he acknowledged that PHH had received the trustee's letters and ignored them. According to PHH's counsel, PHH treated letters and motions differently. JA 731-33. The contempt motion got PHH's attention. The trustee's letters did not. *Id.*

B. Fee harvesting programs harm debtors, trustees, and the administration of the bankruptcy system.

In arguing that its assessment of fees caused no harm, PHH Brief p.48, PHH emphasizes that neither the debtors nor the trustee paid the fees. PHH's argument misses an important point. Rule 3002.1 states that the secured creditor must file and serve the notice of post-petition fees charged to an account when these fees "are recoverable against the debtor *or against the debtor's principal residence*." Fed. R. Bankr. P. 3002.1(c)(emphasis added). In the course of the sanctions proceedings PHH offered records showing that the fees in question were in fact "assessed" against the debtors' accounts at various times between 2011 and 2016. JA 614, 630, 647. PHH's argument ignores what happens when it assesses charges to a mortgagor's account.

PHH services loans for secured creditors. When PHH assesses a $15 inspection fee or a $30 late fee to a borrower's mortgage account, these charges become secured by real property. The creditor's lien on the debtor's property is augmented by the amount of the charge, and the debtor's interest in the property is diminished by the equivalent amount. This is a concrete harm to the debtor and the debtor's property.

The economies of scale make a difference. When PHH assess $65 million in fees against mortgagors, as it did in 2012, the $65 million becomes debt secured by tens of thousands of borrowers' homes. In a real sense, when PHH assessed these fees it impaired the borrowers' collective home equity by $65 million.

To distract from its own admissions regarding its pattern of violations of Rule 3002.1 and court orders, PHH repeatedly mentions that its letters that instigated the trustee's motions did not contain express demands for payment, were sent to comply with a local court rule, and contained disclaimers of a debt collection intent. These are stock claims that creditors and debt collectors often raise after they have violated statutes that regulate their activities. Courts routinely reject them.

Boilerplate disclosures purporting to deny any debt collection intent cannot negate clear statutory violations. *In re Williams*, 612 B.R. 682, 693 (Bankr. M.D.N.C. 2020) ("the inclusion of boilerplate disclaimers is not a talisman, cleansing a creditor's ongoing misrepresentation of the total payoff balance owed on a discharged debtor's mortgage loan"). Many courts have rejected attempts to use boilerplate disclaimers of a debt collection intent as a defense to violations of the Fair Debt Collection Practices Act.[9] *Tabb v. Ocwen Loan Servicing, LLC*, 798 Fed. Appx. 726 (3d Cir. 2020); *Parente v. Fay Servicing, LLC*, 2020 WL 1182714, at *3-4 (N.D. Ill. Mar. 12, 2020); *Johnson v. Fay Servicing, LLC.*, 2018 WL 5262078, at *13 (N.D. Ga. July 2, 2018) (summarizing decisions). As the Third Circuit noted, "a communication need not contain an explicit demand for payment to constitute debt collection activity." *McLaughlin v. Phelan Hallinan & Schmieg, LLP*, 756 F.3d 240, 245 (3d Cir. 2014). Similarly, courts have rejected creditors' attempts to label monthly account statements as simply "informational" when the

---

[9] 15 U.S.C. § 1692.

statements revealed account activities that violated applicable laws. *Miller v. Carrington Mortg. Services, LLC*, 607 B.R. 1, 4-5 (D. Mass. 2019).

In the instant case, PHH violated court orders and Rule 3002.1. It does not matter that PHH happened to have revealed these violations in the context of notices that it had to send debtors in order to comply with a local bankruptcy court rule. *Hart v. FCI Lender Services, Inc*., 797 F.3d 219, 226 (2d Cir. 2015) (including improper debt amount in a letter the debt collector must send to comply with a statute can still be unfair debt collection practice); *In re Trevino*, 615 B.R. 108, 134 (Bankr. S.D. Tex. 2020) (improper charge contained in statement served pursuant Rule 3002.1). The point is that if PHH had wanted to, it could have easily complied with Rule 3002.1, the bankruptcy court orders, and the local bankruptcy court rule requiring accurate account statements without violating any of them.

The purpose of Rule 3002.1 is "to aid in the implementation of [11 U.S.C.] § 1322(b)(5), which permits a chapter 13 debtor to cure a default and maintain payment of a home mortgage over the course of the debtor's plan." Fed. R. Bankr. P. 3002.1, 2011 Advisory Committee Notes. Preserving homeownership is the reason most consumers choose chapter 13 over chapter 7 when they decide to file a bankruptcy case. Because chapter 13 fosters debt repayment as an alternative to discharge, Congress acknowledged a policy of preferring that consumer debtors proceed under chapter 13 rather than chapter 7.[10]

For chapter 13 to remain the preferred option that Congress intended, one outcome is essential. Homeowners must emerge from chapter 13 with their mortgages conclusively reinstated. Homeowners must be able to rely on a judicial process that protects them after they cured the pre-bankruptcy default and made all payments that came due during the pendency of the chapter 13 case.[11] If after years of effort to pay under a plan homeowners emerge from bankruptcy to face continuing threats of foreclosure, chapter 13 will have no attraction for debtors.

II. Section 105(a) empowers bankruptcy courts to enforce 11 U.S.C. § 1322(b)(5), Fed. R. Bankr. P. 3002.1, and their own orders.

Through section 105(a) of the Bankruptcy Code Congress gave bankruptcy courts the power to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Code]." Bankruptcy courts have the authority to employ section 105(a) when necessary or appropriate to implement

[10] "The premises of the bill with respect to consumer bankruptcy are that use of bankruptcy law should be a last resort; that if it is used, debtors should attempt repayment under Chapter 13." H. Rep. No. 595, 95th Cong. 1st Sess. 117 (1977) (House Judiciary Committee Report).

[11] In amending section 1322 in 1994 to further facilitate cures of mortgage defaults in chapter 13 the House Judiciary Committee noted, "It is the Committee's intention that a cure pursuant to a plan should operate to put the debtor in the same position as if the default had never occurred."

section 1322(b)(5). Congress also authorized the bankruptcy courts to use section 105(a) to "tak[e] any action or mak[e] any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent abuse of process." 11 U.S.C. § 105(a). Bankruptcy courts therefore have authority to take necessary or appropriate actions to enforce Rule 3002.1 and to ensure that parties obey court orders, including orders that implement section 1322(b)(5) and Rule 3002.1.

In the instant case the bankruptcy court's sanctions were necessary and appropriate to correct a pattern of creditor misconduct that undermined the implementation of section 1322(b)(5) and Rule 3002.1. PHH argues that the sanctions exceeded limits on the bankruptcy court's powers. PHH points to two sources of these limits. One is Rule 3002.1 itself. The other is the Constitution.

III. Contrary to PHH's misleading "legislative history," Rule 3002.1 does not limit the bankruptcy court's authority under 11 U.S.C. § 105(a) or its inherent authority.

Section 105(a) does not allow a bankruptcy court to issue an order that contravenes a specific provision of the Bankruptcy Code; no one disputes that proposition. *Law v. Siegel,* 134 S. Ct. 1188, 1194 (2014). In a desperate attempt to find some aspect of the Code that it can claim the instant orders violated, PHH latched on to Rule 3002.1 itself. PHH Brief pp.50-62. As discussed below, Rule 3002.1 contains two distinct subparts related to sanctions. One is relevant to this case. The other is not. PHH's arguments focus only on the irrelevant subpart.

The two subparts of Rule 3002.1 that authorize bankruptcy courts to impose sanctions are found in subsection (i). Subpart (1) of subsection (i) authorizes a sanction focused on evidence preclusion. Under this option, upon finding that the holder of a claim violated Rule 3002.1, the bankruptcy court may:

> (1) preclude the holder 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;

Under subpart (1) the bankruptcy court may sanction a creditor who violates Rule 3002.1 by denying the creditor the right to assert all or part of its proof of claim in the chapter 13 case.

Subpart (2) of Rule 3002.1(i) provides for sanctions with a broader scope. Under subpart (2), upon finding a failure to comply with the Rule, a bankruptcy court may:

> (2) award other appropriate relief, including reasonable expenses and attorney's fees caused by the failure.

Subparts (1) and (2) of Rule 3002.1(i) are cumulative and not mutually exclusive. The bankruptcy court may "take either or both" types of action in a given case. The broad authority to impose sanctions under subpart (2) is not inconsistent with or limited by the specific evidence preclusion sanction under subpart (1).

In its Brief to this Court and throughout the lower court proceedings PHH delved into a lengthy discussion of the history behind subpart (1) of subsection (i) of Rule 3002.1. This subpart of Rule 3002.1, like its counterpart in Rule 3001(c)(2)(D)(i), was the subject of debate in the various rules committees. The automatic preclusion of the entirety of a creditor's claim for minor, even unintentional, mistakes in filling out proof of claim forms and documenting charges could be disproportionate to the harm caused in a specific case. For example, preclusion of evidence that could lead to denial of the mortgage lender's claim for the principal balance of $500,000 owed on a mortgage because of an error in listing a $15.00 fee would be disproportionate under any reasonable view. Therefore, the Rules Committee drafted the terms of subpart (1) of Rule 3002.1(i) to allow courts to tailor the sanction of evidence preclusion to the severity of creditor misconduct in an individual case. That is the extent of the legislative history of Rule 3002.1 that PHH discusses at great length. PHH Brief pp.50-62. None of it is relevant to the issues in this appeal.

The bankruptcy court in this case imposed sanctions under subpart (2) of Rule 3002.1(i). This subpart authorized the bankruptcy court to "award other appropriate relief" upon finding that PHH failed to comply with Rule 3002.1.

In a misleading statement PHH attempts to link its history of Rule 3002.1(i)(1) (the evidence preclusion sanction) to the "other appropriate relief" language of Rule 3002.1(i)(2). PHH Brief p.61. The Court should carefully review the texts PHH cites to as authority here. The cited texts address only the evidence preclusion sanctions under subpart (1) and do not refer at all to the "other appropriate relief" sanction authorized by subpart (2). The "legislative history" that, according to PHH, "actually suggests" limits on the "other appropriate relief" sanction in subpart (2) does not exist.

Nothing in the plain language of subpart (2) of Rule 3002.1(i) limits the bankruptcy court's ability to fashion "other appropriate relief" to deal with a systemic violation of Rule 3002.1. By the Rule's express terms sanctions are not limited to case-by-case considerations of evidence preclusion. Nor does the text limit "other appropriate relief" to awarding reasonable expenses and attorney's fees. The Rule describes the "other appropriate relief" as "including" reasonable expenses and attorney's fees. Fed. R. Bankr. P. 3002.1(i)(2). The word "including" means that the bankruptcy court can award sanctions other than compensation for expenses and fees.

IV. The bankruptcy court did not exceed constitutional limits on its powers.

A. Introduction – the roles of Article III and due process are distinct.

In holding that the bankruptcy courts exceeded constitutional limits on their powers when they imposed punitive sanctions, the Ninth and Fifth Circuits referred simultaneously to limits imposed by Article III and by due process. *In re Dyer,* 322

F.3d 1178, 1193-94 (9th Cir. 2003); *Matter of Hipp,* 895 F.2d 1503, 1514-15 (5th Cir. 1990). These courts' analyses tended to merge the Article III and due process rationales together. When the Sixth Circuit adopted the reasoning of *Dyer* and *Hipp*, it similarly conflated Article III and due process principles. *In re John Richards Home Bldg. Co,* 552 Fed. Appx. 401, 416 (6th Cir. 2013).

As will be discussed below, conflating the distinct constitutional principles led to erroneous conclusions. Article III does not limit bankruptcy courts' powers to impose punitive sanctions. Bankruptcy courts have jurisdiction to impose sanctions in proceedings, such as the instant one, where Congress gave them full authority to made determinations. 11 U.S.C. § 157(b). Due process *does* place limits on the bankruptcy courts' ability to impose punitive sanctions. But the same due process limitations apply to the district courts when they impose punitive sanctions. There is not a list of due process protections carved in stone that every federal court must apply in every case involving punitive sanctions. The due process standards are flexible. They depend on the severity of the sanction, the identity of the defendant, and the nature of the evidentiary record.

B. Article III did not limit the bankruptcy court's powers to impose sanctions in this case.

The bankruptcy court below acted pursuant to section 105(a) and its inherent powers to enforce its own orders as well as pursuant to Rule 3002.1 (a rule promulgated to implement 11 U.S.C. § 1322(b)(5). These were proceedings "arising under" Title 11. The bankruptcy court thus had jurisdiction to hear and make determinations in these proceedings. 28 U.S.C. § 157(a), (b); *See In re Matter of General Motors Liquidation,* 829 F.3d 135, 153 (2d Cir. 2016).

The power to sanction is essential to the effective functioning of the bankruptcy courts. *In re Anderson*, 884 F.3d 382, 391-92 (2d Cir. 2018). The ability to sanction is intertwined with the court's authority to issue orders, enforce the Bankruptcy Code, and require obedience to rules. *Id.* As the court described in *Anderson,*

> . . . the bankruptcy court retains a unique expertise in interpreting its own injunctions and determining when they have been violated. Congress afforded the bankruptcy courts wide latitude to enforce their own orders, specifically granting these specialty courts the power to "issue any order, process or judgment that is necessary or appropriate to carry out the provisions of" the Bankruptcy Code. 11 U.S.C. § 105(a). We have previously observed that "[t]he statutory contempt powers given to a bankruptcy court under § 105(a) complement the inherent powers of a federal court to enforce its own orders." *In re Kalikow,* 602 F.3d 82, 96 (2d Cir. 2010).

884 F.3d at 390-91.

In *Stern v. Marshall,* 564 U.S. 462 (2011), the Supreme Court distinguished the types of proceedings in which bankruptcy courts, as Article I courts, have authority to enter final judgments from the proceedings in which the district courts must enter final judgments. At one end of the spectrum, bankruptcy courts lack constitutional authority to enter final judgments on certain claims arising solely under state law and involving private parties. *Id*. at 493. The state law defamation counterclaims at issue in *Stern* bore only a remote relation to administration of the bankruptcy case. The counterclaims derived entirely from state law and did not depend at all on "the will of Congress." *Id.* At the other end of the spectrum bankruptcy courts can fully adjudicate claims that "flow from a federal statutory scheme." *Id*. Specifically, legal claims that are central to the administration of claims in a bankruptcy case, legal claims that would not exist outside of the bankruptcy, are clearly within the constitutional authority of the bankruptcy courts to determine up to entry of a final judgment. A bankruptcy court has full constitutional authority to resolve a dispute that "stems from the bankruptcy itself." *Id.* at 499.

The issues the bankruptcy court addressed in the instant case go to the most essential functions of the Congressionally-created bankruptcy system: the orderly determination of claims; oversight of the debtor's plan of reorganization; payments to creditors; interpretation and enforcement of bankruptcy court rules; interpretation and enforcement of the bankruptcy court's own orders; and protection of the debtor's fresh start. Consistently with *Stern's* guidelines, an Article I court can enter appropriate orders to carry out these essential duties defined by federal law.

In recently affirming that bankruptcy courts have the power to impose contempt sanctions for violation of their orders, the Supreme Court did not express any concerns about the bankruptcy courts status as Article I courts to do so. *Taggart v. Lorenzen,* 139 S. Ct. 1795, 1801 (2019). In order to fashion the appropriate standard to determine whether sanctions should be imposed in a particular case, the Supreme Court did not look to Article III. Instead, the Court examined general nonbankruptcy law. *Id.*

The Fifth Circuit's *Hipp* decision, dating from 1990, is a vestige of the uncertainty about the constitutional limits of bankruptcy courts' powers that existed in the wake of the Bankruptcy Amendments and Federal Judgeship Act of 1984 ("BAFJA") and *Northern Pipeline Construction Co. v. Marathon Pipeline Co.,* 458 U.S. 50 (1982). The subsequent rulings in *Dyer, John Richards Home Bldg.,* and the district court opinion below did little more than repeat what the *Hipp* court said thirty years ago about the impact of Article III on the bankruptcy courts' contempt powers.

The judicial climate in 1990 was reflected in the Advisory Committee Notes to the version of Rule 9020 promulgated in 1987: "This rule, as amended, recognizes that bankruptcy judges may not have the power to punish for contempt." Fed. R. Bank. P. 9020, 1987 Advisory Committee Notes. Clearly there were open questions at the time as to whether the bankruptcy courts had any contempt powers at all.[12] The Notes to the current version of Rule 9020, implemented in 2001, acknowledge subsequent court rulings that recognized the contempt powers of bankruptcy courts. *Compare* Fed. R. Bankr. P. 9020, 1987 and 2001 Advisory Committee Notes. Today, the bankruptcy courts' possession of contempt powers is not in dispute. *Taggart v. Lorenzen,* 139 S. Ct. at 1801; *In re Sanchez,* 941 F.3d 625 (2d Cir. 2019).

The rulings that adhere to *Hipp* fail to explain why Article III limits apply to bankruptcy courts' powers to impose certain types of sanctions, but not to civil contempt. The courts point to the absence of a clear directive giving bankruptcy courts authority to impose criminal contempt sanctions. That is true. A clear delegation of Article III authority to bankruptcy courts to impose criminal contempt and punitive non-contempt non-contempt sanctions does not exist. The problem, however, is that this clear delegation does not exist for civil contempt either.

The *Hipp* court also failed to account for statutory and regulatory changes that were inconsistent with its holding. Prior to BAFJA, there *had been* express statutory limits on the bankruptcy courts' contempt powers, and particularly

[12] For example, in an initial post-*Marathon Pipeline* ruling the Ninth Circuit held that bankruptcy courts did not have authority to impose contempt sanctions. *In re Sequoia*, 827 F.2d 1281, 1284-85 (9th Cir. 1987). Less than ten years later, the Ninth Circuit overruled *Sequoia*, ruling that the bankruptcy courts had contempt powers. *In re Rainbow Magazine*, 77 F.3d 278, 284-85 (9th Cir. 1996).

regarding the use of criminal contempt. 28 U.S.C. § 1481. However, the BAFJA repealed section 1481. Similarly, as discussed above, Rule 9020 was amended to remove express restrictions on the bankruptcy courts' ability to impose contempt sanctions.

Finally, the *Hipp* and *Dyer* courts construed section 105(a) to mean that criminal contempt sanctions were neither "necessary" nor "appropriate" to enforce bankruptcy statutes, rules, and court orders. *Dyer,* 322 F.3d at 1193; *Hipp,* 895 F.2d at 1515. Neither court offered an analysis to support this conclusion. The interpretation fails to give effect to the plain meaning of the statutory terms "necessary" and "appropriate." Apparently, it could be "necessary or appropriate" for a district court judge to use criminal contempt to enforce the Bankruptcy Code, but not for a bankruptcy court judge. The meaning of statutory terms should not depend on the unit of the district court that enforces the statute.

C. The bankruptcy court proceedings were conducted consistently with PHH's due process rights.

PHH's basic argument is that the sanctions the bankruptcy court imposed fit the definition of "criminal" contempt. Therefore, it was entitled to a fixed list of criminal procedural protections, including a jury trial. The bankruptcy court "refused" to provide PHH these protections. PHH Brief p.39. PHH's view of the law and the facts is erroneous.

Nonbankruptcy law sets out the basic standards that distinguish civil and criminal contempt. *International Union, United Mine Workers of America v. Bagwell,* 512 U.S. 821, 827-30 (1994); *Mackler Productions, Inc. v. Cohen,* 146 F.3d 126, 129 (2d Cir. 1998), subsequent decision, 225 F.3d 136 (2d Cir. 2000). However, as these decisions make clear, labeling sanctions as of one type or the other does not determine the procedural protections available to the particular contemnor in a given case. The union in *Bagwell* faced a $52 million fine. The Supreme Court noted that it had not defined the magnitude of a fine that entitled a contemnor to criminal procedural protections such as a jury trial, but that sanctions of this magnitude against the union met that substantiality threshold. 512 U.S. at 837-38 n.5. The defendant in *Mackler* was a 78-year old attorney with an "apparently unblemished record" before the incident in question and who faced a $2,000 penalty. 225 F.3d 136, 143. The two Second Circuit panels that considered the *Mackler* sanctions held that the procedural protections afforded the defendant had been insufficient. At the same time, neither court mandated a fixed list of procedural protections 146 F.3d at 130 n.3 (expressing no view on whether a jury trial was warranted); 225 F.3d at 142-43 n.3 (not addressing whether more modest punitive sanctions could be imposed without criminal procedural protections).

The bankruptcy court appropriately examined rulings that considered when contempt sanctions imposed on a large corporation become substantial enough to warrant particular criminal procedural protections. *In re Gravel,* 601 B.R. 873, 894-902 (Bankr. D. Vt. 2019). Based on that review, the upper level of sanctions in the total amounts of $175,000 imposed in the Gravel case, $100,000 in the Beaulieu case, and $25,000 in the Knisley case were not substantial enough to warrant criminal protections.

The bankruptcy court's sanctions were commensurate with those imposed in enforcement actions that faulted PHH's mortgage servicing. For example, in November 2016 as the culmination of a multi-year investigation of PHH's servicing practices the New York Department of Financial Services ("NYDFS") imposed $28 million in penalties on PHH.[13] The NYDFS found significant defects in PHH's technology systems and oversight of contractors. One error caused $1.2 million in fees and costs to be assessed improperly, causing substantial harm to borrowers already facing default. NYDFS Consent Decree pp.10-11.

In May 2018, PHH reached a settlement with 49 state attorneys general to conclude another long-standing investigation into its servicing practices.[14] PHH did not admit liability in the consent decree and agreed to pay $30.5 million to

---

[13] New York Dept. of Financial Services, *In the Matter of PHH Mortgage Corporation and PHH Home Loans LLC,* Consent Order Pursuant to New York Banking Law § 44, Nov. 9, 2016, available at https://www.dfs.ny.gov/system/files/documents/2020/04/ea161109_phh_mortgage_home_loans.pdf

[14] Joint Federal-State National Mortgage Servicing Settlements. http://www.nationalmortgagesettlement.com/

borrowers as well as abide by the terms of an order that required that it meet specific servicing standards, including in its handling of borrower payments in chapter 13 cases.[15]

Assuming for the sake of argument that the sanctions imposed were substantial enough to warrant criminal procedural protections, the appropriate protections were available to PHH. PHH cites to decisions holding that a party facing criminal contempt is entitled to a jury trial. A jury trial in the bankruptcy court is an option. 28 U.S.C. § 157(e). PHH never requested a jury trial.

PHH may have legitimate tactical reasons *not* to request a jury trial in this case. In certain individual cases jurors have reacted negatively to evidence of systemic misconduct by mortgage servicers and imposed substantial punitive awards. *See, e.g., Brash v. PHH Mortgage,* 2011 WL 1375218 (M.D. Ga. Mar. 21, 2011) (jury assessed $20 million punitive award against PHH in individual case for faulty mortgage servicing). Courts have had to reduce or vacate juries' substantial punitive awards against PHH and its current owner, Ocwen. *See Saccameno v. Ocwen Loan Servicing, LLC,* 372 F. Supp. 3d 609 (N.D. Ill. 2019) (upholding $3 million punitive jury verdict against Ocwen for deceptive servicing in individual case), *modified by* 943 F.3d 1071 (7th Cir. 2019) (reducing punitive award to

---

[15] Consent Judgment, State of Alabama, et al v. PHH Mortgage Corp., Exhibit A pp. A-18-20. https://www.nationalphhsettlement.com/ .

$582,000); *Linza v. PHH Mortg. Corp.,* 2017 WL 4769082 (Cal. Ct. App. Oct. 23, 2017) (vacating $15.7 million punitive jury award in individual case against PHH).

There were no factual disputes in the proceedings below. PHH submitted affidavits from one of its executive vice presidents admitting all essential acts in violation of Rule 3002.1 and the debtor current orders. JA 609, 625, 642. In its Brief, PHH agrees that the question of whether it violated court orders is a question of law. PHH Brief p.34 n.2. On appeal PHH does not refer to any material factual dispute for a jury to resolve. PHH's focus on claimed deprivations of criminal procedural protections, such as the beyond a reasonable doubt evidence standard and the presumption of innocence, simply do not apply given the lack of disputed facts in this case. *Isaacson v. Manty,* 721 F.3d 533, 541 (8th Cir. 2013) ("Given the essentially uncontroverted evidence of contempt, there likewise is no basis for concluding that any error seriously affected the fairness, integrity, or public reputation of [the] judicial proceedings.")

CONCLUSION

PHH's arguments involve claims of deprivation of procedural protections that were actually available to it in the bankruptcy court, that it chose not to request, or that were simply not relevant to the dispute. PHH's claims of harm ring distinctly of the "gamesmanship" that certain litigants have exhibited in strategically raising challenges to the constitutional powers of bankruptcy courts.

Wellness International Network, Ltd. v. Sharif, 135 S. Ct. 1932, 1948 (2015). This litigation conduct, like PHH's handling of borrower accounts in chapter 13, should not be rewarded. The judgment of the Bankruptcy Court should be affirmed.

Respectfully submitted,

s/ Tara Twomey

TARA TWOMEY, ESQ.
NATIONAL CONSUMER BANKRUPTCY RIGHTS CENTER
1501 The Alameda, Suite 200
San Jose, CA 95126
(831) 229-0256

CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing brief with the Clerk of the Court for the United States Court of Appeals for the Second Circuit by using the appellate CM/ECF system on August 11, 2020. All participants that are registered as CM/ECF users will receive service via appellate CM/ECF system.

s/ Tara Twomey

Tara Twomey
Attorney for Amici Curiae

CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Fed. R. App. P. 29(d) because this brief contains 6,982 words, excluding parts exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This filing complies with Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word in Century Schoolbook 12-point type.

s/ Tara Twomey

Tara Twomey
Attorney for Amici Curiae