

**Mortgages, Debt Buyers and PDI:  
Consumer Bankruptcy's Biggest  
Mysteries Unraveled**

Presented to the:  
**Utah Bankruptcy Lawyers Forum**  
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# **Disclaimer**

**This presentation is for informational purposes only and is not intended to present a legal opinion on any issues referred to or discussed.**

# Agenda

1. Sales of Unsecured Debt
2. Unsecured Proofs of Claim: The battle over documentation
3. Claims filed for out of statute debts
4. Credit reporting of discharged debts
5. Projected Disposable Income

# 1. Sales of Unsecured Debts

- The majority of sales are for credit card accounts
- Creditors sell delinquent accounts and/or bankrupt accounts
- Health care and utilities are emerging areas of debt that are offered for sale
- Account information included in sale varies by seller; typically, the contract between the Seller and Purchaser contains representations and warranties regarding ownership of the accounts and balances due
- Sales of Chapter 7 debt on the rise

# Types of Bankruptcy Sales

- **“Bulk” Sale:**
  - Purchaser buys an inventory of accounts for which the seller has already received a notice of bankruptcy and has filed Proofs of Claim. (In a bulk sale of Chapter 7 debts, claims may not have been filed)
- Purchaser files a “Transfer of Claim”

# Types of Bankruptcy Sales

- **“Forward Flow” Sale:**
  - Purchaser agrees to buy accounts at regular intervals (usually monthly) upon notification of bankruptcy or subsequent charge off by the seller
- Purchaser files a Proof of Claim as the “creditor”

# **Account Data Requested by**

## **Purchasers**

- Name(s) of all liable account holders
- Most recent mailing address
- Social Security Number(s)
- Dates account was opened/closed
- Historical account balance information
- Date of last payment
- Amount of last payment
- Bankruptcy case number and chapter
- Date of Proof of Claim filing and amount (bulk sales)
  
- Data furnished varies by Seller and is sometimes dependent on system capabilities.  
Mergers/acquisitions affect availability of data

# **Servicing of Unsecured Debts in Bankruptcy: “Bulk Sales”**

- Sale file of accounts delivered to Purchaser
- Purchaser:
  - Scrubs for data integrity and eligibility for sale
    - Excludes non-bankrupt or previously discharged debts
  - Reconciles discrepancies with seller, finalizes purchase of remaining accounts
  - Verifies claim filing (court claim number, trustee claim number) and creates a Transfer of Claim
  - Files claims for any accounts that do not already have a claim filed

# **Servicing of Unsecured Debts in Bankruptcy: “Forward Flow” Sales**

- **Variations:**
  - **Sale of accounts as soon as bankruptcy is filed**
    - Purchaser files claim in its own name “as assignee” of the original creditor
  - **Sale of accounts only after charge off**
    - POC deadline may approach before charge off
    - Prospective purchaser, as agent for the seller, will file claim in seller’s name
    - Seller and Purchaser reconcile any status changes, such as dismissals, and eligible accounts are sold
  - **When account charges off and is sold, Purchaser files a “Transfer of Claim”**

# Post Sale

- Purchaser provides ongoing account servicing:
  - Responds to Claim Objections
  - Responds to debtor/trustee inquiries
  - Responds to title companies, etc.
  
- Purchaser updates account statuses by posting payments, EBN's and other notices from the court, trustees and/or other parties

## 2. Proofs of Claim – Documentation

- The battle over allowance rages on
- Contests focus on account and assignment documentation
- Debt purchasers face additional difficulties

# The Basics:

## Account Documentation

### ■ **Bankruptcy Rule 3001(c):**

When a claim is based on a writing, the original, or a duplicate shall be filed with the proof of claim. If the writing has been destroyed, a statement of the circumstances of the loss or destruction shall be filed with the claim.

### ■ **Official Form 10 (Instructions):**

You must attach to this proof of claim form copies of documents that show the debtor owes the debt claimed or, if the documents are too lengthy, a summary of those documents.

### ■ **Official Form 10 (Box 3a.):** “Debtor may have scheduled debt as:”

# What's Required?

- No consensus among the courts
- Court's requirements range from minimal to extraordinary, including:
  - Application
  - Original contract
  - Contract updates
  - Account statements sufficient to show compilation of outstanding balance
  - Complete chain of title
  - Assignment of specific account

***In re Cluff*, 313 B.R. 323 (Bankr. D. Utah 2004), *aff'd sub nom. Cluff v. eCAST Settlement Corp.*, No. 2:04-CV-00978-TS, 2006 U.S. Dist. LEXIS 71904 (D. Utah Sept. 29, 2006)**

If a claim is not granted *prima facie* validity, a formal objection coupled with some evidence which tends to "meet, overcome, or at least equalize" the statements on the proof of claim is sufficient to rebut the claim. But it is not enough for a debtor to file a mere formal objection without more, because the allegations on the face of the proof of claim are more than a mere pleading: they are signed under penalty of up to \$500,000 or up to five years in prison. Additionally, the face of the proof of claim provides at least *some evidence* of a demand for payment from the estate and includes the creditor's name, the account number, and amount of the debt.

# **The Basics: Transferred Claims**

## **Bankruptcy Rule 3001(e):**

(e)(1): If a claim has been transferred ... before proof has been filed, the proof of claim may be filed only by the transferee.... (Forward Flow)

(e)(2): If a claim ... has been transferred ... after the proof of claim has been filed, evidence of the transfer shall be filed by the transferee. (Bulk)

## **Advisory Committee Notes to 1991 Amendments to Rule 3001(e)**

“Subdivision (e) is amended to limit the court’s role to the adjudication of disputes regarding transfers of claims. If a claim has been transferred prior to the filing of a proof of claim, there is no need to state the consideration for the transfer or to submit other evidence of the transfer. If a claim has been transferred after a proof of claim has been filed, the transferee is substituted for the transferor in the absence of a timely objection by the alleged transferor.”

# **Additional Issues Facing Debt Purchasers**

- Availability of documentation
- Legal requirements for document proponents
- Cooperation from seller

***In re Wingerter,***

**376 B.R. 221 (Bankr. N.D. Ohio 2007)**

Appeal dismissed by *In re Wingerter*, 2008 Bankr. LEXIS 2497  
(B.A.P. 6th Cir., Oct. 8, 2008)

*...this case poses the central question whether an industry that has grown up solely to operate within the bankruptcy system can expect courts to ignore procedural rules that were in place prior to the birth of the industry because compliance with those rules would not promote maximum efficiency for the claims trading industry.*

*That [the purchaser] admitted it did not have any original documents ... raised, from the Court's perspective, serious questions whether the advent of bulk claims purchased in consumer cases is accompanied by sufficient assurances that valid claims existed in the files of an originating creditor, or its assignee.*

*...when the purported originating creditor or one of its assignees is not listed on the debtor's schedules, should a claims purchaser be allowed to file its claim first and look for originating documents later?*

*In re Wingerter, 376 B.R. 221 (Bankr. N.D. Ohio 2007)*

***In re Andrews***  
**394 B.R. 384 (Bankr. E.D.N.C. 2008)**

*The court agrees with [the] observation that "[w]ith such imaginative and innocuous names, it is easy to underestimate the negative impact large-scale consumer debt buyers like B-Real, LLC and Roundup Funding are having on the bankruptcy court system."*

...

*The debtor argues further that the claims filing practices of bulk debt buyers undermines the Bankruptcy Code's and the Bankruptcy Rules' goal of promoting the efficient and economical administration of bankruptcy estates.*

# On The Other Hand ...

- Claims trading enhances the creditors' economic freedom
- Claims trading encourages creditors to extend credit to distressed debtors
- Claims purchasers are more patient participants in the bankruptcy process than are the original creditors
- Claims purchasers are competent professionals, unlike most ordinary creditors

From Brief of Amicus Curiae in *In re Wingerter*,  
394 B.R. 859 (B.A.P. 6th Cir. 2008)

# Proposed Rule Changes

3001(c)

(2) *Additional Statements Required.*

(A) If, in addition to its principal amount, a claim includes interest, fees, expenses or other charges incurred prior to the date of the petition, an itemized statement of the interest, fees, expenses, or charges shall be filed with the proof of claim.

## 3001(c)

(3) *Failure to Provide Supporting Information.* If the holder of a claim fails to provide the information required in subdivision (c) of this rule, the holder may not present that information, in any form, as evidence in any hearing or submission in any contested matter or adversary proceeding in the case, unless the failure was substantially justified or is harmless. In addition to or instead of this sanction, the court, after notice and hearing, may award other appropriate relief, including reasonable expenses and attorney's fees caused by the failure.

### **3. Out of Statute Debt**

- Out of statute debt
  - May a creditor file a claim?
  - Does a creditor violate non-bankruptcy law by filing a claim?
  - Is a claim subject to disallowance?
  - Burden of proof on a claim objection

# Proofs of Claim: Out of Statute Debt

...[T]hese claims are neither false nor fraudulent. The claims facially indicate the circumstances under which they were incurred; there is no attempt to obfuscate the timing of their incurrance so as to mask the potential bar of time. Most importantly, while collection of the claims is arguably time-barred, under Virginia law the debts continue to exist. The bar of the statute of limitations raised by the Varonas in their Claim Objections prevents enforcement of the claims, but the claims are not extinguished. As such, asserting the claims in the bankruptcy of the Varonas does not render the claims either "false" or "fraudulent," and the imposition of sanctions is not appropriate.

*In re Varona*, 2008 Bankr. LEXIS 1544 (Bankr. E. D. Va. 2008)

## ***In re Andrews***

Many courts have looked into this emerging issue and found that sanctions were not warranted for filing stale claims or for filing claims without the accompanying documentation required by Rule 3001(c) of the Federal Rules of Bankruptcy Procedure.

## **See also**

- *In re McGregor*, 2008 Bankr. LEXIS 3269 (Bankr. N.D. Miss. Dec. 7, 2008)
- *Simpson v. PRA Receivables Mgmt., LLC* (In re Simpson), 2008 Bankr. LEXIS 2457 (Bankr. N.D. Ala. Aug. 29, 2008)
- *Middlebrooks v. Interstate Credit Control, Inc.*, 391 B.R. 434 (D. Minn. 2008)
- *In re Pearce*, 2008 Bankr. LEXIS 3225 (Bankr. E.D. La. Oct. 1, 2008)
- *In re Andrews*, 394 B.R. 384 (Bankr. E.D.N.C. 2008)

# 4. Credit Reporting of Discharged Debt

## Truth vs. Consequences

When a debt is discharged:

- Is it accurate to continue to report a “charge off”?
- Is it accurate to report a balance due?
- Is a creditor required to report the “discharge”?
- Is a creditor required to report after the account is sold, if the buyer is not reporting updates?
- Is a creditor required to report the debt is sold?

# Discharge Injunction Not Violated

- Section 524 does not eliminate the debt, only the debtor's liability, thus the reporting must be coupled with some other overt act to collect to be actionable
- The mere act of reporting the status of an account with a balance due is not an "act to collect," violating the discharge injunction
- See e.g.
  - *Vogt vs. Dynamic Recovery Services (In re Vogt)*, 257 B.R. 65 (Bankr. D. Colo. 2000)
  - *Irby vs. Fashion Bug (In re Irby)*, 337 B.R. 293 (Bankr. N.D. Ohio 2005).
  - *Mahoney vs. Washington Mutual Inc. (In re Mahoney)*, 368 B.R. 579 (Bankr. W.D. Tx. 2007)

# Discharge Injunction May Be Violated

- *In re Jones*, 367 B.R. 564 (Bankr. E.D. Va. 2007)(nb. Court required debtor to prove that credit reporting was intended to coerce debtor to pay.)
- *Torres v. Chase Bank USA N.A.*, (*In re Torres*), 367 B.R. 478 (Bankr. S.D.N.Y. 2007)(nb. Intent to coerce payment inferred from creditors refusal to update its credit report post-discharge.)
- *Bruno vs. First USA Bank* (*In re Bruno*), 356 B.R. 89 (Bankr. W.D.N.Y. 2006)(n.b. There was no post-petition reporting.)

- Decisions both ways consistently focus on any creditor acts *in addition to* the credit reporting to determine if an intent to coerce exists.
- Motions to dismiss are denied based on a factual issue as to whether the creditor intended to coerce.

# 5. What is Projected Disposable Income?

- Does DI = PDI (Either is a “net” number)
  - Income:
    - Forward-looking vs. historical
  - Expenses:
    - Allowances vs. Allowances w/ Forward View vs. Forward View
- Considerations:
  - 22C
  - Schedule I
  - Schedule J
  - Something else?
- Official Form vs. Statute

# More PDI Mysteries

- Must expenses be “reasonably necessary” under section 1325?
- May a debtor claim the Local Standard ownership expense for a car (or house) owned outright?
- Is the IRM relevant?
- What are the limitations for expenses claimed under the IRM's “Other Necessary Expenses”?
- May a debtor claim expenses for items being surrendered?

# More Mysteries...

- Do “special circumstances” apply in Chapter 13?
- What is (or is not) a “special circumstance“?
- Step-ups
- Is §707(b)(2)(A)(iii) a *carte blanche* for luxuries or a only a method of calculation?
- IRS “Other Necessary Expenses”: what if production of income is to the negative?

# Slightly Less Mysterious

- Good Faith, both in filing petition and proposing plan
- Applicable commitment period
- Non-filing spouse's income/expenses
- Is income excluded from CMI also excluded if Schedule I is used?
- \$200 old car expense
- Determining household size

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