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## Developments and Ideas For the Practice of Consumer Law

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### Challenging Mortgage Servicer “Junk” Fees and Plan Payment Misapplication: Making Use of New Section 524(i)

A new and specific cause of action was created by the Code’s 2005 amendments. Under new § 524(i), a creditor’s willful failure to credit payments received under a confirmed plan in the manner required by the plan which causes material injury to the debtor constitutes a violation of the injunction of § 524(a). This provision applies unless confirmation of the plan is revoked, the plan is in default, or the creditor has not received the plan payments as required by the plan.

#### Distinguishing Features of Section 524(i) Claim

While § 524(i) may seem unremarkable at first blush, closer review reveals a potentially powerful remedy for responding to the pervasive problems with miscrediting payments made to cure a default under a chapter 13 plan.<sup>1</sup> These problems are generally caused by the inability of loan programs used by mortgage servicers to distinguish between and properly apply pre- and post-petition payments in accordance with the legal requirements of § 1322(b).<sup>2</sup>

One unique aspect of this new amendment is its placement in § 524. Although § 524(a) previously was limited to violations of the discharge order, § 524(i) is not limited to acts occurring after discharge. In fact, while the debtor must wait until the discharge has entered before pursuing a claim under § 524(i), it is the pre-discharge actions of the creditor

occurring during the chapter 13 case that provide the grounds for the discharge injunction violation.

Another key distinction of § 524(i) is that it establishes that there can be a discharge injunction violation even without an act to collect on a dischargeable debt. Prior to the enactment of § 524(i), servicers argued that since a long-term mortgage debt that is cured under § 1322(b)(5) is not subject to discharge, based on § 1328(a)(1), there could be no discharge violation for a post-discharge attempt to collect improper cure-related fees. Although arguably § 524(a) does apply in that situation, § 524(i) makes clear that there can be a discharge violation if material injury is caused by the servicer’s failure to credit payments under the plan, even though the underlying mortgage debt has not been discharged.

Section 524(i) also provides a response to decisions in which courts questioned whether they had the authority to remedy a creditor’s failure to credit payments properly. For example, it provides a remedy that the Eleventh Circuit found missing in *Telfair v. First Union Mortgage Corp.*,<sup>3</sup> when a chapter 13 debtor challenged a creditor’s application of plan payments to charges not contemplated by the plan. It also makes clear that a failure to properly credit plan payments that results in a post-discharge assertion that the debtor is in default is not simply a matter for state courts to resolve, but rather a critical issue that must be resolved by the bankruptcy court to ensure that the provisions and purposes of a plan are effectuated.

The willfulness requirement of § 524(i) should not be a significant obstacle for debtors. As in § 362(k)(1), willfulness should be interpreted to mean simply that the creditor intended to commit the act, that is, credit the payment in the manner it did. The debtor should not need to prove that the creditor intended to violate the Code or the plan provisions.<sup>4</sup> Absent a creditor’s proof that the improper crediting was a mistake in conflict with the creditor’s normal procedures, the creditor should be presumed to have intended its acts.

The material injury requirement will be met in virtually every case involving a secured creditor. The failure to properly credit payments will almost always result in a higher pay-off balance for the debtor and therefore a larger lien on the debtor’s property than if the payments were credited properly. A creditor that has collected the payments made by the debtor under the plan and credited them in a manner leading to improper charges and a higher balance remaining on a debt has caused a material injury to the debtor. Similarly, a creditor who has reported negative information on the debtor’s credit report about nonpayment or collection efforts with respect to fees resulting from the improper crediting of payments has caused a material injury to the debtor.

<sup>1</sup> See NCLC, *Consumer Bankruptcy Law and Practice* § 13.4.3.4 (8th ed. 2006). See also *In re Wines*, 239 B.R. 703 (Bankr. D.N.J. 1999) (example of case reconciling payments made and proof of claim); *In re Turner*, 221 B.R. 920 (Bankr. M.D. Fla. 1998) (attorneys fees and costs awarded for contempt based on accounting on secured debt inconsistent with completion of confirmed plan); *In re McCormack*, 203 B.R. 521 (Bankr. D.N.H. 1996) (mortgagee bank held liable for \$10,000 punitive damages when it did not adjust its computer records to reflect effect of plan confirmation and sent debtor demand letter expressing intent to collect fees that were not due under plan).

<sup>2</sup> Although the decision in *Nosek v. Ameriquist Mortgage Co.*, 2006 WL 1867096 (Bankr. D. Mass. 2006) awarding debtor \$250,000 damages for servicer’s breach of good faith and fair dealing in inadequately applying, tracking, and crediting payments made by the debtor was reversed on appeal, it provides a detailed review of the payment application problems of loan servicing programs.

<sup>3</sup> 216 F.3d 1333 (11th Cir. 2000).

<sup>4</sup> See NCLC, *Consumer Bankruptcy Law and Practice* § 9.6 (8th ed. 2006).

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