Business Litigation Update

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Bankruptcy Court Holds That Filing a False Rule 3002.1 Notice is an Abuse of Process Under the Bankruptcy Code and Violates FDCPA

Key Notes:

- The U.S. Bankruptcy Court for the Southern District of Texas issued a decision in *In re Trevino*, to consider whether the owner and servicer of a home mortgage loan abused judicial process and violated FDCPA by filing and then failing to correct an erroneous Rule 3002.1 Notice.
- The Court applied its broad discretion under Rule 105(a) of the Bankruptcy Code and held that by failing to withdraw the erroneous 3002.1 Notice, the owner and servicer committed an abuse of process.
- The Court also held that the 3002.1 Notice was false and threatened to take action that could not legally be taken by seeking reimbursement of taxes no longer owing in violation of the FDCPA.
- Owners and servicers of loans should ensure the accuracy of what they file and review what was filed by prior owners and servicers when acquiring mortgage loans that are involved in ongoing bankruptcy proceedings.

The Bankruptcy Court for the Southern District of Texas recently issued a decision in *In re Trevino*, 2020 Bankr. LEXIS 268 (Bankr. S.D. Tex. Jan. 31, 2020) holding that the owner and servicer of a mortgage loan abused the judicial process and that the servicer violated the Fair Debt Collection Practices Act ("FDCPA") by filing to withdraw a false Rule 3002.1 Notice (which is intended to update a debtor of outstanding amounts throughout a bankruptcy) that was filed by a prior servicer. As a result of the Court's ruling, it is imperative that mortgagees and loan servicers conduct reasonable due diligence and ensure information submitted to a court (whether directly or by prior owners or servicers) via a Rule 3002.1 Notice is accurate.

Facts

Jose Trevino executed a promissory note, and he and his wife ("the Trevinos") executed a deed of trust (collectively with the promissory note, "the Loan") in connection with the purchase of a home.

In 2010, the Trevinos filed a chapter 13 petition seeking relief under title 11 of the United States Code. The Trevinos' bankruptcy plan ("Plan") did not provide for payment of certain pre- and post-petition taxes ("Taxes").

After the owner of the Loan and the bankruptcy trustee both paid the Taxes, the taxing authorities issued a refund to the owner. Despite receiving the refund, owner filed a Rule 3002.1 Notice seeking payment of the Taxes from the Trevinos. After receiving the Rule 3002.1 Notice, the Trustee sought dismissal of the Trevinos' bankruptcy because the Plan would not be financially feasible if the Taxes were included.

In 2013, both ownership and servicing rights for the Loan were transferred. The Trevinos subsequently filed suit against the new owner and servicer (collectively, "Defendants"). Among other things, the Trevinos alleged that Defendants abused the judicial process in failing to amend or withdraw the Rule 3002.1 Notice and that the servicer also violated various sections of the FDCPA. The Court found merit in the Trevinos' claims.

11 U.S.C. § 105(a) of the Bankruptcy Code, gives bankruptcy courts broad authority to issue orders or judgments necessary to carry out the provisions of the Bankruptcy Code or to prevent an abuse of process. The *Trevino* Court used this provision to sanction, holding that the failure to modify or withdraw the Rule 3002.1 Notice jeopardized the Trevinos' ability to obtain a "fresh start" and frustrated their ability to obtain relief. The Court noted that Rule 3002.1 Notices are filed under penalty of perjury and found that, had Defendants conducted due diligence, they would have recognized the error and modified or withdrawn the Rule 3002.1 Notice. The Court reasoned: "Defendants' actions, or lack thereof, taken together, constituted a maneuver which undermined the integrity of the bankruptcy system, disrupted the bankruptcy process, and were a deliberate abuse of the judicial process."

The Court also found that filing a Rule 3002.1 Notice is an attempt to collect a debt that can be subject to the FDCPA. The Court then held that the Rule 3002.1 Notice at issue was "unequivocally false" on its face because it sought reimbursement for the Taxes that were not owed. The Court also held that the Rule 3002.1 Notice threatened to take action that could not legally be taken in violation of the FDCPA. The Court ultimately awarded the Trevinos $9,000 in punitive damages, $1,000 for statutory damages, and reasonable attorneys' fees.

Conclusion

Although couched by many as an FDCPA decision, *Trevino* presents issues beyond the FDCPA. The Supreme Court's current interpretation of the definition of a "debt collector" shields many mortgagees and servicers from the FDCPA's provisions, but those principles will not shield creditors or their servicers from sanctions under 11 U.S.C. § 105(a). Mortgagees and loan servicers must conduct due diligence before filing Rule 3002.1 Notices. Additionally, that duty extends to mortgagees or servicers that inherit accounts in bankruptcy. Such filings are submitted under penalty of perjury and any discrepancy may subject the filer (or, in this instance, the filer's successor) to actual, statutory, and/or punitive damages.

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