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When Is It "Safe" to Collect Foreclosure or Bankruptcy-Related Fees?

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The collection of foreclosure and bankruptcy-related fees in Chapter 13 bankruptcy cases has been the cause of much grief for mortgage servicers of late. Learning how to do it right on the front end of a bankruptcy is the remedy. Unfortunately, the law varies to a wide degree depending upon the state where the borrower resides. This leaves mortgage lenders and servicers with little ability to streamline activities on a nationwide basis.

Almost every mortgage agreement gives the lender the right to collect fees that it incurs to protect its rights in the property as well as the value of the property. This right typically covers fees for property inspections, broker's price opinions, foreclosures and bankruptcy. These fees may be incurred by a lender at various points after a borrower has defaulted and even after the borrower has declared bankruptcy.

Because the rights and obligations of a lender and borrower are governed by the terms of the mortgage agreement, it is never "safe" for a lender or servicer to collect fees arising out of foreclosure or bankruptcy unless the mortgage agreement authorizes that activity. As indicated above, most mortgage agreements allow lenders the ability to collect foreclosure and bankruptcy-related fees, but that right should be confirmed by the lender. In addition, state law must allow the lender (or mortgage servicer) to collect fees arising out of foreclosure efforts and bankruptcy.

Bankruptcy law comes into play when the borrower files a bankruptcy petition. Once the borrower files a bankruptcy petition, any pending foreclosure or collection efforts must stop. Thereafter, the manner by which a lender may collect foreclosure or bankruptcy-related fees will depend upon applicable provisions of the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure.

The Bankruptcy Code prevents bankruptcy plans from modifying a mortgage lender's rights under the mortgage agreement, subject to the debtor's ability to satisfy a mortgage arrearage through the plan. The Code and Rules nevertheless impose certain requirements upon a mortgage lender relating to collection of costs and fees. The anti-modification provisions of the Bankruptcy Code will be of little help to a lender who does not follow the bankruptcy court's rules.

If the lender intends to collect foreclosure or bankruptcy-related fees from a Chapter 13 debtor, the lender may include the fees incurred in its Proof of Claim. If allowed, the fees will be included in the debtor's bankruptcy plan as part of the lender's secured claim and will be collected through the plan. In the event the lender misses the opportunity to include fees in its Proof of Claim, a minority of bankruptcy courts require the lender to file an application demonstrating the reasonableness of the fees and seek the bankruptcy court's approval before collecting them.[1] Thus, to be "safe," the lender should file an application with the bankruptcy court to have the fees approved. This most often occurs in cases where the debtor falls behind on payments, and the lender files a motion for relief from the bankruptcy stay and seeks the court's permission to foreclose. The court, in many cases, may deny the motion for relief, but will allow the lender to add its attorney fees to the arrearage the debtor must pay during the course of the Chapter 13 case. In all cases, when a lender claims fees in the bankruptcy court, the lender must fully disclose the fees it is claiming. Inadequate disclosure, by itself, can result in sanctions.

Lenders often record fees incurred in connection with a borrower's default or bankruptcy for book-keeping purposes, regardless of whether the lenders intend to collect the fees. Most courts find that completely internal record-keeping measures do not require disclosure or approval of fees,[2] although in at least one jurisdiction, simply recording the fees without approval may be actionable.[3]

From time to time, a Chapter 13 debtor's bankruptcy case may be dismissed. Generally speaking, after dismissal, bankruptcy law no longer applies to the rights of the lender and borrower regarding the collection of fees. Thus, collection of bankruptcy or foreclosure-related fees after dismissal of the bankruptcy case should be controlled only by the terms of the mortgage agreement and state law. The bankruptcy courts, however, retain jurisdiction to enforce their own orders even after dismissal. It is therefore unclear whether lenders may "safely" collect foreclosure or bankruptcy-related fees when a Chapter 13 debtor's case is dismissed if the bankruptcy court has not approved the fees previously.

The most critical stage of a bankruptcy case occurs when the debtor receives a Chapter 13 discharge. Here, a lender is actually enjoined from collecting fees that have been discharged. At discharge, a lender is well-advised to audit the borrower's account and to remove all attorneys' fees that have not been disclosed and approved. Otherwise, attempts to collect the fees may subject the lender to sanctions for violation of the discharge injunction.

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1. Compare *In re Padilla*, 379 B.R. 643, 655, 662, 664, 668 (S.D. Tex. 2007) with *In re Padilla*, 389 B.R. 409, 435 (Bankr. E.D. Pa. 2008) (citing cases).

2. Mann v. Chase Manhattan Mortgage Corp., 316 F.3d 1, 3 (1st Cir. 2003); *In re Padilla*, 379 B.R. 643, 655, 662, 664, 668 (S.D. Tex. 2007)

3. See, e.g., In re Sheffield, 281 B.R. 24, 32 (S.D. Ala. 2000) (finding that class representative had standing to seek an injunction removing charges recorded for possible future collection).