Legal Tips *for* Servicers

BY DAVID E. WORSLEY

Headlines are filled with daunting news concerning the mortgage lending industry. Default rates are rising. Interest rates on adjustable-rate mortgages (ARMs) are being recalculated. Some borrowers are unable to make their new higher monthly payments. Interest-rate freezes and loan-relief legislation are under consideration for certain loans. ● Some mortgage lenders have declared bankruptcy, while others have eliminated jobs in order to reduce costs. As mortgage lenders go out of business, mortgage loan servicing is being transferred to new servicers. ● It is to be expected that loan servicers (whether lenders servicing their own loans or subservicers engaged by a lender to service its loans) will face increased workloads and many challenges, such as sending numerous collection letters, filing an increased number of foreclosure actions and responding to more borrower inquiries. ● As servicing is transferred from one servicer to another, servicers will need to ensure that borrower information is correctly recorded

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Case law holds some important lessons for mortgage servicers. A brief review of some decided cases could help servicers avoid unwanted liability.

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on their systems and that borrower payments are posted correctly. In addition, as more mortgages are refinanced, servicers will need to have procedures in place in order to release borrowers' old mortgages within the time period required by law.

This article addresses loan servicing legal issues, and is based on decided court cases. The lessons to be learned from these cases should not be ignored; otherwise, liability may follow.

Subjective response

Under the Real Estate Settlement Procedures Act (RESPA), a mortgage servicer has an obligation to respond to a borrower's qualified written request. Issues concerning qualified written requests were litigated in *Holland v. GMAC Mortg. Corp.,* 2006 WL 1133224 (D. Kan. 2006). There, a lender made a mortgage loan to Bryan Holland in February 2001 and, less than one month later, sent notice to Holland that GMAC Mortgage Corporation would subservice the loan. GMAC also sent Holland a servicing transfer notice.

Holland noticed that his first payment had not been credited, and called GMAC on April 23, 2001. A GMAC representative offered to investigate if given front and back copies of the incorrectly posted check, which Holland claimed he sent and GMAC denied it received. GMAC consistently reported Holland past due to credit-reporting agencies (CRAs) from July 2001 through September 2003.

On March 4, 2003, Holland wrote to GMAC stating that he had made timely payments and describing the effect of not posting the first payment and the corresponding late fees. In addition, Holland's March 4, 2003, letter addressed other issues, including his belief that 1) all of his payments had been timely received by GMAC; 2) GMAC was not posting his checks in a timely manner; 3) his overpayment should be applied toward principal; 4) GMAC was not sending his statements on time; 5) the amount requested by GMAC did not match the amount Holland believed he paid; 6) he did not owe any of the fees for late penalties; 7) he did not understand some of the fees charged to him; and 8) he was bothered by what he considered GMAC's harassment and threats of foreclosure.

GMAC responded to Holland's letter on April 16, 2003. Subsequently, Holland hired an attorney, who wrote to GMAC on July 14, 2003, about Holland's account. GMAC replied that it could not research the issue any further without receiving copies of the missing cancelled checks. On or about Sept. 16, 2003, Holland's attorney sent GMAC another letter.

On Oct. 3, 2003, GMAC credited Holland's account and reversed all late fees. On Oct. 23, GMAC asked the CRAs to amend Holland's credit file to reflect that he was current and had never been delinquent.

Holland filed suit against GMAC and alleged various causes of action, including violations of RESPA. One of the alleged RESPA violations involved GMAC's response to Holland's March 4, 2003, qualified written request.

GMAC's response to Holland's March 4, 2003, letter was based on the belief that the letter expressed confusion over GMAC's calculation of Holland's escrow account. However, the court found that no reasonable person could have concluded that Holland's three-page letter and accompanying two-page spreadsheet were limited to an inquiry about his escrow account.

The court noted that Holland had clearly outlined the problem and ruled in favor of Holland, concluding that GMAC's April 16, 2003, response did not address Holland's primary inquiries and did not indicate that GMAC had conducted an investigation into Holland's inquiries.

What lesson can be learned from the *Holland* case?

When a servicer receives a large number of qualified written requests, it may be tempting to try to deal with them quickly. However, as *Holland* demonstrates, a servicer responding on the basis of what it presumes the borrower is asking may face liability under RESPA.

When responding to a qualified written request, a servicer should conduct an investigation and respond to each of the borrower's inquiries, indicating in the response to the borrower that those steps were taken. A servicer's response should not be based on what he or she "thought" the borrower was asking. The court in *Holland* noted that it could find no authority supporting the proposition that a servicer's subjective belief was an appropriate standard to apply in adjudicating Holland's claim.

Inadequate evidence

In *James v. New Century Mortgage Corp.,* 2006 WL 2989242 (E.D. La.), Josephine James claimed that she sent her servicer a qualified written request for an accounting of her mortgage payments and that the servicer failed to provide a timely response. The servicer moved for summary judgment on the grounds that it had not received James' letter.

The letter had been addressed to the wrong office suite number, and James produced no evidence showing that the servicer had received the letter. The servicer relied on the affidavit of its assistant vice president, who stated that he had reviewed the company's records and found that

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the servicer had not received James' letter.

The court denied the servicer's motion for summary judgment, holding that such a minor error in the address did not negate the presumption of delivery; the affidavit was insufficient to negate the presumption of delivery and to demonstrate the absence of any material fact; and the assistant vice president did not profess to have personal knowledge of the company's mailroom procedures, which would have provided insight into what may have happened to the incorrectly addressed letter.

What lesson can be learned from the *James* case?

If a servicer is going to rely on the nonreceipt of a qualified written request as a defense to a RESPA claim, and to move for summary judgment on the basis of an affidavit, the servicer will need an affidavit executed by an employee with personal knowledge of the company's mailroom procedures. Such a person would need to be able to explain those procedures and provide insight into what might have happened to the qualified written request. An affidavit signed by company brass without the requisite personal knowledge will not provide an adequate defense.

Lender as a debt collector

As defaults increase, it may be tempting to engage an attorney to send collection letters *en masse.* After all, a letter from an attorney sends a strong message to a borrower. However, such a course of action can be risky, both for the attorney and the lender.

In *Nielsen v. Dickerson,* 307 F.3d 623 (7th Cir. 2002), Ann Nielsen filed a class action against Household Bank and an attorney (David Dickerson) who had sent Nielsen a collection letter on behalf of Household Bank. After certifying a class of all Illinois residents who had received collection letters from Dickerson's firm, the district court granted summary judgment in favor of the plaintiffs. Household Bank and Dickerson appealed, and the Seventh Circuit affirmed the district court's ruling.

Dickerson was an experienced debt collector who had been engaged by Household Bank to send collection letters to delinquent debtors. Household Bank approved the initial form of Dickerson's letter and reserved the right to approve any changes to it. When the bank engaged Dickerson, he agreed to exercise due diligence and to provide legal services consistent with applicable laws, including the Fair Debt Collection Practices Act (FDCPA).

Household Bank sent Dickerson computer disks that included each debtor's account number, name, address, account balance and amount past due. Dickerson's firm put this information on its computer system and performed a three-level review. An attorney conducted the final level of the review, and sometimes one of the first two levels. Dickerson himself briefly reviewed nearly all of the printouts of the pertinent data.

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After completing the three-level review, Household Bank was informed of those debtors who would receive a collection letter and those who would not, so that the bank could make any necessary corrections. Then Dickerson's firm sent the data to a business that printed and mailed the letters on firm letterhead with a facsimile of Dickerson's signature.

The firm's review was confined to the information supplied by Household Bank, which did not give Dickerson a copy of a debtor's file, and Dickerson did not have access to the bank's account system. Dickerson relied on the bank's judgment as to the validity and delinquency of the debt. Dickerson did not request additional information from the bank before having the collection letters mailed.

The firm received written responses and calls from debtors; however, Dickerson had no authority to resolve matters for Household Bank and did not attempt to do so. The appeal in *Nielsen* involved several issues, some of which are discussed here.

The FDCPA prohibits a debt collector from using any false, deceptive or misleading representations or means in connection with the collection of any debt. The FDCPA identifies 16 nonexclusive instances of conduct that would constitute a violation of this prohibition, including a false representation or implication that a communication is from an attorney, and the use of any false representation or deceptive means to collect or attempt to collect any debt or to obtain information concerning a consumer.

The FDCPA defines a "debt collector" as a person who endeavors to collect debts owed to others. As a result, creditors (as defined in the FDCPA, but in this article referred to as lenders) that attempt to collect their own debts are not generally considered to be debt collectors under the FDCPA. Nevertheless, there is a "false name" exception, under which a lender will be a debt collector if, in the process of collecting its own debts, the lender uses any name other than its own that would indicate a third person was collecting or attempting to collect such debts.

According to the Seventh Circuit, Dickerson was liable under the FDCPA for the misleading nature of the letters he sent to class members, because those letters were not truly "from" him. Dickerson neither made a considered, professional judgment that Nielsen or any other class

member was delinquent on his or her debt and was a candidate for legal action, nor meaningfully involved himself in the decision to send the collection letter to any individual debtor.

What about Household Bank? After all, it had not sent the letters. Nevertheless, the Seventh Circuit concluded that the bank was a debt collector for purposes of liability under the FDCPA.

The bank was the true source of Dickerson's letter. It was the bank that selected debtors for receipt of Dickerson's letter; supplied the information Dickerson required (and only such information as he required) to complete the letter; had the final say over the recipient list; handled the responses to Dickerson's letters; and took legal action as necessary to enforce the debt.

Because Household Bank issued letters under Dickerson's name, giving debtors the false impression that a third party (Dickerson) was involved in collecting the debt, the bank became a debt collector under the FDCPA and shared Dickerson's liability for the violations of the FDCPA.

What lesson can be learned from the *Nielsen* case?

An attorney sending collection letters must be directly and genuinely involved in the mailing of collection letters in order to comply with the FDCPA, or risk violating the FDCPA's prohibition against "the use of any false representation or deceptive means to collect or attempt to collect any debt."

The point is not that a form letter rules out the possibility of an attorney's genuine involvement in the collection of a debt. Rather, a large number of collection letters prepared in assembly-line fashion demonstrates the purely nominal nature of a lawyer's participation in the collection process. The fact that a lawyer wrote the form collection letter does nothing to prove the lawyer's professional involvement in the debtor's file.

In addition, when a lender engages a lawyer to prepare collection letters *en masse* and the lender's lawyer is not genuinely involved in the effort to collect the lender's debts, the lender runs the risk that a court will conclude the letter is not from the lawyer and that the lender should be treated as a debt collector for purposes of liability under the FDCPA.

Failure to release lien

In *Exparte Rowan* 774 So. 2d 530 (Ala. 2005), the plaintiffs filed a class-action lawsuit against GE Capital Mortgage Services Inc., seeking to recover statutory penalties under Alabama law for GE Capital's alleged failure to record a satisfaction of their mortgage within 30 days after receiving full payment.

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The trial court disallowed statewide discovery for purposes of class certification, because the judge reasoned that the court could hear only claims related to mortgages filed in the county where the court was located. The plaintiffs petitioned the Supreme Court of Alabama for a *writ of mandamus* directing the trial court judge to vacate that order. However, the Alabama Supreme Court held the trial court properly limited discovery to the county where the plaintiffs' mortgage was recorded, ruling that claims for the statutory penalty for failure to record the satisfaction of mortgages recorded in different counties may not be joined in one civil action.

What lesson can be learned from the *Exparte Rowan* case?

If releases are not filed in a timely manner, liability may result. GE Capital was very fortunate that the Alabama statute did not allow statewide class actions to be filed when a servicer fails to record a mortgage release.

Failure to release a lien within the time period required by law can result in litigation and the imposition of penalties. Servicers need to have a system in place that not only informs them of the time period in which the mortgage release needs to be filed, but flags borrower files so that the release can be prepared in a timely manner for each borrower.

Conclusion

Complications can and do arise when loans are being serviced, especially in today's environment. For example, servicing is complicated by the sheer number of loans, which may result in some borrowers becoming disgruntled by servicers mishandling problems. This and complex loan servicing regulatory requirements may create opportunities for aggressive consumers and their litigation counsel. As always, the loan servicing area can be expected to produce complex compliance challenges and novel legal theories. Loan servicers and their counsel should closely monitor developments in the loan servicing area in order to minimize the possibility of liability. **MB**

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