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BIG BANKS & SMALL CONSEQUENCES IN CHAPTER 13

Alexandra P. E. Sickler[*]

ABSTRACT

Mortgage creditors struggle to properly service mortgages in chapter 13 cases, as evidenced by numerous cases describing violations of Bankruptcy Rule 3002.1. The consumer bankruptcy system, however, is not calibrated to compel systemwide compliance from these large, institutional repeat actors. This Essay argues that the Consumer Financial Protection Bureau (CFPB) is well-suited to support the consumer bankruptcy system by exercising its monitoring and enforcement powers to promote, and even compel, mortgage creditor compliance in chapter 13 cases.

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INTRODUCTION

Obtaining a chapter 13 discharge is an arduous endeavor. The debtor must adhere to a multi-year payment plan *and* a strict budget that often leaves little to no margin for unexpected expenses. Once the debtor has completed plan payments and cured mortgage arrears, they exit bankruptcy with their discharge. But mortgage creditors often assess fees and costs to the debtors' accounts or change their payment amounts during the case without notifying them.[1] Even if these assessments or changes are lawful, the amounts tied to them may remain hidden to the debtor and the trustee until after the case has closed. Unpaid amounts, as bankruptcy professionals know, lead to defaults. As a result, soon after obtaining their discharge, the debtor may face a new foreclosure proceeding due to the undisclosed—and unpaid—amounts.[2] While administering chapter 13 cases during the mortgage crisis fallout, bankruptcy courts discovered that mortgage creditors engaged in such practices.[3]

In 2011, the Federal Advisory Committee for Bankruptcy Rules tried to address this specific problem by promulgating Bankruptcy Rule 3002.1.[4] This Rule is designed to prevent such "gotcha" fees and charges by imposing post-petition, pre-discharge noticing requirements on mortgage creditors.[5] To ensure compliance, the Rule provides an array of sanctions. The court may preclude the mortgage creditor from presenting the undisclosed information and award "other appropriate relief, including reasonable expenses and attorney's fees."[6] But mortgage creditors have struggled to comply with the rule, generating litigation that reveals systemic compliance problems persist in chapter 13 cases.[7] The more things change, the more they stay the same.

1 *See, e.g.*, Blanco v. Bayview Loan Servicing, LLC (*In re* Blanco), 633 B.R. 714 (Bankr. S.D. Tex. 2021).

2 *See In re* Roper, 621 B.R. 899, 902 (Bankr. D. Colo. 2020) ("The rule does not allow the secured creditor to silently accrue additional amounts and then spring a 'gotcha' foreclosure after the debtor has completed her plan and emerged from bankruptcy protection.").

3 *See In re* Blanco, 633 B.R. 714.

4 *See* FED. R. BANKR. P. 3002.1(a) ("This rule applies in a chapter 13 case to claims (1) that are secured by a security interest in the debtor's principal residence, and (2) for which the plan provides that either the trustee or the debtor will make contractual installment payments.").

5 *In re* Roper, 621 B.R. at 902; *see also In re* Vega, No. 16-08722, 2019 WL 927006, at *2 (Bankr. D.P.R. Feb. 21, 2019) (noting that the rule was implemented to prevent "unexpected deficiencies" in residential mortgage payments when a chapter 13 case is completed and closed); *In re* Rivera, 599 B.R. 335, 343 (Bankr. D. Ariz. 2019) (observing that post-discharge claims where such deficiencies existed had been a persistent problem in chapter 13 cases prior to promulgation of the rule).

6 FED. R. BANKR. P. 3002.1(i).

7 *See, e.g.*, PHH Mortg. Corp. v. Sensenich (*In re* Gravel) (*Gravel II*), 6 F.4th 503, 509 (2d Cir. 2021); Neria v. Wells Fargo Bank (*In re* Neria), No. 14-32911, 2022 WL 17254478, at *2, *27–28 (Bankr. N.D. Tex.

One bankruptcy court, fed up with repeated violations of Rule 3002.1 across multiple consumer bankruptcy cases, held that punitive damages were appropriate.[8] In *In re Gravel* (*Gravel I)*, the chapter 13 trustee moved for sanctions against a mortgage creditor for Rule 3002.1 violations in three separate cases.[9] The bankruptcy court granted the motions, ordering the mortgagee to pay $75,000 in punitive damages for the Rule 3002.1 violations and an additional $300,000 for violations of the court's orders pursuant to its section 105 powers.[10] Consumer bankruptcy professionals monitored *Gravel I* for several years to see if appellate courts would uphold the sanctions order. In 2021, the Second Circuit ruled that Rule 3002.1 does not authorize punitive damages.[11] Other courts have disagreed, concluding not only that courts may award punitive damages to remedy violations of Rule 3002.1, but also that more limited sanctions would not deter systemic violations.[12]

The obvious tension point is disagreement about whether the language of Rule 3002.1 authorizes courts to order punitive monetary sanctions—a discrete interpretative issue.[13] But the divide connects more broadly with ongoing challenges to regulate systemic noncompliance in consumer bankruptcy cases. The challenges are multidimensional, arising out of the highly automated nature of modern mortgage servicing and the diffuse, case-by-case, court-centered model of bankruptcy regulation.

Legal scholarship, including mine, extensively documents these challenges, drawing on judicial decisions that expose flaws in the bankruptcy system's ability to deter systemic noncompliance.[14] The scholarship proposes solutions

Nov. 28, 2022) (declining to order additional remedies beyond reasonable costs and attorney's fees under Rule 3002.1(i)'s "other appropriate relief" grounds because punitive damages were not warranted); *In re* Blanco, 633 B.R. at 754–55 (holding that punitive monetary sanctions are recoverable for Rule 3002.1 violations).

8 *See* PHH Mortg. Corp. v. Sensenich (*In re* Gravel) (*Gravel I*), 601 B.R. 873 (Bankr. D. Vt. 2019), *vacated*, 6 F.4th 503 (2d Cir. 2021).

9 *See id.* at 904.

10 *See id.* at 879 n.2.

11 *Gravel II*, 6 F.4th at 509.

12 *In re* Blanco, 633 B.R. at 753 ("Costs and attorney's fees alone may be an insufficient deterrent because the fees and charges that violate Rule 3002.1 may either go unnoticed by the debtor or the debtor will find it easier to pay the small fees rather than litigate them. This permits Rule violators to escape sanction altogether. It is precisely because many of the fees that violate Rule 3002.1 are small that punitive damages should be levied in the appropriate case.").

13 *Compare Gravel II*, 6 F.4th at 509, *with In re* Blanco, 633 B.R. 714.

14 *See, e.g.*, Alexandra P. E. Sickler & Kara J. Bruce, *Bankruptcy's Adjunct Regulator*, 72 FLA. L. REV. 159 (2020) [hereinafter Sickler & Bruce, *Bankruptcy's Adjunct Regulator*].

such as amplifying private rights of action for consumers in bankruptcy,[15] shifting bankruptcy policymaking from the judiciary to an administrative agency,[16] and capitalizing on natural synergies with the Consumer Financial Protection Bureau's (CFPB) work to support the consumer bankruptcy system.[17]

This Essay builds on my previous research, which has made the case that the CFPB is well suited to address systemic noncompliance in consumer bankruptcy cases. First, in *Bankruptcy's Adjunct Regulator*, my coauthor and I identified defects in consumer bankruptcy's institutional design that allow noncompliance to persist and proposed a framework for how the CFPB could collaborate with bankruptcy's existing regulators to better address these consumer bankruptcy violations.[18] More recently, we examined Congress's proposal to carve out a regulatory role for the CFPB in the consumer bankruptcy system.[19]

Recent consumer bankruptcy reform legislation embraces our proposed approach. The Consumer Bankruptcy Reform Act of 2022 ("CBRA") creates a regulatory role for the CFPB in bankruptcy in two ways. First, the CBRA proposes establishing a "Consumer Bankruptcy Ombuds" at the CFPB.[20] This Ombuds would perform high-level data analysis and reporting, make policy recommendations, and resolve informal disputes between individual debtors and creditors.[21] Second, the CBRA would give the CFPB supervisory and enforcement authority—but not rulemaking authority—over the Bankruptcy Code.[22]

This Essay isolates the special case of mortgage creditor noncompliance in consumer bankruptcy cases—especially chapter 13 cases—to underscore the need for a more comprehensive, less diffuse regulator for the consumer

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15 *See, e.g.*, Kara J. Bruce, *Closing Consumer Bankruptcy's Enforcement Gap*, 69 BAYLOR L. REV. 479 (2017) [hereinafter Bruce, *Closing Consumer Bankruptcy's Enforcement Gap*]; Kara J. Bruce, *The Debtor Class*, 88 TUL. L. REV. 21 (2013) [hereinafter Bruce, *The Debtor Class*]; Kara J. Bruce, *Vindicating Bankruptcy Rights*, 75 MD. L. REV. 443 (2016) [hereinafter Bruce, *Vindicating Bankruptcy Rights*]; William Whitford, *The Ideal of Individualized Justice*, 68 AM. BANKR. L.J. 397 (1994).

16 *See* Rafael I. Pardo & Kathryn A. Watts, *The Structural Exceptionalism of Bankruptcy Administration*, 60 UCLA L. REV. 384, 386 (2012) (arguing that bankruptcy policymaking should be shifted from the judiciary to administrative agency with rulemaking powers).

17 *See* Sickler & Bruce, *Bankruptcy's Adjunct Regulator*, *supra* note 14, at 205.

18 *See id.* at 159.

19 *See* Kara J. Bruce & Alexandra P. E. Sickler, *The CFPB Enters Consumer Bankruptcy*, BANKR. L. LETTER, Oct. 2021, at 1 [hereinafter Bruce & Sickler, *The CFPB Enters Consumer Bankruptcy*].

20 Consumer Bankruptcy Reform Act of 2022, S. 4980, § 201(a), 117th Cong. (2022).

21 *Id.*

22 *Id.* § 201(d)(2).

bankruptcy system. This Essay proceeds as follows: Section I demonstrates that the consumer bankruptcy system isn't calibrated to combat systemic mortgage creditor noncompliance. Drawing on *Bankruptcy's Adjunct Regulator*, I briefly highlight the institutional design flaws of consumer bankruptcy's court-centered, litigation-based model of regulation, which explains why widespread violations persist. Section II explores how some bankruptcy courts have tried to creatively address systemwide noncompliance by ordering remedies that have effects beyond the boundaries of an individual case. Here I use well-known cases to illustrate why bankruptcy courts cannot effectively perform the monitoring and enforcement functions of an administrative agency like the CFPB. Section III advocates for empowering the CFPB with the supervisory and enforcement authority proposed in the CBRA to preserve the integrity of the bankruptcy process and promote its policy goals.

I. THE CONSUMER BANKRUPTCY SYSTEM ISN'T CALIBRATED TO REGULATE SYSTEMIC NONCOMPLIANCE

The consumer bankruptcy process is intensely technical and procedural.[23] The Bankruptcy Code and Rules meticulously detail how debtors must marshal their income and assets, and how their debts must be settled before they receive a fresh start.[24] During the bankruptcy case, the Code limits the type of collection activity that creditors may pursue.[25] Creditors must file a proof of claim in order to obtain their pro-rata share of a debtor's assets and plan payments.[26] They must comply with lift-stay procedures to enforce their rights against the debtor's property.[27] And they must comply with discharge provisions once the debtor has obtained their fresh start.[28]

Compliance with the Bankruptcy Code and Rules can be onerous and costly. The requirements imposed on mortgage creditors in chapter 13 cases are illustrative. Chapter 13 debtors pay their mortgage obligations over a three-to-

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23 Sickler & Bruce, *Bankruptcy's Adjunct Regulator*, *supra* note 14, at 188–89.

24 *Id.*

25 *See* 11 U.S.C. § 362(a) (providing that the filing of a bankruptcy petition operates as a stay of a vast array of collection activities).

26 *See* 11 U.S.C. § 501 (providing that creditors and interest holders may file proofs of claim); FED. R. BANKR. P. 3001–05 (setting forth the procedure for claims filing).

27 *See* 11 U.S.C. § 362(d); FED. R. BANKR. P. 4001(a).

28 *See* 11 U.S.C. § 524(a) (providing that the entry of an order of discharge enjoins creditors from collecting discharged debt).

five-year plan term.[29] During that period, mortgage creditors must adapt their operations to ensure compliance with consumer bankruptcy laws. But compliance can be difficult because chapter 13 bankruptcy permits debtors to cure home mortgage arrearages and continue paying their mortgages according to the chapter 13 plan terms.[30] Mortgage creditors must therefore implement systems and procedures that conform to the plan provisions[31] while also being careful not to violate bankruptcy laws.[32]

Mortgage creditors, however, often fail to comply with the numerous technical requirements in the Bankruptcy Code and Rules, leading to legal violations.[33] Indeed, mortgage creditors are repeat violators in chapter 13 cases.[34] Their loan administration practices violate bankruptcy laws at critical points in consumer cases: the proof of claim process, the automatic stay, and the

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[29] 11 U.S.C. § 1321 ("The debtor shall file a plan."); 11 U.S.C. § 1322(d) (providing for three-to-five year plan term).

[30] *See* 11 U.S.C. § 1322(c) (providing for a statutory right to cure defaults). *But see* John Rao, *Servicing of Home Mortgages in Bankruptcy: When Worlds Need Not Collide*, AM. BANKR. INST. J., Feb. 2009, at 1 ("While there are some unique payment application issues that arise when a mortgage default is cured in a chapter 13 case, even these are similar to servicers' handling of payments under nonbankruptcy repayment and modification agreements.").

[31] Sickler & Bruce, *Bankruptcy's Adjunct Regulator*, *supra* note 14, at 176.

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> As noted above, debtors often continue to pay their mortgage obligations over the course of a pending bankruptcy case. As such, mortgage creditors must build bankruptcy compliance into their operations. This task can be onerous, as the bankruptcy process often alters both the status of a debtor's loan and the schedule and amount of future payments. In particular, chapter 13 bankruptcy permits debtors to cure home mortgage arrearages and continue paying their mortgages pursuant to the terms of the chapter 13 plan. Mortgage creditors must therefore be attuned to court orders and plan provisions, which supplant any pre-bankruptcy accounting records that the servicer maintained. Mortgage creditors must also comply with a variety of additional Bankruptcy Code provisions and procedural rules, including taking care not to violate the automatic stay, and disclosing changes in payments or other fees and amounts due.

Id.

[33] *Id.* at 189 ("But creditors can economize by ignoring the details required by the Code and procedural rules, or by failing to invest in technology that can accommodate the particular requirements of an ongoing bankruptcy case. Some creditors have also affirmatively overdrawn from the bankruptcy process by seeking payment of debts in a manner that does not align with bankruptcy's distributional rules.").

[34] *See infra* Section II (highlighting well-known case decisions featuring mortgage creditor violation); Bruce, *The Debtor Class*, *supra* note 15, at 26–30 (detailing several instances where mortgage lenders either (1) ignore the procedural structures of the bankruptcy system, or (2) are so large and automated that their processes cannot adapt to consumer bankruptcy laws).

discharge injunction.[35] Undoubtedly, the highly automated nature of modern mortgage servicing causes systemic noncompliance.[36]

Moreover, mortgage creditors are often sophisticated lenders with significant financial means and appear in consumer cases nationwide, compounding the harm that stems from noncompliance. The top twenty-five closed-end mortgage lenders hold a combined market share of 43.9%, a figure that has risen consistently since 2018,[37] and the top sixteen mortgage servicers hold roughly one-third of the residential mortgage market, measured by total dollar amount of loans serviced.[38] The implication is that upon discovery of mortgage creditor noncompliance in one chapter 13 case, there is a strong likelihood that the violation replicates across judicial districts.[39] If the violation is left unchallenged and uncorrected, the offending creditor extracts multiplied benefits from the bankruptcy system.[40]

To be sure, consumer bankruptcy's existing monitors and enforcers—the debtor, competing creditors, the private trustee, or the United States trustee—might challenge a mortgage creditor's noncompliance. But often, the violation goes unaddressed because of institutional design defects and resource constraints. The bankruptcy system uses a diffuse, litigation-based model of regulation, and lacks a robust administrative agency to exercise the extensive monitoring and oversight functions of the CFPB.[41] This system relies instead on parties involved in a case to challenge noncompliance by filing objections or commencing contested matters or adversary proceedings.[42] But because

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[35] Sickler & Bruce, *Bankruptcy's Adjunct Regulator*, *supra* note 14, at 180; Anne Wells, *Not in My House: Combating Unethical Mortgage Lender Practices and Related Attorney Misconduct in the Bankruptcy Courts*, 32 CAL. BANKR. J. 483 (2013); *see infra* Section II (describing examples of violations at these trigger points).

[36] *See, e.g.*, Neria v. Wells Fargo Bank (*In re* Neria), No. 14-32911, 2022 WL 17254478, at *1–2 (Bankr. N.D. Tex. Nov. 28, 2022) (observing that "[t]he overarching theme in the [chapter 13 debtor's] Adversary Proceeding is that Wells Fargo has systemic problems dealing with Chapter 13 debtors").

[37] CONSUMER FIN. PROT. BUREAU, DATA POINT: 2021 MORTGAGE MARKET ACTIVITY AND TRENDS 8 (Sept. 2022), *available at* https://files.consumerfinance.gov/f/documents/cfpb_data-point-mortgage-market-activity-trends_report_2022-09.pdf. A closed-end mortgage is loan secured by a lien on real estate, repayable by the borrower in installments.

[38] CONSUMER FIN. PROT. BUREAU, MORTGAGE SERVICING COVID-19 PANDEMIC RESPONSE METRICS: NEW OBSERVATIONS FROM DATA REPORTED BY SIXTEEN SERVICERS FOR MAY-DECEMBER 2021, at 2 (May 2022), *available at* https://files.consumerfinance.gov/f/documents/cfpb_mortgage-servicing-covid-19-pandemic-response-metrics_report_2022-05.pdf.

[39] Sickler & Bruce, *Bankruptcy's Adjunct Regulator*, *supra* note 14, at 207.

[40] *Id.* at 193.

[41] *See* Pardo & Watts, *supra* note 16, at 386 (observing that the Bankruptcy Code is a statutory framework administered almost exclusively through court adjudication and not through a regulatory agency).

[42] Sickler & Bruce, *Bankruptcy's Adjunct Regulator*, *supra* note 14, at 192–93.

consumer bankruptcy emphasizes efficient case administration, bankruptcy professionals often carry large caseloads and cannot devote resources to monitoring and addressing low-value noncompliance.[43] This is particularly true when the violations produce harms too small to justify the costs of fighting them.[44]

The United States Trustee Program ("USTP") is the "watchdog" of the bankruptcy process,[45] dedicated to promoting "the integrity and efficiency of the bankruptcy system."[46] The agency performs many regulatory functions,[47] including monitoring mortgage creditor noncompliance, a key USTP enforcement priority for more than a decade.[48] Its accomplishments include numerous nationwide settlements with a variety of large, mortgage servicers to remedy systemic bankruptcy law violations.[49] But the USTP lacks the expansive

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43 *Id.*

44 *Id.* at 162, 194–95; *see also* Bruce, *The Debtor Class*, *supra* note 15, at 24, 37, 39; Bruce, *Closing Bankruptcy's Enforcement Gap*, *supra* note 15, at 482–83; Bruce, *Vindicating Bankruptcy Rights*, *supra* note 15, at 444–46; Kara J. Bruce & Alexandra P. E. Sickler, *Private Remedies and Access to Justice in a Post-Midland World*, 34 EMORY BANKR. DEV. J. 365, 375 (2018).

45 H.R. REP. NO. 95-595, at 4 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 5966 (describing United States trustees as "bankruptcy watchdogs"); U.S. DEP'T OF JUST., UNITED STATES ATTORNEYS' MANUAL 18 (1988), *available at* https://www.justice.gov/archive/usao/usam/1988/title1general.pdf.

46 *See* Program Mission, U.S. DEP'T OF JUST., https://www.justice.gov/ust/program-mission (last updated Nov. 2, 2020) ("The mission of the United States Trustee Program is to promote the integrity and efficiency of the bankruptcy system for the benefit of all stakeholders—debtors, creditors, and the public.").

47 *See* EXEC. OFFICE FOR U.S. TRS., U.S. DEP'T OF JUST., UNITED STATES TRUSTEE PROGRAM ANNUAL REPORT OF SIGNIFICANT ACCOMPLISHMENTS FOR FISCAL YEAR 2016, at 2 (2016), *available at* https://www.justice.gov/ust/file/ar_2016.pdf/download. The Program has broad administrative authority over all bankruptcy cases. *See id.* (describing the Program's core authority). Its core responsibilities include participating directly in chapter 11 cases; overseeing the work of thousands of private trustees appointed in chapter 7, 12, and 13 bankruptcy cases; supervising credit counseling and financial education agencies that operate in tandem with the bankruptcy process; pursuing criminal enforcement; and participating in appeals on key bankruptcy issues. *See id.*; 28 U.S.C. § 586.

48 *See* Clifford J. White III, Dir., U.S. Tr. Program, Director Cliff White Addresses the 2017 Fall Conference of the National Creditors Bar Association (Oct. 12, 2017), *available at* https://www.justice.gov/ust/speeches-testimony/narca_10122017; *see also Ongoing Oversight: Monitoring the Activities of the Justice Department's Civil, Tax and Environment and Natural Resources Divisions and the U.S. Trustee Program: Hearing Before the Subcomm. on Regul. Reform, Com. & Antitrust L. of the H. Comm. on the Judiciary*, 114th Cong. 55 (2015) (statement of Clifford J. White III, Director, Executive Office for United States Trustees, U.S. Department of Justice) ("In fiscal year 2014, United States Trustees initiated more than 6,800 civil enforcement actions and inquiries against creditors, lawyers, bankruptcy petition preparers, and other parties who acted improperly towards debtors. Nearly 2,100 of these related to abusive conduct by creditors, including about 72 percent of which involved mortgage fraud and abuse.").

49 *See, e.g.*, Order Approving Settlement Between the United States Trustee Program, Citibank, N.A. and Department Stores National Bank at 4, *In re* Fazzon, No. 18-00201, (Bankr. N.D. Ga. Sept. 25, 2018), ECF No. 2 (requiring Citibank to pay $5 million to remediate robo-signed proofs of claim in consumer bankruptcy cases); Order Approving Settlement Between the United States Trustee Program and JPMorgan Chase Bank, N.A. at 2,

data collection and systemwide monitoring capabilities of the CFPB.[50] The United States trustee's civil investigation tools are narrow.[51] While the agency has the ability to examine entities pursuant to Rule 2004[52] and to engage in ordinary discovery in adversary proceedings and contested matters,[53] it may exercise these powers only within an individual case. As a result, its discovery tools are not well-calibrated to evaluate market-wide compliance with consumer bankruptcy laws. Also, the USTP lacks rulemaking authority that would permit them to shape substantive bankruptcy policy.[54] Finally, the USTP's efforts to remedy systemic noncompliance are limited by bankruptcy courts' remedial constraints described below.[55]

Bankruptcy courts have some authority to deter and punish mortgage creditor noncompliance through their statutory and inherent powers to sanction.[56] But their ability to remedy systemic noncompliance with punitive monetary sanctions is limited by the Code's remedial structure and their status under Article I of the Constitution.[57] As such, courts are divided about whether bankruptcy courts have criminal contempt authority.[58] Punitive monetary sanctions would more effectively deter noncompliance that implicates the entire

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In re Belzak, No. 10-23963 (Bankr. E.D. Mich. Mar. 9, 2015), ECF No. 143; *see also A Time to Reform: Oversight of the Activities of the Justice Department's Civil, Tax, and Environmental and Natural Resources Divisions and the U.S. Trustee Program: Hearing Before the Subcomm. on Regul. Reform, Com. & Antitrust L. of the H. Comm. on the Judiciary*, 115th Cong. 3, 10–11 (2017) (statement of Clifford J. White III, Director, Executive Office for United States Trustees, U.S. Department of Justice) ("[T]he USTP has entered into six national settlements that provided monetary remediation and other relief for homeowners in bankruptcy and, in some cases, required mortgage servicing standards to prevent future abuse of the bankruptcy rules.").

50 *See infra* Section III.B.

51 The USTP does have informal channels for gathering information, including its fraud reporting lines, its relationship with case trustees, and its town hall meetings, but these lack the breadth of the CFPB's ability to examine regulated entities for compliance with federal consumer financial laws.

52 FED. R. BANKR. P. 2004(a) ("On motion of any party in interest, the court may order the examination of any entity.").

53 FED. R. BANKR. P. 7026 (incorporating Federal Rule of Civil Procedure 26 with respect to adversary proceedings); FED. R. BANKR. P. 9014 (providing that Federal Rule of Bankruptcy Procedure 7026 also applies to contested matters).

54 *See* Pardo & Watts, *supra* note 16, at 391–413.

55 Sickler & Bruce, *Bankruptcy's Adjunct Regulator*, *supra* note 14, at 196, 199; *see also infra* Section II.

56 *See* 11 U.S.C. § 105(a) (giving bankruptcy judges authority to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]"); Sickler & Bruce, *Bankruptcy's Adjunct Regulator*, *supra* note 14, at 196.

57 *See* Hipp, Inc. v. Oles (*In re* Hipp, Inc.), 895 F.2d 1503, 1510 (5th Cir. 1990) ("The principal constitutional concern here arises from the fact that bankruptcy judges do not have the life tenure during good behavior and protection against diminished compensation which Article III, section 1, requires for federal judges exercising '[t]he judicial Power of the United States.'").

58 *See, e.g.*, Dyer v. Lindblade (*In re* Dyer), 322 F.3d 1178, 1193 n.15 (9th Cir. 2003) (collecting cases).

bankruptcy system, but most courts hold that bankruptcy courts are limited to awarding compensatory or coercive relief, or perhaps de minimis penalties.[59] In addition, remedies that aim to address harms beyond the case before the court have been characterized as matters of criminal contempt, and therefore beyond the court's authority to sanction.[60] As a result, bankruptcy judges' creative attempts to address widespread bankruptcy law violations have been reversed on appeal.[61]

Further complicating these issues is the highly automated nature of mortgage servicing. Modern mortgage servicer misconduct lawsuits are challenging for courts.[62] They involve "few human fact witnesses," no individual is assigned responsibilities for particular borrower accounts, the humans involved appear to lack discretionary authority in decision-making, and most of the necessary activity involves automated function.[63] Additionally, mortgage servicers typically use acronyms, code numbers, and "screenshots" to explain account activity which can "obscure rather than clarify the facts."[64]

The cumulative effect of these defects and restraints is a bankruptcy process "vulnerable to opportunistic behavior" in which "[s]ome repeat players—large lenders and servicers with thousands of borrowers in bankruptcy—may take advantage of the lack of direct oversight" to extract value from the bankruptcy system.[65] As a result, some amount of noncompliance escapes bankruptcy's enforcement system.[66] Several bankruptcy courts, alarmed by what they recognize as widespread rather than isolated violations of consumer bankruptcy laws, have tried to compel mortgage creditors to comply by ordering creative remedies that would have systemwide effects. Section II features some of these

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59 *See* John A. E. Pottow & Jason S. Levin, *Rethinking Criminal Contempt in the Bankruptcy Courts*, 91 AM. BANKR. L.J. 311, 314–15 (2017) (cataloguing various courts' approaches to this issue).

60 *See, e.g.*, Wells Fargo Bank v. Stewart (*In re* Stewart) (*Stewart III*), 647 F.3d 553, 555–56 (5th Cir. 2011); Casamatta v. Resurgent Cap. Servs., L.P. (*In re* Freeman-Clay), 578 B.R. 423, 431 (Bankr. W.D. Mo. 2017).

61 *See, e.g.*, *Gravel II*, 6 F.4th 503, 515 (2d Cir. 2021); *Stewart III*, 647 F.3d at 555–56; *infra* Section II.

62 *See* Neria v. Wells Fargo Bank (*In re* Neria), No. 14-32911, 2022 WL 17254478, at *2, *26 (Bankr. N.D. Tex. Nov. 28, 2022) (holding that Wells Fargo violated Rule 3002.1(b) multiple times in debtor's chapter 13 case, "at least once with respect to the change resulting from the payment of post-petition interest on pre-petition arrearages, and twice for its escrow adjustments," and awarding reasonable expenses and attorney's fees caused by those failures).

63 *Id.* at *2.

64 *Id.*

65 Bruce, *Closing Bankruptcy's Enforcement Gap*, *supra* note 15, at 480.

66 *Id.*

cases to demonstrate regulatory weaknesses in the bankruptcy system identified here.

II. BANKRUPTCY COURTS' CREATIVE ATTEMPTS TO MONITOR MORTGAGE CREDITOR NONCOMPLIANCE

Contemporary mortgage servicing is highly automated and requires compliance with an extensive framework of federal and state laws in and out of bankruptcy. The caselaw is replete with examples of mortgage creditor noncompliance. The Rule 3002.1 violations in *Gravel I* are simply among the more recent to percolate in bankruptcy jurisprudence. Unfortunately, as noted above, bankruptcy's court-centered model of administration is not calibrated to address widespread mortgage creditor noncompliance.

Some bankruptcy courts have tried to exercise greater oversight over mortgage creditors with creative remedies designed to have regulatory effects outside the boundaries of the individual case in which they are ordered. This Section describes some of these cases and explains how they illustrate the bankruptcy system's limited ability to deter and remedy widespread mortgage creditor noncompliance in consumer cases, thereby underscoring the imperative for a more robust regulator.

A. In re Stewart*'s Attempt to Supervise Proof of Claim Practices*

In re Stewart (*Stewart I),* a well-known case to consumer bankruptcy professionals that predates Rule 3002.1,[67] is a prime example of the bankruptcy system's regulatory limitations. Here, the U.S. Bankruptcy Court for the Eastern District of Louisiana sanctioned a mortgage servicer for inflating proofs of claim with a variety of unnecessary and unlawful fees.[68] These fees included excessive drive-by property inspections, inspections on property other than the debtor's, and two broker price opinions that were allegedly conducted when the property was inaccessible to civilians in the wake of Hurricane Katrina.[69] As a result, the bankruptcy court found that the mortgage creditor's claims exhibited systematic errors arising from its highly automated, computerized loan-servicing system.[70]

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67 Rule 3002.1 was added in 2011.

68 *In re* Stewart (*Stewart I*), 391 B.R. 327, 355–58 (Bankr. E.D. La. 2008), *rev'd*, 647 F.3d 553 (5th Cir. 2011).

69 *Id.* at 343–47, 350–55 (detailing improper charges, misallocation of payments, and other sanctionable conduct).

70 *Stewart III*, 647 F.3d 553, 555–56 (5th Cir. 2011).

Because of the severity of the misconduct and the mortgage creditor's failure to remedy these problems after warnings from the court, the court ordered, pursuant to its section 105(a) authority,[71] that the creditor audit every claim filed in that district since 2007 and provide a complete loan history of every account.[72] The bankruptcy court's order reflects an attempt to function as a compliance monitor for this mortgage creditor's bankruptcy claims practices.[73]

However, on appeal, the Fifth Circuit vacated the injunction ordering the audit because it exceeded the bankruptcy court's authority.[74] Though it acknowledged that the bankruptcy court's frustration was justified, the Fifth Circuit explained that the injunction was not necessary to remedy the individual debtor's injuries.[75] Further, the injunction lacked "jurisdictional legs" because it extended "beyond the dimensions" of the debtor's case "to police a range of cases untested here by the adversary process."[76] It was improperly aimed at "other cases" in which the mortgage creditors "appeared or might appear before the bankruptcy courts."[77]

The bankruptcy court's attempted audit of Wells Fargo's proofs of claim was a novel solution to a pronounced problem in the wake of the mortgage crisis. It clearly saw the potential for systemwide noncompliance, expressing the concern that inflated, erroneous claims largely left unchallenged by debtors harm the entire bankruptcy process because they "enlarge the debt of the estate, make reorganization more difficult for the debtor, and adversely impact" the claims of other creditors.[78] The court essentially attempted to impose a form of regulatory monitoring on the creditor's problematic approach to bankruptcy claims by prioritizing information gathering, verification and evaluation of practices and procedures, and reporting as mechanisms for assessing systemwide compliance. Nonetheless, the remedy failed because it would have applied to more than just the individual case in which the bankruptcy court discovered the misconduct.

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71 *In re* Stewart (*Stewart II*), No. 07–11113, 2008 WL 5096011, at *10 (Bankr. E.D. La. Oct. 15, 2008).

72 *Stewart I*, 391 B.R. at 357.

73 In a companion case, *In re Jones*, the same bankruptcy court, concerned that attorney's fees and costs would not sufficient deter the mortgage creditor's future noncompliance, accepted the mortgage creditor's offer to allow the court to monitor its actions after deliberating the relevant advantages and disadvantages of punitive damages awards. Jones v. Wells Fargo Home Mortg., Inc. (*In re* Jones), No. 03-16518, 2007 WL 2480494, at *5 (Bankr. E.D. La. Aug. 29, 2007), *rev'd*, 391 B.R. 577 (E.D. La. 2008).

74 *See Stewart III*, 647 F.3d at 558.

75 *See id.*

76 *Id.*

77 *Id.*

78 *Id.* at 554.

B. Channeling Punitive Damages Awards in In re Sundquist

In re Sundquist is another well-known case that emphasizes the need to regulate mortgage creditors' practices and procedures in consumer bankruptcy cases.[79] These debtors had been current on their mortgage payments but with difficulty.[80] They needed more affordable terms so they pursued a loan modification with their lender.[81] Ultimately, they defaulted, but only because their lender told them to do so as a precondition for loan modification discussions.[82] As a result, the debtors faced foreclosure.[83] They filed a chapter 13 case, expecting to cure the default though a plan and continue their loan modification efforts.[84] The lender, despite knowledge of the case, proceeded with the foreclosure sale, thereby violating the automatic stay.[85] It then proceeded to commit numerous, knowing, and willful violations of the automatic stay.[86] The bankruptcy court found that the lender had forced the debtors through a "Kafkaesque nightmare" that included dual tracking, harassing and threatening behavior, and—once they filed a chapter 13 case—repeated violations of the automatic stay, including foreclosing on the home with full knowledge of the bankruptcy case.[87] As a result, the plaintiffs lost income and property and suffered extreme physical and emotional distress.[88]

Under section 362(k), which expressly authorizes punitive damages in appropriate circumstances,[89] the bankruptcy court awarded the debtors

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79 Sundquist v. Bank of Am. (*In re* Sundquist) (*Sundquist I*), 566 B.R. 563 (Bankr. E.D. Cal. 2017).

80 *Id.* at 572.

81 *Id.*

82 *Id.*

83 *Id.*

84 *Id.* at 574.

85 *Id.* ("The automatic stay-violating foreclosure was thereafter apparent to anyone at Bank of America who cared to look. Nobody at Bank of America cared to look.").

86 *Id.* at 575.

87 *Id.* at 571. For a more detailed synopsis of these egregious facts, see generally Kara J. Bruce, *Channeling Punitive Damages Awards under Section 362(k)*, BANKR. L. LETTER, Apr. 2018, at 1.

88 *Sundquist I*, 566 B.R. at 584–85 ("The Sundquists entered their ordeal with Bank of America as physically strong people . . . . They had been elite athletes . . . . He emerged from the ordeal restricted to exercising only on an elliptical trainer and had attempted suicide. She was hospitalized with heart attack symptoms that were found to be stress-related, has been diagnosed with post-traumatic stress disorder, and was left with near-daily debilitating migraine headaches that persist into the present and that constrain her ability to engage in a wide range of activities.").

89 11 U.S.C. § 362 ("Except as provided in paragraph (2), an individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages.").

$1,074,581.50 in actual damages[90] and $45 million in punitive damages.[91] The court's order directed $5 million of the punitive damages to the debtors, and instructed them to the deliver the after-tax residue of the remaining $40 million to specified consumer advocacy organizations and law schools.[92] The bankruptcy court explained that channeling the large award to support greater enforcement of consumer bankruptcy laws furthers the "societal interest" vindicated by punitive damages.[93]

The size of the award was meant to compel compliance from this large, institutional lender with substantial financial assets *and* deter other mortgage creditors from engaging in similar illegal conduct. The bankruptcy court characterized the problem as one of "corporate culture" stemming from the involvement of the senior management in the unlawful decision making.[94] Emphasizing the lender's "long rap sheet of fines and penalties in cases relating to its mortgage business,"[95] as well as the company's net income, the bankruptcy court set an amount high enough to not "be laughed off in the boardroom as petty cash or 'chump change.'"[96] Even when the debtors later settled with the lender for a different amount, the bankruptcy court refused to vacate the original judgment, calling the request a "naked effort to coerce this court to erase the record."[97] "To name and to shame" the company "on the public record in an opinion that stays on the books serves a valuable purpose casting sunlight on practices that affect ordinary consumers."[98]

Here, as in *Stewart I*, the bankruptcy court identified egregiously unlawful conduct in mortgage servicing and shaped an innovative remedy intended to have ripple effects outside of the individual case in which the automatic stay violations occurred. The astronomical amount was designed to grab attention and motivate other companies to ensure their loan administration practice

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90 *Sundquist I*, 566 B.R. at 620. This amount represented the cost of finding alternative housing when the debtors were displaced during the stay-violating foreclosure; attorney's fees; lost income; lost property; damages relating to the lender's bad-faith refusal to entertain loan modification requests; personal injury and related medical expenses; and emotional distress. *Id.* at 593–609.

91 *Id.* at 618.

92 *Id.* at 618–19.

93 *Id.* at 614–16 ("A solution based on common sense is to direct to a public purpose the portion of legitimate punitive damages that exceed what private victims ought to be allowed to retain—the societal interest component of punitive damages.").

94 *Id.* at 612.

95 *Id.*

96 *Id.*

97 Sundquist v. Bank of Am. (*In re* Sundquist) (*Sundquist II*), 580 B.R. 536, 540 (Bankr. E.D. Cal. 2018).

98 *Id.* at 545.

complied with bankruptcy laws. The channeled award was designed to fulfill the societal interest dimension of punitive damages awards, while avoiding an excessive windfall to the debtor.[99] Because the parties later settled the dispute, the viability of the channeled award was not tested by an appeal.

C. Awarding Punitive Damages for Rule 3002.1 Violations

Two cases frame recent disagreement among courts about whether Rule 3002.1 authorizes punitive monetary sanctions for failing to comply with the noticing requirements set forth in the rule.[100] Ultimately, as explained below, the bankruptcy courts in both cases acknowledge that mortgage creditors need greater incentives to make changes to properly service mortgages in bankruptcy.

Bankruptcy Rule 3002.1 applies whenever a chapter 13 debtor's plan provides for the maintenance of post-petition payments on a home mortgage.[101] It requires timely disclosure to debtors of additional post-petition mortgage payment obligations, giving them time to pay or challenge the amounts claimed.[102] It also requires the chapter 13 trustee to file and serve on the mortgage creditor a notice "stating that the debtor has paid in full the amount required to cure any default on the claim."[103] In turn, the mortgage creditor must respond to that notice stating whether it agrees that the debtor has paid in full the amount required to cure the default on the claim.[104]

The requirements of Rule 3002.1 are detailed, and technical violations are common. But some mortgage creditors have violated Rule 3002.1 by repeatedly failing to comply with its noticing requirements. To address these problems, Rule 3002.1 provides for a robust array of sanctions. If a creditor fails to comply with Rule 3002.1, a bankruptcy court may preclude the creditor from presenting the claim as evidence in the case or award the debtor "other appropriate relief" including expenses and attorney's fees.[105] But courts disagree about whether

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99 *Id.* at 555.

100 *Gravel II*, 6 F.4th 503, 516 (2d Cir. 2021); Blanco v. Bayview Loan Servicing, LLC (*In re* Blanco), 633 B.R. 714, 750 (Bankr. S.D. Tex. 2021).

101 FED. R. BANKR. P. 3002.1(a).

102 FED. R. BANKR. P. 3002.1(b), (c).

103 FED. R. BANKR. P. 3002.1(f).

104 FED. R. BANKR. P. 3002.1(g).

105 FED. R. BANKR. P. 3002.1(i).

"other appropriate relief" permits bankruptcy courts to order punitive sanctions against noncomplying mortgage creditors.[106]

One bankruptcy court, fed up with repeated violations of Rule 3002.1 across multiple consumer bankruptcy cases, held that punitive damages were appropriate.[107] In *Gravel I*, the chapter 13 trustee moved for sanctions against a mortgage creditor for Rule 3002.1 violations in three separate cases.[108] The bankruptcy court granted the motions, ordering the creditor to pay $75,000 in punitive damages for the Rule 3002.1 violations and an additional $300,000 for violations of the court's orders pursuant to its section 105 powers.[109] The district court vacated the sanctions and remanded the matter, observing that the bankruptcy court could refer the matter for criminal contempt proceedings or enforce its order using other, non-punitive forms to compel compliance.[110] On remand, the bankruptcy court imposed the same $75,000 sanction for the Rule 3002.1 violations and reduced the $300,000 sanction by $75,000.[111] The trustee asked the bankruptcy court to certify the remand order for appeal to the Second Circuit, which granted review.[112]

The Second Circuit held that bankruptcy courts may not order contempt sanctions for Rule 3002.1 violations.[113] First, it construed the rule's language "other appropriate relief" as authorizing only non-punitive sanctions because it was included as a "general phrase among specific [remedial] examples" like "reasonable attorney's fees and costs" which are compensatory in nature.[114] The Second Circuit also contrasted the rule's language with section 362(k), which expressly authorizes punitive damages if appropriate, concluding that had punitive sanctions been intended, they would have been specified in the rule.[115] Finally, it disagreed that evidence preclusion and an award of attorney's fees

106 *Compare Gravel II*, 6 F.4th 503, 514–15 (2d Cir. 2021) (holding that Rule 3002.1 does not authorize punitive sanctions), *and In re* Tollstrup, No. 15-33924, 2018 WL 1384378, at *5 (Bankr. D. Or. Mar. 16, 2018) (holding that Rule 3002.1 does not authorize punitive sanctions), *with* Blanco v. Bayview Loan Servicing, LLC (*In re* Blanco), 633 B.R. 714, 753 (Bankr. S.D. Tex. 2021) (holding that Rule 3002.1 does permit punitive sanctions).

107 *See Gravel I*, 601 B.R. 873, 882–83 (Bankr. D. Vt. 2019), *vacated and rev'd*, 6 F.4th 503 (2d Cir. 2021).

108 *See id.* at 877.

109 *See id.*

110 *Gravel II*, 6 F.4th at 510.

111 *Id.*

112 *Id.*

113 *Id.* at 516.

114 *Id.* at 514.

115 *Id.* at 515.

would be insufficient to deter Rule 3002.1 violations.[116] The dissent, however, viewed the rule's plain meaning and purpose as authorizing court discretion to impose punitive monetary sanctions.[117]

Recently, a bankruptcy court disagreed with the Second Circuit, holding that a debtor can seek punitive damages under Rule 3002.1(i)(2) when a mortgage creditor violates Rule 3002.1(b) and (c) by failing to give notice of changes in the payment, charges, fees, and expenses.[118] The facts in this case, *In re Blanco*, are all too familiar: The debtors filed a chapter 13 case in 2011, and the court confirmed their plan.[119] The plan cured mortgage arrears, and the trustee made the monthly payments under the plan terms.[120] The debtors paid monthly mortgage payments in accordance with the plan terms and completed plan payments.[121] The trustee issued a notice of plan completion, and the debtors received a discharge.[122] Later, the debtors learned the mortgage creditor had changed the required minimum monthly payments three times during the plan but never filed the notices required by Rule 3002.1(b) and (c).[123] As a result, the mortgage creditor claimed the debtors had defaulted and initiated foreclosure.[124] The debtors filed a second chapter 13 case to halt foreclosure.[125] The mortgage creditor claimed around $33,000 in arrearages.[126] Among the disputed issues was whether the bankruptcy court could order punitive monetary sanctions for Rule 3002.1 violations.[127]

Writing shortly after the Second Circuit's reversal of *Gravel I*, the bankruptcy court described the Second Circuit majority's reasoning but ultimately agreed with its dissent.[128] Like the dissenting judge, this bankruptcy court found that the plain language of Rule 3002.1 authorizes awarding punitive monetary sanctions.[129] The court also explained that punitive sanctions may be warranted in appropriate circumstance to advance the purposes of the rule,

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116 *Id.*
117 *Id.* at 520.
118 Blanco v. Bayview Loan Servicing, LLC (*In re* Blanco), 633 B.R. 714, 750 (Bankr. S.D. Tex. 2021).
119 *Id.* at 724.
120 *Id.*
121 *Id.* at 725.
122 *Id.*
123 *Id.*
124 *Id.* at 725–26.
125 *Id.* at 726.
126 *Id.*
127 *Id.* at 754.
128 *Id.* at 752–54.
129 *Id.* at 754–55.

namely to compel mortgage creditors to "make the systemic changes required to service loans properly in chapter 13."[130] Costs and attorney's fees alone "may be insufficient" deterrents because violations "may either go unnoticed by the debtor or the debtor will find it easier to pay the small fees rather than litigate them."[131] Such an interpretation, it wrote, "best serves the policy goals underlying the bankruptcy system."[132]

Blanco, like *Sundquist I* and *Stewart I*, recognizes that mortgage creditors need greater incentives to make systemic changes required to properly service loans in chapter 13 cases, that the stakes must be higher, or the errors will persist. Collectively, these cases demonstrate that the highly automated nature of modern mortgage servicing requires more compliance monitoring and systemwide enforcement than the bankruptcy system's court-centered, regulatory model can provide. Section III advocates for using the CFPB to combat widespread noncompliance by mortgage creditors.

III. USING THE CFPB TO REGULATE MORTGAGE CREDITOR COMPLIANCE WITH BANKRUPTCY LAWS

I have argued that conferring some bankruptcy regulatory authority on the CFPB would ameliorate these institutional design challenges baked into the consumer bankruptcy system. In *Bankruptcy's Adjunct Regulator*, Professor Kara Bruce and I contended that the CFPB should adopt a bankruptcy-specific regulatory agenda.[133] That article explored how the CFPB already engages in some bankruptcy-related oversight and argued that the CFPB could expand its work in bankruptcy without additional law reform efforts.[134] We also considered how building information-sharing pathways between the United States trustee and the CFPB might strengthen bankruptcy's existing regulatory checks.[135]

More recently, we examined the CBRA's proposal to create a Consumer Bankruptcy Ombuds and give the CFPB supervisory and enforcement authority for consumer bankruptcy laws.[136] This Section expands on that research, connecting bankruptcy courts' creative remedial attempts to regulate mortgage

130 *Id.* at 755.
131 *Id.*
132 *Id.* at 754.
133 *See generally* Sickler & Bruce, *Bankruptcy's Adjunct Regulator*, *supra* note 14.
134 *See id.* at 218.
135 *See id.*
136 *See* Bruce & Sickler, *The CFPB Enters Consumer Bankruptcy*, *supra* note 19, at 1.

creditors with two key regulatory powers of the CFPB—supervision and enforcement.

A. The Consumer Bankruptcy Reform Act of 2022

The CBRA proposes a comprehensive restructuring of the consumer bankruptcy process, including carving out a regulatory role for the CFPB.[137] Among the proposed reforms are the consolidation of chapters 7 and 13 into a unified chapter 10 process, the elimination of credit counseling requirements, and dischargeability of student loan debt.[138] The CBRA would also create a "Consumer Bankruptcy Ombuds" to perform high-level data analysis and reporting, make policy recommendations, and engage in informal dispute resolution between individual debtors and other stakeholders.[139] More importantly, the CFPB would be given supervisory and enforcement authority—but not rulemaking authority—over the Bankruptcy Code.[140]

Giving the CFPB regulatory authority in consumer bankruptcy cases might seem both redundant and radical. Doing so could seem redundant because consumer cases already benefit from the oversight of the bankruptcy judge, the United States trustee, case trustee, and competing creditors, allowing CFPB to operate in bankruptcy might seem to inject unnecessary bureaucracy into this seemingly heavily regulated space. But as explained above, the institutional design of bankruptcy law enforcement suffers from defects that make meaningful, comprehensive oversight for large, institutional actors impossible. Thus, far from duplicating efforts of bankruptcy's existing monitors, the CFPB would fill regulatory gaps described above.

It could seem radical to give the CFPB such regulatory authority because many tend to silo the two fields of consumer financial protection and bankruptcy. Consumer protection advocates view bankruptcy as a specialized field, while bankruptcy professionals tend to view bankruptcy as a closed and exhaustive system.[141] But the reality is that the two fields overlap. Bankruptcy

137 Consumer Bankruptcy Reform Act of 2022, S. 4980, 117 Cong. § 201 (2022) (recommending changes to the Consumer Financial Protection Act of 2010).

138 *See generally id.*

139 *Id.* § 201(a) (proposed Consumer Financial Protection Act section 1035A(c)).

140 *Id.* (proposed Consumer Financial Protection Act section 1035A(d)).

141 *See, e.g.*, Walls v. Wells Fargo Bank, 276 F.3d 502, 510 (9th Cir. 2002) (stating that the Bankruptcy Code features "complex, detailed, and comprehensive provisions" that "demonstrate[] Congress's intent to create a whole system . . . [to] adjust all of the rights and duties of creditors and embarrassed debtors alike" (quoting MSR Expl., Ltd. v. Meridian Oil, Inc., 74 F.3d 910, 914 (9th Cir. 1996))).

exists as a possible last resort for repayment in many of the financial transactions subject to the CFPB's existing regulatory authority. Moreover, in the case of mortgage servicing, it has become increasingly difficult to draw clear boundaries around CFPB regulations and bankruptcy laws, because the CFPB has promulgated rules that govern how mortgage creditors communicate with borrowers in bankruptcy.[142]

The next section illustrates how the CFPB's supervisory authority and existing operations could be deployed in collaboration with the USTP to provide the regulatory monitor the consumer bankruptcy system needs.

B. Extending the CFPB's Supervisory Authority to Consumer Bankruptcy

The CBRA would expand the CFPB's supervisory authority to include the Bankruptcy Code.[143] This would give the CFPB power to monitor creditors' compliance with consumer bankruptcy law and require the CFPB to formalize information-sharing with the USTP.

Supervision is one of the CFPB's primary functions. It exercises this authority by conducting periodic examinations of regulated entities' compliance with federal consumer financial law. The CFPB's examination process emphasizes compliance and risk monitoring.[144] Most examinations focus on the quality of the institution's internal compliance management systems and procedures, ensuring that they are designed to prevent violations and promote appropriate self-monitoring, correction, and remediation where violations have occurred.[145] The CFPB also uses examination to detect emergent practices and assess risks of harm to consumers and markets.[146] The CFPB publishes on its

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[142] *See, e.g.*, Cole v. MidFirst Bank, No. 18-01402, 2018 WL 6504433, at *3 (N.D. Ala. Dec. 11, 2018) (granting defendant's motion to withdraw the reference for plaintiff's claimed automatic stay violations required "material and substantial consideration" of the CFPB's recently amended mortgage servicing regulations and the "mini-Miranda" language of the Fair Debt Collection Practices Act).

[143] Consumer Bankruptcy Reform Act of 2022, S. 4980, 117 Cong. § 201(a) (2022) (proposed Consumer Financial Protection Act section 1035A(d)).

[144] 12 U.S.C. § 5514(b)(1)(A)–(B).

[145] The Bureau has an internal "playbook" that explains the examination process, including how decisions are made, who makes them, and how information is evaluated. Letter from Raynell D. Lazier, FOIA Manager, Consumer Fin. Prot. Bureau, to Jonathan Pompan, Chair of Consumer Fin. Servs. Practice Grp., Venable LLP (Mar. 31, 2017), *available at* https://connect.venable.com/13/449/uploads/cfpb-examination-playbook-3-31-2017.pdf. Venable LLP attorneys obtained a copy of this playbook through a Freedom of Information Act Request. *Id.* For an extensive discussion of the Bureau's examination process, see Jean Braucher & Angela Littwin, *Examination as a Method of Consumer Protection*, 58 ARIZ. L. REV. 33 (2016).

[146] 12 U.S.C. § 5514(a)–(b).

website a detailed Supervision and Examination Manual that functions as a guide for examiners and regulated entities.[147] This manual exceeds 1,500 pages and includes product- and statute-based examination guides.[148] Although it is designed for use by the CFPB's examiners, regulated entities can use the manual as a set of guidelines to measure their compliance.

The CFPB already has supervisory authority over many creditors that are repeat players in consumer bankruptcy cases nationwide, including mortgage creditors. It supervises banking institutions with assets over $10 billion,[149] nonbank mortgage originators and servicers,[150] payday lenders,[151] and private student lenders of all sizes.[152] The CFPB also supervises larger participants of other consumer financial markets, including consumer debt collection businesses,[153] consumer reporting agencies,[154] student loan servicers,[155] international money transfer participants,[156] and automobile finance companies.[157] Because the CFPB already assesses these entities' compliance with other federal consumer financial laws, the operational infrastructure to supervise consumer bankruptcy compliance is already in place.

Moreover, giving the CFPB authority to supervise mortgage creditors' compliance would provide the systemwide monitoring lacking in consumer bankruptcy's existing oversight mechanisms. Consider the bankruptcy court's attempted proof of claim audit in *Stewart I*, discussed above.[158] That bankruptcy court was concerned that the mortgage creditor lacked adequate processes and procedures to comply with bankruptcy laws and hoped an audit would reveal errors, compel compliance, and avoid broader harm to the system. Like

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147 *See generally* CONSUMER FIN. PROT. BUREAU, SUPERVISION AND EXAMINATION MANUAL (2022), *available at* https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/cfpb_supervision-and-examination-manual.pdf.

148 *See id.* The manuals for individual products and services and statutes are published on the CPFB's website. *Supervision and Examinations*, CONSUMER FIN. PROT. BUREAU, https://www.consumerfinance.gov/policy-compliance/guidance/supervision-examinations/ (last visited Feb. 25, 2023).

149 12 U.S.C. § 5515(a). In measuring the assets of a banking institution, this provision includes affiliates. *Id*.

150 12 U.S.C. § 5514(a)(1)(A).

151 12 U.S.C. § 5514(a)(1)(E).

152 12 U.S.C. § 5514(a)(1)(D).

153 12 C.F.R. § 1090.105(b).

154 12 C.F.R. § 1090.104(b).

155 12 C.F.R. § 1090.106(b).

156 12 C.F.R. § 1090.107.

157 12 C.F.R. § 1090.108.

158 *See supra* Section II.A.

supervision, an audit would have fulfilled the monitoring function consumer bankruptcy needs. Under the CBRA, the CFPB could marshal its existing infrastructure to build out consumer bankruptcy examination in collaboration with the USTP.

The CFPB could—and in limited ways already does—monitor and verify compliance mortgage creditor compliance with some aspects of bankruptcy laws. The CFPB already gathers limited data on creditors' compliance with bankruptcy laws, including mortgage creditors. For example, CFPB examiners routinely obtain information about whether mortgage servicers have internal policies and procedures that identify accounts as being active in bankruptcy, in order to ensure these companies comply with bankruptcy laws and procedural rules.[159] The Examination Manual also includes provisions that cover chapter 13 notice of payment changes and other fees and amounts due.[160] Finally, examiners must obtain information about whether and how servicers apply payments received from consumers or bankruptcy trustees.[161]

Supervision is resource-intensive, not unlike litigation, but it is a better "regulatory fit" for large, institutional mortgage creditors who appear in bankruptcy cases nationwide. Supervision is broader and more flexible than the court-centric model of bankruptcy enforcement. As noted, bankruptcy courts are limited to policing conduct within individual cases and according to the Code's restrictive remedial scheme. In contrast, supervision would allow the CFPB to identify and resolve a mortgage creditor's bankruptcy compliance issues systemwide, across markets and jurisdictions, without the limitations of case-by-case litigation, correcting issues before they cause systemic harm. Indeed, bankruptcy courts have observed that modern mortgage servicer lawsuits are difficult to unravel because servicing is automated, lacks discretionary decision-making by humans, and uses codes, acronyms, and screenshots to explain account activity.[162] Supervision would more effectively and efficiently navigate these challenges.

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[159] CONSUMER FIN. PROT. BUREAU, *Examination Procedures: Mortgage Servicing*, *in* SUPERVISION AND EXAMINATION MANUAL, at Procedures 23–24 (2022), *available at* https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/cfpb_supervision-and-examination-manual.pdf.

[160] *Id.*

[161] *Id.*

[162] The lawsuits involve "few human fact witnesses," no individual is assigned responsibilities for borrower accounts, the humans involved appear to lack discretionary authority in decision-making, and most of the necessary activity involves automated function. Neria v. Wells Fargo Bank (*In re* Neria), No. 14-32911, 2022 WL 17254478, at *2 (Bankr. N.D. Tex. Nov. 28, 2022). Also, mortgage servicers typically use acronyms, code

Moreover, some scholars have observed that monitoring may lead to a more efficient and collaborative compliance process.[163] Because the examination process is confidential, it could promote more candid communication between supervised entities and the CFPB.[164] And, the CFPB could work with mortgage creditors to find realistic solutions to increase compliance with bankruptcy laws and, importantly, do so without litigation.[165]

Additionally, increased bankruptcy-specific supervision has the potential to compel compliance not just from the supervised entities, but also across the market. For example, if the CFPB discovers that a creditor's policies and procedures are deficient, it can use its "Supervisory Highlights" to signal to other market actors conduct the CFPB wishes to prevent.[166] This might prompt those other parties to adjust their compliance management systems to conform with bankruptcy law and procedural rules.

Finally, the CFPB's ability to gather information and deeply examine the practices and procedures of mortgage creditors can provide valuable aggregate data to support the USTP's oversight. Here, the CFPB and USTP are natural partners. On one hand, the USTP can collaborate with the CFPB to adjust its Examination Manuals to target bankruptcy compliance issues based on insight from USTP field attorneys. On the other, by sharing the fruits of examination with the USTP, the CFPB can help uncover more bankruptcy noncompliance than is currently detected.

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numbers, and "screenshots" to explain account activity which can "obscure rather than clarify the facts." *Id.* at *2.

[163] *See* Rory Van Loo, *Regulatory Monitors: Policing Firms in the Compliance Era*, 119 COLUM. L. REV. 369, 375 (2019) (contrasting rulemaking and enforcement with examination because monitors work with industry and not against it); Jody Freeman, *Collaborative Governance in the Administrative State*, 45 UCLA L. REV. 1, 5 (1997) (arguing that "collaborative governance" should be a focus of administrative law).

[164] 12 C.F.R. § 1070.40–.48. Typically, the process concludes with a supervisory letter or an examination report that identifies potential areas of noncompliance.

[165] *See* Van Loo, *supra* note 163, at 375 (contrasting rulemaking and enforcement with examination because monitors work with industry and not against it); Freeman, *supra* note 163, at 5 (arguing that "collaborative governance" should be a focus of administrative law).

[166] Although the examination process is confidential, the Bureau periodically publishes supervisory highlights on its website, which report important examination findings to help industry identify marketplace risks and ensure compliance. *See Supervisory Highlights*, CONSUMER FIN. PROT. BUREAU, https://www.consumerfinance.gov/policy-compliance/guidance/supervisory-highlights/ (last visited Feb. 25, 2023).

C. Using the CFPB Enforcement to Close Consumer Bankruptcy's Remedial Gaps

The CBRA would imbue the CFPB with the authority to enforce the Bankruptcy Code through administrative and civil litigation.[167] In *Bankruptcy's Adjunct Regulator*, I advocated for deploying the CFPB's existing enforcement authority to address systemic noncompliance in consumer bankruptcy cases.[168] In a later publication, I shared some thoughts about how the CFPB might implement the enforcement authority authorized by the CBRA.[169] This section builds on those ideas by discussing how the CFPB's ability to obtain more expansive remedies through enforcement of the Bankruptcy Code would support the consumer bankruptcy system.

The CFPB is authorized to enforce federal consumer financial laws through judicial actions and administrative adjudication proceedings.[170] The CBRA would add the Bankruptcy Code to the list of laws that constitute federal consumer financial laws,[171] and as a result, dramatically expand the range of legal and equitable remedies available to remedy violations of consumer bankruptcy laws.

There are advantages to giving the CFPB enforcement authority over the Bankruptcy Code. As explained earlier, the bankruptcy system isn't calibrated to remedy widespread mortgage creditor noncompliance because it is a forum for administering and adjusting private rights in individual cases.[172] The CFPB, however, would be able to use its enforcement powers to aggregate the claims individual debtors, private trustees, or the United States trustee currently must raise in individual cases. It could bring a single enforcement action against an offending mortgage creditor to address systemwide noncompliance. Further, the CFPB's bankruptcy enforcement efforts would overlap with related non-bankruptcy enforcement of other federal consumer financial laws, allowing the agency to regulate mortgage creditor compliance in a more integrated way.[173] The CFPB already regulates these same mortgage creditors outside of

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167 Consumer Bankruptcy Reform Act of 2020, S. 4980, 117th Cong. § 201(d) (2020).

168 Sickler & Bruce, *Bankruptcy's Adjunct Regulator supra* note 14, at 210–13.

169 Bruce & Sickler, *The CFPB Enters Consumer Bankruptcy*, *supra* note 19, at 10–13.

170 12 U.S.C. §§ 5563, 5564.

171 Consumer Bankruptcy Reform Act of 2020, S. 4980, 117th Cong. § 201(d) (2020).

172 *See supra* Section I.

173 *See* Sickler & Bruce, *Bankruptcy's Adjunct Regulator*, *supra* note 14, at 203–06.

bankruptcy,[174] and mortgage creditors' non-bankruptcy compliance problems become bankruptcy compliance problems when in bankruptcy.[175]

In addition, the CFPB can obtain wide-ranging relief in an enforcement action, while bankruptcy courts are more limited in this respect.[176] The CFPB is authorized to seek rescission or reformation of contracts, refunds or returns of money or real property, restitution, disgorgement or compensation for unjust enrichment, payment of damages, civil monetary penalties, public notification of the violations, and injunctive limits or bans on defendants' future activities and functions in the market.[177] Civil monetary penalties are limited by statute, but are substantial and complement any relief available under other consumer financial protection statutes.[178] In particular, the CFPB can seek civil monetary penalties of up to $5,000 per day for each violation, up to $25,000 per day for each reckless violation, and up to $1,000,000 per day for each knowing violation of the law.[179] The CFPB may also recover its litigation costs but not punitive damages.[180]

The CFPB deposits the civil monetary penalties it collects into the "Consumer Financial Civil Penalty Fund"[181] The funds, in turn, are distributed to compensate eligible victims and for "consumer education and financial literacy programs."[182] Since its inception, the CFPB has ordered approximately $1.8 billion in civil money penalties in enforcement actions.[183] Mortgage creditors are among the companies that have been ordered to pay civil monetary funds.

Civil monetary penalties, as part of a public enforcement mechanism, perform important regulatory functions. Like punitive damages, they deter

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174 *Id.* at 203.

175 *Id.* at 183–84 (discussing CFPB investigatory findings that mortgage servicer Ocwen Corporation "engaged in significant and systemic misconduct at nearly every stage of the mortgage servicing process," including bankruptcy).

176 *See supra* Section II.

177 12 U.S.C. § 5565(a)(2).

178 12 U.S.C. § 5565(c)(2).

179 *Id.*

180 12 U.S.C. § 5565(a)(3).

181 12 U.S.C. § 5497(d)(1). Congress mandated the creation of the "Consumer Financial Civil Penalty Fund" to compensate consumers harmed by violations of federal consumer financial laws. *Id.*

182 12 U.S.C. § 5497(d)(2).

183 *Enforcement by the Numbers*, CONSUMER FIN. PROT. BUREAU, https://www.consumerfinance.gov/enforcement/enforcement-by-the-numbers/ (last visited Feb. 25, 2023).

noncompliance and promote the law's policy goals.[184] Indeed, Congress mandated inflation adjustments of civil monetary penalties to preserve their deterrent effect and to encourage legal compliance.[185] Although courts are divided about whether bankruptcy courts have authority to order substantial punitive monetary sanctions, Congress has expressly authorized the CFPB to impose larger civil penalties that are more likely deter noncompliance and motivate mortgage creditors to invest in developing or acquiring systems that comply with bankruptcy laws.

CONCLUSION

This Essay calls for systemic regulation of systemic harm. I have advocated for empowering the CFPB to supervise and enforce compliance with the Bankruptcy Code by featuring the bankruptcy system's challenges in eradicating persistent noncompliance by mortgage creditors. Some bankruptcy courts, alarmed by what they recognize as widespread rather than isolated violations of consumer bankruptcy laws, have tried to compel mortgage creditors to correct their systems by ordering creative remedies that have systemwide effects. But these attempts have been unsuccessful because bankruptcy courts are limited in their ability to address conduct outside the confines of individual cases. The CBRA's proposed reforms would fill this gap, providing systemwide monitoring and enforcement of mortgage creditors in consumer bankruptcy cases. The CFPB could marshal its supervisory authority to encourage mortgage creditor compliance in a more collaborative, less adversarial regulatory environment than bankruptcy's litigation-centered model. Moreover, by deploying its enforcement authority for the benefit of the consumer bankruptcy process, the CFPB could leverage its ability to levy substantial civil penalty fines to deter and remedy violations.

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[184] James Ming Chen, *Inflation-Based Adjustments in Federal Civil Monetary Penalties*, 34 YALE L. & POL'Y REV. 1, 5 ("Congress has concluded that 'the power of Federal agencies to impose civil monetary penalties for violations of Federal law and regulations plays an important role in deterring violations and furthering the policy goals embodied in such laws and regulations.'" (quoting Inflation Adjustment Act, Pub. L. No. 101-410, sec. 2(a)(1), 104 Stat. 890, 890 (1990) (codified as amended at 28 U.S.C. § 2461))).

[185] *Id.* at 6 ("The legislative history of the Inflation Adjustment Act reflects primary congressional concern over the deterrent, punitive, and retributive purposes of federal civil monetary penalties.").