Chapter 13 Trustees Weigh Advantages and Disadvantages of Paying Debtors' Ongoing Mortgages

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Receipt of Ongoing Mortgage Payments

In 1999, the United States Trustee Program ("Program") began collecting data designed to identify whether standing trustees receive funds from the debtors sufficient to make ongoing mortgage payments, which are also known as "direct payments" or "conduit payments," as part of debtors' chapter 13 plan payments. That year, only 15 of 177 trustees, or 8 percent, chose to accept such payments on a regular basis. By Fiscal Year 2009, the number of trustees accepting these payments in all of their cases had increased to 81 of 189, or 43 percent.

The reasons trustees receive ongoing mortgage payments vary in each judicial district, but the change in procedures is usually initiated by an interested party in the bankruptcy community, including the court, bar or standing trustee. The Program takes no position on whether a standing trustee should run ongoing mortgage payments through the chapter 13 plan. However, the Program will work with trustees who want to implement ongoing mortgage payments through the plan and will generally approve budget requests to accommodate the costs of implementation, including additional training costs.

This article provides a brief overview of the current case law and local rules that may affect a trustee's decision to make ongoing mortgage payments, and discusses the advantages and disadvantages of requiring debtors to pay ongoing mortgages to the trustee for disbursement to the mortgage servicer through the plan.

Case Law and Local Rules

The Bankruptcy Code does not require trustees to run ongoing mortgage payments through the plan. Section 1326(c) of the Bankruptcy Code permits the debtor to act as his or her own disbursing agent and make payments directly to the creditor. 11 U.S.C. § 1326(c). The absence of an express mandate gives the courts discretion to decide which payments to creditors the debtor may make directly. In some jurisdictions, courts have exercised that discretion and allowed debtors to make their own ongoing mortgage payments directly, over the objections of the trustee. *See Cohen v. Lopez (In re Lopez)*, 372 B.R. 40 (9th Cir. B.A.P. 2007), *aff'd*, 550 F.3d 1202 (9^{th} Cir.2008); *In re Clay*, 339 B.R. 784 (Bankr. D. Utah 2006); and *In re Vigil*, 344 B.R. 624 (Bankr. D.N.M. 2006).

Courts that disfavor the practice of allowing debtors to pay creditors directly have promulgated local rules and administrative procedures that require the debtor to make ongoing mortgage payments through the trustee, particularly if the debtor was in arrears on the mortgage pre-petition. For example, in the Southern District of Texas, Local Rule 3015(b) requires a debtor to make home mortgage payments through the trustee in accordance with the Chapter 13 Trustee's Procedures for Administration of Home Mortgage Payments, unless the debtor qualifies for exemption. *In re Perez*, 339 B.R. 385, 392 (Bankr.S.D.Tex.2006) (affirmed, and local rule upheld, by *Perez v. Peake (In re Perez)*, 373 B.R. 468 (S.D. Tex. 2007)). These procedures provide:

> "The debtor's plan payments to the chapter 13 trustee shall include the amount due on the debtor's regular monthly mortgage installments for a claim secured by a security interest in real property that is the debtor's principal residence pursuant to the terms of 11 U.S.C. § 1322(b)(5) ("the ongoing mortgage") unless there is no default on the mortgage as of the petition date, the date of plan confirmation and the date of the filing of a plan modification."

See Chapter 13 Trustee's Procedures for Administration of Home Mortgage Payments (U.S. Bankruptcy Court for the Southern District of Texas, as amended on December 20, 2007). These procedures are posted on the website for the Bankruptcy Court for the Southern District of Texas.

Similarly, the Bankruptcy Court for the Southern District of Ohio implemented Local Rule 3015-1(d)(1), which provides that a "plan payment on the real estate mortgage pursuant to 11 U.S.C. § 1322(b)(5) of the Code shall be made by the trustee if the obligation is in arrears as of the petition date, unless otherwise ordered by the court." Bankr. S.D. Ohio L.B.R. 3015-1(d)(1).

<u>Advantages of Payment by Trustees</u>

The advantages of having the standing trustee receive and distribute payments to the mortgage servicer include a more accurate and complete accounting of mortgage payments, and a reduction in creditor motions to lift the automatic stay.

More Accurate Accounting of Payments

The standing trustee and trustee staff maintain a comprehensive system of records. Payments from debtors, payments to creditors, and other relevant case information are entered on a daily basis. The trustee uses a sophisticated software program to track all case administration events, including the identities of succeeding mortgage servicers if the mortgage is sold. In the event of a home sale or refinancing, the system is able to generate an accurate payoff figure.

The trustee's records provide a reliable, and sometimes the only reliable, source of information concerning the mortgage. This can be critical if there are disputes over payments, penalties or the status of the loan at the end of the case. In fact, the Bankruptcy Court for the District of Kansas requires debtors to make ongoing mortgage payments to the trustee specifically to avoid situations where debtors emerge from bankruptcy only to find they are in default because they were unaware of additional charges. *See Payne v. Mortgage Electronic*

Registration Systems, Inc. (In re Payne), 387 B.R. 614, 631 (Bankr. D. Kan. 2008).

Fewer Motions to Lift Stay

The trustee has a system in place for monitoring and addressing missed plan payments. A mortgage servicer may be less inclined to file a motion for relief from stay upon the first missed payment if the mortgage payments are coming from the trustee, because the servicer knows the trustee is aware of the problem. Reducing the number of automatic stay motions reduces the time spent opposing those motions, which also reduces the legal fees incurred by the debtor, and the burden on the bankruptcy court.

Disadvantages of Payment by Trustees

The disadvantages of running ongoing mortgage payments through the trustee include the need to hire additional staff with special skills, initial non-reimbursed expenses, and liability of the trustee.

Need for Additional Staff with Special Skills

Handling ongoing mortgage payments increases the workload of the trustee's office. The additional tasks may require more staff, or at least a more highly trained and skilled employee who may command a higher salary. An employee who is responsible for processing ongoing mortgage payments must be able to perform more complex duties, such as determining if critical information is missing, and recalculating payments if the interest rate adjusts, property taxes increase or decrease, or the debtor refinances. Mistakes in these areas may cause the claim to be paid incorrectly.

In some situations it may be advantageous for the trustee and staff to receive training from another trustee who has been making ongoing payments. With adequate justification, the U.S. Trustee will approve such training costs.

Initial Non-Reimbursed Operating Expenses

A trustee who commences making ongoing mortgage payments incurs costs before the disbursements generate percentage fee revenue sufficient to cover the expenses of administering the claim. Trained staff must be on board before the trustee begins to make ongoing mortgage payments. Frequently, the trustee must temporarily increase the percentage fee to cover those initial costs. As receipts grow, the trustee may be able to lower the percentage fee, perhaps to a level below the initial rate. (The U.S. Trustee will entertain frequent percentage fee changes during the transition to ensure that the trustee is able to meet the operation's ongoing needs.) If a trustee is already at or near the maximum 10 percent fee, the ability to increase the fee is severely limited. This may create a significant cash flow problem that can be solved only by reducing other operating expenses or the trustee's compensation.

Potential Liability

A trustee may be liable if a debtor's ongoing mortgage payments are not made to the mortgage servicer or are misapplied. For example, if a claim is incorrectly coded as unsecured, it will not be paid timely and may be paid on a prorated basis instead of in full. If a claim is assigned to the wrong case, the funds will be applied to someone else's mortgage. However, these are the same type of risks that trustees currently assume when paying any other claim.

Conclusion

If a trustee chooses not to handle ongoing mortgage payments, the U.S. Trustee will support that decision. Conversely, if a trustee chooses to accept and make ongoing mortgage payments, the U.S. Trustee will support the trustee's efforts. We understand that managing these mortgages will require more resources, and we will authorize additional staff and training costs to the extent allowed by Program policy. The trustee must evaluate the various factors particular to his or her situation, as well as consider the wishes of the bankruptcy community, in reaching this decision.