No. 10-1285

IN THE

Supreme Court of the United States

COUNTRYWIDE HOME LOANS, INC.,
Petitioner,

v.

FRANCISCO & ANNA RODRIGUEZ,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

REPLY BRIEF IN SUPPORT OF PETITIONER

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The Debtors' Brief in Opposition (the "Opposition") highlights the urgent need for review of this case. The Third Circuit Majority and the Fifth Circuit in *Campbell* adopted interpretations of a "claim" in bankruptcy that are so overly broad that they require mortgage lenders to extend post-petition loans to debtors in Chapter 13 bankruptcy cases to cover post-petition tax, insurance, and other escrow obligations. Like the Third Circuit Majority and the Fifth Circuit, the Opposition disregards the lender's absolute right under Section 2609(a)(2) of the Real Estate Settlement Procedures Act ("RESPA"), 12 U.S.C. §2609(a), to require additional escrow deposits to avoid actual or projected deficiencies and shortages in the bor-

rower's escrow account (*i.e.* loans) that are caused by making payments on the debtor's behalf where the debtor does not have sufficient funds on deposit in the escrow account.

The Opposition also ignores the conflict in the reasoning employed by the Third Circuit Majority and the Fifth Circuit to reach their erroneous conclusions. Currently, there are at least three different approaches to the question of how to handle escrow accounts in Chapter 13 bankruptcy cases (*i.e.* the Third Circuit Majority, the Fifth Circuit, and the RESPA approach endorsed by Judge Sloviter). Mortgage lenders need to know how to handle this issue given the number of Chapter 13 cases being filed each year.

The Opposition concludes by arguing an issue not reached by either the Third Circuit Majority or the Fifth Circuit—that Section 1322(b) of the Bankruptcy Code requires a different analysis of escrow accounts than that provided under RESPA and Reg. X on home mortgage loans for borrowers in Chapter 13 bankruptcy cases. Although Countrywide disagrees with the Debtors' analysis under Section 1322(b), Countrywide submits that the dispute between borrowers and mortgage lenders over the proper scope of a Chapter 13 Plan under Section 1322(b) should not be converted into a bankruptcy stay violation action potentially subjecting lenders to claims for damages, attorneys' fees, and punitive damages (as the Third Circuit Majority and the Fifth Circuit have now done). *See* 11 U.S.C. §362(k)

This Court should grant review now so that the erroneous application of the automatic stay is not extended further into the hundreds of thousands of pending Chapter 13 cases.

A. The Debtors Admit They Are Seeking to Compel Countrywide to Extend an Involuntary Post-Petition Loan to Cover Debtors' Anticipated Post-Petition Tax, Insurance, and Other Escrow Obligations.

1. The Debtors write: "the issue is not that the mortgagee is forced to loan money to fund post petition advances, but rather the rate at which it is repaid . . ." (Opp. at 15). If Countrywide must advance money to debtors to be repaid later, regardless of the rate of repayment, it is a loan. And although Debtors repeatedly accuse Countrywide of "eliminating a projected escrow surplus" (or "cushion" or "balance") (Opp. at 1, 3, 4, 11, & 14), the undisputed fact in the real world—as opposed to the Debtors' "Alice in Wonderland" accounting—is that there was no money in the escrow account to fund the Debtors' future, post-petition obligations because the Debtors failed to deposit money into that account.[1] Despite the absence of funds in the escrow account, the Debtors still expect Countrywide to follow RESPA's mandate to pay post-petition tax, insurance, and other escrow obligations as they come due. *See* 12 U.S.C. §2605(g); 24 C.F.R. §3500.17(k). Because there is no money in the escrow account to fund those payments, Countrywide must do so with its own money, thereby extending a post-petition loan to borrowers in bankruptcy. No other bankruptcy creditors are placed in the disfavored position of being compelled to fund a post-petition loan to debtors.[2]

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[1] The Debtors and the Third Circuit Majority do not appear to agree on the extent of this alleged "cushion." (*Compare* Pet. at 3a ("$1,787.69") *with* Opp. at 11 ("$2,494.89")).

[2] In Section 1322(b)(2) of the Bankruptcy Code, Congress actually placed home mortgage lenders in Chapter 13 cases in a

There is nothing in the Bankruptcy Code that compels any creditor to extend an involuntary loan to a bankrupt debtor. Although this Court has endorsed a broad definition of the word "claim" in bankruptcy, the definition of a "claim" should not be extended so far that it can be used to force creditors to make involuntary loans.

2. The Debtors try to frame the issue as a dispute over whether the mortgage lender should be repaid the involuntary loan over a period of twelve (12) months or over a period of sixty (60) months. (Opp. at 14). Countrywide has already explained the significant risks that mortgage lenders face when having to extend involuntary loans to bankrupt debtors. (*See* Pet. at 12). Congress provided lenders a right to address those risks in RESPA Section 2609(a)(2):

> in the event the lender determines there will be or is a deficiency he shall not be prohibited from requiring additional monthly deposits in such escrow account to avoid or eliminate such deficiency.

12 U.S.C. §2609(a)(2). The Department of Housing and Urban Development ("HUD") promulgated regulations to implement Section 2609(a). *See* 24 C.F.R. §3500.17. Debtors, by contrast, completely ignore RESPA §2609(a)(2) in their analysis. Debtors do not even cite that section in their Opposition. The decision to ignore, rather than to harmonize, applicable federal statutes is in direct conflict with this Court's decision in *Morton v. Manchuria,* 417 U.S. 535, 551 (1974).

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preferred position over other creditors by expressly limiting the authority of the bankruptcy courts to adopt Chapter 13 plans that modify their rights. *See* 11 U.S.C. §1322(b)(2).

The Debtors' hollow assurance that the mortgage lender "will be repaid in full" upon completion of the Chapter 13 plan (Opp. at 16) does not resolve the problem. The mortgage lender will be repaid only *if* the debtor (who has already defaulted on a loan and filed for bankruptcy) succeeds in completing his Chapter 13 plan. In many Chapter 13 cases, that does not happen. The "Bankruptcy Abuse Prevention and Consumer Protection Act Statistics" published on the website of the Administrative Office of the United States Courts reveal that few Chapter 13 debtors complete their plan payments:

	2009	2008	2007
Total Cases Closed	156,494	118,440	54,958
Total Plans Completed	9,937	4,969	1,627
Cases Dismissed	145,940	113,289	53,077
Cases Dismissed for Failure To Make Plan Payments	71,114	48,081	17,134

See www.uscourts.gov/Statistics/Bankruptcy/Statistics.aspx (Table 6 "Chapter 13 Individual Debtor Cases with Predominantly Nonbusiness Debts Closed by Dismissal or Plan Completion"). Based on those statistics, it is over eight (8) times more likely that a debtor's case will be dismissed for defaulting on the plan rather than completing the plan. In light of these startling statistics, mortgage lenders should not be compelled to extend additional post-petition loans to debtors.

The Debtors provide no answers to the problems created by their interpretation of the Bankruptcy Code. Congress and HUD, by contrast, confirmed

through RESPA and Reg. X that they did not intend to subject mortgage lenders to the risk of being compelled to make involuntary loans to borrowers to be repaid over a period of several years.

B. There Is a Clear Conflict in Authorities Regarding How to Handle Escrow Accounts in Chapter 13 Bankruptcy Cases.

Debtors erroneously claim there is no conflict between the Third Circuit Majority and the Fifth Circuit in *Campbell*, and label "the distinction raised by the Petitioner between the Fifth and Third" as "unpersuasive." (Opp. at 7 n.4). But the Debtors recognize the courts reached conflicting conclusions regarding whether a missed pre-petition escrow deposit was a "contingent" or "matured" claim.[3] (Opp. at 7). Judge Sloviter agreed with Countrywide that there was *no claim* for those missed estimated escrow deposits. Accordingly, there is a clear conflict in the law on this issue.

This Court should not allow there to be continued disagreement as to what is included within a mortgage lender's claim in Chapter 13 cases. On pages 29 and 30 of the Petition, Countrywide provided an illustration showing the three competing approaches to this issue differ in result. (Pet. at 29-30). The

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[3] The Debtors suggest that the difference between the Third Circuit Majority and Fifth Circuit opinions was the result of differences in New Jersey and Texas tax law. (Opp. at 5-6). This is not true. There is nothing in either the Third Circuit or Fifth Circuit opinions that tied their conclusions to the requirements of state tax laws. The issue presented is one calling for an interpretation of federal law, under RESPA and the Bankruptcy Code.

Debtors do not even attempt to respond to that illustration. Mortgage lenders, by contrast, cannot ignore the real differences that exist on how to define a claim in bankruptcy relating to escrow accounts. Given that there are hundreds of thousands of Chapter 13 cases filed each year, mortgage lenders should not be forced to face the risk of punitive damage lawsuits asserting alleged violations of the automatic stay just because there is no uniform guidance on how to handle escrow accounts in Chapter 13 cases.

C. By Incorrectly Finding an Automatic Stay Violation, the Third Circuit Majority and Fifth Circuit Are Preventing the Harmonization of RESPA and the Bankruptcy Code Through a Correct Application of Section 1322.

The issue of how to handle escrow accounts in Chapter 13 bankruptcy cases is one that should be resolved by applying RESPA and Reg. X in light of Section 1322 of the Bankruptcy Code (which establishes the permissible content of a Chapter 13 Bankruptcy plan). *See* 11 U.S.C. §1322. The Debtors are correct when they assert that the Third Circuit Majority and Fifth Circuit did not reach the issue of how to apply Section 1322—because those courts treated this issue as an automatic stay problem. (Opp. at 3, 9). When Section 1322(b) is analyzed in full, it should be clear that Countrywide's approach to escrow accounts is correct.

A Chapter 13 plan may *not* modify the "rights" of a mortgage lender holding a claim secured by the debtor's interest in his or her principal residence. 11 U.S.C. §1322(b)(2). This should mean that a Chapter 13 plan cannot modify the mortgage lender's right to

handle escrow accounts on home mortgage loans under the governing provisions of RESPA and Reg. X.

The Debtors' reliance upon the ability to cure "defaults" under Section 1322(b)(5) does not change that conclusion. Section 1322(b)(5) provides: "the plan may . . . notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time . . ." 11 U.S.C. §1322(b)(5). Missed pre-petition estimated escrow deposits are not a "default" that can be cured outside of RESPA and Reg. X. Instead, the specific provisions of RESPA and Reg. X that govern the collection of shortages and deficiencies in escrow accounts should be applied in harmony with the more general "reasonable time" standard in Section 1322(b)(5). *See Morton*, 417 U.S. at 550-51. When harmonized with the other applicable statutes, there is no reasonable reading of Section 1322(b)(5) that would authorize a bankruptcy court to compel a lender to extend an involuntary loan over the life of the debtor's Chapter 13 plan.

CONCLUSION

This Court should grant this Petition because the rights of mortgage lenders with respect to the administration of escrow accounts in Chapter 13 bankruptcy cases should be analyzed in light of RESPA, Reg. X, and Bankruptcy Code Section 1322. By treating this question as an issue implicating the Bankruptcy Code's automatic stay, the Third Circuit Majority and the Fifth Circuit are imposing a substantial cost of litigation (including potential exposure to punitive damages) on the mortgage lender's ability to obtain certainty on the proper procedures for administering escrow accounts in the hundreds of thousands of Chapter 13 cases pending in the bank-

ruptcy courts. That threat is further heightened by the fact that the two federal appellate courts to rule on the issue do not even agree with each other. This Court should resolve this conflict in authority, and hold that there is no bankruptcy "claim" for missed pre-petition estimated escrow deposits. Mortgage lenders need a uniform standard to apply in all Chapter 13 cases; it should be the one already adopted by Congress and HUD in RESPA and Reg. X.

Respectfully submitted,

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