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Good News for Mortgage Lenders in Consumer Bankruptcy Class Actions

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While there has not been much good news for the mortgage banking industry coming out of bankruptcy courts in years, a recent opinion issued by the United States Court of Appeals for the Fifth Circuit provides not just good news, but very good news for mortgage lenders. The Fifth Circuit's opinion in *Wilborn v. Wells Fargo Bank, N.A. (In re Wilborn)*, 609 F.3d 748 (5th Cir. 2010) dealt a severe blow to the plaintiff's bar's repeated attempts to target mortgage lenders in class action cases, particularly with regard to the assessment of fees and expenses charged by mortgage servicers during the course of Chapter 13 bankruptcy cases.

The *Wilborn* case originated in the United States Bankruptcy Court for the Southern District of Texas, in which there has been an abundance of lawsuits against mortgage lenders. That district is the source of a number of cases where mortgage lenders have been sanctioned for the assessment of allegedly unreasonable fees. Decisions from this district have been widely cited by plaintiff's bars in other jurisdictions. In *Wilborn*, Judge Jeff Bohm, a well-known and well-respected bankruptcy judge, certified a district-wide class action in an adversary proceeding on behalf of a putative class of Chapter 13 debtors. The basis of the action was the alleged assessment and collection by Wells Fargo Bank, N.A. of undisclosed and unapproved post-petition professional fees and costs.

Wells Fargo appealed the certification of the class to the Fifth Circuit Court of Appeals. The Fifth Circuit began by throwing the plaintiff's bar a small bone, by holding that the bankruptcy court had jurisdiction to certify a class of debtors in its own district. This ended the dispute, in the Fifth Circuit, about whether bankruptcy courts, which are courts of limited jurisdiction, have the power to certify district-wide class actions.[1] The Wilborn court did not decide whether bankruptcy courts have the power to certify class actions on a nationwide basis.[2]

But in a decision with broad implications, the *Wilborn* court held that the bankruptcy court abused its discretion in certifying the class action. The bankruptcy court held that the class could be certified under Rule 23(b)(3) because "the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy." The Fifth Circuit reversed the bankruptcy court's decision to certify the class under Rule 23(b)(3) of the Federal Rules of Civil Procedure.

The Fifth Circuit disagreed, holding that there were too many unique issues with respect to each proposed class member, particularly with regard to damages, and that the bankruptcy court's class certification was therefore inappropriate under Rule 23(b)(3). Some debtors, the Fifth Circuit observed, may have agreed to the fees in connection with a loan modification. In other cases, the fees, or some of the fees, may have been approved by the bankruptcy court. In some cases, disgorgement would be the appropriate remedy, in other cases it would not. In each instance, the rulings made and procedures adopted by the bankruptcy judge would vary. "In short, the myriad issues that may arise in each case as to whether and how fees and costs were imposed preclude a class-wide disposition of the case under Rule 23(b)(3)."

For the same reason, the Fifth Circuit reversed the bankruptcy court's decision to certify a class under Rule 23(b)(2). Rule 23(b)(2) focuses on whether the defendant "has acted or refused to act on grounds that apply generally to the class" so that injunctive or declaratory relief is appropriate for the class as a whole. Monetary relief must be incidental to the damages requested, such that relief is automatic once liability is established.

Here, the Fifth Circuit found that the disgorgement of fees was an individual issue, which would have to be determined based on the facts and circumstances of each case. Hence, class certification was improper.

In this instance, the variability and complexity of the bankruptcy courts – so vexing to loan servicers trying to administer loans in bankruptcy – has worked in favor of the lenders. The Fifth Circuit, as least, has decided that the rights of debtors and obligations of lenders in bankruptcy cases are so individual and case specific that certification of class action cases, even class actions confined to a single district, will often not be appropriate. This is very good news for mortgage lenders.

The *Wilborn* decision has already had a significant impact at the bankruptcy court level. Bankruptcy judges are less keen to certify class actions and, accordingly, debtors' lawyers, particularly those in the Fifth Circuit, are less likely to file bankruptcy class actions. Although the Fifth Circuit did not close the door on bankruptcy class actions, it has rendered them much less attractive to debtors.

1. Some courts hold that a bankruptcy judge may not certify a class of debtors because only the bankruptcy judge before whom the debtor's case is pending has the power to hear and determine the debtor's legal claims. *See, e.g., In re Cline*, 282 B.R. 686, 690 (W.D. Wash. 2002); *In re Lenior*, 231 B.R. 662, 668 (Bankr. N.D. Ill. 1999); *In re Fisher*, 151 B.R. 895, 898 (Bankr. N.D. Ill. 1993). Other courts have held to the contrary. *See, e.g., Rodriguez v. Countrywide Home Loans, Inc*., 421 B.R. 341, 354-55 (S.D. Tex. 2009) (collecting cases); *Bank United v. Manley*, 273 B.R. 229, 250 (N.D. Ala. 2001); *In re Tate*, 253 B.R. 653, 662 (Bankr. W.D.N.C. 2000); *In re Williams*, 244 B.R. 858, 865-66 (S.D. Ga. 2000).

2. There also is disagreement in the bankruptcy and district courts about whether the bankruptcy court may exercise jurisdiction over a nationwide class of debtors or is limited to exercising jurisdiction over debtors whose petitions are filed within the same judicial district. In the late 1990s and early 2000s, Bankruptcy Judge Margaret Mahoney from the Southern District of Alabama certified a number of different nationwide class cases against mortgage lenders based upon fees included in Proofs of Claim filed by mortgage lenders that were not properly disclosed. *See In re Noletto*, 244 B.R. 845, 849 (Bankr. S.D. Ala. 2000) (permitting nation-wide class). This lead to widespread changes in the mortgage industry in the way fees and expenses are accounted for by lenders in bankruptcy cases. Other courts have declined to certify nationwide class actions, holding that bankruptcy courts only have jurisdiction over putative class members whose cases are pending in the bankruptcy judge's district. *See Barrett v. Avco Fin. Servs. Mgmt. Co*., 292 B.R. 1, 8 (D. Mass. 2003) (holding court lacks jurisdiction over putative class members whose bankruptcies were discharged outside of judicial district).