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ABOUT THE AUTHOR



[Landon Van Winkle](#) is an associate within the firm's [Consumer Financial Services Compliance & Litigation](#) practice group where he assists clients with pre-suit negotiations and litigation in matters involving consumer financial services litigation and compliance and bankruptcy. His areas of practice are Consumer Financial Services Litigation & Compliance, Commercial Creditor Bankruptcy, and Commercial Litigation.

District Court Reverses Bankruptcy Court Order Imposing Sanctions on Mortgage Servicer

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The U.S. District Court for the Eastern District of North Carolina recently reversed an order of the U.S. Bankruptcy Court for the Eastern District of North Carolina. The bankruptcy court order held mortgage servicer Newrez, LLC (“Newrez”) and the holder of the mortgage note at issue in civil contempt for failing to abide by the terms of the individual debtors’ confirmed chapter 11 plan (the “Plan”). *Newrez, LLC v. Beckhart*, No. 7:20-cv-00192-BO, 2021 U.S. Dist. LEXIS 125293, at *1 (E.D.N.C. July 6, 2021). The district court found that the nebulous terms of the Plan, coupled with Newrez’s good faith reliance on the advice of counsel in interpreting those terms, was sufficient to establish that Newrez had an objectively reasonable basis for its conduct, thus insulating it from civil contempt sanctions under the rule established in *Taggart v. Lorenzen*, 139 S. Ct. 1795 (2019). The court’s reversal emphasizes the benefits to a creditor of securing legal advice when the bankruptcy court orders governing the creditor’s claim are unclear.

The controversy centered around the Plan’s treatment of Newrez’s secured claim. When the debtors filed their voluntary chapter 11 case in 2009, they owned a beach house subject to a mortgage with a prepetition arrearage in excess of \$22,000, arising from ten months of missed payments. The Plan made no provision for the repayment of the prepetition arrearage or for the post-petition payments that came due prior to confirmation. It was confirmed over the objection of Newrez’s predecessor in late 2010, and the debtors began making payments under the Plan around the same time. Newrez began servicing the mortgage in 2014 and treated the loan as if it were in default from that time through 2019, based on the significant uncured arrearage. The debtors repeatedly contended that the loan was current based on the terms of the Plan, and challenged Newrez’s determination that it was in default.

In January 2020, the debtors filed a motion in the bankruptcy court seeking to have Newrez and the holder of the loan held in civil contempt for failing to comply with the terms of the Plan and sought significant sanctions. Following an evidentiary hearing, the bankruptcy court entered an order finding Newrez and the holder in civil contempt and assessing monetary sanctions in excess of \$110,000, consisting largely of lost wages, a loss of a fresh start, and attorneys’ fees. Newrez appealed, and the district court

reversed.

In analyzing the bankruptcy court's order, the district court recited the standard for civil contempt clarified by the Supreme Court in *Taggart*: A creditor may be held in civil contempt for violation of a bankruptcy court's order if there is no "fair ground of doubt as to whether the order barred the creditor's conduct." *Taggart*, 139 S. Ct. at 1799. Thus, civil contempt is appropriate only where there is "no objectively reasonable basis for concluding that the creditor's conduct might be lawful." *Id.*

In holding that there was a fair ground of doubt as to whether the Plan required Newrez to treat the mortgage as current and not in default, the Court focused on the multiple questions the Plan left unanswered regarding the mortgage:

Nothing in the confirmation order expressly addressed what amount [the debtors] would owe on loan as of November 25, 2010, or how the \$22,836.40 in pre-petition arrearage would be repaid if at all. Although the order set a due date for the first payment, it offered no guidance on how much that payment would be.

Beckhart, 2020 U.S. Dist. LEXIS 125293, at *7. Further, the court observed that the Plan's terms created additional confusion because the Plan purported to leave the rights of the holder of the mortgage unmodified except as expressly provided in the Plan, but the Plan did not expressly provide for any treatment of the arrearage or post-petition payments. *Id.* Similarly, the court found that because Newrez had repeatedly sought and relied upon the advice of outside counsel in conducting itself under the Plan, it had an objectively reasonable basis to believe that its conduct was lawful. *Id.* at *8-9 (citing *Waller v. Sprint Mid Atl. Tel.*, 77 F. Supp. 2d 716, 722 (E.D.N.C. 1999)). It also found that the same reliance on outside counsel made clear that Newrez had acted in good faith in adopting a reading of the Plan "that seemed consistent with the contractual terms of the loan." *Id.* at *8. Because Newrez established both that there was a fair ground of doubt as to whether the Plan prohibited its conduct, and because it had an objectively reasonable basis for acting as it did, the court concluded that the bankruptcy court's order finding it in contempt "falls far short of the standard required for a finding of civil contempt," and reversed the order and remanded the matter to the bankruptcy court for further proceedings.

Beckhart showcases the dual benefits to a creditor in seeking competent legal advice where there is any question about the interpretation or effect of bankruptcy court orders on the creditor's claims. First, relying on the advice of counsel can help establish that a creditor was acting in good faith, which is significant since *Taggart* did not foreclose the permissibility of holding a creditor in contempt when it acts in bad faith. *See Taggart*, 139 S. Ct. at 1802 ("Our cases suggest, for example, that civil contempt sanctions may be warranted when a party acts in bad faith."). Second, acting on the good faith advice of counsel can supply the creditor with an objectively reasonable basis for concluding that its conduct is permitted under the order at issue. This is particularly beneficial where, as in *Beckhart*, the order is unclear and subject to multiple reasonable interpretations.

CONTACT US

919.250.2000

mail@smithdebnamlaw.com

RALEIGH OFFICE

The Landmark Center
4601 Six Forks Road, Suite 400
Raleigh, NC 27609

Phone: 919.250.2000

Fax: 919.250.2100

CHARLESTON OFFICE

171 Church Street
Suite 120C
Charleston, SC 29401

Phone: 843.714.2530

Fax: 843.714.2541