

HSBC FORECLOSURES AND THE NEWTRAK SYSTEM OF LENDER PROCESSING SERVICES

By Lynn E. Szymoniak, Esq., Ed. Fraud Digest, August 26, 2011

On August 24, 2011, Circuit Judge Fuentes of the United States Third Circuit Court of Appeals, issued an opinion in a case appealing the reversal by the District Court of sanctions originally imposed in the bankruptcy court on attorneys Mark J. Urden and Lorraine Doyle, the Udren Law Firm, and HSBC for violations of Federal Rule of Bankruptcy Procedure 9011. Highlights from that opinion, particularly regarding Lender Processing Services and HSBC, are set forth below. In this decision, the Third Circuit reversed the District Court and affirmed the bankruptcy court's imposition of sanctions with respect to Lorraine Doyle, the Udren Law Firm, and HSBC. The District Court's decision reversing the bankruptcy court's sanctions against attorney Mark Urden was affirmed. The appeal was taken by Acting United States Trustee Roberta A. DeAngelis, In re Nile C. Taylor, et al., Case No. 10-2154, 3d Cir. 2011. Ultimately, the Taylors lost their home. The sanctions imposed by the Bankruptcy Court, reversed by the District Court and finally affirmed by the Circuit Court, were minimal. Doyle was ordered to take 3 CLE credits in professional responsibility; Udren himself to be trained in the use of NewTrak and to spend a day observing his employees handling NewTrak; and both Doyle and Udren to conduct a training session for the firm's relevant lawyers in the requirements of Rule 9011 and procedures for escalating inquiries on NewTrak. The court also required HSBC to send a copy of its opinion to all the law firms it uses in bankruptcy proceedings, along with a letter explaining that direct contact with HSBC concerning matters relating to HSBC's case was permissible.

The Court made the following findings:

- HSBC does not deign to communicate directly with the firms it employs in its high-volume foreclosure work; rather, it uses a computerized system called NewTrak (provided by a third party, LPS) to assign individual firms discrete assignments and provide the limited data the system deems relevant to each assignment. The firms are selected and the instructions generated without any direct human involvement. The firms so chosen generally do not have the capacity to check the data (such as the amount of mortgage payment or time in arrears) provided to them by NewTrak and are not expected to communicate with other firms that may have done related work on the

matter. Although it is technically possible for a firm hired through NewTrak to contact HSBC to discuss the matter on which it has been retained, it is clear from the record that this was discouraged and that some attorneys, including at least one Udren Firm attorney, did not believe it to be permitted. [The Udren Firm represented HSBC in this bankruptcy foreclosure.](Page 6-7)

- LPS is also not involved in the present appeal, as the bankruptcy court found that it had not engaged in wrongdoing in this case. However, both the accuracy of its data and the ethics of its practices have been repeatedly called into question elsewhere. *See, e.g., In re Wilson*, 2011 WL 1337240 at 9 (Bankr. E.D.La. Apr. 7, 2011) (imposing sanctions after finding that LPS had issued “sham” affidavits and perpetrated fraud on the court); *In re Thorne*, 2011 WL 2470114 (Bankr. N.D. Miss. June 16, 2011); *In re Doble*, 2011 WL 1465559 (Bankr. S.D. Cal. Apr. 14, 2011). (Footnote 5, Page 6)

- Doyle [the attorney from the Udren Firm representing HSBC] did nothing to verify the information in the motion for relief from stay besides check it against “screen prints” of the NewTrak information. She did not even access NewTrak herself. In effect, she simply proofread the document. It does not appear that NewTrak provided the Udren Firm with any information concerning the Taylors’ equity in their home, so Doyle could not have verified her statement in the motion concerning the lack of equity in any way, even against a “screen print.” (Page 8)

- In May 2008, the bankruptcy court held a hearing on both the motion for relief and the claim objection. HSBC was represented at the hearing by a junior associate at the Udren Firm, Mr. Fitzgibbon. At that hearing, Fitzgibbon ultimately admitted that, at the time the motion for relief from the stay was filed, HSBC had received a mortgage payment for November 2007, even though both the motion for stay and the response to the Taylors’ objection to the proof of claim stated otherwise.⁸ Despite this, Fitzgibbon urged the court to grant the relief from stay, because the Taylors had not responded to HSBC’s RFAs (which included the “admission” that the Taylors had not made payments from November 2007 to January 2008). It appears from the record that Fitzgibbon initially sought to have the RFAs admitted as evidence even though he knew they contained falsehoods. (Page 10)

- The bankruptcy court denied the request to enter the RFAs as evidence, noting that the firm “closed their eyes to the fact that there was evidence that . . . conflicted with the very admissions that they

asked me [to deem admitted]. They . . . had that evidence [that the assertions in its motion were not accurate] in [their] possession and [they] went ahead like [they] never saw it." (App. 108-109.) (Page 11)

- At the next hearing, in June 2008, Fitzgibbon stated that he could not obtain an accounting from HSBC, though he had repeatedly placed requests via NewTrak. He told the court that he was literally unable to contact HSBC—his firm’s client—directly to verify information which his firm had already represented to the court that it believed to be true. (Page 11)

- The bankruptcy court held four hearings over several days, making in-depth inquiries into the communications between HSBC and its lawyers in this case, as well as the general capabilities and limitations of a system like NewTrak. Ultimately, it found that the following had violated Rule 9011: Fitzgibbon, for pressing the motion for relief based on claims he knew to be untrue; Doyle, for failing to make reasonable inquiry concerning the representations she made in the motion for relief from stay and the response to the claim objection; Udren and the Udren Firm itself, for the conduct of its attorneys; and HSBC, for practices which caused the failure to adhere to Rule 9011.

- Rule 9011 of the Federal Rules of Bankruptcy Procedure, the equivalent of Rule 11 of the Federal Rules of Civil Procedure, requires that parties making representations to the court certify that “the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support.” Fed. R. Bank. P. 9011(b)(3). A party must reach this conclusion based on “inquiry reasonable under the circumstances.” Fed. R. Bank. P. 9011(b). The concern of Rule 9011 is not the truth or falsity of the representation in itself, but rather whether the party making the representation reasonably believed it at the time to have evidentiary support.

- As an initial matter, the appellees’ insistence that Doyle’s and Fitzgibbon’s statements were “literally true” should not exculpate them from Rule 9011 sanctions. First, it should be noted that several of these claims were not, in fact, accurate. There was no literal truth to the statement in the request for relief from stay that the Taylors had no equity in their home. Doyle admitted that she made that statement simply as “part of the form pleading,” and “acknowledged having no knowledge of the value of the property and having made no inquiry on this subject.” (App. 215.) Similarly, the statement in the claim

objection response that the figures in the original proof of claim were correct was false. (Page 16)

- In particular, even assuming that Doyle's and Fitzgibbon's statements as to the payments made by the Taylors *were* literally accurate, they were misleading. In attempting to evaluate whether HSBC was justified in seeking a relief from the stay on foreclosure, the court needed to know that at least partial payments had been made and that the failure to make some of the rest of the payments was due to a bona fide dispute over the amount due, not simple default. Instead, the court was told only that the Taylors had "failed to make regular mortgage payments" from November 1, 2007 to January 15, 2008, with a mysterious notation concerning a "suspense balance" following. (App. 214-15.) A court could only reasonably interpret this to mean that the Taylors simply had not made payments for the period specified. As the bankruptcy court found, "[f]or at best a \$540 dispute, the Udren Firm mechanically prosecuted a motion averring a \$4,367 post-petition obligation, the aim of which was to allow HSBC to foreclose on [the Taylors] "house." (App. 215.) Therefore, Doyle's and Fitzgibbon's statements in question were either false or misleading. (Pages 16-17)

- With respect to the Taylors case in particular, Doyle ignored clear warning signs as to the accuracy of the data that she did receive. In responding to the motion for relief from stay, the Taylors submitted documentation indicating that they had already made at least partial payments for some of the months in question. In objecting to the proof of claim, the Taylors pointed out the inaccuracy of the mortgage payment listed and explained the circumstances surrounding the flood insurance dispute. Although Doyle certainly was not obliged to accept the Taylors' claims at face value, they indisputably put her on notice that the matter was not as simple as it might have appeared from the NewTrak file. At that point, any reasonable attorney would have sought clarification and further documentation from her client, in order to correct any prior inadvertent misstatements to the court and to avoid any further errors. Instead, Doyle mechanically affirmed facts (the monthly mortgage payment) that *her own prior filing* with the court had already contradicted. (Page 20)

- Doyle's reliance on HSBC was particularly problematic because she was not, in fact, relying directly on HSBC. Instead, she relied on a computer system run by a third-party vendor. She did not know where the data provided by NewTrak came from. She had no capacity to

check the data against the original documents if any of it seemed implausible. (Page 20)

- Although the initial data the Udren Firm received was not, in itself, wildly implausible, it was facially inadequate. In short, then, we find that Doyle's inquiry before making her representations to the bankruptcy court was unreasonable.

In making this finding, we, of course, do not mean to suggest that the use of computerized databases is inherently inappropriate. However, the NewTrak system, as it was being used at the time of this case, permits parties at every level of the filing process to disclaim responsibility for inaccuracies. HSBC has handed off responsibility to a third-party maintainer, LPS, which, judging from the results in this case, has not generated particularly accurate records. LPS apparently regards itself as a mere conduit of information. Appellees, the attorneys and final link in the chain of transmission of this information to the court, claim reliance on NewTrak's records. Who, precisely, can be held accountable if HSBC's records are inadequately maintained, LPS transfers those records inaccurately into NewTrak, or a law firm relies on the NewTrak data without further investigation, thus leading to material misrepresentations to the court? It cannot be that all the parties involved can insulate themselves from responsibility by the use of such a system. (Page 21)

- We also find that it was appropriate to extend sanctions to the Udren Firm itself. Rule 11 explicitly allows the imposition of sanctions against law firms...In this instance, the bankruptcy court found that the misrepresentations in the case arose not simply from the irresponsibility of individual attorneys, but from the system put in place at the Udren Firm, which emphasized high-volume, high-speed processing of foreclosures to such an extent that it led to violations of Rule 9011. (citations omitted)(Page 24)

- We appreciate that the use of technology can save both litigants and attorneys time and money, and we do not, of course, mean to suggest that the use of databases or even certain automated communications between counsel and client are presumptively unreasonable. However, Rule 11 requires more than a rubber-stamping of the results of an automated process by a person who happens to be a lawyer. Where a lawyer systematically fails to take any responsibility for seeking adequate information from her client, makes representations without any factual basis because they are included in a "form pleading" she has been trained to fill out, and ignores obvious indications that her

information may be incorrect, she cannot be said to have made reasonable inquiry. (Page 26)