

The following is a summary and analysis of Judge Sigmund's opinion by Texas Bankruptcy Attorney Stephen Sather.

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Pennsylvania Judge Writes Epic Opinion on Technology and Professional Responsibility

Technology has dramatically changed the practice of law. Thanks to Westlaw and Lexis, it is no longer necessary to keep large expensive libraries. PACER and ECF have made court filings and filing documents available 24/7. I recently observed a case where the parties used GoToMeeting to handle thousands of pages of exhibits electronically. All of these developments have made the practice of law more efficient. However, a recent opinion from Judge Diane Weiss Sigmund highlights that professionals must be masters of the technology rather than being mastered by it. In re Taylor, No. 07-15385 (Bankr. E.D. Pa. 4/15/09).

The Taylor case started with a simple question that comes up frequently in consumer bankruptcy cases: Why couldn't the creditor's lawyer get a payment history? The answer given to this question prompted Judge Sigmund to launch a one year investigation into the technology behind the case and how it was being used and to award some very creative sanctions. The Judge authored a 58 page opinion "to share my education with participants in the bankruptcy system who may be similarly unfamiliar with the extent that a third party intermediary drives the Chapter 13 process." Opinion, p. 30.

What Happened

Taylor involved a chapter 13 filing to try to keep a house. Two firms appeared on behalf of HSBC, the mortgage holder. A national firm filed a proof of claim, while a local firm filed a motion for relief from stay and responded to an objection to claim. All three documents were defective. The proof of claim attached the wrong mortgage and listed the wrong payment amount. The motion for relief from stay recited that the debtors had failed to make their post-petition payments for three months, when in fact they had been making the payments, but at a lower amount due to a dispute over flood insurance. According to the Court, "at the time the Stay Motion was filed, the Debtors were short \$360 for payments more than 60-days overdue, a fact not clear from the canned pleading prepared by a paralegal from New Trak screens. The Debtors were charged \$800 for the cost of the motion." Opinion, p. 14. The motion also recited that the debtors had no equity in the property which the attorney later attributed to being part of a boilerplate form. The response to the objection to claim said that the claim was just fine when it was not. The Debtor's attorney did not do much better. She filed a late response, which incorrectly stated that the debtors had made all of their payments but they had been returned by HSBC. The Debtor's attorney also failed to respond to requests for admission tendered with the motion, incorrectly believing that her response to the motion was sufficient.

Upon receiving the Debtor's attorney's response, HSBC's local counsel continued the hearing for further investigation. The Debtor's lawyer then filed an amended response, which included copies of the checks for the months of September through January with both front and back and the checks for February and March with just the front. The amended response alleged that the payments for September through March had all been made. As it turns out, the reason that there were only copies of the front side of the February and March payments was because the Debtor's counsel was still in possession of these checks which had not yet been tendered. Debtor's counsel erroneously mailed these checks to the person at HSBC's attorney's office who handled Sheriff's Sales rather than to the Bankruptcy Department. The person in the Sheriff's Sale department sat on the checks and did not inform the Bankruptcy Department that they had been received. The Debtor's counsel also requested a payment history.

On May 1, a young associate appeared for HSBC and insisted on prosecuting the motion even though he had been provided with proof of payments. The young attorney sought to proceed based on the deemed admissions even though he knew they were not accurate. The court denied the motion and instructed the debtor to escrow the disputed flood insurance premiums while the parties worked through the issue.

One month later, the parties appeared on the claims objection and things rapidly escalated. The young associate (he had been licensed a few months at the time) stated that he could not get a payment history from his client. He explained that he had submitted a request for a payment history through an electronic system, but that he was forbidden to speak directly with the client. This statement caused the Court to issue a show cause order.

In response to the Court's Show Cause Order, HSBC retained new counsel and the problem with the claim was quickly settled. As noted by the Court, "What could not be accomplished for six months through the use of electronic communication was finalized in an hour the old way, by people sitting down with all relevant information and talking to each other." Opinion, p. 19.

While the contested matters were quickly settled, the Court was not satisfied. It launched an inquiry which brought the technology center stage.

The Technology and Professional Responsibility

The technology involved was the NewTrak system developed and operated by Lender Processing Services, Inc. f/k/a Fidelity Information Services, Inc. To its credit, LPS was "extremely cooperative" with the court's inquiry and "provided a detailed demonstration of how NewTrak works in a hypothetical case." Opinion, p. 9, n. 15. As a result, the Court had a substantial knowledge base to draw on when writing her opinion.

NewTrak is an automation system which allows lenders and attorneys to communicate with each other. The lender uploads its information onto the system which then generates a referral to an attorney on the approved list. The attorney receives the information and generates the proof of claim, motion for relief from automatic stay or other pleading. The system also allows the attorney to request information from the client by opening an issue on the system. Another system called the mortgage servicing platform handles routine mortgage servicing. According to LPS, it was used by 39 of the 50 largest banks in 2007 and processed approximately 50% of the loans in the United States.

While NewTrak provides a flow of information between attorney and client, it is not meant to prohibit direct contact between the parties. The Default Services Agreement specifically provides that "The Firm will never be prohibited from directly contacting any client where, in the professional opinion of the Firm such contact is necessary." Opinion, p. 34, n. 45. As a result, the agreement contemplates that the Firm will exercise professional judgment. However, the Court found that when an attorney mechanically uses the system "the attorney abandons any pretense of independent judgment to the greater goal of expeditious and economical client service." Opinion, p. 31.

The Court contrasted the benefits of using the technology with its pitfalls when a matter is not routine. It is a regrettable reality, especially in this economic climate, that many homeowners are defaulting on their mortgages. While bankruptcy affords an opportunity to save the family home through a Chapter 13 plan that stretches the payments of mortgage arrears, it also requires debtors to maintain current payment on their mortgages. (citation omitted). This obligation is beyond the capability of many debtors who use a bankruptcy to forestall the inevitable. It seems reasonable that a mortgage lender should be able to avail itself of economic and expeditious means of collecting defaulted loans through the use of technology and delegation of tasks to lower cost labor. In many cases, the motions are granted by default, the debtors, or often more accurately their attorneys, filing no answer or making no appearance, where there is simply no defense to the relief sought. However, **where, as here, the debtor contests the relief sought, the flaws in the automated process become apparent. At this juncture, an attorney must cease processing files and act like a lawyer. That means she must become personally engaged, conferring with the client directly and abandoning her reliance on computer screens as an expression of her client's will. This did not happen in this case until the Court became involved. It should not have taken judicial intervention to bring the Claim Objection to its conclusion. Opinion, p. 32 (emphasis added).**

In this case, the court found that professional judgment was not used.

The attorney for the national firm which filed the proof of claim testified that he reviewed only a representative sample of 10% of the claims which were electronically signed with his name. He did not review the specific claim in this case and as a result, did not find the mistakes in it.

The president of the local firm which utilized NewTrak testified that he delegated the administrative aspects of the firm's practice and was unaware of how NewTrak worked.

The head of the bankruptcy section of the firm electronically signed all of the pleadings in the matter, but delegated all of the court appearances to an attorney who had been licensed for only one month when the initial pleading was filed. The court found that the head of the bankruptcy section failed to supervise the young attorney and asked the rhetorical question, "Could it be with ten lawyers and 130 paralegals and processors, a young attorney is expected to figure it out himself?" Opinion, p. 42.

The Court also found that the client had restricted the firm's authority.

The Udren Firm's authority from HSBC allowed them to take only three actions: (1) seek a continuance; (2) settle with Motion with an agreement for a six month maximum cure of the mortgage arrears with an agreement for stay relief upon certification of default of any future payment; and failing either of the foregoing; (3) press the motion. (citation omitted). No consultation with HSBC was expected nor occurred during the pendency of the contested matter. Opinion, p. 37, n. 49.

Sanctions

The Court found that several parties to the case had violated their obligations under Rule 9011, including the obligation to make reasonable inquiry. However, the Court was also mindful that sanctions should be "limited to what is sufficient to deter a repetition of such conduct or comparable conduct by others similarly situated." Rule 9011(c)(2). As a result, the Court granted some very creative relief.

As to the Udren Firm, which acted as local counsel, the Court found that the expense of having to hire counsel and defend itself and the productive time lost in attending to the matter was punishment enough. However, the Court devoted additional attention to the specific lawyers from the firm.

The Court found that the head of the Udren Firm's bankruptcy section "may be so enmeshed in the assembly line of managing the bankruptcy department's volume mortgage practice that she has lost sight of her duty to the court and has compromised her ethical obligations." Opinion, p. 52. The Court ordered her to obtain 3 credits of CLE in professional responsibility/ethics in addition to her regular requirements. The court declined to award sanctions against the young associate, finding that "I believe these proceedings have been very hard on this young lawyer and while lack of experience is not a defense to a Rule 9011 violation, I suspect that he has learned all that he needs to learn without protracting this unfortunate time in his nascent career." Opinion, p. 52.

The Court found that the head of the firm "sets the tone and establishes its culture. He notes his firm's reliance on NewTrak and other such aids as essential to the economic structure of the law practice. However, he had little familiarity with the actual operation of NewTrak and did not appear to get involved in the 'weeds' of the bankruptcy practice." Opinion, pp. 52-53. The Court found this lack of involvement to be troubling and ordered relief accordingly.

Mr. Udren may not be aware of the questionable practices imposed by his firm's acquiescence to NewTrak and how little legal judgment is employed as a result or he may be aware and find it acceptable. To examine these practices in light of extant ethical obligations, I will direct him to obtain training in NewTrak and spend a day observing his bankruptcy attorneys, paralegals, managers and processors as they handle referrals. Since policy emanates from the top, I will also order Udren and (the head of the bankruptcy section) to conduct a training session for all members of the bankruptcy department in the appropriate use of the escalation procedure and the requirements of Rule 9011 with respect to pre-filing due diligence. Opinion, p. 53.

The Court did not award sanctions against the national firm which prepared the proof of claim, but not because she found their conduct appropriate. The Court found that the record had not been fully developed with regard to this party, that the practices were national in scope and that the U.S. Trustee was investigating the firm. As a result, the Court left it to another day and another court to address these issues.

The Court found that some of the problems in the case resulted from the Udren firm's reluctance to contact its client directly and found that other firms used by HSBC might be under the same impression. As a result, the Court ordered HSBC "to prepare and transmit by mail and e-mail a letter to all the Network Firms outlining the escalation policy and encourage its use consistent with the Rules of Professional Conduct. HSBC should also advise the Network Firms that use of direct contact will not reflect adversely on the firm." Opinion, p. 55.

The Court did not sanction LPS.

Based on the record, I find that sanctions against LPS are not warranted. While it does appear from the limited screens that have been introduced in this case, that LPS' involvement goes beyond passing data through their automatic system, I cannot conclude that it imposed restrictions on the Udren Firm's handling of this case. (citation omitted). The Udren Firm entered into a contract with Fidelity which it viewed as advantageous to the business relationships with its mortgage lender clients and presumably its bottom line. As attorneys, the Udren Firm understood an attorney's obligations under Rule 9011 to investigate and took a lesser approach. While NewTrak prescribed that approach, LPS did not dictate how they would handle cases referred to them when problems with the procedure were apparent. By misusing the resources made available to them, the Udren Firm, not LPS, was responsible for the Rule 9011 deficiencies in this case. Opinion, pp. 55-56.

CONCLUSION

Judge Sigmund's remarkable opinion demonstrates that she is no Luddite. Her opinion focuses on the need to exercise professional judgment in conjunction with technology rather than mindlessly bashing the technology itself. In her conclusion, she stated: My research has disclosed no other published opinion that explains the NewTrak process that is utilized by so many consumer mortgage lenders seeking relief in bankruptcy cases. I have attempted to share my education in this Opinion. Finally, it is my hope that by bringing the NewTrak process to the light of day in a published opinion, system changes will be made by the attorneys and lenders who employ the system or at least help courts formulate the right questions when they have not. While NewTrak has many features that make a volume business process more efficient, the users may not abandon their responsibility for fairness and accuracy to the seduction of electronic communication. The escalation procedures in place at HSBC and the Udren Firm existed on paper only. When an attorney appears in a matter, it is assumed he or she brings not only substantive knowledge of the law but judgment. The competition for business cannot be an impediment to the use of these capabilities. The attorney, as opposed to a processor, knows when a contest does not fit the cookie cutter forms employed by paralegals. At that juncture, the use of technology and automated queries must yield to hand-carried justice. The client must be advised, questioned and consulted. Young lawyers must be trained to make those judgments as opposed to merely following the form manual. Until they are capable of doing so they should be supported and not left to sink or swim alone in an effort for the firm to be more profitable by leveraging the cheapest labor.

At issue in these cases are the homes of poor and unfortunate debtors, more and more of whom are threatened with foreclosure due to the historic job loss and housing crisis in this country. Congress, in its wisdom, has fashioned a bankruptcy law which balances the rights and duties of debtors and creditors. Chapter 13 is a rehabilitative process with a goal of saving the family home. The thoughtless mechanical employment of computer-driven models and communications to inexpensively traverse the path to foreclosure offends the integrity of our American bankruptcy system. It is for those involved in the process to step back and assess how they can fulfill their professional obligations and responsibly reap the benefits of technology. Nothing less should be tolerated. Opinion, pp. 57-58 (emphasis added).