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Mortgage Loan Servicer's Failure to Plan for Errors is Costly

Loan servicers' employees are human beings. Loan servicing employees use systems designed by other human beings. We all know this and so should anticipate that there will be mistakes in loan servicing operations. Recently, the Seventh Circuit Court of Appeals reminded us that how loan servicers plan for and react to inevitable mistakes is important. The case also has some good reminders for litigation counsel and planning tips for loan servicers.

After the start of a foreclosure proceeding against her, the "Borrower" (Ms. Saccameno) filed a Chapter 13 bankruptcy case. The confirmed Chapter 13 plan required the Borrower to make current mortgage loan payments and cure the arrearage through 42 plan payments. These are common provisions and once completed entitle the Borrower to "a fresh start." According to the appellate court, the Borrower "had done everything that was required of her: she cured the delinquencies in her mortgage and made 42 monthly mortgage payments under the court's watchful eye. Near the end of her bankruptcy, she obtained statements from her mortgage servicer, Ocwen Loan Servicing, LLC [the "Servicer" or "Ocwen"], that she was paid up—that she was paid ahead even." The Borrower received her bankruptcy discharge.

For reasons that were not explained, the Servicer's records were incorrect. Part of the problem was the Servicer's simultaneous operation of two parallel computer "modules" for the Borrower – a "foreclosure" module that was initiated before the Borrower filed bankruptcy and a "bankruptcy" module that was initiated after the bankruptcy case was filed. During Borrower's bankruptcy, the foreclosure module placed the Borrower's plan payments into a "suspense" account instead of applying them even as the bankruptcy module acknowledged the payments being made both current and against the arrearage.

As you have guessed, the Servicer is going to try to collect mortgage payments that were not owed. The court noted that the payments were not owed both because they had been paid and

because the Borrower had received a discharge. The Servicer tried to explain the violation of the discharge injunction by asserting that an employee had inadvertently treated the discharge notice as a dismissal of the Borrower's bankruptcy proceeding. That mistake might not have caused a litigation loss if the Servicer had prepared a plan to catch and correct inevitable errors.

The Servicer's human error (misunderstanding the bankruptcy court discharge order) was compounded by the Servicer's above-described computer system. Discussing that computer system, the appellate court said:

..., an Ocwen employee, whom Ocwen refers to only as "Marla," reviewed the discharge but mistakenly treated it as a dismissal. As far as Ocwen was concerned, then, the bankruptcy stay had been lifted and it could immediately start collecting Saccameno's debts. This might not have been a problem—for Saccameno of course did not have a debt anymore—but Marla's mistake was only the tip of the iceberg. Apparently, in March, Ocwen had manually set the due date for Saccameno's plan payments to September 2013, hence the credit. That manual setting took place in a bankruptcy module that overrode and hid [but did not close] Ocwen's active foreclosure module, which instead reflected that Saccameno had not made a single valid payment in 2013, as each check was being placed into a suspense account and not being applied to the loan. Marla's dismissal entry deactivated the bankruptcy module and reactivated the foreclosure one.

Stated simply, the Servicer's computer system was designed so that one human error could and did go unnoticed and could cause significant problems for borrowers due to the fact that two mutually exclusive computer modules could be active simultaneously.

In response to the Servicer's collection efforts, the Borrower (and an attorney acquittance) submitted payment and bankruptcy court records to the Servicer on four different occasions. The Servicer's only response was to assign an ineffective and unprepared problem resolution employee. The Servicer's response to the Borrower was summarized by the court:

[Servicer] did not explain. [Servicer] did not care. [Servicer] did not truly grasp how wrong its records were until almost four years later, two days into Saccameno's jury trial . . .

Two hints: (A) I hope all litigation counsel see the indictment of Servicer's counsel and records systems in this quotation. Even after the Borrower filed suit, neither the Servicer's employees or the Servicer's counsel recognized the problem with the Servicer's records. Even if client and counsel both believe litigation is without merit, it is worth the effort to investigate the facts before trial; and (B) on several occasions the court notes that Servicer's acts violated the discharge injunction even if they had been based on accurate facts. This should remind loan servicers and their counsel that familiarity with the extent of a bankruptcy discharge is important.

Borrower was awarded \$582,000 in compensatory damages and \$3,000,000 in punitive damages. Servicer filed a post-trial motion seeking to eliminate the punitive damages. The trial court denied that motion finding "that the jury reasonably found Ocwen's employees had been deliberately indifferent to the risk that Saccameno would be harmed, and Ocwen's management had notice of—and ratified—its employees conduct.

Servicer appealed the award of punitive damages. Servicer's appeal led the Seventh Circuit's decision. Servicer asserted that punitive damages were inappropriate arguing "that the evidence could support only a finding of negligence, not a 'conscious and deliberate disregard' for Saccameno's rights." In response to that argument, the appellate court said:

Ocwen cannot pin this case on Marla. Her error was one among a host of others, and each error was compounded by Ocwen's obstinate refusal to correct them. If this case were truly Marla's fault, then Saccameno's troubles would have lasted a month—most of July 2013. That was how long it took for Saccameno to point Ocwen toward Marla's mistake, and for Ocwen to change the dismissal to a discharge. The real problems only began at that point though, as Ocwen falsely claimed that Saccameno had missed two plan payments for the first time in August and started improperly rejecting Saccameno's payments in September. Ocwen apparently

did not discover the former until the second day of trial and likely would have continued the latter until it filed for foreclosure, had this lawsuit not gotten in the way.

Ocwen contends that the miscounting of payments was also a human error—though it does not identify a human. We are not sure how many human errors a company like Ocwen gets before a jury can reasonably infer a conscious disregard of a person's rights, but we are certain Ocwen passed it. The record is replete with evidence that Ocwen's servicing of Saccameno's loan was chaos from the moment Ocwen began working on the loan in 2011 to the day of the jury's verdict nearly seven years later. Saccameno's successful bankruptcy should have made things easier by resetting everything to zero—"fully current as of the date of the trustee's notice," the plan said. With her bankruptcy papers in hand, Saccameno repeatedly attempted to inform Ocwen that it had made an obvious mistake.

After this condemnation of Servicer's conduct, the appellate court gave loan servicers some guidance on how to behave when inevitable human errors occur. The appellate court first described *Cruthis v. Firststar Bank, N.A.*, 354 Ill.App.3d 1122, 290 Ill.Dec. 869, 822 N.E.2d 454 (2004), in which the bank illegally reversed payments into the plaintiffs' account. Though this act was conversion, the court found punitive damages unjustified because (i) the bank had credited the plaintiffs' account after being confronted, (ii) a bank manager helped the plaintiffs challenge the withdrawal and did his own internal investigation, and (iii) within two months the bank had corrected the plaintiffs' account and waived all charges.

The appellate court also analyzed *Parks v. Wells Fargo Home Mortgage*, 398 F.3d 937 (7th Cir. 2005). There, a mortgagee failed to pay taxes on a couple's home, allowing a tax sale buyer to obtain title. Concluding that the defendant had not acted with conscious disregard of the Parks' rights and so become liable for punitive damages, the court emphasized that the mortgagee on learning of its mistakes, "set out to make matters right, and it succeeded in doing so in relatively short order." When the Parks complained: the mortgagee: (i) "immediately put two researchers on the job to find out what could be going on"; (ii) the researchers discovered and

explained exactly how the taxes had gone unpaid; and (iii) the company succeeded in getting the tax deed vacated.

After failing to escape liability completely and failing to escape all punitive damages, Servicer did succeed in getting the punitive damage award reduced to \$582,000. Still, the lesson is clear: Servicer suffered a \$1,164,000 judgment plus litigation expenses because it had no plan to detect and correct human errors. And, of course, the business reputation damage is potentially significant.

Experienced litigation counsel has much to offer our clients as they design and implement systems to catch and correct human errors in an efficient and cost-effective manner. We can and should offer tips on where systems have failed others by analyzing situations like the one described herein, and (ii) provide training on common legal documents the client will receive like a bankruptcy court discharge order.

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