

# Supreme Court Declines to Review Bankruptcy Sanctions Order

July 21, 2022

The Supreme Court denied certiorari in *Sensenich v. PHH Mortgage Corporation* on June 13, 2022, allowing to stand a decision of the United States Court of Appeals for the [Second Circuit](#) holding that a federal bankruptcy court erred in imposing punitive sanctions on PHH Mortgage Corp. (PHH), a creditor in multiple Chapter 13 bankruptcies. The bankruptcy court's sanctions purported to punish PHH for failing to follow certain of the court's orders and for violating the notice provisions of [Federal Rule of Bankruptcy Procedure 3002.1](#).

The Second Circuit's decision sheds light on the scope of a federal bankruptcy court's general authority to employ sanctions to enforce its orders, and it is the first federal appellate decision on the question of whether Bankruptcy Rule 3002.1 empowers a bankruptcy court to impose sanctions for violating the Rule's notice provisions. This Sidebar provides an overview of Chapter 13 of the Bankruptcy Code, Bankruptcy Rule 3002.1, and the bases for the Second Circuit's decision vacating the bankruptcy court's sanctions orders. It also discusses considerations for Congress, including Congress's authority to change the bankruptcy rules should it seek to alter the authority those rules grant to federal bankruptcy courts.

## Chapter 13, the Role of the Trustee, and Rule 3002.1(c)

Chapter 13 of the Bankruptcy Code is entitled "Adjustment of Debts of an Individual With Regular Income." As covered in [a prior report](#), Chapter 13 allows an individual debtor to develop and perform a repayment plan under court supervision and protection. The repayment plan may provide [for full repayment](#) of debts or offer creditors a percentage of their claims in full settlement. Debtors make payments to creditors under these repayment plans in installments, over three to five years.

Individual debtors may use Chapter 13 to avoid a foreclosure on their homes. Unlike a Chapter 7 case, in which a debtor's nonexempt assets are turned over to a trustee and sold to pay creditors, under Chapter 13, a debtor remains in possession of estate property. Chapter 13 also allows debtors to [cure past-due mortgage payments](#) and bring them current over a reasonable period of time.

Upon the filing of a Chapter 13 petition, [an impartial trustee](#) is appointed to administer the case. The Chapter 13 trustee evaluates the case, collects payments from the debtor, and makes distributions to creditors.

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Pursuant to the [Rules Enabling Act](#), the [Supreme Court](#) promulgates the Federal Rules of Bankruptcy Procedure on the recommendation of the U.S. Judicial Conference and its committees, [subject to review](#) by Congress. Federal Rule of Bankruptcy Procedure 3002.1 governs installment payments on a home mortgage plan in a Chapter 13 bankruptcy. Rule 3002.1(c) requires a mortgage creditor to provide notice to the trustee of any fees, expenses, or charges it plans to assert against the debtor “within 180 days after the date on which the fees, expenses, or charges are incurred.” Rule 3002.1(i) provides for the award of “appropriate relief, including reasonable expenses and attorney’s fees caused by the failure” to give proper Rule 3002.1(c) notice.

## The Underlying Bankruptcies and Subsequent Procedural History

In *Sensenich*, the United States Bankruptcy Court for the District of Vermont sanctioned PHH for its conduct in three bankruptcies—*In re Gravel*, *In re Beaulieu*, and *In re Knisley*. All three bankruptcies transpired over a similar time frame and were administered by the same Chapter 13 trustee. PHH held or serviced the mortgage on the principal residence for each debtor household.

In *Gravel*, the bankruptcy court issued a “[current order](#)” on May 20, 2016, proclaiming that the Gravels had cured all pre-petition mortgage defaults and were current on all post-petition mortgage payments. The order precluded PHH “from disputing that the debtors are current.” Five days later, PHH sent the Gravels a mortgage statement announcing that property inspection fees of \$258.75 were due. The trustee [moved for an order](#) holding PHH in contempt and imposing sanctions on PHH. The trustee argued that requesting fees at this late stage of the case violated Rule 3002.1(c) and that PHH’s fee notice violated the current order, which expressly barred PHH from disputing the Gravels’ status as having made all payments due during the pendency of the bankruptcy.

In *Beaulieu*, the court issued a [current order](#) in May 2016. It contained the same prohibition on PHH as the order in *Gravel*. Less than three weeks later, PHH sent out a monthly statement that included old charges for which it had never sent a Rule 3002.1(c) notice. The trustee [moved for an order of contempt](#) and sanctions, raising essentially the same arguments made in *Gravel*: that PHH violated both Rule 3002.1(c) and the current order.

Unlike in *Gravel* and *Beaulieu*, the bankruptcy court did not issue a current order in *Knisley* because the debtors had yet to reach the end of their repayment plan. The trustee’s [contempt and sanctions](#) motion in that case focused solely on PHH’s failure to comply with Rule 3002.1(i) when it issued a monthly mortgage statement including charges more than 180 days old without filing the corresponding Rule 3002.1(c) notices.

After a consolidated hearing, the bankruptcy court [granted the trustee’s motions](#). The bankruptcy court ruled that PHH had violated Rule 3002.1(c) 25 times in each case, and also had violated the current orders in *Gravel* and *Beaulieu*. The bankruptcy court sanctioned PHH \$75,000 under Rule 3002.1(i)—in each case, 25 sanctions of \$1,000 for each month in which PHH failed to comply with Rule 3002.1’s notice provisions. These were non-contempt, or punitive, sanctions. The court also imposed civil contempt sanctions on PHH totaling \$300,000 for violating the current orders—\$200,000 in *Gravel* and \$100,000 in *Beaulieu*. In so doing, the court relied on its inherent power and Section 105 of the Bankruptcy Code as the bases for imposing a remedial sanction geared toward compelling future compliance with court orders.

The United States District Court for the District of Vermont [vacated the sanctions](#). It ruled that the \$300,000 sanction as well as the \$75,000 sanction exceeded the bankruptcy court’s “statutory and inherent powers” because the bankruptcy court lacked power to impose “serious punitive sanctions.” On remand, the bankruptcy court issued a [second sanctions order](#). The new order adopted the factual findings of the first order and issued the same non-contempt \$75,000 sanction for the Rule 3002.1 violations in all three cases. It reduced the contempt sanction for violations of the current orders by 25%. This change

lowered the *Gravel* and *Beaulieu* current order sanctions to \$150,000 and \$75,000, respectively, and the total sanctions amount to \$300,000.

PHH appealed the second sanctions order to the district court. While that appeal was pending, the bankruptcy court granted the trustee's [motion to certify](#) the order for [direct review](#) by the Second Circuit under 28 U.S.C. § 158(d)(2)(A).

## Second Circuit Reversal and Denial of Certiorari

A divided panel of the Second Circuit [vacated and reversed](#) the second sanctions order. With respect to the \$225,000 in contempt sanctions for the purported violations of the current orders in *Gravel* and *Beaulieu*, the Second Circuit held that PHH did not, as a matter of law, violate the orders. The Second Circuit explained that a bankruptcy court's contempt authority under Section 105(a) derives from a court's issuance of an injunction. The Supreme Court's 2019 decision in *Taggart v. Lorenzen* permits a bankruptcy court to issue contempt sanctions only if there is no fair ground of doubt as to whether a prior court order barred the creditor's conduct. There is no [fair ground of doubt](#) where the party has notice of the order, the order is clear and unambiguous, and the proof of noncompliance is clear and convincing. The Second Circuit held that the current orders in *Gravel* and *Beaulieu* were not clear and unambiguous prohibitions on PHH's sanctioned conduct. According to the Second Circuit, the current orders, which declared that the debtors were current on their obligations, did not in and of themselves clearly forbid any conduct on the part of PHH. In other words, the current orders did not create an injunction that the bankruptcy court could enforce. Although the current orders prohibited PHH from disputing the debtors' current status "in any other proceeding," the Second Circuit found there was "fair ground of doubt" as to whether that language covered PHH's out-of-court conduct in the *Gravel* and *Beaulieu* cases themselves.

As for the \$75,000 in sanctions issued under Rule 3002.1(i), the Second Circuit noted that whether the rule's language authorizing "other appropriate relief" encompasses punitive sanctions was an issue of first impression among the circuit courts. The Second Circuit answered that question in the negative, reasoning that, because Rule 3002.1(i)(2) lists one general grant of authority ("other appropriate relief") alongside two specific examples of contemplated relief under that authority ("reasonable expenses and attorney's fees"), the general phrase is best construed as confined to the same class of matters as the specific remedies illustrated. Those specific remedies—reasonable expenses and attorney's fees—are compensatory in nature, suggesting that "other appropriate relief" is limited to non-punitive sanctions. Supporting this interpretation is the sanction in Rule 3002.1(i)(1), which, the court explained, "serves the remedial goal of shielding the debtor from unforeseen charges, and thus is also not a punishment." Looking more broadly, the Second Circuit observed that other sections of the Bankruptcy Code expressly permit punitive damages, whereas Rule 3002.1 is silent on the issue. Additionally, the Second Circuit disagreed with the bankruptcy court's analogizing of Rule 3002.1 to [Federal Rule of Civil Procedure 37](#), reasoning that Rule 3002.1 does not contain Rule 37's authorization for "further just orders," and that the two rules serve different purposes. While Rule 3002.1 protects a debtor's interest in fully resolving his status as to particular financial obligations, Rule 37 protects "the integrity of our judicial process." The Second Circuit declined to reach the trustee's alternative argument that the \$75,000 sanction was authorized under the bankruptcy court's inherent sanctioning power, because in the second sanctions order, the bankruptcy court did not assess whether it was imposing the sanction under that inherent power. The court did observe that it was dubious that the bankruptcy court could exercise inherent powers to impose a sanction beyond the express powers provided in Rule 3002.1.

The trustee petitioned for a [writ of certiorari to the U.S. Supreme Court](#). Two groups—a number of [retired bankruptcy judges](#) and the National Association of [Chapter Thirteen Trustees](#)—filed amicus briefs addressing the scope of Rule 3002.1 and the bases for a bankruptcy court to awarding punitive sanctions.

The Supreme Court denied the trustee's petition.

## Considerations for Congress

The Second Circuit's decision came in three parts, with one presenting a novel issue. That issue concerns the \$75,000 punitive, non-contempt sanction under Rule 3002.1, and the scope of Rule 3002.1(i)'s enforcement mechanism.

As stated by [the Supreme Court](#), Congress has the authority to establish and structure lower federal courts and to make rules of procedure in those courts. Recognizing that the courts themselves possess expertise in crafting such rules, Congress passed the [Rules Enabling Act](#), which grants the Supreme Court (in practice, the Judicial Conference of the United States and its attendant committees) primary authority for creating and amending federal procedural rules, with Congress serving in an oversight role. Congress [retains the authority to enact legislation](#) to amend a bankruptcy rule or any other procedural rule.

The Supreme Court transmitted [proposed Rule 3002.1](#) to Congress in December 2010, and the rule became effective the following year. A Judicial Conference memorandum accompanying the proposed rule made passing reference to "sanctions," but the memorandum did not specify whether those sanctions could be punitive. The Supreme Court subsequently sent two proposed amendments, both of which are now in effect. Neither set of amendments addressed the enforcement mechanism in subsection (i). There has been no independent effort by Congress to amend the rule.

Congress could, under its rulemaking authority, alter the language of Rule 3002.1(i) to expressly provide for or disavow punitive sanctions. Alternatively, it could await the results of further litigation over Rule 3002.1 in other circuits, where [one bankruptcy court](#) has since disagreed with the Second Circuit, before it decides whether it wants to change the language.

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