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# LENDING AND RESTRUCTURING ALERT NOVEMBER 2007

## **Federal Court Dismisses Foreclosure Actions After Loan Servicer Fails to Prove Ownership of Loan Documents**

**What happened:** A federal court in Ohio—the state with the highest number of foreclosure actions pending in the nation—dismissed 14 foreclosure actions brought on behalf of mortgage investors, ruling that they had failed to prove that they owned the mortgages they sought to foreclose. The decision threatens to put an end to the common practice of commencing foreclosures on mortgages in pools without establishing proof of ownership of the individual loans.

**What this means for lenders:** Those looking to bring a foreclosure action will have to demonstrate that they are indeed the owner of the note and mortgage as of the time they file their foreclosure complaint. An outright assignment is needed; proof of an “intent to convey” loan documents won’t be enough.

**The details:** The mortgages in this case were held in mortgage pools, and loan servicers brought the foreclosure actions. The servicers alleged that they were the holders of the notes and mortgages being foreclosed. But when the District Court ordered them to submit copies of their loan assignments to demonstrate that they were indeed the owners of the notes and mortgages at the time the foreclosure complaints were filed, they came up short. They were only able to show that there was an “intent to convey” the rights in the loan documents. The servicers did not produce actual assignment documents.

The court dismissed the suits, relying on the strict requirements for establishing standing. “[T]he plaintiff ‘bears the burden of demonstrating standing and must plead its components with specificity,’” the court said, adding that a plaintiff “must be a proper proponent, and the action a proper vehicle, to vindicate the rights asserted.” The court ruled that the servicers lacked proper standing, because they did not own the loans on the date they filed their complaints.

**Industry impact:** After taking note of the impact of the decision on the mortgage industry, as well as the right of banks to foreclose after default, the court nonetheless stated: “[T]his Court possesses the independent obligations to preserve the judicial integrity of the federal court and to jealously guard federal jurisdiction. Neither the fluidity of the secondary mortgage market, nor monetary or economic considerations of the parties, nor the convenience of the litigants supersede those obligations.”

There appear to be other factors at work beneath the surface here. With many homeowners affected by the sub-prime mortgage crisis, judges may feel the need to go out of their way to protect them. Indeed, as noted above, Ohio is the most afflicted state in the nation, and just a week before this decision was announced, Ohio

Governor Ted Strickland vowed “to crack down” on subprime lenders he believes have contributed to Ohio's high foreclosure rates. There is no way to predict whether this approach will be adopted by other federal courts, but the wary lender will avoid the risk altogether by searching for and correcting administrative deficiencies in the title to its loan documents before commencing foreclosure actions.

Herrick represents major financial institutions and other mortgage investors in complex and difficult bankruptcies of commercial, industrial and residential properties. For more information on foreclosure actions, or other real estate litigation matters, please contact:

**Ray Hannigan** at 212.592.1462 or rhannigan@herrick.com

**Paul Rubin** at 212.592.1448 or prubin@herrick.com

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