

CLIENT ALERT

Ohio Federal Court Fires Warning Shots At Mortgage Pool Investors Who Rush To Foreclose Without Adequate Pre-Foreclosure Legal Due Diligence

Nov.16.2007

Over the last several years, collateralized debt and loan obligations (CDOs and CLOs) and other structured investment vehicles (SIVs), such as REMICs, have re-emerged as the fastest growing sector of the asset-backed mortgage securities market. After closing, lenders pool their mortgages as part of a securitization in the secondary market, thereby transferring title to the mortgages to a trustee as the new holder of the loan documents. These structures can be quite complex if the note obligations secured by the mortgages are sliced into several tranches, which result in multiple certificate holders. The new lender-trustee acts at the direction of the certificate holders' special servicer. Often, the assignments from the originating lender to the trustee for the certificate holders may not be documented or even executed simultaneously with the securitization.

Two federal judges in Cleveland recently dismissed without prejudice, on their own initiative, 46 foreclosure actions brought on behalf of investors in mortgage securitization pools. Specifically, on October 31, 2007, Judge Christopher Boyko of the U.S. District Court for the Northern District of Ohio dismissed without prejudice fourteen foreclosure actions on grounds that the plaintiff-lenders could not establish their standing or diversity jurisdiction as of the date their complaints were filed. *See In re Foreclosure Cases*, Case Nos. 07CV2282, *et al.*, Opinion and Order, dated Oct. 31, 2007, ECF 11, www.ohnd.uscourts.gov. Similarly, on November 14, 2007, Judge Kathleen O'Malley of the same court dismissed without prejudice 32 foreclosure actions because the plaintiff-lenders failed, as required by a standing general order, to attach documentation to their foreclosure complaints demonstrating that they owned the notes and mortgages. *See In re Foreclosure Actions*, Case Nos. 07CV1007, *et al.*, Order, dated Nov. 14, 2007, ECF 19, www.ohnd.uscourts.gov.

In these Ohio cases, the assignments of the notes and mortgages were dated after the foreclosure complaints were filed. Thus, the plaintiff-lenders were unable to prove their standing or the existence of diversity jurisdiction as of the date the complaints were filed. The Ohio courts would not accept post-complaint assignment documents as "cures" of the deficiencies.

It has been widely reported that the default rates on residential mortgages have risen sharply. As a result, mortgage holders are foreclosing at higher rates (as compared to the last several years when easy credit was more readily available). Media reports about increased interest rates, the subprime mortgage crisis, and "bearish" markets are driving public opinion about the "alarming" rise in foreclosure rates.

A few press reports suggest that these Ohio decisions are "leading some to hope for a slowdown in foreclosures." In reality, these decisions are little more than a warning to securitized debt holders, CDOs, and investors in other SIVs—initiate foreclosures only after the appropriate assignment documentation has been executed and adequate pre-foreclosure legal due diligence has been completed.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.