July 10, 2009

Housing Preservation Project
A Public Interest Law Firm

Lori A. Vosejpka
Clerk of Court
United States Bankruptcy Court, District of Minnesota
301 US Courthouse
300 South Fourth Street
Minneapolis, MN 55415

Re: Proposed Changes to Local Rule 4001-1 and Form 4001-1

Dear Ms. Vosejpka,

On June 8, 2009, the United States Bankruptcy Court, District of Minnesota requested comments related to proposed changes to Local Rule 4001-1 and Form 4001-1. This letter is in response to that request.

As you may know, the Housing Preservation Project is a non-profit, public interest law firm that specializes in housing issues. Two years ago, the Housing Preservation Project began a program specifically related to the foreclosure crisis, the Foreclosure Relief Law Project ("FRLP"). Since it began, FRLP has represented and helped individual homeowners and neighborhoods affected by foreclosures, as well as the City of Saint Paul and Hennepin County. Through this work FRLP has developed expertise on various foreclosure issues. Its work has been profiled in local and national media, and it has become a national model for other legal service providers.

The Court's request for comment on proposed Local Bankruptcy Rule and Form 4001-1 is very timely. Although the rate of foreclosures in Minnesota has dropped slightly this year, the high-level of foreclosures will continue for the foreseeable future. According to the national Standard & Poor's/Case-Shiller Index of home price values, the Twin Cities metropolitan area has lost over 22% of its value since 2000. The dramatic decrease in the value of a person's home means that many homeowners have negative equity, owing more than the house is worth. As a practical matter, the decreased or negative equity also limits the options that individuals have to avoid foreclosure when they lose their job or have unpaid medical bills. Homeowners cannot easily sell their house either to downsize to one that is more affordable or take a job in another state. Homeowners with no equity or negative equity also cannot refinance and take "cash-out" of a house to pay outstanding bills.

There are also a large number of toxic adjustable rate mortgages that are still in the system and will adjust to unsustainable levels over the next two years. According to an analysis done by Credit-Suisse, between $20-40 billion adjustable rate mortgages will adjust to an unsustainable level **every month** between now and the end of 2011. The majority of these loans are "Alt-A," meaning that they are likely Option ARMs (a loan product that allows homeowners

to pick one of three payments every month, including a negatively amortizing option or interest-only option) and/or stated-income loans a/k/a "liar loans" (a loan product in which a lender did not verify or did minimal verification of a borrower's income and assets). The adjustments are scheduled to peak in the middle of 2010, and it's unclear how recent loss mitigation efforts will impact the likelihood that these loans will result in foreclosure. Since Alt-A borrowers were often more suburban, more educated, and more affluent than sub-prime borrowers, it is reasonable to assume that they will also be more likely to seek relief through bankruptcy proceedings and have the means to hire a bankruptcy attorney.

The Housing Preservation Project supports amending the rules to include the proposed changes to Local Rule and Form 4001-1. These proposed changes provide common-sense safeguards. In addition to protecting homeowners from wrongful foreclosure, these safeguards also ensure the integrity of bankruptcy proceedings and the integrity of the real estate title recording system in Minnesota.

The proposed rule protects the integrity of bankruptcy proceedings by ensuring that the party bringing the motion has standing and that the Court has jurisdiction.

Federal courts of bankruptcy are courts of limited jurisdiction and a motion cannot be brought in any court unless the movant is the real party in interest to the action.[1] Standing is a fundamental aspect of any judicial proceeding. Without the safeguards of proposed rule 4001-1, it is unclear whether the movant has standing, and therefore whether the court has jurisdiction to hear the motion. As discussed below, it is entirely appropriate for the bankruptcy court to *sua sponte* determine whether the party seeking aid of the court to collect a debt is a real party in interest.[2]

Standing is a threshold question in every federal case. The litigant must have constitutional standing, "which requires an injury fairly traceable to the defendant's allegedly unlawful conduct and likely to be addressed by the relief requested."[3] Federal bankruptcy courts have limited jurisdiction and cannot preside over a motion for relief from stay under 11 U.S.C. § 362 if the movant is not the true party in interest. Although "party in interest" is not defined by section 362, courts have held that the party must have an actual pecuniary interest in the outcome of the dispute.[4]

Under the bankruptcy laws, foreclosure agents and servicers do not automatically have standing and must show authority to act for the party that does.[5] If the debtor does not owe the creditor any debt, the creditor is not the party in interest and the bankruptcy court has no authority to hear the case. In such a situation, the "creditor" is not a creditor. The proposed rule helps clarify whether the motion is properly brought before the court.

---

[1] FED. R. CIV. P. 17.
[2] *See In re Hwang*, 396 B.R. 757 (Bankr. C.D. Cal. 2008).
[3] *See In re Jacobson*, No. 08-45120, 2009 Bankr. LEXIS 709, at *14 (Bankr. W.D. Wash. Mar. 10, 2009).
[4] *In re Sheridan*, No. 08-20381-TLM, Chapter 7, 2009 Bankr. LEXIS 552, at *8 (Bankr. Idaho Mar. 12, 2009) (citing *In re Simplot*, 48 Bankr. Ct. Dec. (LRP) 209 (Bankr. Idaho Aug. 28, 2007).
[5] *See In re Jacobson*, 2009 Bankr. LEXIS 709.

Creditors may argue that it is inappropriate for the Court to make this inquiry. They may argue that it is the homeowner's burden to challenge the creditor's standing. However, this burden shifting is inappropriate. The debtor is often the least sophisticated and knowledgeable party. Therefore, it is entirely proper for the court to raise *sua sponte* the issue of whether the creditor is the real party in interest in a motion for relief from stay.[6]

This principle was recently discussed in the decision *In re Hwang*. In that case, the district court rejected the creditor's argument that it was improper for the court to raise *sua sponte* the issue of whether the creditor was the real party in interest for the motion.[7] The Court held that, because standing goes directly to the jurisdiction of the court, it was entitled to make an inquiry into the party's standing. The reasoning in *In re Hwang* was reiterated in *Weissman v. Weener*, which affirmed the district court's ruling that the movant's standing can be raised *sua sponte*.[8]

The adoption of this rule is also an important public policy matter in the context of foreclosure. The two parties involved in a foreclosure proceeding do not have equal bargaining power. The debtor often does not have knowledge of the secondary mortgage market and is also going through a time of personal and financial hardship, including the threat of losing their home. The creditor is in the best position to inform the Court of its basis and authority to proceed with foreclosure.

In a typical securitized mortgage transaction, the mortgage loan has been transferred at least twice. The mortgage loan has to be pooled and transferred to a special purpose vehicle or trust ("depositor"). Then the depositor has to transfer the mortgage loan to the final trust, which issues certificates or bonds back to the depositor. The depositor then sells the certificates or bonds to investors around the world. Typically, none of these intermediary transfers are properly recorded. It is unclear whether the foreclosing entity is the correct trust because many of these transactions took place electronically. Worse yet, the later foreclosing entity is often neither the lender nor the trust. The foreclosing entity is an electronic database company in Virginia called Mortgage Electronic Registration Systems, Inc. ("MERS"), which has no actual interest in the mortgage loan. MERS is just a loan tracking service. Indeed, most transfers are not even entered into the database by MERS. MERS relies on the lenders and Wall Street investment firms to enter the transfers in the database, if these lenders or investment firms make a mistake there is little chance MERS would know.

Simply requiring a moving party to establish that they are the right party under these circumstances is entirely appropriate. It is also consistent with efforts currently being undertaken by the Securities and Exchange Commission to regulate the secondary mortgage market and ensure a party's adherence to the pooling and servicing agreements that underlie these transactions.[9]

---

[6] *See Hwang*, 396 B.R. at 769-70.
[7] *Id.*
[8] *Weissman v. Weener*, 12 F.3d 84, 85-86 (7th Cir. 1993).
[9] 4 BAXTER DUNAWAY, L. DISTRESSED REAL EST. § 56:58 (2009).

The proposed rule is narrowly tailored to determine jurisdiction and protect vulnerable debtors.

Proposed Local Rule 4001-1 is narrowly tailored to determine the federal bankruptcy court's jurisdiction and protect vulnerable debtors. A look at each provision demonstrates how the rule accomplishes these goals. First, the proposed rule only governs motions for relief from stay related to a debtor's principal residence. In limiting the scope of the rule to only apply to principal residences, the Court recognizes the importance of a person's home above other property. Although there are similar standing issues that arise related to the securitization of non-homesteaded or commercial property loans, automobile loans, and defaulted credit card debt, there should be special care when authorizing one person to take away another person's home. The proposed rule aptly reflects the differences between different types of debt, as well as the court's long-tradition of assuring that a person's home is protected.

Second, the rule outlines basic requirements to ensure that the moving creditor has standing. The proposed rule specifically lists required information that must be submitted to the court to prove standing. The applicable subsection defines at a minimum that the movant shall provide a copy of the note, a copy of the mortgage, and a perfection of the mortgage.[10] Further, "if the movant is not the original mortgagee, [there must be] evidence that the movant has authority to make the motion."[11] These requirements are clear, and any creditor---particularly a creditor who seeks to foreclose---should already have such information in its files. Adherence to these requirements will likely establish standing, and it protects the homeowner from defending frivolous motions.

Third, once standing has been established, a movant must next prove cause before the court can grant the motion.[12] Cause can be shown if the movant has "a lack of adequate protection of interest of property"[13] or when "the debtor does not have equity in such property."[14] The proposed rule and form requires information that will assist the court in determining cause and also immediately provide the debtor with the information that he or she needs to determine whether to challenge the motion. The need to clearly understand what is owed and what has been paid was illustrated by a recent decision by Judge Elizabeth Magner, a United States Bankruptcy Judge for the Eastern District of Louisiana.[15] In her decision, Judge Magner set forth requirements that creditors must satisfy when determining escrow amounts on proofs of claim.

These narrowly tailored requirements---proof of standing and evidence for cause---are entirely consistent with Federal R. Civ. P. 26(a)(1), which requires automatic disclosure of

---

[10] Proposed Bankr. D. Minn. R. 4001-1(b)(1).
[11] Proposed Bankr. D. Minn. R 4001-1(b)(1)(d).
[12] 11 U.S.C. § 362(d) (2005).
[13] 11 U.S.C. § 362(d)(1) (2005).
[14] 11 U.S.C. § 362(d)(2)(A) (2005).
[15] *In re Irby Fitch*, 390 B.R. 834 (Bankr. E.D. La. 2008) ("Although both the credit and deduction were listed in Wells Fargo's Response, Wells Fargo never produced evidence, nor could it explain how these amounts were calculated.").

relevant information to the opposing party. Specifically, Rule 26 requires the disclosure of the name of each person who has discoverable information that the party may use to support its claims and defenses as well as all relevant documents. Like Rule 26, the proposed rule similarly requires relevant information to automatically be disclosed to the court and the opposing party. Given the short amount of time available when deciding whether to challenge or grant a motion for relief of stay, the mandatory disclosure as proscribed in the proposed rule is narrowly tailored to achieve these goals.

The proposed bankruptcy rule is consistent with similar local rules in Massachusetts and Ohio.

Minnesota is not the first state to recognize the need for a rule that imposes requirements upon a moving party who seeks to foreclose upon a debtor. Massachusetts and Ohio have adopted similar local bankruptcy rules.

Massachusetts has enacted Massachusetts Local Rule 4001-1 titled, "Motions for Relief from Stay; Submissions of Motions and Oppositions to Motions."[16] The relevant provision of the rule states that, in a motion against real property pursuant to 11 U.S.C. § 362(d), the movant is required to disclose the priority of the debt, encumbrances, any other collateral, declaration of homestead, market value, and any knowledge of the original holder of the secured obligations or whether the party is an agent of that holder.[17] Particularly, section 4001-1(b)(2)(F) requires proof of "the original holder of the obligations secured by the security interest and/or mortgage and any subsequent transferee, if known to the movant, and whether the movant is the holder of that obligation or an agent of that holder."[18] This section is similar to proposed Minnesota Local Rule 4001-1(b)(1).[19]

The most recent case to cite Massachusetts Local Rule 4001-1(b)(2)(F) is *In re Nosek*.[20] In *Nosek*, the creditor, Ameriquest, failed to disclose that it was the agent of Norwest Bank, the subsequent holder of the obligation.[21] The court stated in dicta, that this was in violation of Massachusetts Local Rule 4001-(b)(2)(F) which was in effect at the time of the decision in 2008.[22] This interpretation aligns with Minnesota's intent that standing be proven to comply with the rule, therefore clarifying jurisdiction in federal bankruptcy court.

Ohio has enacted Local Rule 4001-1, titled "Automatic Stay – Relief From."[23] Although not as extensive as either Minnesota's proposed rule or Massachusetts' existing rule, the pertinent provision of Ohio's Local Rule, 4001-1(b) states the following: "If applicable, the motion shall state the names and the purported interests of all parties known . . . who claim an

---

[16] Bankr. D. Mass. R. 4001-1.
[17] Bankr. D. Mass. R. 4001-1(b)(2).
[18] Bankr. D. Mass. R. 4001-1(b)(2)(F).
[19] *See* Proposed Bankr. D. Minn. R 4001-1(b)(1).
[20] *In re Nosek*, 386 B.R. 374 (Bankr. D. Mass. 2008).
[21] *Id.*
[22] *Id.*; Massachusetts Local Rule 4001-1 was effective August 1, 1997, with an amendment made effective January 1, 2005 and October 1, 2006.
[23] Bankr. D. Ohio R. 4001-1.

interest in the property in question. . . . The motion shall be accompanied by a legible and complete copy of all relevant loan and security agreements and evidence of perfection."[24]

Like both Minnesota's and Massachusetts' provisions, Ohio's provision requires the movant to bring evidence with the motion to establish the proper party in interest and therefore standing and jurisdiction. In *In re Dimmings* the Ohio bankruptcy court denied the creditor's motion for relief from stay and stated that "creditors who file motions for relief from stay in this district have notice of what should be included in the motion."[25] It further stated that "it is the creditor's responsibility to file a motion [that complies with the particulars of the local rules]. The court should not have to wade through a mass of information, accompanied by illegible, irrelevant, unmarked or incorrectly marked documents to try to piece together why [the] movant is filing a motion."[26] Likewise, Minnesota's bankruptcy court and the debtor should not have to wade through a mass of illegible, irrelevant, or unmarked information. Minnesota's proposed Local Rule 4001-1 properly solves this problem in an appropriate manner.

In conclusion, the goal of bankruptcy is to provide an orderly way to restructure debt and provide a new financial beginning. As stated by the United States Supreme Court, bankruptcy provides an honest but unfortunate debtor "a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt."[27] The Proposed Local Rule 4001-1 and Form 4001-1 advance that purpose.

Sincerely,

Mark Ireland
Supervising Attorney,
Foreclosure Relief Law Project

---

[24] Bankr. D. Ohio R. 4001-1(b).
[25] *In re Dimmings*, 386 B.R. 199, 205-06 (Bankr. N.D. Ohio 2008).
[26] *Id.*
[27] *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934).