

CALIFORNIA

PREPARING FOR THE NEXT WAVE: BORROWER STANDING TO CHALLENGE ERRORS IN SECURITIZATION

By: Kerry W. Franch, Severson & Werson

No one can say our industry lacks endurance. After surviving a decade of seemingly endless obstacles—the Great Recession, robo-signing, consent judgments, unprecedented regulatory compliance challenges, and record volumes of litigation—the industry is due some respite. Regrettably, another test of fortitude may be lurking around the corner.

Borrower lawsuits alleging loan securitization defects is hardly new. The industry has been mostly successful in defending such claims, with a few notable exceptions.¹ But, that trend might change in 2015.

Over the past three months, the California Supreme Court has granted petitions for review in three separate foreclosure-related cases in which financial institutions had defeated borrowers who alleged various securitization errors.² The California Supreme Court granted review in order to resolve a conflict that has fermented in California's intermediate appellate courts for the past two years: whether borrowers have standing to challenge assignments of their loans which supposedly violate the terms of pooling and servicing agreements.³

How the court answers the question will significantly affect California litigation. The decision could also change the contours of “wrongful securitization” suits nationwide. Borrowers in other jurisdictions—and their attorneys—are monitoring the appeals closely. State and federal courts across the country may follow the California court's decision in resolving similar botched securitization claims.

A California Supreme Court decision granting borrowers standing to challenge errors in securitization could force a change in the way wrongful foreclosure litigation is managed, both within financial institutions and by their outside counsel. Prudent companies won't wait for that disaster to strike. They will begin planning for an adverse ruling now. If the California Supreme Court decides borrowers lack standing, they will be pleasantly surprised and no worse off. If the court decides borrower have standing, they will be ready for the potential fallout. A few points to consider for those who wish to prepare:

Maintain a Sense of Perspective

Standing is just a threshold question. It is not a reflection of the suit's actual merit. So, if

borrowers are conferred with standing to litigate alleged defects in securitization, the development will likely not be as ominous as it might initially appear. Remember these suits are defensible.

Evidence Will Become More Important.

If borrowers are granted standing to challenge perceived errors in the loan securitization process, more cases will inevitably survive pleadings challenges. That means a greater number of cases will need to be disposed of through summary judgment and trial. So, companies will likely need to rely on evidence to a greater degree than before. Witness teams should be familiar with how pooling and servicing agreements operate. They should be familiar with note trans-

A California Supreme Court decision granting borrowers standing to challenge errors in securitization could force a change in the way wrongful foreclosure litigation is managed, both within financial institutions and by their outside counsel.

fer procedure. Securitization-related questions often arise in depositions and written discovery. Questions that might have traditionally been characterized as objectionable might suddenly become fair game. Prudent companies will have substantive responses ready.

Prepare for More Collaboration With Pool Trustees

Servicers and their outside counsel are periodically required to coordinate with pool trustees to get copies of securitization-related instruments, or perhaps even get a witness for deposition or trial. But, it is relatively rare. An adverse decision from the California Supreme Court could change that. For example, the most fashionable securitization-related argument California borrowers assert is that an assignment of their note and deed of trust was untimely and violated a pooling and servicing agreement because it occurred after the trust's closing date. Servicers should not only prepare to disprove these types of assertions, but also have a plan if the allegations are true. That may require exploring ratification of the supposedly defective transfer; by the trust beneficiaries and coordinat-

ing with the pool trustee to accomplish it.⁴

Emphasize Alternative Reasons You Should Win

Until the California Supreme Court weighs in, those in California remain in a sort of appellate purgatory. For this reason, trial and appellate briefs should be anchored with alternative reasons why the company should prevail. If there's a path to victory the court can take without wading into the borrower standing debate, explain why it should do so.⁵ And, have a backup plan for courts that believe untimely assignments are actually void rather than merely voidable. If the assignment is supposedly void, consider foreclosing in the assignor's name—if its attempted transfer was never accomplished it necessarily must still possess title to the note.

Create a Plan for Pending Foreclosures and REO Properties

If the California Supreme Court grants borrowers standing to challenge perceived errors in securitization, servicing departments will need to know whether they can confidently foreclose without compounding their risk of liability. Similarly, REO departments will need to know if they can confidently dispose of post-foreclosure

properties without getting dragged into litigation later by borrowers or third party purchasers. Consider what percentage of the company's litigated loans involve alleged securitization defects. Finally, create a plan for responding to inquiries about whether foreclosure sales or post-foreclosure sales can proceed.

The California Supreme Court may have the final word on borrower standing to raise securitization defects. But, with some foresight and preparation, an adverse decision need not become another daunting hurdle. We will adapt and move forward, as we always have.

¹ Culhane v. Aurora Loan Services of Nebraska (1st Cir. 2013) 708 F.3d 282; Glaski v. Bank of America, N.A. (2013) 218 Cal.App.4th 1079.

² Yvanova v. New Century Mortgage Corp., No. S218973, rev. granted Aug. 27 2014; Keshtgar v. U.S. Bank, N.A., No. S220012, rev. granted October 1, 2014; Mendoza v. JPMorgan Chase Bank, N.A., No. S220675, rev. granted November 12, 2014.

³ Glaski v. Bank of America, N.A., supra, 218 Cal.App.4th 1079 (borrowers have standing); Jenkins v. JP Morgan Chase Bank, N.A. (2013) 216 Cal.App.4th 497 (borrowers lack standing). ⁴ See Rajamin v. Deutsche Bank Nat. Trust. Co. (2nd Cir. 2014) 757 F.3d 79, 88-89.

⁵ Kan v. Guild Mortgage Co. (2014) 230 Cal.App.4th 736, 743-744.