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## Otten Johnson Alert:

### Federal Judge Questions Whether Colorado's Rule 120 Proceeding Provides Adequate Due Process for Borrowers in Foreclosure

On May 6, 2013, U.S. District Judge William Martinez issued an interim preliminary injunction in the sale of an Arapahoe County woman's home. There was an evidentiary hearing scheduled for May 15, 2013 to determine whether a permanent preliminary injunction should be granted, but this hearing was vacated because the foreclosing bank withdrew its public trustee foreclosure and agreed to a permanent preliminary injunction against proceeding with a public trustee foreclosure against the borrower in the future. Instead, the foreclosing bank has stated that it will pursue a judicial foreclosure against the borrower.

Due to the foreclosing bank's agreement to a permanent injunction, it is unlikely that the federal judge will have an opportunity to evaluate the constitutional merits of Colorado's public trustee foreclosure process, in particular, the Rule 120 proceeding with respect to this case. (The federal judge has not yet dismissed the case as moot because the state judge has not yet vacated its order authorizing the sale of the borrower's home.) Nevertheless, the borrower's challenge to Colorado's public trustee foreclosure process and the federal court's response is significant and could have important implications for the future of public trustee foreclosures in Colorado.

On April 29, 2013, the borrower filed a motion in U.S. District Court to enjoin the sale of her home, which was scheduled for May 8, 2013. She had previously challenged the foreclosing bank's right to foreclose on her home in a state level Rule 120 proceeding in Arapahoe County District Court. The basis of her challenge was that the foreclosing bank lacked standing to foreclose because it did not provide original evidence of the debt. In Colorado, certain "qualified holders," namely banks, savings and loan associations, credit unions, federal agencies and certain supervised lenders, are exempt from proving that they are the party entitled to

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foreclose. Instead, all that is necessary is a statement signed by the qualified holder, or its attorney, stating that the qualified holder's interest is valid. Other non-qualified holders are required to present evidence of the original debt and deed of trust, including any endorsements and assignments thereof, to the public trustee prior to commencing a foreclosure.

Although the borrower contests the foreclosing bank's standing to foreclose, the foreclosing bank's standing was not the central issue in the federal judge's decision to issue the interim preliminary injunction. Rather, the federal judge questioned whether the Rule 120 proceeding provided adequate due process for the borrower's claims. This is particularly significant due to the fact that federal courts are generally required to abstain from intervening in state court matters, such as a foreclosure proceeding at the state level.

Federal courts are required to abstain from exercising jurisdiction when (1) there is an ongoing state proceeding, (2) the state court provides an adequate forum to hear the claims, and (3) the state proceedings involve an important state interest or matters which traditionally look to state law for their resolution.

In this case, the public trustee foreclosure process is an ongoing state proceeding governed by Colorado law. The public trustee foreclosure process is largely administrative, and judicial involvement is limited to obtaining court authorization for the sale through a Rule 120 proceeding.

In a Rule 120 proceeding there are only two questions: (1) whether the foreclosing party has complied with the Servicemembers Civil Relief Act, and (2) whether a default exists. In his order authorizing the interim preliminary injunction, the federal judge found that there was a substantial question as to whether the borrower's due process claims could be adequately heard within the limited scope of a Rule 120 proceeding.

As stated above, the foreclosing bank withdrew its public trustee foreclosure and consented to the permanent preliminary injunction so the evidentiary hearing was vacated. Although it now seems unlikely that the federal judge will have an opportunity to determine whether the Rule 120 proceeding provides adequate due process in this case, the federal judge's grant of the preliminary injunction is noteworthy.

This case will likely fuel advocacy groups (both the Colorado Center on Law and Policy, Inc. and Colorado Progressive Coalition filed a joint *Amici* Brief in the case) and may increase pressure on lawmakers to amend the current foreclosure process whether through modification of the qualified holder exemption or the scope of the Rule 120 proceeding. Last year, lawmakers tried to pass House Bill 1156, also known as Initiative 84, which would have eliminated the qualified holder exemption and would have required all foreclosing parties to provide the underlying original promissory note, deed of trust and all endorsements or assignments thereof. The bill did not pass and was postponed indefinitely.

Otten Johnson will continue to monitor this case and the implications on Colorado's current public trustee foreclosure process.

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