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Otten Johnson Alert -

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

Last May, Otten Johnson reported on the issuance of an interim preliminary injunction by U.S. District Judge William Martinez against the public trustee foreclosure sale of an Arapahoe County woman's home. (Please [click here](#) to read the original OJ Alert.)

The basis of the borrower's challenge to the public trustee foreclosure sale, which gave rise to the preliminary injunction, was that the foreclosing bank lacked standing to foreclose because it did not produce the original promissory note secured by the deed of trust. In Colorado, certain "qualified holders," namely banks, savings and loan associations, credit unions, federal agencies and certain supervised lenders, are exempt from producing the original evidence of debt. 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 the original promissory note or other instrument secured by the deed of trust, including any endorsements and assignments thereof, to the public trustee prior to commencing a foreclosure.

Although the borrower contested the foreclosing bank's standing to foreclose, the foreclosing bank's standing was not the central issue in Judge Martinez's decision to issue the interim preliminary injunction. Rather, he questioned whether the Rule 120 proceeding provided adequate due process for the borrower's claims. This is particularly significant due to the fact that, absent the existence of a right protected by the U.S. Constitution or a federal statute, federal courts are generally required to abstain from intervening in state court matters, such as a foreclosure proceeding.

The evidentiary hearing scheduled for the permanent injunction was vacated because the foreclosing bank withdrew its public trustee foreclosure and agreed to a permanent injunction against proceeding with a public trustee foreclosure against the borrower in the future. Instead, the foreclosing bank began a judicial foreclosure against the borrower.

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Whereas 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, a judicial foreclosure provides for a complete adjudication of the parties' rights followed by a sale, including any challenge to the lender's status as holder of the indebtedness.

Following the commencement of the judicial foreclosure in state court, the borrower sought to challenge the action by filing a motion for sanctions against the foreclosing bank for violating the terms of the injunction, which required that the parties preserve the "status quo." Judge Martinez denied this motion, stating that the injunction applied only to the foreclosure proceeding under Rule 120 and that the court could identify no sanctionable conduct.

Following the denial of the injunction, the borrower sought to remove the state judicial foreclosure action to federal court, arguing that the second lawsuit was a strain on judicial resources, that all judicial actions related to this matter should be decided by one judge in order to avoid conflict and that the state judicial foreclosure action violates a civil rights law protecting racial equality. The borrower's arguments were unsuccessful and Judge Martinez remanded the judicial foreclosure action back to state court.

Following the remand to state court, Judge Martinez dismissed the challenge to the public trustee foreclosure action, specifically, the Rule 120 proceeding, as moot. The borrower then filed a second motion to remove the state judicial foreclosure action to federal court citing diversity jurisdiction because she and the foreclosing bank are citizens of different states. This motion was also denied.

Although Judge Martinez did not ultimately have the opportunity to determine whether the Rule 120 proceeding provides adequate due process in this case, his grant of the preliminary injunction remains noteworthy. The federal court's reticence to preside over the state judicial foreclosure action, in which there is a complete adjudication of the parties' rights, further highlights potential challenges to the due process provided by the Rule 120 proceeding.

This case may increase pressure on lawmakers to amend the current public trustee foreclosure process 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.

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