City on the Brink: The City of Cleveland Sues Wall Street for Public Nuisance

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This Comment examines the City of Cleveland's lawsuit (as plaintiff, "City") against more than twenty major investment firms for violations of Ohio common law public nuisance. Racked by the collapse of the housing and subprime mortgage markets, the City's lawsuit represents a new way in which municipalities are attempting to vindicate their rights against the businesses and corporations operating within their borders. In its complaint, the City claims that Wall Street's irresponsible securitization of subprime mortgages led to a continuing rash of foreclosures in Cleveland, necessitating greater expenditures on police and fire protection while costing the City significant tax revenues. For Cleveland Mayor Frank Jackson, the lawsuit is more than merely a symbolic gesture against the financial elite. The mayor hoped the lawsuit would hold Wall Street "accountable for what they've done." "We're going after them to get the resources to build our city."

Part I of this Comment introduces the history of the subprime mortgage market and describes the resultant rise and collapse of the

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* The facts cited in this Comment are current as of August 30, 2008.
2 The City of Baltimore has also brought suit against Wells Fargo Bank regarding its activities in the subprime mortgage market. See Complaint for Declaratory and Injunctive Relief and Damages at ¶ 1, Mayor and City Council of Baltimore v. Wells Fargo Bank, N.A., No. 1:08-CV-00062 (D. Md. Jan. 8, 2008), 2008 WL 117894.
market. Part II illuminates how Cleveland became particularly susceptible to the worst aspects of the subprime market and explains why defaults and foreclosures on subprime mortgages have ravaged the city. Part III unpacks the City's complaint, introducing the legal issues and claims raised therein. It then addresses the significant procedural barriers threatening to derail the lawsuit before it ever reaches the merits. Specifically, the City may be unable to show that it has standing to sue the Wall Street defendants or, if the City can leap that initial hurdle, that the defendants were the proximate cause of the City's injuries. Finally, this Comment briefly concludes by addressing how Cleveland might better protect its population from the decimating foreclosures that have thus far gutted the city.

I. HISTORY OF THE SUBPRIME MORTGAGE MARKET

Over the course of several decades, the subprime mortgage market developed into a new means for Americans previously excluded from the prime mortgage market—due to limited financial means and, at times, racial and socioeconomic discrimination—to become homeowners and realize the increased wealth that homeownership offers. Prior to the evolution of the subprime market, individuals and families that could neither afford nor qualify for a prime mortgage, characterized by a 20 percent down payment and fixed thirty-year 6 percent rate, rarely became homeowners. Recognizing that many Americans could not enjoy the quintessential "dream" of homeownership, Congress took several steps to encourage banks, thrifts, and other mortgage lenders to utilize wider and varied lending practices.

A. Congress Encourages Broader Lending Practices

In 1980, Congress passed the Depository Institutions Deregulatory and Monetary Control Act of 1980 ("Monetary Control Act"), which eliminated state usury laws on first-lien mortgages. Before the Monetary Control Act, usury laws—which varied from state to state—forbade the offering of mortgages above certain rates and placed a limit on the types and quality of mortgages that banks and


thrifts could offer.⁶ Once enacted, the Monetary Control Act freed lenders from the strict parameters set by usury laws and permitted experimentation with lending rates for borrowers who may have been unable to qualify for a mortgage under the former system. As discussed in detail below, this paradigm of experimentation was permissive enough to relax limitations on lending to the point that unscrupulous lenders could entice lenders with considerable (and considerably-burdened) lines of credit.

Not long thereafter, the Community Reinvestment Act ("CRA") was passed to encourage banks and thrifts to lend to a broader cross-section of their communities by providing credit and mortgage opportunities to historically-underserved and disenfranchised neighborhoods.⁷ The CRA recognized that financial institutions had a "continuing and affirmative obligation to help meet the credit needs of the local communities in which they are chartered."⁸ To ensure that lending institutions were not improperly withholding funds, the CRA authorized federal financial supervisory agencies such as the Federal Deposit Insurance Corporation ("FDIC") to review the lending practices of banks and other financial entities for compliance.⁹

B. Mortgage Lenders Respond with New Products and Creative Gimmicks

Faced with these new lending obligations, mortgage lenders began to create new mortgage schemes to entice low- and middle-income homebuyers—the most common of which was the subprime mortgage. A subprime mortgage is, as the name suggests, a mortgage offered below prime mortgage rates to a borrower who may not qualify for a prime mortgage loan.¹⁰ As a way to compensate for the increased risk of default and foreclosure that such potential borrowers often present, lenders quantify the risk in terms of higher interest rates and fees. Oftentimes, the percentage rates on subprime loans are "4 to

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⁶ See GRAMLICH, supra note 4, at 4.
⁸ Id. § 2901.
⁹ Id. Some commentators have directly accused the federal government of creating the subprime mortgage crisis through initiatives such as the CRA and the Monetary Control Act. See generally Stan Liebowitz, The Real Scandal: How Feds Invited the Mortgage Mess, N.Y. POST, Feb. 5, 2008, at 33 available at http://www.nypost.com/seven/02052008/postopinion/opedcolumnists/the_real_scandal_243911.htm?page=0. But others disagree, noting that mortgages made pursuant to CRA initiatives charge low mortgage rates and thus enjoy lower default rates. See, e.g., GRAMLICH, supra note 4, at 5.
¹⁰ See In re First Alliance Mortgage Co., 471 F.3d 977, 984 (9th Cir. 2006) ("Subprime lending . . . generally consists of borrowers who, for a variety of reasons, might otherwise be denied credit. . . . Subprime lenders generally charge somewhat higher interest rates to account for the increased risk associated with these loans.").
6 percentage points above the APR on prime mortgages." The availability of such loan options marked the end of the supremacy of the thirty-year fixed-rate mortgages. A new age of experimentation had begun.

Initially, the development of the subprime market had both positive and negative effects. On one hand, mortgage credit became available to individuals who never qualified for a thirty-year fixed-rate mortgage. Along with accessing capital to buy homes, these borrowers could develop wealth in their homes, "live in better neighborhoods, and send their kids to better schools." They had an opportunity not only for increased wealth and security, but could secure better futures for their children.

But for many families, the risks associated with subprime lending clearly outweighed the benefits. Consumer debt, little savings, and other expenses made these homeowners particularly vulnerable to default if the slightest shock or setback in their finances occurred. Moreover, external factors such as predatory lenders, unscrupulous mortgage brokers (discussed in detail below), and opaque mortgage terms all contributed to make subprime mortgages especially dangerous products.

Even today, many of these dangers reside in the terms of the subprime mortgages, hidden in contractual language that may not be disclosed to the consumer. Along with the increased interest rates, lenders may gimmick the terms of the mortgage, abandoning the predictability of the thirty-year fixed-rate scheme common to prime mortgages. Subprime mortgages may be fixed at low "teaser" rates for two to three years and then increased to significantly-higher rates.

11 Gramlich, supra note 4, at 17.
12 See id. at 9.
13 Id.
14 Id.
15 As other commentators have noted, finding a succinct, sufficient definition of predatory lending is a difficult task. See Jonathan L. Entin & Shadya Y. Yazback, City Governments and Predatory Lending, 34 Fordham Urb. L.J. 757, 759 (2007) (noting that predatory lending is difficult to define because "loan attributes may or may not be 'predatory' depending on the sophistication or financial position of the borrower" and because "the lending market is always evolving in light of technological, regulatory, and judicial advancements"). Most, however, agree that subprime mortgages in and of themselves are not inherently predatory; rather, it is the terms of the mortgage and the circumstances in which the loan is offered that make a loan predatory. Factors include lender actions of misleading borrowers, hiding loan terms, or charging unreasonable fees. See, e.g., Rebecca Porter, Minorities Pay More for Mortgages, Studies Find, Trial, Vol. 42, No. 9, Sept. 2006, at 77, 78. Another recognized form of predatory lending is the offering of subprime mortgage loans to those individuals who would qualify for prime rates. See Anna Beth Ferguson, Note, Predatory Lending: Practices, Remedies and Lack of Adequate Protection for Ohio Consumers, 48 Clev. St. L. Rev. 607, 609 (2000) ("[P]redatory lending occurs when lenders employ unethical and/or illegal tactics to secure the loans or offer subprime loans to those who qualify for prime loans.").
for the life of the loan (also known as adjustable-rate mortgages).\textsuperscript{16} These "teaser" rates can entice unsophisticated consumers into taking out a loan by promising low initial payments despite considerable increases later in the life of the loan.\textsuperscript{17} Consequently, many transactions are tainted with unwise decision-making on the part of the consumer and downright fraud by the broker or lender.

"Teaser" rates are just one example of the unorthodox lending practices that have epitomized the subprime market. Subprime lending practices have developed such that consumers for whom "it was [once] impossible . . . to get credit . . . are often swimming in a sea of possible loan products."\textsuperscript{18} Instead of requiring a down payment (a fixture of the prime mortgage market), some subprime mortgages are "interest only," meaning that the mortgage delays the payment of the loan for several years, thereby attracting consumers unable to pay any money upfront.\textsuperscript{19}

Similarly, as the variety of mortgage options have increased, the requirements to secure a mortgage have decreased—often to the point that anyone can secure a mortgage without meeting any qualifications. Brokers and lenders might not perform credit checks, consumers might be freed from producing documentation of assets or income, and, as mentioned above, consumers might not have to place a down payment.\textsuperscript{20} Freed of any reasonable limitations on lending practices, brokers and lenders are able to provide immediate lines of credit to individuals who are in no way qualified or capable of taking on a home mortgage. And, in some cases, unethical consumers are able to misrepresent their assets or earning capabilities because no documentation is required, thereby fraudulently securing loans.\textsuperscript{21}

For example, in a recent case in Cuyahoga County (the county in which Cleveland is located), one mortgage broker was found guilty of mortgage fraud for selling a $490,000 home to a consumer who could not afford it.\textsuperscript{22} The consumer, in turn, lied on his credit form to secure

\textsuperscript{17} GRAMLICH, supra note 4, at 17.
\textsuperscript{18} Id. at 18 (citing BD. OF GOVERNORS OF THE FED. RESERVE SYS. ET AL., INTEREST-ONLY MORTGAGE PAYMENTS AND PAYMENT-OPTION ARMS—ARE THEY FOR YOU? (2006)).
\textsuperscript{19} Id.
\textsuperscript{20} Id.
\textsuperscript{21} Christopher E. Ware & Laura Gramling Perez, Main Street Meets Wall Street: The Mortgage Meltdown, WIS. LAW., Vol. 80, No. 12, Dec. 2007, at 8, 11 (citing Gretchen Morgenson, Inside the Countrywide Lending Spree, N.Y. TIMES, Aug. 26, 2007, § 3 (Sunday Business), at 1).
\textsuperscript{22} Jesse Tinsley, Mortgage Broker Convicted, 2nd Pleads, PLAIN DEALER (Cleveland), Mar. 21, 2008, at B2.
the home and is now serving an eleven-month prison sentence. As this example shows, many of the shortcomings of the subprime mortgage market can be traced to the role played by the mortgage broker.

C. Mortgage Brokers Further Perpetuate Subprime Mortgages

Many of the developments in the subprime mortgage market would not have occurred with such frequency without the rise of the mortgage broker—the middleman of the mortgage industry. Unlike loan officers, who work directly for the mortgage lenders to pursue interested consumers, mortgage brokers are independent entities that seek out potential consumers and pair them with a lender for a fee. They are normally not involved in either the lending or the collection of the loan. Rather, once they have matched a consumer with a lender and received their commission (often subsumed into the consumer’s costs), the relationship ends.

The rise of the mortgage broker as a major player in the housing industry has paralleled the increase in popularity of subprime lending. Only approximately 7,000 mortgage broker firms existed in 1987. As of 2004, it was estimated that 53,000 mortgage broker firms operated in the United States. Indeed, the National Association of Mortgage Brokers notes that two out of every three homebuyers in the United States employ a mortgage broker.

Like subprime mortgages themselves, mortgage brokers are important players in the housing market that have proven to be both effective and, for the vulnerable consumer, quite risky. Filling the void in communities traditionally ignored or underserved by banks and conventional lenders, mortgage brokers can operate face-to-face with individuals in their own communities. As a result, mortgage brokers can assist a greater number of individuals in communities—often minority communities—with securing

25 GRAMLICH, supra note 4, at 19 (citing William C. Apgar & Allen J. Fishbein, Changing Industrial Organization of Housing Finance and Changing Role of Community-Based Organizations, in BUILDING ASSETS, BUILDING CREDIT: CREATING WEALTH IN LOW-INCOME COMMUNITIES 107 (Nicolas P. Retsinas & Eric S. Belsky eds., 2005)).
26 Id.
When acting in such a capacity, the mortgage broker can help realize Congress’s vision of providing mortgages to a wider cross-section of American society and positively promote homeownership.

But evidence suggests that broker-originated loans are more likely to become delinquent or foreclosed. One likely cause of this higher rate of delinquency is the fact that brokers will proactively seek out potential homeowners who may or may not be in the housing market, thereby offering loans to consumers who may not be able to afford them. This practice, known as “reverse redlining,” involves “targeting and aggressively soliciting homeowners in predominantly lower-income and minority communities who may lack sufficient access to mainstream sources of credit.” Other mortgage brokers have engaged in outright fraud, either by misrepresenting the terms of the loan or by encouraging consumers to lie in their applications. Others have been purely negligent in locating consumers capable of paying off the entire mortgage; once the broker originates the mortgage loan, he has little incentive to ensure the success of the loan.

Further complicating matters, the mortgage broker industry is highly unregulated. Mortgage brokers and mortgage firms, such as Ameriquest and New Century Mortgage Corporation, are chartered by states and therefore are free from federal regulation. And although states may determine that some regulation is appropriate, generally mortgage brokers enjoy significantly less oversight than other entities in the mortgage market.

D. Wall Street Enters the Fray

The rise of the subprime mortgage market is only half of Cleveland’s unfortunate story; the other involves the securitization of mortgages and their popularity with investment firms around the country and around the world. As the City’s complaint correctly points out, the secondary mortgage market has played a significant

28 See GRAMLICH, supra note 4, at 20.
29 Id.
30 Id.
33 See GRAMLICH, supra note 4, at 20.
34 Id. at 20–22.
role in perpetuating the offering of subprime mortgages. Wall Street investment firms, however, were not the first entities to securitize and market subprime mortgages. Both the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") began the securitizing of prime mortgages in the 1970s. These government-sponsored enterprises were created with the authority to buy mortgages from mortgage holders and banks, thereby providing increased capital to the mortgage holders who could then give out a higher number of loans. Fannie Mae and Freddie Mac, along with the Government National Mortgage Association ("Ginnie Mae"), hold approximately $5 trillion in total mortgages.

Wall Street followed suit, albeit at a slower pace. Wall Street began the securitization of subprime mortgages in the early 1990s. The results were decidedly positive; Wall Street had unearthed "huge new sources of capital and financing" and had a growing market for mortgage-backed securities. Because these mortgage-backed securities were valued and rated similarly to traditional forms of commercial paper, they became "highly sought after by pension funds, hedge funds, investment banks, insurers, and municipalities all over the world."

Wall Street then infused much of the money back into the housing market to encourage more lending, including subprime lending. The secondary mortgage market allowed lending institutions to provide more subprime mortgages with money borrowed from Wall Street. Essentially, "the ability to sell subprime mortgages to Wall Street conditioned lenders and their brokers to ignore default risk" because the sale of the mortgage and the resultant securitization passed the risk on to Wall Street. This system created an ebb and flow of money between lenders and Wall Street, allowing lenders to provide more mortgages at varying rates.

35 Complaint, supra note 1, ¶¶ 1–2.
36 GRAMLICH, supra note 4, at 5.
37 Id. at 15.
38 Id. at 5.
39 Id.
40 Kenneth C. Johnston et al., The Subprime Morass: Past, Present, and Future, 12 N.C. BANKING INST. 125, 130 (2008). Interestingly, this rating system has drawn scrutiny independent of the City's lawsuit. The SEC is investigating investment banks to determine whether they improperly valued mortgage-backed securities when selling to investors. Id. at 136 (citing Susan Pulliam & Kara Scannell, Pricing Probes on Wall Street Gather Steam, WALL ST. J., Dec. 21, 2007, at C1).
41 Vikas Bajaj & Eric Dash, Big Changes and Big Loan for Lender, N.Y. TIMES, Aug. 17, 2007, at C1.
42 Ware & Perez, supra note 21, at 10.
E. The Subprime Mortgage Market Balloons and Bursts

Business boomed. Between 1994 and 2005, subprime mortgage originations increased by $590 billion dollars, with subprime mortgage originations comprising 20 percent of all originations in 2005.43 The Census Bureau estimated that the rate of home ownership in the United States increased from 64 percent in 1994 to 69.2 percent in 2004—an all-time high.44 While over two-thirds of Americans owned a home, their homeownership stood on precarious ground.

Perhaps nothing demonstrates the precariousness of the subprime mortgage market more than the present foreclosure crisis, portending the burst of the housing bubble. Foreclosure filings in 2007 increased 75 percent from 2006.45 By the end of 2007, some experts suggested that the subprime defaults would total approximately $200–300 billion dollars.46 And the trend continued into 2008. According to a recent study by RealtyTrac, a foreclosure-tracking organization, approximately 650,000 foreclosures were filed in the first quarter of 2008, an increase of 112 percent over those filed in 2007.47 As of April 29, 2008, 156,463 families had lost their homes to foreclosure and repossession.48

No market has been hit harder by foreclosures than the subprime market. While approximately 5 percent of prime mortgages may go delinquent, incurring the risk of foreclosures, almost 15 percent of subprime mortgages are expected to go delinquent.49 Numerous factors have combined to contribute to the extraordinarily high rate of subprime foreclosures. First, a rise in interest rates increased the amounts paid by individuals with subprime mortgages, creating the risk of foreclosures.50 Second, along with the increased interest rates, house prices have steadily declined. During the last three months of 2007, the national median price of homes dropped 5.8 percent, the

43 GRAMLICH, supra note 4, at 6. The prime mortgage market swelled right alongside the subprime market, boosted by a stable economy and lower long-term and short-term interest rates. Id.
48 Id.
50 GRAMLICH, supra note 4, at 7.
sharpest decline since the recording of prices began.\textsuperscript{51} For consumers relying on the improvement of the housing market to boost equity in their homes, the downturn in the market resulted in lost equity and an increased risk of foreclosure.

To make matters worse, many of the adjustable-rate mortgages have aged to the point that the two- or three-year "teaser" rates are expiring and the new, higher interest rates are taking effect. RealtyTrac estimates that 2.5 million adjustable-rate mortgages will adjust to higher rates in 2008, perpetuating the mortgage crisis.\textsuperscript{52} These higher rates significantly increase monthly mortgage payments, threatening households already struggling to pay the lower rates. Often, this leads to default, which in turn can lead to foreclosure and repossession.

\section*{II. Cleveland's Economic Vulnerability Exposes the City to Rampant Foreclosures}

The foreclosure crisis hit the city of Cleveland, Ohio, particularly hard, and the suffering of Cleveland and its surrounding communities is well documented. Nearly 30 percent of subprime mortgages in Cuyahoga County "are either delinquent or in foreclosure."\textsuperscript{53} In 2007, Cleveland had four of the top twenty-one ZIP codes for foreclosure filings in the United States, including the highest ZIP code (the community of Slavic Village), with 783 foreclosures.\textsuperscript{54} Reports indicate that entire city blocks have been abandoned due to foreclosures.\textsuperscript{55} Overall, the city has suffered approximately 7,000 foreclosures a year for the last two years.\textsuperscript{56}

While nearly every city in the United States has experienced the negative effects of the housing bust, few cities were as vulnerable as the city of Cleveland. With a shrinking population, a stagnant housing market (even during the boom preceding the housing bust), and the flight of many manufacturing jobs, Cleveland had numerous economic problems even prior to the wave of foreclosures.\textsuperscript{57} The City claims as much in its complaint, noting its "struggling, Rust-Belt


\textsuperscript{52} \textit{America's Property Crisis}, supra note 49, at 31.


\textsuperscript{55} Maag, supra note 3.

\textsuperscript{56} \textit{Id.}

\textsuperscript{57} Christie, \textit{Foreclosure Focus}, supra note 54.
economy, the disappearance of the manufacturing sector . . . and its inability at the beginning of this decade to attract any meaningful replacement." When combined with high levels of poverty that relegated much of the existing population to the rental market, these factors made Cleveland an attractive market for subprime mortgage lenders and brokers.

While these economic factors certainly contributed to Cleveland's vulnerability, some attribute the high rate of foreclosures to poor state regulation of mortgage lenders and brokers. The state statute regulating predatory lending and other unlawful lending practices, Substitute House Bill Number 386, requires lenders to disclose terms to borrowers and contains general protections against predatory lending. The House Bill also expressly preempted Ohio cities and municipalities from passing ordinances that might further regulate predatory lending.

But Cleveland, dissatisfied by what it saw as insufficient protections against predatory lending in the state law, passed its own anti-predatory lending ordinance. Unlike the state law, the Cleveland ordinance placed lower thresholds on the interest rates lenders could offer, lowered overall fees associated with mortgage lending, and increased disclosure responsibilities. The ordinance received two responses: 1) national financial institutions abandoned Cleveland as a market, and 2) the state legislature pursued litigation to eliminate the ordinance. After months of litigation, the state legislature succeeded in overturning the Cleveland ordinance, winning a ruling before the Ohio Supreme Court that the ordinance was unconstitutional because it attempted to regulate matters of general and statewide concern.

Safe from the higher restrictions, the mortgage lenders returned to the city and the cycle of lending continued. As a result, Cleveland has developed a new strategy to curb subprime lending: litigation.

58 Complaint, supra note 1, ¶ 50.
59 Christie, Foreclosure Focus, supra note 54.
61 Id.
63 Christie, Foreclosure Focus, supra note 54.
64 Am. Fin. Servs. Ass'n v. City of Cleveland, 858 N.E.2d 776 (Ohio 2006).
III. CITY OF CLEVELAND V. DEUTSCHE BANK TRUST COMPANY

A. The Complaint

On January 10, 2008, the City filed its lawsuit in the Cuyahoga County Court of Common Pleas, naming twenty-one defendants in the action. The complaint asserts that Cleveland, at the “epicenter of a mortgage foreclosure crisis triggered by sub-prime lenders and the monied interests that support them,” has suffered significantly in both increased expenditures on fire and police services and in a loss of tax revenue. Once a paragon of “neighborhood revitalization,” the complaint alleges that the sub-prime mortgage boom, bust, and resultant foreclosures decimated the progress the city had made in rebuilding its communities while encouraging home values upward. Instead, the plague of foreclosures left the city with blighted neighborhoods, increased crime and fewer resources with which to combat the increase.

While the complaint alludes to the numerous proponents of sub-prime lending, the City places liability for the damages to its neighborhoods squarely on Wall Street investment banking firms (as defendants, “Securitizers”) that, as part of the secondary mortgage market, created mortgaged-backed securities, developed a market for these securities and generated more revenue that in turn perpetuated the sub-prime mortgage market. According to the City, the Securitizers directly financed the sub-prime market, generating substantial revenue for themselves and their investors.

The City predicates its cause of action on Ohio common law public nuisance. The City claims that the defendants proliferated “toxic sub-prime mortgages” in Cleveland “under circumstances that made the resulting spike in foreclosures a foreseeable and inevitable result.” The crux of Cleveland’s argument is that both the Lenders

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65 Complaint, supra note 1.
66 Id. ¶ 1, 3
67 Id. ¶ 2. However, the City is quick to note that Cleveland, unlike many other cities in the United States, had never enjoyed a large upswing in housing prices. Id. ¶ 49. The City suggests that Cleveland was both a rising star in city revitalization but also a weak housing market. The City characterizes itself as a “struggling, Rust-Belt economy . . . [one of] the poorest cities in the nation in 2003, when sub-prime money began ‘seeking borrowers.’” Id. ¶ 50–51.
68 Id. ¶¶ 1–3.
69 Examples of other Securitizers named in the complaint include Goldman Sachs Group, Bear Stearns, and J.P. Morgan Chase Co. Id. ¶¶ 15, 21, 25.
70 Id. ¶¶ 6–8.
71 Id.
72 Id. ¶ 64.
(e.g., Countrywide Financial Corporation) and Securitizers (e.g., Goldman Sachs Group, Deutsche Bank Trust Company, Ameriquest Mortgage Company, Bank of America Corporation) should have known (and, indeed, did know) that the rampant increase in sub-prime lending would eventually turn into an equally-widespread wave of foreclosures, especially in vulnerable Cleveland. Securitizers "used their preeminent status to set the standard that lenders applied to determine who did (almost everyone) and did not (almost no one) qualify for sub-prime financing." The complaint alleges that Securitizers did away with accepted, responsible underwriting standards, instead preferring to "turn a blind eye when lenders and brokers originated loans that made no economic sense." These loans, which came with such gimmicks as "teaser" rates, were inappropriate for Cleveland—a city that never benefited from the upsurge in housing prices. According to the City, it was the responsibility of Wall Street to "eliminate[] Cleveland as a market for sub-prime lending," thereby denying Cleveland citizens of a popular (if risky) means to secure housing. Instead of doing so, the defendants preyed on Cleveland's "relatively high concentration of lower-income families with below-average credit," especially focusing on Cleveland's large "African-American population."

According to the City's complaint, between 2002 and 2007, the foreclosure rate in Cleveland went from fewer than 120 to more than 7,500. But the City is quick to make clear that, separate from those citizens exposed to the risk of foreclosure, the City has suffered its own, unique damages as a result of the foreclosure crisis. Specifically, the City argues that while it had "absolutely nothing to gain from the sub-prime industry," the foreclosure crisis has devastated Cleveland, necessitating "increased expenditure for fire and police protection, or the cost of demolition." Foreclosures have also injured Cleveland's property-tax revenues, lowering the property value of both the foreclosed home and those homes in the surrounding neighborhoods. To wit, the City cites a recent study compiled by the

73 Id. ¶¶ 48–54.
74 Id. ¶ 42.
75 Id. ¶ 47.
76 Id. ¶¶ 48–49.
77 Id. ¶ 53.
78 Id. ¶ 54.
79 Id. ¶ 56. The City further explains that, in 2007, approximately twenty Cleveland homeowners per day faced the threat of foreclosure. Id. ¶ 57.
80 Id. ¶ 59.
81 Id. ¶ 60.
Center for Responsible Lending which states that home values in Cuyahoga County depreciated by more than $462 million.\(^8\)

Despite the widespread damage alleged in the complaint, the City moderated its demand for damages, at least for the time being. In its request for relief, the City asked for "compensatory damages of more than $25,000... interest... reasonable attorneys fees [sic]... and any other relief that the Court deems just and equitable."\(^8\)\(^3\) The full amount of damages, the City explained, would be specifically quantified at trial.\(^8\)\(^4\)

**B. The Removal**

The form and substance of the City's lawsuit raises some obvious questions. Although the complaint names twenty-one defendants, not one defendant is either headquartered or has its principal place of business in the state of Ohio.\(^8\)\(^5\) Despite the role of Ohio-based National City Bank as a leader in sub-prime lending in Ohio in general and Cleveland in particular—\(^8\)\(^6\)—the same activities that allegedly cost Cleveland millions of dollars—National City managed to avoid being named in the complaint.\(^8\)\(^7\) In fact, the City's failure to list any Ohio-based businesses in its complaint was a deliberate action likely driven by several considerations.

By omitting Ohio-based corporations in its complaint, the City eschewed the precarious position of placing liability on those corporations for whom many of its citizens work and that already pay taxes to Cleveland and the state. The City avoided alienating its state-based businesses while still vindicating its rights against what the complaint describes as the "Wall Street" parties.\(^8\)\(^8\) The City's theory of the case is predicated on "Wall Street's" irresponsible business practices, greed, and lack of concern for a struggling Midwestern city.\(^8\)\(^9\) It would be incongruous (and frankly, incompatible\(^9\)) for the City to group Ohio institutions in with the Wall Street lot.\(^9\)

\(^{82}\) Id. ¶ 61
\(^{83}\) Id. ¶ 27.
\(^{84}\) Id.
\(^{85}\) See id. ¶¶ 12–32.
\(^{87}\) See Complaint, supra note 1, ¶¶ 12–32.
\(^{88}\) See id. ¶ 7.
\(^{89}\) See id. ¶¶ 48–54.
\(^{90}\) By failing to include Ohio institutions heavily involved in sub-prime mortgage lending
Additionally, by failing to include any Ohio-based businesses in its complaint, the City exposed itself to removal to federal court. No doubt desirous to escape the jurisdiction of the Cuyahoga County Court of Common Pleas, located in Cleveland, the Securitizers removed to federal court. Conventional wisdom suggests that the City would want to keep its lawsuit in the Cuyahoga County Court of Common Pleas; arguably, this court would give preferential treatment to the City's arguments and claims. But removal to federal court may have been a concession that the City was willing to make to protect its lawsuit. As discussed below in Part III.C.1, the City's complaint is vulnerable to dismissal for lack of standing. By removing the case to federal court, the Securitizers assumed the burden of showing that the City lacks standing: "The party invoking federal jurisdiction bears the burden of establishing" the elements of standing. Therefore, when defendants remove cases to federal court, they invoke the district court's jurisdiction and bear the burden of showing that the plaintiffs lack standing. This burden shift could prove to be determinative if (and when) the Securitizers move to dismiss the City's complaint.

C. Legal Issues Raised by the City's Complaint

As demonstrated above, the process of subprime mortgage lending cannot easily be reduced to a commercial transaction between a borrower and a lender. Rather, the process of lending is a chain of events connecting the borrower, appraiser, broker, lender, securitizer, and investor—any of whom might in a given transaction commit fraud or other lending abuses. Yet the City identifies Securitizers as the party most appropriate for its current litigation. Given the in the complaint, the City arguably loses some credibility. The City has excluded those businesses predominately operating in Cleveland and Ohio while advancing a cause of action based on the actual or implied knowledge of the parties as to events occurring in Ohio. If any of the sub-prime mortgage Securitizers and other lenders knew that Cleveland was ill-suited for sub-prime lending, logic suggests that they would be those corporations operating within the city limits.

91 Although National City avoided being named in the City's suit, it has its own problems regarding the subprime market. A New York law firm is preparing a class-action lawsuit against National City for allegedly failing to inform its shareholders about the risk of the subprime mortgages it held on its books. See Matt Burns, N.Y. Firm Mounts Class-Action Suit Against National City, BUSINESS FIRST (Columbus), Jan. 30, 2008 at 1, available at http://columbus.bizjournals.com/columbus/stories/2008/01/28/daily19.html.
94 See id.
interrelated activities of numerous players in the mortgage game, the City may not be able to show that the Securitizers caused its injuries.

The Securitizers can elect to raise this issue in one of two ways. First, the Securitizers can argue that the City lacks standing to bring its lawsuit because the City cannot demonstrate Article III standing—specifically that its injuries are fairly traceable to the Securitizers’ actions. In addition, the Securitizers could contend that they are not the proximate cause of the City’s injuries, thereby precluding the City’s claims on the merits. The concepts of the fairly-traceable element of standing and proximate causation are unique but overlapping restrictions on a plaintiff’s claims and therefore will be discussed together below.

1. Standing Issues

The City’s lawsuit first raises standing issues, mostly because the City itself has not been a victim of predatory lending. The City has not received subprime mortgages nor has it been defrauded by brokers or lenders. Even so, the City can likely establish that it has standing to sue the twenty-one defendants because the City is seeking redress for its own unique injuries separate from those injuries suffered by its citizens.

The Supreme Court has established a three-factor test to determine whether a party has standing to sue in federal court. In *Lujan v. Defenders of Wildlife*, the Supreme Court held that, in order to satisfy the minimal standing requirements, the plaintiff must plead a concrete and particularized “injury in fact,” caused by or fairly traceable to the defendants (and not a third party not before the court) that may be redressed by a favorable outcome.

In addition to these constitutional requirements, a plaintiff may lack standing due to several prudential considerations. One of these considerations—particularly relevant to this case—is a third-party standing limitation. Generally speaking, a plaintiff must vindicate its own rights and not those of a third party. Therefore, if the City attempts, either overtly or subtly, to stand in the shoes of its citizens and pursue a suit against the defendants, the district court could find that the proper plaintiffs are the citizens and dismiss the City’s

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95 See id. at 560–61.
96 As mentioned above, the burden rests on the defendants to show that the City lacks standing, because the defendants removed the case to federal court.
97 504 U.S. at 560–61.
99 Id. at 499.
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complaint. This prudential concern blends with the first prong of the *Lujan* test (injury in fact) and therefore warrants consideration alongside the injury discussion.

*a. Injury in Fact*

Here, the City avoids a potential standing issue by pleading unique grievances and injuries separate from those injuries suffered by its citizens. The City claims that the defendants caused it to expend significant amounts for fire and police protection and also negatively impacted the City's tax-income revenue. Although these injuries may have arisen from the same or similar conduct that injured Cleveland citizens, the City's harms are uniquely its own. The increased municipal costs and lost revenue have already occurred and indeed may continue to occur. They directly affect the City and do not depend on an injury suffered by the Cleveland citizenry. Therefore, the City can establish the requisite injury without being barred by the prudential consideration of third-party standing.

*b. Redressability*

Moving to the third *Lujan* prong, a favorable judgment in federal court would compensate the City for its losses, thereby redressing the alleged injury. Because the City can quantify its damages and can be compensated for those damages by the defendants if they are found liable, the City satisfies the third prong.

*c. Fairly Traceable to the Defendants*

The major problem with the City's complaint can be reduced to proximate causation, which is part of the second prong of the *Lujan* test. Assuming that the Securitizers did exactly what the pleadings say they did and accepting the truth of the City's injuries (as required

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100 For an interesting discussion of whether cities such as Cleveland could sue predatory lenders and other defendants under a theory of *parens patriae*, see Entin & Yazback, *supra* note 15, at 762–67, 783 (concluding that it is highly unlikely that cities could succeed with *parens patriae* claims).

101 Complaint, *supra* note 1, ¶¶ 59–60.

102 See *Lujan*, 504 U.S. at 563 (“[The injury in fact test] requires that the party seeking review be himself among the injured.”) (quoting Sierra Club v. Morton, 405 U.S. 727, 734–35 (1972)).

103 See White v. Smith & Wesson Corp., 97 F. Supp. 2d 816, 824 (N.D. Ohio 2000) (holding that lost tax revenue and increased police costs are injuries in fact sufficient to satisfy the minimal standing requirement); *see also* City of Sausalito v. O'Neill, 386 F.3d 1185 (9th Cir. 2004) (holding that a city had standing to sue for damages to its own interests caused by the development of a military base).
under a motion to dismiss\textsuperscript{104}, those injuries may still not be traceable to the Securitizers. Too many other parties—predatory brokers, unethical borrowers, appraisers over-valuing houses, and negligent lenders—contribute to the failure of mortgages and the resulting foreclosures.\textsuperscript{105} The City faces the near-impossible task of convincing the court to ignore the myriad extenuating and intervening factors and parties that together have created the subprime mortgage mess.\textsuperscript{106} The City’s myopic focus on the Securitizers belies the complexity of the issues and ignores the links in the causal chain.

According to Supreme Court precedent, injuries suffered as the result of a causal chain of actions by various parties become too attenuated when based more on speculation than on actual facts or data.\textsuperscript{107} In \textit{Simon v. Eastern Kentucky Welfare Rights Organization},\textsuperscript{108} the plaintiffs argued that the IRS had caused hospitals to deny services to the homeless and indigent because the IRS had promised favorable tax treatment if hospitals only provided emergency-room services to these people.\textsuperscript{109} The Supreme Court held that “[i]t is purely speculative whether the denials of [non-emergency] service[s] . . . fairly can be traced to [the IRS’s] ‘encouragement’ or instead result from decisions made by the hospitals without regard to the tax implications.”\textsuperscript{110} Moreover, the Court found it purely speculative that a favorable ruling for the plaintiffs would cause hospitals to provide these services to the homeless.\textsuperscript{111} The Supreme Court therefore refused to permit the plaintiffs to proceed because “speculative inferences” were necessary to connect the injury to the defendant’s actions.\textsuperscript{112}

\textsuperscript{104}See \textit{Lujan}, 504 U.S. at 561.

\textsuperscript{105}Although more related to the issue of proximate cause, the Second Restatement of Torts notes that causal connections are more restrictive where the tort is based on a defendant’s negligence (as it is here), than when there is a cognitive component to the tort. \textit{RESTATEMENT (SECOND) OF TORTS} § 501 cmt. a (1965); see also \textit{City of Springfield v. Kibbe}, 480 U.S. 257, 269 (1987) (O’Connor, J., dissenting) (“[T]he law has been willing to trace more distant causation when there is a cognitive component to the defendant’s fault than when the defendant’s conduct results from simple or heightened negligence.”).

\textsuperscript{106}Some in the financial world would be quick to agree with the City’s assessment. Recently, Alan Greenspan blamed securitizers for the subprime mortgage failure. See \textit{Excerpts of an Interview with Former Federal Reserve Chairman Alan Greenspan}, \textit{WASH. POST}, Mar. 21, 2008, at D3.


\textsuperscript{108}426 U.S. 26 (1976).

\textsuperscript{109}Id. at 28, 41–42.

\textsuperscript{110}Id. at 42–43.

\textsuperscript{111}Id. at 43–44.

\textsuperscript{112}Id. at 45.
Such inferences are arguably as necessary here. First, the foreclosures that created the City’s alleged public nuisances could have likely occurred had the defendants not securitized mortgages. As in *Simon*, speculation is necessary to determine whether the foreclosures resulted from the securitization of the mortgage or from some other event, such as fraud by the borrower or some other extenuating financial circumstance that caused the borrower to default. Because securitization does not affect the terms or quality of the mortgage, it becomes harder to suggest that subprime mortgages foreclosed in Cleveland due to the securitization and not because of some other action along the causal chain.

Additionally, subprime mortgages will continue to go into foreclosure even if the City succeeds in its suit against the Securitizers. While there may be less money to go around if investment banks cease securitizing mortgages, mortgage lenders will still make subprime mortgages that, as discussed above, have a naturally-higher foreclosure rate than prime loans. And even without the securitization of mortgages, foreclosures will continue—some due to criminal activity by parties involved and others due to the natural flux of the housing market.

The need for speculation demonstrates that the causal connection could be too attenuated to satisfy the standing requirements. But the district court may wish to get more information, either through discovery or expert testimony regarding the role the Securitizers played in the subprime market. Indeed, because standing presents a threshold question involving constitutional and prudential limitations on who may sue, regardless of the merits, the district court might deny any motion to dismiss on standing.113

However, the proximate cause issue may be raised again after the case progresses further, either at the motion to dismiss or the summary judgment stage of the case. If, for example, discovery or expert testimony reveals that foreclosures result primarily from the activities of mortgage brokers or fraud by borrowers or appraisers, then the court could be within its discretion to dismiss or render judgment on the City’s claims if the liability of the Securitizers is too unforeseeable or attenuated.114 Therefore, issues of proximate causation and the attenuation of the City’s claims are likely to be reoccurring issues that the parties must address throughout the proceedings.

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2. Additional Legal Issues Raised by the Cause of Action

Assuming that the City is able to overcome any constitutional and prudential bars to its lawsuit, the City could still be vulnerable to a motion to dismiss for failure to state a cause of action. The City claims that the defendants created a public nuisance by funneling money to mortgage lenders who encouraged mortgage brokers to target borrowers whom the defendants knew or should have known could not afford to take out home mortgages. Once these mortgages defaulted and the banks foreclosed the mortgages, Cleveland became blighted with abandoned buildings and collapsing neighborhoods (the public nuisance in question), thereby necessitating increased spending on fire and safety protections. Because there are so many links in the causal chain connecting the nuisance alleged to the actions of the defendants, the district court could likely find that the defendants did not proximately cause the City’s injuries.

a. Ohio’s Broad Definition of Public Nuisance

Ohio law on public nuisance, which adopts the Restatement of Torts definition, is incredibly broad. Ohio defines public nuisance as an “unreasonable interference with a right common to the general public,” which includes acts significantly interfering with public health, safety, peace, or conduct that has produced a long-lasting effect on a public right. To be liable, the defendant must be aware or should have been aware of the negative effect. This negligence concept is incorporated into the definition of public nuisance. The Ohio Supreme Court has held that an action for public nuisance is often “predicated upon carelessly or negligently allowing such condition to exist.”

Two recent cases—one in Ohio state court and the other in federal court—offer examples of the ability of Ohio's public nuisance laws to accommodate sweeping claims by cities against corporations. First, in White v. Smith & Wesson Corp., the U.S. District Court for the Northern District of Ohio denied the defendant gun manufacturers' motion to dismiss the City of Cleveland’s lawsuit for public

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115 See FED. R. CIV. P. 12(b)(6).
116 See Complaint, supra note 1, ¶¶ 53–54.
117 Id. ¶¶ 63–65.
119 Id. (quoting RESTATEMENT (SECOND) OF TORTS § 821(B) (1965)).
120 Id.
nuisance.\textsuperscript{122} In \textit{White}, the City of Cleveland alleged that Smith & Wesson and other gun manufacturers had created a public nuisance by negligently designing handguns, thereby requiring Cleveland to increase spending on police and other protection services.\textsuperscript{123} The negligent design also cost the city substantial tax revenue.\textsuperscript{124} In denying the defendants' motion to dismiss, the district court held that Cleveland could use these damages to show the existence of a public nuisance.\textsuperscript{125}

In a nearly-identical case to \textit{White}, the Ohio Supreme Court in \textit{City of Cincinnati v. Beretta U.S.A. Corp.}\textsuperscript{126} held that the City of Cincinnati stated claims for public nuisance for damages caused by gun manufacturers.\textsuperscript{127} Noting the unique role that gun manufacturers played in the city's crime rate, the Ohio Supreme Court stated that "[j]ust as the individuals who fire the guns are held accountable . . ., [the defendants] can be held liable for creating the alleged nuisance."\textsuperscript{128}

Both \textit{White} and \textit{Beretta} demonstrate the expansive reading given to Ohio's public nuisance laws. Any district court considering the City's complaint against the Securitizers will likely give a similar reading, especially under the deferential stance of a motion to dismiss. When reviewing a complaint under the Federal Rule of Civil Procedure 12(b)(6) standard, federal courts will accept "all of the factual allegations as true, and determine whether the plaintiff undoubtedly can prove no set of facts in support of his claims that would entitle him to relief."\textsuperscript{129} Federal courts will presume that a plaintiff's "'general allegations embrace those specific facts that are necessary to support the claim.'"\textsuperscript{130} Therefore, given the generous standard of Rule 12(b)(6) and the City's pleading that the Securitizers proliferated subprime mortgages in Cleveland by funding the market negligently, it is possible that the City's complaint can survive a motion to dismiss.\textsuperscript{131}

\begin{footnotes}
\item[122] 97 F. Supp. 2d 816 (N.D. Ohio 2000).
\item[123]  Id. at 824. The similarities between the handgun litigation and the present mortgage litigation are striking.
\item[124]  Id.
\item[125]  See id. at 829.
\item[126]  768 N.E.2d 1136 (Ohio 2002).
\item[127]  Id. at 1150-51.
\item[128]  Id. at 1143.
\item[129]  Columbia Natural Resources, Inc. v. Tatum, 58 F.3d 1101, 1109 (6th Cir. 1995).
\item[131]  See Complaint, supra note 1, ¶ 8. This assumes that the district court does not dismiss the City's complaint for lack of standing as discussed supra Part III.C.1.
\end{footnotes}
b. The City’s Complaint Imposes a Duty Where the Law Does Not

But the City’s complaint is predicated on imposing a legal duty where there is none. As the Ohio Supreme Court has stated, legal activities cannot constitute public nuisances. "What the law sanctions cannot be held to be a public nuisance."\(^1\) Although no law requires that investment firms exercise due diligence in packaging mortgage-backed securities,\(^2\) the City seeks to impose liability for the failure to do so. The City finds liability because the Securitizers packaged mortgages into securities without first "corroborat[ing] the borrowers’ wherewithal to pay."\(^3\)

Essentially, the City’s complaint is a claim of omission on the part of the Securitizers; their failure to properly review the quality of loans given by lenders caused the City’s injuries. Yet Comment a of the Second Restatement of Torts section on public nuisance notes that, historically, the common law recognized that an omission could result in a public nuisance only if there was a corresponding duty to perform the act omitted.\(^4\) Without a legal obligation to perform the due diligence demanded in the complaint, the City cannot claim that the Securitizers created a public nuisance for failing to take certain steps. The City’s complaint is predicated on the argument that the Wall Street investment firms should have supervised the subprime mortgage lenders. This means essentially that the City is faulting Wall Street investment firms (private organizations) for failing to supervise and regulate subprime mortgage lenders (other private organizations). Therefore, although the definition of common law public nuisance in Ohio is broad enough to encompass the alleged activities, the absence of any duty imposed on the Securitizers could be the means by which the defendants have the City’s complaint dismissed.\(^5\)

\(^{132}\) Beretta, 768 N.E.2d at 1143 (quoting Mingo Junction v. Sheline, 196 N.E. 897 (Ohio 1935)).

\(^{133}\) Some commentators have suggested a scheme for forcing greater due diligence requirements on investment banks. See Kathleen C. Engel & Patricia A. McCoy, Turning a Blind Eye: Wall Street Finance of Predatory Lending, 75 FORDHAM L. REV. 2039 (2007).

\(^{134}\) Complaint, supra note 1, ¶ 8.

\(^{135}\) RESTATEMENT (SECOND) OF TORTS § 821B cmt. a (1965).

\(^{136}\) This problem of imposing a duty on the Securitizers also raises an interesting state constitutional question. As discussed in Part II, the Ohio Supreme Court struck down Cleveland’s ordinance imposing higher reporting and disclosure requirements on lenders to curb predatory lending because a state statute forbade such ordinances. Am. Fin. Servs. Ass’n v. City of Cleveland, 858 N.E.2d 776, 785 (Ohio 2006). Arguably, the City’s lawsuit here is a gambit to implicitly impose similar diligence requirements on investment banks securitizing mortgages. Having its ordinance struck down, the City is now attempting to further regulate the mortgage market by suing (and thereby changing the practices) of investment banks.
While lawsuits against the financial elite may garner headlines and promote stronger state laws against predatory lending, the city of Cleveland can more effectively eliminate future instances of predatory lending in three ways: 1) by providing legal assistance to Cleveland’s citizens to seek legal redress against wrong-doing lenders and brokers; 2) to pursue criminal sanctions against those lenders and brokers committing fraud; and 3) by resurrecting previously-rejected attempts at regulating the mortgage industry. To precipitate such changes, Cleveland may have to lobby the state government to take active measures to support regulatory action.

Even the most successful lawsuit against the Wall Street elite will not substantially affect the number of subprime mortgages offered in Cleveland, because the market, through the bursting of the housing bubble, has already diminished the amount of money lenders have for such mortgages. Rather, the City should seek to discourage future acts of fraud and other dishonest lending practices by actively prosecuting criminal activities and empowering its citizens with both protective regulations and effective legal remedies.

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