15-2398

In the United States Court of Appeals for the Second Circuit

BEVERLY ADKINS, CHARMAINE WILLIAMS, REBECCA PETTWAY, RUBBIE McCOY, and WILLIAM YOUNG, on behalf of themselves and all others similarly situated, and MICHIGAN LEGAL SERVICES,
Plaintiffs-Appellants,

v.

MORGAN STANLEY, MORGAN STANLEY & CO. LLC, MORGAN STANLEY ABS CAPITAL I INC., MORGAN STANLEY MORTGAGE CAPITAL INC., and MORGAN STANLEY MORTGAGE CAPITAL HOLDINGS LLC,
Defendants-Appellees.

Appeal from an Opinion and Order of the United States District Court for the Southern District of New York, Case No. 1:12-cv-7667-VEC-GWG

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I. INTRODUCTION

The Fair Housing Act prohibits all banks, including Morgan Stanley, from discriminating in their purchase of mortgage loans. Morgan Stanley may not employ any policy that, although facially neutral, unjustifiably harms members of a protected class. Nonetheless, during the class period here—the run-up to the housing crash—Morgan Stanley made no effort to monitor whether its common practices for acquiring highly predatory New Century loans for securitization had such a prohibited disparate impact. As a result of the common loan purchase and funding policies that are the subject of this lawsuit and this Rule 23 appeal, every member of the proposed class received an expensive, layered-risk New Century loan, and every class member was disproportionately likely to receive her loan because of her race. The certification of this coherent class is straightforward and warranted.

Appellees' chief argument is that predatory lending, like the kind Morgan Stanley caused here, must work through different policies or processes depending upon the particular features in each loan, rendering class certification inappropriate if class members are not identical. The relevant standard, however, asks whether there are sufficient common questions susceptible to common proof. The record here, including a robust regression analysis, shows that the answer is yes: Morgan Stanley's practices raise numerous common questions crucial to the resolution of

this civil rights litigation. Its funding and purchase policies functioned together to incentivize and direct New Century's lending. New Century did not employ a separate, severable set of practices when, for example, it issued balloon payment loans as opposed to loans with high debt-to-income ratios; individual loans contained *multiple* risk features and were issued through New Century's centralized underwriting system. New Century issued all the risky loans, on a basis disparate and adverse to African-American borrowers, for the same acknowledged purpose: to meet the demands of loan purchasers. Questions about Morgan Stanley's particular role in this scheme are entirely and prototypically common.

Having set New Century's discriminatory lending in motion, Morgan Stanley continued to fund and purchase enormous numbers of these risky loans throughout the class period. Morgan Stanley now seeks to artificially disaggregate the borrowers' claims, despite the fact that it acquired and securitized their loans on an aggregate basis and caused the harmful discrimination experienced by every class member.

II. **ADDITIONAL RELEVANT FACTS**

Plaintiffs described the relevant facts in their opening brief, Appellants' Opening Brief 5-20 (hereinafter "Br."), and respond here only to Morgan Stanley's

arguments, which raise a number of merits issues not suitable for resolution at this stage and underscore the suitability of class treatment here.

A. The Morgan Stanley – New Century Relationship.

Although Morgan Stanley now attempts to distance itself from its own contemporaneous acknowledgements, the Morgan Stanley – New Century relationship was, as Morgan Stanley then described it, "indisputably close" and "synergistic." SA 7-8. Morgan Stanley was, by an enormous margin, New Century's largest buyer of loans during the class period, purchasing 20% of New Century's loans while the next largest outside purchaser bought just 8% of those loans. JA 1690-1691; Brief of Defendants-Appellees 4 (hereinafter "MS Br."). As Morgan Stanley's own expert report demonstrates, Morgan Stanley provided New Century with more warehouse credit capacity than any other lender over the course of the class period, and at no point during the class period did any lender provide New Century with a larger warehouse line than did Morgan Stanley. JA 1032.

Morgan Stanley is the only bank whose loan purchase volume New Century mentioned in both of its 10-K filings from the class period. JA 20, 648. As New Century was spiraling into bankruptcy, its securities filings continued to reflect Morgan Stanley's ongoing singular role. JA 143 ($2.5 billion of New Century's $8.4 billion in outstanding debt was owed to Morgan Stanley), JA 140 (Morgan

Stanley extended $265 million in new financing to New Century just before bankruptcy).

The functional aspects of this partnership were reflected in common practices. For example, Morgan Stanley due diligence staff worked on site at New Century, SA 8, and some Morgan Stanley employees received New Century email addresses. Appellants' Supplemental Appendix 1, 10-12 (hereinafter "ASA").

Morgan Stanley's argument that its relationship with New Century was unremarkable, MS Br. 4-9, both improperly delves into the merits and strains credulity on the facts—Morgan Stanley's relationships with other originators were simply not in the same ballpark. The very day that Morgan Stanley filed its brief with this Court, it agreed to pay billions of dollars to end a federal and state investigation into wrongdoing in its mortgage securitization business that focused on Morgan Stanley's New Century relationship. Morgan Stanley – Dep't of Justice Settlement Agmt. & Annex 1 (Feb. 11, 2016).[1] New Century is the *only*

[1] http://www.justice.gov/opa/file/823671/download. "Judicial notice [of a fact not subject to reasonable dispute] may be taken at any stage of [a] proceeding." *In re Drexel Burnham Lambert Grp., Inc.*, 960 F.2d 285, 289 n.2 (2d Cir. 1992) (quoting Fed. R. Evid. 201(f), renumbered to 201(d)). The fact that Morgan Stanley entered into a publicly-available settlement agreement with the United States, and the text of that agreement and its annexes, "can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned." Fed. R. Evid. 201(b)(2). Appellants hereby move this Court to take judicial notice of these facts.

mortgage originator mentioned by name in the Statement of Facts that Morgan Stanley acknowledged as part of the settlement. *See id.*, at 1 & Annex 1.

B. New Century's Lending Resulted From Morgan Stanley's Common Securitization Scheme.

During the class period, New Century was absolutely clear that it issued the types of loans that it believed Wall Street would buy and that Morgan Stanley was a major component of its market. Its 2004 10-K stated that it focused "on originating or purchasing the types of loans that meet [purchasers'] requirements and for which institutional purchasers tend to pay higher premiums. During the year ended December 31, 2004, [it] sold $14.1 billion of loans to Morgan Stanley." JA 20. New Century's Senior Vice President of Secondary Marketing recalled that New Century's goal was to "try to tailor the production to meet" the demands of Morgan Stanley and other investment banks. JA 46-47; *see also* JA 48-50, 1486.[2] New Century's secondary marketing department communicated loan purchasers' views to the New Century credit committee, which determined the loan products that New Century would offer. JA 761.

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[2] Morgan Stanley's assertion that New Century made decisions about which loan products to offer principally as a response to its subprime lender competitors is thus flatly contradicted by the record insofar as it removes Wall Street (and Morgan Stanley) from the equation. *See* MS Br. 11. Perhaps more importantly, it is both a common question and a red herring: the real issue is whether Wall Street in general, and Morgan Stanley in particular, was in the driver's seat.

The resulting guidelines ensured that underwriting would be uniform across personnel and across the nation. Br. 11; JA 755, 770. Underwriters assessed the documentation supporting loans, but otherwise exercised little discretion. JA 1654-1657.[3] Centralized authority tables limited the circumstances under which exceptions from the underwriting guidelines could be made based upon compensating credit factors, and higher-level New Century personnel had to approve many of these exceptions. ASA 14-16. Decisions about who could make an exception, and under what circumstances, were "centralized through the chief credit officer." ASA 15-16.

More important, the "policy" versus "exception" dichotomy that Morgan Stanley relies so heavily upon ignores the context of Appellants' claims. The issues that are relevant here involve the relationships between Morgan Stanley and New Century and between Morgan Stanley and the class. The regression analyses incorporated all *appropriate* variables, JA 482, 507-509, and they form a crucial part of the relevant common proof demonstrating the pattern and results of New Century's originations.

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[3] The district court relied upon the declaration of Kelly Finley, JA 1130-36, to find that New Century underwriters exercised discretion in their underwriting and were not constrained by underwriting guidelines. SA 42-43 & n.36. However, Finley was "not an underwriter," JA 1134, and to the extent her testimony conflicts with that of New Century's Chief Credit Officer, who wrote the underwriting guidelines and supervised their implementation, JA 2015-2018, 2021, it is not credible.

C. New Century's Layered-Risk Lending Harmed Class Members.

The Combined-Risk Loans ("CRLs") that all class members received were uniformly risky. Br. 12-13. Every CRL, regardless of its additional layered-risk features, is by definition a high-cost loan under the Home Mortgage Disclosure Act ("HMDA"). SA 11-12. Regardless of how the particular CRL features were layered in individual class members' loans, the common high interest rate increased the risk of default and foreclosure. SA 11 (citing JA 397). Plaintiff's expert demonstrated that African Americans in the Detroit area were more likely than similarly creditworthy white borrowers to receive high-cost loans, JA 511-12, and every class member shares the harm of this discrimination.

The inclusion of other layered-risk features in the CRL definition both creates a far more precise and data-driven proxy for the *actual* dynamics of predatory lending during the class period, Br. 12, and further delimits the already small and discrete class: the entire CRL class is actually a subset of individuals who would be included in a class defined by receiving high-cost loans on a discriminatory basis.

D. Morgan Stanley's Common Policies Led to the Discriminatory Issuance of Combined-Risk Loans to Class Members.

Morgan Stanley's uniform policies for the funding and purchase of New Century loans, described in detail in Appellants' Opening Brief, Br. 14-18, worked in tandem to ensure that Morgan Stanley received a stream of subprime mortgages

for securitization, thereby leading to the origination of class members' discriminatory loans.

1. *Morgan Stanley employed common policies for purchasing and funding New Century mortgages.*

Morgan Stanley argues that its purchase of nearly $28 billion in New Century subprime loans over the class period, JA 1690-1691, could not have influenced the origination of those loans. It is hard to imagine a merits question more clearly inappropriate to consider in a class certification proceeding. Nonetheless, it is undisputed that Morgan Stanley entered into agreements to purchase the vast bulk of the New Century subprime loans it would acquire *before those loans had even been issued*. SA 20; Br. 8. Some of those agreements arose from "reverse inquiries," in which Morgan Stanley communicated to New Century its specific demands for a quantity of loans, with a price it was willing to pay. JA 211, 743. Moreover, New Century provided Morgan Stanley with non-competitive bidding opportunities. JA 90, 218, 220.

Morgan Stanley's uniform loan review policies structurally ensured that bad loans would go unreviewed and that due diligence interests would remain subordinate to the needs of the trading desk. These policies also buttressed Morgan Stanley's practice of buying layered-risk loans in enormous quantities, in spite of the risk of default they created. By agreement with New Century and throughout the class period, Morgan Stanley did not review the credit and

compliance qualities of seventy-five percent of the New Century loans it purchased. Br. 15-16. Although Morgan Stanley ostensibly selected an adverse sample to review for credit and compliance, it not only held that sample steady even when risk sampling showed an elevated proportion of loans with problems, but even removed loans from the adverse sample, thus cementing the purchase of toxic loans. JA 320-321, 323. Valuation due diligence was also uniformly inadequate throughout the class period, Br. 16, to such an extent that a Morgan Stanley employee referred to its failures as "standard operating procedure," JA 356.

Morgan Stanley argues that its review process became increasingly robust over the course of the class period—a merits defense—but the record makes clear that its common policies persisted without material change throughout the entire class period. Br. 16; *see also* Morgan Stanley – Dep't of Justice Settlement Agmt., Annex 1 at 14 (flawed loan review practices were in effect during 2006 and 2007, despite the fact that Morgan Stanley was aware of New Century's "problematic lending practices").

These uniform policies are the foreseeable result of Morgan Stanley's decision to allow traders, rather than due diligence professionals, to set policies for review of New Century loans. ASA 7-9. Because their chief concern was securing the profits booked at the moment mortgage-backed securities were issued, traders

made clear that the diligence team should maximize the “pull-through” rate, that is, buy as many of New Century’s toxic loans as possible. *See* Br. 17.[4]

Additionally, throughout the class period, Morgan Stanley reviewed just 5% of the loans it funded through New Century’s warehouse facility for credit and compliance. Br. 17-18; JA 1032. Morgan Stanley ascribes relevance to the fact that it did not purchase loans for a period in 2005, but Morgan Stanley maintained its $2 billion warehouse line to New Century throughout that period—and the statistical analysis includes this timeframe, during which the policies did not change. JA 272; Br. 40 n.17. These funding policies prioritized volume without concern for borrowers’ ability to repay their loans; in any event, the role of Morgan Stanley’s funding policies is a common merits question.

2. *Combined-Risk Loans resulted from the combined operation of these policies.*

Throughout the class period, Morgan Stanley’s purchase and funding policies worked together to cause New Century to issue CRLs, which Morgan Stanley bought in large numbers. In addition to being the largest outside purchaser of New Century loans overall, JA 1690-1691, Morgan Stanley bought, by a wide

[4] Morgan Stanley also offers a merits defense that it was a better actor than other loan purchasers because it claims it weeded out more of the worst loans than others did. MS Br. 8; *cf.* JA 747-749 (New Century Senior Vice President of Secondary Marketing contradicting this assertion). Even if true, this claim affects neither Rule 23 certification nor even Morgan Stanley’s anticipated business-justification defense.

margin, more CRLs than did any other purchaser over the class period.[5] It bought nearly $15 billion in such loans, while the next-largest purchaser bought slightly more than half that amount. JA 1690-1693.[6] Its purchase habits conveyed to New Century the message that it should continue to issue layered-risk loans because Morgan Stanley would continue to buy them—to what extent is a common merits question.

Moreover, there is a direct relationship between Morgan Stanley's purchase policies and each CRL feature. In the pools it purchased from New Century, Morgan Stanley actively sought to maximize interest rates, the number of adjustable-rate mortgages, and loans with prepayment penalties throughout the class period. SA 11-12, 15, 19; JA 301. Although the bid terms capped the proportion of loans in the pools with other CRL features, recognizing their riskiness, these caps were high enough to ensure that Morgan Stanley would purchase hundreds of millions of dollars' worth of loans with these CRL features

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[5] The district court cited Morgan Stanley's expert for the proposition that Morgan Stanley purchased a "minimal share" of one type of CRL. SA 39. It declined to mention Appellants' evidence showing that New Century originated fewer than 600 loans of that type nationwide during the class period, whereas it originated more than 68,000 loans of the type of which Morgan Stanley bought "a considerably greater share." *Id.*; JA 1701.

[6] These numbers were calculated by multiplying the loan purchaser share figures found at JA 1690-1691 by the Combined-Risk Loan percentages found at JA 1692-1693.

each month, and allowing these features enabled the purchase of loans with the other terms. For example, one representative set of bid terms allowed the $1 billion pool to contain 40% balloon loans, 42% stated-income loans, 10% interest-only loans, and nearly 9% loans with excessive combined loan-to-value ("LTV") ratios, *with no prohibition on layering multiple of these high-risk features in individual loans*. ASA 2-6; JA 33, 35. Morgan Stanley's focus on the ceilings only confirms the common policies.

Beyond the bid terms, the known deficiencies in Morgan Stanley's loan review procedures not only enabled and ensured the purchase of bad loans, they also contributed directly to the origination of loans with CRL features. Valuation review policies systematically accepted appraisals that overestimated a property's value, building in the purchase of excessive-LTV loans. Br. 16. Declining to review most loans for credit-and-compliance fundamentals and performing under-inclusive adverse sampling meant that unaffordable loans, that is, loans with high debt-to-income ratios, could be and were systematically purchased.

Morgan Stanley's funding policies also led directly to New Century's origination of loans with CRL features. Morgan Stanley contracted with New Century to fund the origination of stated-income loans, loans with excessive LTV ratios, and those with balloon payment features on New Century's longstanding warehouse line. Br. 17; JA 274, 282-283.

Morgan Stanley's funding and purchase policies were deeply interrelated, as Morgan Stanley itself recognized at the time. Br. 17. For example, it extended warehouse credit to New Century because it believed the funding relationship would cause New Century to sell it more whole loans. JA 77, 132. Morgan Stanley's interrelated policies conveyed to New Century the distinct message that it should issue as many loans as possible, including loans with the full range of CRL features.

Appellants' core claim is that Morgan Stanley's policies worked together before any particular loan was issued to a borrower to cause that origination. Whether or not Morgan Stanley purchased a particular loan or subjected it to review *after it had been originated* cannot logically or practically affect the issuance of that loan. Instead, Morgan Stanley's funding and purchase of these types of risky loans, part and parcel of its common scheme, pushed New Century to issue the loans in large numbers. There should be no doubt that the common policies are relevant, at minimum with respect to loans that Morgan Stanley purchased.

III. **ARGUMENT**

A. The Claims of the Class Representatives are Typical of Those of the Class.

Under long-established Second Circuit law, typicality under Rule 23(a)(3) "is satisfied when each class member's claim arises from the same course of

events, and each class member makes similar legal arguments to prove the defendant's liability." *Marisol A. v. Giuliani*, 126 F.3d 372, 376 (2d Cir. 1997).[7] Appellants respectfully argue that the district court's typicality analysis was outside "the range of permissible decisions" because it erroneously required complete identity among class representatives, class members, and their claims. *Roach v. T.L. Cannon Corp.*, 778 F.3d 401, 405 (2d Cir. 2015).

1. *The Class Representatives, like all class members, were injured when they received discriminatory Combined-Risk Loans.*

Although the district court correctly found that the five named plaintiffs were adequate class representatives, SA 34, it found that their claims were not typical of those of the class because their loans did not represent "a broad enough swath" of the Combined-Risk Loans issued to members of the putative class, SA 29.

Class members all received layered-risk loans issued as a result of the same policies and through the same processes, but the district court required that there be a class representative whose loan terms precisely match the loan terms of each class member in order to satisfy typicality. The additional twenty-nine class

[7] Despite Morgan Stanley's protestations, *Marisol A.* indisputably remains good law in the Second Circuit. Indeed, this Court confirmed that case's typicality analysis just last year, in language Morgan Stanley cites in its own brief. MS Br. 48 (citing *Sykes v. Mel S. Harris & Associates LLC*, 780 F.3d 70, 85 (2d Cir. 2015) (quoting "unitary course of conduct" language)).

representatives that this requirement calls for, SA 29-30, would do nothing to further ensure that the "interests of the [absent] class members will be fairly and adequately protected." *Sykes v. Mel S. Harris & Associates LLC*, 780 F.3d 70, 80 (2d Cir. 2015) (quoting *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338 n.5 (2011)).

As even Morgan Stanley concedes, MS Br. 47, purchasers of different versions of a product satisfy typicality when the defendant's wrongful acts are the same across all products. *See Marcus v. BMW of N. Am., LLC*, 687 F.3d 583, 598-99 (3d Cir. 2012) (typicality satisfied although named plaintiff purchased only one of forty-nine tire types covered by class claims because no indication that wrongful acts "differed significantly" across tire types); *In re Sumitomo Copper Litig.*, 182 F.R.D. 85, 92 (S.D.N.Y. 1998) ("[I]t is settled in this Circuit that factual differences in . . . date, size or manner of purchase, the type of purchaser, . . . and other such concerns will not defeat class action certification when plaintiffs allege that the same unlawful course of conduct affected all members of the proposed class.") (citation omitted).[8] That is because the "central feature" of the typicality

[8] Morgan Stanley cites several cases in which typicality was absent, but none of these cases stands for the proposition that product differences alone defeat typicality, and none is a civil rights case. MS Br. 47 n.15. *See Salvagne v. Fairfield Ford, Inc.*, 264 F.R.D. 321, 328 (S.D. Ohio 2009) (distinguishing *Stout v. J.D. Byrider*, 228 F.3d 709, 717 (6th Cir. 2000), cited by Morgan Stanley, and finding typicality for automobile purchaser class despite "differences in the terms and conditions of each" sale because all class injuries are "sufficiently related to Ford's financing procedures"); *In re Fosamax Products Liab. Litig.*, 248 F.R.D. 389, 399 (S.D.N.Y. 2008) (finding typicality absent for medical monitoring class

analysis is whether "defendants committed the same wrongful acts in the same manner, against all members of the class." SA 27 (quoting *Fort Worth Emps.' Ret. Fund v. J.P. Morgan Chase & Co.*, 301 F.R.D. 116, 132 (S.D.N.Y. 2014)).

Here, the injury shared by class members is the racial discrimination they suffered at the moment they received Combined-Risk Loans, and this discrimination resulted from Morgan Stanley's common policies. *See* JA 1666. Although the district court held that the determination of injury must be borrower-specific because borrowers' circumstances may affect the level of risk posed by certain loan features, SA 28-29, the Fair Housing Act ("FHA") case law against which the Rule 23 elements must be measured makes clear that receiving a risky loan on a discriminatory basis is itself an injury for purposes of the statute. *See* Br. 30. This concept is especially straightforward here, where regression analysis has shown that African Americans were issued loans that were more costly at the moment of issuance.

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because claims depended upon what defendant knew at time class members began taking drug, their confounding medical conditions, reasons for their prescriptions, and other factors); *Benner v. Becton Dickinson & Co.*, 214 F.R.D. 157, 166 (S.D.N.Y. 2003) (finding typicality absent because "[u]nder New York's risk/utility test, the risks of each specific product design, not general categories of different designs, must be weighed against each specific design's utility and costs."); *Pa. Pub. Sch. Emps.' Ret. Sys. v. Morgan Stanley & Co. Inc.*, 772 F.3d 111, 121 n.4 (2d Cir. 2014) (in absence of typicality or adequacy analysis to review, noting in dicta that class differences that defeated commonality and numerosity also "cut against" typicality and adequacy findings).

The law could not be otherwise: if FHA injury were contingent upon a borrower's eventual default, a lender that intentionally added risky features to an African-American borrower's loan would escape FHA liability if that borrower were able to somehow avoid default. No authority supports such a weak reading of the FHA, and Morgan Stanley offers none. Moreover, if the precise contours of every loan must be identical in order for any borrower's claim to be typical of others', class certification would be entirely foreclosed as a mechanism for addressing predatory lending under any theory of liability, regardless of whether the claimed "injuries derive from a unitary course of conduct by a single system." *Marisol A.*, 126 F.3d at 377.

Finally, Morgan Stanley also disputes whether receiving high-cost loans on a discriminatory basis, as all class members did, constitutes a common injury satisfying typicality. However, this assertion is unsupported by the cited expert testimony. MS Br. 48 n.16. As noted above, Appellants' expert controlled for legitimate borrower- and loan-related characteristics to demonstrate that African Americans in the Detroit area were more likely to receive high-cost loans in addition to CRLs. JA 511-512; SA 20-21. Morgan Stanley cannot escape the import of this analysis by speculating that, although African-American borrowers were more likely to receive loans at rates above the HMDA high-cost threshold than similarly-situated white borrowers, their rates might somehow nonetheless be

the same as those paid by white borrowers. The FHA bars discrimination in the allocation of high-cost loans, which all class members experienced.[9]

2. *The Class Representatives, like all class members, were injured by Morgan Stanley's unitary course of conduct.*

Here, all class members' injuries arise as a result of Morgan Stanley's "unitary course of conduct." *Marisol A.*, 126 F.3d at 377. Morgan Stanley funded and purchased New Century loans in the aggregate, pursuant to common policies, *see supra* Section II.D.1; Br. 14-18, and the interconnected set of policies that Appellants have described in detail governed this centralized scheme for securitizing subprime loans, *see supra* Section II.D.2; *In re Petrobras Sec. Litig.*, ___ F.R.D. ___, __, 2016 WL 413122, at *4 (S.D.N.Y. Feb. 2, 2016) (Rakoff, J.) (differences between debt and equity securities not relevant to typicality analysis "when the same alleged misconduct drives the claims" as when defendants

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[9] The cases cited by Morgan Stanley to support its disparate-injury argument discuss injury in contexts far removed from discrimination and the civil rights laws and are inapposite in other ways. *See Deiter v. Microsoft Corp.*, 436 F.3d 461, 468 (4th Cir. 2006) (in certified antitrust class action, upholding the exclusion of certain class members who had purchased products under a different pricing program because proof as to that program would have been entirely distinct); *In re Flag Telecom Holdings, Ltd. Sec. Litig.*, 574 F.3d 29, 39 (2d Cir. 2009) (in securities fraud action, investors who sold stock before disclosures at issue were made could not, as a matter of law, prove element of loss causation, so plaintiff from this group did not satisfy adequacy or typicality); *Lundquist v. Sec. Pac. Auto. Fin. Servs. Corp.*, 993 F.2d 11, 14 (2d Cir. 1993) (in Consumer Leasing Act case, finding in one-line typicality analysis that form leases did not make for similar circumstances satisfying typicality).

allegedly committed the same wrongful acts "by participating in a bribery and kickback scheme").

Although the district court was troubled by the fact that "numerous different Morgan Stanley policies" are at issue here, SA 30, the fact that multiple policies comprised Morgan Stanley's securitization scheme does not undermine typicality. This Court held just last year that policies can combine to form a unitary course of conduct. *Sykes*, 780 F.3d at 85 ("defendants' scheme, *which had multiple components*, was a unitary course of conduct" satisfying typicality (emphasis added) (citation and internal marks omitted));[10] *see also Charron v. Pinnacle Grp. N.Y. LLC*, 269 F.R.D. 221, 226, 241 (S.D.N.Y. 2010) (finding typicality satisfied for class of current and former tenants because all were targeted "through the same general course of conduct" which included misrepresenting regulated rents, filing meritless eviction suits, and engaging in other harassing conduct).[11]

Class representatives experienced a common injury caused by a common system. Their claims are therefore typical.

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[10] Morgan Stanley's brief elided the italicized language in its discussion of the *Sykes* typicality holding. MS Br. 48.

[11] Even if a class consisted only of borrowers whose loans Morgan Stanley purchased, both Morgan Stanley's purchasing policies and the common funding policies that ensured the stream of loans for purchase would still be relevant.

B. A Revised Typicality Analysis Would Make Certification of an Issue Class or the Proposed Alternative Class Appropriate.

Where this Court finds a Rule 23(a) error, remand is warranted in order to enable the district court to consider further appropriate action. *Cordes & Co. Fin. Servs. v. A.G. Edwards & Sons, Inc.*, 502 F.3d 91, 95 (2d Cir. 2007) (remanding to district court after finding that errors on adequacy of representation and common questions required revised predominance analysis, with instruction to consider use of (c)(4) classes if it declined to certify the case as a whole). Here, the district court's erroneous typicality analysis prevented it from fully considering whether it could employ the class device to create efficiencies in the resolution of class members' claims. A corrected typicality analysis would render it appropriate to certify an issue class to resolve aspects of liability or to certify a proposed alternative class. Remand makes particular sense here, where the district court specifically noted the interrelationships among typicality, commonality, and predominance before declining to certify any class. SA 27 n.19.

1. *An issue class for aspects of liability is appropriate here.*

Appellants sought certification of an issue class in the district court, Br. 19-20,[12] and they would urge the district court to consider employing that tool on

[12] Both *Lundquist*, 993 F.2d at 14 and *United States Parole Comm'n v. Geraghty*, 445 U.S. 388, 408 (1980) are inapposite because neither addresses a scenario in which movants had raised issue class certification in the district court, as is the case here. *See Rosetti v. Shalala*, 12 F.3d 1216, 1226 n.23 (3d Cir. 1993) (noting

remand. Issue class certification can facilitate the resolution of their claims regardless of the district court's view of predominance as to the (b)(3) class as a whole. *See* Br. 37; *Charron*, 269 F.R.D. at 241 (when certification is limited to "common issues under Rule 23(c)(4), those issues necessarily predominate" (citation and internal marks omitted)); *Cordes*, 502 F.3d at 109 ("On remand, if the district court concludes that the action ought not to be certified in its entirety because it does not meet the predominance requirement of Rule 23(b)(3)" plaintiffs may litigate one element of their claim as an issue class.).

Morgan Stanley strains to claim that the district court definitively resolved that no common questions exist here, despite the fact that the section on commonality in the district court's opinion itself is titled "There May Be Common Questions of Law and Fact." MS Br. 20-21, 31-32; SA 25. That section does not merely recite Appellants' common questions. Rather, the district court noted that claims relating to Morgan Stanley's influence were "likely to rise or fall as a class" and that the existence of a "large-scale disparate impact study . . . can be a powerful argument in support of commonality." SA 26. The district court also noted that the "existence of some individualized issues is irrelevant to the question of commonality." *Id.* at n.18.

Geraghty reversed earlier decision "only to the extent that we had instructed the district court to consider the possibility of certifying subclasses on its own initiative").

Morgan Stanley argues that, even under a revised typicality analysis, commonality under Rule 23(a)(2) should not be found because it believes some class members benefited from receiving a high-cost loan with two additional risky features. *See* MS Br. 37-38; *cf. Kohen v. Pac. Inv. Mgmt. Co. LLC*, 571 F.3d 672, 677 (7th Cir. 2009) ("[A] class will often include persons who have not been injured by the defendant's conduct . . . Such a possibility or indeed inevitability does not preclude class certification."). Once again, however, this argument ignores the high-cost feature common to all the loans. For purposes of Appellants' FHA claims, the question is not whether the risk of default for each CRL at the time of origination was identical. Instead, the common question is whether each class member experienced an adverse impact, that is, whether she was disproportionately likely to receive a loan with adverse features as a result of her race.

Appellants' evidence with respect to high-cost loans, unmentioned by the district court, shows that the answer is yes. *See supra* Section II.C. The presence of additional risky loan terms cannot mitigate this common injury, regardless of how much a particular term increased risk in a particular loan. Although individual questions about the level of harm to individual class members would not necessarily defeat class certification even if Appellants did seek damages, that

logic certainly cannot obtain here, where Appellants seek disgorgement, a defendant-focused remedy.

Moreover, the fact that mortgage brokers were involved in the issuance of some class members' loans does not mean that the question of Morgan Stanley's influence on New Century is not a common question suitable for resolution on a classwide basis.[13] Regardless of brokers' actions, each loan issued to a class member was issued through New Century's centralized underwriting system, which was subject to the influence of Morgan Stanley's common loan funding and purchase policies. *See supra* Section II.B. Even after *Wal-Mart*, the existence of some "subjective, case-by-case criteria" at the end of a process does not "alleviate the disparate impact" of the relevant common policies or defeat commonality for those questions. *Chicago Teachers Union, Local No. 1 v. Bd. of Educ. of City of Chicago*, 797 F.3d 426, 435 (7th Cir. 2015); *see also Houser v. Pritzker*, 28 F. Supp. 3d 222, 242-43 (S.D.N.Y. 2014) (uniform employment policy presents

[13] Morgan Stanley cites *UFCW Local 1776 v. Eli Lilly & Co.*, 620 F.3d 121, 134 (2d Cir. 2010) to assert that the involvement of third parties in the issuance of class members' loans means that causality cannot be a common question. But its quotation from that case concerns whether the third-party reliance required to make out a RICO claim can exist where plaintiffs' injuries were "distinct from the conduct giving rise to the fraud." *Id.* (citation omitted).

common questions although applied across different positions and in different offices).[14]

More important, given that the claims here concern Morgan Stanley's common policies, their disparate impact on African-American borrowers, and Morgan Stanley's acknowledged failure to monitor for disparate impact, the fact that some loans were issued as purported "exceptions" is not germane: Morgan Stanley acquired and funded loans pursuant to the same policies for the same reasons regardless of whether they were "exceptions" or not.

2. *Certification of the proposed alternative class is similarly appropriate.*

As an alternative to the original proposed class, Appellants proposed certification of a subset of the original class whose mortgage loans Morgan Stanley actually purchased. Br. 40-43. It is undoubtedly true that this class presents additional common questions that facilitate a finding of predominance. Moreover, this class hews closely to the statutory mandate against discrimination in the purchase of loans.

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[14] Neither of the out-of-circuit cases cited by Morgan Stanley, both of which concern lenders' discretionary pricing policies, control. *In re Countrywide Fin. Corp. Mortgage Lending Practices Litig.*, 708 F.3d 704 (6th Cir. 2013); *Rodriguez v. Nat'l City Bank*, 726 F.3d 372 (3d Cir. 2013). Moreover, that both cases relate to predatory lending does not make them relevant; neither involved the key issue in this case—how a third-party purchaser of mortgage loans worked through a mortgage originator to secure the loan product that it needed.

Morgan Stanley claims that pursuing certification of the alternative class is a "fundamental shift of theory." MS Br. 42. However, the alternative class represents a *narrowing* of the originally-proposed class and consequently involves a *narrower* theory of liability: it eliminates some potential individualized issues by including only class members whose loans Morgan Stanley actually held. Morgan Stanley's only substantive arguments against certifying this alternative class simply rehash the arguments they make against certification of the original class, *compare* MS Br. 39-43 *with* MS Br. 24-26, 43-53, despite the fact that the district court noted at oral argument that the alternative class requires "a very, very different" analysis. JA 1823.

Morgan Stanley could not be prejudiced by the certification of this class, *see* MS Br. 42-43, because its arguments with respect to the narrower class do not require any additional evidence. The burden to show prejudice from amending a class definition is on the defendant. *See Brown v. Yellow Transp., Inc.*, No. 08 C 5908, 2010 WL 2911786, at *2 (N.D. Ill. July 26, 2010). Appellants provided case law in support of their argument that Morgan Stanley suffered no prejudice, and Morgan Stanley did not attempt to distinguish or contradict it. *See* Br. 43; MS Br. 42-43. The district court noted that Morgan Stanley had spent time and money litigating with an eye to the original proposed class, SA 46, but the ordinary incursion of litigation costs, even by prevailing parties, does not constitute

prejudice. Otherwise, narrowing a proposed class definition would be *per se* impermissible.

C. Under the District Court's 23(b)(3) Analysis, Loan Purchasers Will Escape FHA Liability.

The district court erred in failing to consider how class members would litigate their claims in the absence of class certification, as required by Rule 23(b)(3)'s superiority requirement. Br. 44-47; *see Gintis v. Bouchard Transp. Co., Inc.*, 596 F.3d 64, 67-68 (1st Cir. 2010) (Souter, J., sitting by designation) (noting "the need for a trial court to come to grips with the actual alternatives of common versus individual litigation in the specific circumstances").[15] Because there is no other procedure through which class members can bring their claims, a class action is necessarily superior in light of the commonalities presented here.[16]

Appellants believe that both the district court's predominance and superiority determinations were flawed. Problems with the predominance analysis

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[15] Morgan Stanley contends that Appellants' petition for interlocutory review waived arguments regarding Rule 23(b)(3). MS Br. 54. They cite no authority for this proposition and none exists. Rule 23(f) does not provide for the certification of particular questions for review; instead, it "permit[s] an appeal from an order granting or denying class-action certification" in full. Fed. R. Civ. P. 23(f); *In re Flag Telecom Holdings, Ltd. Sec. Litig.*, 574 F.3d 29, 38 (2d Cir. 2009) (on 23(f) appeal, any "factual findings or conclusions of law with respect to any of the Rule 23 requirements" are reviewable).

[16] Because the required comparative analysis concerns the alternative procedures available for all class members to vindicate their rights, the fact that this litigation can continue on behalf of the named plaintiffs in the absence of class certification is irrelevant. *See* MS Br. at 56.

are addressed throughout this brief. Appellants focus here on the superiority analysis, which more straightforwardly has sweeping consequences for all FHA claims alleging racial discrimination by purchasers of mortgage loans. *See* Br. of Amici Curiae NAACP Legal Defense & Educational Fund, Inc., et al. 24-29.

There is no realistic alternative to class certification for vindicating the rights of class members harmed by disparate impact discrimination.[17] As a result, the district court's ruling here would effectively immunize purchasers of mortgage loans from the liability that the FHA expressly contemplates. Br. at 47-50. Morgan Stanley nonetheless struggles to explain why the district court's decision has no wider implications whatsoever. It points first to the CRL definition as making this case unique, but Appellants have shown that the CRL definition accurately reflects the way predatory lending looks in the real world, *id.* at 49, and thus cannot render Appellants' claims unusual. Morgan Stanley also contends that Appellants have described the policies they challenge only generally, but the class certification record is robust. *See, e.g.*, JA 19-645, 1637-1705, 2000-2037.

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[17] Although the expense of proving a disparate impact claim are cost-prohibitive for individual class members, *see* Br. 48; Br. of Amici Curiae Jerome N. Frank Legal Services Clinic et al. 8., class certification here under (c)(4) or (b)(3) followed by a liability finding would enable them to bring individual suits for damages and injunctive relief, to bring quiet-title claims to prevent foreclosure, and to defend against eviction after foreclosure, *id.* at 9-16; 20-28.

Morgan Stanley has not provided any sound reason why the district court's ruling here will not prevent other victims of mortgage discrimination effectuated by mortgage securitizers from vindicating their FHA rights. Morgan Stanley's argument that, because it did not acquire all class members' loans, this case does not implicate the FHA regulation language barring discrimination in the "pooling or packaging" of mortgage loans is not relevant to the alternative class. 24 C.F.R. § 100.125(b)(2). As to the originally-proposed class, if Morgan Stanley means to raise the question of its liability for loans ultimately purchased by another bank, that too is a common merits question.

The last paragraphs of Morgan Stanley's brief are revealing. MS Br. 60-61. Morgan Stanley argues that it is not terribly important for courts to give effect to the provision of the FHA that creates liability for "purchasing" mortgage loans. 42 U.S.C. § 3605(a)-(b). Instead of a suit against a purchaser of mortgage loans, Morgan Stanley would prefer that borrowers sue lenders.[18] That decision, however, does not belong to Morgan Stanley; it belongs to Congress, which made clear that secondary market actors can and should be held liable for discrimination in their purchasing behavior.

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[18] Of course, it is not unusual for predatory subprime originators to disappear, leaving borrowers without remedy when they are faced with foreclosure. Br. of Amici Curiae AFSCME et al. 12-13 & n.19 & 20.

The class mechanism exists for exactly this scenario. First, acting as a class is the only realistic way that borrowers can hold Morgan Stanley responsible for the discriminatory impact of its funding and purchase of mortgages because only aggregated data can demonstrate that impact with statistical significance. Second, Rule 23 allows the court to determine efficiently whether these African-American borrowers, who were more likely to receive dangerous loans than similar white borrowers, have valid FHA claims against Morgan Stanley for its common and deleterious mortgage securitization scheme.

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CERTIFICATE OF COMPLIANCE
WITH TYPE-VOLUME LIMITATION

I, Rachel E. Goodman, counsel for Appellants and a member of the Bar of this Court, certify, pursuant to Federal Rule of Appellate Procedure 32(a)(7)(B), that the foregoing Appellants' Opening Brief is proportionately spaced, has a typeface of 14 points or more, and contains 6,890 words.

Dated: March 3, 2016

/s/ Rachel E. Goodman
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