UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

BEVERLY ADKINS, CHARMAINE WILLIAMS, REBECCA PETTWAY, RUBBIE MCCOY, WILLIAM YOUNG,

Plaintiffs,

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.

1:12-CV-7667-VEC-GWG

ORAL ARGUMENT REQUESTED

MEMORANDUM IN SUPPORT OF DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

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INTRODUCTION

Plaintiffs filed this lawsuit four years ago, asserting that Morgan Stanley is liable for the allegedly discriminatory lending of another, unaffiliated company—New Century. Judge Baer permitted their Fair Housing Act (FHA) claims to proceed to discovery based on Plaintiffs' general and unsubstantiated allegations that Morgan Stanley "dictated" New Century's lending, causing it to originate so-called "combined-risk" loans disproportionately to African American borrowers in Detroit. Compl. ¶¶ 3-4; *see* ECF No. 47. After extensive fact and expert discovery, and this Court's denial of Plaintiffs' motion for class certification, it is clear that there is no evidence to support Plaintiffs' ambitious theories and that the theories themselves are fatally flawed. Summary judgment should be granted in Morgan Stanley's favor on numerous grounds.

First, because Plaintiffs received their loans between 2004 and 2006 but did not file this action until 2012, their claims are barred by the FHA's two-year statute of limitations. Judge Baer declined to dismiss the claims on the ground that the FHA's limitations provision includes a discovery rule. That conclusion, which is contrary to an *en banc* decision by the Ninth Circuit, was legally erroneous and should be reconsidered. And even if Judge Baer was right about the law, it is clear that all five Plaintiffs should have discovered their claims more than two years before this action was filed. That is especially the case for Plaintiff Pettway, the only Plaintiff whose loan Morgan Stanley purchased.

Second, based on the undisputed factual record, the claims of Plaintiffs Adkins, McCoy, Young, and Williams fail as a matter of law under the FHA. Morgan Stanley purchased none of their loans, and there is no basis under the FHA to hold Morgan Stanley liable for the terms or conditions of loans that it never purchased.

Third, there is no evidence that Morgan Stanley's alleged policies of purchasing New Century's loans, conducting due diligence on its purchases, and providing a warehouse line of

credit caused New Century to originate any of the Plaintiffs' loans, to originate them with the alleged risk factors they contain, or to distribute "combined-risk" loans disproportionately to African American borrowers. This Court has recognized that Plaintiffs' central evidence in support of their causation theory—the expert report of Patricia McCoy—is fundamentally flawed and inadmissible under Federal Rule of Evidence 702. Plaintiffs' speculative theory that Morgan Stanley "controlled" New Century's lending has also been emphatically rejected by each of the New Century witnesses whom Plaintiffs deposed, and finds no other support in the record.

Fourth, there is no evidence that Plaintiffs experienced an actual disparate impact. The evidence that Plaintiffs submitted to try to establish such an impact—the expert report of Dr. Ian Ayres—is fatally flawed for many of the same reasons that led this Court to deny class certification. In particular, Dr. Ayres attempts to measure a disparate impact in the distribution of *all* "combined-risk" loans, but there is no evidence that receipt of every "combined-risk" loan that falls within the arbitrary definition invented by counsel is adverse. There is accordingly no basis for conducting a single disparate-impact analysis based on an aggregation of all such loans. Further, Dr. Ayres improperly assumes that all of the "combined-risk" loans he analyzes were the result of Morgan Stanley's alleged policies, as distinct from a host of other possible causal agents for each such loan and the particular terms therein, including other secondary market purchasers, individual mortgage brokers, and/or New Century itself. Because there is no evidence that any of the loan terms in the loans in his data set were "caused" by Morgan Stanley, there is no evidence that the disparity he purports to find is attributable to Morgan Stanley.

Finally, if Plaintiffs' claims are not dismissed, summary judgment should be granted on Plaintiffs' request for disgorgement, which is not a remedy available to them under the FHA.

STATEMENT[1]

As Morgan Stanley has emphasized, Plaintiffs' theory is unique and problematic in several ways. They seek to lump together under a single label—"combined-risk"—dozens of different kinds of loans and assert that they are invariably worse than other loans. And Plaintiffs' theory seeks to prove a disparate impact by measuring the effects of Morgan Stanley's alleged policies in the origination decisions of an independent company—New Century. Even assuming such a theory is permitted by the FHA,[2] it requires at minimum that Plaintiffs show that Morgan Stanley's policies caused New Century to issue African American borrowers loans containing more harmful terms than the loans it issued to non-Hispanic white borrowers.

Acknowledging at least one of these challenges, Plaintiffs' Complaint promised to show that Morgan Stanley "effectively dictated the types of loans that New Century issued" and that New Century "issued large volumes of Combined-Risk Loans" "at Morgan Stanley's direction." Compl. ¶¶ 3-4; *see also id.* ¶ 241 (Morgan Stanley "orchestrate[d] the sale of Combined Risk Loans"). Judge Baer left the "factual inquiry" regarding causation to "a later stage of this litigation." ECF No. 47 at 12. The undisputed evidence—amassed through extensive factual and expert discovery—has shown that Plaintiffs' allegations lack any factual basis.

I. NEW CENTURY MORTGAGE COMPANY

New Century was an "independent mortgage company that ranked among the leaders in subprime loan originations." ECF No. 230 ("Class Op.") at 4. Like its competitors, New

[1] Morgan Stanley's Rule 56.1 Statement of Material Facts is cited herein as "SOF." Exhibits cited herein as "Def. Ex." are attached to the Declaration of Colin Reardon, filed herewith. The reports of Defendants' experts Marsha Courchane and Timothy Riddiough are cited as "Courchane Report" and "Riddiough Report" and are filed at ECF Nos. 205 and 206, respectively. The reports of Plaintiffs' experts Patricia McCoy and Ian Ayres are cited as "McCoy Report" and "Ayres Report," and are filed at ECF Nos. 187-83 and 187-84, respectively.

[2] Morgan Stanley's motion to dismiss argued that the FHA does not recognize a theory of liability under which a loan purchaser "causes" a loan originator to discriminate in *its* origination of loans, *see* ECF No. 37 at 14-17; ECF No. 43 at 5-6, but Judge Baer ruled otherwise. Morgan Stanley does not repeat those arguments in this motion, but does maintain that the statute precludes liability on this theory for the reasons set forth in its motion to dismiss. Four of the Plaintiffs' claims fail under the FHA's text for separate reasons discussed below. *See infra* pp. 17-19.

Century originated loans and then either securitized them itself or sold them on the secondary market in "bulk" pools often worth $1 billion or more. SOF ¶ 2. Many different banks purchased its loans between 2004 and 2007. *See* SOF ¶¶ 3-4. Morgan Stanley was one purchaser, but from 2004 to 2007, the vast majority of New Century loans—about 80%—were sold to other banks or securitized by New Century itself. SOF ¶ 5.

II. MORGAN STANLEY'S ALLEGED "POLICIES"

Morgan Stanley was one of many financial institutions that bought residential subprime mortgages between 2004 and 2007. Plaintiffs claim that Morgan Stanley "dictat[ed]" New Century's lending through three highly generalized "policies"—purchasing loans, conducting allegedly inadequate due diligence on those loans, and providing warehouse funding. *See* ECF No. 187-1 at 10-20.

A. Morgan Stanley's Purchases of New Century Loans

Between 2004 and 2007, many banks were interested in New Century's loans, and the company sold loans to more than 20 entities. SOF ¶ 4. Morgan Stanley purchased 20% of New Century's loans, while New Century sold more than three times as many loans—62%—to other financial institutions and securitized 18% itself. SOF ¶¶ 5-6. Even when New Century sold loans to Morgan Stanley, it was aware that there were "many more potential buyers" interested in its loans. SOF ¶ 7. As one former New Century executive testified, New Century actively fostered this "diversification of [its] investment banks" in order to "create more competition" for its loans. SOF ¶ 23.

Because New Century controlled which secondary market purchasers acquired its loans, Morgan Stanley's purchasing varied over time. Morgan Stanley purchased 33% of New Century's loans in 2004, 10% in 2005, and 21% in 2006. SOF ¶ 8. For six months in 2005, Morgan Stanley did not make any bulk loan purchases from New Century because it "was

unwilling to pay what its competitors paid." Class Op. 19-20; *see* SOF ¶¶ 9-11. That year Carrington Capital was New Century's largest loan purchaser, and New Century itself securitized more than twice the number of loans it sold to Morgan Stanley. SOF ¶¶ 12-13.

New Century also controlled the process by which it sold its loans. In order to manage the timing of its loan sales, New Century structured its sales to Morgan Stanley and other banks as "forward sales," in which it would "set[] a price today for delivery in the future." SOF ¶¶ 14-15. New Century often invited bids on "indicative pools" through a competitive process that could involve "14 different investors." SOF ¶¶ 17-23. New Century itself determined the types and proportions of loans in these "indicative pools," which reflected "what New Century expect[ed] the production characteristics to look like at a future date," SOF ¶¶ 18-19. New Century also sometimes sold loans through "reverse bids"—where the bidder initiated the process by offering to buy a pool of loans. SOF ¶ 24. Even in "reverse" sales, New Century—not the loan purchaser—generally determined the characteristics of loans in the pool. SOF ¶ 26.

Once New Century selected a winning bidder, it entered into a purchase agreement attaching a set of "bid terms." SOF ¶ 27. Through bid terms, the winning bank sought to ensure that the features of the loans New Century delivered matched those of the "indicative pool" that New Century had selected and presented, and upon which the bank had based its bid price. SOF ¶¶ 30-31. There is no evidence that bid terms caused New Century's origination of particular loans. New Century expressly warranted that its "decision to originate any mortgage loan" was "independent" of Morgan Stanley's "decision to purchase" the loan and the "price" offered. SOF ¶ 32. Indeed, as one New Century executive testified, New Century "had no idea when [a loan] was originated who the investor was going to be." SOF ¶ 33.

There is also no evidence that Morgan Stanley's bid terms dictated the interest rates of

the loans New Century originated. Those rates were, instead, influenced by other factors, such as the general "interest rate environment," New Century's responses to the actions of "competitors [who] lowered rates" to gain market share, and the actions of New Century's independent mortgage brokers. SOF ¶¶ 71-72.

B. Morgan Stanley's Due Diligence

Before a loan sale closed, Morgan Stanley (like other loan purchasers) conducted due diligence on the loans New Century delivered. Morgan Stanley subjected every loan to valuation diligence, analyzing the appraised value and condition of the property securing the loan. *See* SOF ¶¶ 37-38. Morgan Stanley also subjected a sample of loans to credit and compliance diligence, assessing them for compliance with New Century's underwriting guidelines and pertinent legal requirements. SOF ¶ 40. Through this process, Morgan Stanley regularly declined to purchase—"kicked out"—a significant number of loans presented by New Century in each trade. *See* SOF ¶¶ 41-42; Riddiough Rpt. ¶ 110.

The evidence indicates that Morgan Stanley's diligence was more rigorous than other banks' diligence. For example, most banks reviewed only 10% to 25% of appraisals, but Morgan Stanley reviewed the appraisal for every loan presented for purchase. SOF ¶¶ 38-39. New Century also complained to Morgan Stanley that its "kick-out" rate was higher than New Century's other purchasers and its standards more demanding. *See* SOF ¶ 43 (complaints that "Lehman and others are buying loans that [Morgan Stanley] won't").

C. Warehouse Lending

New Century had access to vast amounts of credit, maintaining its own commercial paper facility and "warehouse" facilities from many investment banks. The company's warehouse lenders included Bank of America, Barclays, Bear Stearns, Citigroup, Credit Suisse, and UBS, in addition to Morgan Stanley. SOF ¶ 46. Morgan Stanley's warehouse line represented between

14% and 20% of New Century's total available credit between 2004 and 2006. SOF ¶ 47. In that period, New Century received as much or more credit from other lenders (such as Bank of America and UBS) or its own commercial paper facility. *See* SOF ¶¶ 50-55.

New Century was able to move loans from one warehouse lender's line of credit to another's. SOF ¶ 49. It also maintained much larger credit lines than it needed at any one time, and thus did not depend on Morgan Stanley—or any other single warehouse lender—to operate. SOF ¶ 56. Notably, "even if Morgan Stanley's warehouse line to New Century had *not existed* New Century would still have had between $1.7 billion and $7.6 billion in excess credit" at the end of each quarter from 2004 to the third quarter of 2006. Riddiough Rpt. ¶ 41; *see* SOF ¶¶ 57-58. New Century also had access to many other potential sources of financing beyond the lenders it used. Riddiough Rpt. ¶¶ 104-105, 108.

III. ABSENCE OF CONTROL BY MORGAN STANLEY

Contrary to Plaintiffs' allegations, there is no evidence that Morgan Stanley "orchestrat[ed]," "dictated," or otherwise "control[led]" New Century's lending or underwriting practices. Compl. ¶¶ 3, 241; McCoy Rpt. 29. The record is entirely to the contrary.

First, every New Century witness to testify in this action has *rejected* the notion that their company was controlled by Morgan Stanley. Patricia Lindsay, a former New Century executive quoted in the Complaint, *see* Compl. ¶¶ 65, 76, 85, described Plaintiffs' theories as "absurd" and rejected the notion that Morgan Stanley "effectively dictated the types of loans that New Century issued." SOF ¶¶ 75-76; *see also* SOF ¶ 59 ("It was New Century's internal decision what loans [it was] going to make[.]"). Other former New Century executives also rejected Plaintiffs' theory, confirming that no "one bank [had] any specific control over New Century," and that no "particular bank" dictated the terms of New Century's loans. SOF ¶ 79. They also testified that New Century's underwriting guidelines were drafted internally at New Century without Morgan

Stanley's involvement. SOF ¶¶ 60-62. No fact witness has supported Plaintiffs' contentions.

Second, just as no fact witness supports Plaintiffs' theory of causation, no reliable expert evidence demonstrates that Morgan Stanley dictated New Century's lending. Plaintiffs attempted to provide such testimony through the expert report of Patricia McCoy, who claimed that "Morgan Stanley exerted singular influence over New Century." McCoy Rpt. at 22. As this Court has recognized, however, Professor McCoy's discussion of causation was inadmissible because it was plagued by fundamental methodological problems: Her report "offer[ed] no expert analysis" or "methodology" and instead simply "conclude[d] *ipse dixit* that Morgan Stanley had a 'singular influence' on New Century's practices." Class Op. 47.

Third, Plaintiffs previously relied on several internal Morgan Stanley documents that boasted about the perceived strength of the bank's relationship with New Century. *See* ECF No. 187-1. This Court correctly recognized that these documents were essentially "self-congratulatory." Class Op. 7. For example, certain documents noted that Morgan Stanley was at times New Century's largest ("#1") loan purchaser. *Id.* at 7. But there is no evidence that being the largest loan purchaser—which even in 2004 left fully *two-thirds* of New Century's loans to be purchased by other banks or securitized by New Century itself—gave Morgan Stanley "control" over New Century's lending or dictated its origination of "combined-risk" loans. As noted, New Century's witnesses expressly rejected the notion that Morgan Stanley controlled or specifically influenced the terms on which New Century originated loans.

Finally, there is no evidence that Morgan Stanley controlled or influenced *which* borrowers received New Century loans, much less which borrowers received *which terms* in those loans. Most New Century loans were originated through its "network of independent mortgage brokers." SOF ¶ 63; *see also* Class Op. 4. Brokers could influence a loan's terms

because they were able to "shop the loan around to find an originator willing to fund it." Class Op. 5; *see also* SOF ¶ 65. Brokers dealt directly with borrowers and with New Century. SOF ¶ 64. There is no evidence Morgan Stanley ever interacted with New Century's brokers or directed their activities. Nor is there any evidence that Morgan Stanley directed or influenced what neighborhoods New Century or its brokers chose to operate in.

IV. THE PLAINTIFFS' LOANS AND ALLEGATIONS OF DISCRIMINATION

Plaintiffs are five African Americans in Detroit who received "combined-risk" loans from New Century between 2004 and 2006. *See* SOF ¶¶ 84, 102-06. Morgan Stanley did not purchase the loans of four of them. New Century offered the loans of Plaintiffs Adkins, McCoy, and Young to Morgan Stanley, but Morgan Stanley rejected them. *See* SOF ¶¶ 85-86. New Century made its loan to Plaintiff Williams in April 2005, during the six-month period in which Morgan Stanley made no bulk loan purchases from New Century. *See* SOF ¶¶ 92-93. New Century sold those four loans to Credit Suisse, Lehman Brothers, and Carrington. Among the Plaintiffs, Morgan Stanley purchased Ms. Pettway's loan alone. *See* SOF ¶¶ 87-88, 90, 94, 96.

Plaintiffs advance a novel disparate impact claim: They challenge Morgan Stanley's alleged policies, but assert a disparate impact in New Century's origination and distribution of loans. Plaintiffs claim that Morgan Stanley caused New Century to disproportionately distribute "combined-risk" loans to African American borrowers. Plaintiffs invented the "combined-risk" loan concept for "this litigation." Class Op. 2 n.3. They define it as a loan that is both (a) "high cost" under a 2002 Home Mortgage Disclosure Act ("HMDA") regulation and (b) contains any two of eight diverse features that they claim "increase the risk of default." *Id.* at 2.

At class certification, this Court recognized the problems raised by this novel definition in a disparate impact case, in which a court is tasked with measuring *adverse* effects on minorities within an identified group. While Plaintiffs treat all "combined-risk" loans

interchangeably for disparate impact purposes, the undisputed record evidence shows that the eight "risk" features "are clearly distinct" and "each affects borrowers differently." Class Op. 24. Whether a particular loan did or did not present "increased risk" necessarily varies according to a loan's particular "risk" features and the borrower's individual circumstances. Further, the "risk" features provided genuine benefits for many borrowers, such as lower monthly payments or down payments, and thus were not necessarily adverse and could reasonably have been chosen notwithstanding any marginal increase in a theoretical default risk.

For example, each of the five individual Plaintiffs received loans that contained adjustable rates and prepayment penalties. SOF ¶ 102; Class Op. 29-30.[3] Adjustable-rate loans were desirable for many borrowers because, for an initial period, they had lower interest rates (and thus lower monthly payments) than fixed-rate loans. SOF ¶ 107. Plaintiffs' expert McCoy acknowledged that an adjustable rate may be "cheaper" and economically "rational" for borrowers who "know that they will own the house for a relatively short period." SOF ¶ 108. Similarly, prepayment penalties were "associated with more favorable interest rates," and thus benefited borrowers by providing lower monthly payments for the lifetime of a loan. Class Op. 18; *see* SOF ¶ 111. And none of the Plaintiffs received the type of "large prepayment penalties" that McCoy asserts increase the likelihood of default, because "prepayment penalties that were 'large' under McCoy's definition" were forbidden by Michigan law. Class Op. 18-19; SOF ¶¶ 112-18.

Plaintiffs' other "risk" features are likewise each distinct, and whether they entail any heightened risk or instead provide offsetting benefits depend on a borrower's individual circumstances. *See* Class Op. 11-19; SOF ¶¶ 119-22. Complicating matters further, as this

[3] In addition, Plaintiffs Adkins, Young, and Williams had LTV ratios of at least 90 percent, McCoy had a stated income loan, and Young had a balloon payment term. *See* SOF ¶¶ 103-05.

Court has found, different *combinations* "'affect the probability of foreclosure differently,'" and not all combinations necessarily entail an increased default risk. Class Op. 38 n.29; SOF ¶ 123.

Ignoring the differences among the many combinations of Plaintiffs' "risk" features and the potential benefits of specific features for individual borrowers, Plaintiffs' expert Dr. Ayres conducted a disparate impact analysis premised on the assumption that receipt of any "combined-risk" loan was necessarily adverse for all borrowers. Ayres Rpt. 34-36. He also assumed, contrary to the evidence, that Morgan Stanley was responsible for all of the "combined-risk" loans New Century originated. *See id.* at 55; Class Op. 49; SOF ¶¶ 127-31. Having made these assumptions, Dr. Ayres purports to find a disparate impact in New Century's overall distribution of "combined-risk" loans in Detroit. *See* Ayres Rpt. 9 & tbl. 1.

ARGUMENT

Summary judgment should be granted when "there is no genuine dispute as to any material fact and the [moving party] is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a). On issues where the nonmoving party bears the burden of proof, the moving party may simply point to an absence of evidence to support the non-moving party's case, at which point the burden of presenting specific facts showing a genuine issue for trial shifts to the nonmoving party. *PepsiCo, Inc. v. Coca-Cola Co.*, 315 F.3d 101, 105 (2d Cir. 2002). The non-moving party must "do more than simply show that there is some metaphysical doubt as to the material facts." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586 (1986). The dispute must be genuine: the "mere existence of a scintilla of evidence in support of the [non-moving party's] position will be insufficient." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 252 (1986).

I. SUMMARY JUDGMENT SHOULD BE GRANTED BECAUSE PLAINTIFFS' CLAIMS ARE BARRED BY THE STATUTE OF LIMITATIONS

Plaintiffs' Complaint was not filed until October 2012, more than six years after Plaintiffs received their loans and far outside the FHA's two-year statute of limitations. Judge Baer dismissed two of Plaintiffs' claims as untimely, ECF No. 47 at 8-10, but allowed their FHA claims to proceed, concluding (1) that the FHA includes a "discovery rule," and (2) that when Plaintiffs should have discovered their claims could not be "resolve[d] on a motion to dismiss." *Id.* at 6-8. The holding that the FHA includes a discovery rule was legally erroneous. And even if a discovery rule applies, Plaintiffs' claims are still untimely given the undisputed evidence.

A. The FHA's Statute of Limitations Is Not Subject to a Discovery Rule

The Court should reconsider Judge Baer's holding that the FHA includes a discovery rule, which was contrary to both the FHA's text and the prevailing view among federal courts.

A discovery rule is "an exception to the general limitations rule that a cause of action accrues once a plaintiff has a complete and present cause of action," *Merck & Co. v. Reynolds*, 559 U.S. 633, 644-45 (2010) (internal quotation marks omitted), and will only be applied where doing so is consistent with the statute's "text and structure," *TRW Inc. v. Andrews*, 534 U.S. 19, 28 (2001); *see also John Wiley & Sons, Inc. v. DRK Photo*, 998 F. Supp. 2d 262, 285 (S.D.N.Y. 2014) ("*TRW* … made clear that the discovery rule had limited application."). The FHA's limitations period runs for two years from "the occurrence or the termination of an alleged discriminatory housing practice." 42 U.S.C. § 3613(a)(1)(A). Judge Baer held that this language "does not expressly preclude a discovery rule." ECF No. 47 at 6. We respectfully disagree. The Supreme Court has noted that similar statutory language tying "the start of the limitations period to 'the date of the occurrence of the violation'" "plainly establish[es]" that a discovery rule does

not apply. *TRW*, 534 U.S. at 32. And the Ninth Circuit, sitting *en banc*, has squarely held that the statutory language of the FHA *does* preclude a discovery rule:

> Holding that each individual plaintiff has a claim until two years after he discovers [an FHA violation] would contradict the text of the FHA, as the statute of limitations for private civil actions begins to run when the discriminatory act occurs—not when it's encountered or discovered.

Garcia v. Brockway, 526 F.3d 456, 465 (9th Cir. 2008) (en banc). Judge Baer suggested that *Garcia* is inapplicable because it did not involve a "racial disparate impact claim," ECF No. 67 at 3, but *Garcia* construed the very same limitations provision—section 3613(a)(1)(A)—at issue here, *see* 526 F.3d at 461.[4]

District courts have likewise generally held that because the "FHA unambiguously states that the 'occurrence' of the discriminatory act will trigger the statute of limitations" a "discovery rule does not apply." *Moseke v. Miller & Smith, Inc.*, 202 F. Supp. 2d 492, 509 (E.D. Va. 2002); *see also Kuchmas v. Towson Univ.*, 2007 WL 2694186, at *4 n.4 (D. Md. 2007) ("federal courts have not generally applied the discovery rule to FHA cases").[5] As Judge Baer noted, a few district courts have held that a discovery rule applies under the FHA, but those decisions largely ignore the text of the FHA's limitations provision. *See* ECF No. 47 at 6 (citing *Clement v. United Homes, LLC*, 914 F. Supp. 2d 362, 371 (E.D.N.Y. 2012)).

Judge Baer also suggested that the "policy behind the language" of the FHA "requires a discovery rule." ECF No. 47 at 7. But "limitations periods, while guaranteeing the protection of

[4] Similarly, the Fifth Circuit has held that a materially identical limitations provision in the Equal Credit Opportunity Act tied to "the date of the occurrence of the violation" precludes a discovery rule. *Archer v. Nissan Motor Acceptance Corp.*, 550 F.3d 506, 508 (5th Cir. 2008) (construing 15 U.S.C. § 1691e(f)).

[5] *See also Walton v. Wells Fargo Bank, N.A.*, 2013 WL 3177888, at *3 (D. Md. 2013) ("The discovery rule … does not apply to the unambiguous language of the FHA's statute of limitations provision."); *Coulibaly v. J.P. Morgan Chase Bank, N.A.*, 2011 WL 3476994, at *8 (D. Md. 2011) ("Given [the FHA's] language, which is triggered by an *occurrence*, courts have been unwilling to apply the discovery rule…."); *Thompson v. Mt. Peak Assocs., LLC*, 2006 WL 1582126, at *3 (D. Nev. 2006) ("[s]everal courts … have found that the application of the discovery rule would be inconsistent with the language of" the FHA).

the civil rights laws to those who promptly assert their rights, also protect [defendants] from the burden of defending claims arising from … decisions that are long past." *Del. State Coll. v. Ricks*, 449 U.S. 250, 256-57 (1980). And in any event, such policy concerns do not trump the plain language of the FHA. *See Garcia*, 526 F.3d at 466 ("application of the discovery rule … would render the clear language of the statute meaningless and superfluous").

A district court has the "power to reconsider its own decisions prior to final judgment." *DiLaura v. Power Auth. of State of N.Y.*, 982 F.2d 73, 76 (2d Cir. 1992). Reconsideration is appropriate here because Judge Baer's discovery rule holding was legally erroneous. *See Cohen v. UBS Fin. Servs., Inc.*, 2014 WL 240324, at *2 (S.D.N.Y. 2014) (law of the case may be disregarded where "court has 'a clear conviction of error' with respect to a point of law on which its previous decision was predicated"). Because Plaintiffs are ineligible for any other form of tolling, *see* ECF No. 47 at 8-10, that error has caused Morgan Stanley to incur substantial litigation expenses defending against stale claims that should have been dismissed years ago. Permitting Plaintiffs' untimely claims to proceed to trial would only make matters worse. The Court should reconsider Judge Baer's ruling and grant summary judgment to Morgan Stanley.

B. Plaintiffs' Claims Are Untimely Even Under a Discovery Rule

In any event, Plaintiffs' claims are also untimely under a discovery rule. That rule delays a claim's accrual only until a "plaintiff has or with reasonable diligence should have discovered the critical facts of both his injury and its cause." *Kronisch v. United States*, 150 F.3d 112, 121 (2d Cir. 1998). It is undisputed that the key facts alleged in the Complaint were available in numerous public sources more than two years before Plaintiffs filed this action in October 2012.

The public sources Plaintiffs relied on in the Complaint included:

- New Century's SEC filings prior to its 2007 bankruptcy, which disclosed Morgan Stanley's loan purchases from and warehouse lending to New Century, *see* SOF ¶¶ 138-41;

- Morgan Stanley SEC filings for securitizations of New Century loans originated prior to its 2007 bankruptcy, *see* SOF ¶¶ 142-43;

- The lengthy report by the New Century bankruptcy examiner in February 2008, which chronicled New Century's origination practices, loan quality issues, and relationship to the secondary market, *see* SOF ¶¶ 150-52;

- Articles published in 2007 and 2008 in the *New York Times*, *Wall Street Journal*, and other publications regarding allegedly predatory lending by New Century and secondary market purchases of New Century loans by Morgan Stanley and others, *see* SOF ¶¶ 144-47;

- Numerous reports and academic studies published prior to 2010 regarding the phenomenon of "reverse redlining" nationwide and in Detroit, *see* SOF ¶¶ 148-49;

- The April 2010 testimony of former New Century employee Patricia Lindsay before the Financial Crisis Inquiry Commission, *see* SOF ¶¶ 153-54;

- The June 2010 Assurance of Discontinuance between Morgan Stanley and the Massachusetts Attorney General, which addressed Morgan Stanley's loan purchasing from New Century (including purchasing of loans with Plaintiffs' alleged "risk" features), due diligence practices, and warehouse lending, *see* SOF ¶¶ 155-56; and

- All of the data on which the Complaint relied to conduct a disparate impact analysis, *see* SOF ¶¶ 157-64.

Thus, the "critical facts" alleged in the Complaint were publicly available more than two years before this action was filed (and often much longer). *Kronisch*, 150 F.3d at 121.

Plaintiffs allege that their FHA claims are nonetheless timely because they were unaware of these facts until they were recruited for this lawsuit by their attorneys in 2012. *See* Compl. ¶ 221. But under the discovery rule the accrual of a claim does not "turn[] on when a plaintiff (or his lawyers) finally decides to take action," because such a standard would "render the limitations period meaningless." *A.Q.C. ex rel. Castillo v. United States*, 656 F.3d 135, 141-42 (2d Cir. 2011). Rather, the relevant question is when Plaintiffs' FHA claims "with reasonable diligence *should* have [been] discovered." *Kronisch*, 150 F.3d at 121 (emphasis supplied). That question "may be decided on summary judgment" where, as here, "the facts in the record are

clear and sufficient." *131 Maine St. Assocs. v. Manko*, 179 F. Supp. 2d 339, 349 (S.D.N.Y.), *aff'd*, 54 F. App'x 507 (2d Cir. 2002). Plaintiffs, in the exercise of reasonable diligence, should have discovered the publicly available facts underlying their claims more than two years before the Complaint was filed.

Plaintiffs have also suggested that their "consultations" with counsel did not take place until after the filing of two securities cases against Morgan Stanley in 2011. *See* ECF No. 42 at 22-23. But similar securities claims were asserted as early as 2008. *See* SOF ¶¶ 180-84 (allegations that "Morgan Stanley had a longstanding relationship with New Century and regularly purchased large pools of mortgages" and provided warehouse financing). And the Complaint's factual allegations based on the complaints in the 2011 securities cases are also duplicative of other earlier sources, such as the June 2010 Massachusetts Assurance of Discontinuance and Patricia Lindsay's April 2010 testimony to the Financial Crisis Inquiry Commission. *See* SOF ¶¶ 165-79. Thus, the 2011 securities cases provide no basis for invoking the discovery rule. *See Clement*, 914 F. Supp. 2d at 372 (a "plaintiff need not know each and every relevant fact of his injury" for FHA claim to accrue).[6]

Thus, Plaintiffs' claims are untimely even if the FHA includes a discovery rule. That is particularly clear with respect to Plaintiff Pettway—the only Plaintiff whose loan Morgan Stanley purchased. New Century originated her loan in 2004, more than eight years before the Complaint was filed. *See* SOF ¶ 185. She testified that she had believed since 2006 that her loan was based on an inflated appraisal. *See* SOF ¶ 186. She also testified to having read three articles in Detroit newspapers in 2007 (five years before the Complaint was filed) highlighting

[6] Plaintiffs have also claimed that they could not have discovered the alleged disparate impact until their counsel conducted an "analysis of aggregate data." ECF No. 42 at 23. However, the data on which they relied had been publicly available since at least 2008, and Plaintiffs have offered no justification for their long delay in analyzing that data. *See* SOF ¶¶ 157-64.

potential discrimination against African American borrowers who received subprime mortgages, and that she specifically remembered believing, based on those articles, that she had been targeted for her loan because of her race. *See* SOF ¶¶ 187-90. She thus knew, or should have known, "enough to protect h[er]self by seeking legal advice." *A.Q.C.*, 656 F.3d at 140. And with minimal effort, she or her counsel could have discovered Morgan Stanley's purchase of her loan, which was publicly recorded. *See* SOF ¶ 191. Coupled with the vast amount of publicly available information discussed above, there can be no question that Pettway's claim should have been discovered, for statute of limitations purposes, long before the filing of this action.

II. SUMMARY JUDGMENT SHOULD BE GRANTED AGAINST THE FOUR PLAINTIFFS WHOSE LOANS MORGAN STANLEY DID NOT PURCHASE

In its class certification opinion, this Court observed that "Morgan Stanley is plainly covered by the FHA's text insofar as it purchased or securitized mortgages" but "expresse[d] no view whether that coverage extends as far as Plaintiffs' theory, which seeks to hold Morgan Stanley responsible under the FHA for loans that it neither purchased nor securitized." Class Op. 36 n.26. The FHA does not reach Plaintiffs' theory. Given the undisputed evidence that Morgan Stanley declined to purchase the loans of Plaintiffs Adkins, McCoy, and Young and was never offered Plaintiff Williams' loan, their claims fail as a matter of law under the FHA.

The FHA makes it unlawful for an entity "whose business includes engaging in residential real estate-related transactions to discriminate against any person in making available such a transaction, or in the terms or conditions of such a transaction, because of race" or other protected characteristic. 42 U.S.C. § 3605(a). A "residential real estate-related transaction" includes the "purchasing of loans … secured by residential real estate." § 3605(b)(1)(B). The provision thus bars an entity engaging in the purchasing of loans from (1) discriminating in "making available" such a loan purchase because of race, as would be the case if it refused to

purchase a loan based on the borrower's race, or (2) discriminating in the "terms and conditions" of such a loan purchase based on the borrower's race. The regulation defining the FHA's coverage of "[d]iscrimination in the purchasing of loans," 24 C.F.R. § 100.125, confirms that a loan purchaser may be liable for only those two categories of conduct. It makes it unlawful for an "entity engaged in the purchasing of loans … secured by residential real estate[] [1] to refuse to purchase such loans, … or [2] to impose different terms or conditions for such purchases, because of race." § 100.125(a).

Plaintiffs Adkins, McCoy, Williams, and Young cannot establish that Morgan Stanley is liable for either category of conduct: (1) discriminating in refusing to purchase their loans, or (2) discriminating in imposing different terms and conditions for such purchases of their loans.

As to the first category, there is no evidence that New Century offered to sell Plaintiff Williams' loan to Morgan Stanley, *see supra* p. 9, so Morgan Stanley obviously cannot be liable for "refu[sing] to purchase" it, § 100.125(a). Morgan Stanley did refuse to purchase the loans of Plaintiffs Adkins, McCoy, and Young during due diligence, *see supra* p. 9, but Plaintiffs have never claimed that the refusal was based on, or in any way related to, their race. Indeed, under Plaintiffs' own theory that Morgan Stanley was required to reject "risky" loans, *see* ECF No. 187-1 at 14, Morgan Stanley acted properly in refusing to purchase their loans.

Nor can the claims of Plaintiffs Adkins, McCoy, Williams and Young proceed under the second category. They cannot sue Morgan Stanley for "impos[ing] different terms or conditions for such purchases" of their loans, § 100.125(a), because Morgan Stanley did not purchase their loans. Morgan Stanley cannot be liable for discriminating in the terms or conditions of a purchase that never occurred.

Plaintiffs identify no support in the text of § 3605 for construing it to hold a secondary market purchaser liable even for the "terms or conditions" of loans that it never purchased. Plaintiffs have argued (ECF No. 187-1 at 26) that § 3605's implementing regulation states that unlawful discrimination includes "[p]ooling or packaging loans … differently because of race." § 100.125(b)(2). But nothing in that language even hints that liability can flow from the "terms or conditions" of loans that an entity never possessed, and thus could not "pool" or "package."[7]

Nor does Plaintiffs' interpretation find support in the caselaw or the FHA's legislative history. Courts applying § 3605 have rejected claims when the defendants "did not make or purchase the mortgage loan in question." *Green v. Diamond*, 2014 WL 5801351, at *5 (N.D. Ill. 2014). That is because "§ 3605 applies only to transactions involving the 'making or purchasing of loans,'" so if defendants "did not enter into—or refuse to enter into—any loan with [plaintiff] … their conduct is not covered by § 3605." *Davis v. Wells Fargo Bank*, 685 F. Supp. 2d 838, 844 (N.D. Ill. 2010), *aff'd*, 633 F.3d 529 (7th Cir. 2011).[8] Likewise, there is no evidence that in extending the FHA to "the secondary mortgage market" Congress intended to subject loan purchasers to liability for the terms or conditions of loans they never purchased. *See* H.R. Rep. No. 100-711, 100th Cong., 2d Session, at 30 (1988), *reprinted in* 1988 U.S.C.C.A.N. 2173, 2191.

Under a proper interpretation of the FHA, the undisputed record evidence shows that summary judgment should be granted against Plaintiffs Adkins, McCoy, Williams, and Young.

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[7] The regulation's other examples are to the same effect. They provide that unlawful conduct includes "[p]urchasing loans … secured by dwellings in certain communities … but not in others because of race" and "marketing or s[elling] securities issued on the basis of loans … secured by[] dwellings" differently "because of race." 24 C.F.R. § 100.125(b). The examples contain no suggestion that a secondary market purchaser may be responsible for the terms or conditions of a loan it never purchased.

[8] *See also Jordan v. Chase Manhattan Bank*, 91 F. Supp. 3d 491, 504 (S.D.N.Y. 2015) ("The FHA applies only to 'residential real estate-related transactions,' not all activities related to residential real estate-related transactions."); *Pandozy v. Segan*, 518 F. Supp. 2d 550, 557 (S.D.N.Y. 2007) (claim dismissed because defendants were not "engaged in 'residential real estate-related transactions'"); *Berry v. Fargo*, 2015 WL 8601866, at *3 (N.D. Ill. 2015) (claim dismissed because defendant "was not making or purchasing a loan"); *Walton v. Diamond*, 2013 WL 1337334, at *5 (N.D. Ill. 2013) (claim dismissed because "Section 3605 only applies to transactions involving the 'making or purchasing of loans'").

III. SUMMARY JUDGMENT SHOULD BE GRANTED BECAUSE NO EVIDENCE SUPPORTS PLAINTIFFS' ALLEGATION THAT MORGAN STANLEY'S ALLEGED POLICIES CAUSED NEW CENTURY TO ORIGINATE PLAINTIFFS' "COMBINED-RISK" LOANS

Discovery also has shown that no evidence supports the causation element of Plaintiffs' disparate impact claim against Morgan Stanley. To prove a disparate impact, a plaintiff "must show a causal connection between the facially neutral policy and the alleged discriminatory effect." *Tsombanidis v. W. Haven Fire Dep't*, 352 F.3d 565, 574-75 (2d Cir. 2003). This is far from a perfunctory matter. The Supreme Court recently emphasized that the FHA contains a "robust causality requirement" for disparate impact claims to "protect[] defendants from being held liable for racial disparities they did not create." *Texas Dep't of Hous. & Cmty. Affairs v. Inclusive Cmtys. Project*, 135 S. Ct. 2507, 2523 (2015).

The danger the Supreme Court identifies is very present in this case, and the need for careful attention to the robust causation requirement is thus particularly acute. Unlike a typical disparate impact case, this action involves two independent actors: The alleged causal policies are *Morgan Stanley's*, but the alleged disparate impact is in *New Century's* origination and distribution of loans. And the allegedly "influenced" actor—New Century—was an independent company that interacted with countless other third parties, including other loan purchasers, warehouse lenders, brokers, and borrowers. Judge Baer held that even to establish standing on such a theory Plaintiffs must prove that Morgan Stanley's policies "had a 'determinative or coercive effect' on" New Century's actions. ECF No. 47 at 5 (quoting *Carver v. City of New York*, 621 F.3d 221, 225-26 (2d Cir. 2010)).

After a lengthy period of fact and expert discovery, there is no evidence that Morgan Stanley's alleged policies dictated, coerced, or otherwise caused New Century's origination or distribution of "combined-risk" loans to Plaintiffs.

A. The New Century Witnesses Unanimously Refuted Plaintiffs' Causation Theories

The only directly relevant testimony in the record—that of New Century's own former employees—strongly refutes Plaintiffs' case. As noted, Plaintiffs say that *New Century* originated the allegedly adverse loans disproportionately to African Americans. They further allege that *the reason* New Century did so was Morgan Stanley's policies. New Century—an independent company—is thus the key link in Plaintiff's chain of causation. The problem for Plaintiffs is that the testimony by those who worked at New Century refutes their theory.

Plaintiffs deposed several New Century witnesses. Those witnesses unanimously rejected the notion that Morgan Stanley "effectively dictated the types of loans that New Century issued," and testified that no bank had "any specific control over New Century." SOF ¶¶ 76, 79; *see also id.* ¶ 59 ("It was New Century's internal decision what loans we were going to make."). New Century executive Bill McKay even expressed "surprise[]" that this case had not been filed "against New Century." Def. Ex. 5 at 146. These witnesses' authoritative testimony about the company's own motivations and reasons for originating loans—which is not contradicted by anything in the record—is dispositive.

B. Plaintiffs Have Not Presented Admissible Expert Testimony to Demonstrate Causation

Summary judgment should also be granted because Plaintiffs have not submitted admissible expert evidence establishing that Morgan Stanley was the cause of New Century originating their five loans with the so-called risk factors those loans contain. *See DeRienzo v. Metro. Transp. Auth.*, 694 F. Supp. 2d 229, 235 (S.D.N.Y. 2010) ("Summary judgment is proper if a party fails to provide admissible, necessary expert testimony on causation.").

Courts require expert testimony on causation where, as here, a plaintiff's causation theory involves complex matters outside the understanding of ordinary jurors and the plaintiff's injury

has multiple potential causes. *See, e.g.*, *Wills v. Amerada Hess Corp.*, 379 F.3d 32, 46 (2d Cir. 2004) (Sotomayor, J.) (expert testimony required in wrongful death case where "the nexus between the injury and the alleged cause would not be obvious to the lay juror" and "injury has multiple potential etiologies"); *Matarese v. Archstone Pentagon City*, 761 F. Supp. 2d 346, 365 (E.D. Va. 2011) (granting summary judgment on FHA disability claims where causation issue was "not within the knowledge of a layperson" and plaintiffs submitted no expert testimony). Before inferences with respect to causation can be drawn from purported circumstantial evidence in this case, expert testimony is obviously necessary to address the many potential alternative causes of New Century's lending. New Century itself is the first and perhaps most obvious competing cause. To the extent New Century was not the sole "cause" of its own loans, the complexity of New Century's economic relationships gives rise to many potential causes other than Morgan Stanley, including the other large banks that purchased its loans or provided it warehouse credit, as well as its independent brokers. *See* Class Op. 8 (discussing New Century's relationship to "Wall Street" generally); *id.* at 5, 42-43 (disparate impact Plaintiffs found may "be entirely explained by brokers' exercise of discretion"); SOF ¶¶ 3-4, 45-46, 63-70.

Recognizing the need for expert evidence, Plaintiffs submitted the report of Patricia McCoy, who purported to conclude that Morgan Stanley "exerted singular influence over New Century." McCoy Rpt. 22. Morgan Stanley moved to exclude Professor McCoy's causation opinion, showing that her report failed to apply any methodology whatsoever, failed to consider alternative causes of New Century's lending, and failed to consider the testimony of the former New Century executives and other critical evidence. *See* ECF No. 193-1 at 5-13; ECF No. 200 at 1-6. This Court dismissed the motion to exclude as moot in light of its denial of class certification, but nonetheless agreed that "McCoy's opinion as to Morgan Stanley's influence

over New Century would not be admissible under Rule 702," and neither would "her related conclusions regarding Morgan Stanley's role as a purchaser, underwriter, and securitizer." Class Op. 48. The Court also recognized that insofar as Dr. Ayres opined that New Century's loans were "caused by Morgan Stanley" his opinion would also be excluded. *Id.* at 49.

Thus, Plaintiffs have failed to present any admissible expert testimony on causation. That failure provides a second reason to grant summary judgment on causation.

C. There is No Other Evidence that Morgan Stanley Caused Plaintiffs' New Century Loans

Nor is there any other evidence that meets the FHA's robust causation requirement.

First, while Plaintiffs have suggested that Morgan Stanley's "bid terms" in "forward sales" caused New Century to originate the five Plaintiffs' loans, there is no evidence for that proposition, much less for the proposition that the bid terms caused New Century to distribute "combined-risk" loans disproportionately to African Americans in Detroit. *See* SOF ¶ 29-34. It is undisputed that New Century—not Morgan Stanley—determined the contents of the "indicative pools" for which it solicited bids. *See* SOF ¶ 18. Those pools reflected "what New Century expect[ed] the production characteristics to look like at a future date." SOF ¶ 19. It is likewise undisputed that Morgan Stanley based its bid price on the indicative pool established by New Century, and that the bid terms on which Plaintiffs rely simply memorialized New Century's agreement to deliver loans consistent with the indicative pool. SOF ¶¶ 29-31. In other words, bid terms were the *result* of New Century's estimates of its future production; they were not the *cause* of that production. Indeed, there is no evidence whatsoever that New Century ever originated specific loans to satisfy Morgan Stanley's bid terms. To the contrary, as one New Century executive testified, New Century "had no idea when [a loan] was originated who the investor was going to be." SOF ¶ 33. In fact, because loans were originated without bid terms in

mind, the loans New Century actually delivered never precisely matched its bid terms. SOF ¶ 34.

Second, although Plaintiffs contend that Morgan Stanley's warehouse lending somehow had a determinative effect on New Century's origination of "combined-risk" loans, there is not a shred of record evidence for that wholly speculative theory. Between 2004 and 2006, Morgan Stanley's warehouse line never constituted more than one-fifth of New Century's total available credit. *See* SOF ¶ 47. New Century maintained a large amount of excess credit—so much so, that even if Morgan Stanley's warehouse line had not existed New Century would still have had billions of dollars in unused credit. *See* SOF ¶¶ 56-58. New Century also had access to other potential sources of credit in the marketplace, so it could have replaced Morgan Stanley had that ever become necessary. *See* SOF ¶ 48. And New Century had the ability to shift loans from one warehouse line to another as it saw fit. *See* SOF ¶ 49. Given these facts, it is unsurprising that Plaintiffs have identified no evidence showing that Morgan Stanley's warehouse line had any effect (much less a determinative one) on New Century's origination of Plaintiffs' loans or the loans' terms. Even where New Century did temporarily place a loan on Morgan Stanley's warehouse line, New Century could have placed the loan on a different warehouse line, and had Morgan Stanley's line been unavailable, it would have had no impact whatever.

Third, Plaintiffs cannot create a genuine dispute by relying on "self-congratulatory" internal Morgan Stanley documents which boasted about Morgan Stanley's relationship with New Century. Class Op. 7. The fact that those documents noted that Morgan Stanley was at times New Century's "#1" loan purchaser provides no evidence that Morgan Stanley controlled or dictated New Century's lending. *Id.* Other banks collectively purchased far more loans than Morgan Stanley did, and were ready and willing to purchase still more. *See* SOF ¶¶ 5-7. Nor

can Plaintiffs show that Morgan Stanley dictated New Century's lending through documents indicating that Morgan Stanley at times provided New Century with "advice." Class Op. 8. There is no evidence that Morgan Stanley's advice was the determinative "cause" of all (or any) of New Century's loans, allegedly "risky" loan terms, or their demographic distribution. As this Court has noted, "New Century was receptive to the advice of 'investors' writ large." *Id.* And at most, these documents suggest that Morgan Stanley's advice *improved* New Century's loan quality. *Id.* (presentation suggesting that New Century imitated "Morgan Stanley's best practices," leading to "higher quality" loans). Nor does any of this remotely show that Morgan Stanley determined, coerced, or otherwise caused New Century to originate Plaintiffs' loans—a notion that the New Century witnesses themselves explicitly rejected.

Fourth, circumstances specific to each plaintiff afford further reasons that attribution of their loans to the alleged Morgan Stanley policies is untenable on the undisputed record. Plaintiff Williams' loan was originated during the six-month period in 2005 in which Morgan Stanley made *no* bulk loan purchases from New Century. *See* SOF ¶¶ 92-93. New Century sold her loan to Carrington Capital, which was New Century's largest loan purchaser in 2005 and in which New Century owned a major ownership stake. SOF ¶¶ 12, 94-95. As a result, Plaintiffs' speculative theory that Morgan Stanley caused New Century's lending through its bid terms cannot apply to Williams.

As to Plaintiffs Adkins, McCoy, and Young, Morgan Stanley refused to purchase their loans during its valuation due diligence process, which fatally undermines any claim that Morgan Stanley "caused" their loans to be made on allegedly discriminatory terms. *See* Class Op. 37 (finding Plaintiffs' causation theories "even less persuasive in the context of loans that were caught and rejected by Morgan Stanley's due diligence process"). New Century was able to sell

those three loans to Credit Suisse First Boston and Lehman Brothers. *See* Riddiough Rpt. ¶ 124. Plaintiffs cannot show that Morgan Stanley was the cause of loans that failed to meet Morgan Stanley's valuation standards. This is particularly true, given other banks' demand for New Century's loans and less rigorous valuation diligence processes. *See supra* pp. 4, 6.

Finally, no evidence creates a genuine dispute with respect to Plaintiff Pettway's loan, which Morgan Stanley purchased in 2004. SOF ¶ 96. There is no evidence that Morgan Stanley caused New Century to offer loans like the so-called "2/28 ARM" loan she obtained, in which the interest rate was fixed for the first two years and adjusted thereafter. *See* SOF ¶¶ 97-98. To the contrary, New Century executive Warren Licata testified that the 2/28 ARM was a "primary product" at New Century "since the day that he started" in 1998. SOF ¶ 99. Moreover, Pettway acquired the loan through independent mortgage brokers, who placed the loan with New Century (and who had no relationship with Morgan Stanley), *and Ms. Pettway testified that she believed it was the mortgage brokers who targeted her based on her race*. SOF ¶¶ 100-01. Plaintiffs' expert has acknowledged brokers could "affect[] the terms that were offered to borrowers." SOF ¶ 70; *see also* Class Op. 42-43. There is no possibility on this record that the Supreme Court's robust causation requirement is met with respect to any of the Plaintiffs' loans.

Ultimately, the fact that there is no evidence that Morgan Stanley controlled, dictated, or otherwise caused New Century's origination of "combined-risk" loans should come as no surprise. As the Sixth Circuit noted in affirming the dismissal of an action against secondary market participants on proximate causation grounds, originators like New Century

> that sold mortgages to home buyers decided which loans should be made and on what conditions. … [T]hese companies ultimately made the decisions regarding where they would seek financing, which types of loans they would market and sell, and, once the mortgagee, whether to keep the mortgage or sell it to another buyer, such as one of the Defendants.

City of Cleveland v. Ameriquest Mortg. Sec., Inc., 615 F.3d 496, 504-05 (6th Cir. 2010). Given the FHA's robust causation requirement, summary judgment is equally warranted here.

IV. SUMMARY JUDGMENT SHOULD BE GRANTED BECAUSE PLAINTIFFS HAVE FAILED TO ESTABLISH EVIDENCE OF A DISPARATE IMPACT

Summary judgment is also proper because Plaintiffs have failed to present evidence of a disparate impact. *See B.C. v. Mount Vernon Sch. Dist.*, 2016 WL 4926147, at *7 (2d Cir. 2016) (affirming grant of summary judgment where plaintiffs "failed to make their prima facie showing that [defendants'] policy adversely impacted" protected individuals). In particular, Plaintiffs have yet to come forward with any proper disparate impact analysis because they have yet to identify (or show how they can identify) the group of borrowers and loans properly relevant to that analysis. The undisputed evidence shows that the flaws that precluded class certification also doom their disparate impact case.

Plaintiffs have relied on the expert testimony of Dr. Ayres, who purported to find a disparate impact in New Century's distribution of "combined-risk" loans in Detroit. *See supra* p. 11. Yet as this Court recognized in denying Plaintiffs' motion for class certification, the record evidence shows that the many different combinations of "risk" factors Plaintiffs identify have different effects and potential benefits. *See* Class Op. 24, 38-40. That renders the concept of a "combined-risk" loan fundamentally unsuited to measuring whether African American borrowers were *adversely* affected by their loans, as required to demonstrate a disparate impact. Dr. Ayres' analysis is also flawed because he simply assumes that Morgan Stanley was the cause of the disparity that he purports to find. For reasons this Court has already recognized, that assumption is unsupported by—and indeed contrary to—the evidence.

In other words, the analysis that Plaintiffs' expert has conducted lacks an evidentiary foundation and thus cannot properly show either that any Plaintiff suffered an actual disparate

impact (*i.e.*, disproportionately adverse results for African Americans) or that that impact was caused by Morgan Stanley. Absent such evidence, this case must be dismissed.

A. Dr. Ayres Improperly Assumes That Receipt Of Every "Combined-Risk" Loan Is Necessarily Adverse, And Conducts No Analysis Specific To Plaintiffs' Combined-Risk Loan Terms

The premise of any disparate-impact claim is that the alleged impact was adverse—*i.e.*, that the alleged disparity had a "*negative* impact on minority populations." *M & T Mortg. Corp. v. White*, 736 F. Supp. 2d 538, 574 (E.D.N.Y. 2010) (emphasis added). Thus, disparate-impact suits frequently identify obviously adverse impacts, such as similarly situated persons paying different amounts for the same loan. *See, e.g.*, *In re Countrywide Fin. Corp. Mortg. Lending Practices Litig.*, 708 F.3d 704, 708 (6th Cir. 2013). Dr. Ayres' disparate impact analysis is premised on the assumption that receipt of any "combined-risk" loan is invariably negative for disparate impact purposes when compared to a non-"combined-risk" loan (*e.g.*, a loan with only one so-called "risk" feature). Ayres Rpt. 34-36. As this Court recognized in denying class certification, however, no evidence shows that receipt of a "combined-risk" loan is necessarily adverse, which fatally undermines Dr. Ayres' analysis. *See* Class Op. 24, 38-40.

Contrary to Plaintiffs' theory, there is no evidence that what they call "risk" features—even when "combined"—invariably increase the risk of default. Rather, the evidence shows that whether a loan did or did not present an "increased" risk of default would vary according to the loan's particular "risk" features and the circumstances of the borrower. For example, this Court found, and Professor McCoy conceded, that stated-income loans—such as Plaintiff McCoy's—have "no effect on the risk of default if the borrower is truthful," and increase the risk of default only for "borrowers who exaggerate or lie about their income." Class Op. 12; *see also* SOF ¶ 119. Academic studies have also found that prepayment penalties—which all five Plaintiffs' loans included—"have little to no effect on defaults." SOF ¶ 112. And even Professor McCoy

"found only that large prepayment penalties increased the likelihood of default," yet Morgan Stanley did not purchase loans containing "prepayment penalties that were 'large' under McCoy's definition" because they were forbidden by Michigan law. Class Op. 18-19; *see* SOF ¶¶ 113-118. Plaintiffs' failure to present any evidence that the prepayment penalties Plaintiffs received were associated with increased risk independently dooms the claim of Plaintiff Pettway, whose loan qualified as "combined-risk" only because of the inclusion of that feature in her loan. *See* SOF ¶ 106 (Pettway's loan had only a prepayment penalty and an adjustable rate).

This Court also correctly recognized that different *combinations* of features "affect the probability of foreclosure differently," and not all combinations necessarily entail an increased default risk. Class Op. 38 n.29. Indeed, as this Court noted, certain combinations are "associated with *substantially lower* probability of foreclosure." *Id.* (emphasis added) (discussing combination of purchase fixed-rate mortgages "with reduced documentation [*i.e.*, stated-income loans] and either a long prepayment penalty period or a balloon payment"); *see* SOF ¶¶ 123-24. Similarly, Professor McCoy conceded that different "risk" features might "offset" one another, and that sorting out their interaction would "depend on a variety of factors." SOF ¶¶ 125-26.

Further, the evidence shows that many of the "risk" factors provided real benefits that made them more suitable for certain borrowers than loans without them. *See supra* p. 10. For example, New Century loans with prepayment penalties had lower interest rates, and thus lower monthly payments for the lifetime of the loan. SOF ¶ 111. Adjustable-rate loans were desirable for many borrowers because, for an initial period, they had lower interest rates (and lower monthly payments) than fixed-rate loans. SOF ¶ 107. Whether or not a rate's later adjustment offsets the initial rate advantage depends on market conditions and how long the borrower holds

the loan. SOF ¶¶ 108-09. Even Professor McCoy acknowledged that an adjustable rate may be "cheaper" and economically "rational" for borrowers who "know that they will own the house for a relatively short period." SOF ¶ 108. Accordingly, even if the combination of "risk" features a particular borrower received presented a theoretical "increased" risk of default, whether that risk level is adverse *for that borrower* will depend on her circumstances and objectives, which may make the terms suitable, and more suitable than any alternative.

For these reasons, this Court properly recognized that Plaintiffs' proposed class of African American borrowers who received "combined-risk" loans could not be certified, notwithstanding Dr. Ayres' conclusion that there was a disparity in the distribution of "combined-risk" loans in Detroit. *See* Class Op. 20-21, 38-39. Much the same problems render Dr. Ayres' analysis insufficient to establish a disparate impact on the merits.

When using statistics to demonstrate a disparate impact, plaintiffs must identify "appropriate comparison groups." *Tsombanidis*, 352 F.3d at 576. As the Supreme Court has recognized, a comparison pool that is "too broad" is "an improper basis for making out a claim of disparate impact" and cannot "make out a prima facie case of disparate impact." *Wards Cove Packing Co. v. Atonio*, 490 U.S. 642, 653-64 (1989). Where an expert fails to appropriately limit his or her disparate impact analysis to a protected group whose members experienced an adverse effect, summary judgment is appropriate. *See B.C.*, 2016 WL 4926147, at *7 (affirming summary judgment on ADA claim brought by students with disabilities where expert's disparate impact analysis improperly included students who were not necessarily disabled under the ADA); *see also Aliotta v. Bair*, 614 F.3d 556, 569 (D.C. Cir. 2010) (rejecting disparate-impact age-discrimination claim where employer's policy "may often be beneficial to older or more senior employees").

Here, by treating as invariably adverse *every* "combined-risk" loan, regardless whether the loan's particular features (or combination of features) as applied to the particular borrower entailed increased risk (without offsetting benefits), Dr. Ayres failed to properly limit his impact analysis to a group of borrowers who were in fact adversely affected. Rather, he improperly assumed that that "each of the 33 different categories of Combined-Risk loan[s]" that New Century originated in Detroit was "harmful[]" to every borrower with such a loan, and purported to determine an adverse impact by comparing the incidence of all such loans in the protected and control groups of New Century borrowers Class Op. 39. Because the evidence does not establish that the loans he assumes are less favorable are in fact less favorable, his disparate impact conclusions are improper. As this Court recognized, "[e]ach potential combination of risk factors might … yield different results with respect to a disparate impact analysis," *id.*, yet Dr. Ayres has not conducted that analysis, nor has he conducted such an analysis concerning just the combinations of features in the five Plaintiffs' loans.

Dr. Ayres' analysis was flawed from the outset because he simply relied on Plaintiffs' arbitrary "combined-risk" loan concept. His report thus does not establish a disparate impact.

B. Dr. Ayres Improperly Assumes Morgan Stanley Caused All of New Century's "Combined-Risk" Loans

There is a separate and equally fundamental problem with Dr. Ayres' analysis: he assumes without evidentiary support that Morgan Stanley "caused" the disparate impact he claims to find. That unsupported assumption is also fatal.

As set forth above, there is no evidence that Morgan Stanley was the cause of *any* of New Century's "combined-risk" loans. *See supra* pp. 20-27. To the extent Plaintiffs' causation theories have any merit, however, then a proper disparate impact analysis must distinguish between the effects of Morgan Stanley's alleged policies and the many other potential causes of

New Century's lending, such as its other loan purchasers and warehouse lenders and its independent brokers. *See Robinson v. Metro-N. Commuter R.R. Co.*, 267 F.3d 147, 160 (2d Cir. 2001) (in disparate impact case "statistics must be of a kind and degree sufficient to reveal a causal relationship between the challenged practice and the disparity"); *Cinnamon Hills Youth Crisis Ctr., Inc. v. Saint George City*, 685 F.3d 917, 922 (10th Cir. 2012) (statistical evidence should support "reasonable inference that any disparate effect identified was caused by the challenged policy and not other causal factors"). Given the Supreme Court's emphasis on a robust showing of causation—and the presence of evidence from which it might be posited that many loans were "caused" by New Century itself, by brokers, or by other secondary market purchasers—there is no evidentiary basis for Professor Ayres to simply assume the connection of the disparity he purports to find to Morgan Stanley's alleged policies.

In denying class certification, this Court recognized that determining the cause of New Century's origination of any individual "combined-risk" loan would involve a litany of complex factors, including, (1) "the risk factors present in a particular loan"; (2) "Morgan Stanley's financial involvement"—or absence of involvement—"in the particular loan"; (3) the "time" during the class period when the particular loan was made; (4) whether the loan was "caught and rejected by Morgan Stanley's due diligence process"; and (5) the extent to which the origination of the loan or its terms is explained by discretionary decisions of New Century's underwriters or independent brokers. Class Op. 37-38.

The Court's reasoning highlights a fundamental flaw in Plaintiffs' attempt to establish a disparate impact: Dr. Ayres did not account for these factors, and his analysis cannot isolate what, if any, causal effect Morgan Stanley's alleged policies had in creating the disparate impact he purports to find. Indeed, Dr. Ayres himself admitted at his deposition that (a) he could not

link his disparate-impact findings to the "specific policies" Plaintiffs challenge; (b) he could not exclude other potential causes of any disparate impact like "broker discretion" or "other lenders"; and (c) he could not even determine "the relative influence of Morgan Stanley and New Century." SOF ¶¶ 127, 129-31. Plaintiffs' purported causation expert Professor McCoy—whose testimony is inadmissible for the reasons discussed above—likewise failed to account for these factors, and even acknowledged that other banks were the cause of some of New Century's "combined-risk" loans. *See supra* pp. 22-23; SOF ¶ 134.

Plaintiffs have thus failed to present evidence demonstrating that the loans included in Dr. Ayres' analysis belong there or that the disparity that he purports to find is due to the policies of Morgan Stanley. Indeed, as the Court has recognized, the "disparate impact" Plaintiffs wrongly attribute to Morgan Stanley "could—consistent with Plaintiffs' theory of the case—be entirely explained by brokers' exercise of discretion." Class Op. 43. Further, this Court has noted that to properly measure whether Morgan Stanley caused a disparate impact Plaintiffs would need to separately analyze the cause of "each combination of ['risk'] factors" and changes in "Morgan Stanley's relationship with New Century … over time." *Id.* at 39. Yet Dr. Ayres fails to tie his statistical analysis to whatever subset of loan terms Morgan Stanley allegedly caused. Here too his analysis is built around a comparison pool that is at best far "too broad," and thus fails to show an actual disparate impact. *Wards Cove*, 490 U.S. at 653-64.

The FHA's "robust causality requirement" exists for precisely this situation—to "protect[] defendants from being held liable for racial disparities they did not create." *Inclusive Cmtys.*, 135 S. Ct. at 2523. Because Dr. Ayres' analysis is fundamentally flawed, it cannot satisfy Plaintiffs' burden of demonstrating a disparate impact.[9]

[9] Morgan Stanley notes that Plaintiffs' theory has always been that they experienced a disparate impact by virtue of their receipt of "combined-risk" loans. *See* Compl. ¶ 241. They therefore may not shift theories to assert a disparate

V. DISGORGEMENT IS NOT A REMEDY AVAILABLE TO PLAINTIFFS

If the Court does not grant Morgan Stanley summary judgment on the merits of Plaintiffs' claims, it should grant summary judgment on their request for disgorgement, which is not a remedy available to them under the FHA. *See United States v. Philip Morris USA, Inc.*, 396 F.3d 1190, 1202 (D.C. Cir. 2005) (granting summary judgment on disgorgement claim where disgorgement was not available remedy to plaintiff under RICO). When it comes to federal statutory claims, "[d]isgorgement is a distinctly public-regarding remedy, available only to government entities seeking to enforce explicit statutory provisions." *FTC v. Bronson Partners, LLC*, 654 F.3d 359, 372 (2d Cir. 2011). The Ninth Circuit has thus correctly held that disgorgement is unavailable to a private party seeking to enforce the FHA. *See Smith v. Pac. Props. & Dev. Corp.*, 358 F.3d 1097, 1106 (9th Cir. 2004); *see* Class Op. 32 n.24.

The FHA permits a court to award private plaintiffs *preventive* equitable remedies but not *retrospective* equitable remedies like disgorgement. Its private-enforcement provision makes this clear by providing that in a private action a court may grant, in addition to damages, "*any permanent or temporary injunction, temporary restraining order, or other order* (including an order enjoining the defendant from engaging in such practice or ordering such affirmative action as may be appropriate)." 42 U.S.C. § 3613(c)(1) (emphasis added). The term "other order" does not include disgorgement because that is not similar to the enumerated remedies, which are all

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impact based on their receipt of "high cost" loans at this late stage of the litigation. *See, e.g.*, *Family Dollar Stores, Inc. v. United Fabrics Int'l, Inc.*, 896 F. Supp. 2d 223, 235 (S.D.N.Y. 2012) (rejecting party's "attempt to change the theory of the case after the close of discovery"). Such a shift would be futile in any event: There is no record evidence that Morgan Stanley's alleged policies had any impact on the interest rates New Century charged. *See supra* pp. 5-6. Further, it would be improper to measure a disparate impact based on whether or not loans crossed an arbitrary "high cost" threshold. Traditional disparate-impact pricing cases involve, instead, allegations that the *actual interest rates* of loans received by a minority population are higher than the rates received by the non-minority population, after controlling for a number of potential non-discriminatory reasons. *See, e.g.*, *Ramirez v. Greenpoint Mortg. Funding, Inc.*, 268 F.R.D. 627, 633 (N.D. Cal. 2010) (discussing expert testimony regarding the "annual percentage rate or 'APR' … amount paid by white and minority borrowers"). Dr. Ayres admitted he had not undertaken such an analysis and it is far too late to start down that road now. *See* SOF ¶ 132.

preventive relief directed toward future conduct.[10] The FHA's public-enforcement provision confirms the point. *See id.* § 3614(d)(1)(A) ("court may award *such preventive relief*, including a permanent or temporary injunction, restraining order, or *other order*" (emphasis added)). Courts interpreting analogous statutes with enumerated equitable remedies that are "forward looking, and calculated to prevent … violations in the future," and "do not afford broader redress," have thus held that retrospective disgorgement like Plaintiffs seek here is not available. *United States v. Carson*, 52 F.3d 1173, 1181-82 (2d Cir. 1995) (RICO).[11] Because "Congress has provided 'elaborate enforcement provisions' for remedying the violation of" the FHA, a court cannot "'authorize by implication additional judicial remedies for private citizens suing under' the statute," including disgorgement. *See Meghrig v. KFC W., Inc.*, 516 U.S. 479, 487-88 (1996) (restitution not available in private action under Resource Conservation and Recovery Act because statute authorized only preventive equitable remedies such as injunctive relief).[12]

Thus, the FHA does not permit Plaintiffs to seek disgorgement in this action.

CONCLUSION

For the foregoing reasons, Defendants' motion for summary judgment should be granted.

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[10] *See Washington State Dep't of Soc. & Health Servs. v. Guardianship Estate of Keffeler*, 537 U.S. 371, 384 (2003) (interpreting statutory phrase "'or other'" "under the established interpretative canons … 'to embrace only objects similar in nature to those objects enumerated by the preceding specific words'").

[11] *Accord Philip Morris*, 396 F.3d at 1200 ("The remedies explicitly granted … are all directed toward future conduct …. Disgorgement is a very different type of remedy."); *Richard v. Hoechst Celanese Chem. Grp.*, 355 F.3d 345, 354 (5th Cir. 2003); *see also Owner-Operator Indep. Drivers Ass'n v. Landstar Sys., Inc.*, 622 F.3d 1307, 1324 (11th Cir. 2010) (disgorgement unavailable under Truth in Lending Act because "disgorgement [is] not similar in nature to injunctive relief"); *United States ex rel. Taylor v. Gabelli*, 2005 WL 2978921, at *13 (S.D.N.Y. Nov. 4, 2005) (disgorgement unavailable under False Claims Act).

[12] As Morgan Stanley has noted (ECF No. 203 at 41), Plaintiffs have never cited *any* case awarding disgorgement under the FHA. They earlier cited (ECF No. 195 at p. 24) only two cases, an unpublished opinion and an opinion from 1975, but neither actually awarded disgorgement and neither is consistent with the analysis in *Carson* and *Meghrig*. First, in *Steele v. GE Money Bank*, 2009 WL 393860 (N.D. Ill. 2009), the court improperly inferred that the FHA authorizes disgorgement merely because it authorizes preventive equitable remedies, *see id.* at *10-11, failing to recognize that a retrospective remedy like disgorgement is not similar to preventive remedies, *Carson*, 52 F.3d at 1181-82, and that a court cannot imply a retrospective equitable remedy where the statute expressly provides other comprehensive remedies, *Meghrig*, 516 U.S. at 488. Second, in *Zuch v. Hussey*, 394 F. Supp. 1028 (E.D. Mich. 1975), the court did not even analyze whether the FHA's text authorizes disgorgement. *See id.* at 1055 n.13.

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