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

REPLY MEMORANDUM IN SUPPORT OF DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

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INTRODUCTION[1]

Plaintiffs filed this lawsuit four years ago, in a misguided attempt to hold Morgan Stanley responsible for a different company's allegedly discriminatory lending. As should be yet more clear from Plaintiffs' Opposition (Opp.), this case should come to an end. Plaintiffs filed their claims far out of time and based them on an untenable interpretation of the Fair Housing Act (FHA). Plaintiffs also fail to identify any evidence that satisfies the FHA's "robust" causation requirement, nor have they satisfied their burden of properly demonstrating an actual disparate impact caused by the defendant here, Morgan Stanley. Summary judgment should be granted.

I. PLAINTIFFS' CLAIMS ARE TIME BARRED

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

Judge Baer's holding that the FHA statute of limitations is subject to a discovery rule is contrary to the FHA's text and the overwhelming weight of authority. *See* Memorandum in Support 12-14 (Mem.). The Court should reconsider the issue and reach the opposite conclusion.

It is telling that Plaintiffs choose to defend the discovery rule holding only on law-of-the-case grounds, not on the merits. Opp. 26-27. But they greatly exaggerate the weight of that doctrine here. The "law of the case doctrine 'is, at best, a discretionary doctrine, which … merely expresses a general reluctance, absent good cause, to reopen rulings that the parties have relied upon.'" *LNC Invs., Inc. v. First Fidelity Bank, N.A.*, 173 F.3d 454, 467 n.12 (2d Cir. 1999). It has less weight for pre-trial rulings, in particular, which "are subject to revision by th[e] court 'at any time before the entry of final judgment.'" *Rezzonico v. H & R Block, Inc.*, 182 F.3d 144, 148 (2d Cir. 1999) (quoting Fed. R. Civ. P. 54(b)); *see also* Wright et al., *Federal*

[1] Morgan Stanley previously filed a Rule 56.1 Statement of Material Facts, to which Plaintiffs filed a Counterstatement and a Statement of Additional Material Facts. *See* ECF No. 271. Morgan Stanley herewith files its Responses to Plaintiffs' Counterstatement and Statement of Additional Material Facts. All facts and responses in those filings are cited herein as "SOF." Unless otherwise noted, other abbreviations in this reply correspond to those used in Morgan Stanley's opening memorandum.

Practice & Procedure § 4478.1 (2d ed.) ("reconsideration often is better deserved, and more important, while an action wends its way toward the first final judgment in the trial court").

This case is a plainly appropriate one for law of the case to give way to "get[ting] it right." *Federal Practice & Procedure* § 4478. Respectfully, Judge Baer's discovery-rule holding is clearly contrary to (1) the FHA's text, which states that the limitations period runs from the "occurrence" or "termination" of an allegedly discriminatory practice and makes no reference to its discovery, 42 U.S.C. § 3613(a)(1)(A); (2) Supreme Court precedent interpreting similar "text and structure" to reject a discovery rule, *TRW Inc. v. Andrews*, 534 U.S. 19, 28 (2001); (3) the Ninth Circuit's persuasive *en banc* decision holding that "application of the discovery rule … 'would render the clear language of the [FHA] meaningless,'" *Garcia v. Brockway*, 526 F.3d 456, 466 (9th Cir. 2008); and (4) the view of most federal courts (Mem. 13).[2] Plaintiffs are wrong to suggest (Opp. 26 n.10) that this Court cannot correct the earlier error because a few outlier district courts have made the same mistake. Counsel themselves elsewhere admit that only "a minority of courts have followed the federal discovery rule" in FHA cases. National Consumer Law Center, *Credit Discrimination* 254 & n.446 (6th ed. 2013).[3]

Plaintiffs would nonetheless put Morgan Stanley (and the Court and themselves) through the expense of trial and appeal before allowing the clear error to be corrected. That is senseless. "Self-correction is manifestly important if the alternative is the greater delay and expense that would result from persisting in the error and eventual appellate reversal." *Federal Practice & Procedure* § 4478.1. Because the discovery rule holding is clearly wrong—and contrary to the

[2] While claiming that the discovery-rule holding was "well-reasoned" (Opp. 26), Plaintiffs ignore the serious flaws Morgan Stanley has identified in the decision, including, for example, the decision's failure to acknowledge that the Ninth Circuit decision in *Garcia* involved the same limitations provision at issue here (*see* Mem. 13).

[3] Like the discovery-rule holding here, those decisions generally ignore the FHA's text tying the limitations period to the "occurrence" or "termination" of an allegedly discriminatory practice. *See, e.g.*, *Saint-Jean v. Emigrant Mortg. Co.*, 50 F. Supp. 3d 300, 314-16 (E.D.N.Y. 2014) (no analysis of language of FHA's limitations provision).

prevailing view—this Court can and should exercise its discretion to reconsider that ruling. *See Stiller v. Costco Wholesale Corp.*, 2013 WL 5417134, at *2 (S.D. Cal. 2013) (declining to follow law of case where prior judge adopted "minority view" on legal question). Once the error is corrected, the suit is plainly out of time because Plaintiffs' Complaint was not filed until October 2012, more than six years after they received their loans.

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

The undisputed material facts also require summary judgment even if a discovery rule applies. Under that rule, a plaintiff's claims accrue when they knew or should have known the "'critical facts' of injury and causation," which "is not an exacting requirement." *Kronisch v. United States*, 150 F.3d 112, 121 (2d Cir. 1998). Plaintiffs received their loans between 2004 and 2006, yet this lawsuit was not filed until October 2012—long after they should, with reasonable diligence, have discovered the critical facts regarding their claims. Plaintiffs' arguments to the contrary rely on a flawed view of the discovery rule that would, if accepted, mean that the FHA's limitations period could never run absent legal malpractice.

Plaintiffs' principal argument is that their claims cannot have accrued until counsel recruited them to this case. Opp. 28-29. That proposition is inconsistent with Second Circuit law, which rejects the notion that under the discovery rule the date of accrual should be "mechanically set[] … to coincide with the retention of counsel." *A.Q.C. ex rel. Castillo v. United States*, 656 F.3d 135, 142 (2d Cir. 2011). And with good reason: Plaintiffs' proposed rule would "render the limitations period meaningless." *Id.* at 141-42. Indeed, it would allow parties or their attorneys to "set the accrual date to coincide with their own litigation strategy, regardless of the length of the delay." *Id.* at 143-44; *see also Deal v. Waldman*, 2004 WL 2793263, at *1 (E.D. Pa. 2004) ("If the discovery rule were to rest on when a plaintiff decided to

retain counsel, the limitations period would be extended indefinitely.").[4] Under Plaintiffs' view, their claims would still be timely *today* if counsel had not solicited them and filed this action in 2012. As the Second Circuit has made clear, that cannot be right.

Virtually every source Plaintiffs relied upon in their Complaint was publicly available more than two years before this action was filed. *See* Mem. 14-15; SOF ¶¶ 136-192. Plaintiffs do not dispute this. They identify only a pair of securities complaints from 2011, which were cited in only six paragraphs of the 273-paragraph Complaint, as having been published within two years of filing. *See* Compl. ¶¶ 45, 53, 54, 68, 72, 75. Not a sentence in those six additional paragraphs was remotely "necessary to plead [Plaintiffs'] cause of action." Opp. 29. Those allegations are cumulative of others in the Complaint based on older sources. *See* SOF ¶¶ 166-179. And regardless, it is well established that a "plaintiff need not know each and every relevant fact of his injury" for a claim to accrue. *Kronisch*, 150 F.3d at 121.[5]

When it has suited them, Plaintiffs have argued that securities cases like those discussed in the six paragraphs were far less relevant to their claims than the Massachusetts Attorney General's Assurance of Discontinuance (AOD), which became public in June 2010. *See* ECF No. 92 at 2-3 & n.2 ("the Massachusetts A.G. investigation overlaps substantially with the claims in this lawsuit," while "in contrast" securities cases "focus on the impact of Morgan Stanley's policies on securities investors"). Moreover, given the wealth of information already in the

[4] Contrary to Plaintiffs' suggestion (Opp. 29 n.11), *A.Q.C.*'s holding concerning the discovery rule fully applies in "discrimination action[s]." *See Twersky v. Yeshiva Univ.*, 579 F. App'x 7, 9 (2d Cir. 2014) (applying *A.Q.C.* in Title IX case). *Saint-Jean v. Emigrant Mortgage Co.*, 50 F. Supp. 3d 300 (E.D.N.Y. 2014), on which Plaintiffs rely, ignores *A.Q.C.*'s holding that a claim's accrual is not delayed indefinitely until a plaintiff meets with counsel. Further, *Saint-Jean* addressed whether allegations were sufficient at the pleading stage. *Id.* at 316. On the record here, it is clear that Plaintiffs should have known about their claims more than two years before this case was filed.

[5] Plaintiffs wrongly suggest that they were not on notice of a fact until they could plead it with "detail and particularity." Opp. 29-30 (quoting *City of Pontiac Gen. Employees' Retirement Sys. v. MBIA, Inc.*, 637 F.3d 169, 175 (2d Cir.2011)). *City of Pontiac* addressed the heightened pleading standard for securities fraud claims, *see* 637 F.3d at 175-76, not the lower Rule 8 standard for pleading an FHA claim that applied here.

public record, Plaintiffs should have discovered the basis for their claims even before the Massachusetts AOD. *See* Mem. 14-15. There can be no genuine dispute that even under the discovery rule, all Plaintiffs' claims accrued at least *by* that date and are therefore time-barred.

That is especially apparent for Ms. Pettway, the only plaintiff whose loan Morgan Stanley purchased. She conceded in her deposition that she read articles in Detroit newspapers in 2007 regarding discrimination against African Americans in subprime lending and that she had believed, based on those articles, that her broker had targeted her based on her race. Mem. 16-17.[6] Contrary to Plaintiffs' suggestion (Opp. 31), such "'suspicions do give rise to a duty to inquire into the possible existence of a claim in the exercise of due diligence.'" *Pipitone v. City of N.Y.*, 57 F. Supp. 3d 173, 188 (E.D.N.Y. 2014). While Plaintiffs suggest that Ms. Pettway was not "sufficiently sophisticated" to pursue her claim (Opp. 31), this evidence shows that she needed no complex regression analysis to be put on notice of her potential claim; she already suspected discrimination. Moreover, a claim can accrue "even if identifying the elements of a complete cause of action is 'a matter of real complexity.'" *Twersky v. Yeshiva Univ.*, 993 F. Supp. 2d 429, 440 (S.D.N.Y. 2014). There is no reason why, with diligence, Ms. Pettway or her counsel would not have been able to identify the public sources on which the Complaint relied.[7]

II. THE FOUR PLAINTIFFS WHOSE LOANS MORGAN STANLEY DID NOT PURCHASE HAVE NO FHA CLAIMS AGAINST MORGAN STANLEY

Plaintiffs still fail to provide any legal support for their unprecedented theory that Morgan Stanley can be liable under 42 U.S.C. § 3605(a) for discriminating in the terms or conditions of a loan that it never purchased—indeed, for one loan that Morgan Stanley never

[6] The other four Plaintiffs were, of course, on notice of those same articles.

[7] Plaintiffs claim that Ms. Pettway was not required to "monitor[] the Register of Deeds" to discover Morgan Stanley's purchase of her loan. Opp. 30-31. That is wrong, but also beside the point: Because Plaintiffs' claims have never hinged on whether Morgan Stanley actually purchased a particular loan, Ms. Pettway's claim accrued regardless of when and whether she could have learned that Morgan Stanley bought her loan.

even knew about until this case, and for three others that Morgan Stanley refused to purchase because they were too "risky," just as Plaintiffs think Morgan Stanley should have done.

Plaintiffs emphasize the FHA's "any person" language (Opp. 34) but ignore that the FHA prohibits a loan purchaser from discriminating against "any person" in two explicitly defined circumstances: either (1) "in making available" such a loan purchase based on the person's race or (2) "in the terms and conditions" of a loan purchase based on the person's race. 42 U.S.C. § 3605(a); *see* 24 C.F.R. § 100.125(a) (unlawful "to refuse to purchase such loans" or "to impose different terms or conditions for such purchases" because of race). Plaintiffs do not argue that Morgan Stanley is liable for failing to "mak[e] available" purchases of their loans (*i.e.*, refusing to purchase their loans). Nor do they argue that it imposed different "terms and conditions" in the purchase of their loans; Morgan Stanley never purchased their loans. Because it neither wrongly refused to purchase Plaintiffs' loans nor imposed different terms or conditions in the purchase of their loans, Morgan Stanley cannot be liable to Plaintiffs under the FHA.

Plaintiffs argue that the FHA cannot be read as its plain language dictates because that would lead to an "illogical outcome" in a contorted hypothetical they posit. Opp. 34-35. But in their example, the secondary-market purchaser's conduct is exactly what the statute prohibits: refusing to purchase the African-American borrowers' loans based on their race (unless the originator pledged additional collateral) and imposing different terms or conditions in the purchases of the African-American borrowers' loans it did purchase based on the borrowers' race. Such discrimination in the terms of the secondary market purchases, and among the constellation of loans purchased *by the defendant,* is entirely different from the alleged discrimination here in the terms of mortgage originations by a completely different entity.[8]

[8] Plaintiffs are wrong (Opp. 35) that § 3605's regulation encompasses conduct untethered to the refusal to purchase loans or imposition of different terms and conditions on loan purchases. The regulation's examples prohibit

No case endorses Plaintiffs' highly attenuated theory. Plaintiffs cite only one case that even discusses § 3605 (Opp. 33), and that case rejects an overly broad reading of the provision because it "would strain language past the breaking point." *NAACP v. Am. Family Mut. Ins. Co.*, 978 F.2d 287, 297 (7th Cir. 1992). Their reading is likewise irreconcilable with § 3605's text.

Plaintiffs instead rely (Opp. 33-34) on cases interpreting a different FHA provision, 42 U.S.C. § 3604, which they are not suing under, does not apply to the secondary market, and does not support their theory. The insurance cases they cite hold merely that "Section 3604 applies to discriminatory denials of insurance, and discriminatory pricing." *NAACP*, 978 F.2d at 301. In other words, an insurer is liable for (1) refusing to provide insurance because of race or (2) imposing different terms on its provision of insurance because of race. An insurer, however, is *not* liable for alleged discrimination against homeowners who were not wrongly refused, or who did not apply for or purchase, an insurance policy from the insurer. Yet Plaintiffs' theory under § 3605 would impose just that sort of liability in the loan purchase scenario.

Finally, Plaintiffs are wrong (Opp. 32-33) that the law of the case forecloses Morgan Stanley's argument. This Court has stated that it "expresse[s] no view whether [the FHA's] 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." ECF No. 230 (Class Op.) at 36 n.26. Nor did Judge Baer definitively rule on that issue. On the motion to dismiss, he ruled only that "whether Morgan Stanley ultimately purchased all of the toxic loans that New Century issued is not relevant at the pleading stage." ECF No. 47 (MTD Op.) at 12. At that stage, the record did not yet show which loans Morgan Stanley had purchased or why it had rejected some. The record now makes clear that Morgan Stanley did not purchase four Plaintiffs' loans, and

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discrimination in the terms and conditions imposed in purchased loans in the pooling, packaging, marketing, or selling of those loans (and securities based on them). 24 C.F.R. § 100.125(b)(2), (b)(3). They do not make a loan purchaser liable for allegedly discriminatory terms of loans that it did not purchase, pool, package, market, or sell.

none allege that Morgan Stanley refused to purchase their loans on any improper grounds.

Even if Judge Baer had concluded that Morgan Stanley could be liable for terms in loans that it did not purchase or improperly refuse to purchase—and we do not understand him to have done that, for the reasons above—that conclusion would be flatly contrary to the FHA's text and regulation for the reasons set forth above and thus should be rejected at this stage. There is no support for that conclusion in any case law. It would lead to absurd consequences whereby a loan purchaser could be held liable for discrimination "in making available" a purchase or "in the terms and conditions" of a purchase when the purchaser rejected the loan or was never even offered the opportunity to purchase it—and when a competitor instead bought the loan.

III. PLAINTIFFS HAVE PRESENTED NO EVIDENCE THAT MORGAN STANLEY CAUSED NEW CENTURY'S ISSUANCE OF THEIR "COMBINED-RISK" LOANS

Summary judgment should also be granted because Plaintiffs present no evidence that can satisfy the FHA's "robust causality requirement," which protects defendants "from being held liable for racial disparities they did not create." *Texas Dep't of Hous. & Cmty. Affairs v. Inclusive Cmtys. Project, Inc.*, 135 S. Ct. 2507, 2512, 2523 (2015). Courts recognize that *Inclusive Communities* establishes a demanding standard for causation in FHA disparate impact cases. For example, on remand, the trial court in *Inclusive Communities* held that it was required to "apply[] a materially different (and more onerous) prima facie case burden of proof" and reversed its prior verdict because plaintiff had "not satisfied the robust causality requirement." *Inclusive Cmtys. Project, Inc. v. Texas Dep't of Hous. & Cmty. Affairs*, 2016 WL 4494322, at *1, 10 (N.D. Tex. 2016); *see also Ellis v. City of Minneapolis*, 2016 WL 1222227, at *7 (D. Minn. 2016) (*Inclusive Communities* "announced a new 'robust causality requirement'").

The causation standard is all the more demanding here because Plaintiffs assert that Morgan Stanley caused the allegedly discriminatory lending decisions of an independent party,

New Century. As Judge Baer made clear (MTD Op. 5) and Plaintiffs recognize (Opp. 15), even to have standing they must demonstrate that Morgan Stanley policies had a "determinative or coercive" effect on New Century's origination of their loans. The "determinative or coercive" standard is strict: Evidence that a defendant "encouraged, caused, and induced" a third party's conduct will not suffice. *Nat'l Council of La Raza v. Mukasey*, 283 F. App'x 848, 851 (2d Cir. 2008). Nor will evidence that a defendant "created incentives" that may have motivated a third party's conduct. *Hollander v. United States*, 354 F. App'x 592, 593 (2d Cir. 2009) ("'incentive' arguments have been rejected as a basis for establishing causation" for standing).[9]

Plaintiffs have presented no evidence that remotely satisfies these demanding standards.

A. Plaintiffs Present No Direct or Expert Evidence of Causation

First, the direct evidence flatly contradicts Plaintiffs' causation theories. New Century's employees unanimously rejected the notion that Morgan Stanley exerted coercive influence on their company, testifying that it was "absurd" and that no bank had "any specific control over New Century." *See* SOF ¶¶ 75-76, 79, 83; Mem. 21. This testimony—the only directly relevant evidence on the question whether Morgan Stanley influenced New Century in a determinative or coercive way—not only fails to support Plaintiffs' causation theory; it directly undermines it.

Second, Plaintiffs fail to present any admissible expert testimony regarding causation. *See* Mem. 21-23. Morgan Stanley's expert Dr. Riddiough explained the need for such evidence, noting that Plaintiffs' theories implicate "highly complex market interactions, with complex and varied motivations and incentives among the market participants, and with market forces changing rapidly over time." Riddiough Rpt. ¶ 64. Plaintiffs once recognized the need for such

[9] Plaintiffs note (at 15) that *Carver v. City of New York*, 621 F.3d 221, 226-227 (2d Cir. 2010) states that the "determinative or coercive" standard "turns on the degree to which the defendant's actions constrained or influenced the decision of the final actor in the chain of causation." But *Carver* does not suggest that *any* degree of influence is sufficient. There, the standard was satisfied where the defendant city's prior conduct caused a state agency's conduct, and the state agency had "no discretion" under state law to take any other action. *Id.* at 227.

evidence, submitting the expert report of Professor McCoy. But they now abandon her causation opinions, which this Court recognized are inadmissible. *See* Class Op. 46-49.

Incongruously, having once relied upon expert testimony on causation, Plaintiffs now argue that it is unnecessary, even in cases "involving complicated markets and multiple actors." Opp. 18. To the contrary, many courts recognize that it is necessary in cases, like this one, involving complex economic questions.[10] Indeed, Plaintiffs previously acknowledged:

> Courts allow expert testimony regarding the mortgage-backed securities and mortgage lending industries that is premised on an expert's practical experience and research, with the understanding that *these are complex subject matters that lie outside the realm of common understanding*.

ECF No. 194 at 7 (emphasis added). This very argument demonstrates why, under the governing legal standard, expert testimony supporting causation is required here and why its absence should require summary judgment: "Expert opinion is necessary to establish a causal link where such causation is outside the common knowledge of a layperson." *Koger v. Synthes N. Am., Inc.*, 2009 WL 5110780, at *2 (D. Conn. 2009); *see also, e.g.*, *In re Mirena IUD Prod. Liab. Litig.*, 2016 WL 4059224, at *11 (S.D.N.Y. 2016) (noting "the paramount importance of expert testimony on complex technical issues with which jurors are unfamiliar"). Given their previous position, Plaintiffs cannot now credibly claim that no "specialized knowledge" (Opp. 17) is implicated by their complex theories regarding the alleged effect of a single secondary market purchaser and warehouse lender on an independent lender's origination of "combined-risk"

[10] *See Colsa Corp. v. Martin Marietta Servs., Inc.*, 133 F.3d 853, 855 n.4 (11th Cir. 1998) (holding, in antitrust case, that "construction of a relevant economic market or a showing of monopoly power in that market cannot be based upon lay opinion testimony" (internal quotation omitted)); *Hynix Semiconductor Inc. v. Rambus Inc.*, 2008 WL 73689, at *10 n.13 (N.D. Cal. 2008) ("Establishing market definition in this case likely requires expert testimony."); *Drs. Steuer & Latham, P.A. v. Nat'l Med. Enterprises, Inc.*, 672 F. Supp. 1489, 1512 n.25 (D.S.C. 1987) ("Failure to adduce expert testimony on competitive issues such as market definition augurs strongly in favor of granting summary judgment against an antitrust plaintiff."), *aff'd*, 846 F.2d 70 (4th Cir. 1988). The discussion in Plaintiffs' main case (Opp. 18) was arguably dicta. *See Lantec, Inc. v. Novell, Inc.*, 146 F. Supp. 2d 1140, 1148 (D. Utah 2001) (granting summary judgment because plaintiffs' other evidence was insufficient and noting "absence of controlling case law from the Tenth Circuit" regarding need for expert testimony).

loans, where that originator operated in a market affected by borrowers, brokers, other loan purchasers, other warehouse lenders, rating agencies, investors, and many others.

B. Plaintiffs' Other Evidence Does Not Satisfy the FHA's Robust Causation Requirement

No other evidence Plaintiffs present is sufficient to create a genuine dispute as to whether Morgan Stanley had a determinative or coercive effect on New Century's issuance of their loans.

First, the centerpiece of Plaintiffs' causation theory is their claim (Opp. 6) that Morgan Stanley caused New Century's origination decisions through "bid terms" used in forward sales. But as we explained and Plaintiffs still fail to address, they offer *no evidence*, nor is there any, that bid terms caused any New Century origination decision. Mem. 23-24. Rather, as former New Century executive Warren Licata testified, New Century entered into forward sales based on what *New Century* "expect[ed] the production characteristics to look like at a future date." SOF ¶ 19. Originators like New Century knew in advance that loans in their pipeline were expected to close in the near future (because, *e.g.*, loans had a specific "rate lock" period). *See* Def. Ex. 3 (Shapiro Dep.) at 55-57. New Century also monitored "general market condition[s]." Def. Ex. 46 (Licata Dep.) at 49-50. It thus entered into forward sales *already knowing* what loans it expected to originate. There is no evidence that New Century ever modified its origination decisions *after* entering into a forward sale to satisfy the terms of that sale. Plaintiffs apparently now agree, arguing themselves that "when New Century originated a loan, it did not know which of its purchasers would acquire it." Opp. 19. Plaintiffs' bid-term theory is thus mere "speculation [and] conjecture," which "will not avail a party resisting summary judgment." *Conroy v. N.Y. State Dept. of Corr. Servs.*, 333 F.3d 88, 94 (2d Cir. 2003).[11]

[11] For the same reasons, Plaintiffs' argument (Opp. 6) that New Century was contractually obligated to deliver loans matching its bid terms is immaterial. Indeed, to the extent contract terms are relevant at all, the contracts warranted that New Century's origination decisions were independent of Morgan Stanley's purchases. SOF ¶ 32.

Second, Plaintiffs speculate that Morgan Stanley caused each of their five loans because New Century "originated the mortgage loans that its *Wall Street* purchasers wanted to acquire" and "Morgan Stanley was a component of *Wall Street*." Opp. 17 & n.2 (emphasis added). But that attempted syllogism fails the most basic test of logic. Morgan Stanley purchased only a small fraction—20%—of New Century's loans between 2004 and 2007 and no loans at all for six months in 2005. SOF ¶¶ 4-5, 9. The New Century witnesses also made clear that, to the extent "Wall Street" had any influence on New Century, "Wall Street" was a broad group of actors—including not only many banks but also ratings agencies, Fannie Mae, and Freddie Mac. Def. Ex. 5 (McKay Dep.) at 143, 153-154; Def. Ex. 20 (Lindsay Dep.) at 143, 173-174. Plaintiffs' generic invocation of "Wall Street" and the multiplicity of actors included within that collective term underscore that Plaintiffs cannot identify any specific influence that Morgan Stanley had on their loans, much less a determinative or coercive impact on the loans' origination.[12]

Nor is there any basis for Plaintiffs' suggestion (Opp. 18-19) that Morgan Stanley's purchase of 20% of New Century's loans can render it responsible for the collective influence of all of Wall Street. *Paroline v. United States*, 134 S. Ct. 1710 (2014), a case involving restitution for child pornography victims, is irrelevant; it does not address liability or the causation standard for a disparate impact claim. Morgan Stanley is not aware of *any* disparate impact case holding that one defendant can be held liable for the alleged effects of the separate policies of other entities. The Supreme Court has emphasized just the opposite: defendants may *not* be "held liable for racial disparities they did not create." *Inclusive Cmtys.*, 135 S. Ct. at 2523.

Third, there is yet another fundamental problem with Plaintiffs' "Wall Street" argument.

[12] Plaintiffs' argument also assumes, without any evidence, that "Wall Street" caused the purported disparate impact here, rather than other causes, such as New Century's independent brokers. *See infra* 18-19.

Their theory is that the market as a whole created certain general incentives to which New Century responded. *See* Opp. 4.[13] We are unaware of any case in which a court allowed a claim to proceed based on the theory that any or every market participant can be held liable for *market-level* incentives allegedly influencing an independent actor to lend in a discriminatory way. Indeed, in a third-party causation context, a plaintiff must do more than merely show that a defendant "encouraged" or "incentivize[d]" a third party's conduct. *See supra* 9. As Plaintiffs admit (Opp. 15), the *defendant* must have *determined* or *coerced* the third party's conduct—*i.e.*, left the third party with little meaningful choice. *See Bennett v. Spear*, 520 U.S. 154, 169 (1997).

There is no evidence even that "Wall Street" determined or coerced New Century in that sense, much less that Morgan Stanley—a single purchaser among many market actors—could (or did) determine or coerce New Century's decisions to originate Plaintiffs' loans. The fact that New Century chose *not* to sell any loans to Morgan Stanley for six months in 2005, and instead sold only to other banks who paid more than Morgan Stanley (*see* SOF ¶¶ 9, 12), belies any suggestion that Morgan Stanley had the power to determine or coerce New Century's decisions. *Cf. Nat'l Council*, 283 F. App'x at 851-852 (no determinative or coercive effect where third party could "choose not to comply" with defendant's requests without "adverse consequences"). If and when Morgan Stanley stayed on the sidelines, New Century had other options. Similarly, Plaintiffs do not dispute that New Century maintained vast amounts of excess credit capacity during 2004 to 2006. *See* SOF ¶¶ 56-58. New Century was an independent company, not Morgan Stanley's pawn. Plaintiffs' persistent suggestion to the contrary is pure speculation.

Fourth, Plaintiffs fail to raise a dispute of material fact as to causation for reasons specific to each Plaintiff. *See* Mem. 25-26. Plaintiffs do not dispute that Ms. Williams' loan was

[13] This is a far cry from what Plaintiffs promised to show in their Complaint, which alleged that "Morgan Stanley effectively dictated the types of loans that New Century issued." Compl. ¶ 3.

originated in April 2005 during the six-month period in which Morgan Stanley made no bulk loan purchases from New Century. *See* Opp. 19. They claim, however, that Morgan Stanley somehow caused her loan because in late May 2005—*i.e.*, a month *after* New Century originated her loan—Morgan Stanley entered into a forward agreement to buy loans in July 2005. *See id.*; Pl. Ex. 11 (Vanacker email). In other words, Plaintiffs' theory is that Morgan Stanley's bid terms were the cause of a loan that *already existed*. That makes no sense, and should be rejected.

With respect to Ms. Adkins, Ms. McCoy, and Mr. Young, Plaintiffs do not dispute that Morgan Stanley refused to purchase their loans because their loans did not satisfy Morgan Stanley's valuation diligence standards. *See* SOF ¶¶ 38, 85-86. Nor do they dispute that other banks were willing to purchase their loans. *See* SOF ¶¶ 87-91. Nonetheless, they assert that Morgan Stanley caused those loans because "forward agreements applied on the dates that all three of these Plaintiffs' loans were originated." Opp. 20. But as noted, Plaintiffs offer *no evidence* that bid terms caused any New Century decisions (*supra* 11), much less New Century's origination decisions on *their loans*.[14]

Nor is there a genuine dispute of fact as to whether Morgan Stanley caused New Century to originate Ms. Pettway's loan. Plaintiffs speculate that Morgan Stanley's bid terms somehow affected New Century's decision to issue Pettway a 2/28 ARM loan (Opp. 20), but it is undisputed that this loan type was a "primary product" at New Century since at least 1998 (*see* SOF ¶¶ 97-99). Ms. Pettway's theory that one set of Morgan Stanley bid terms in 2004 caused those terms in her loan thus makes no sense. Plaintiffs also claim that the fact that Ms. Pettway believes that she was targeted by her brokers based on her race "changes nothing." Opp. 20. But

[14] Plaintiffs note that New Century temporarily placed McCoy and Young's loans on Morgan Stanley's warehouse line (*see* Opp. 20), but it did so two weeks (McCoy) and six weeks (Young) *after* those loans were originated (*see* SOF ¶¶ 299, 303). Further, a wide variety of different loan types were permitted on Morgan Stanley's warehouse line. *See* SOF ¶¶ 271-72. Unsurprisingly, then, there is no *evidence* that the warehouse line had any role in determining the specific loan terms that Plaintiffs received.

this is a disparate impact case: Plaintiffs must prove that Morgan Stanley was the cause of the alleged disparity in who received loans from New Century. There is no evidence Morgan Stanley interacted with Pettway's broker or otherwise influenced the broker's apparent decision to target Pettway. There is thus no basis for attributing to Morgan Stanley the fact that Ms. Pettway (rather than, *e.g.*, a white borrower) received a "combined-risk" loan from New Century.

Ultimately, Plaintiffs offer no actual evidence substantiating their theories. Instead, they abandon their purported expert and draw speculative inferences about the supposed causal effects of Morgan Stanley's bid terms, all the while ignoring the authoritative sources—New Century's own witnesses—who reject their theory entirely. No reasonable juror could find that Morgan Stanley caused New Century to originate Plaintiffs' loans, to do so with the terms those loans have, or to make those loans on allegedly worse terms than to comparable non-Hispanic whites.

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

To prove a disparate impact Plaintiffs must show (1) a disparity that is adverse to African-American borrowers and (2) that Morgan Stanley caused that adverse impact. Mem. 27-33. Plaintiffs have not made a prima facie showing of either, so summary judgment should be granted. *See B.C. v. Mount Vernon Sch. Dist.*, 837 F.3d 152, 162 (2d Cir. 2016).

A. Plaintiffs' Disparate Impact Analysis Improperly Assumes an Adverse Impact For All Combined Risk Loans

Plaintiffs' disparate impact claim has, until now, been premised on the arbitrary concept of a "combined-risk" loan. Morgan Stanley has shown, as reflected in this Court's class certification ruling, that Plaintiffs' proof falls far short of demonstrating that all "combined-risk" loans in fact increase the risk of default: "combining the various "risk" features does not necessarily increase the risk of default, many of the features do not increase the risk of default, and many features provided real benefits to borrowers. *See* Mem. 28-31; *see also* Class Op. 39

(noting that Plaintiffs "would need to establish the harmfulness of [each] particular combination of risk factors" separately). Plaintiffs still offer no evidence by which a reasonable juror could conclude that every loan in Dr. Ayres' analysis was adverse, yet his analysis critically relies on that assumption. His assertion of a disparate impact based on the distribution of "combined-risk" loans is thus improper. *See* Mem. 28-31; *see also Aliotta v. Bair*, 614 F.3d 556, 569 (D.C. Cir. 2010) (rejecting disparate impact claim where employer's policy "may often be beneficial").

Given the lack of evidence, Plaintiffs now effectively abandon the "combined-risk" loan concept, and instead now claim (Opp. 21) they can prove a disparate impact merely by pointing to an alleged disparity in the frequency of distribution of "high-cost" loans. That is wrong.

First, the Court should reject Plaintiffs' "late-in-the-game" theory shift, just as it rejected similar attempts previously. *See* Class Op. 45. The overwhelming focus of this case has been on the causation and distribution of "combined-risk" loans, and it is unfair and too late for Plaintiffs to change course now and attempt to turn this into an interest-rate pricing case.

Second, there is no legal basis for Plaintiffs' new theory. They cite no precedent—not a single case—for measuring a disparate pricing impact based not on a comparison of the actual loan prices, but rather on a comparison of the frequency with which the APRs of loans made to different demographic groups cross HMDA's arbitrary "high cost" threshold. *See* Opp. 23-24. It is not surprising they can find no such precedent: In disparate impact cases, the accepted way to determine whether, controlling for appropriate variables, one group paid more than the other is to compare the *actual prices* people paid for their loans. *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"). Analyzing the number of loans that happen to cross HMDA's arbitrary "high cost" threshold is no substitute

for that pricing analysis. Indeed, Plaintiffs' expert Dr. Ayres conceded that a disparity in the frequency of issuance of high-cost loans does not necessarily demonstrate an *actual* pricing disparity. *See* Def. Ex. 27 (Ayres Dep.) at 184. There is no basis to conclude, on this record, that a disparity in high cost loans is evidence of an adverse impact for disparate impact purposes.

Third, even if it were possible to properly measure a disparate pricing impact based on the frequency of distribution of high-cost loans, Dr. Ayres did not do so. He focused on proving a disparity in the issuance of "combined-risk" loans—and his methodological choices make no sense in the context of Plaintiffs' belated pricing theory. When Dr. Ayres has tested for a pricing disparity in other cases, he has controlled for at least four "risk" features that he does not control for here: interest-only terms, prepayment penalties, ARMs, and documentation type (*e.g.*, stated income). *See* Def. Ex. 51 at 43-44 (report in *Barrett v. Option One Mortg. Corp.*, No. 08-10157, ECF No. 100-5 (D. Mass.)).[15] He explained that those features are "important" controls because they were "used to price mortgages." *Id.* at 44. He did not control for them here because his analysis was built for Plaintiffs' "combined-risk" loan theory. Thus, he testified that he could exclude ARMs as a control variable because he was trying to analyze the "combined risks" of "these eight combined risk characteristics." Def. Ex. 50 (Ayres Dep.) at 277-78. Whatever the merits of that choice in the context of his analysis of the distribution of "combined-risk" loans, it is contrary to the approach he has taken in evaluating loan pricing. In other words, his high-cost analysis was not designed to stand on its own as an analysis of pricing—and it cannot do so.

Fourth, the new focus on loan pricing makes it essential that Plaintiffs present evidence that Morgan Stanley had a determinative or coercive effect on the interest rates New Century offered them. Yet there is no such evidence here. Plaintiffs' theory about Morgan Stanley's

[15] This Court has previously noted the oddity of Dr. Ayres' decision to control for three of the other eight risk features in his analysis. *See* Class Op. 39 n.30 (citing Ayres Rpt. 48 tbl. 12).

influence is, instead, pure speculation. For example, Plaintiffs claim that Morgan Stanley's bid terms "required New Century to keep interest rates up." Opp. 17. But, as explained, that claim mischaracterizes how New Century engaged in forward sales. *See supra* 11. Moreover, the Morgan Stanley bid terms Plaintiffs point to provided for rates (weighted average coupons) a full 1 to 2 interest points *below* the interest rates Plaintiffs received from New Century. SOF ¶¶ 285, 288, 292, 295, 298, 302. Plaintiffs offer no explanation how Morgan Stanley could somehow cause them to receive interest rates *above* the rate in the bid terms. And they do not dispute that New Century's interest rates *were* influenced by numerous other factors—the general rate environment, rates New Century's competitors charged, and independent brokers. SOF ¶¶ 71-72. There is simply no evidence that Morgan Stanley determined Plaintiffs' interest rates, or determined which New Century borrowers received high cost loans and which did not.

Plaintiffs' shift in theory is thus not only too late but also futile. Because Plaintiffs have presented no evidence by which a reasonable juror could find that every loan in Professor Ayres' analysis was adverse, his analysis cannot satisfy Plaintiffs' prima facie burden to show a disparate impact. Summary judgment should be granted.

B. Plaintiffs Fail to Show That the Disparate Impact That Dr. Ayres Purports to Find Was Caused by Morgan Stanley

In a disparate impact case, it is the plaintiff's burden to show "that the specific factor challenged under the disparate impact model results in the discriminatory impact." *Brown v. Coach Stores, Inc.*, 163 F.3d 706, 712 (2d Cir. 1998) (internal quotation omitted). The plaintiff's disparate impact analysis must also be limited to "appropriate comparison groups," which requires "identify[ing] members of a protected group that are affected by the neutral policy and then identify similarly situated persons who are unaffected by the policy." *Tsombanidis v. W. Haven Fire Dep't*, 352 F.3d 565, 576-577 (2d Cir. 2003)

Here, Plaintiffs fail to present evidence by which a reasonable juror could find that Morgan Stanley caused *every* loan in Dr. Ayres' analysis, yet his disparate-impact finding relies on that assumption. *See* Mem. 31-33. His analysis therefore suffers from the same problem that led this Court to deny class certification—namely, that to the extent Plaintiffs' theory that New Century's conduct was caused by outside influences has any merit, then there are a variety of potential causes for New Century's lending that must be accounted for in any disparate impact analysis. Because Dr. Ayres has not done so, his analysis is not focused on the proper comparison groups, and there is no basis to attribute the disparate impact he purportedly found to Morgan Stanley. Thus, even if this Court disagrees with the arguments above that Morgan Stanley caused none of the five Plaintiffs' loans, summary judgment should still be granted.

This Court recognized at class certification that many factors are relevant to assessing the cause of each New Century loan, including when a loan was originated, who purchased it, the loan's particular "risk" features, and the discretionary decisions of New Century's underwriters and brokers. Mem. 32 (citing Class Op. 37-38); *see also* Class Op. 37 ("[T]he question of causation is simply not subject to a classwide proof."). Plaintiffs do not (and could not) seriously challenge that conclusion, which the Second Circuit affirmed. Summ. Order 2, ECF No. 161-1, No. 15-2398 (2d Cir. July 14, 2016).[16] This Court further recognized that a proper disparate impact analysis would need to account for alternative causes of New Century's lending. *See* Class Op. 39 (noting need to separately analyze "each combination of ['risk'] factors"). It is undisputed that Dr. Ayres did not account for these other causal factors. *See* Opp. 24. Instead,

[16] This Court has already recognized that Plaintiffs' assertion that New Century's underwriting was fully "automated" and "centralized" (Opp. 5) is unsupported by the evidence and contrary to the testimony of their own expert. *See* Class Op. 43 n.37 ("Plaintiffs' argument that brokers' discretion was minimal is unpersuasive, particularly in light of their discussion of 'steering,' a process by which brokers or loan officers would write Combined-Risk or other subprime loans for borrowers who were eligible for prime loans." (citing McCoy Rpt. 8 & n.15)); *id.* at 42-43 n.36 (noting that FastQual did not limit a "broker's discretion in selecting which terms to include in a loan or when to deviate from the guidelines"); *see also* SOF ¶¶ 67, 69-70.

he conducted a one-size-fits-all disparate impact analysis premised on the *assumption* that none of those other causal factors mattered, because he *assumed* that all of New Century's conduct could be attributed to a single cause—Morgan Stanley. His assumption has no support in the record, however, so his analysis cannot satisfy Plaintiffs' prima facie burden.

Plaintiffs were afforded an opportunity under the summary judgment briefing schedule to submit new expert testimony, but they elected not to attempt to fix this central deficiency in Dr. Ayres' analysis. *See* ECF No. 269. Instead, Plaintiffs double down on the notion that they can use "qualitative evidence" to show that Morgan Stanley caused *all* of New Century's lending, rendering it unnecessary to consider other potential causes or to limit Dr. Ayres' analysis to whatever subset of loans Morgan Stanley purportedly caused. Opp. 24. On this evidentiary record, however, no reasonable jury could ever agree with Plaintiffs' premise that Morgan Stanley caused all of New Century's loans. Indeed, even Plaintiffs' discredited expert, Professor McCoy, did not believe that. *See* SOF ¶¶ 70, 72, 134.

Because Dr. Ayres claims to find a disparate impact only by analyzing *all* of New Century's "combined-risk" loans (or *all* such loans purchased by Morgan Stanley)—absent evidence that establishes that Morgan Stanley caused all of those loans, and ignoring every other potential cause—his analysis is necessarily based on a comparison pool that is "too broad" and fundamentally flawed. *Wards Cove Packing Co. v. Atonio*, 490 U.S. 642, 643 (1989). Plaintiffs accordingly have not made a proper prima facie showing that Morgan Stanley's alleged policies caused the overall "[r]acial imbalance" he finds in New Century's lending. *Id.* at 653.

CONCLUSION

For the foregoing reasons, and those presented in Morgan Stanley's opening memorandum, Morgan Stanley's motion for summary judgment should be granted.

Dated: January 13, 2017

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