UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

BEVERLY ADKINS, CHARMAINE WILLIAMS, REBECCA PETTWAY, RUBBIE McCOY, and WILLIAM YOUNG,

Plaintiffs,

-against-

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

MEMORANDUM IN OPPOSITION TO DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

TABLE OF CONTENTS

INTRODUCTION 1

STATEMENT OF FACTS 2

I. The Morgan Stanley-New Century Partnership 2

A. Evidence Exists that Morgan Stanley Was New Century's Predominant Wall Street Partner 2

B. Evidence Exists that New Century Conformed Its Lending Practices to Wall Street's Demands 4

C. Evidence Exists that New Century Used Automated, Centralized Systems to Underwrite All of its Loans 5

II. Evidence Exists Linking Morgan Stanley Policies to Combined-Risk Loans 6

III. Evidence Exists that Combined-Risk Loans Are Harmful and Discriminatory 8

IV. Evidence Exists that Each Plaintiff's Discriminatory Loan Was Caused by Morgan Stanley's Loan Purchase Relationship with New Century 9

A. Beverly Adkins 9

B. Rebecca Pettway 10

C. Charmaine Williams 10

D. William Young 11

E. Rubbie McCoy 13

LEGAL STANDARD 14

ARGUMENT 14

I. A Genuine Dispute Exists as to Whether Morgan Stanley's Policies Caused the Origination of Plaintiffs' Predatory and Discriminatory Loans 14

A. Causation is a Question of Fact for the Jury 14

B. A Reasonable Jury Could Find That Morgan Stanley Caused the Issuance of the Plaintiffs' Loans on Discriminatory Terms 16

II. A Reasonable Jury Could Find that Plaintiffs Experienced an Adverse Impact 21

A. Plaintiffs Proffer Sufficient Evidence for a Jury to Find That the Kind of Loans They Received Were Harmful 21

B. Plaintiffs' Causation Evidence is Not Contained Within Prof. Ayres' Opinion, Which Analyzes How Harmful Loans Were Ultimately Allocated........ 24

III. Plaintiffs' Claims Are Timely Under the Discovery Rule........ 25

A. The Discovery Rule Applies Here 26

B. A Genuine Dispute Exists as to When Plaintiffs Could Have Discovered Facts Sufficient to Survive A Motion to Dismiss this Claim........ 27

C. A Genuine Dispute Exists as to Whether Ms. Pettway Could Have Discovered the Facts of Her Injury and Its Cause before October 2010 30

IV. The FHA Does Not Foreclose the Claims of Plaintiffs Whose Loans Morgan Stanley Did Not Ultimately Purchase........ 32

V. Plaintiffs Do Not Seek Disgorgement........ 35

CONCLUSION........ 35

TABLE OF AUTHORITIES

Cases

A.Q.C. ex rel. Castillo v. United States,
656 F.3d 135 (2d Cir. 2011).. 29
Adams v. Ameritech Servs., Inc.,
231 F.3d 414 (7th Cir. 2000).. 25
Aliotta v. Bair,
614 F.3d 556 (D.C. Cir. 2010) 23
Amnesty Am. v. Town of W. Hartford,
361 F.3d 113 (2d Cir. 2004)... 14
Anderson Grp., LLC v. City of Saratoga Springs,
805 F.3d 34 (2d Cir. 2015)... 19
B.C. v. Mt. Vernon Sch. Dist.,
837 F.3d 152 (2d Cir. 2016)... 23
Bano v. Union Carbide Corp.,
361 F.3d 696 (2d Cir. 2004)... 27
Bazemore v. Friday,
478 U.S. 385 (1986). 24, 25
Beaulialice v. Fed. Home Loan Mortg. Corp.,
No. 8:04-CV-2316-T-24-EA, 2007 WL 744646 (M.D. Fla. Mar. 6, 2007)............................ 15
Berry v. Wells Fargo,
No. 15 C 5269, 2015 WL 8601866 (N.D. Ill. Dec. 14, 2015).. 33
Burlington N. & Santa Fe Ry. Co. v. White,
548 U.S. 53 (2006) 22
Burrell v. State Farm & Cas. Co.,
226 F. Supp. 2d 427 (S.D.N.Y. 2002).. 33
Carver v. City of N.Y.,
621 F.3d 221 (2d Cir. 2010)... 15, 16
Castaldi v. Land Rover N. Am., Inc.,
No. 06-CV-1008JGKAM, 2007 WL 4165283 (E.D.N.Y. Nov. 21, 2007) 18
Chandok v. Klessig,
648 F. Supp. 2d 449 (N.D.N.Y. 2009) 14, 23
Chandok v. Klessig,
632 F.3d 803 (2d Cir. 2011)... 14, 23
Christianson v. Colt Indus. Operating Corp.,
486 U.S. 800 (1988) 26, 32
Cinnamon Hills Youth Crisis Ctr., Inc. v. Saint George City,
685 F.3d 917 (10th Cir. 2012)... 25

City of Cleveland v. Ameriquest Mortg. Sec., Inc.,
615 F.3d 496 (6th Cir. 2010)..20

City of Pontiac Gen. Employees' Ret. Sys. v. MBIA, Inc.,
637 F.3d 169 (2d Cir. 2011)..27, 29

Clement v. United Homes, LLC,
914 F. Supp. 2d 362 (E.D.N.Y. 2012)..26

Cohen v. S.A.C. Trading Corp.,
711 F.3d 353 (2d Cir. 2013)..30, 31

Council v. Better Homes Depot, Inc.,
No. 04 Civ. 5620, 2006 WL 2376381 (E.D.N.Y. Aug. 16, 2006) 29, 31

Cyrus v. Town of Mukwonago,
624 F.3d 856 (7th Cir. 2010)..17

Davis v. Wells Fargo Bank,
685 F. Supp. 2d 838 (N.D. Ill. 2010) 33

Delaney v. Bank of Am. Corp.,
766 F.3d 163 (2d Cir. 2014)..14

DiLaura v. Power Auth. of State of N.Y.,
982 F.2d 73 (2d Cir. 1992)...26, 27

Estate of Davis v. Wells Fargo Bank,
633 F.3d 529 (7th Cir. 2011)..33

Estate of Ungar v. Palestinian Auth.,
451 F. Supp. 2d 607 (S.D.N.Y. 2006)..22

Family Dollar Stores, Inc. v. United Fabrics Int'l, Inc.,
896 F. Supp. 2d 223 (S.D.N.Y. 2012)..24

Faryniarz v. Nike, Inc.,
No. 00 CIV. 2623 (NRB), 2002 WL 530997 (S.D.N.Y. Apr. 8, 2002) 18

Gen. Indus. Corp. v. Hartz Mountain Corp.,
810 F.2d 795 (8th Cir. 1987)..18

Green v. Diamond,
No. 14 C 2601, 2014 WL 5801351 (N.D. Ill. Nov. 7, 2014) 33

Guccione v. United States,
670 F.Supp. 527 (S.D.N.Y.1987)...28

Hack v. President & Fellows of Yale College,
237 F.3d 81 (2d Cir. 2000)...33

Heights Cmty. Cong. v. Hilltop Realty, Inc.,
774 F.2d 135 (6th Cir. 1985)..20

In re Initial Pub. Offerings Sec. Litig.,
471 F.3d 24 (2d Cir. 2006)...23

Jordan v. Chase Manhattan Bank,
91 F. Supp. 3d 491 (S.D.N.Y. 2015)...33

Katz v. Goodyear Tire & Rubber Co.,
737 F.2d 238 (2d Cir. 1984) 27

Kronisch v. United States,
150 F.3d 112 (2d Cir. 1998) 28

Lantec, Inc. v. Novell, Inc.,
146 F. Supp. 2d 1140 (D. Utah 2001) 18

Lantec, Inc. v. Novell, Inc.,
306 F.3d 1003 (10th Cir. 2002) 18

Matarese v. Archstone Pentagon City,
761 F. Supp. 2d 346 (E.D. Va. 2011) 18

Mazzocchi v. Windsor Owners Corp.,
__F. Supp. 3d__, __, 2016 WL 4542035 (S.D.N.Y. Aug. 31, 2016) 33

Meyer v. Holley,
537 U.S. 280 (2003) 19

Mhany Mgmt., Inc. v. Cty. of Nassau,
819 F.3d 581 (2d Cir. 2016) 21

N. River Ins. Co. v. Phila. Reinsurance Corp.,
63 F.3d 160 (2d Cir. 1995) 26

NAACP v. American Family Mut. Ins. Co.,
978 F.2d 287 (7th Cir.1992) 33

Pac. Shores Props., LLC v. City of Newport Beach,
730 F.3d 1142 (9th Cir. 2013) 14, 15, 16

Pandozy v. Segan,
340 F. App'x 723 (2d Cir. 2009) 33

Pandozy v. Segan,
518 F. Supp. 2d 550 (S.D.N.Y. 2007) 33

Paroline v. United States,
134 S. Ct. 1710 (2014) 19

Phillips v. Better Homes Depot, Inc.,
No. 02-CV-1168 (ERK), 2003 WL 25867736 (E.D.N.Y. Nov. 12, 2003) 29

Phillips v. Cohen,
400 F. 3d 388 (6th Cir. 2005) 25

Prendergast v. Analog Modules, Inc.,
503 F. App'x 49 (2d Cir. 2012) 14

Prendergast v. Analog Modules, Inc.,
No. 08 CIV. 6891 WHP, 2011 WL 3962598 (S.D.N.Y. Sept. 2, 2011) 14

Robinson v. Metro-N. Commuter R.R. Co.,
267 F.3d 147 (2d Cir. 2001) 25

Saint-Jean v. Emigrant Mortg. Co.,
50 F. Supp. 3d 300 (E.D.N.Y. 2014) 26, 27, 29, 32

Salem v. U.S. Lines Co.,
370 U.S. 31 (1962) 18

Smith v. Barnesandnoble.com, LLC,
839 F.3d 163 (2d Cir. 2016) 14

Sobel v. Yeshiva Univ.,
839 F.2d 18(2d Cir. 1988) 25

Texas Dep't of Hous. & Cmty. Affairs v. Inclusive Cmtys. Project, Inc.,
135 S. Ct. 2507 (2015) 15, 21

Texas Dep't of Hous. & Cmty. Affairs v. Inclusive Cmtys. Project, Inc.,
135 S. Ct. 46 (2014) 16

Thompson v. Metro. Life Ins. Co.,
149 F. Supp. 2d 38 (S.D.N.Y. 2001) 30

Trafficante v. Metropolitan Life,
409 U.S. 205 (1972) 33, 35

United States v. Mejia,
545 F.3d 179 (2d Cir. 2008) 17

United States v. Oakland Cannabis Buyers' Co-op.,
532 U.S. 483 (2001) 16

Virgin Atl. Airways v. National Mediation Bd.,
956 F.2d 1245 (2d Cir. 1992) 26

Walton v. Diamond,
No. 12-CV-4493, 2013 WL 1337334 (N.D. Ill. Mar. 29, 2013) 33

Wills v. Amerada Hess Corp.,
379 F.3d 32 (2d Cir. 2004) 18

Statutes & Regulations

24 C.F.R. § 100.125 35

24 C.F.R. § 100.500 21

42 U.S.C. § 3604 33

42 U.S.C. § 3605 .... 34, 35

12 U.S.C. §§ 2801-2811 .... 8, 22

Rules & Other Authorities

Fed. R. Civ. P. 56 14

Petition for a Writ of Certiorari,
Texas Dep't of Hous. & Cmty. Affairs v. Inclusive Cmtys. Project, Inc.,
No. 13-1371, 2014 WL 1989121 (filed May 13, 2014) 16

Restatement (Second) of Torts § 431(a) (1965) 15

INTRODUCTION

Plaintiffs, five African-American homeowners who received discriminatory subprime mortgages, seek the opportunity to prove to a jury that Morgan Stanley's loan securitization policies and practices violated the Fair Housing Act (FHA) and caused the injuries that they suffered within the meaning of that statute.[1] Morgan Stanley would deny them that opportunity. To do so, it must convince this Court that no jury could reasonably find Morgan Stanley liable, despite evidence that New Century tailored its loan production to meet Wall Street demands; that Morgan Stanley was the largest and most consistent purchaser of New Century's loans, working in self-described "partnership" with New Century; that contracts bound New Century to Morgan Stanley around the time each Plaintiff's loan was originated, requiring New Century to originate loans with certain terms; and that, controlling for creditworthiness, African-Americans like Plaintiffs were disproportionately likely to receive more expensive and riskier loans. Morgan Stanley cannot meet this heavy burden, and Plaintiffs are therefore entitled to their day in court.

More than three years ago, Judge Baer's decision on Morgan Stanley's motion to dismiss set forth the legal framework through which Plaintiffs could prove their claims. Although Morgan Stanley asks this Court to disregard crucial aspects of Judge Baer's ruling, this attempt should be rejected under the law of the case doctrine. The FHA empowers private attorneys general like Plaintiffs to bring claims against loan purchasers, in order both to assert their own rights and to further the FHA's goal of securing equal housing opportunity. To vindicate these aims, and in light of Plaintiffs' evidence, the Motion for Summary Judgment must be denied.

[1] Plaintiffs' Counterstatement to Morgan Stanley's Rule 56.1 Statement of Material Facts and Plaintiffs' Statement of Additional Material Facts is cited herein as "CSOF." Morgan Stanley's Memorandum in support of its Motion for Summary Judgment, ECF No. 259, is cited herein as "Br."

STATEMENT OF FACTS

I. The Morgan Stanley-New Century Partnership.

A. Evidence Exists that Morgan Stanley Was New Century's Predominant Wall Street Partner.

During the subprime boom, Morgan Stanley played a special and singular role among New Century Mortgage Company's Wall Street loan funders and purchasers. Morgan Stanley was New Century's predominant and most consistent purchaser and funder of New Century loans. *See* CSOF ¶ 194.

In 2004, when Plaintiffs Beverly Adkins and Rebecca Pettway received their New Century loans, Morgan Stanley purchased 46.4% of the dollar value of loans sold by New Century, while the second-largest purchaser bought just 17.2%. *Id.* ¶ 197.

In 2005, when Plaintiffs Charmaine Williams and William Young received their mortgages, Morgan Stanley was nearly tied as the largest purchaser of New Century loans with Carrington Capital, *id.* ¶ 12, in which New Century held a 38% ownership stake, *id.* ¶ 95. That year, Morgan Stanley boasted that it was "the largest whole loan purchaser of New Century's production purchasing over 50% of New Century's production . . . since 2001." *Id.* ¶ 195; *see also id.* ¶ 196. Also that year, 71% of the loans Morgan Stanley purchased were Combined-Risk Loans. *Id.* ¶ 198. Although there were six months in 2005 in which Morgan Stanley closed no purchases of New Century loans, Morgan Stanley did enter into at least one forward agreement to purchase New Century loans during this time period. *Id.* ¶ 93.

In 2006, when Plaintiff Rubbie McCoy received her mortgage, Morgan Stanley was once again New Century's predominant purchaser by a large margin, purchasing more than twice as many New Century loans as the second-largest purchaser. *Id.* ¶ 199. That year, 71% of the loans that Morgan Stanley purchased were Combined-Risk Loans. *Id.* ¶ 198.

Throughout 2004, 2005, and 2006, Morgan Stanley's warehouse lines of credit provided between 13% and 20% of New Century's total credit capacity. *Id.* ¶ 47. At no moment in 2004, 2005, or 2006 did any other warehouse lender provide New Century with more credit capacity than did Morgan Stanley. *Id.* ¶¶ 51-55; 200. Morgan Stanley maintained its $2 billion warehouse line of credit to New Century throughout the 2005 period in which it did not close purchases of New Century loans. *Id.* ¶ 52. New Century was so dependent on Morgan Stanley's warehouse lines of credit and Morgan Stanley's consistent bulk purchases of loans that when Morgan Stanley pulled the plug and ceased doing business with New Century, New Century was forced to declare bankruptcy. *Id.* ¶¶ 201-202.

Morgan Stanley boasted contemporaneously of its deep involvement in New Century's activities. Senior Morgan Stanley employees noted that Morgan Stanley was New Century's "largest and most important counter-party," and that "Morgan Stanley [was] involved in almost every strategic decision that New Century makes in securitized products." *Id.* ¶ 203-204. Contemporaneous documents also noted that Morgan Stanley's purchasing power had caused New Century to incorporate "[m]any of Morgan Stanley's best practices into their origination practices." *Id. ¶* 205; *see also id.* ¶ 206. The two companies collaborated closely, with Morgan Stanley due diligence staff consistently working on site at New Century's offices and some Morgan Stanley employees receiving New Century email addresses. *Id.* ¶¶ 207-209. This close relationship earned Morgan Stanley special treatment relative to other Wall Street firms. For example, Morgan Stanley received opportunities to bid on pools of loans without competition. *Id.* ¶ 22; 210. Even in competitive situations, New Century sometimes awarded loans to Morgan Stanley when it did not place the highest bid. *See id.*

Morgan Stanley recently paid billions of dollars to settle a federal investigation into its mortgage securitization business between 2004 and 2007; New Century is the *only* mortgage originator mentioned by name in the Statement of Facts that Morgan Stanley acknowledged as part of the settlement. *Id.* ¶¶ 211-212.

B. Evidence Exists that New Century Conformed Its Lending Practices to Wall Street's Demands.

Throughout the period during which the Plaintiffs received New Century mortgages, New Century's ability to do business depended entirely on liquidity it received from Wall Street banks through loan sales and warehouse lines of credit—with Morgan Stanley playing the principal role. *See* CSOF ¶ 213.

William McKay was New Century's Chief Credit Officer and "led" the company's credit committee. *Id.* ¶ 214. Mr. McKay testified that Wall Street demands dominated New Century's decisions about what loans to issue. *Id.* ¶¶ 215-219. Other New Century witnesses echoed this sentiment. *Id.* ¶¶ 221-223. New Century was also explicit with investors in stating that its lending criteria and its product mix were driven by secondary market purchasers. *See id.* ¶¶ 224-225. New Century gave its associates classes on secondary marketing. *Id.* ¶ 226.

New Century received regular feedback from Morgan Stanley and its investors regarding the loan products Morgan Stanley was interested in purchasing. *Id.* ¶¶ 227-228. New Century's goal "would be to take that information . . . and try to tailor the production to meet the market demands." *Id.* ¶ 228. McKay told the New Century Bankruptcy Examiner that New Century's "credit committee would discuss what they wanted to do and then go to Wall Street and match their products and their loan pools with Wall Street's expectations." *Id.* ¶ 229. The secondary market created clear incentives for New Century to focus on originating loans with several Combined-Risk Loan features, including adjustable-rate mortgages, loans with high loan-to-

value ratios, stated-income loans, and loans with prepayment penalties. *Id.* ¶¶ 230-234. Its efforts to meet Wall Street's demands also led New Century to issue more layered-risk loans. *Id.* ¶¶ 235-236.

C. Evidence Exists that New Century Used Automated, Centralized Systems to Underwrite All of its Loans.

Guided by the imperative to originate loans to sell to Wall Street, where Morgan Stanley was its biggest partner, New Century's credit committee incorporated Wall Street's demands into uniform underwriting guidelines. *See* CSOF ¶ 237. Those guidelines defined the full range of loan products and programs New Century offered. *Id*. at ¶ 238. New Century's chief credit officer oversaw the "automated underwriting system" through which all New Century loans were originated. *Id*. at ¶ 239.

Morgan Stanley was keenly aware of this centralized system and its effect on mortgage brokers working with New Century. Morgan Stanley referred to FastQual, New Century's online portal designed to render underwriting decisions for brokers instantly, as a "key success factor" for New Century. *Id.* ¶ 240; *see also id.* ¶ 241. Morgan Stanley also knew about New Century's "CloseMore University" workshops, at which it trained affiliated brokers and taught them to use FastQual. *Id.* ¶ 241-242.

The centralized underwriting guidelines applied to all individual lending decisions, whether through New Century account executives or through brokers. *Id.* ¶¶ 243-244. The system was designed to make sure the underwriting guidelines were applied consistently, and it achieved that purpose. *Id.* ¶ 245. Every New Century broker was essentially a conduit to the automated underwriting system. *See id.* ¶ 243. New Century underwriters mainly confirmed that various forms of documentation required by the underwriting guidelines had actually been submitted; they did not exercise substantive discretion about what loan products to offer. *Id.*

¶ 246. In the limited circumstances in which exceptions from the underwriting guidelines could be made based upon compensating credit factors, centralized authority dictated which higher-level New Century personnel could approve such exceptions. *Id.* ¶¶ 247-248. Decisions about who could make an exception, and under what circumstances, were "centralized through the chief credit officer." *Id.* ¶ 248.

II. Evidence Exists Linking Morgan Stanley Policies to Combined-Risk Loans.

Evidence exists that Morgan Stanley's policies for the purchasing of New Century loans led to New Century's origination of Combined-Risk Loans. Morgan Stanley bought New Century's loans in bulk pools of approximately $1 billion per month. CSOF ¶ 249. Between 90 and 100% of Morgan Stanley's whole loan purchases from New Century were the result of "forward sales," meaning that Morgan Stanley would agree to a purchase price for loans with particular features to be originated in the future. *Id.* ¶ 250.

There were two types of forward sales: "open bids" and "reverse inquiries." *Id.* ¶ 251. In open bids, Morgan Stanley would bid on an "indicative" (*i.e.*, hypothetical) pool of loans. *Id.* ¶ 252. In reverse inquiries, Morgan Stanley would call New Century "and say we have a demand for X-amount of product for this particular point in time, and here's what we would be willing to pay." *Id.* ¶ 253. In either scenario, Morgan Stanley would memorialize the characteristics of the loans it required New Century to deliver in the future in a "bid terms" agreement. *Id.* ¶¶ 254-255.

Morgan Stanley's bid terms had a direct effect on the types of loans New Century would originate because, in these forward sale transactions, the bid terms were agreed upon a month or more in advance of the date when loans were to be delivered, meaning that loans often were originated *after* the bid terms were set. *Id.* ¶ 256. Once the bid terms were agreed upon, New Century was contractually required to generate loans with the specified features. *Id.* ¶¶ 34, 257.

Some features of the Combined-Risk Loans issued by New Century were a direct result of requirements imposed by Morgan Stanley in bid terms and forward trades. Morgan Stanley sought loans with higher interest rates that would generate larger returns for investors and Morgan Stanley. *Id.* ¶ 258. Morgan Stanley also sought loans with prepayment penalties and adjustable interest rates. *Id.* ¶¶ 259-260.

Morgan Stanley's inadequate policies for the review of loans ensured that it would purchase loans with the other Combined-Risk Loan features. Although Morgan Stanley was on notice that the New Century loans it was purchasing had exceedingly high default rates, it maintained inadequate due diligence procedures and even relaxed compliance requirements to increase the "pull-through rate," that is, the number of loans purchased. *Id.* ¶¶ 261-262. Indeed, in early 2004, just before Plaintiff Beverly Adkins' loan was originated, Morgan Stanley significantly reduced the sample size for review of New Century loans, from 30-35% down to 25%, and the sample remained near 25% until after Plaintiff Rubbie McCoy's loan was originated in 2006. *Id.* ¶¶ 263-64.

Valuation due diligence was also inadequate throughout the relevant period, to such an extent that a Morgan Stanley employee referred to its failures as "standard operating procedure," *Id.* ¶ 265. Further compounding these problems, Morgan Stanley's trading desk superseded due diligence decisions in order to facilitate Morgan Stanley's continued purchase of high volumes of New Century loans, including those with Combined-Risk Features. *Id.* ¶¶ 266-267.

Morgan Stanley extended warehouse lines of credit to New Century as part of its strategy to purchase New Century loans. *Id.* ¶¶ 268-269. Morgan Stanley shaped New Century's lending through the warehouse line by determining what types of loans it would accept as collateral on the line. *See id.* ¶ 270. For example, the head of the trading desk noted in March of 2005 that

Morgan Stanley was "pushing" originators toward forty-year balloon loans over forty-year loans without balloons. *Id.* ¶ 271. Morgan Stanley also funded loans with up to 100% LTVs and No Income No Asset ("NINA") loans. *Id.* ¶¶ 272-273.

III. Evidence Exists that Combined-Risk Loans Are Harmful and Discriminatory.

Each feature of a Combined-Risk Loan ("CRL") has been shown individually to correlate with a higher risk of default. *See* CSOF ¶¶ 274-275. When these risk factors are combined, such risk layering "boosted the already high risk of default even higher than the sum of its parts." *Id.* ¶ 276. Accordingly, Plaintiffs' expert, Prof. McCoy, concluded that "Plaintiffs' definition of combined-risk loans is a useful and accurate proxy for the type of layered-risk loans associated with high rates of default and foreclosure." *Id.* ¶ 277. Moreover, every CRL, regardless of its additional layered-risk features, is by definition a high-cost loan under the Home Mortgage Disclosure Act, 12 U.S.C. §§ 2801-2811 (HMDA). *Id.* ¶ 274, 307. Regardless of how particular CRL features were layered in each Plaintiff's loan, the high-cost feature increased the risk of default and foreclosure. *Id.* ¶ 278.

Plaintiffs have proffered expert regression analysis that carefully controls both for loan-related features and for the creditworthiness of the borrower. The analysis shows that African-American borrowers were (a) more likely than similarly creditworthy white borrowers to receive CRLs; and (b) more likely than similarly creditworthy white borrowers to receive high-cost loans. *Id.* ¶ 279. The results were consistent in the Detroit area and nationwide, whether considering all New Century loans or solely those loans purchased by Morgan Stanley. *Id.* ¶ 280. All of these findings were "statistically significant at the 99% confidence level. *Id.* ¶ 281. Like the policies at issue in most disparate impact cases, CRLs are not categorically illegal, but they

have a harmful discriminatory impact that runs afoul of the Fair Housing Act. Given stark residential segregation in the Detroit region, this impact was entirely foreseeable. *See id.* ¶ 282.

IV. Evidence Exists that Each Plaintiff's Discriminatory Loan Was Caused by Morgan Stanley's Loan Purchase Relationship with New Century.

A. Beverly Adkins

Plaintiff Beverly Adkins received a mortgage loan from New Century on May 3, 2004. CSOF ¶ 283. That year, Morgan Stanley bought nearly half of New Century's loan production. *Id.* ¶ 197.

Ms. Adkins' loan was high-cost, and high-cost loans were issued to African-American borrowers in Detroit on a discriminatory basis. *Id.* ¶¶ 279-280. In addition, Ms. Adkins' loan had an adjustable rate and a prepayment penalty, *id.* ¶ 102, both loan features Morgan Stanley sought to maximize in its purchases of New Century loans. *See, e.g., id.* ¶¶ 285-286; 259-260. Ms. Adkins' loan also had a high loan-to-value ratio, *id.* ¶ 103, and Morgan Stanley's valuation due diligence policies systematically ensured that it would purchase loans with inflated appraisals and thus high loan-to-value ratios. *Id.* ¶ 265.

On February 12, 2004, before Ms. Adkins' loan was issued, Morgan Stanley entered into a forward agreement to purchase two pools of loans from New Century to close in May and June. *Id.* ¶ 284. The bid terms governing the May 27, 2004 purchase described pools composed of at least 70% adjustable-rate loans; set a weighted average coupon rate and a minimum average gross margin for adjustable rate mortgage loans; and required that a minimum of 78% of the loans have prepayment penalties. *Id.* ¶ 286.

Morgan Stanley has proffered no evidence that Ms. Adkins knew or could have discovered that she received a mortgage on discriminatory terms before meeting with her attorneys in 2012.

B. Rebecca Pettway

Plaintiff Rebecca Pettway received a mortgage loan from New Century on May 18, 2004. *Id.* ¶ 287. That year, Morgan Stanley bought nearly half of New Century's loan production. *Id.* ¶ 197.

Ms. Pettway's loan was high-cost, and high-cost loans were issued to African-American borrowers in Detroit on a discriminatory basis. *Id.* ¶¶ 279-280. In addition, Ms. Pettway's loan had an adjustable rate and a prepayment penalty, *id.* ¶ 102, both loan features Morgan Stanley sought to maximize in its purchases of New Century loans. *Id*. ¶¶ 289; 259-260.

On March 10, 2004, before Ms. Pettway's loan was issued, Morgan Stanley entered into a forward agreement to purchase New Century loans on July 29, 2004. *Id.* ¶ 288. The bid terms governing the purchase required that the pool be composed of 70% adjustable rate mortgages; set a minimum weighted average coupon rate and a minimum average gross margin for adjustable rate mortgage loans; and required that 78% of the loans have prepayment penalties. *Id.* ¶ 289.

Morgan Stanley purchased Ms. Pettway's loan in June 2004. *Id.* ¶ 96.

Ms. Pettway was represented by bankruptcy counsel before 2011. *Id.* ¶ 192-93. However, her retainer in that bankruptcy matter specifically excluded any representation for any matter outside the bankruptcy. *Id.* at ¶ 193.

C. Charmaine Williams

Plaintiff Charmaine Williams received a mortgage loan from New Century on April 22, 2005. *Id.* ¶ 290.

Ms. Williams' loan was high-cost, and high-cost loans were issued to African-American borrowers in Detroit on a discriminatory basis. *Id.* ¶¶ 279-280. In addition, Ms. Williams' loan had an adjustable rate and a prepayment penalty, *id.* ¶ 102, both loan features Morgan Stanley

sought to maximize in its purchases of New Century loans. *Id.* ¶ 293; 259-260. Ms. Williams' loan also had a high loan-to-value ratio, *id.* ¶ 103, and Morgan Stanley's valuation due diligence policies systematically ensured that it would purchase loans with inflated appraisals and thus high loan-to-value ratios, *id.* ¶ 265.

On May 19, 2005, the head of Morgan Stanley's trading desk noted in an email that New Century's head of secondary marketing wanted to see Morgan Stanley back in the subprime loan program, "and with the amount of loans that he needs to sell I think he realizes that he is going to need our liquidity." *Id.* ¶ 291. The email then discussed a plan for Morgan Stanley and New Century to work together to "get a trade done." *Id.* On May 31, 2005, Morgan Stanley entered into a forward agreement to purchase $500 million worth of loans from New Century. *Id.* ¶ 292. That pool could contain loans originated on or after January 1, 2005. *Id.* ¶ 293.

The bid terms governing this purchase required that the pool be composed of no fewer than 81.5% adjustable rate mortgages; set a minimum weighted average coupon rate and a minimum average gross margin for adjustable rate mortgage loans; and required that no fewer than 75% of the loans have prepayment penalties. *Id.*

Morgan Stanley has proffered no evidence that Ms. Williams knew or could have discovered that she received a mortgage on discriminatory terms before meeting with her attorneys in 2012.

D. William Young

Plaintiff William Young received a mortgage loan from New Century on November 3, 2005. *Id.* ¶ 294.

Mr. Young's loan was high-cost, and high-cost loans were issued to African-American borrowers in Detroit on a discriminatory basis. *Id.* ¶¶ 279-280. In addition, Mr. Young's loan had

an adjustable rate and a prepayment penalty, *id.* ¶ 102, both loan features Morgan Stanley sought to maximize in its purchases of New Century loans, *id.* ¶¶ 296; 259-260. Mr. Young's loan also had a high loan-to-value ratio, *id.* ¶ 103, and Morgan Stanley's valuation due diligence policies systematically ensured that it would purchase loans with inflated appraisals and thus high loan-to-value ratios, *id.* ¶ 265. Mr. Young's loan additionally had a balloon payment feature, *id.* ¶ 105, which Morgan Stanley "push[ed]" New Century toward, *id.* ¶ 271.

On October 27, 2005, before Mr. Young's loan was issued, Morgan Stanley entered into a forward agreement to purchase New Century loans on December 23, 2005. *Id.* ¶ 295. That pool could contain loans originated as early as Nov. 1, 2005. *Id.* ¶ 296. The bid terms governing the purchase required that the pool be composed of 80.48% adjustable rate mortgages; set a minimum weighted average coupon rate and a minimum average gross margin for adjustable rate mortgage loans; and required that 72.12% of the loans have prepayment penalties. *Id.*

On December 6, 2005, Morgan Stanley was given an "exclusive look" at a pool of New Century loans to take them "off the table tomorrow before the bid is shown elsewhere." *Id.* ¶ 297. On December 8, 2005, Morgan Stanley agreed to purchase $500 million of New Century loans on a forward basis, with the purchase to settle at the end of January. *Id.* ¶ 298. The bid terms governing this purchase required that the pool be composed of no fewer than 79.54% adjustable rate mortgages; set a minimum weighted average coupon rate and a minimum average gross margin for adjustable rate mortgage loans; and required that at least 73.11% of the loans have prepayment penalties. *Id.* ¶ 299.

For more than three months beginning on December 15, 2005, Mr. Young's loan served as collateral on New Century's warehouse line of credit from Morgan Stanley. *Id.* ¶ 300.

Morgan Stanley has proffered no evidence that Mr. Young knew or could have discovered that he received a mortgage on discriminatory terms before meeting with his attorneys in 2012.

E. Rubbie McCoy

Plaintiff Rubbie McCoy received a mortgage loan from New Century on July 31, 2006. *Id.* ¶ 301. That year, Morgan Stanley bought more than one out of every five New Century loans, a share more than twice as large as the next-largest outside purchaser of loans. *Id.* ¶ 199.

Ms. McCoy's loan was high-cost, and high-cost loans were issued to African-American borrowers in Detroit on a discriminatory basis. *Id.* ¶¶ 279-280. In addition, Ms. McCoy's loan had an adjustable rate and a prepayment penalty, *id.* ¶ 102, both loan features Morgan Stanley sought to maximize in its purchases of New Century loans, *id.* ¶ 303; 259-260. Ms. McCoy's loan was also a stated income loan, *id.* ¶ 104, a product that Morgan Stanley funded on its warehouse line, *id.* ¶ 273.

On May 24, 2006, before Ms. McCoy's loan was originated, Morgan Stanley entered into a forward agreement to purchase New Century loans on August 25, 2006. *Id.* ¶ 302. The bid terms governing the purchase required that the pool be composed of 83% adjustable rate mortgages; set a minimum weighted average coupon rate and a minimum average gross margin for adjustable rate mortgage loans; and required that at least 68.95% of the loans have prepayment penalties. *Id.* ¶ 303.

Ms. McCoy's loan served as collateral on New Century's warehouse line of credit from Morgan Stanley for ten days beginning on August 15, 2006. *Id.* ¶ 304.

Morgan Stanley has proffered no evidence that Ms. McCoy knew or could have discovered that she received a mortgage on discriminatory terms before meeting with her attorneys in 2012.

LEGAL STANDARD

Summary judgment is appropriate "if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a). The burden is on the moving party "to demonstrate the absence of any genuine issues of material fact" and courts "view the evidence in the light most favorable to the party opposing summary judgment, [ ] draw all reasonable inferences in favor of that party, and [ ] eschew credibility assessments." *Smith v. Barnesandnoble.com, LLC*, 839 F.3d 163, 166 (2d Cir. 2016) (quoting *Amnesty Am. v. Town of W. Hartford*, 361 F.3d 113, 122 (2d Cir. 2004)). "[W]here the evidence is such that a reasonable jury could decide in the nonmovant's favor," a genuine dispute exists. *Delaney v. Bank of Am. Corp.*, 766 F.3d 163, 167 (2d Cir. 2014); *see also Chandok v. Klessig*, 648 F. Supp. 2d 449, 456 (N.D.N.Y. 2009), *aff'd*, 632 F.3d 803 (2d Cir. 2011) ("If there is more than one reasonable inference, the matter must go to a jury.").

ARGUMENT

I. A Genuine Dispute Exists as to Whether Morgan Stanley's Policies Caused the Origination of Plaintiffs' Predatory and Discriminatory Loans.

A. Causation is a Question of Fact for the Jury.

"Causation [in an FHA case] is an intensely factual question that should typically be resolved by a jury." *Pac. Shores Props., LLC v. City of Newport Beach*, 730 F.3d 1142, 1168 (9th Cir. 2013) (citations omitted); *see also Prendergast v. Analog Modules, Inc.*, No. 08 CIV. 6891 WHP, 2011 WL 3962598, at *3 (S.D.N.Y. Sept. 2, 2011), *aff'd*, 503 F. App'x 49 (2d Cir. 2012) ("[C]ausation is typically a fact-intensive inquiry not suitable for summary judgment.").

For standing purposes, Plaintiffs need not demonstrate that "'the defendant's actions [were] the very last step in the chain of causation' to demonstrate that the defendant's actions caused the claimed injury." Opinion & Order, ECF No. 47 ("MTD Decision") at 5 (quoting *Carver v. City of N.Y.*, 621 F.3d 221, 226 (2d Cir. 2010) (alteration in original). Instead, "causation is shown 'if the defendants' actions had a 'determinative or coercive effect' on the action that produced the injury.'" *Id.* (quoting *Carver*, 621 F.3d at 226). As *Carver* explains, causation therefore "turns on *the degree to which* the defendant's actions constrained or influenced the decision of the final actor in the chain of causation." 621 F.3d at 226 (emphasis added). This factual line-drawing exercise is particularly appropriate for the jury. *See Beaulialice v. Fed. Home Loan Mortg. Corp.*, No. 8:04-CV-2316-T-24-EA, 2007 WL 744646, at *7-8 (M.D. Fla. Mar. 6, 2007) (in FHA disparate impact case, although court was skeptical of plaintiff's evidence that third-party policy caused discriminatory origination of her mortgage loan, genuine issue for trial existed as to whether policy had a determinative or coercive effect).

Actual cause is similarly a question for the jury. FHA plaintiffs "can demonstrate causation by proving that the defendant's wrongful conduct was a 'substantial factor' in bringing about the harm in question." *Pac. Shores Props.*, 730 F.3d at 1168 (quoting Restatement (Second) of Torts § 431(a) (1965)). The jury determines, "in any case in which it may reasonably differ on the issue, whether the defendant's conduct has been a substantial factor in causing the harm to the plaintiff." *Id.* at § 434(2) (1965).

In holding conclusively that disparate impact claims are cognizable under the FHA, the Supreme Court recently noted that "a disparate-impact claim that relies on a statistical disparity must fail if the plaintiff cannot point to a defendant's policy or policies causing that disparity." *Texas Dep't of Hous. & Cmty. Affairs v. Inclusive Cmtys. Project, Inc.*, 135 S. Ct. 2507, 2523

(2015). Plaintiffs here have pointed to these policies in great detail, meeting this "robust causality requirement." *Id.* The Court also affirmed that this causality requirement "protects defendants from being held liable for racial disparities they did not create," *id.*, but this statement points back to the fact-intensive question of when a defendant can be said to have created the racial disparity in question—a question appropriate for the jury. Moreover, *Inclusive Communities* does not represent a change in the standard of proof; the Court had granted certiorari solely to determine whether disparate-impact claims are cognizable under the FHA, and it explicitly declined to grant certiorari on the question of "what . . . standards and burdens of proof . . . should apply" if disparate-impact claims are cognizable, although the petitioner sought review of that question. Petition for a Writ of Certiorari, 2014 WL 1989121, at *i; 135 S. Ct. 46 (2014) (noting that grant was "limited to Question 1"). *See also United States v. Oakland Cannabis Buyers' Co-op.*, 532 U.S. 483, 499 (2001) (Stevens, J., concurring) (distinguishing "broad dicta" and noting that Court's "confined holding is consistent with our grant of certiorari, which was limited to the question" on which certiorari had been granted).

B. <u>A Reasonable Jury Could Find That Morgan Stanley Caused the Issuance of the Plaintiffs' Loans on Discriminatory Terms.</u>

There is a genuine issue of material fact as to whether Morgan Stanley's loan purchasing policies had a "determinative or coercive" effect on New Century's issuance of the Plaintiffs' loans on discriminatory terms, that is, "the degree to which the defendant's actions constrained or influenced the decision of the final actor in the chain of causation." *Carver*, 621 F.3d, at 226. Similarly, with respect to cause in fact, there is a genuine issue as to whether Morgan Stanley's conduct was a "substantial factor" leading to the issuance of the Plaintiffs' discriminatory loans. *Pac. Shores Props.*, 730 F.3d at 1168.

Plaintiffs have provided evidence sufficient to create a genuine dispute as to whether Morgan Stanley caused the origination of Plaintiffs' discriminatory loans. New Century made clear, contemporaneously and with testimony in this case, that it originated the mortgage loans that its Wall Street purchasers wanted to acquire. CSOF ¶¶ 217-225.[2] Morgan Stanley was New Century's largest and most consistent Wall Street partner, both in terms of purchasing loans and providing warehouse credit to originate loans. *Id.* ¶¶ 194; 50-56. Around the time that each Plaintiff's loan was originated, Morgan Stanley entered into forward trade agreements with New Century which obligated New Century to originate and sell loans to Morgan Stanley, and the bid terms governing these trades required New Century to keep interest rates up, to focus on adjustable-rate loans, and to originate large numbers of loans with prepayment penalties. *Id.* ¶¶ 285-286; 289; 293; 296; 299. Mr. Young's mortgage loan and Ms. McCoy's mortgage loan were collateral on Morgan Stanley's warehouse line of credit to New Century, *id.* ¶¶ 300, 304, and Morgan Stanley purchased and securitized Ms. Pettway's loan, *id.* ¶¶ 96, 192, 193.

In light of this documentary evidence, which itself could allow a reasonable jury to find that Morgan Stanley caused the loans to issue, expert testimony is not necessary to create a genuine dispute as to whether Morgan Stanley played a causal role in the issuance of Plaintiffs' loans. This Court has already noted that "'factual testimony about matters that require[] no specialized knowledge' is not the province of experts." Class. Cert. Op. at 48 (quoting *United States v. Mejia*, 545 F.3d 179, 196 (2d Cir. 2008)). And "the general rule is that expert testimony is not necessary to prove causation 'if all the primary facts can be accurately and intelligibly described to the jury.'" *Cyrus v. Town of Mukwonago*, 624 F.3d 856, 864 (7th Cir. 2010)

[2] Morgan Stanley argues that New Century witnesses "unanimously" rejected the notion that Morgan Stanley exercised control over New Century's lending. Br. at 21. Their selective quotation is misleading with respect to the testimony of these witnesses. *See* CSOF ¶¶ 59, 76. New Century witnesses confirmed that "Wall Street" was heavily involved in the relevant decisions, and that Morgan Stanley was a component of Wall Street. *Id.* ¶¶ 217-225.

(quoting *Salem v. U.S. Lines Co*., 370 U.S. 31, 35 (1962)). This rule applies even in contexts, like antitrust, involving complicated markets and multiple actors: there, "expert testimony is not required, but in its absence a plaintiff must show by other evidence sufficient facts from which a jury could infer market share, market power, relevant market," etc. *Lantec, Inc. v. Novell, Inc.*, 146 F. Supp. 2d 1140, 1148 (D. Utah 2001), *aff'd*, 306 F.3d 1003 (10th Cir. 2002); *see also Gen. Indus. Corp. v. Hartz Mountain Corp*., 810 F.2d 795, 806 (8th Cir. 1987). Plaintiffs proffer sufficient facts here, creating a genuine dispute. *See Castaldi v. Land Rover N. Am., Inc*., No. 06-CV-1008JGKAM, 2007 WL 4165283, at *10 (E.D.N.Y. Nov. 21, 2007) ("It is not necessary that any particular element of a prima facie case be proved by expert testimony, only that each element be proved by admissible evidence.").[3]

Morgan Stanley relies substantially on the notion that, because other banks bought New Century loans (albeit fewer) and issued New Century warehouse lines of credit (albeit less), Morgan Stanley cannot possibly be found to have caused the origination of Plaintiffs' loans. But the Supreme Court has recently stated that "[i]t would be anomalous to turn away a person harmed by the combined acts of many wrongdoers simply because none of those wrongdoers alone caused the harm and nonsensical to adopt a rule whereby individuals hurt by the combined wrongful acts of many . . . would have no redress, while those hurt by the acts of one person

[3] Morgan Stanley cites two cases to support its claim that expert evidence is required to demonstrate causation here, Br. at 21-22, but both discuss the need for medical expert testimony to demonstrate the relationship between prolonged exposure to chemicals and subsequent health effects—a relationship involving complex biological science that lay jurors could not intuit. *Wills v. Amerada Hess Corp.*, 379 F.3d 32, 46 (2d Cir. 2004) (expert testimony necessary to prove "toxins emitted from defendants' vessels caused decedent's cancer"); *Matarese v. Archstone Pentagon City,* 761 F. Supp. 2d 346, 365 (E.D. Va. 2011) (whether proposed accommodation would "ameliorate the effects allegedly caused by certain chemicals to the degree necessary to afford [FHA plaintiff alleging disability discrimination] equal opportunity in housing . . . is not within the knowledge of a layperson"). Business relationships such as those at issue in this case do not create the same need for expert testimony. *Cf. Faryniarz v. Nike, Inc*., No. 00 CIV. 2623 (NRB), 2002 WL 530997, at *2 (S.D.N.Y. Apr. 8, 2002) (distinguishing cases requiring medical expert evidence to demonstrate causation from design defect case, where expert evidence is not required).

alone would." *Paroline v. United States*, 134 S. Ct. 1710, 1724 (2014).[4] The Court offered an example: when three people lean on a car and their combined force rolls it off of a cliff, each individual is the factual cause of the car's destruction even if, acting alone, she did not exert enough force to have moved it. *Id.* at 1723-24. So here: that other banks contributed some additional force to the demands that Morgan Stanley placed on New Century cannot mean, as a matter of law, that Morgan Stanley did not cause the issuance of Plaintiffs' loans.

Morgan Stanley is also wrong to assert that a reasonable jury could not infer cause with respect to any of the five Plaintiffs loans for reasons specific to each individual. With respect to Ms. Williams, Morgan Stanley has misleadingly asserted that her loan was originated during a "six-month period" in which Morgan Stanley purchased no New Century loans. While it may be true that no forward trades *closed* during that period of time, Morgan Stanley entered into a forward agreement to purchase New Century loans in May 2005, shortly after Ms. Williams' loan was originated and two months before the end of the six months Morgan Stanley describes. CSOF ¶¶ 93, 292. As discussions of the trade began, the head of Morgan Stanley's trading desk wrote that "with the amount of loans that [New Century's head of secondary marketing] needs to sell I think he realizes that he is going to need our liquidity." *Id.* ¶ 291. By its terms, the pool could include loans originated on the date Ms. Williams' loan was originated. *Id.* at ¶ 293.

With respect to Plaintiffs Adkins, McCoy, and Young, Morgan Stanley argues that because its due diligence process happened to catch their loans, Morgan Stanley cannot be said to have had a causal role in their origination. Br. at 25-26. But when New Century originated a loan, it did not know which of its purchasers would acquire it. CSOF ¶ 33. As a result, the extent

[4] "[G]eneral tort principles" apply to an FHA action, *Anderson Grp., LLC v. City of Saratoga Springs*, 805 F.3d 34, 52 (2d Cir. 2015) (citing *Meyer v. Holley*, 537 U.S. 280, 285 (2003), and *Paroline* makes clear that it is those principles that require "that alternative and less demanding causal standards are necessary in certain circumstances" to vindicate the purposes of a statute. *Paroline*, 134 S. Ct. at 1724.

to which Morgan Stanley caused the origination of a particular loan does not depend on whether Morgan Stanley ultimately purchased it. It is the extent to which New Century was obligated to Morgan Stanley for originating loans like the Plaintiffs' at the time they were originated, against the backdrop of the broader relationship, that is significant here—and forward agreements applied on the dates that all three of these Plaintiffs' loans were originated. *See* Statement of Facts, Section IV, *supra*. Moreover, if Morgan Stanley's post-origination behavior is relevant to assessing its liability, a genuine dispute exists with respect to Ms. McCoy and Mr. Young, whose loans served as collateral securing Morgan Stanley's warehouse credit line to New Century.

Morgan Stanley argues that it cannot have been a cause in fact of Ms. Pettway's loan because it was an adjustable-rate mortgage, and New Century had originated adjustable rate mortgages beginning before the period of time on which discovery in this case has focused. Br. at 26. But at the moment when New Century originated Ms. Pettway's loan, it owed Morgan Stanley a pool of loans composed of 70% adjustable rate mortgages. *See* CSOF ¶ 289. A genuine dispute exists on this point.[5] Moreover, that the origination of Ms. Pettway's loan involved mortgage brokers changes nothing. *Cf. Heights Cmty. Cong. v. Hilltop Realty, Inc.*, 774 F.2d 135, 141 (6th Cir. 1985) (argument that real estate brokers are independent contractors, defeating liability for their acts, "has consistently been rejected in Fair Housing Act cases"). New Century originated the loan while contractually obligated to Morgan Stanley to produce loans like it, and

[5] Morgan Stanley relies on language from a Sixth Circuit decision upholding the determination that proximate cause was absent in a public nuisance action where secondary market actors were alleged to have caused foreclosures that led to increased expenditures for the plaintiff city in maintaining safety in those neighborhoods, and property tax losses. Br. at 26-27 (citing *City of Cleveland v. Ameriquest Mortg. Sec., Inc.*, 615 F.3d 496, 504-05 (6th Cir. 2010)). This out-of-circuit case does not involve causation under the Fair Housing Act, and the claim here is solely that the secondary market actor caused the origination of loans.

Morgan Stanley has provided no evidence that Ms. Pettway's brokers requested particular loan features or tacked on fees that elevated her interest rate.

II. A Reasonable Jury Could Find that Plaintiffs Experienced an Adverse Impact.

Morgan Stanley is wrong to contend that Plaintiffs' expert does not properly identify a disparate and adverse impact. To establish a prima facie case of disparate impact discrimination under the FHA, a plaintiff must show "(1) the occurrence of certain outwardly neutral practices, and (2) a significantly adverse or disproportionate impact on persons of a particular type produced by the defendant's facially neutral acts or practices." *Mhany Mgmt., Inc. v. Cty. of Nassau*, 819 F.3d 581, 617 (2d Cir. 2016) (citations omitted); *see also* 24 C.F.R. § 100.500 (practice has a prohibited discriminatory effect "where it actually or predictably results in a disparate impact on a group of persons . . . because of race" and no legally sufficient justification for the practice exists). With respect to the impact, the question is whether a group of individuals in a protected class was subject to an adverse impact—*i.e.*, a bad outcome—at a rate that is different from similarly situated individuals who are not in the protected class. *See Inclusive Cmtys.*, 135 S. Ct. at 2525. Prof. Ayres shows such a disparate impact upon Plaintiffs.

A. Plaintiffs Proffer Sufficient Evidence for a Jury to Find That the Kind of Loans They Received Were Harmful.

Morgan Stanley's burden here is to show that *no reasonable jury could find* based on Prof. Ayres' analysis that African-Americans were more likely to receive harmful loans than were their similarly-situated white counterparts. Morgan Stanley does not meet its burden because, in addition to being harmful as a result of layered risks, each CRL is a high-cost loan, and the harmful high-cost feature was itself distributed on a discriminatory basis. Under these

circumstances, a reasonable jury could certainly find that the kinds of loans that Plaintiffs received on a discriminatory basis were harmful.[6]

CRLs are a subset of high-cost loans—those high-cost loans with two or more additional risk features. CSOF ¶ 274. Plaintiffs define a "high-cost" loan the same way that the federal government does in regulations implementing HMDA, namely, a loan whose APR is 3.0% or more above the prime rate. *See id.* ¶¶ 274, 307. Borrowing at a higher interest rate means paying more overall to borrow money and more each month to stay current on a mortgage; more expensive loans increase the risk of default and foreclosure, as this Court noted without qualification in its class certification opinion. *Id.* ¶ 278. African-Americans were more likely to receive high-cost loans than similarly creditworthy non-Hispanic whites. *Id.* ¶ 279. Prof. Ayres controlled for all appropriate loan and borrower characteristics to reach this conclusion. *Id.* ¶ 308. Thus, the high-cost feature alone puts it beyond question that, for each plaintiff, receipt of a CRL constitutes a discrimination harm.

Plaintiffs recognize that this Court has expressed some doubt as to whether each CRL feature is adverse in all circumstances, Opinion & Order, ECF No. 230 ("Class Cert. Op.") at 38-40, but respectfully submit that the determination of whether receipt of a Combined-Risk Loan with a discriminatory high-cost feature constitutes a harm is nonetheless a question for the jury. *See Burlington N. & Santa Fe Ry. Co. v. White*, 548 U.S. 53, 71 (2006) (it is for a jury to decide whether, "from the perspective of a reasonable person," a particular action is "adverse"). A jury could certainly conclude that receiving a CRL was harmful because higher interest rates made

[6] Notably, Morgan Stanley does not contest that African-Americans were more likely than non-Hispanic whites to receive the allegedly harmful loans in question, however defined; that an increased risk of default is a cognizable harm; or that the injury happens at the time of origination, not the time of default. It cannot now make these arguments. *See Estate of Ungar v. Palestinian Auth.*, 451 F. Supp. 2d 607, 611 (S.D.N.Y. 2006) ("[A]s a general rule, courts will not consider arguments raised for the first time in a reply brief").

these loans more likely to default than other loans. *See* CSOF ¶ 278.[7] Indeed, Morgan Stanley's own expert found that CRLs were more than twice as likely to go delinquent as loans that did not meet that definition. *Id.* ¶¶ 309-310. Given the increased risk posed by elevated interest rates, the possibility that one of the additional risk factors *sometimes* does not further raise the risk of default does not change the fact that receipt of a CRL raises the risk of default. Even if some CRL features might "offset" each other in some circumstances, Br. at 29, Morgan Stanley has not pointed to any scenario in which the inclusion of these features would offset the increased risk of an elevated interest rate—nor could it.

This Court has not concluded that no jury could find receiving a Combined-Risk loan to be harmful. *Cf.* Br. at 28 (citing Class Cert. Op. at 24, 28-30). The Court's prior analysis did not focus on the high-risk feature common to each Combined-Risk Loan, which it noted without qualification would increase the risk of default. Class Cert. Op. at 11. As important, "the determination as to a Rule 23 requirement is made only for purposes of class certification and is not binding on the trier of facts, even if that trier is the class certification judge." *In re Initial Pub. Offerings Sec. Litig*., 471 F.3d 24, 41 (2d Cir. 2006); *see also Chandok*, 648 F. Supp. 2d at 456, *aff'd*, 632 F.3d 803 (2d Cir. 2011) ("If there is more than one reasonable inference, the matter must go to a jury.").

Morgan Stanley contends that Plaintiffs may not "shift theories" to assert a disparate impact based on the receipt of high-cost loans. Br. at 33-34 n.9. Plaintiffs are doing nothing of the kind. The high-cost feature has been the core shared feature of all CRLs since this suit's

[7] Morgan Stanley cites *Aliotta v. Bair*, 614 F.3d 556 (D.C. Cir. 2010), Br. at 30, which makes clear that an action must be adverse to have a prohibited disparate impact. Plaintiffs agree, and have presented evidence from which a jury could conclude that they received harmful, discriminatory loans. As a result, *B.C. v. Mt. Vernon Sch. Dist.*, 837 F.3d 152 (2d Cir. 2016) is inapposite; there, the court merely upheld a ruling that a disparate impact on students with disabilities under the IDEA was not proven by disparate impact on students with disabilities recognized under the ADA, which defines them differently.

inception, *see* CSOF ¶ 274, and it was part of the record on class certification.[8] Morgan Stanley then contends, without support, that it would be improper to measure a disparate impact based on the frequency of interest rates qualifying as high-cost rather than based on analyzing average interest rates. Br. at 33-34 n.9. But the fact that some discrimination plaintiffs have adopted that latter approach says nothing about whether a jury could find a harmful disparate impact based on the former approach. Furthermore, it makes little sense to contend that there is no evidence of discrimination where equally creditworthy African-American borrowers were more likely to get high-cost loans than were their white counterparts.

B. Plaintiffs' Causation Evidence is Not Contained Within Prof. Ayres' Opinion, Which Analyzes How Harmful Loans Were Ultimately Allocated.

Morgan Stanley criticizes the opinion of Prof. Ayres at some length based on his failure to detail a causal relationship between Morgan Stanley's policies and the loans that Plaintiffs and others ultimately received. This criticism is misguided. As this Court has already recognized, "the Ayres Report focuses on the disparate impact of the Combined-Risk loans that New Century made," and causality is "unrelated to the subject of Ayres' study." Class Cert. Op. at 49. A jury could find that Morgan Stanley *caused* Plaintiffs and others to receive loans with certain features because Plaintiffs proffer *other* evidence of causation, evidence that is in no way contained in Professor Ayres' report. *See* Section I.B., *supra.*

Combining qualitative evidence of this kind with quantitative evidence like that contained in Prof. Ayres' report is typical in discrimination cases. *See, e.g.*, *Bazemore v. Friday*, 478 U.S. 385, 400 (1986) (holding that whether regression analysis demonstrates discrimination

[8] *Cf. Family Dollar Stores, Inc. v. United Fabrics Int'l, Inc.*, 896 F. Supp. 2d 223, 235 (S.D.N.Y. 2012) (plaintiff prohibited from asserting a new cause of action in a summary judgment opposition) (cited at Br. 33-34 n.9).

depends "on the factual context of each case in light of all the evidence presented by both the plaintiff and the defendant"); *Adams v. Ameritech Servs., Inc*., 231 F.3d 414, 427-28 (7th Cir. 2000) (reversing summary judgment in disparate impact case and noting that, when statistical analysis proved part of the case, "the other items of evidence, if believed by a jury, could have done the rest of the job"). A reasonable jury could certainly find causality to be demonstrated by the totality of Plaintiffs' factual evidence and the ultimate disparate impact to be proven by Prof. Ayres' multivariate regression analysis. *See Phillips v. Cohen*, 400 F.3d 388, 401 (6th Cir. 2005) ("[E]xpert statistical evidence in disparate impact cases is not to be considered in a vacuum . . . it must be considered 'in light of all the evidence in the record.'") (quoting *Bazemore*, 478 U.S. at 401).[9]

Morgan Stanley also argues that Prof. Ayres "did not account for [some] factors" that Morgan Stanley believes he ought to have included because the Court identified them as relevant to the question of causality. Br. at 32. But a party challenging expert testimony based on omitted variables must show how those variables would alter the analysis, *Sobel v. Yeshiva Univ.*, 839 F.2d 18, 34 (2d Cir. 1988), and Morgan Stanley has made no attempt at such a showing.

III. Plaintiffs' Claims Are Timely Under the Discovery Rule.

That a discovery rule applies to Plaintiffs' claims is the law of the case, and genuine disputes exist as to when Plaintiffs knew or could have known "that Morgan Stanley's policies were discriminatory" more than two years before they filed this action. MTD Decision at 7-8.

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[9] *Robinson v. Metro-N. Commuter R.R. Co*., 267 F.3d 147, 160 (2d Cir. 2001), quoted by Morgan Stanley, Br. at 32, does not discuss the question of how expert testimony interacts with other evidence of causation. Neither does *Cinnamon Hills Youth Crisis Ctr., Inc. v. Saint George City*, 685 F.3d 917, 922 (10th Cir. 2012) (cited at Br. at 32), engage with this issue; that case addresses a situation in which the plaintiff proffered "no formal statistics or other evidence" to show a disparate impact.

A. The Discovery Rule Applies Here.

Morgan Stanley suggests that this Court should "reconsider" Judge Baer's holding that a discovery rule applies to Plaintiffs' FHA claims because they believe it to be "legally erroneous." Br. 12, 14. Morgan Stanley has invented this legal standard out of whole cloth, ignoring the law of the case doctrine. While "[a] court has the power to revisit prior decisions of its own or of a coordinate court in any circumstance, . . . as a rule courts should be loathe to do so in the absence of *extraordinary circumstances*." *Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 817 (1988) (emphasis added); *see also N. River Ins. Co. v. Phila. Reinsurance Corp.*, 63 F.3d 160, 164-65 (2d Cir. 1995) (citing *Christianson* language). In the Second Circuit, "[t]he major grounds justifying reconsideration are 'an intervening change of controlling law, the availability of new evidence, or the need to correct a clear error or prevent manifest injustice.'" *DiLaura v. Power Auth. of State of N.Y.*, 982 F.2d 73, 76 (2d Cir. 1992) (quoting *Virgin Atl. Airways v. National Mediation Bd.*, 956 F.2d 1245, 1255 (2d Cir. 1992). Morgan Stanley makes no attempt to meet this stringent standard, and its attempt to relitigate this issue must therefore be denied.[10]

Morgan Stanley's argument that this Court should abandon Judge Baer's discovery rule holding is especially misplaced given that Morgan Stanley made precisely these arguments to Judge Baer more than once, ECF No. 37, at 9-11; ECF No. 43, at 1-2, and Judge Baer considered and rejected them. Judge Baer found that a discovery rule applied under the FHA in several pages of his well-reasoned decision on Morgan Stanley's Motion to Dismiss. MTD Decision 6-8.

[10] Morgan Stanley could not meet the standard. It cites no intervening change in Second Circuit law, and new evidence would not be relevant to the assessment of this question of law. While Morgan Stanley might attempt to argue that discarding Judge Baer's decision would correct a clear error or prevent manifest injustice, that is extremely unlikely here, given that district courts in the Second Circuit addressing the question have reached the same conclusion in other cases. *See, e.g., Saint-Jean v. Emigrant Mortg. Co.*, 50 F. Supp. 3d 300, 315 (E.D.N.Y. 2014); *Clement v. United Homes, LLC*, 914 F. Supp. 2d 362, 371 (E.D.N.Y. 2012).

Morgan Stanley nonetheless repeated its argument that no discovery rule applied when it sought interlocutory review of that decision, citing exactly these cases, *compare* ECF No. 49, 11-12 *with* Br. at 12-14, and Judge Baer rejected them again, Mem. Order, ECF No. 67 at 2-3. To gloss over these multiple pages of reasoning in two separate decisions, Br. at 20, is to do Judge Baer and his careful consideration of the parties' claims a great disservice. *Cf. DiLaura*, 982 F.2d at 77 (approving successor judge's reconsideration given "preliminary and summary nature of [first] ruling" and that issue in question "was not directly before" original judge). Should this Court opt nonetheless to engage with the substance of Morgan Stanley's attempt to disrupt Judge Baer's holdings, Plaintiffs incorporate by reference their prior arguments on this point. ECF No. 42, at 19-21; ECF No. 56, at 14-18.

B. A Genuine Dispute Exists as to When Plaintiffs Could Have Discovered Facts Sufficient to Survive A Motion to Dismiss this Claim.

Morgan Stanley asserts that, even under a discovery rule, Plaintiffs' claims should be barred because facts on the public record more than two years prior to the filing of this action could have allowed Plaintiffs to discover their claims. For statute of limitations purposes, a fact is not deemed discovered until a reasonably diligent plaintiff could "plead that fact with sufficient detail and particularity to survive a 12(b)(6) motion to dismiss." *City of Pontiac Gen. Employees' Ret. Sys. v. MBIA, Inc.*, 637 F.3d 169, 175 (2d Cir. 2011); *see also Saint-Jean v. Emigrant Mortg. Co*., 50 F. Supp. 3d 300, 315 (E.D.N.Y. 2014) (applying *Pontiac* standard to disparate impact FHA claim).

As with any statute of limitations defense, disputed issues of fact "must be submitted to the jury." *Katz v. Goodyear Tire & Rubber Co*., 737 F.2d 238, 242 n.2 (2d Cir. 1984); *see also Bano v. Union Carbide Corp.*, 361 F.3d 696, 712 (2d Cir. 2004) ("The existence of material factual disputes concerning [application of diligence-discovery rule] precludes summary

dismissal of the action."). Judge Baer held that "while certain underlying facts related to this action were made publicly available over time, whether this public knowledge may be imputed to Plaintiffs to render their claims 'discovered' is a question of fact" that would need to be answered by the trier of fact. MTD Decision at 8. Because disputed factual issues related to this question remain, it cannot be resolved on summary judgment.

Most important, Morgan Stanley's argument on this point completely ignores the standard it cites. The discovery rule delays the accrual of a claim until a plaintiff should have discovered the "critical facts of *both his injury and its cause*." Br. at 14 (citing *Kronisch v. United States*, 150 F.3d 112, 121 (2d Cir. 1998)) (emphasis added). The injury alleged by Plaintiffs here is discrimination on the basis of their race. With respect to four of the five Plaintiffs, Morgan Stanley makes no argument, and provides no facts whatsoever, demonstrating when it believes they should, with reasonable diligence, have discovered that they had been victims of discrimination (Morgan Stanley's arguments with respect to the fifth Plaintiff, Rebecca Pettway, are wrong for reasons explained below). All of Morgan Stanley's facts about which documents were on the public record at which point in time are not relevant unless and until they are connected to a moment at which a particular plaintiff, having become aware of his injury and its cause, could have "protect[ed] himself by seeking legal advice." *Kronisch*, 150 F.3d at 121 (quoting *Guccione v. United States*, 670 F.Supp. 527, 536 (S.D.N.Y.1987)). Because Morgan Stanley provides no evidence, nor even an argument, about this moment for four of the five plaintiffs, the argument must fail with respect to those Plaintiffs.

Morgan Stanley also ignores the nature of the injury in a discrimination suit. As Judge Baer recognized, "[t]here is a difference between being aware that you got a bad deal and being aware that you were discriminated against in a systematic fashion." MTD Decision at 8 (quoting

Phillips v. Better Homes Depot, Inc., No. 02-CV-1168 (ERK), 2003 WL 25867736, at *25 (E.D.N.Y. Nov. 12, 2003). Since that decision, the Eastern District of New York has once again recognized that a complex mortgage discrimination scheme "would be invisible to individual borrowers and sufficiently sophisticated to require . . . the understanding of counsel experienced in discrimination litigation, to appreciate and explain the discriminatory conduct." *Saint-Jean*, 50 F. Supp. 3d at 316. Accordingly, the notion that the "accrual date commences when Plaintiffs met with counsel and understood they were victims of a discriminatory lending scheme is credible and consistent with authority in this circuit." *Id.*; *see also Council v. Better Homes Depot, Inc.*, No. 04 Civ. 5620, 2006 WL 2376381, at *10 (E.D.N.Y. Aug. 16, 2006) ("In matters of fraud and discrimination, including predatory lending cases, plaintiffs are deemed to be aware of their right of action from the point at which they met with counsel.").[11]

Finally, while some materials that Plaintiffs cite in their Complaint were publically available before October 2010, Morgan Stanley is wrong to assert that there is no genuine issue of fact as to whether 2011 materials were necessary to plead their cause of action. Morgan Stanley contends that the allegations in Plaintiffs' Complaint supported by materials made public in 2011 were merely "duplicative" of earlier sources. Br. at 16. Far from it. Morgan Stanley artfully omits that many of these allegations relied on statements of confidential witnesses made public for the first time in a 2011 filing. *See* CSOF ¶¶ 169, 171, 173, 178. Morgan Stanley would be hard-pressed to argue that, as a matter of law, "the detail and particularity" in these allegations was not necessary for Plaintiffs to survive a motion to dismiss, *see City of Pontiac*, 637 F.3d at

[11] Morgan Stanley's quotation of *A.Q.C. ex rel. Castillo v. United States*, suggesting that such a rule cannot apply, is deeply misleading. Br. at 15 (quoting 656 F.3d 135, 141 (2d Cir. 2011)). In that case, it was clear that the plaintiff in the medical malpractice action "knew the critical facts of her daughter's injury at or near the time of her birth," 656 F.3d at 140, and the court rejected the argument that she could not have suspected the cause of the injury until after she retained counsel, id. at 141-42. *Castillo* is straightforwardly inapposite to this discrimination action.

175, as Judge Baer explicitly cited them in allowing Plaintiffs' FHA claim to proceed. *See* CSOF ¶ 178; MTD Decision at 12 (quoting allegations from confidential witnesses as exclusive support for statement that "Morgan Stanley's policies set the terms and conditions on which it would purchase loans from New Century"). Finally, with respect to the earlier-filed securities litigations that Morgan Stanley mentions, it is not the case that "reasonable diligence will in all circumstances result in discovery of any lawsuit." *Cohen v. S.A.C. Trading Corp.*, 711 F.3d 353, 363 (2d Cir. 2013). Here, where Morgan Stanley has not provided any facts demonstrating that the two 2008 filings it cites received significant publicity, *see id.*, or that otherwise meet the *Cohen* standard as to when reasonable diligence would have revealed these cases, their mention does not aid Morgan Stanley's argument. *See* CSOF ¶¶ 181-85.

C. A Genuine Dispute Exists as to Whether Ms. Pettway Could Have Discovered the Facts of Her Injury and Its Cause before October 2010.

This Court has noted that whether public knowledge may be imputed to Plaintiff to render her claims discovered is a question of fact. MTD Decision at 8. For purposes of the discovery rule, it is Second Circuit law that "[o]nly after a plaintiff can adequately plead his claim can that claim be said to have accrued, and only after a claim has accrued can the statute of limitations on that claim begin to run." *City of Pontiac*, 637 F.3d at 175. Given any mortgagor's relative lack of sophistication with respect to the complex financial transaction at issue in this case, Morgan Stanley fails to demonstrate that no genuine issue of fact exists as to whether Plaintiff Pettway knew about her injury and its cause, or whether a reasonable person in her shoes would have been put on inquiry notice of the injury before October 2010. *See Thompson v. Metro. Life Ins. Co.*, 149 F. Supp. 2d 38, 48 (S.D.N.Y. 2001).

Morgan Stanley seems to contend that Ms. Pettway, having suspected that her mortgage brokers had targeted her because of her race and gender, CSOF ¶ 189, would with reasonable

diligence have discovered the injury at issue here and its cause when the assignment of her mortgage to the securitization trust was recorded with the Wayne County Register of Deeds." CSOF ¶ 192.[12] This claim is specious for several reasons. First, inquiry notice is not triggered by "unfounded suspicions," such as those Ms. Pettway had about her mortgage brokers, and when the record includes no fact known to the Plaintiff at the time that would support the suspicion, a duty to investigate cannot be said to have arisen. *Cohen*, 711 F.3d at 363; *see also id.* (even where hindsight shows that a claim "*could* have been discovered, that fact does not support the conclusion that, on reasonable inquiry, the [claim] *would* have been discovered"). Second, Morgan Stanley's argument suggests that Ms. Pettway, having received a loan she believed might be discriminatory in 2004, and which, in fact, was purchased by Morgan Stanley that year, CSOF ¶ 96, ought to have been monitoring the Register of Deeds nearly six years later in case a clue to the discrimination was recorded there (Morgan Stanley has provided no evidence that the filing received publicity. *Cf. Cohen*, 711 F.3d at 363). For that reason, the fact that Ms. Pettway was represented by bankruptcy counsel at that time, Br. at 17, is irrelevant. Moreover, the retainer in that bankruptcy matter specifically excluded representation for matters outside the bankruptcy, and it is unreasonable to pretend that Ms. Pettway's counsel should have been seeking to investigate a claim of mortgage discrimination. *See id.* at ¶ 193; *see also Council*, 2003 WL 25867736, at *25 (statute of limitations did not begin to run when plaintiff met with a lawyer who did not investigate discrimination).

Courts in this circuit have held that when plaintiffs allege a discrimination scheme "sufficiently sophisticated to require the development of a critical mass of cases involving

[12] Although Ms. Pettway remembered seeing newspaper articles about women and minorities being subject to higher interest rates in earlier years, those articles did not give her actual knowledge of her legal injury or its cause. *See* CSOF ¶¶ 188, 190, 191. In fact, none of the articles so much as mentioned either New Century or Morgan Stanley.

[similar] circumstances, as well as the understanding of counsel experienced in discrimination litigation, to appreciate and explain the discriminatory conduct," their claims do not accrue until they have met with such experienced counsel. *Saint-Jean*, 50 F. Supp. 3d at 316. Morgan Stanley has not proffered evidence that would preclude a reasonable jury from finding that Ms. Pettway's claims accrued at such a moment.

IV. The FHA Does Not Foreclose the Claims of Plaintiffs Whose Loans Morgan Stanley Did Not Ultimately Purchase.

Morgan Stanley argues that the claims of the four plaintiffs whose mortgages Morgan Stanley did not purchase fail under the FHA as a "matter of law," regardless of whether a genuine dispute exists as to whether Morgan Stanley caused the origination of their loans. Br. at 17. This argument is foreclosed by Judge Baer's opinions in this case, and in making it, Morgan Stanley completely ignores the law of the case doctrine with its "extraordinary circumstances" standard. *Christianson*, 486 U.S. at 817; *see* Section III.A, *supra*.

Judge Baer made clear that the FHA, far from foreclosing claims by plaintiffs whose loans had not been purchased by Morgan Stanley as a matter of law, would allow for such claims depending upon the facts that emerged during the course of discovery.[13] His decision on Morgan Stanley's Motion to Dismiss held that "whether Morgan Stanley ultimately purchased all of the toxic loans that New Century issued is not relevant at the pleading stage." MTD Decision at 12. After Morgan Stanley sought certification for interlocutory review of, among other things, "whether mortgage loan purchasers can be liable under the FHA for discrimination in the terms and conditions of loans that they did not purchase," Judge Baer put a finer point on it, holding that "whether Defendants' policies resulted in a disparate impact even with regard to loans they

[13] This Court's Opinion & Order denying Plaintiffs' motion for class certification "expresses no view" on whether Morgan Stanley could be liable under the FHA for loans that it did not purchase. Class Cert. Op., at 36 n. 26.

did not purchase cannot be resolved without a detailed review of the record." Mem. Order, ECF No. 67, at 1, 4. Judge Baer's decisions are, moreover, the only judicial opinions addressing the question of whether a secondary market purchaser of mortgage loans can be liable for the discriminatory impact of its purchasing business, regardless of whether that secondary market actor ultimately purchased the particular loan in question.[14]

It is not Judge Baer's two earlier holdings in this case, however, that render Morgan Stanley's cramped reading of the FHA untenable. Courts are clear that the FHA merits a "generous construction" and that its terms are "broad and inclusive." *Mazzocchi v. Windsor Owners Corp.*,__F. Supp. 3d__, __, 2016 WL 4542035, at *13 (S.D.N.Y. Aug. 31, 2016) (quoting *Trafficante v. Metropolitan Life*, 409 U.S. 205, 209, 212, (1972)); *see also Hack v. President & Fellows of Yale College*, 237 F.3d 81, 87 (2d Cir. 2000). For example, courts interpret the language in 42 U.S.C. § 3604 that prohibits practices that "otherwise make unavailable or deny" housing to persons because of protected class status to cover discrimination in the provision of homeowner's insurance. *See., e.g., NAACP v. American Family Mut. Ins. Co.*, 978 F.2d 287, 297 (7th Cir. 1992) ("No insurance, no loan; no loan, no house; lack of insurance thus makes housing unavailable.") (Easterbrook, J.); *Burrell v. State Farm & Cas. Co.*, 226 F. Supp. 2d 427, 442 (S.D.N.Y. 2002) (citing *Trafficante* and *Hack* in finding that § 3604 applies to

[14] All of the cases that Morgan Stanley cites in support of its interpretation of 42 U.S.C. § 3605 are drawn from completely distinct factual contexts, not one of which involves a secondary market actor's role in the origination of a mortgage. Br. at 19 & n.8; *see Jordan v. Chase Manhattan Bank*, 91 F. Supp. 3d 491, 504 (S.D.N.Y. 2015) (no § 3605 claim based on "retail banking relationship" with mortgagee); *Berry v. Wells Fargo*, No. 15 C 5269, 2015 WL 8601866, at *3 (N.D. Ill. Dec. 14, 2015) (no § 3605 claim against servicer for its role in foreclosing on mortgage); *Green v. Diamond*, No. 14 C 2601, 2014 WL 5801351, at *5 (N.D. Ill. Nov. 7, 2014) (no § 3605 claim against contractor alleged to have stolen proceeds of plaintiff's reverse mortgage); *Walton v. Diamond*, No. 12-CV-4493, 2013 WL 1337334, at *6 (N.D. Ill. Mar. 29, 2013) (same); *Davis v. Wells Fargo Bank*, 685 F. Supp. 2d 838, 844 (N.D. Ill. 2010) (no § 3605 claim against subsequent holder of mortgage based on attempt to foreclose) *aff'd on other grounds sub nom. Estate of Davis v. Wells Fargo Bank*, 633 F.3d 529, 539 n.3 (7th Cir. 2011) (no review of abandoned § 3605 claim); *Pandozy v. Segan*, 518 F. Supp. 2d 550, 557 (S.D.N.Y. 2007), *aff'd*, 340 F. App'x 723 (2d Cir. 2009) (no § 3605 claim against prospective buyer of apartment).

property insurance). A similarly generous construction of § 3605 cannot preclude suit by those who received discriminatory loans caused by Morgan Stanley's loan purchases. *See* MTD Decision at 12 ("[T]he terms and conditions governing Morgan Stanley's loan purchases directly resulted in a disparate impact when they caused New Century to issue toxic loans to Plaintiffs.")

Nonetheless, Morgan Stanley asks this Court to impose an overly narrow interpretation of the provision. Section 3605 prohibits an entity that purchases loans "secured by residential real estate" from "discriminat[ing] *against any person* in making available [a residential real estate-related] transaction, or in the terms or conditions of such a transaction" based on protected class status. 42 U.S.C. § 3605 (a), (b)(1)(B) (emphasis added). Morgan Stanley ignores the statute's reference to the individual experiencing discrimination, arguing that prohibited conduct here can be reduced to two clean and separate categories—a purchaser can discriminate only against (1) an individual whose mortgage it refuses to purchase; or (2) an individual whose loan it does purchase on discriminatory terms.

But consider the illogical outcome of this reading with an example: a Wall Street securitizer has a policy of refusing to buy mortgages originated to African-American borrowers unless the originator pledges to cover the cost of any delinquencies. In Morgan Stanley's view, an FHA injury exists for an African-American who received a mortgage (on any terms) that the securitizer declined to purchase under this policy, although his mortgage was issued in spite of the purchaser's ban. An FHA injury also exists for an African-American who received a mortgage (on any terms) that the securitizer did acquire, regardless of whether the costs of the discriminatory policy were passed on to her. But whether there were an FHA injury to an African-American who received a more expensive loan because an originator did pass along the costs of the policy by charging all African-American borrowers more would depend upon

whether the Wall Street purchaser ultimately acquires the loan. This arbitrary result is not the one dictated by a "broad and inclusive" reading of the FHA's terms. *Trafficante*, 409 U.S. at 209.

Morgan Stanley argues that § 3605's implementing regulation should be read to "confirm" that a loan purchaser can be liable for "only those two" narrow categories of conduct, Br. at 18 (citing 24 C.F.R. § 100.125 (a)), but the regulation provides no such confirmation. It gives examples of prohibited conduct that do not fit into Morgan Stanley's categories, and it makes clear that unlawful conduct "is not limited to" enumerated examples. § 100.125(b). It bars "[p]ooling or packaging loans" differently based on protected class status, § 100.125(b)(2), conduct which entails neither refusing to purchase loans nor imposing different conditions of purchase based on protected class status. It also prohibits marketing mortgage securities differently based on protected class status, § 100.125(b)(3), conduct which once again does not fit into either of the two categories to which Morgan Stanley seeks to reduce conduct prohibited by § 3605.

V. Plaintiffs Do Not Seek Disgorgement.

Morgan Stanley argues that disgorgement is unavailable to Plaintiffs under the FHA, Br. at 34, but Plaintiffs, proceeding as individuals, seek damages, not disgorgement; they sought disgorgement on behalf of the putative class and in their capacity as representatives of the putative class. Pls. Memo in Support of Class Cert., ECF No. 187-1, at 28-29. Accordingly, the Court need not reach Morgan Stanley's arguments on this point.[15]

CONCLUSION

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

[15] Although the Court need not reach this question here, Plaintiffs' rebuttal to Morgan Stanley's contention that disgorgement is unavailable to private plaintiffs under the FHA is contained in their Reply in Support of their Motion for Class Certification, which is incorporated here by reference. ECF No. 195 at 18-19 & n.21.

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Respectfully submitted,

By: /s/ Rachel E. Goodman

Dennis D. Parker
Rachel E. Goodman
AMERICAN CIVIL LIBERTIES UNION FOUNDATION
125 Broad Street, 18th Floor
New York, NY 10004
Telephone: (212) 549-2500

Rachel Geman
LIEFF CABRASER HEIMANN & BERNSTEIN LLP
250 Hudson Street, 8th Floor
New York, NY 10013
Telephone: (212) 355-9500

Elizabeth J. Cabraser
Michael W. Sobol
Nicole D. Sugnet
LIEFF CABRASER HEIMANN AND BERNSTEIN LLP
275 Battery Street, 29th Floor
San Francisco, CA 94111
Telephone: (415) 956-1000

Stuart T. Rossman
THE NATIONAL CONSUMER LAW CENTER
7 Winthrop Square, 4th Floor
Boston, MA 02210
Telephone: (617) 542-8010

Michael J. Steinberg
AMERICAN CIVIL LIBERTIES UNION FUND OF MICHIGAN
2966 Woodward Avenue
Detroit, MI 48201
Telephone: (313) 578-6814

Counsel for Plaintiffs