UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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

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.

12-CIV-7667-HB

MEMORDANDUM IN OPPOSITION TO DEFENDANTS' MOTION TO DISMISS

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INTRODUCTION

This civil rights case seeks to hold Morgan Stanley accountable for serious racial disparities caused by its insatiable appetite for high-risk loans, which it packaged into investment securities. From 2004 to 2007, Morgan Stanley[1] purchased and securitized the lion's share of loans issued by New Century Mortgage Company ("New Century"), one of the most notorious predatory lenders of the subprime lending boom. Morgan Stanley actively shaped New Century's abusive lending practices, ensuring that the lender specialized in loans that placed borrowers at high risk of foreclosure. Morgan Stanley purchased a larger share of New Century's loans than any other financial institution, and it provided the lines of credit that fueled New Century's harmful business. Using this leverage, Morgan Stanley required that loan pools it purchased were composed of loans with specific high-risk features, and it actively circumvented the safeguards of the underwriting process. Morgan Stanley went so far as to station its employees onsite at New Century to ensure the origination of unsound "stated income" loans. The Complaint describes in detail Morgan Stanley's policy of orchestrating the sale and securitization of toxic loans. For the homeowner, these loans were destined to fail.

The effects on Plaintiffs, and the Class they seek to represent, have been dramatic. The loans generated in response to Morgan Stanley's securitization policy contained a fatal combination of risky features, leaving borrowers with economically unviable mortgage obligations. The rates of foreclosure for borrowers receiving these loans were astronomical, even by the standards of the recent foreclosure crisis. But not all borrowers felt those effects equally. In the Detroit region, African-American borrowers were far more likely than white

[1] Although several affiliated Morgan Stanley entities were instrumental in conducting this business, and those entities are each named as Defendants in this case, Compl. ¶¶ 19-23, Defendants are referred to collectively as "Morgan Stanley."

borrowers to receive these harmful loans. The individual Plaintiffs are five African-American Detroit residents who received, and were harmed by, these toxic loan products. Additionally, because of Defendants' discriminatory conduct, Plaintiff Michigan Legal Services has been forced to divert an overwhelming portion of its scarce resources to foreclosure-related services in the Detroit region. Plaintiffs contend that Morgan Stanley violated the Fair Housing Act ("FHA"), the Equal Credit Opportunity Act ("ECOA"), and Michigan's Elliot-Larsen Civil Rights Act ("ELCRA"). Defendants identify no valid reason to dismiss these claims.

First, Defendants argue that they are insulated from liability under the civil rights laws invoked here. In Morgan Stanley's view, mortgage securitizers are immune from liability for the discriminatory effects of their practices so long as they do not evince an explicit intent to discriminate. This position ignores the text and implementing regulations of the FHA and the ECOA. The FHA bars discrimination in any "residential real estate-related transaction," which it defines to include the "purchasing of loans . . . secured by residential real estate," 42 U.S.C. § 3605(a)-(b), and the statute's implementing regulations expressly prohibit discrimination in the secondary mortgage market, 24 C.F.R. § 100.125. Similarly, the ECOA extends its anti-discrimination mandate to "any assignee of an original creditor who participates in the decision to extend, renew, or continue credit." 15 U.S.C. § 1691a(e). The positions advanced by Defendants would prevent these statutes from redressing discrimination caused by any facially neutral policy for purchasing mortgages on the secondary market, no matter how starkly discriminatory the effects of that policy.

Second, Defendants claim that Plaintiffs have not adequately pled disparate impact claims. This argument is an effort to require, at the pleading stage, proof of the ultimate issues in the case, such as the statistical comparison that will eventually be needed to prove Plaintiffs'

claims. Morgan Stanley's attempt to compel Plaintiffs to put up a trial-ready case at this threshold stage is not only inconsistent with bedrock principles of pleading, it is also precluded by black-letter law on the pleading requirements in a disparate impact case.

Third, Defendants assert that Plaintiffs' claims are untimely. However, well-established tolling doctrines render claims timely where, as here, Plaintiffs could not have discovered the basis for their cause of action until (1) Defendants' non-public policies became a matter of public record in 2011 and (2) the disparate impact of those policies could be measured through the analysis of aggregated data. Additionally, in a disparate impact lawsuit, the statute of limitations runs from each instance in which Plaintiffs feel the effects of the challenged discrimination; in a lending case, that means the clock starts again each time a Plaintiff is subject to action taken pursuant to a discriminatory loan, including each demand for payment on the mortgage or any effort to effect a foreclosure. Finally, Defendants rely on an argument against Plaintiffs' standing to sue that largely recycles the arguments they pursue on the merits, and an argument aimed at Plaintiffs' request for relief that is plainly inconsistent with the provisions of the statutes Plaintiffs invoke.

Defendants orchestrated, funded, and profited from the abusive lending practices whose effects were suffered by Plaintiffs and other African Americans in Detroit. This is discrimination. Plaintiffs' well-pled Complaint seeks to hold Morgan Stanley accountable for those violations of the civil rights laws, and this Court should decline to dismiss it.

STATEMENT OF FACTS

I. MORGAN STANLEY ORCHESTRATED THE SECURITIZATION OF LARGE POOLS OF LOANS WITH MULTIPLE HIGH-RISK CHARACTERISTICS

In the years leading up to the national foreclosure crisis, Morgan Stanley ramped up its practice of purchasing pools of home loans from New Century and packaging them into securities for sale on Wall Street. Compl. ¶¶ 25, 41. In so doing, Morgan Stanley actively encouraged New Century to generate large quantities of Combined-Risk Loans.[2] *Id.* ¶¶ 3-5, 25, 27, 72. Because Morgan Stanley generated fees from the sale of these securities regardless of whether the borrowers of the underlying New Century loans continued to make payments on their mortgages, it was unconcerned about the heightened risk of foreclosure faced by borrowers. *Id.* ¶¶ 3-5, 29, 40-42.

Morgan Stanley used its influence as the principal financer of New Century loans to pre-determine the characteristics of the loans it would eventually purchase. *Id.* ¶¶ 3, 37-38, 41, 65, 67-68. Through "warehouse lending," Morgan Stanley lent billions of dollars to New Century so that it could originate loans. *Id.* ¶¶ 61-64. New Century was so dependent on these warehouse lines of credit that when Morgan Stanley eventually cut them off, New Century could no longer originate loans. *Id.* ¶¶ 64-66. Morgan Stanley provided New Century with lines of credit through its "early purchase" program, in which it committed to buying loans with risky features before they had even been originated. *Id.* ¶¶ 67-68. Morgan Stanley also "wet-funded" New Century loans, providing cash to borrowers to ensure that the loans closed. *Id.* ¶ 69.

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[2] Combined-Risk Loans are defined in the Complaint as "high-cost" loans, as defined by the Home Mortgage Disclosure Act ("HMDA"), *see* Compl. ¶ 31, that also contain two or more of the following high-risk terms: (a) the loan was issued based upon the "stated income," rather than the verified income, of the borrower; (b) the debt-to-income ratio exceeds 55%; (c) the loan-to-value ratio is at least 90%; (d) the loan has an adjustable interest rate; (e) the loan has "interest only" payment features; (f) the loan has negative loan amortization features; (g) the loan has "balloon" payment features; and/or (h) the loan imposes prepayment penalties. Compl. ¶ 34.

Morgan Stanley used this leverage to orchestrate the origination of predatory loans. Morgan Stanley purchased a greater share of New Century's loans than any other institution and paid above-market prices for them. *Id.* ¶¶ 38, 41. Morgan Stanley aggressively solicited loans with multiple high-risk characteristics. *Id.* ¶ 43. For example, Morgan Stanley required that the majority of loans it purchased from New Century contain prepayment penalties, with large numbers also containing balloon payments. *Id.* ¶¶ 57-60. In addition, Morgan Stanley regularly purchased New Century loans with reported loan-to-value ("LTV") ratios of 90% or greater, meaning that the loan amounts were nearly identical to or exceeded the actual value of the borrowers' homes. *Id.* ¶¶ 51-53. Morgan Stanley knew that these ratios were based on inflated appraisals, so that actual LTV levels were even higher than they appeared. *Id.* ¶ 54. Similarly, Morgan Stanley favored loans with excessive debt-to-income ("DTI") ratios, which indicated that the borrowers could not afford the loans. *Id.* ¶¶ 44-45. These loans often included adjustable rates ("ARMs") that exacerbated the problem by increasing a borrower's monthly payment after an initial period, but Morgan Stanley understated the loans' true DTIs by failing to take into account these adjustable rates. *Id.* ¶ 46. Morgan Stanley preferred unverified "stated income" loans, knowing that these loans often falsely inflated borrowers' income. *Id.* ¶¶ 44, 47-49. Morgan Stanley even directed New Century to get false stated incomes so that certain loans would appear less risky. *Id.* ¶ 75. Morgan Stanley affirmatively enabled the origination of high-risk loans by actively circumventing the underwriting process. *Id.* ¶¶ 70-75.

New Century's origination of these Combined-Risk loans spiked in tandem with Morgan Stanley's increasing participation in its business. *Id.* ¶ 77. New Century ceased focusing on whether borrowers could meet their mortgage obligations and instead structured its business to maximize the number of loans it could sell to Morgan Stanley. *Id.* ¶¶ 41-42, 76-79. New

Century's definition of a good loan changed from "one that pays" to "one that can be sold" for securitization. *Id.* ¶ 76. Morgan Stanley boasted to investors that "all" of the loans in its mortgage pools "were underwritten with a view toward the resale of the mortgage loans in the secondary mortgage market." *Id.* ¶ 42.

In combination, these practices constituted Morgan Stanley's policy of orchestrating the sale of Combined-Risk Loans for securitization. *Id.* ¶ 241. As a result, New Century became one of the most abusive predatory lenders in the industry—by 2008, the Office of the Comptroller of the Currency identified New Century as responsible for the greatest share of foreclosures in the worst-hit metropolitan areas, including Detroit. *Id.* ¶ 37. Foreclosure rates for New Century loans in Detroit were astronomically high compared to prevailing rates nationwide. *Id.* ¶¶ 87-88, 92-95.

II. MORGAN STANLEY'S DEMAND FOR COMBINED-RISK LOANS HAD AN ADVERSE AND DISPARATE IMPACT ON AFRICAN-AMERICAN BORROWERS IN DETROIT

To feed Morgan Stanley's demand for Combined-Risk Loans, New Century targeted African-American communities in Detroit, *id.* ¶¶ 116-122, where a history of residential segregation and credit discrimination allowed predatory lending to flourish, *id.* ¶¶ 100-114. New Century disproportionately allocated its toxic loans to African-American borrowers in these communities. *Id.* ¶¶ 81, 116-122. For instance, an African-American borrower in Detroit was 70 percent more likely than a similarly situated white borrower to obtain a HMDA-defined "high-cost" loan—which is one feature of a "Combined-Risk" loan—from New Century. *Id.* ¶ 121.

III. MORGAN STANLEY'S PRACTICES HARMED PLAINTIFFS AND THE CLASS

The origination of Combined-Risk Loans significantly injured Plaintiffs and the Class. *Id.* ¶¶ 3, 35, 86-88, 92-95. Individual Plaintiffs were issued loans with costlier and riskier

features than those issued to similarly situated white borrowers, and they now face a heightened threat of foreclosure or have already lost their homes because they cannot meet their obligations on these discriminatory loans. *Id.* ¶¶ 123-203. The members of the putative class likewise were adversely impacted by these toxic loans. *Id.* ¶¶ 241, 245, 255, 259, 270.

ARGUMENT

"In reviewing a motion to dismiss pursuant to Rule 12(b)(6), the Court must accept the factual allegations set forth in the complaint as true and draw all reasonable inferences in favor of the plaintiff." *Gusler v. City of Long Beach*, 823 F. Supp. 2d 98, 121 (E.D.N.Y. 2011). A court reviewing a motion to dismiss should "assume [the] veracity" of all well-pleaded factual allegations "and then determine whether they plausibly give rise to an entitlement to relief." *Ashcroft v. Iqbal*, 556 U.S. 662, 664 (2009).

I. THE DISCRIMINATION ALLEGED BY PLAINTIFFS VIOLATES THE FAIR HOUSING ACT, THE EQUAL CREDIT OPPORTUNITY ACT, AND THE ELLIOT-LARSEN CIVIL RIGHTS ACT

A. The Fair Housing Act and the Elliot-Larsen Civil Rights Act Prohibit the Discrimination Alleged in the Complaint

The FHA proscribes discrimination by entities, like Morgan Stanley, that purchase loans on the secondary mortgage market. Defendants acknowledge that the statute applies to the activities of mortgage securitizers, but they contend that the practices challenged in this lawsuit, and the discriminatory effects of those practices, lie beyond the statute's reach. The logical consequence of Morgan Stanley's cramped reading of the statute is that, no matter how stark the discriminatory effects of its policies for securitizing subprime loans, the FHA does not apply unless the bank explicitly discriminated in purchasing individual loans for securitization. Defs' Mot. to Dismiss ("MTD") at 14-16. This reading of the FHA has no support in law.

"'The Supreme Court has repeatedly directed the courts to give a "generous construction" to the Fair Housing Act.'" *Hirschfeld v. Metlife Bank, N.A.*, 2012 WL 3240669, at *5 (E.D.N.Y. July 31, 2012) (quoting *Hack v. President & Fellows of Yale Coll.*, 237 F.3d 81, 87 (2d Cir. 2000), *abrogated on other grounds*, *Swierkiewicz v. Sorema N.A.*, 534 U.S. 506 (2002)). Among other things, the statute makes it unlawful for any "entity whose business includes engaging in residential real estate-related transactions to discriminate against any person in making available such a transaction, or in the terms or conditions of such a transaction, because of race." 42 U.S.C. § 3605(a). A residential real estate-related transaction is defined to include, *inter alia*, the "purchasing of loans or providing other financial assistance . . . secured by residential real estate." 42 U.S.C. § 3605(b).

The text of § 3605 plainly prohibits discrimination by entities purchasing loans in the secondary mortgage market. Its implementing regulations amplify this interpretation, specifying that "unlawful conduct under this section includes, *but is not limited to*:

> (1) Purchasing loans or other debts or securities which relate to, or which are secured by dwellings in certain communities or neighborhoods but not in others because of the race . . . of persons in such neighborhoods or communities.
>
> (2) Pooling or packaging loans or other debts or securities which relate to, or which are secured by, dwellings differently because of race. . . ."

24 C.F.R. § 100.125 (emphasis added). The provision's legislative history also states that, when the FHA was amended in 1988, "the provisions of the Act [were] extend[ed] to the secondary mortgage market." H.R. Rep. No. 711, 100th Cong., 2d Session 1988, at 30, *reprinted in* 1988 U.S.C.C.A.N. 2173, 2191.

Defendants' argument simply ignores the Complaint's core claim: Morgan Stanley's facially neutral policy of orchestrating the sale of Combined-Risk Loans for securitization

resulted in a disparate impact based on race, thereby violating § 3605.[3] *See Tsombanidis v. W. Haven Fire Dept.*, 352 F.3d 565, 574 (2d Cir. 2003) ("Disparate impact analysis focuses on facially neutral policies or practices that may have a discriminatory effect."). Courts have specifically found that disparate impact claims are cognizable under § 3605. *See Rodriguez v. Bear Stearns Cos., Inc.*, 2009 WL 995865, at *7 (D. Conn. Apr. 14, 2009); *Barkley v. Olympia Mortg. Co.*, 2007 WL 2437810, at *13 (E.D.N.Y. Aug. 22, 2007). Further, the safe haven provision in the HUD regulations implementing § 3605 unequivocally confirms that disparate impact liability applies to entities purchasing loans in the secondary mortgage market: the regulation provides that institutions may consider, "in the purchasing of loans, [ ] factors justified by business necessity . . . relating to a transaction's financial security or to protection against default or reduction of the value of the security." 24 C.F.R. § 100.125(c). Of course, if entities could only violate § 3605 by intentionally discriminating, it would not be necessary to insulate them from liability for considering "factors justified by business necessity."

Moreover, Plaintiffs' allegations establish that Morgan Stanley's liability arises from its own conduct, not (as Morgan Stanley contends, MTD at 15) as a matter of third-party liability.[4] The Complaint focuses on Morgan Stanley's transactions, detailing the bank's financing of New

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[3] Defendants "dispute" that disparate impact claims are available under the FHA, ECOA, and ELCRA, MTD at 19; however, as Defendants concede, disparate impact claims are cognizable under the FHA as a matter of settled Second Circuit law. *See Huntington Branch, NAACP v. Town of Huntington*, 844 F.2d 926, 933-35 (2d Cir. 1988). Moreover, "everyone of the eleven circuits to have considered the issue has held that the FHA similarly prohibits not only intentional housing discrimination, but also actions having a disparate impact." *2922 Sherman Ave. Tenants' Assoc. v. District of Columbia*, 444 F.3d 673, 679 (D.C. Cir. 2006). *See also* Dep't Housing & Urban Development et al., *Policy Statement on Discrimination in Lending*, 59 Fed. Reg. 18,266-01, 18,269 (Apr. 15, 1994).

[4] As the U.S. Department of Justice has explained in an analogous context, liability under the FHA and ECOA depends "not on a wooden application of vicarious liability doctrine, but more broadly on the principal's exercise of control over the discriminatory conduct and whether the principal benefited from the discrimination," regardless of whether a formal agency relationship existed. Br. Amicus Curiae of United States, *Cason v. Nissan Motor Accept. Corp.*, 98-cv-0223 (M.D. Tenn. July 31, 2000), *available at* http://www.justice.gov/crt/about/hce/documents/nissan1.php.

Century's lending practices, Compl. ¶¶ 38, 61-69, its emphasis on purchasing New Century loans with Combined Risk features, *id.* ¶¶ 44-60, and its active circumvention of established underwriting practices in connection with its purchases of loans from New Century, *id.* ¶¶ 70-75. To the extent the Complaint describes New Century's practices, it is not because those practices, standing alone, give rise to Morgan Stanley's liability, but because they demonstrate that Morgan Stanley's purchasing practices caused New Century to specialize in Combined-Risk Loans, *id.* ¶¶ 76-85, and that the consequences of those lending practices fell most harshly on African Americans in the Detroit region, *id.* ¶¶ 117-122.

None of the cases cited by Defendants call into doubt § 3605's application here. Rather, they stand for the unexceptional premise that the assignee of a loan will not be held liable merely by virtue of discrimination committed by the loan's originator.[5] None of those cases insulate a defendant from liability where its own policies and practices for purchasing mortgage loans resulted in a discriminatory effect on borrowers.[6]

[5] *See Stewart v. Bank of N.Y. Mellon*, 2011 WL 3267321, at *4 (D. Ariz. July 29, 2011) ("Plaintiff's pleadings provide no sufficient allegation that Defendant [as assignee] did engage in [discriminatory] conduct or what that 'wrongful conduct' was."); *Levey v. CitiMortgage, Inc.*, 2009 WL 2475222, at *2 (N.D. Ill. Aug. 10, 2009) ("All of [plaintiff's] allegations of wrongdoing are directed at [co-defendants], not against CitiMortgage."); *Wright v. Castle Point Mortg.*, 2006 WL 1468678 (D.N.J. May 22, 2006) (dismissing FHA claim where assignee-defendant had no connection to any of the alleged discriminatory acts).

[6] The arguments in support of the FHA claim apply with equal force to the ELCRA claim. That statute also prohibits race discrimination in the "making or purchasing of loans or the provision of other financial assistance secured by residential real estate." Mich. Law Comp. § 37.2504. Michigan courts typically look to analogous provisions of federal law to interpret the ELCRA. *Radke v. Everett*, 501 N.W.2d 155, 162 (Mich. 1993). They recognize that disparate impact claims are authorized under the ELCRA and look to federal precedent for guidance in applying that standard. *Vermett v. Hough*, 627 F. Supp. 587 (W.D. Mich. 1986).

B. <u>The Equal Credit Opportunity Act Prohibits the Discrimination Alleged in the Complaint</u>

The discrimination alleged in the Complaint violates the ECOA. Under the ECOA, it is unlawful for "any creditor to discriminate against any applicant, with respect to any aspect of a credit transaction . . . on the basis of race." 15 U.S.C. § 1691(a).[7] The statute defines "creditor" to include, *inter alia*, "any assignee of an original creditor who participates in the decision to extend, renew, or continue credit." *Id.* §1691a(e). Morgan Stanley's extensive participation in New Century's lending practices render it a "creditor" under the ECOA and its implementing regulations, which extend to any entity that, "in the ordinary course of business, regularly participates in a credit decision, including setting the terms of credit." 12 C.F.R. § 202.2(*l*).

As described *supra*, Morgan Stanley participated in critical aspects of New Century's lending. Tellingly, Defendants stationed Morgan Stanley employees onsite at New Century, and in some instances those employees would shred applications with verified (but insufficient) income and tell New Century to obtain a "stated income" application instead. Compl. ¶ 75. They also funded New Century's loan originations and purchased huge quantities of those loans, along the way requiring New Century to originate loans bearing specific Combined-Risk features. *Id.* at ¶¶ 38, 56-58, 62-64, 67. Finally, when New Century stood on the brink of bankruptcy, Defendants stepped in to provide cash to New Century borrowers at the closing table, enabling New Century to close millions of dollars worth of Combined-Risk Loans before folding its business. *Id.* ¶ 69.

Defendants fail to explain why such extensive participation would not place it within the ECOA's ambit. Instead, they argue that the statute imposes an anemic definition of "creditor," one that is inconsistent with the implementing regulation, Regulation B. Indeed, Morgan Stanley

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[7] The ECOA, like the FHA, authorizes plaintiffs to bring disparate impact claims. *See Jones*, 2002 WL 88431 at *3-4; 12 C.F.R. § 202.6(a) n.2; 12 C.F.R. Part 202, Supp. I, § 202.6(a)(2).

seriously overstates the level of participation required by the definition of "creditor," claiming that "'participation' *must* specifically include 'setting the terms of credit.'" MTD at 17 (emphasis added) (citing 12 C.F.R. § 202.2(*l*)). What the regulation actually says is that "[c]reditor means a person who, in the ordinary course of business regularly participates in a credit decision, *including* setting the terms of credit." 12 C.F.R. § 202.2(*1*) (emphasis added). Morgan Stanley's argument hinges on transforming one illustrative example into a definitive requirement.[8] The actual regulations will not bear that interpretation.[9]

Morgan Stanley's truncated definition of "creditor" finds no support in the case law. "Courts have found entities to be creditors for purposes of ECOA even when they did not directly review credit applications, when they regularly participated in determining binding policies for extending credit to customers." *Coleman v. Gen. Motors Acceptance Corp.*, 220 F.R.D. 64, 76 n.9 (M.D. Tenn. 2004). The *Coleman* court found that a General Motors-affiliated auto finance company was an ECOA "creditor" where it influenced auto finance transactions by "providing loan documents to dealers," setting "buy rates and finance charge markups," and providing training in how to satisfy secondary purchase requirements. *Id.* at 76; *see also Wise v. Union Acceptance Corp.*, 2002 WL 31730920, at *3 (S.D. Ind. Nov. 19, 2002); *cf. Treadway v.*

[8] Defendants attempt to draw support for this position from commentary in the Federal Register stating that merely "establish[ing] underwriting guidelines" will not turn a potential assignee into a creditor. MTD at 17. As discussed *supra*, Morgan Stanley's participation went far beyond establishing underwriting guidelines.

[9] Morgan Stanley also asserts that it cannot be liable for any ECOA violation because there is no allegation that Morgan Stanley was on inquiry notice of New Century's alleged discrimination. MTD at 18-19 (citing 12 C.F.R. § 202.2(*l*)). As argued *supra*, Plaintiffs contend that Morgan Stanley *itself* engaged in discrimination through its policies and practices that resulted in a disparate impact. *Cf. Jones*, 2002 WL 88431 at *3 (rejecting invocation of § 202.2(*l*) safe-harbor where "the allegations . . . are directed at Ford Credit itself and not just the alleged wrongdoing of the car dealers"). Even if Defendants' liability under the ECOA flowed only from New Century's wrongdoing, an assignee-defendant is liable when it is on "notice of the policy or practice that results in discrimination . . . especially where the allegation is of disparate impact." *Wise*, 2002 WL 31730920 at *3; *see also Smith v. Chrysler Fin. Co.*, 2003 WL 328719, at *5 (D.N.J. Jan 15, 2003).

Gateway Chevrolet Oldsmobile Inc., 362 F.3d 971, 980 (7th Cir. 2004) (recognizing "a continuum of participation in a credit decision . . . [a]t some point along the continuum, a party becomes a creditor") (quotation marks and citation omitted).[10]

Finally, Defendants' argument is premature. Whether an entity regularly participates in the decision to extend credit "is obviously a factual matter, not usually appropriate for resolution in a motion to dismiss." *S & G Petroleum Co. v. Brice Capital Corp.*, 1993 WL 22182, at *2 (E.D. Pa. Jan. 26, 1993).

II. PLAINTIFFS HAVE ADEQUATELY PLED A DISPARATE IMPACT VIOLATION

Plaintiffs have more than adequately pled their claims for disparate impact discrimination. To survive a motion to dismiss, a complaint alleging disparate impact under the FHA or ECOA need only identify a facially neutral practice that causes an adverse impact on a protected group. *See Hack v. President & Fellows of Yale Coll.*, 237 F.3d 81, 88 (2d Cir. 2000). Plaintiffs need not plead a prima facie case of discrimination.[11] , *Swierkiewicz v. Sorema N.A.*, 534 U.S. 506, 510 (2002) ("The prima facie case . . . is an evidentiary standard, not a pleading requirement."). Instead, the complaint need only allege facts rendering the prima facie case plausible. *See Jenkins v. N.Y.C. Transit Auth.*, 646 F. Supp. 2d 464, 469 (S.D.N.Y. 2009).

The allegations in the Complaint meet that standard. Plaintiffs identify Morgan Stanley's facially neutral policy of orchestrating the sale of Combined-Risk Loans for securitization as the

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[10] The sole case cited by Defendants, *Levey*, 2009 WL 2475222, is not to the contrary. In that case, plaintiffs "failed to allege *any* facts accusing CitiMortgage of *any* involvement whatsoever in the origination of the Mortgage or the BNC Loan." *Id.* at *3 (emphasis added).

[11] To make out a prima facie case of disparate impact, after discovery, a plaintiff must (1) identify a policy or practice, (2) demonstrate that a disparity exists, and (3) establish a causal relationship between the two. *Robinson v. Metro-North Commuter R.R. Co.*, 267 F.3d 147, 160 (2d Cir. 2001), *abrogated on other grounds*, *Wal-Mart v. Dukes*, 131 S. Ct. 2541 (2011).

source of the discriminatory effects they suffered. Compl. ¶¶ 241, 255, 267. The Complaint identifies that policy as consisting of five elements, each of which is described in detail. *Id.* ¶¶ 43-75. Plaintiffs allege that this policy adversely impacted African-American homeowners. *Id.* ¶¶ 115-22. Plaintiffs then describe (going beyond what is required to state their claims) how that policy caused the discriminatory effects giving rise to this lawsuit. *Id.* ¶¶ 76-85, 99-114. Defendants' arguments to the contrary mischaracterize the pleading requirements, raise premature questions of fact that will require expert analysis of not-yet-produced data, and ignore the specific allegations in the Complaint.

A. Plaintiffs Adequately Allege Disparate Impact in the Detroit Area and Have Sued on Behalf of the Correct Class of Homeowners

Morgan Stanley asserts the novel argument that, as a matter of law, a disparate impact case against a national financial institution with uniform policies for purchasing loans may *only* proceed if plaintiffs plead nationwide disparities.[12] MTD at 21-22. Defendants cite no authority for that sweeping proposition. This fact-based challenge to the proper comparison pool (*i.e.*, which populations of people should be compared to analyze disparate impact) would ratchet up the pleading requirements far beyond what the law requires.[13] *See Hargraves v. Capital City Mortg. Corp.*, 140 F. Supp. 2d 7, 29 n.9 (D.D.C. 2000) (holding a disparate impact analysis

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[12] Even if Defendants' legal premise were valid, the Complaint *does* allege nationwide disparities. Although the focus of the Complaint is the disparate impact in the Detroit region, it also alleges that "[a]mong all borrowers represented in [a sample of New Century loans securitized by Morgan Stanley], the rate of foreclosure among African Americans was 28.57% greater than the rate of foreclosure among white borrowers." Compl. ¶ 96. Accordingly, even under Defendants' theory, Plaintiffs have adequately pleaded a disparity.

[13] Defendants also contend that the Complaint identifies "the wrong borrowers" because Plaintiffs include New Century borrowers whose individual loans may not have been securitized by Morgan Stanley. MTD at 23. Plaintiffs' allegation is that Morgan Stanley's policies shaped *all* of New Century's lending because it purchased a greater share of New Century loans than any secondary market institution, Compl. ¶¶ 38, 62, and provided the credit lines that were the lifeblood of New Century's Combined-Risk lending business, *id.* ¶¶ 61-69.

based on a geographic subset of lender's activity "sufficient to survive defendants' motion for summary judgment").

Defendants seek at the pleading stage to litigate a fact-intensive question about the proper mode of statistical analysis. After discovery, Plaintiffs will demonstrate that African Americans were adversely impacted by the challenged policy. *See Swierkiewicz*, 534 U.S. at 512 ("Before discovery has unearthed relevant facts and evidence, it may be difficult to define the precise formulation of the required prima facie case in a particular case."). The case law Defendants rely on, moreover, confirms that their arguments are premature. *See Greater New Orleans Fair Hous. Action Ctr. v. HUD*, 639 F.3d 1078, 1086 (D.C. Cir. 2011) (reversing preliminary injunction, on ample evidentiary record, because plaintiffs had not identified "a sound benchmark for assessing the disparateness of a grant formula's impact"); *Smith v. Xerox Corp.*, 196 F.3d 358, 368-70 (2d Cir. 1999) (on review of summary judgment, assessing competing statistical analyses proffered by parties' experts); *Tsombanidis*, 352 F.3d at 576 (rejecting disparate impact claim, post-trial, where "plaintiffs did not present any statistical information"); *Betsey v. Turtle Creek Assocs.*, 736 F.2d 983, 987 (4th Cir. 1984) (rejecting defendant's claim that plaintiffs were required to show a discriminatory impact on a broader group than what was proffered at trial).

Finally, Defendants question Plaintiffs' reference to disparities in the origination of high-cost loans, as defined by HMDA, in alleging racial disparities. MTD at 23-24. That argument is simply inconsistent with case law in this area. Several recent discriminatory lending cases have rejected motions to dismiss where HMDA data supported a plausible inference of disparate impact, including where the alleged discrimination did not precisely mirror HMDA's definition of high-cost loans. *See, e.g.*, *City of Memphis v. Wells Fargo Bank, N.A.*, 2011 WL 1706756, at

*1-3, 14 (W.D. Tenn. May 4, 2011) (denying motion to dismiss reverse redlining case and citing disparities in HMDA data); *Miller v. Countrywide Bank, N.A.*, 571 F. Supp. 2d 251, 258-59 (D. Mass. 2008) (denying motion to dismiss and finding argument that "the complaint does not allege with the required specificity a racial imbalance . . . . goes to questions of proof rather than the adequacy of the pleading"); *Taylor v. Accredited Home Lenders, Inc.*, 580 F. Supp. 2d 1062, 1069 (S.D. Cal. 2008) (denying motion to dismiss where plaintiffs relied on HMDA data to demonstrate disparity in high-cost loans); *Ramirez v. GreenPoint Mortg. Funding, Inc.*, 633 F. Supp. 2d 922, 928-29 (N.D. Cal. 2008) (denying motion to dismiss where plaintiffs proffered, *inter alia*, HMDA data showing minorities more likely to receive high-cost loans). Indeed, the fit here is even tighter than in those cases, because any Combined-Risk Loan is by definition a high-risk loan for purposes of HMDA. Compl. ¶ 34.

B. Defendants Misstate the Causation Requirement and Raise Premature Merits Defenses

Defendants argue that Morgan Stanley cannot legally have caused the disparate impact alleged here because New Century originated the loans.[14] MTD at 24-26. That argument misstates the causation requirement in a disparate impact case. At the pleading stage, Plaintiffs need not make "allegations specifically supporting the causal connection" between the challenged policy and the adverse impact. *Reyes v. Fairfield Properties*, 661 F. Supp. 2d 249, 266 (E.D.N.Y. 2009). Further, a disparate impact claim properly focuses on the underlying policy causing the eventual disparity, even if that policy is channeled through intermediaries.

[14] Defendants also claim, as "a matter of law," that a mortgage securitizer cannot cause a lender to originate unlawful mortgages. MTD at 24. Their only support for this proposition comes from a nuisance case brought under Ohio law which found the requirement of "directness" inherent in tort law to be absent in a case involving generalized claims about neighborhood violence and crime. *See City of Cleveland v. Ameriquest Mortg. Sec., Inc.*, 615 F.3d 496, 504 (6th Cir. 2010). The Sixth Circuit did not opine on the causation requirement for a disparate impact claim, much less *the pleading requirements* under the FHA and ECOA.

See McReynolds v. Merrill Lynch, 672 F.3d 482, 489 (7th Cir. 2012) (Posner, J.) (a disparate impact claim arises where a practice can be "challenged as enabling . . . racial discrimination").

The Complaint plausibly alleges that Morgan Stanley's policy of orchestrating the sale of Combined-Risk Loans for securitization resulted in racial disparities. Morgan Stanley was New Century's primary source of funds, Compl. ¶¶ 38, 62, 67-69, which were indispensable to New Century, *id.* ¶¶ 64-66. Morgan Stanley consistently purchased Combined-Risk Loans, *id.* ¶¶ 44-60, and intervened in the underwriting process to ensure the origination of such loans, *id.* ¶¶ 72-75. The Complaint also describes the influence of the secondary mortgage market on New Century's lending practices, especially when it came to the riskiest loan features. *Id.* ¶¶ 41, 42, 76-80. New Century specialized in these high-risk loans, *id.* ¶¶ 87, 92-96, which are easier to market in segregated communities, *id.* ¶¶ 100-106, resulting in the adverse impact on African Americans in the Detroit region, *id.* ¶¶ 116-122.[15] *Cf. Griggs v. Duke Power Co.*, 401 U.S. 424, 430 (1971) ("[P]ractices, procedures, or tests neutral on their face, and even neutral in terms of intent, cannot be maintained if they operate to 'freeze' the status quo of prior discriminatory employment practices").

Finally, Defendants' claim that Plaintiffs have failed to challenge a specific policy, MTD at 26, is untenable. The cases they cite bear no analogy to this case. *See Malave v. Potter*, 320 F.3d 321 (2d Cir. 2003) (engaging in no analysis of specific policy question); *Byrnie v. Town of Cromwell, Bd. of Educ.*, 243 F.3d 93 (2d Cir. 2001) (finding no disparate impact claim where plaintiff pointed to *no specific practice or policy*); *Smith v. City of Jackson, Miss.*, 544 U.S. 228, 241 (2005) (affirming dismissal where petitioners had "not identified *any specific test, requirement, or practice* . . . that has an adverse impact on older workers") (emphasis added).

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[15] Defendants attempt to reduce the allegations supporting an inference of causality to a pair of paragraphs describing a 2005 Bid Sheet. MTD at 25. While those allegations *do* powerfully support an inference of causation, they *do not* stand alone.

Surely, the thirty-two paragraphs detailing Morgan Stanley's policy of orchestrating the sale of Combined-Risk loans, Compl. ¶¶ 43-75, are sufficient.

C. <u>Defendants' Argument That Plaintiffs Must Allege Their "Qualifications" For Better Loans Is Inapposite</u>

Finally, Defendants argue that Plaintiffs cannot make out their disparate impact claim without alleging that they were "qualified" for loans with different terms. MTD at 20-21. This argument is a red herring. First, whatever role "qualifications" have in the prima facie case for a *disparate treatment* claim involving loan *denials*, Defendants can point to no authority suggesting that such an allegation is required as part of the prima facie showing in a disparate impact case, much less that it is required at the pleading stage.[16] Second, a "qualifications" requirement makes little sense in a case like this, which involves the extension of toxic loans, as opposed to the denial of conventional loans. *See Hargraves*, 140 F. Supp. 2d at 20 ("In order to show a claim based on reverse redlining, the plaintiffs must show that the defendants' lending practices and loan terms were 'unfair' and 'predatory,' and that the defendants either intentionally targeted on the basis of race, or that there is a disparate impact on the basis of race."). Imposing a "qualifications" requirement in this context defies logic: most of the harmful features associated with Combined-Risk Loans (*e.g.*, high DTI or LTV levels, adjustable rates, negative amortization) do nothing to counterbalance the credit risk associated with being a "less qualified" borrower; accordingly, there is no reason why Plaintiffs (or anyone else) would need to be more "qualified" in order to receive a loan that lacks those features. Finally, it is hard to imagine how that analysis would work at this early stage in the case—on Defendants' theory, Plaintiffs would need to plead that they met the hypothetical underwriting standards associated with a "better" loan. *Cf. M&T Mortg. Corp. v. White*, 736 F. Supp. 2d 538, 575 (E.D.N.Y.

[16] Significantly, Defendants rely on cases involving allegations of intentional discrimination.

2010) ("[T]he court does not wish to substitute any judgment it has in lending practices for that of the defendants.").

III. PLAINTIFFS' CLAIMS ARE TIMELY

The applicable statutes of limitations pose no bar to Plaintiffs' claims. The FHA provides that a plaintiff must file suit within two years of "the occurrence or the termination of an alleged discriminatory housing practice." 42 U.S.C. § 3613(a)(1)(A). Actions under the ECOA similarly had a two-year statute of limitations prior to July 21, 2011. 15 U.S.C. § 1691e(f).[17] Defendants argue that Plaintiffs' claims are time-barred, MTD at 7-13, but this argument fails because the federal discovery rule, equitable tolling, and the continuing violations doctrine all render Plaintiffs' claims timely. Further, the applicability of these doctrines depends upon factual allegations set out in the complaint, and it would be premature to dispose of Plaintiffs' claims at this early stage of litigation, before discovery and appropriate findings of fact. *Harris v. City of New York*, 186 F.3d 243, 250 (2d Cir. 1999).

A. Both the Discovery Rule and Equitable Tolling Render Plaintiffs' Claims Timely

1. The Discovery Rule Applies to Plaintiffs' Claims

Under the discovery rule, the statute of limitations begins to run on the date on which a plaintiff discovers or should have discovered that he has been injured by the defendant's conduct. *Corcoran v. N.Y. Power Auth.*, 202 F.3d 530, 544 (2d Cir. 1999). It is a rule of federal common law, "read into statutes of limitations . . . in the absence of a contrary directive from Congress." *Cada v. Baxter Healthcare Corp.*, 920 F.2d 446, 450 (7th Cir. 1990).

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[17] As of that date, the applicable statute of limitations under the ECOA was extended to five years. *See* Pub. L. No. 111-203, § 1085(7).

As this Court has stated, "where plaintiff would reasonably have had difficulty discerning the fact or cause of injury at the time it was inflicted, the so-called 'diligence-discovery rule of accrual' applies." *Thompson v. Metro. Life Ins. Co.*, 149 F. Supp. 2d 38, 48 (S.D.N.Y. 2001) (Baer, J.). District courts in this and other circuits have applied the discovery rule in cases alleging claims under the ECOA and the FHA. *See, e.g.*, *Clement v. United Homes, LLC*, 2012 WL 6720701, at *8 (E.D.N.Y. Dec. 27, 2012) ("Claims under the FHA . . . are subject to the discovery rule and thus accrue when a plaintiff knows or has reason to know of the injury that serves as the basis for the action.") (internal quotation marks omitted); *Jones*, 2002 WL 88431 at *5 (applying discovery rule to ECOA claim); *Estate of Henderson v. Meritage Mortg. Corp.*, 293 F. Supp. 2d 830 (N.D. Ill. 2003) (applying discovery rule to FHA and ECOA claims).

Morgan Stanley attempts to rely upon the Supreme Court's decision in *TRW Inc. v. Andrews*, 534 U.S. 19 (2001), as foreclosing application of the discovery rule to FHA and ECOA claims. MTD at 9. However, the Court in *TRW* found that, given the narrow discovery rule expressly included in the text of the Fair Credit Reporting Act ("FCRA"), "Congress implicitly excluded a general discovery rule by explicitly including a more limited one." *Id.* at 28, 31. The holding of *TRW* is thus not relevant to the FHA or the ECOA, which do not contain explicit discovery rule provisions. *See Mangum v. Action Collection Servs., Inc.*, 575 F.3d 935, 941 (9th Cir. 2009) (affirming that discovery rule applies generally and that nothing in *TRW* requires reevaluation of that principle outside FCRA context); *Wise*, 2002 WL 31730920 at *5 n.2 (rejecting *TRW* argument and finding that "[b]ecause the FCRA delineates a specific, limited discovery rule, it excludes application of a general discovery rule," but "[t]his reasoning does not

apply to the ECOA").[18]

2. Equitable Tolling Applies to Plaintiffs' Claims

Equitable tolling, which is distinct from the discovery rule but which Defendants fail to address, also applies to Plaintiffs' claims.[19] Equitable tolling allows courts to "toll the statute of limitations until such a time that the court determines would have been fair for the statute of limitations to begin running on the plaintiff's claims." *Arce v. Garcia*, 434 F.3d 1254, 1261 (11th Cir. 2006). Its application is appropriate when "it would have been impossible for a reasonably prudent person to learn" that discrimination had occurred. *Miller v. Int'l Tel. & Tel. Corp.*, 755 F.2d 20, 24 (2d Cir. 1985). Numerous courts have held that equitable tolling applies to ECOA and FHA claims. *See, e.g.*, *AMS Grp. LLC v. J.P. Morgan Chase Bank*, 371 F. App'x 149, 150 (2d Cir. 2010) ("[T]he limitations period governing an ECOA . . . claim may be equitably tolled under some circumstances."); *Council v. Better Homes Depot, Inc.*, 2006 WL 2376381 (E.D.N.Y. Aug. 16, 2006) (finding equitable tolling applied to preserve plaintiffs' ECOA and FHA claims).[20] Just this Term, the Supreme Court reaffirmed the "'rebuttable presumption of equitable tolling applicable to suits against private defendants.'" *Sibelius v. Auburn Reg'l Med. Ctr.*, 2013 WL 215485, Slip. Op. at 13 (Jan. 22, 2013) (quoting *Irwin v. Dep't of Veterans Affairs*, 498 U.S. 89, 95-96 (1990)).

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[18] Defendants rely on *Archer v. Nissan Motor Acceptance Corp.*, 550 F.3d 506 (5th Cir. 2008) and *Moseke v. Miller & Smith, Inc.*, 202 F. Supp. 2d 492 (E.D. Va. 2002). MTD at 9-10. District Courts in the Second Circuit have not adopted the view of those courts. *See, e.g.*, *Clement*, 2012 WL 6720701.

[19] Defendants' arguments addressed to the discovery rule do not automatically apply to equitable tolling. Defendants rely on *Garcia v. Brockway*, 526 F.3d 456 (9th Cir. 2008), but *Garcia*, addressing the specific context of FHA design-and-construction claims, distinguishes the discovery rule from equitable tolling and notes that its holding should not be read to foreclose equitable tolling. *Id.* at 465 n.8 (noting that opinion does not bar equitable tolling for FHA claims).

[20] Courts have also applied equitable tolling to ELCRA claims. *Downer v. Rite Aid Corp.*, 2011 WL 3799884 (E.D. Mich. Aug. 29, 2011); *Krause v. Lexisnexis*, 2007 WL 201023 (E.D. Mich. Jan. 23, 2007).

Defendants' argument regarding fraudulent concealment, MTD at 12, is misplaced because Plaintiffs need not satisfy the standard of Rule 9(b) in order to establish that equitable tolling applies. *See Sexton v. Franklin First Fin., Ltd.*, 2009 WL 1706535, at *16 (E.D.N.Y. June 16, 2009). "[F]raudulent concealment is not essential to equitable tolling," although the two are "often confused." *Valdez ex rel. Donely v. United States*, 518 F.3d 173, 182 (2d Cir. 2008).[21]

3. Plaintiffs Have Alleged Facts Sufficient to Satisfy the Elements of the Discovery Rule and Equitable Tolling

As this Court has noted, the critical inquiry in both equitable tolling and discovery rule analysis is determining the earliest date on which either 1) plaintiffs actually became aware of their claims or 2) plaintiffs through due diligence could have become aware of their claims. *Thompson*, 149 F. Supp. 2d at 48, 53.

Plaintiffs did not know, and could not have known, that Morgan Stanley's policies caused a disparate impact on them and other African-American borrowers in Detroit before consultation with their attorneys in 2012. Compl. ¶¶ 140, 160, 175, 191, 204; *see Council*, 2006 WL 2376381, at *10 ("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."). These consultations only took place after the publication of the Financial Crisis Inquiry Commission's final report in January 2011,[22] the filing of the Federal Housing Finance

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[21] Indeed, the requirements of fraudulent concealment may even be met without affirmative action on the part of the defendant where "the wrong itself was of such a nature as to be self-concealing," *New York. v. Hendrickson Bros., Inc.*, 840 F.2d 1065, 1083 (2d Cir. 1988), as in a case of fraud or discrimination, *see Council*, 2006 WL 2376381 at *9 (noting facts in case asserting FHA and ECOA claims resembled those recognized to be "self-concealing" in Second Circuit courts). Among other things, Morgan Stanley's deviation from its own underwriting standards certainly qualifies as self-concealing.

[22] *See* Financial Crisis Inquiry Commission Homepage, *available at* http://fcic.law.stanford.edu/about/history. ("On January 27, 2011 the Commission delivered its report to the President, Congress and the American people.") (website maintained by Stanford Law School).

Administration's lawsuit in September 2011,[23] and the filing of *Allstate v. Morgan Stanley* in July 2011,[24] all of which revealed Morgan Stanley's close relationship with New Century, its influence in New Century's origination of Combined-Risk loans, and its attempts to conceal the high risk nature of the loans it securitized. *See* Compl. ¶¶ 53 (FHFA), 65, 76, 85 (FCIC), 45, 54, 68, 72, 75 (Allstate). Even if Plaintiffs had known of both the existence of Morgan Stanley's alleged policies and the effect of those policies on the mortgage loans they obtained from New Century, they could not have been—and were not—aware of the disparate impact that the policies created, which only becomes apparent upon analysis of aggregated data. *See Davidson v. Bd. of Governors*, 920 F.2d 441, 445 (7th Cir. 1990) (Posner, J.) (holding that statute of limitations period is tolled until disparate impact plaintiff has "enough evidence to determine whether the practice is unlawful," so long as "he could not obtain that evidence with due diligence"); *Phillips v. Better Homes Depot, Inc.*, 2003 WL 25867736, at *25 (E.D.N.Y. Nov. 12, 2003) ("There is a difference between being aware that you got a bad deal and being aware that you were discriminated against in a systematic fashion.").

Given the applicability of the discovery rule and the doctrine of equitable tolling, any further questions are factual rather than legal and therefore inappropriate for decision on a motion to dismiss. *See Thompson*, 149 F. Supp. 2d at 49 (declining to resolve discovery rule question on summary judgment because issues of fact remained).

B. <u>Plaintiffs' Claims Are Timely Under the Continuing Violations Doctrine</u>

The continuing violations doctrine also renders Plaintiffs' claims timely because Plaintiffs allege "not just one incident of conduct" that violates the relevant statutes, but a set of

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[23] Complaint, *Fed. Hous. Fin. Admin. v. Morgan Stanley*, No. 652440, (N.Y. Sup. Ct. Sept. 2, 2011).

[24] Complaint, *Allstate v. Morgan Stanley*, No. 651840, (N.Y. Sup. Ct. July 5, 2011).

violations that continue into the limitations period. *Havens Realty Corp. v. Coleman*, 455 U.S. 363, 380-81 (1982).[25] Violations of the FHA and the ECOA occurred when Plaintiffs were issued Combined-Risk Loans and each time an action was taken to enforce those discriminatory mortgage contracts. *See Taylor*, 580 F. Supp. 2d at 1066 (finding, for FHA and ECOA claims, that "each mortgage statement that seeks inflated payments for the loan based upon discriminatory terms is another violation visited upon Plaintiff"); *Lomboy v. SCME Mortg. Bankers*, 2009 WL 1457738, at *8 (N.D. Cal. May 26, 2009) ("[T]he claim is not barred by ECOA's two-year statute of limitations, as Plaintiff alleges a violation not only at the time of closing (which is outside of the statute of limitations period), but every time she makes a payment that is inflated because of the alleged discrimination.") (citations omitted); *Jackson v. Novastar Mortg., Inc.*, 645 F. Supp. 2d 636, 645 (W.D. Tenn. 2007) (denying motion to dismiss where Plaintiff contends "that each new loan and each loan payment paid by an affected minority borrower constitutes a continuing violation"). Because demands for payment and threats of foreclosure were made pursuant to those contracts during the two year period before the filing of this lawsuit, Compl. ¶¶ 138, 158, 172, 190, 203, 218-19, Plaintiffs' claims are timely.

Defendants' argument to the contrary fails to acknowledge that Plaintiffs' assert *disparate impact* claims rather than discriminatory treatment claims. Defendants insist that the continuing effects of an incident of discrimination are not themselves new violations rendering applicable the continuing violation doctrine. MTD at 11-12 (citing *Delaware State Coll. v. Ricks*, 449 U.S. 250 (1980) (disparate treatment claim); *United Air Lines, Inc. v. Evans*, 431 U.S.

[25] Congress endorsed the *Havens* continuing violation doctrine in its 1988 amendments to the FHA, which provides that the statute of limitations runs from either the date of "occurrence" or the date of "termination" of the discriminatory housing practice. 42 U.S.C § 3613(a)(1)(A). The inclusion of the term "termination" was "intended to reaffirm the concept of continuing violations, under which the statute of limitations is measured from the date of the last occurrence of the unlawful practice." *Miller*, 571 F. Supp. 2d at 261 n.20 (citations omitted).

553 (1977) (same); *Harris v. City of New York*, 186 F.3d 243 (2d Cir. 1999) (same); *Garcia v. Brockway*, 526 F.3d 456 (9th Cir. 2008) (design and construction claim)).

As the Supreme Court recently held in a unanimous decision, however, disparate impact claims raise different statute-of-limitation considerations. In *Lewis v. City of Chicago*, 130 S. Ct. 2191 (2010) (Scalia, J.), the Court rejected the proposition that "present effects of prior actions" could not be cognizable violations of Title VII in a disparate impact case. 130 S. Ct. at 2199. In a discriminatory intent case, "the plaintiff must demonstrate deliberate discrimination within the limitations period." *Id.* (citations omitted). But "[t]hat reasoning has no application when, as here, the charge is disparate impact." *Id.* Accordingly, the Court held that the City of Chicago could have violated Title VII not only when it administered to aspiring firefighters a written examination alleged to have caused a disparate impact, but also on each subsequent date on which it hired firefighters based on the results of that examination. *Id.* at 2198. In so doing, the *Lewis* court specifically rejected the argument that, because "the exclusion of petitioners when selecting classes of firefighters *followed inevitably* from the earlier decision" to hire only applicants who had reached a certain cutoff score, "no new violations could have occurred" thereafter. *Id.* at 2198-99 (emphasis added). Although the initial decision might have violated the law, "it does not follow that no new violation occurred—and no new claims could arise—when the City implemented that decision down the road." *Id.* at 2199.

The application of *Lewis* to Plaintiffs' claims is clear. The Second Circuit interprets the FHA and the ECOA in tandem with Title VII. *See Hack*, 237 F.3d at 90; *Jones v. Ford Motor Credit Co.*, 2005 WL 743213, at *8 (S.D.N.Y. Mar. 31, 2005). Because Plaintiffs assert disparate impact claims, a new violation occurs each time Plaintiffs feel the effect of an action that "follow[s] inevitably" from the origination of Plaintiffs' mortgages or that "implements" the

terms of those mortgages. *See Lewis*, 130 S. Ct. at 2198-99. In a disparate impact suit, because the gravamen of the claim is the effect of the challenged policy, the operative question is whether plaintiffs experienced that effect during the limitations period. *See Miller*, 571 F. Supp. 2d at 262 (applying continuing violations doctrine where "the disparate effects likewise continue in the relevant period"); *Davis v. Gen. Motors Acceptance Corp.*, 406 F. Supp. 2d 698, 706 (N.D. Miss. 2005) (recognizing as consistent with Supreme Court precedent that, in disparate impact suit, monthly payments inflated as a result of challenged policy constitute violations in limitations period); *cf. Woodworth v. Bank of Am., N.A.*, 2011 WL 1540358, at *14 (D. Or. Mar. 23, 2011) *report and recommendation adopted sub nom. Woodworth v. Bank of Am., N.A.*, 2011 WL 1542514 (D. Or. Apr. 21, 2011) (recognizing that *Lewis* requires different analysis of statute of limitations question for FHA discriminatory treatment and disparate impact claims).[26] Plaintiffs' allegations that they have been subject to demands for payment and threats of foreclosure during the limitations period are therefore sufficient.

IV. PLAINTIFFS HAVE STANDING

"Congress and the Supreme Court have made clear that standing to sue under the FHA is extraordinarily permissive." *Clearing House Ass'n, L.L.C. v. Cuomo*, 510 F.3d 105, 125 (2d Cir. 2007) *aff'd in part, rev'd in part*, 557 U.S. 519 (2009). The standing inquiry is "subject to the same degree of proof that governs other contested factual issues," which means that "at the

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[26] None of the cases cited by Defendants on this point address *Lewis* and, in some cases, they do not address claims of disparate impact at all. *Hernandez v. Sutter W. Capital*, 2010 WL 3385046 (N.D. Cal. Aug. 26, 2010) (no mention of *Lewis*); *King v. Ameriquest Mortg. Co.*, 2009 WL 3681688 (D. Md. Oct. 30, 2009) (no discrimination claims); *Cervantes v. Countrywide Home Loans, Inc.*, 2009 WL 3157160 (D. Ariz. Sept. 24, 2009) (discriminatory treatment, pre-*Lewis*); *Thiel v. Veneman*, 859 F. Supp. 2d 1182, 1198 (D. Mont. 2012) (disparate treatment); *Ohio Civil Rights Comm'n v. Wells Fargo Bank, N.A.*, 2012 WL 1288489 (N.D. Ohio Apr. 16, 2012) (post-*Lewis*, relying entirely on *Hernandez*, *King*, and *Cervantes*).

pleading stage, standing allegations need not be crafted with precise detail, nor must the plaintiff prove his allegations of injury." *Baur v. Veneman*, 352 F.3d 625, 631 (2d Cir. 2003). On a Rule 12(b)(1) motion, Plaintiffs need only "affirmatively and plausibly suggest" that they have standing. *Amidax Trading Grp. v. S.W.I.F.T. SCRL*, 671 F.3d 140, 145 (2d Cir. 2011).

Plaintiffs meet this standard by alleging an injury that was caused by Morgan Stanley's policy of orchestrating the sale of Combined-Risk Loans for securitization. In arguing that Plaintiffs lack standing, Defendants recycle their merits arguments, suggesting that Article III requires a Plaintiff to plead "qualifications" for a "better" loan, and repeating the causality point they raised in connection with the requirements for pleading disparate impact. *See supra* Sections II.B & II.C.[27]

Defendants' "qualifications" point defies logic as a standing argument for all the same reasons it falls short as an argument on the merits. *Supra* Section II.C. Defendants identify no authority in support of the premise that a Plaintiff will lack standing to bring a discrimination claim unless she alleges that her credit "qualifications" meet the hypothetical underwriting standards for a "better" loan. Instead, they rely on several inapposite cases.[28]

Plaintiffs also sufficiently allege that their injuries are "fairly traceable" to the actions of

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[27] Defendants do not argue that Michigan Legal Services lacks standing, and indeed, the Second Circuit takes a "broad view" of organizational standing. *E. Paralyzed Veterans Ass'n, Inc. v. Lazarus-Burman Assocs.*, 133 F. Supp. 2d 203, 211 (E.D.N.Y. 2001).

[28] *See* MTD at 27 (citing *Lee v. Bd. of Governors of the Fed. Reserve Sys.*, 118 F.3d 905, 913 (2d Cir. 1997) (finding no standing to challenge administrative order under statute that lacks private right of action); *Melendez v. Ill. Bell Tel. Co.*, 79 F.3d 661 (7th Cir. 1996) (Title VII plaintiff must prove that, but for challenged employment test, he was eligible for job); *Boucher v. Syracuse Univ.*, 164 F.3d 113, 116 (2d Cir. 1999), *aff'ing* 1996 WL 328444, *3 (N.D.N.Y. June 12, 1996) (affirming lower court holding that plaintiffs lack standing to bring Title IX "equal athletic benefits claim" when they were not on varsity team and so could not receive unequal athletic benefits); *In Re Taxable Mun. Bond Sec. Litig.*, 51 F.3d 518, 523 (5th Cir. 1995) (finding no standing where plaintiff did not participate in loan program he alleged was a RICO enterprise); *Palmieri v. Town of Babylon*, 2006 WL 1155162, at *13 (E.D.N.Y. Jan. 6, 2006) (finding no standing in light of absolute lack of showing of disparate impact)).

Defendants. The Supreme Court has rejected the notion that fair traceability is equivalent to "proximate cause" or that it requires that the "defendant's actions are the very last step in the chain of causation." *Bennett v. Spear*, 520 U.S. 154, 168-69 (1997). Rather, a plaintiff may have standing even when alleging that the defendant's conduct "indirectly caused" the injury, so long as "the defendant's actions *constrained or influenced* the decision of the final actor in the chain of causation." *Carver v. City of New York*, 621 F.3d 221, 226 (2d Cir. 2010) (emphasis added).[29] Plaintiffs have alleged in very detailed terms that Morgan Stanley "constrained or influenced" New Century's lending practices. *See* Compl. ¶¶ 43-85; *see also supra* Section II.B.

V. PLAINTIFFS ARE ENTITLED TO SEEK INJUNCTIVE AND DECLARATORY RELIEF

The FHA and ECOA are sweeping remedial statutes, both of which expressly empower courts to issue injunctive and declaratory relief. *See* 42 U.S.C. § 3613(c)(1); 15 U.S.C. § 1691e(c). Accordingly, "[t]he district court's power to craft relief in the housing and civil rights area is broad." *Ueno v. Napolitano*, 2007 WL 1395517, at *3 (E.D.N.Y. May 11, 2007) (quotation marks and citation omitted). That authority includes "not merely the power but the duty to render a decree which will so far as possible eliminate the discriminatory effects of the past as well as bar like discrimination in the future." *Williamsburg Fair Hous. Comm. v. N.Y.C. Hous. Auth.*, 493 F. Supp. 1225, 1250-51 (S.D.N.Y. 1980) (quoting *Louisiana v. United States*, 380 U.S. 145, 154 (1965)).

Defendants argue, first, that Plaintiffs lack standing to seek injunctive relief because New

[29] Defendants rely on *Nat'l Council of La Raza v. Mukasey*, 283 Fed. App'x 848 (2d Cir. 2008). There, plaintiffs were unable to show a causal nexus between the challenged federal policy and the actions of local authorities because, according to the complaint, "a number of state and local authorities choose not to comply with" requests made pursuant to the policy, and the plaintiffs did not "allege that such authorities suffer any adverse consequence from this resistance." *Id*. at 852. In this case, nothing in the Complaint suggests that New Century resisted Morgan Stanley's policies.

Century is no longer in business and Plaintiffs do not allege a specific intention to obtain new mortgages in the future. MTD at 29. As an initial matter, New Century's bankruptcy has no bearing on this issue. The allegations in the Complaint describe Morgan Stanley's policy of orchestrating the sale of Combined-Risk Loans for securitization; prospective injunctive relief would therefore focus on Morgan Stanley's policies for purchasing and securitizing loans. *Cf.* Assurance of Discontinuance, *In re Morgan Stanley*, 10-cv-2538 (Mass. Sup. Ct. June 24, 2010), ¶¶ 45-47 (outlining prospective relief benefiting Massachusetts borrowers relating to the purchasing and securitizing of subprime loans in settlement involving securitization of New Century loans).[30]

Additionally, each individual Plaintiff is either at imminent risk of losing her current home, Compl. ¶¶ 139 & 172, has already lost her home, *id.* ¶ 159, or is subject to Combined-Risk Loan terms carrying an inherent risk of foreclosure, *id.* at ¶¶ 190 & 203, and therefore faces an imminent need to reenter the housing market.[31] Any doubt about the level of future harm Plaintiffs face should be resolved with the benefit of discovery. *See Alliance of Am. Insurers v. Cuomo*, 854 F.2d 591, 597 (2d Cir. 1988); *Rodriguez*, 2009 WL 995865, at *11. Finally, Defendants' argument has no bearing on Plaintiffs' right to seek equitable disgorgement of the unjust enrichment Defendants derived from their discriminatory practices. Because disgorgement is "a quintessentially backward-looking remedy focused on remedying the effects of past conduct to restore the status quo," *United States v. Philip Morris USA, Inc.*, 396 F.3d 1190, 1198 (D.C. Cir. 2005), its availability will not turn on the likelihood of future injury.

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[30] The Assurance of Discontinuance is cited numerous times in the Complaint (¶¶ 48, 52 & 62) and is available at http://www.mass.gov/ago/docs/press/2010/2010-06-24-ms-settlement-attachment3.pdf

[31] The actual or imminent foreclosures faced by Plaintiffs, and the attendant need to reenter the housing market, supply the level of concreteness missing in *Vaughn v. Consumer Home Mortg. Co.*, 297 Fed. Appx. 23, 26 (2d Cir. 2008), which Defendants cite, MTD at 30.

Defendants also argue that equitable relief is unavailable absent a showing of irreparable harm or the inadequacy of legal remedies, MTD at 30, but as noted above, the statutes at issue here expressly provide for equitable relief. "Therefore, '[t]he contention that [ ] plaintiff[s] failed to prove the existence of the usual equitable grounds for relief, such as irreparable damage, is plainly irrelevant. Where an injunction is authorized by statute it is enough if the statutory conditions are satisfied.'" *Barkley v. United Homes, LLC*, 848 F. Supp. 2d 248, 273-74 (E.D.N.Y. 2012) (alterations in original) (quoting *Henderson v. Burd*, 133 F.2d 515, 517 (2d Cir. 1943)).

CONCLUSION

For the reasons set out above, Plaintiffs respectfully request that the Court deny Defendants' Motion to Dismiss.

Dated this 25th day of January, 2013.
Respectfully submitted by,

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