15-2398

In the United States Court of Appeals for the Second Circuit

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

v.

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

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

APPELLANTS' OPENING BRIEF

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

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

Elizabeth J. Cabraser
LIEFF CABRASER HEIMANN & BERNSTEIN, LLP
275 Battery Street, 29th Floor
San Francisco, CA 94111
(415) 956-1000

-and-

Rachel J. Geman
250 Hudson Street, 8th Floor
New York, NY 10013
(212) 355-9500

Counsel for Plaintiffs-Appellants

CORPORATE DISCLOSURE STATEMENT

Appellant Michigan Legal Services is a nonprofit corporation incorporated in the State of Michigan. It has no parent corporation, nor does any publicly held corporation own 10% or more of its stock.

All other Appellants are natural persons.

TABLE OF CONTENTS

Pages

TABLE OF CONTENTS

Pages

TABLE OF CONTENTS

Pages

TABLE OF AUTHORITIES

Pages

Cases

TABLE OF AUTHORITIES
(continued)

Pages

TABLE OF AUTHORITIES
(continued)

Pages

TABLE OF AUTHORITIES
(continued)

Pages

Statutes

Rules

Other Authorities

JURISDICTIONAL STATEMENT

The district court has federal question jurisdiction over Appellants' claims because they arise under the federal Fair Housing Act. *See* 28 U.S.C. § 1331.

This appeal challenges the district court's denial of Appellants' motion for class certification. This Court has jurisdiction over this appeal because it granted Appellants' petition for review. JA 2046; *see also* Fed. R. Civ. P. 23(f); Fed. R. App. P. 5(d); 28 U.S.C. § 1292(e). The petition was timely filed fourteen days after the district court entered its Opinion and Order ("Order"). JA 16; Petition for Permission to Appeal the Denial of Class Certification Pursuant to Fed. R. Civ. P. 23(f) ("Petition"), No. 15-1748 (2d Cir.), ECF No. 1; *see also* Fed. R. Civ. P. 23(f).

ISSUES PRESENTED

1. Whether the district court erred in its analysis of Rule 23(a) typicality, requiring a degree of identity among class representatives and the class found nowhere in the law;

2. Whether the erroneous typicality analysis prevented the district court from fully and properly considering certification of an issue class or the proposed alternative class; and

3. Whether the district court erred by not adopting the class mechanism as the superior, and only, available procedure that enables the fair, efficient, and economically-feasible determination of the merits of Appellants' claims.

STATEMENT OF THE CASE

I. NATURE OF THE CASE.

The Fair Housing Act, 42 U.S.C. § 3605, prohibits discrimination by secondary mortgage market actors who purchase pools of mortgage loans. Appellants[1] and the proposed class, African-Americans residing in the Detroit area, experienced such discrimination during the subprime boom: Morgan Stanley's policies for the purchase and securitization of mortgages made them categorically more likely than comparable white borrowers to receive the predatory, layered-risk loans that New Century Mortgage Company ("New Century") issued to them.

The district court denied Appellants' motion for class certification, *see* 307 F.R.D. 119, pointing in various ways to the purported complexity of the systemic policies they challenge as inimical to class treatment. In fact, discrimination by mortgage securitizers will always occur in situations requiring the involvement of intermediary actors—the originators—and will always involve loan pools consisting of various similar, but not identical, loans. Nonetheless, a discernibly common pattern emerges upon analysis—a pattern of common conduct harmed an objectively identifiable group, giving rise to typical claims that are best and most efficiently determined on a group basis. The district court's reasoning realistically

---

[1] Appellants are the class representatives, Beverly Adkins, Charmaine Williams, Rebecca Pettway, Rubbie Mccoy, William Young (each suing on behalf of himself or herself and others similarly situated), and Michigan Legal Services.

forecloses class certification for any cohesive group of borrowers seeking to challenge a securitizer's discrimination, insulating such parties from the liability that the Fair Housing Act explicitly imposes.

II. PROCEDURAL HISTORY.

Plaintiffs-Appellants ("Appellants") filed this class action lawsuit on October 15, 2012. On July 25, 2013, the district court (Judge Harold Baer, Jr.) denied Morgan Stanley's[2] motion to dismiss Appellants' Fair Housing Act ("FHA") claim. Judge Baer dismissed as untimely Appellants' claims under the Equal Credit Opportunity Act and Michigan law, and dismissed their claim for injunctive relief.[3] Thus, the common legal claim for all class members arises under the FHA provision that proscribes discrimination related to bulk purchases of mortgage loans. Appellants are the first victims of discriminatory lending seeking to enforce this provision against a purchaser of loans.

On May 14, 2015, the district court (Judge Valerie E. Caproni) denied Appellants' motion for class certification both with respect to a class of all African-American borrowers in the Detroit region who received certain layered-risk loans as a result of Morgan Stanley's policies, and a narrower alternative class

---

[2] Defendants-Appellants Morgan Stanley, Morgan Stanley & Co. LLC, and the other affiliated defendants are referred to collectively as "Morgan Stanley"

[3] If Appellants have this claim reinstated in a later appeal in these proceedings, a (b)(2) class is appropriate.

consisting only of those borrowers whose loans Morgan Stanley ultimately purchased. SA 1-2, 49. The district court stated that its ruling might be appropriate for review under Rule 23(f). SA 49-50. Appellants filed a petition under Rule 23(f) on May 28, 2015, *see* Petition, which this Court granted on July 30, 2015. JA 2046.

III. RELEVANT FACTUAL AND STATUTORY BACKGROUND.

Each class representative and each member of the original proposed class is an African-American resident of the Detroit area who received a costly, layered-risk mortgage loan (a "Combined-Risk Loan") as a result of Morgan Stanley's policies and practices for purchasing and ensuring the continuing supply of subprime mortgage loans to securitize. Layered-risk loans combine multiple risk factors, each of which "increases the default and foreclosure risk to the borrower," thereby boosting "the already high risk of default even higher than the sum of its parts." JA 397, 403.

In particular, Combined-Risk Loans are layered-risk loans that all share two common features. First, they are all "High-Cost" loans under the Home Mortgage Disclosure Act ("HMDA"), 12 U.S.C. § 2801 *et seq.*, definition.[4] Second, they

[4] High-Cost loans, as defined by the HMDA regulations, are first-lien loans in which the annual percentage rate plus borrowing costs exceeds the Treasury benchmark by more than three points, or subordinate loans with rates that exceed

each "contain two or more of eight risk factors [that] . . . increase the risk of default." SA 2. The factors are:

> "(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."

SA 11.

Morgan Stanley's cohesive, unitary securitization scheme, coupled with its special, singular relationship with the now-defunct subprime lender New Century, caused New Century to issue these loans in unprecedented numbers. As a result of race, each class member was more likely to receive a Combined-Risk Loan.

Notably, New Century's contractual obligations to Morgan Stanley *required* that it originate loans with risky features, regardless of the creditworthiness of potential borrowers. Morgan Stanley consistently and systematically funded and purchased loans with these features, in combination, despite the risk they represented for borrowers. These policies caused the disparate impact that each

---

that benchmark by more than five points. SA 11 (citing 67 Fed. Reg. 43218, 43223 (June 27, 2002)).

class member experienced. The Fair Housing Act renders Morgan Stanley, as a purchaser of pools of mortgages, liable for that discrimination.

A. <u>The Morgan Stanley–New Century Relationship.</u>

Morgan Stanley needed a supply of loans to purchase for the sole purpose of packaging into securities, from which it booked the profits at the time of securitization. JA 2006, 2033-34. It ensured that large quantities of these loans would be issued, and that it could acquire them, through its close relationship with New Century.

During the proposed class period (2004-2007), Morgan Stanley was the principal trading partner of New Century. During each year of the class period, Morgan Stanley purchased the largest share of New Century loans sold on the secondary market. In 2004, Morgan Stanley purchased 46.4% of the dollar value of loans sold by New Century; the second-largest purchaser acquired 17.2%. JA 20. In subsequent years, it maintained its primacy among New Century's purchasers. *See* JA 645. Morgan Stanley was also New Century's largest provider of warehouse credit, lending New Century billions of dollars with which it originated mortgages. *See, e.g.,* JA 1032; SA 7 (quoting internal document stating that "New Century has approached Morgan Stanley because we are their number one relationship and they would like to keep us their number one relationship." (internal quotation marks omitted)). Morgan Stanley's own expert makes clear that there was no time during the class period during which a Wall Street bank provided more warehouse funding than did Morgan Stanley. JA 1032.

Virtually none of the loans Morgan Stanley purchased from New Century required the existence of a known borrower with an extant loan at the time Morgan Stanley agreed to buy it. SA 20. Instead, virtually all the loans were purchased in "forward" and "reverse" trades, in which the parties agreed that New Century would promise a pool of loans to Morgan Stanley with certain collective characteristics, and New Century would then find borrowers to populate those loans. *See* SA 20. Morgan Stanley's contention that each borrower and each loan is a unique snowflake with a unique story cannot, therefore, be taken seriously. During the relevant time, individuals were fungible, so long as they could be slotted into predetermined loans with predetermined characteristics. Having sought and arranged loans with certain terms, Morgan Stanley's common policies ensured that the loans would be rapidly purchased, bundled, and sold.

Beyond the economic scale of their dealings, Morgan Stanley and New Century maintained an "indisputably close" relationship. SA 7. For example, Morgan Stanley materials described the bank as New Century's "largest and most important counterparty." SA 7 (noting Morgan Stanley's statement that it was New Century's "#1 whole loan purchaser, #1 warehouse lender, and #1 underwriter on a market share basis"). Morgan Stanley understood the significance of the leverage it exerted over New Century: an internal Morgan Stanley document noted that New Century was "extremely open to our advice and involvement in all elements of their operation." SA 8 (citing JA 78). Another observed that "Morgan Stanley is involved in almost every strategic decision that New Century makes in securitized products." SA 8 (citing JA 90); *see also* JA 95 ("Because Morgan Stanley is such a large purchaser of loans from New Century, New Century has incorporated many of Morgan Stanley's best practices into their origination practices . . . .") (cited at SA 8). Morgan Stanley staff frequently worked on site at New Century. SA 8.

New Century also recognized the closeness of its relationship with New Century by providing Morgan Stanley with non-competitive bidding opportunities. *See* JA 178-81, 217-21. Even in otherwise-competitive situations, New Century sometimes sold loans to Morgan Stanley when it did not make the highest offer. *See* JA 90 ("New Century has sold loans to Morgan Stanley even when we were not the higher bid[.] New Century has offered to sell loans to Morgan Stanley in non-competitive offerings[.] New Century has given Morgan Stanley the 'last look' on many competitive offerings[.]").[5]

[5] Morgan Stanley acknowledged that no one was monitoring for disparate impact among purchased loans during the class period. JA 104-06, 442.

The interdependence between Morgan Stanley and New Century was such that Morgan Stanley went to extraordinary lengths to attempt to prevent New Century's bankruptcy in 2007, extending it hundreds of millions of dollars in new credit as other funders backed away. JA 126, 140, 143.

B. New Century's Centralized Underwriting Practices.

New Century conformed its underwriting practices to the needs of Wall Street purchasers. *See, e.g.*, JA 412 (New Century's Chief Financial Officer told investors that its "lending criteria [were] very much driven by the secondary market buyers of the loans, because our financing outlet is a buyer wanting to buy those loans." (citing New Century Financial Corporation at Southern California Investor Conference – Final, FD (Fair Disclosure) Wire, Aug. 11, 2006)); JA 41-42, 49, 160; Ex. 17 to Letter from Nicole D. Sugnet (Deposition of Patricia Lindsay), at 96, ECF No. 241-23 at 92 (noting Wall Street banks, including Morgan Stanley, "approved the guidelines"). Among these purchasers, Morgan Stanley exercised principal influence. *See* Section III.A *supra*.

To ensure that it originated loans that met Wall Street's demands, New Century created a centralized, automated underwriting system. Such automation was necessary given that New Century churned out, on average, more than 700 loans per day during the class period. JA 2021, 1639-40, 487 (913,832 total NC loans over 3.25-year class period).

The underwriting guidelines ensured that loan products would be originated "uniformly across the entire organization." JA 1638. They were incorporated into New Century's loan origination and automated underwriting systems, and they applied to all loans originated by the company. JA 1647. Under New Century's automated underwriting system, downstream employees and agents, like brokers and individual underwriters, maintained little to no substantive discretion to determine the loan terms for which any individual borrower qualified. JA 1639-44, 1650-57. Just five percent of New Century's loans represented "exceptions" to these guidelines. JA 1652-53.[6]

In sum, Morgan Stanley's common policies for ensuring pools of loans to purchase led New Century to originate loans with risky features on a discriminatory basis and through a uniform, centralized process.

---

[6] On this point, the district court improperly cited Morgan Stanley's unsupported oral assertion otherwise, without noting the sworn testimony of New Century's Chief Credit Officer—the individual in the best position to know about the exception rate. SA 5. And regardless of whether the figure is five or twenty-five percent, Morgan Stanley's focus on the exception rate misses the point entirely: New Century's underwriting was only a vehicle to ensure that Wall Street (and Morgan Stanley) would get the loans it wanted as quickly as possible.

C. <u>All Members of the Small and Geographically-Concentrated Class Received Predatory and Discriminatory Combined-Risk Loans.</u>

Appellants' proposed class is a small and geographically-concentrated group consisting of approximately 4,600 African-Americans in the Detroit area[7] who received Combined-Risk Loans ("CRLs") from New Century from 2004 until New Century's 2007 bankruptcy. SA 2, 25. As noted above, this definition serves as a "proxy for the type of layered-risk loans associated with high rates of default and foreclosure." JA 405; *see also* JA 495-96. New Century originated 9,826 CRLs in the Detroit area during the class period, and Morgan Stanley purchased one-quarter of them. JA 499.

The record in support of class certification demonstrates that each CRL feature increases the risk of default and that this risk is compounded when a loan contains multiple such features. *See, e.g.*, JA 396-405. The features are associated with higher costs and payment shock. Appellants presented expert regression analysis that carefully controlled both for loan-related features and for the creditworthiness of the borrower. The analysis showed that African-American borrowers were (a) more likely than similarly creditworthy white borrowers to receive High-Cost loans, a common harm shared by all class members; and (b)

---

[7] The Detroit area consists of the nine counties making up the Detroit metropolitan statistical area.

more likely than similarly creditworthy white borrowers to receive CRLs. JA 511-12; SA 20-21. The results were consistent in the Detroit area and nationwide, whether considering all New Century loans or solely those loans purchased by Morgan Stanley. JA 511-12, 509-10. Like the policies at issue in most disparate impact cases, CRLs are not categorically illegal, but they have a harmful disparate impact that runs afoul of the Fair Housing Act. The district court properly found that the expert statistical analysis indicated that common issues exist as to the impact of CRLs. SA 26.

These statistical results are unsurprising; it was clear during the relevant time period that risk layering was a problem. As a senior Morgan Stanley manager noted, the list of layered risk loans "'read[] like a trash novel . . . [h]igh costs, non-arms-length, no income, apparent origination issues.'" JA 403. Morgan Stanley's conduct created this class.

Each of the five proposed class representatives, like the rest of the members of the class, is a Detroit resident who received a CRL from New Century. Morgan Stanley purchased class representative Rebecca Pettway's loan.[8]

---

[8] Morgan Stanley's purchase of one proposed class representative's loan reflects its overall practice of purchasing about twenty-five percent of the Combined-Risk Loans New Century issued in Detroit and a similar proportion of the Combined-Risk Loans New Century issued in Detroit to African-American borrowers. JA 499.

D. Morgan Stanley's Common Policies Made Class Members Disproportionately Likely to Receive Combined-Risk Loans.

Throughout the class period, as noted above, Morgan Stanley needed large numbers of subprime loans to package into mortgage-backed securities. In order to acquire those loans, it enacted policies for the funding and purchase of loans that led New Century to issue CRLs. As a matter of common policy, and in contrast to its prime loan business in which it did conduct individual review of loans, Morgan Stanley did not review most subprime loans. JA 108-09. Instead, it committed to acquire the vast majority of the New Century loans it purchased before New Century had even originated them and, once they were originated, Morgan Stanley purchased them without examining the credit fundamentals of most loans and borrowers, regardless of known, extant risk factors.[9]

1. Purchase policies.

As discussed above, between 90 and 100 percent of Morgan Stanley's whole-loan purchases from New Century were the result of "forward sales": Morgan Stanley would set the purchase price and features, and New Century would then originate loans with those characteristics. JA 28-32. In such scenarios,

[9] The district court ascribed significance to the fact that Morgan Stanley rejected *some* loans. But, that Morgan Stanley did not intend to purchase each and every "bad" loan does not affect the fact that its common policies resulted in the origination of risky loans with a discriminatory effect, the relevant inquiry in a disparate impact case.

Morgan Stanley would memorialize the characteristics of the loans it required New Century to deliver in the future in a "bid terms" agreement. JA 35-36, 101, 205-07, 297-300. Once Morgan Stanley and New Century agreed upon the bid terms, New Century was contractually required to generate loans with those characteristics. JA 162-77. Morgan Stanley's bid terms required the loans it purchased from New Century to have high interest rates, adjustable rates, and prepayment penalties, three CRL features. *See* SA 12, 28; JA 420-22, Ex. 46 to Decl. of Nicole D. Sugnet (describing bid terms), ECF No. 187-47; JA 301 (first page of Ex. 46 *supra*). It is undisputed that the bid terms contained these requirements throughout the class period.

Because purchasing an enormous volume of loans with these features was more important to Morgan Stanley than purchasing high-quality loans, it also systematically purchased loans from New Century with other CRL features, including excessive loan-to-value and debt-to-income ratios, stated- rather than verified-income requirements, and balloon-payment or interest-only features. *See* JA 420-42.

Throughout the class period, Morgan Stanley's purchase policies ignored the presence of these features and the risk of default that they entailed. As a matter of policy, and based on express agreement with New Century, Morgan Stanley did not examine the credit or compliance fundamentals of three-quarters of the loans

New Century presented, thus buying those loans irrespective of their credit or compliance qualities. *See, e.g.*, JA 311-12, 323. Thus, by agreement, New Century could (and did) originate risky loans for purchase by Morgan Stanley. *See* JA 426-31. Morgan Stanley knew well the loans were risky and dangerous—employees referred to "un-cured compliance violations . . . expos[ing] us to potential class-action litigation," JA 305, to "bad loans," JA 307, and to "scaaaarrryyyyy loans," JA 309—but did nothing.

Common policies ensuring lack of review also led directly to the issuance of loans with particular risk features identified in the CRL definition. For example, Morgan Stanley relied on appraisal review procedures that it knew to be faulty, causing widespread origination of loans with excessively high loan-to-value ("LTV") ratios. Specifically, inflated appraisals understate the LTV ratio of a loan because they overstate the denominator in that ratio—the value of the property. Although Morgan Stanley's head of valuation diligence wanted to "eliminate dependence" on its dysfunctional appraisal review system in an effort to "mitigate collateral risk as it relates to potential future default and fraud," JA 343-44, Morgan Stanley continued to use throughout the relevant time period this common, faulty appraisal tool, which systematically allowed through appraisals known to regularly be inflated.

It is not surprising that Morgan Stanley had a common policy of declining to review most loans in order to purchase those with any and all CRL features, given that its trading desk and contract finance group wielded final authority on the policies governing loan review. *See* JA 97 (trading desk personnel had final authority on valuation diligence procedures). The head of due diligence referred to the head of the trading desk as "the boss." JA 347. Morgan Stanley's decision to place that authority with the business side, instead of with due diligence specialists, demonstrates that its ultimate plans for loan securitization drove the entire, unitary loan purchasing enterprise.

2. <u>Funding policies.</u>

Morgan Stanley provided New Century with warehouse lines of credit in order to ensure that New Century originated and sold it large volumes of loans for securitization. JA 77 (Morgan Stanley email recommending approval of New Century request regarding warehouse credit because *inter alia*, "[the Securitized Products Group] will continue to be awarded [sic] by this client for being flexible and helping them during this turbulent time in the market"); JA 132. Morgan Stanley specifically agreed to fund those lines of credit loans with CRL features including excessive LTV ratios, balloon payments, and stated income loans (including even riskier "No Income, No Asset" loans). JA 274, 282-83. Morgan Stanley further permitted and ensured the riskiness of loans it funded by reviewing credit and compliance for just 5% of loans on the warehouse line. *See* Ex. 42 to Letter from Laurence M. Schwartztol (Morgan Stanley – Securitized Products Group – Warehouse Lending Group Procedures Manual, dated 2006), at 15, ECF No. 187-42, at 16.

Thus, Morgan Stanley's overall scheme for acquiring New Century loans to securitize, enacted through policies common across pools of loans and across the class period, led to New Century's issuance of discriminatory loans to the class representatives and the class.

E. **The Fair Housing Act Prohibits Discrimination by Loan Purchasers.**

The Fair Housing Act's bar on discrimination applies to entities like Morgan Stanley purchasing loans on the secondary mortgage market. The FHA prohibits 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). The statute's implementing regulations expressly contemplate the form that Morgan Stanley's loan purchases took, making clear that discrimination by secondary market actors in "pooling or packaging" of mortgages is illegal. 24 C.F.R. § 100.125(b) ("unlawful conduct under this section includes, but is not limited to . . . [p]ooling or packaging loans or other debts or securities which relate to, or which are secured by, dwellings differently because of race." 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.

Like other provisions of the FHA, this antidiscrimination mandate can be enforced through disparate impact claims. *See* 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); *Texas Dep't of Hous. & Cmty. Affairs v. Inclusive Cmtys. Proj., Inc.,* 135 S. Ct. 2507, 2525 (2015). Appellants here bring just such a claim.

F. The Class Certification Proceedings in the District Court.

Appellants moved for certification under Rule 23(b)(3) of a class consisting of all African-Americans in the Detroit area who received Combined-Risk Loans from New Century during the class period (2004-2007). SA 2. During the course of the class certification proceedings, Appellants also argued that it would be proper to certify a narrower alternative class consisting solely of those borrowers whose Combined-Risk Loans Morgan Stanley purchased, and likewise (in the briefing and at argument) that the use of issue classes was a viable alternative. *See* Reply Br. at 17-18; JA 1829. At the class certification hearing, the parties addressed the larger and narrower classes. JA 1826-29, 1834-36, 1921-22, 1925-

26. The parties also further, albeit briefly, addressed the narrower alternative class in post-argument letters. *See* Letter from Plaintiffs' Counsel to Judge Caproni dated April 16, 2015, ECF No. 225; Letter from David W. Ogden to Judge Caproni dated April 21, 2015, ECF No. 226.

On May 14, 2015, the district court (a) found that typicality was not satisfied, and thus that Rule 23(a) was not satisfied, (b) found that Rule 23(b)(3) was not satisfied for either the broader or the narrower class, and (c) did not meaningfully consider using an issue class to resolve aspects of liability. At the Order's suggestion, SA 49-50, and due to the legal errors contained therein, Appellants filed a petition seeking interlocutory review. This appeal followed the granting of that petition.

SUMMARY OF THE ARGUMENT

A secondary market actor is liable for mortgage lending discrimination pursuant to a provision of the Fair Housing Act that bars discrimination in the "purchasing of loans . . . secured by residential real estate," 42 U.S.C. § 3605(b). The district court denied certification of a class bringing claims under this provision, erring primarily in its application of the typicality requirement. The court took an overly granular view of typicality, mandating a uniformity of circumstance and harm that Rule 23(a)(3) does not require, especially where, as here, Appellants challenge a common course of conduct. In addition, the district court did not properly embed the typicality analysis in the substantive claims of this disparate impact case; here, the defendant's intent does not matter, and harm is defined by the riskiness of the loans that were disproportionately issued to African-Americans.

These errors in the application of Rule 23(a) impacted the district court's consideration of whether issues or classes susceptible to common resolution could be certified in this case. Specifically, common issues exist with respect to aspects of Morgan Stanley's liability and with respect to the proposed alternative class of borrowers whose loans Morgan Stanley purchased pursuant to common policies. Relatedly, in the superiority analysis, the district court failed to consider the absence of alternative procedures through which class members could vindicate their FHA rights. A remand is appropriate, in particular for consideration of issue classes or the proposed alternative class.

The FHA provides that purchasers are liable for disparate-impact discrimination in their "pooling or packaging [of] loans," 24 C.F.R. § 100.125(b), but the district court's decision risks making this provision a nullity by requiring that those loans be disaggregated in FHA litigation, leaving discrimination to be challenged only on a loan-by-loan basis (and, realistically, not at all).

ARGUMENT

I. STANDARD OF REVIEW

This Court "review[s] a district court's class certification determination for abuse of discretion," but it "appl[ies] a 'noticeably less deferential' standard when the district court has denied class certification." *Roach v. T.L. Cannon Corp.*, 778 F.3d 401, 405 (2d Cir. 2015). It is also less deferential to underlying legal and factual determinations: it reviews "any findings of fact for clear error," and "the legal conclusions that informed [the] decision de novo." *Sykes v. Mel S. Harris and Assocs. LLC*, 780 F.3d 70, 79 (2d Cir. 2015). For example, review of a district court's "articulation of the legal standard governing" a threshold Rule 23(a) requirement is de novo. *In re Initial Pub. Offerings Sec. Litig.*, 471 F.3d 24, 41 (2d Cir. 2006).

In resolving a class certification motion, "[m]erits questions may be considered to the extent—but only to the extent—that they are relevant to determining whether the Rule 23 prerequisites for class certification are satisfied." *Amgen Inc. v. Connecticut Ret. Plans & Trust Funds*, 133 S. Ct. 1184, 1195 (2013) (citing *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2552 n.6 (2011)).

II. THE DISTRICT COURT MISAPPLIED THE TYPICALITY REQUIREMENT, PREVENTING A FINDING THAT RULE 23(a) WAS SATISFIED.

The district court correctly held that the class satisfied three of the Rule 23(a) prerequisites to certification, but it misapplied the law on typicality and found it to be absent.

A. As the District Court Correctly Concluded, the Class Representatives Established Numerosity, Commonality, and Adequacy.

The Order properly held that the proposed class, comprising more than 4,600 members, was sufficiently numerous, and that both the class representatives and their counsel would adequately represent the class. SA 25, 31-34. The district court also enumerated several common questions Appellants had presented and noted that Morgan Stanley did not dispute commonality. SA 26-27. Specifically, the district court acknowledged the existence of common questions suitable for "classwide resolution" including the extent of Morgan Stanley's influence on New Century's lending practices and the extent of the disparate impact of those lending practices on class members. SA 26.

B. The District Court's Construction and Application of the Typicality Requirement Imposed a Degree of Class Member Uniformity Found Nowhere in the Law.

The class representatives' claims are typical of those of the class: each class representative is an African-American resident of the Detroit area who received a Combined-Risk Loan from New Century that was intended for immediate re-sale to Wall Street—most likely, to Morgan Stanley—during the class period. Each such loan, like the loan of every class member, is High-Cost. Each such loan, like the loan of every class member, has layered risks, containing at least two features that, when combined with the cost of the loan, "increase the default and foreclosure propensity of the loan significantly." JA 397. The class representatives, like all other members of the class, assert claims on an identical theory under the Fair Housing Act. Morgan Stanley purchased class representative Rebecca Pettway's loan, making her claims typical of those of the alternative class.

The district court correctly rejected Morgan Stanley's arguments that purportedly unique defenses rendered the class representatives' claims atypical, but improperly held, misapplying the law, that (a) the class representatives did not represent a broad enough swath of the harms experienced by the proposed class, and (b) the class' claims did not derive from a unitary course of conduct.

1. **The typicality element of Rule 23(a)(3) does not require an identity of claims or wrongs.**

To certify an action for treatment on a class basis, the putative class representatives must show that "the[ir] claims or defenses . . . are typical of the claims or defenses of the class." Fed. R. Civ. P. 23(a)(3). This requirement "is not demanding." William B. Rubenstein, *Newberg on Class Actions* § 3:29 (5th ed. 2015). Plaintiffs "satisf[y typicality] when [1] each class member's claim arises from the same course of events, and [2] each class member makes similar legal arguments to prove the defendant's liability." *Marisol A. v. Giuliani*, 126 F.3d 372, 376 (2d Cir. 1997). As long as plaintiffs meet these requirements, it is generally irrelevant whether they allege precisely the same injury or a "broad range of injuries," *id*. at 377, or whether there is variance in "the specific facts from which the [claims] arose or the particularized relief sought," Rubenstein, *supra*, § 3:34.[10]

Courts adjudicating civil rights claims and similar claims have repeatedly found typicality satisfied when common systems are involved. *See, e.g.*, *Ellis v. Costco*, 285 F.R.D. 492, 535 (N.D. Cal. 2012) (rejecting arguments that individual circumstances of named plaintiffs representing class of employment discrimination claimants defeat typicality); *Taylor v. Hous. Auth. of New Haven*, 257 F.R.D. 23, 30-31 (D. Conn. 2009) ("While the circumstances and nature of each plaintiff's and class member's disability may differ," and claims arise from separate incidents, typicality nonetheless exists for claim that policy discriminated on the basis of disability); *Ansoumana v. Gristede's Operating Corp.*, 201 F.R.D. 81, 86-87 (S.D.N.Y. 2001) (rejecting arguments that typicality was absent among

---

[10] *See also Robidoux v. Celani*, 987 F.2d 931, 936 (2d Cir. 1993) (noting that "minor variations" in circumstances do not defeat typicality and that the typicality requirement "is satisfied when each class member's claim arises from the same [common] course of events and each class member makes similar legal arguments to prove the defendant's liability").

class of delivery workers assigned by labor agents to different stores, although class members performed different tasks, held different roles, and "worked different hours at different locations for different employers, during different periods of time and for different levels of compensation").

By requiring overlap, and not identity, between the class representatives' and class members' claims, the typicality requirement serves two purposes. It ensures both that "maintenance of a class action is economical" and that "the named plaintiff's claim and the class claims are so interrelated that the interests of the class members will be fairly and adequately protected in their absence." *Sykes*, 780 F.3d at 80 (quoting *Gen. Tel. Co. of S.W. v. Falcon*, 457 U.S. 147, 158 n.13 (1982)).

Given the long-established principle that a class representative need not share the exact injuries of every class member, courts have found typicality satisfied in a variety of contexts, many presenting more variation than exists in this case.[11] There is no requirement that the group of class representatives must act as a composite plaintiff, reflecting all class members' harms, nor that each micro-

---

[11] *See, e.g., Marisol A.*, 126 F.3d at 376-77 (affirming typicality finding where class of children raised wide variety of deficiencies in child welfare system, implicating different constitutional, statutory, and regulatory schemes, and no single child was affected by all claimed deficiencies).

facet of an overall scheme or course of discriminatory conduct must have its own class representative.

2. The class representatives' harms reflect those of the class.

Recently, the district court and Second Circuit opinions in *Sykes v. Mel Harris & Associates, LLC*, 285 F.R.D. 279, 291 (S.D.N.Y. 2012) (Chin, J.), *aff'd*, 780 F.3d 70, 84-87 (2d Cir. 2015), confirmed that factual differences among the plaintiffs as to the precise mechanism through which they were injured by a fraudulent scheme in no way defeat typicality. The plaintiffs in *Sykes* alleged that the defendants had fraudulently obtained default judgments against them, and defendants contended that typicality could not be satisfied, among other reasons, because they had properly served some class members with notice of debt actions while others had experienced fraud in both affidavits of service and affidavits of merit. 285 F.R.D. at 292. The court disagreed, concluding that typicality was satisfied because "any named plaintiff that appears to have been properly served still shares with the putative class the common fact of having fallen victim to an allegedly false affidavit of merit." *Id.*

By contrast, the district court here overlooked the pronounced commonalities among the injuries suffered by class members as a result of Morgan Stanley's discriminatory scheme. First, just as all *Sykes* class members shared the harm created by false affidavits of merit, all class members here received CRLs that are High-Cost.[12] Second, all the loans had layered-risk features that together operated to significantly increase the risk of default already elevated by the high interest rate. Even Morgan Stanley's own statistician found that over half the CRLs went delinquent, a rate significantly more than twice as high as for loans that were not CRLs and were issued to similar borrowers. JA 925-26, 982.

Instead of focusing on these bigger-picture similarities, the district court held that typicality was not satisfied because, in its view, the class representatives do not, collectively, represent a broad enough swath of the CRL permutations—Morgan Stanley tallied 33 different combinations of CRL features among class members' loans, and class representatives received loans with four of those combinations. SA 29-30.[13] But predatory lending schemes are characterized by myriad risky loan features allocated to different borrowers, *see* Section IV.B *infra* (quoting descriptions of such loans in *Saint-Jean v. Emigrant Mortg. Co*., 50 F. Supp. 3d 300, 313 (E.D.N.Y. 2014) and *City of Miami v. Bank of Am. Corp.*, 800 F.3d 1262, 1266 (11th Cir. 2015)), and such breadth does not mean that litigation

---

[12] Because African-Americans were more likely than white comparators on a statistically significant basis to receive High-Cost loans from New Century in the Detroit area (and nationwide), JA 511-12, all class members were harmed by this discrimination at the moment of origination. JA 1659-60, 1666.

[13] *See* SA 24 (noting "difficulty in identifying plaintiffs whose claims are 'typical' of the 33 differently-situated subsets of borrowers that exist in Plaintiffs' class"); SA 24 n.17 (suggesting more class representatives necessary to account for when and whether Morgan Stanley purchased loans and timing of origination).

concerning such schemes and their impacts must proceed separately for each borrower. Appellants have introduced expert evidence about the appropriateness of the CRL definition as an appropriate proxy for layered-risk lending, the sort of lending that creates payment shock and leaves borrowers stuck in unaffordable loans. JA 405, 495-98. It is unclear how another class representative who had received a loan with a high debt-to-income ratio—or 29 more representatives, for that matter—would better "fairly and adequately protect[]" the "interests of the [absent] class members," the central concern of the typicality analysis. *Marisol A. v. Giuliani*, 126 F.3d 372, 376 (internal quotation marks omitted).

The district court's other criticisms in the typicality analysis did not take the substantive claims into account. First, the district court noted that the class was defined regardless of the outcome of the loan—in other words, that some of the loans ultimately defaulted and some did not. SA 28-29. However, under the Fair Housing Act, receiving a predatory, risky loan is a cognizable harm regardless of whether the borrower ultimately defaults. *See Adkins v. Morgan Stanley*, No. 12-cv-7667(HB), 2013 WL 3835198, at *3 (S.D.N.Y. July 25, 2013) (finding that discriminatory issuance of high-risk loans itself constitutes an injury); *Saint-Jean v. Emigrant Mortg. Co.*, 50 F. Supp. 3d 300, 315 (E.D.N.Y. 2014) (rejecting argument that "injury [occurs upon] default[ ] on the mortgage"). Thus, to find that differences in whether an inherently risky (and costly) loan defaults prevent a finding that Rule 23(a)(3) is satisfied is improper in this context.

Second, the district court further concluded that the class representatives did not satisfy the typicality requirement on the basis that some of the harmful CRL features were terms that Morgan Stanley affirmatively sought, and some were loan terms that it "would have preferred to avoid" (such as a high loan-to-value ratio). SA 28. Yet the nature of the proof in this case does not differ based on which combination of CRL features were contained in each class member's loan, because each class member received a CRL and was therefore harmed by Morgan Stanley's unitary scheme. Consistent with *Sykes*, typicality is satisfied here.

Moreover, this is a claim of disparate impact discrimination. Morgan Stanley did not have to *intend* to discriminate, which renders problematic the Court's division between loan terms that Morgan Stanley affirmatively sought and those it purportedly wanted to avoid yet still knowingly purchased in droves. Identical policies resulted in Morgan Stanley's acquiring layered-risk loans; that it did not publically acknowledge systematically purchasing loans with certain of the risky features does not exonerate Morgan Stanley. It is undisputed that Morgan Stanley sought and needed High-Cost loans and those with certain CRL features (namely, adjustable rates, prepayment penalties, and balloon payments), and in order to get that supply, it funded and purchased loans with the other CRL features. Factually, the practices are not separable, and the various features were bound together in the same loans.[14]

3. The class' claims derive from a unitary course of conduct.

To determine whether "each class member's claim arises from the same course of events, and each class member makes similar legal arguments to prove the defendant's liability," *Marisol A.*, 126 F.3d at 376, courts "compare what is needed to prove the plaintiff's claim" with "the proofs needed for those of the proposed class." *In re Fosamax Prods. Liab. Litig.*, 248 F.R.D. 389, 398 (S.D.N.Y. 2008) (internal quotations omitted). *See* 1 Joseph M. McLaughlin, *McLaughlin on Class Actions* § 4:16 (11th ed. 2015) ("The purpose of the typicality requirement is to ensure that the interests of the class representative align with those of the class, so that by prosecuting his own case he simultaneously advances the interests of the absent class members.").

[14] Morgan Stanley also ensured the issuance of CRLs through the common faulty post-purchase practices described above, such as subjecting only a small fraction of New Century loans to credit or compliance review. The district court appears to have misunderstood the role of these policies. SA 37. Morgan Stanley's purported "diligence" (performed on a particular loan *after* it was originated) did not cause the origination. However, the absence of internal controls and disparate impact monitoring conveyed to New Century that it should rush, and enabled New Century in fact to rush, to satisfy bid terms by putting borrowers into the agreed-upon loans. Overall, Morgan Stanley's post-purchase policies were part of unitary scheme for the rapid and unfettered origination, sale, and securitization of certain kinds of loans.

As a result, where class representatives claim that discriminatory policies caused them harm, courts focus on those policies, and not the ways they impact individual class members, to find typicality. As one district court in this circuit put it in a disability discrimination case, typicality is satisfied where plaintiffs' "theory of liability is based on Defendants' alleged policy in relation to the *fact* of their disability, and not to the *nature* of their individual disabilities. *Taylor v. Hous. Auth. of New Haven*, 257 F.R.D. 23, 31 (D. Conn. 2009).[15] There, the court made clear that the individual manifestations of alleged discriminatory policies do not defeat typicality. *Id.*; *see also Colo. Cross Disability Coal. v. Abercrombie & Fitch Co.*, 765 F.3d 1205, 1216-17 (10th Cir. 2014) (affirming finding of typicality for disability discrimination claim based on common entrance design of many stores in nationwide chain, where lead plaintiff had only visited one store); *Lamumba Corp. v. Oakland*, No. 05-2712 MHP, 2007 WL 3245282, at *9-10 (N.D. Cal. Nov. 2, 2007) (finding typicality for proposed class of African-American businesses that had borrowed amounts from $1 to $15,000,000 challenging "City's discriminatory policies or practices in loan collection and

[15] *Vacated after trial sub nom. Taylor v. The Hous. Auth. of New Haven*, 267 F.R.D. 36 (D. Conn. 2010), *aff'd sub nom. Taylor ex rel. Wazyluk v. Hous. Auth. of City of New Haven*, 645 F.3d 152 (2d Cir. 2011).

management;" rejecting argument that need to look at individual loan applications and circumstances would defeat typicality).

By proving their own claims, the class representatives further those of the class. The Order compares a class member who had an adjustable rate mortgage with a prepayment penalty to one who had a stated income loan with a high debt-to-income ratio, suggesting that their claims differ significantly. SA 28. But both sets of features create the same risk that the borrower will be stuck in an unaffordable loan.

The real basis for the Court's distinction was the purported dichotomy between loan features Morgan Stanley explicitly sought to purchase and those it ostensibly did not want—but nonetheless knowingly funded and obtained through identical policies. All of these loan terms, individually and collectively, and especially in combination with elevated interest rates, make loans risky. Typicality requires that a court focus on a defendant's policies as a whole rather than parsing them in a manner that does not reflect the facts on the ground.

Moreover, in rejecting the notion that Appellants' injuries derived from a unitary course of conduct, the district court found that the "decisions of numerous third parties" were involved in causing those injuries. SA 30. This is speculation. Whether through a broker or New Century employee, New Century, using the same systems, and pursuant to the same demands, originated loans to sell. Morgan

Stanley's funding, contracting, purchase, and review of loans did not depend on whether a loan was originated through a New Century employee or a New Century broker.

Overall, Morgan Stanley wanted certain loans, and through common policies ensured it had access to them. It wanted those loans to bundle and securitize. In order to produce those loans, which New Century was contractually obligated to provide to Morgan Stanley and other Wall Street actors, New Century originated scores of predatory, risky loans. All of the CRL features were mixed together—in individual loans, in pools sold to Morgan Stanley, and in the securities that Morgan Stanley created, as the Fair Housing Act contemplates that they will be. *See* 24 C.F.R. §100.125.

III. AGAINST THE BACKDROP OF A REVISED TYPICALITY ANALYSIS, CERTIFICATION OF A LIABILITY CLASS OR THE PROPOSED ALTERNATIVE CLASS IS APPROPRIATE.

Because the district court found that the class did not meet the requirements of Rule 23(a), it did not meaningfully consider whether certifying an issue class to resolve aspects of liability or modifying the class definition would allow for efficient resolution of common questions. Reversal on this front and remand to consider the remaining questions pertaining to class certification is warranted. *See In re Am. Int'l Grp., Inc. Sec. Litig.*, 689 F.3d 229, 241-44 (2d Cir. 2012) (identifying legal error underlying district court's decision to deny settlement class certification and vacating for reconsideration rather than reversing outright); *see also Williams v. Mohawk Indus., Inc.*, 568 F.3d 1350, 1358-59 (11th Cir. 2009) (remanding to reconsider Rule 23(b)(3) analysis anew where the first attempt rested on error in Rule 23(a) analysis, and noting that "[t]hese are questions 'for the district court to address in the first instance, not this Court'").

Appellants address, first, how a Rule 23(c)(4) liability class would present common issues for resolution and would meaningfully forward the case, and, second, how the proposed alternative class, consisting only of borrowers whose loans Morgan Stanley purchased, would be proper.

A. Certification of an Issue Class Is Appropriate.

1. The Second Circuit has endorsed a broad reading of Rule 23(c)(4).

Rule 23(c)(4) allows for class certification "with respect to particular issues." The Second Circuit has instructed courts to "take full advantage" of this provision "to certify separate issues in order to reduce the range of disputed issues in complex litigation and achieve judicial efficiencies." *Robinson v. Metro-N. Commuter R.R. Co.*, 267 F.3d 147, 167 (2d Cir. 2001) (internal marks omitted); *Charron v. Pinnacle Grp. N.Y. LLC*, 269 F.R.D. 221, 242 (S.D.N.Y. 2010) (citing *Robinson*); *see also Gulino v. Bd. of Educ. of City Sch. Dist.*, 907 F. Supp. 2d 492, 507 (S.D.N.Y. 2012), *aff'd sub nom. Gulino v. Bd. of Educ. of N.Y.C. Sch. Dist.*, 555 F. App'x 37 (2d Cir. 2014) (noting continuing validity of *Robinson*'s "mandate" to utilize Rule 23(c)(4)). *Robinson*'s mandate is especially relevant in disparate impact suits because "[l]iability in [such] action[s] is established via class-wide, statistical proof." *Easterling v. Conn. Dep't of Correction*, 278 F.R.D. 41, 46 (D. Conn. 2011).

This obligation to consider issue classes persists regardless of the district court's view of predominance with respect to the claim as a whole. *See In re Nassau Cnty. Strip Search Cases* 461 F.3d 219, 227 (2d Cir. 2006) ("[A] court may employ subsection (c)(4) to certify a class as to liability regardless of whether the claim as a whole satisfies Rule 23(b)(3)'s predominance requirement."); *Jacob v. Duane Reade, Inc.*, 602 F. App'x 3, 7 (2d Cir. 2015) (citing *In re Nassau County*). Overall, this Court has "consistently endorsed a broad reading of Rule 23(c)(4)." *United States v. City of New York*, 276 F.R.D. 22, 33 (E.D.N.Y. 2011). Were the district court to find the Rule 23(a) prerequisites satisfied on remand, that finding would reframe its consideration of whether to certify an issue class.

2. <u>**An issue class for liability elements is appropriate for consideration here.**</u>

"Common preliminary issues" are appropriate for issue class treatment here. 5 J. Moore, et al., *Moore's Fed. Prac.,* § 23.23 (3d ed. 2014); *see also Chiang v. Veneman*, 385 F.3d 256, 267 (3d Cir. 2004) ("[C]ourts commonly use Rule 23(c)(4) to certify some elements of liability for class determination, while leaving other elements to individual adjudication") (citations omitted). Classwide resolution of these liability issues would "materially advance a disposition of the litigation as a whole." *Jacob v. Duane Reade, Inc.*, 293 F.R.D. 578, 593 (S.D.N.Y. 2013) *aff'd*, 602 F. App'x 3 (2d Cir. 2015).

In order to make out their prima facie case of disparate impact discrimination under the FHA, Appellants will need to prove "'that a challenged practice caused or predictably will cause a discriminatory effect.'" *Tex. Dep't of Hous. & Cmty. Affairs v. Inclusive Cmtys. Proj. Inc.*, 135 S. Ct. 2507, 2514 (2015) (quoting 24 CFR § 100.500(c)(1) (2014)).[16] Each element of the prima facie case lends itself to common resolution, but to the extent that the district court believes certain elements to be inappropriate for class treatment, there nonetheless remain liability issues that a Rule 23(c)(4) analysis would reveal to be proper for certification. *See Charron v. Pinnacle Grp. N.Y. LLC*, 269 F.R.D. 221, 242 (S.D.N.Y. 2010) (certifying common liability issues in (c)(4)/(b)(3) although "individualized issues of injury and causation are present and significant").

[16] At that point, the burden shifts to Morgan Stanley to "prov[e] that the challenged practice is necessary to achieve one or more substantial, legitimate, nondiscriminatory interests." *Id.* at 2514-15 (quoting § 100.500(c)(2)). Finally, the burden shifts back to Appellants, who "prevail upon proving that the substantial, legitimate, nondiscriminatory interests supporting the challenged practice could be served by another practice that has a less discriminatory effect." *Id.* at 2515 (quoting § 100.500(c)(3)).

The Order notes that "whether and to what extent Morgan Stanley controlled New Century and therefore is liable for its loans may be susceptible to classwide resolution" and that Appellants' claims about Morgan Stanley's liability for New Century's lending are likely "to rise or fall as a class." SA 26. The Order also recognizes ample evidence suggesting that the scale of Morgan Stanley's relationship influenced New Century's business practices. SA 8 (noting Morgan Stanley documents asserting, *inter alia*, that "Morgan Stanley is involved in almost every strategic decision that New Century makes in securitized products") (internal citations omitted). Moreover, the district court observed that the existence of a "large-scale disparate impact study . . . can be a powerful argument in support of commonality," SA 26, and Appellants have presented testimony showing that an African-American borrower was nearly 35% more likely than a similarly creditworthy white borrower to receive a CRL, and that this finding was statistically significant, SA 20-21; JA 470.

Resolution of the questions of whether Morgan Stanley is responsible for New Century loans or certain categories of them and whether those loans had a discriminatory impact, and the related common issues of whether, if so, Morgan Stanley's policies were justified or could have been altered to avoid that impact, would "materially advance" the litigation. *Jacob*, 293 F.R.D. at 593.[17] *See, e.g.*, *McReynolds v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 672 F.3d 482, 490 (7th Cir. 2012) (reversing denial of class certification, holding that where "[t]he incremental causal effect (overlooked by the district judge) of those company-wide policies—which is the alleged disparate impact—could be most efficiently determined on a class-wide basis."). Any remaining individual issues could be resolved at a later stage. *See* SA 32 n.24 (recognizing possibility of bifurcating liability and remedy phases in this action for disgorgement).

Resolution of these issues would advance the claims for borrowers whose loans Morgan Stanley solicited, bid on, and purchased. The appropriateness and efficiency of this narrow alternative class is described in further detail below.

B. Certification of the Proposed Alternative Class Is Likewise Appropriate.

Rule 23 also gives courts the power to modify class definitions and to certify sub-classes "when appropriate." Fed. R. Civ. P. 23(c). "In the Second Circuit, 'Rule 23 is given liberal rather than restrictive construction, and courts are to adopt

[17] The district court expressed concern that Morgan Stanley might have different liability for loans issued during a period in 2005 when Morgan Stanley did not purchase New Century's loans. SA 38. This issue is irrelevant to the alternative class, but even for the originally-proposed class it does not create issues relevant to Rule 23 because the policies were the same throughout the class period. *See generally, e.g.*, *Moore v. Napolitano*, 926 F. Supp. 2d 8, 24-25 (D.D.C. 2013) (noting propriety of aggregating data over an overall time period where policies during the time period are common).

a standard of flexibility' when assessing motions for class certification." *In re Beacon Assocs. Litig*., 282 F.R.D. 315, 323 (S.D.N.Y. 2012). To the extent a class action can be maintained for a narrower set of plaintiffs than originally contemplated, the Second Circuit has made clear that a court should consider certification of the narrower class. *See Robidoux v. Celani*, 987 F.2d 931, 937 (2d Cir. 1993); *see generally* Charles Alan Wright et al., 7AA *Fed. Practice & Proc. Civ.* § 1785.4 (3d ed. 2015) ("Courts have modified or decertified classes at the outset of pretrial, the completion of discovery, after summary judgment in favor of plaintiff class's injunctive claims, but before awarding damages, at the close of plaintiff class's case-in-chief, and at the completion of the trial on the merits.")

Here, the district court suggested that certain additional questions would be common in a class consisting only of those borrowers whose loans Morgan Stanley purchased. SA 36 n.26; SA 37 n.28. However, the district court declined to certify such a class. SA 45-46. It found that the narrower alternative class could not be certified for largely the same reasons that, in its view, typicality was not satisfied. SA 45-46; JA 503, 510-11. Once again, the fact that the district court appears not to have credited the common evidence that class members were harmed by receiving CRLs influences its analysis.[18] But whether or not receiving a CRL is a harm is a merits matter and, more importantly, a common question. As detailed above with respect to typicality, Morgan Stanley's unitary scheme for the acquisition and securitization of subprime loans led to the discriminatory issuance of loans with all the CRL features.

Against the backdrop of its singular relationship with New Century, and buttressed by its large credit facilities and on-the-ground efforts to ensure supply, Morgan Stanley bid on, purchased, and securitized loans originated by New Century with certain characteristics that were good for Morgan Stanley but bad for borrowers. This scheme and the harm it caused borrowers, at the very least with respect to the loans Morgan Stanley purchased, is ripe for aggregate litigation. Although the district court conjectured that dispositive differences would still exist among loans purchased by Morgan Stanley, because some of those loans might have been placed on another lender's warehouse line or "made with an eye to a different bank's forward sale," SA 45, it should not engage in speculation not suggested by the record over possible differences among class members. The record shows that when New Century and Morgan Stanley agreed on terms for a

---

[18] Plaintiffs have presented expert testimony explaining why the definition of CRLs captures the risk-layering that ran rampant during the subprime boom, setting borrowers up to suffer default or foreclosure. SA 39 n.31.

pool of loans, Morgan Stanley got loans with those terms—and had common policies that ensured that loans with other CRL terms were also purchased and securitized.

In rejecting this alternative class definition, the district court also suggested that Appellants cannot propose an altered class definition at this stage lest Morgan Stanley be unfairly prejudiced. SA 46. Where, as here, the new class is narrower than that originally proposed, and no new discovery is therefore necessary to litigate the claim,[19] it is difficult to imagine what prejudice could accrue to defendants. *See Abdeljalil v. Gen. Elec. Capital Corp.*, 306 F.R.D. 303, 306 (S.D. Cal. 2015) (rejecting argument that defendant is prejudiced by narrowed class definition); *Garcia v. Tyson Foods, Inc.*, 890 F. Supp. 2d 1273, 1298 (D. Kan. 2012) *aff'd,* 770 F.3d 1300 (10th Cir. 2014) (same).

IV. UNDER THE DISTRICT COURT'S RULE 23(b)(3) ANALYSIS, LOAN PURCHASERS WILL ESCAPE FAIR HOUSING ACT LIABILITY.

Rule 23(b)(3) requires that, before certifying a class, a court must determine (1) that common questions of law or fact "predominate over any questions affecting only individual members," and (2) "that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy." Fed. R.

[19] Experts have already opined as to racial disparities within this purchase-only group, SA 20-21; JA 946-948, and document and deposition discovery regarding Morgan Stanley's purchasing policies and practices has already occurred.

Civ. P. 23(b)(3). While Appellants believe the district court's predominance analyses as to both the broader original class and the narrower alternative class was flawed, the argument here focuses on the district court's superiority analysis, which is erroneous in the same way for both the original class and the narrower alternative class, *see* Section III.B *supra*. *See In re Am. Int'l Grp., Inc. Sec. Litig.*, 689 F.3d 229, 242 (2d Cir. 2012) ("Although litigants frequently conceive of predominance and manageability as separate requirements of Rule 23(b)(3), they are not." (quoting *In re IPO*, 226 F.R.D. 186, 195 n. 51 (S.D.N.Y. 2005); internal quotation marks omitted)). Simply put, the district court failed to consider the significance of the fact that no other procedure exists through which Appellants can vindicate their rights.

A. **The District Court Did Not Conduct the Comparative Analysis Required to Determine Whether Class Certification is Superior to Alternative Means of Adjudicating the Class Members' Claims.**

Rule 23(b)(3)'s superiority requirement mandates that a court consider how all of the claims would be litigated in the absence of class certification. *See* Advisory Cmte. Note to 1966 Amendments to Rule 23, Subdivision (b)(3), 39 F.R.D. 69, 103 (1966) (noting superiority requirement "reinforce[s] the point that the court with the aid of the parties ought to assess the relative advantages of alternative procedures for handling the total controversy"). The requirement "is comparative: the court must assess efficiency with an eye toward 'other available methods.'" *Mullins v. Direct Digital, LLC*, 795 F.3d 654, 664 (7th Cir. 2015); *see also Morangelli v. Chemed Corp.*, 275 F.R.D. 99, 116 (E.D.N.Y. 2011) ("'[T]he superiority analysis requires . . . consideration of the alternative methods of adjudication available for the claims.'" (quoting 1 Joseph M. McLaughlin, *McLaughlin on Class Actions* § 5:63 (6th ed. 2010))), *amended on reconsideration on other grounds*, *id.* at 122-25.

Here, although the district court noted that it would be "impractic[al]" for class members who are "unlikely to be wealthy or sophisticated" to bring expensive individual litigation, SA 44, it nonetheless concluded that class treatment of their claims was not superior. *Cf. Casale v. Kelly*, 257 F.R.D. 396, 407 (S.D.N.Y. 2009) ("It is appropriate for the court to consider the inability of the poor or uninformed to enforce their rights and the improbability that large numbers of class members would possess the initiative to litigate individually.") (quoting *D'Alauro v. GC Servs. L.P.*, 168 F.R.D. 451, 458 (E.D.N.Y.1996)) (internal marks omitted).

In the absence of an alternative, the district court ought not to have reached this conclusion. Indeed, where there are "no other 'realistic possibilities'" for adjudication, superiority "is satisfied, particularly when the action is 'predicated on a statutory mandate that is designed to promote the private rectification of conduct thought undesirable.'" *Morangelli,* 275 F.R.D. at 116 (quoting Charles Alan

Wright et al., 17A *Fed. Prac. & Proc. Civ.* § 1779 (3d ed. 2011). The FHA, with its prohibition on discrimination in the secondary mortgage market, represents just such a mandate. And the principle is especially important in a mortgage securitization context, where the notorious complexity and opacity of the processes and products virtually guarantees that individual borrowers will not be able to make out discrimination claims, to say nothing of the fact that disparate impact claims rely on aggregate statistical evidence. Because the district court failed to identify any other vehicle for vindicating class members' rights, and because none exists, its superiority ruling was flawed. *See Carnegie v. Household Int'l, Inc.*, 376 F.3d 656, 661 (7th Cir. 2004) (Posner, J.) ("[A] class action has to be unwieldy indeed before it can be pronounced an inferior alternative—no matter how massive the fraud or other wrongdoing that will go unpunished if class treatment is denied—to no litigation at all.").

The absence of comparative analysis also impacts the Order's discussion of manageability.[20] The district court found that, because no "uniform trial" could address the various issues presented by different borrowers, the putative class is unmanageable. SA 45. However, myriad class management tools make class

---

[20] As the district court recognized, manageability and the other three factors identified by Rule 23(b)(3) apply to both predominance and superiority, but they "more clearly implicate the superiority inquiry." SA 34 (quoting *Sykes*, 780 F.3d at 82).

litigation under the district court's supervision the best procedure "for fairly and efficiently adjudicating the controversy." Fed. R. Civ. P. 23(b)(3). It is "well-settled," moreover, "that courts should not refuse to certify a class merely on the basis of manageability concerns." *Mullins v. Direct Digital, LLC*, 795 F.3d 654, 663 (7th Cir. 2015) (citing *In re Visa Check/MasterMoney Antitrust Litig.*, 280 F.3d 124, 140 (2d Cir. 2001) (Sotomayor, J.), *overruled on other grounds by In re IPO*, 471 F.3d 24 (2d Cir. 2006)).[21]

B. <u>The District Court's Rule 23(b)(3) Analysis Renders Mortgage Loan Purchasers Immune from the Very Liability for Racial Discrimination That the Fair Housing Act Expressly Contemplates.</u>

The Fair Housing Act proscribes discrimination in the secondary mortgage market. 42 U.S.C. § 3605(a)-(b); 24 C.F.R. § 100.125(b). Any claim seeking to enforce the prohibition on secondary mortgage market discrimination will resemble Appellants' claim in important respects, such that the district court's

[21] The district court cited to *Seijas v. Republic of Arg.*, 606 F.3d 53, 58 (2d Cir. 2010) for the proposition that "manageability is an issue peculiarly within a district court's discretion." SA 34-35 (citing *Seijas*, 606 F.3d at 58). *Seijas*, however, relies for that proposition on *In re Visa Check*, and in both cases, the Second Circuit *rejected* the argument that a district court could err by certifying a class that defendants believed to be unmanageable. Accordingly, rather than releasing a district court from its obligation to use the tools at its disposal to address any manageability concerns, this statement is properly read to praise the district court's employment of those tools. *See In re Visa Check*, 280 F.3d at 140 ("[F]ailure to certify an action under Rule 23(b)(3) on the sole ground that it would be unmanageable is disfavored and should be the exception rather than the rule.") (citation and internal marks omitted).

manageability ruling represents a significant obstacle to vindicating borrowers' rights against Wall Street actors.

First, loan purchasers like Morgan Stanley are most likely to engage in disparate impact discrimination—we would not expect to see a securitizer refuse to purchase loans issued to African-American borrowers.

Second, such a claim is overwhelmingly likely to be a class action, both because the statistical and expert evidence necessary to prove a disparate impact claim is cost-prohibitive in the context of an individual case and because secondary market actors purchase mortgage loans in bulk, *see* 24 C.F.R.§ 100.125(b)(2) (applying FHA coverage to "pooling" of loans). In any pool of loans, all the impacted borrowers will never have identical circumstances or have received the identical loan terms.

Third, in any conceivable FHA litigation against a loan purchaser, the injured borrowers (or would-be borrowers) will have transacted with the lender, not the loan purchaser. Measuring the alleged discriminatory effects will therefore mean examining the relationship between loan purchaser and lender, and in a class action, examining that relationship over the course of a class period. If, as the district court held, the variations that will necessarily appear within a class of borrowers seeking to hold a loan purchaser liable for discrimination render the putative class unmanageable, loan purchasers will always evade liability under the FHA.

Finally, the district court expressed concern about the loan permutations within the class, but it is important to note that predatory lending schemes like those that typified the recent crisis did not focus on a single loan feature. *See, e.g.*, *Saint-Jean v. Emigrant Mortg. Co.*, 50 F. Supp. 3d 300, 313 (E.D.N.Y. 2014) ("The foreclosure crisis has been characterized by revelations of predatory lending in various forms, including exorbitant fees, prepayment penalties, inflated interest rates, steering and targeting of loans toward vulnerable groups, [and] 'exploding' adjustable interest rates . . . ."). The loan features included in Plaintiffs' definition of a Combined-Risk Loan tracks accepted definitions of such schemes. JA 405 ("Plaintiffs' definition of combined-risk loans is a useful and accurate proxy for the type of layered-risk loans associated with high risks of default and foreclosure); *City of Miami v. Bank of Am. Corp.*, 800 F.3d 1262, 1266 (11th Cir. 2015) (finding standing for city alleging FHA injuries based on discriminatory issuance of predatory loans, defined as including, *inter alia* "high-cost loans, . . . interest-only loans, balloon payment loans, loans with prepayment penalties, negative amortization loans, no documentation loans, and adjustable rate mortgages with teaser rates"); *see also Ricci v. Ameriquest Mortg. Co.*, No. 27-cv-05-2546, 2007 WL 1581484 (Minn. Dist. Ct. Apr. 18, 2007) (relying on federal class action jurisprudence to certify class of borrowers with loans that had "negative, unwanted, and undisclosed common features and charges").

CONCLUSION

For all the foregoing reasons, this Court should vacate the denial of class certification and remand to the district court (1) with instructions to determine that Rule 23(a) is satisfied and to consider whether an issue class would advance the litigation or whether Rule 23(b) is satisfied as to the alternative class; or (2) to remand generally for further consideration under Rules 23(a), (b), and (c).

Dated: November 12, 2015

Respectfully submitted,
By: /s/ Elizabeth J. Cabraser

Elizabeth J. Cabraser
LIEFF CABRASER HEIMANN & BERNSTEIN, LLP
275 Battery Street, 29th Floor
San Francisco, CA 94111
Telephone: (415) 956-1000

-and-

Rachel J. Geman
250 Hudson Street, 8th Floor
New York, NY 10013
(212) 355-9500

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

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

Counsel for Plaintiffs-Appellants

CERTIFICATE OF COMPLIANCE
WITH TYPE-VOLUME LIMITATION

I, Elizabeth J. Cabraser, counsel for Appellants and a member of the Bar of this Court, certify, pursuant to Federal Rule of Appellate Procedure 32(a)(7)(B), that the foregoing Appellants' Opening Brief is proportionately spaced, has a typeface of 14 points or more, and contains 10,904 words.

Dated: November 12, 2015

/s/ Elizabeth J. Cabraser
Elizabeth J. Cabraser