15-2398

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

BEVERLY ADKINS, on behalf of herself and all others similarly situated, CHARMAINE WILLIAMS, on behalf of hersel and all others similarly situated, REBECCA PETTWAY, on behalf of herself and all others similarly situated, RUBBIE MCCOY, on behalf of herself and all others similarly situated, WILLIAM YOUNG, on behalf of himself and all others similarly situated, MICHIGAN LEGAL SERVICES,

Plaintiffs-Appellants,

—against—

MORGAN STANLEY, MORGAN STANLEY & CO. LLC, MORGAN STANLEY ABS CAPITAL I INC., MORGAN STANLEY MORTGAGE CAPITAL, INC., 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

BRIEF OF *AMICI CURIAE* JEROME N. FRANK LEGAL SERVICES ORGANIZATION AND MICHIGAN POVERTY LAW PROGRAM IN SUPPORT OF PLAINTIFFS-APPELLANTS

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IDENTITY AND INTEREST OF *AMICI CURIAE*

The Jerome N. Frank Legal Services Organization at the Yale Law School ("LSO") is a legal clinic in which law students, supervised by faculty attorneys, provide legal assistance to individuals who cannot afford private counsel.[1] The Mortgage Foreclosure Litigation Clinic (the "Clinic"), part of LSO, has been representing homeowners fighting foreclosure in Connecticut since 2008, though its work is national in scope. In that capacity, the Clinic has appeared in state and federal court proceedings at both the trial and appellate levels, and filed *amicus* briefs with appellate courts in Florida, North Carolina, California, and Maine. LSO and its clients also have testified before the Connecticut legislature on foreclosure policy. The students of the LSO are the primary authors of this brief. This brief does not reflect the views of the Yale Law School.

LSO has an interest in the development of securitization law, as the issues surrounding such practices are important to homeowners across the country. Through our work with homeowners who have been the recipients of subprime loans, we have seen first-hand the pernicious incentives securitization can create. Additionally, LSO has a strong interest in holding violators of the Fair Housing Act accountable for discriminatory practices.

[1] Pursuant to Federal Rule of Appellate Procedure 29(c)(5), this brief was not authored, in whole or in part, by counsel for a party. No person other than the *amici* and their counsel made a monetary contribution intended to fund the preparation or submission of this brief. All parties have consented to the filing of this brief.

The Michigan Poverty Law Program ("MPLP") is a joint project of the Michigan Advocacy Program and the University of Michigan Law School. MPLP provides state support services to local legal services programs and other poverty law advocates. Our goals are: to support the advocacy of field programs; to coordinate advocacy for the poor among the local programs; and to assure that a full range of advocacy continues on behalf of the poor. MPLP also advocates and represents individuals in areas such as low-income housing, consumer protection, predatory lending, and foreclosure prevention.

In response to the foreclosure crisis, MPLP established the Michigan Foreclosure Prevention Project ("MFPP"). MFPP is a collaborative statewide project involving several legal services programs and housing counselors throughout Michigan. MFPP provides comprehensive and coordinated foreclosure prevention advocacy throughout the state by (1) providing direct legal representation to homeowners facing foreclosure, (2) providing support to housing counseling organizations, (3) coordinating policy advocacy on a statewide basis, and (4) providing training and technical support. MFPP has developed a breadth and depth of expertise in foreclosure issues, including predatory lending practices, that arise throughout the state.

INTRODUCTION AND SUMMARY OF ARUGMENT

Federal Rule of Civil Procedure 23(c)(4) appropriately allows for the certification of the *Adkins* class of homeowners discriminatorily saddled with high-risk, subprime mortgages. Metro Detroit homeowners who were wrongly targeted for high-risk loans as a result of Morgan Stanley's policies are entitled to pursue, and in need of, judicial relief to prevent unjust foreclosures. This *Adkins* class seeks to prove that Morgan Stanley was responsible for discriminatory lending practices through its policies relating to securitizing loans originated by New Century. If successful, the case would result in a liability judgment against Morgan Stanley. Such a ruling would give class members multiple avenues through which to pursue relief and prevent imminent foreclosures or evictions. Homeowners could use the Rule 23(c)(4) determination as a defense in eviction proceedings, as the basis for affirmative suits to enjoin foreclosure under the Fair Housing Act ("FHA"), or for efforts to quiet title. Class members could also seek to recover damages under the FHA from Morgan Stanley on an individual basis. In the alternative, if the Court certifies the *Adkins* class under Rule 23(b)(3), individual homeowners could also use a favorable ruling to prevent foreclosure and eviction.

ARGUMENT

I. MICHIGAN LAW OFFERS HOMEOWNERS SEVERAL OPPORTUNITIES TO CHALLENGE FORECLOSURE.

There are two types of foreclosure in Michigan: judicial foreclosure and foreclosure by advertisement. Mich. Comp. Laws §§ 600.3101, 600.3201. Nearly all foreclosures are by advertisement, which means that a lender may foreclose on a property without a court order. Whichever route the lender chooses, all class members who still reside in their homes would have recourse to challenge a pending foreclosure action based on a finding of liability under the FHA.

a. Foreclosure By Advertisement

Although not supervised by a court, foreclosure by advertisement is nonetheless regulated by federal and Michigan law. In advertisement proceedings, a lender must satisfy several federal procedural requirements before foreclosing on an owner-occupied home. First, mortgage servicers must wait until 120 days after the homeowner defaults on her mortgage before initiating the foreclosure process. 12 C.F.R. § 1024.41(f)(1). Second, all but the smallest servicers must attempt to contact the homeowner and advise her of "loss mitigation" options. *Id.* § 1024.39. Third, if a homeowner submits a complete loss mitigation application prior to day 120, these servicers must evaluate the application before proceeding to foreclosure. *Id.* § 1024.41(f)(2). These requirements allow homeowners to engage in loan

workout negotiations with their servicers, and give them time to seek to enjoin foreclosure under the FHA or to quiet title—remedies discussed further below.

Under state law, a lender initiates the foreclosure-by-advertisement process by advertising the sale of the property at least four weeks prior to the prospective sale date. Mich. Comp. Laws § 600.3208. During this time, the homeowner may continue to pursue loss mitigation options, or file suit to stop foreclosure. The sale date may be "adjourned" repeatedly, usually by one week at a time. *Id.* § 600.3220. The sale is conducted by the county sheriff. The highest bidder at the sale is often the lender itself. Even after the sale, a homeowner can "redeem"—that is, reverse the foreclosure—by paying the sale price plus interest and fees. The redemption period usually lasts six months (or twelve months if the amount due at the time of sale is less than two-thirds of the original indebtedness). *Id.* § 600.3240. The homeowner may remain on the property during this period. Only when the redemption period expires is the sale complete. *Id.* § 600.3236; *accord. Collins v. Wickersham*, 862 F. Supp. 2d 649, 654 (E.D. Mich. 2012).

If the homeowner remains in the house after the redemption period, the new owner may begin a summary eviction proceeding in Michigan district court (a state court for landlord-tenant matters). In this proceeding, the homeowner may challenge the validity of the foreclosure by way of a defense or counterclaim. *See Mfrs. Hanover Mortg. Corp. v. Snell*, 142 Mich. App. 548, 554 (1985) (stating that

in general, "[t]he district court has jurisdiction to hear and determine equitable claims and defenses involving the mortgagor's interest in the property").

b. Judicial Foreclosure

If a lender opts for judicial foreclosure, a court oversees the entire process. This process, equitable in nature, Mich. Comp. Laws § 600.3180, gives homeowners ample opportunity to fight foreclosure. Because this process takes more time and legal resources, it is rarely used on residential properties. A lender may choose judicial foreclosure, however, when title is unclear or when there are competing liens on the property.

A lender initiates a judicial foreclosure by filing a summons and complaint in Michigan circuit court (the state trial court of general jurisdiction). The circuit court judge may not order a sale until six months after the filing of the complaint. *Id.* § 600.3115. In answering the complaint, a homeowner may raise defenses or counterclaims attacking the validity of the mortgage or foreclosure process. *See, e.g.*, *Cooper v. Jefferson Inv. Co.*, 402 Mich. 294, 295 (1978) (remanding a judgment of foreclosure in order to ensure that the defendant had an "opportunity to answer on the merits").

After a court-ordered sale, there is a six-month redemption period. Mich. Comp. Laws § 600.3140. Thereafter, the state circuit court may "order and compel

the delivery of the possession of the premises to the purchaser at the sale." *Id.* § 600.3150. Here again, homeowners may raise equitable defenses to eviction.

As discussed below, a class member at risk of losing her home could use a finding of liability to challenge either judicial or non-judicial foreclosure.

II. BIFURCATING THE LIABILITY ISSUE UNDER RULE 23(c)(4) IS APPROPRIATE IN THIS CONTEXT.

a. The *Adkins* Class Is Well-Suited For Certification Under Rule 23(c)(4).

Issue class certification under Rule 23(c)(4) is a valuable tool for class action case management. This Court has recognized that Rule 23(c)(4) may be used when the action as a whole cannot satisfy the predominance requirement of Rule 23(b)(3). *See In re Nassau Cty. Strip Search Cases*, 461 F.3d 219, 223 (2d Cir. 2006) (holding that "a court may employ [Rule 23(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"); *accord. Smilow v. Sw. Bell Mobile Sys.*, 323 F.3d 32, 41 (1st Cir. 2003) (finding that even if individualized determinations were necessary to calculate damages, Rule 23(c)(4) would still allow the court to maintain the class action with respect to other issues); *Valentino v. Carter-Wallace, Inc.*, 97 F.3d 1227, 1234 (9th Cir. 1996) ("Even if the common questions do not predominate over the individual questions so that class certification of the entire action is warranted, Rule 23 authorizes the district court in appropriate cases to

isolate the common issues under Rule 23(c)(4)(A) and proceed with class treatment of these particular issues."). This case is well-suited for issue class certification because Morgan Stanley's discriminatory practices were common to the class and can be separated from the remaining individual issues. Armed with a judgment on one of the core issues in this case, class members could seek to keep their homes or recover money damages without having to prove Morgan Stanley's liability themselves.

b. The Class Should Be Certified Because Homeowners Will Not Be Able To Prove Liability In Individual Actions.

Furthermore, individual homeowners likely cannot support the litigation costs of proving a disparate impact case, and therefore would not have the opportunity to establish Morgan Stanley's liability without the class action. The purpose of Rule 23 is to vindicate "the rights of groups of people who individually would be without effective strength to bring their opponents into court at all." *Amchem Products, Inc. v. Windsor*, 521 U.S. 591, 617 (1997) (internal quotation marks omitted). If the Rule 23(c)(4) class is not certified to allow the members to jointly demonstrate Morgan Stanley's liability, it seems highly unlikely that individual members will be able to "bring their opponents into court at all." *Id*.

Courts have recognized that litigation costs can essentially bar individual suits that would otherwise be cost-effective through class action. "In most [individual] cases, litigation costs would dwarf potential recovery. . . . A fair

examination of alternatives can only result in the apodictic conclusion that a class action is the clearly preferred procedure in this case." *Hanlon v. Chrysler Corp.*, 150 F.3d 1011, 1023 (9th Cir. 1998).

The instant case presents similar issues regarding litigation costs. The discovery and data analysis costs are too expensive for almost any class member to bear; in a case such as this, it is standard for expert and related data analysis to cost $1 million. Additionally, it is unlikely that homeowners would be able to find counsel willing to pursue a disparate impact claim outside the class action context. The potential class members will likely not be able to have their day in court without the class certification.

III. CLASS MEMBERS COULD USE A LIABILITY JUDGMENT IN INDIVIDUAL AFFIRMATIVE SUITS FOR INJUNCTIVE RELIEF AND DAMAGES.

Certifying a class under Rule 23(c)(4) would provide class members facing foreclosure with a tool to avoid losing their homes. A finding of discrimination in this case would demonstrate Morgan Stanley's culpability in the harms caused to class members, and serve as proof of the toxic nature of class members' mortgages. Class members could use this proof in both FHA suits and quiet title actions in order to prevent foreclosure and obtain damages.

a. Class Members Could Use A Liability Judgment To Seek Injunctive Relief And Damages In Individual FHA Suits.

A liability judgment would allow class members to bring affirmative claims under the FHA by filing a complaint in federal or state court. The class member must be an "aggrieved person," which includes any person who claims to have been injured by an act unlawful under 42 U.S.C. § 3605. 42 U.S.C. § 3602(i). The Supreme Court has interpreted this to mean that FHA standing extends to the "Art. III minima of injury in fact." *Havens Realty Corp. v. Coleman*, 455 U.S. 363, 372 (1982). A judgment in this case as to disparate impact would be preclusive in class members' affirmative suits, significantly easing their evidentiary burdens.

Courts are empowered to grant broad relief to class members filing affirmative suits alleging violations of the FHA in order to help them avoid foreclosure.[2] In such actions, a court may grant "any permanent or temporary injunction, temporary restraining order, or other order (including an order enjoining the defendant from engaging in such practice or ordering such affirmative action as may be appropriate)." 42 U.S.C. § 3613. This authority to

[2] Although class members would not seek injunctive relief from Morgan Stanley itself, successive holders of the mortgage would be considered holders in due course and therefore be bound by the same finding of liability. U.C.C. §§ 3-302, 3-305.

Furthermore, the Anti-Injunction Act, 22 U.S.C. § 2283, does not prevent federal courts from using their equitable powers to halt foreclosures in Michigan. Non-judicial foreclosure proceedings in Michigan—which represent nearly all foreclosures in the state—are not a "proceeding in a State court" for purposes of the Anti-Injunction Act; therefore, federal courts are not precluded by that Act from enjoining foreclosure proceedings. *See Rea v. Wells Fargo Home Mortg., Inc.*, 2009 WL 2750935, at *7 (E.D. Mich. Aug. 25, 2009).

remedy harms brought about by past discrimination is broad in scope and depth. *See Swann v. Charlotte-Mecklenburg Bd. of Educ.*, 402 U.S. 1, 15 (1971) ("Once a right and a violation have been shown, the scope of a district court's equitable powers to remedy past wrongs is broad, for breadth and flexibility are inherent in equitable remedies."); *see also Trafficante v. Metro. Life Ins. Co.*, 409 U.S. 205, 209 (1972) (describing the language of the FHA as "broad and inclusive"); *Marr v. Rife*, 503 F.2d 735, 740 (6th Cir. 1974) (describing the purpose of the FHA as "to eliminate all traces of discrimination within the housing field"). In a reverse redlining suit like the one at bar, the harm in need of remedy is inherent in the mortgage itself. This is because the discriminatory practices are embodied in the very "terms and conditions" of the contract. *Wiltshire v. Dhanraj*, 421 F. Supp. 2d 544, 554 n.9 (E.D.N.Y. 2005). With their broad powers to remedy discrimination under the FHA, courts thus have the authority to fix those "terms and conditions"—namely, by enjoining foreclosures and reforming contracts to allow for modified mortgage payment structures.

Class members may also sue under the FHA for actual and punitive damages. 42 U.S.C. §§ 3612(g)(3), 3613(c). The Supreme Court has suggested that a private suit for damages under the FHA operates similar to a tort claim. *Curtis v. Loether*, 415 U.S. 189, 195 & n.10 (1974) (stating that "under the logic of the common law development of a law of insult and indignity, racial discrimination might be treated

as a dignitary tort"); *see also Meyer v. Holley*, 537 U.S. 280, 285 (2003) (relying on *Curtis* in holding that ordinary tort principles generally govern FHA cases). Plaintiffs thus may be compensated for economic loss caused by Morgan Stanley's actions as well as intangible losses such as emotional distress. In addition, punitive damages may be "awarded in the jury's discretion 'to punish the defendant for his outrageous conduct and to deter him and others like him from similar conduct in the future.'" *Smith v. Wade*, 461 U.S. 30, 54 (1983) (quoting Restatement (Second) of Torts § 908(1) (1979)) (alteration omitted); *see also Douglas v. Metro Rental Servs., Inc.*, 827 F.2d 252, 257 (7th Cir. 1987) (applying *Smith* to FHA claims). All class members therefore may use the FHA to obtain compensation for Morgan Stanley's discriminatory conduct. In turn, those facing foreclosure could use damages they receive to reinstate their mortgages or otherwise help with their unaffordable, inflated monthly mortgage payment.

b. Class Members Could Use A Liability Judgment To Support Quiet Title Claims Seeking To Enjoin Foreclosure And Reform Their Toxic Mortgages.

Class members fighting imminent foreclosure may also use a favorable Rule 23(c)(4) determination to support quiet title claims. Such claims, if successful, would allow courts to provide immediate relief by enjoining foreclosure proceedings. Courts could also remedy the toxic nature of class members' mortgages through reformation.

In Michigan, quiet title is a statutory cause of action to determine parties' interests in land. Michigan law provides that "[a]ny person, whether he is in possession of the land in question or not, who claims any right in, title to, equitable title to, interest in, or right to possession of land, may bring an action in the circuit courts against any other person who claims or might claim any interest inconsistent with the interest claimed by the plaintiff."[3] Mich. Comp. Laws § 600.2932(1). Plaintiffs must allege three elements to advance a quiet title action: "a) the interest the plaintiff claims in the premises; b) the interest the defendant claims in the premises; and c) the facts establishing the superiority of the plaintiff's claim." *Gagacki v. Green Tree Servicing LLC*, No. 14-11378, 2015 WL 93476, at *3 (E.D. Mich. Jan. 7, 2015).

Class members will be able to adequately allege quiet title claims because, by signing their mortgages, they can show the first two elements necessary to such an action: first, that their present interest is represented in a legal and equitable title to the property, and second, that their mortgagee's interest in the land is a

[3] Two recent Sixth Circuit opinions indicate that a "quiet title action" is not an independent cause of action in Michigan. *See Goryoka v. Quicken Loan, Inc.*, 519 F. App'x 926, 928 (6th Cir. 2013); *Jarbo v. Bank of N.Y. Mellon*, 587 F. App'x 287, 290 (6th Cir. 2014). However, a more recent ruling from the Eastern District of Michigan held "the language of [Mich. Comp. Laws] § 600.2932(1) explicitly creates an individual cause of action for quiet title. As the Sixth Circuit opinions in *Goryoka* and *Jarbo* are unpublished, the Court finds they lack precedential value and are unpersuasive." *Gagacki v. Green Tree Servicing LLC*, No. 14-11378, 2015 WL 93476, at *3 (E.D. Mich. Jan. 7, 2015).

contingent one represented by a lien on the property. *See Union Guardian Trust Co. v. Nichols*, 311 Mich. 107, 115 (1945); *McKeighan v. Citizens Commercial & Savings Bank of Flint*, 302 Mich. 666, 670 (1942). Most importantly, a finding of disparate impact discrimination from this litigation can support the third element necessary to plead a quiet title action: facts establishing the superiority of the plaintiff's claim by "challenging the validity" of the mortgage. *Berry v. Main Street Bank*, 977 F. Supp. 2d 766, 776 (E.D. Mich. 2013) (citing *Yuille v. Am. Home Mortg. Servs., Inc.*, 483 F. App'x 132, 135 (6th Cir. 2012)). A finding that class members' mortgages were the product of reverse redlining practices violative of the FHA could support a finding that such mortgages were not valid.

Courts have broad powers to assist class members who succeed on their quiet title claims. In Michigan, actions to quiet title are of an equitable nature. *Beach v. Twp. of Lima*, 489 Mich. 99, 106 (2011). In such cases, "the nature of the violation determines the scope of the remedy." *Swann*, 402 U.S. at 16. Considering that a finding of disparate impact discrimination by this Court would confirm the existence of a deep, harmful violation to class members, courts will be able to provide a wide range of effective remedies in successful quiet title actions.

Such remedies could include preliminary injunctions allowing homeowners to fend off an impending foreclosure. Michigan courts may exercise their equitable powers to enjoin foreclosure under "unusual circumstances or where the party

against whom the action has been brought has raised a valid fraud claim." *Mitchell v. Dahlberg*, 215 Mich. App. 718, 724-25 (1996); *see also Senters v. Ottawa Savings Bank, FSB*, 443 Mich. 45, 56-57 (1993) (recognizing that fraud, accident, or mistake would permit a court to equitably intervene in an action for statutory foreclosure by advertisement); *Gordon Grossman Bldg. Co v. Elliott*, 382 Mich. 596, 604 (1969) (fraudulent conduct may justify equitable intervention in an action for statutory redemption from foreclosure); *Horvath v. Langel*, 276 Mich. 381, 386 (1936) (foreclosure action precluded where note and mortgage induced by fraud). A finding that class members' mortgages were generated by systematic discrimination by Morgan Stanley could convince courts that "unusual circumstances" were present in a given action to halt foreclosure. Indeed, courts in Michigan have used those powers repeatedly to issue preliminary injunctions and temporary restraining orders to enjoin foreclosure sales. *See, e.g.*, *Deans v. Long Beach Mortg. Co.*, No. 1:07-CV-205, 2007 WL 772892 (W.D. Mich. Mar. 12, 2007) (issuing temporary restraining order against foreclosure sale); *Walker v. Michael W. Colton Trust*, 33 F. Supp. 2d 585 (E.D. Mich. 1999) (foreclosure sale enjoined); *Pridemore v. Rodriquez*, No. 2006-1404-CH, 2006 WL 4006339 (Mich. Cir. Ct. Jul. 28, 2006) (same); *Johnson v. Flagstar Bank, F.S.B.*, No. 01-70219-CZ, 2001 WL 36012951 (Mich. Cir. Ct. Aug. 13, 2001) (foreclosure sale enjoined and sheriff's deed tolled).

Class members could also seek reformation of their mortgage contract as an ultimate remedy. Michigan courts will reform contracts, including mortgages, where there is "a mistake by one party and fraud or inequitable conduct by the other." *Johnson Family Ltd. P'ship. v. White Pine Wireless, LLC*, No. 06-25433-CK, 2007 WL 7021794 (Mich. Cir. Ct. May 7, 2007) (citing *Najor v. Wayne Nat'l Life Ins. Co.*, 23 Mich. App. 260 (1970)). Class members could argue that they mistakenly believed they entered into non-discriminatory contracts that were not in violation of the FHA. Proof of such violation, along with the fact that harm inheres in the mortgage itself in reverse redlining cases, could serve as the basis for a finding of inequitable conduct by the originator of the mortgage, New Century.

Without a finding of disparate impact discrimination resulting from this litigation, class members will be left with little ability to file affirmative suits to save their homes from foreclosure. Homeowners facing foreclosure will not gain broad injunctive relief to stay in their homes by bringing a private suit under the FHA without a finding of disparate impact—a finding, as noted above, that individual members cannot prove outside of class litigation. Such a finding is also the only way class members can establish the toxic nature of their mortgages. Without such evidence, class members would have no basis for equitable relief in quiet title actions. Thus, both FHA and quiet title actions to stave off foreclosure will only be viable if this class is certified as to liability issues under Rule 23(c)(4).

c. Individual Homeowners Will Not Be Barred By Statutes Of Limitations From Bringing Affirmative Claims.

The FHA provides a two-year statute of limitations to bring a claim in court. The statute begins running after the later of (1) the occurrence of an alleged discriminatory practice, (2) the termination of a discriminatory practice, or (3) the breach of a Housing and Urban Development ("HUD") conciliation agreement. 42 U.S.C. § 3613(a)(1)(A).

In certain circumstances, the statute of limitations begins to run at a later point than any of the three events listed in § 3613(a)(1)(A). If the plaintiff could not have known of the injury within the time allotted by the statute of limitations, the statute does not begin to accrue under the diligence-discovery rule of accrual. *See Kronisch v. United States*, 150 F.3d 112, 121 (2d Cir. 1998). The District Court in this case found that "the discovery rule applies to Plaintiffs' FHA claims." *Adkins v. Morgan Stanley*, No. 12 CV 7667 HB, 2013 WL 3835198, at *5 (S.D.N.Y. July 25, 2013). Several other courts have also applied the discovery rule in the context of FHA claims. *See, e.g.*, *Montanez v. Wolfenberger*, 567 F. App'x 461, 463 (7th Cir. 2014), *cert. denied*, 135 S. Ct. 756 (2014) (finding the accrual date the point when "a reasonably diligent person in [plaintiff's] position would have questioned" defendant's conduct); *Nicolas v. Ocean Plaza Condominium Ass'n, Inc.*, 73 F. App'x 537, 540-41 (3d Cir. 2003) (stating that the FHA's statute of limitations could be tolled in the event "a defendant actively misleads a plaintiff"

or "other extraordinary circumstances" do not allow the plaintiff to assert her claim); *Saint-Jean v. Emigrant Mortg. Co.*, 50 F. Supp. 3d 300, 315-16 (E.D.N.Y. 2014); *Clement v. United Homes, LLC*, 914 F. Supp. 2d 362, 372 (E.D.N.Y. 2012) (applying the discovery rule to the FHA).

Furthermore, the statute of limitations is tolled while litigation is pending. Therefore, the statute of limitations will not begin to accrue as the class members pursue this litigation. The Second Circuit found in *Boykin v. KeyCorp*, 521 F.3d 202 (2d Cir. 2008) that a plaintiff's FHA "claims were timely because her administrative proceeding remained pending before [HUD], and the two-year period for filing a complaint was tolled, until the date of HUD's final letter informing Boykin that it had terminated the proceeding." *Id*. at 204. While the class proceeds with the case to determine the Morgan Stanley's liability, the statute of limitations cannot expire. With respect to class certification, the Supreme Court has held that the statute of limitations does not begin to run until after a class determination has been made. *See, e.g.*, *Crown, Cork & Seal Co. v. Parker*, 462 U.S. 345, 353-54 (1983) (noting that once the statute is tolled, it remains tolled until the issue of class certification is decided); *Am. Pipe & Constr. Co. v. Utah*, 414 U.S. 538, 554 (1974) ("[T]he commencement of a class action suspends the applicable statute of limitations as to all asserted members of the class who would have been parties had the suit been permitted to continue as a class action."). Thus,

the statute of limitations will be tolled until the issues of class certification and liability are determined.

Homeowners seeking to use the liability judgment to bring individual FHA claims will therefore not necessarily be barred by statutes of limitations even though they received their toxic mortgage several years ago. Determining whether a given class member knew of Morgan Stanley's discriminatory practices may be a matter for fact discovery, but it seems unlikely that any class member would have conducted the requisite regression analysis in order to determine that Morgan Stanley discriminated against them. *See Saint-Jean*, 50 F. Supp. 3d at 316 ("Such a scheme, if proven, would be invisible to individual borrowers and sufficiently sophisticated to require the development of a critical mass of cases involving defaults under these circumstances, as well as the understanding of counsel experienced in discrimination litigation, to appreciate and explain the discriminatory conduct."). As long as the class member was not aware of Morgan Stanley's discriminatory practices prior to the commencement of this class action, therefore, the statute of limitations would not bar a class member's affirmative FHA suit.

Additionally, class members seeking to quiet title would not be barred by statute of limitations. All class members received their toxic mortgages between 2004 and 2007, so their claims will not be barred by the 15-year statute of

limitations on quiet title actions. Mich. Comp. Laws § 600.5801(4); *Gorte v. Dep't of Transp.*, 202 Mich. App 161, 165 (1993).

IV. CLASS MEMBERS COULD USE A LIABILITY JUDGMENT AS A DEFENSE IN A SUMMARY PROCEEDING FOLLOWING A FORECLOSURE.

Even if a class member does not bring an affirmative action for damages or injunctive relief before the end of the redemption period, he may still be able to raise claims after the redemption period expires, although options at that stage are considerably more constrained. The case law remains unsettled despite the recent and significant limitations on mortgagors' claims post-redemption period. Class members would still have a colorable argument for raising their discrimination claims as equitable defenses to the eviction. Nevertheless, the additional difficulties of raising such claims at that late stage speak to the urgency of resolving this class litigation quickly, so that more homeowners can make use of a favorable decision before their redemption periods expire.

Under Michigan law, a mortgagee who has foreclosed on a mortgage by advertisement may bring summary proceedings to recover possession of the premises "[w]hen a person continues in possession of [the] premises . . . after the time limited by law for redemption." Mich. Comp. Laws § 600.5714(g). Since most foreclosures are conducted through non-judicial foreclosure by advertisement, this summary eviction proceeding is often the first time the dispute between the

servicer and homeowner comes before a judge. Such proceedings are therefore a vital setting for homeowners challenging improper or inequitable foreclosures.

When there has been a foreclosure by advertisement, Michigan law allows mortgagors to "hold over after redemption ha[s] expired and test the validity of the sale in the summary proceedings." *Reid v. Nusholtz*, 264 Mich. 220, 224 (1933). This ability is crucial because "[o]therwise, the typical mortgagor who faces an invalid foreclosure would be without remedy, being without the financial means to pursue the alternate course of filing an independent action to restrain or set aside the sale." *Snell*, 142 Mich. App. at 553.

When opposing eviction, Michigan mortgagors may raise equitable defenses. In earlier cases, Michigan courts held that only the procedural validity of the sale could be tested in the subsequent summary proceeding, and not the "underlying equities." *Reid v. Rylander*, 270 Mich. 263, 267 (1935). This case has been interpreted as allowing only challenges to compliance with the technical requirements of the foreclosure-by-advertisement process. *See, e.g.*, *Jones v. Bank of Am.*, No. 12-11608, 2012 WL 5412236, at *2 (E.D. Mich. Nov. 6, 2012) ("*Reid* held that the borrower is limited to challenging only foreclosure sale procedures, and cannot challenge the validity or enforceability of the underlying instruments."). However, the statute governing summary process, enacted in 1972, was subsequently amended in 1980 to provide state district courts with equitable

jurisdiction. This statute now provides that in a summary eviction proceeding under Chapter 57, the "district court may hear and determine an equitable claim relating to or arising under chapter 31," which provides for the foreclosure of mortgages or land contracts, "or involving a right, interest, obligation, or title in land." Mich. Comp. Laws § 600.8302(3). Furthermore, Michigan court rules provide that a party to a summary proceeding may join a "claim or counterclaim for equitable relief." Mich. Ct. Rule 4.201.

The seminal modern case examining the ability of the district courts to hear and consider equitable defenses in an eviction proceeding following a non-judicial foreclosure is *Snell*, 142 Mich. App. 548. In that case, the Michigan Court of Appeals held that the mortgagee's right to challenge a foreclosure in a summary eviction proceeding includes the right to raise equitable claims and defenses. The mortgagors in that case attempted to raise a "mortgage servicing defense" in the eviction proceedings following the non-judicial foreclosure of their FHA-insured mortgage. The homeowners argued that their servicer's failure to follow the loss mitigation requirements set for FHA loans should invalidate the subsequent foreclosure. Although the court rejected the mortgage servicing defense itself, on the grounds that judges "lack authority to promulgate mortgage regulations under the guise of 'equity,'" it nevertheless upheld the broad availability of equitable defenses in summary eviction proceedings. *Id.* at 405.

Subsequent cases have followed *Snell* to allow mortgagors to bring equitable defenses in a summary proceeding. In several of these cases, courts have recognized the impact of the aforementioned changes to the summary process statute. *See e.g.*, *Pine Oaks, LLC v. Devries*, No. 249163, 2004 WL 2827396, at *3 (Mich. Ct. App. Dec. 9, 2004) (holding that as a result of the summary proceedings act enacted in 1972, "[t]he former separation of actions at law and equitable claims, which mandated that equitable defenses could not be raised in a summary proceeding, is . . . no longer viable" (citation omitted)); *Ferguson v. Abbs*, No. 227223, 2002 WL 1803916, at *2-3 (Mich. Ct. App. Aug. 6, 2002) (recognizing that the 1980 enactment of Mich. Comp. Laws § 600.8302 expanded the jurisdiction of the district court in a summary eviction proceeding to include equitable claims). Similarly, federal district courts applying Michigan law have held that mortgagors' claims in later federal court cases are barred by the doctrine of *res judicata* because their equitable claims could have been fully raised and determined during earlier eviction proceedings in state court, since the state court had jurisdiction under Michigan law to hear such claims. *See Baldwin v. CitiMortgage Inc.*, No. 12-14907, 2013 WL 1163369, at *2 (E.D. Mich. Mar. 20, 2013) (holding that state court in earlier eviction proceeding had jurisdiction under Michigan law to hear and determine homeowner's equitable claims relating to loan modification process, and therefore her subsequent action in federal court was

barred by *res judicata*); *Hines-Flagg v. First Franklin*, No. 12-12663, 2012 WL 4514443, at *5 (E.D. Mich. Oct. 2, 2012) (because plaintiff could have raised all her claims in summary eviction proceeding, *res judicata* bars her federal claims).

The modern cases holding that only attacks on the foreclosure process itself may be raised during a summary proceeding[4] rely heavily on the 1935 *Reid* decision, without recognizing the changes wrought by the later amendments to the summary process statute. Outside the eviction context, however, a recent line of cases has held that mortgagors bringing an affirmative suit seeking to set aside a sheriff's sale during or after a redemption period may only challenge failures to comply with the foreclosure-by-advertisement statute. Specifically, in order to set aside a foreclosure by advertisement, a mortgagor

> must allege facts to support three essential elements of the claim: (1) fraud or irregularity in the foreclosure procedure, (2) prejudice to the mortgagor, and (3) a causal relationship between the alleged fraud or irregularity and the alleged prejudice, i.e., that the mortgagor would have been in a better position to preserve the property interest absent the fraud or irregularity.

[4] *See, e.g.*, *Freeman v. Wozniak*, 241 Mich. App. 633, 638 (2000) (holding that where the foreclosure procedure was technically proper, there is no room for equitable considerations absent fraud, accident, or mistake; and dismissing claims of homeowner who was incompetent due to dementia at the time of foreclosure, where there was no dispute regarding whether the foreclosure procedure was technically proper and no claim of fraud, accident, or mistake).

Diem v. Sallie Mae Home Loans, Inc., 307 Mich. App. 204, 210-11 (2014) (citing *Kim v. JPMorgan Chase Bank, N.A.*, 493 Mich. 98, 115-16 (2012)).[5] Because these decisions clash with others and with the 1972 amendments, the Michigan Judicial Institute has observed that it remains unclear "whether a mortgagor may challenge the validity of the underlying mortgage during summary proceedings following foreclosure." Phoenix Hummel, Michigan Judicial Institute, *Residential Landlord Tenant Law Benchbook* 7-24.[6] How class members could use a liability finding here as a defense in an eviction action thus remains unsettled.

Class members attempting to raise their discrimination claims after the end of their statutory redemption periods are also likely to face arguments that they no longer have standing to bring their claims. Several recent cases have held that the expiration of the redemption period extinguishes the mortgagor's standing to challenge the foreclosure. For example, in *HSBC Bank USA, NA v. Young*, No. 313212, 2014 WL 3529418 (Mich. Ct. App. July 15, 2014), *leave denied*, 497 Mich. 972 (2015), the appellate court held that the mortgagors lacked standing to challenge the foreclosure in the summary eviction proceeding because their

[5] Although the *Diem* court cites to the Michigan Supreme Court's decision in *Kim* for this proposition, the *Kim* case concerned whether a mortgagor's claim of defects or irregularities in the foreclosure process resulted in a foreclosure that is voidable, or void *ab initio*. *Kim* itself therefore did not directly decide whether claims other than fraud or irregularities might allow for a foreclosure sale to be set aside.

[6] Available at http://courts.mi.gov/education/mji/Publications/Documents/LLTBB.pdf.

"'right[s], title, and interest' in and to the property were extinguished" when the redemption period expired. *Id.* at *3 (quoting Mich. Comp. Laws § 600.3236).

But in a number of other decisions, including another decision by the Court of Appeals, courts have indicated that the expiration of the mortgagor's redemption period does not extinguish his or her standing to challenge the foreclosure either in a summary eviction proceeding or in an affirmative suit. *See, e.g.*, *Fed. Home Loan Mortg. Corp. v. Montague*, No. 1:13-CV-1162, 2014 WL 4313633, at *4 (W.D. Mich. Sept. 2, 2014) (finding that homeowners had standing to bring counterclaims alleging a failure to evaluate for loss mitigation and irregularities in the assignment of the mortgage after the expiration of the redemption period); *Yates v. U.S. Bank Nat'l Ass'n*, 912 F. Supp. 2d 478, 485 (E.D. Mich. 2012) (holding that the mortgagors had standing in an affirmative suit brought after the end of the redemption period to challenge the foreclosure based on both irregularities in the foreclosure process and a failure to properly complete the loan modification review); *Ahmad v. Wells Fargo Bank, NA*, 861 F. Supp. 2d 818, 825 (E.D. Mich. 2012) (holding that bank had not shown that homeowner lacked standing to bring claims relating to failure to evaluate for loan modification in affirmative suit brought after expiration of redemption period); *Bond v. U.S. Bank Nat'l Ass'n*, No. 302391, 2012 WL 1145959, at *2 (Mich. Ct. App. Apr. 5, 2012) (noting that a trial

court in an earlier related case had "erroneously concluded that a foreclosure could not be challenged during eviction proceedings.").

Thus, although Michigan case law has evolved to present considerable challenges to such claims, mortgagors facing eviction after a non-judicial foreclosure in Michigan have a colorable argument that they have standing to challenge the underlying foreclosure on equitable grounds, and Michigan district courts have jurisdiction over such claims. A finding of discrimination in the origination of a class member's loan could be raised as an equitable defense in this context. Discrimination in the origination of the underlying mortgage loan speaks to the fundamental equities of allowing a foreclosure to proceed. Although few if any homeowners would have the ability to develop a disparate impact case on their own for use in this context, a finding of discrimination arising out of this class litigation could allow individual class members to bring such a claim as part of a larger effort to prevent the loss of their homes through foreclosure.

The additional constraints placed on mortgagors' claims after the expiration of the redemption period underscore the urgency of reaching a decision on the merits of the Plaintiffs' discrimination claims. A finding of unlawful discrimination relating to the origination of these loans is likely to provide substantial assistance to homeowners attempting to avoid foreclosure who have not yet passed the end of their respective redemption periods. If the ultimate decision

on the class members' discrimination claims comes after an individual class member has passed the end of their redemption period, however, they will face significantly higher barriers to using that determination to prevent the loss of their home. Delays in reaching the merits increases the likelihood that class members who might have used a positive outcome in such a manner will no longer be able to do so. A prompt determination on the underlying merits of the class members' claims is thus crucial to those members still struggling to hold on to their homes.

V. CERTIFICATION UNDER RULE 23(b)(3) WOULD ALSO PROVIDE HOMEOWNERS RELIEF IN FORECLOSURE AND EVICTION PROCEEDINGS.

A Rule 23(b)(3) class certification, followed by a favorable judgment or settlement on the merits, would have the same protective effects as a Rule 23(c)(4) class certification and liability judgment. Class members could use a Rule 23(b)(3) judgment in a summary eviction proceeding as grounds for an equitable defense. *See Snell*, 142 Mich. App. 548. Additionally, with a Rule 23(b)(3) judgment in hand, class members could file for injunctive relief when faced with foreclosure. *See Johnson*, 2001 WL 36012951; *Pridemore*, 2006 WL 4006339.

CONCLUSION

Amici respectfully submit that the resolution of this appeal should take into account the fact that class members could, in the wake of class certification under

Rule 23(c)(4) and a subsequent finding of liability, gain tools by which they could stave off imminent foreclosure threats and stay in their homes.

Dated: November 19, 2015

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I, J.L. Pottenger, Jr., counsel for *Amici* and a member of the Bar of this Court, certify, pursuant to Rule 32(a)(7)(B) of the Federal Rules of Appellate Procedure, that the foregoing brief is in 14-Point Times New Roman proportional font and contains 6,854 words.

Dated: November 19, 2015

/s/ J.L. Pottenger, Jr.
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