15-2398

In The United States Court of Appeals
for the Second Circuit

BEVERLY ADKINS, CHARMAINE WILLIAMS, REBECCA PETTWAY, RUBBIE McCOY, 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.

On 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* THE NAACP LEGAL DEFENSE & EDUCATIONAL FUND, INC., NEW YORK LAW SCHOOL RACIAL JUSTICE PROJECT, THE DAMON J. KEITH CENTER FOR CIVIL RIGHTS, AND THE MICHIGAN WELFARE RIGHTS ORGANIZATION IN SUPPORT OF PLAINTIFFS-APPELLANTS

JIN HEE LEE
DEPUTY DIRECTOR OF LITIGATION
NAACP LEGAL DEFENSE &
EDUCATIONAL FUND, INC.
40 RECTOR STREET, 5TH FLOOR
NEW YORK, NY 10006
(212) 965-2200
COUNSEL OF RECORD FOR AMICI CURIAE

DEBORAH N. ARCHER
PROFESSOR OF LAW
DIRECTOR, RACIAL JUSTICE PROJECT
NEW YORK LAW SCHOOL
185 WEST BROADWAY
NEW YORK, NY 10013
(212) 431-2138

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure, *amicus curiae* files the following statement of disclosure: The NAACP Legal Defense and Educational Fund, Inc. is a nonprofit 501(c)(3) corporation. It is not a publicly held corporation that issues stock, nor does it have any parent companies, subsidiaries or affiliates that have issued shares to the public. The other *amici* are not corporations and are therefore not subject to the disclosure requirement of Federal Rule of Appellate Procedure 26.1.

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INTEREST OF *AMICI CURIAE*[1]

The NAACP Legal Defense & Educational Fund, Inc. ("LDF") is a non-profit legal organization that, for seventy-five years, has helped African Americans secure their civil and constitutional rights. Throughout its history, LDF has challenged laws and policies that deny housing opportunities to African Americans and isolate African-American families in segregated neighborhoods. *See, e.g.*, *McGhee v. Sipes*, 334 U.S. 1 (1948) (companion case to *Shelley v. Kraemer*, 334 U.S. 1 (1948)) (racially restrictive covenants); *Cent. Ala. Fair Hous. Ctr. v. Lowder Realty Co.*, 236 F.3d 629 (11th Cir. 2000) (racial steering); *Comer v. Cisneros*, 37 F.3d 775 (2d Cir. 1994) (racial discrimination in public housing and assistance programs); *NAACP v. Am. Family Mut. Ins. Co.*, 978 F.2d 287 (7th Cir. 1992) (redlining); *Kennedy Park Homes Ass'n, Inc. v. City of Lackawanna*, 436 F.2d 108 (2d Cir. 1970) (exclusionary zoning). LDF has also advocated for the fulsome interpretation and application of the Fair Housing Act of 1968, 42 U.S.C. § 3605 ("FHA" or "Fair Housing Act"); *see Tex. Dep't of Hous. & Cmty. Affairs v. Inclusive Communities Project, Inc.*, 135 S. Ct. 2507 (2015).

[1] This brief is filed with the consent of all parties. Pursuant to Fed. R. App. P. 29(c)(5), counsel for *amici curiae* state that no counsel for a party authored this brief in whole or in part, and that no person other than *amici curiae*, their members, or their counsel made a monetary contribution in preparation or submission of this brief.

Moreover, class actions have proven essential in a variety of economic justice cases that LDF has litigated before the Supreme Court and other federal courts. *See, e.g.*, *Lewis v. City of Chicago*, 560 U.S. 205 (2010); *Cooper v. Fed. Reserve Bank of Richmond*, 467 U.S. 867 (1984); *Franks v. Bowman Transp. Co.*, 424 U.S. 747 (1976); *Albemarle Paper Co. v. Moody*, 422 U.S. 405 (1975); *Griggs v. Duke Power Co.*, 401 U.S. 424 (1971); *Newman v. Piggie Park Enters., Inc.*, 390 U.S. 400 (1968).

The New York Law School Racial Justice Project ("the Racial Justice Project") is a legal advocacy organization dedicated to protecting the constitutional and civil rights of racial minorities. The Racial Justice Project seeks to increase public awareness of racism, racial injustice, and structural racial inequality in the areas of housing, education, employment, political participation, and criminal justice. The Racial Justice Project has a continued interest in the development of jurisprudence that guards against racial discrimination and segregation in housing, and that promotes wide access to the court system in order to redress the discriminatory harms caused by racially predatory lending practices and to vindicate important civil and constitutional rights, such as those guaranteed under the Fair Housing Act.

The Damon J. Keith Center for Civil Rights ("Keith Center") is an academic research center within Wayne State University Law School, located in Detroit,

Michigan, that addresses the civil rights needs of southeast Michigan and beyond. Named after the Honorable Damon J. Keith, who has served on the United States Court of Appeals for the Sixth Circuit since 1977, the Keith Center is a hub for civil rights teaching, research, and action with the mission to promote the educational, economic, and political power of underrepresented communities in urban settings. The Keith Center has focused much of its academic, community engagement, and capacity-building work on the Detroit foreclosure crisis, which has devastated African-American communities and communities of color throughout Detroit. The Keith Center addresses structural racism as this generation's defining civil rights challenge, and housing lies at the center of that struggle.

The Michigan Welfare Rights Organization ("MWRO") is the Michigan state chapter of the National Welfare Rights Union, a nationwide membership organization of welfare recipients and the destitute with the goal of securing adequate income, dignity, justice, and democracy. MWRO organizes public assistance recipients, low-income workers, and no-income people to fight for the elimination of poverty and for the economic and human rights of disenfranchised Michigan residents. A substantial part of MWRO's work has focused on the Detroit residents and communities that have been most harmed by the foreclosure crisis.

SUMMARY OF THE ARGUMENT

Last term, the Supreme Court acknowledged that although "[*d*]*e jure* residential segregation by race was declared unconstitutional almost a century ago, . . . its vestiges remain today, intertwined with the country's economic and social life." *Tex. Dep't of Hous. & Comty. Affairs v. Inclusive Communities Project, Inc.*, 135 S. Ct. 2507, 2515 (2015) (internal citation omitted). The Court reaffirmed the continuing vitality of the Fair Housing Act and the far-reaching protections it erects against racial discrimination in housing. *Id.* at 2525.

One continuing vestige of *de jure* residential segregation is the discriminatory practice of predatory lending, whereby borrowers of color are disproportionately issued high-risk, subprime loans regardless of the their income or creditworthiness. Predatory lending is a contemporary example of the racial discrimination that has long characterized the United States mortgage industry—e.g., government-sanctioned redlining that deliberately excluded African Americans from purchasing homes in certain neighborhoods.

The discriminatory policies and practices of Defendants-Appellants Morgan Stanley et al. ("Morgan Stanley") consisted of purchasing and securitizing high-risk mortgages from the now-defunct subprime lender, New Century Mortgage Company ("New Century"). As the primary purchaser of New Century's high-risk loans, which were then packaged into tradeable securities for substantial profits on

the secondary mortgage market, Morgan Stanley pressured and incentivized New Century into issuing mortgage loans rigged toward default and foreclosure. These types of unfair and discriminatory policies and practices disproportionately impacted African-American homebuyers, who today increasingly face foreclosure and impoverishment as a direct result of the high-risk terms that are characteristic of predatory mortgage loans—such as inflatable interest rates, balloon payments, and/or stricter repayment terms. The subsequent massive loss of capital through home foreclosures has increased wealth disparities and deepened residential segregation along racial lines.

In this case, Detroit residents who fell victim to Morgan Stanley's discriminatory conduct in the secondary mortgage market seek class action relief. A class action is the most effective tool for enforcing the remedial goals of the FHA in the context of predatory lending. Absent a class action, the individual African-American borrowers in Detroit, who are already financially-strapped, would be forced to separately engage in lengthy and costly litigation against one of the largest financial institutions in the country. For many victimized borrowers, and especially the putative class members in this case, such an economic burden would simply put legal relief beyond reach. Moreover, even if the putative class members were able to pursue individual claims, such piecemeal litigation would

consume far more resources—for both the parties and the courts—than a single class action.

Morgan Stanley must be held accountable for its discriminatory mortgage-purchasing and securitization policies and practices, which pressured New Century to disproportionately issue high-risk mortgages to African-American families in Detroit. Affirming the District Court's denial of class certification would, in effect, deprive putative class members of the most viable means of remedying discriminatory harms and injuries long held redressable under the FHA. Accordingly, *amici curiae* respectfully urge this Court to reverse the District Court's denial of class certification.

Because all *amici* have a substantive interest in fair housing and fair lending laws and policies, they believe that their perspectives will be valuable to the Court in addressing the issues presented.

ARGUMENT

I. Contemporary Predatory Lending Practices Continue the Longstanding Racial Discrimination in Mortgage Lending.

Morgan Stanley's significant role in the predatory lending schemes that harmed African-American homebuyers in Detroit is a contemporary form of longstanding racial discrimination in mortgage lending. As with government-sponsored redlining that plagued the mortgage industry decades ago, predatory lending excludes African Americans from fair and equitable access to mortgage

credit and prevents their purchase of homes in integrated neighborhoods—a vestige of *de jure* segregation that falls squarely under the FHA and should be subject to legal redress.

A. Racial Discrimination in Lending Originally Took the Form of State-Sanctioned Redlining.

From the early twentieth century, federal, state, and local governments proactively enforced and subsidized systemic *de jure* racial segregation. *See generally* Douglas S. Massey & Nancy A. Denton, *American Apartheid: Segregation and the Making of the Underclass* (1993). Federal officials divided cities by race with redlining[2] tactics that undervalued minority and racially-mixed neighborhoods. *See id*. at 51-52. Additionally, the Federal Housing Administration required developers seeking federal financing to include racially restrictive covenants in their deeds, thereby preventing the sale or re-sale—or forcing developers to prevent the sale or re-sale—of new homes to African Americans. Richard Rothstein, *Race and Public Housing: Revisiting the Federal Role*, 21 Poverty & Race Res. Action Council, Nov.-Dec. 2012, at 2.

[2] "Redlining" is government-sanctioned discrimination in lending that "circl[ed] minority and low-income communities with red ink to indicate areas of the map upon which a general denial of credit would be enforced." Frank Lopez, *Using the Fair Housing Act to Combat Predatory Lending*, 6 Geo. J. on Poverty L. & Pol'y 73, 75 (1999).

African-American communities throughout the country were also denied conventional forms of credit, which helped create the highly segregated housing patterns that are still visible today. Stephen Trzcinski, *The Economics of Redlining: A Classical Liberal Analysis*, 44 Syracuse L. Rev. 1197, 1199 (1993). Although government agencies promoted home building and greater access to private mortgage loans, they also used race as a benchmark for housing credit eligibility:

> Federal policymakers cooperated with state and local governments, real estate brokers, developers and financial institutions to assure that minorities were excluded from assistance designed to benefit the middle class and that low-income housing was provided only on a segregated basis. The federal government placed its imprimatur on the exclusionary and segregative practices of others and helped shape the current racial demography of the nation's cities.

John Charles Boger & Judith Welch Wegner, *Race, Poverty, and American Cities* 324 (1996). As a result, African Americans were denied the opportunity to secure financing and achieve homeownership. *See* Douglas S. Massey, *Origins of Economic Disparities, in The Rising Costs for America* 39, 69 (James H. Carr & Nadinee K. Kutty eds., 2008).

This combination of racially discriminatory government policies obstructed residential mobility for African Americans and allowed "segregation [to] continue[] unabated" through the early 1960s. Ira Rheingold et al., *From Redlining to Reverse Redlining: A History of Obstacles for Minority Homeownership in*

America, 34 Clearinghouse Rev. 642, 645 (2001). Thus, while the overall homeownership rate in the United States increased from 43.6 percent in 1940 to 62 percent in 1960, that increase inured exclusively to the benefit of the white middle class. Mechele Dickerson, *Home Ownership and America's Financial Underclass: Flawed Premises, Broken Promises, New Prescriptions* 181 (2014). The resultant "residential spatial segregation in America's cities has contributed to the growth of an African-American underclass that threatens to make urban poverty and racial injustice a permanent fixture of American society." John P. Relman, *Foreclosures, Integration, and the Future of the Fair Housing Act*, 41 Ind. L. Rev. 629, 641 (2008) [hereinafter Relman, *Foreclosures*] (citing Massey & Denton, *supra*).

As one of the destinations of the Great Migration,[3] Detroit has had a sizeable African-American population since the 1940s,[4] and it has faced significant

[3] In the early twentieth century, African Americans left the South for northern cities in large numbers because 1) "the mechanization of southern agriculture" made farmworker labor redundant; 2) "the industrialization of the Northeast and Midwest created millions of manufacturing jobs; and 3) "not least in importance, the generally oppressive racial climate in the South acted as a 'push' factor for many decades as blacks sought out more tolerant communities in other regions." Ctr. on Urban and Metro. Policy, *The New Great Migration: Black Americans' Return to the South, 1965-2000*, at 2 (May 2004), http://www.brookings.edu/~/media/research/files/reports/2004/5/demographics%20frey/20040524_frey (last visited Nov. 19, 2015).

[4] Thomas J. Sugrue, *The Origins of the Urban Crisis: Race & Inequality in Postwar Detroit* 23, Tbl.1.1 (2005) ("Fewer than 10 percent of Detroit's population at the outbreak of World War II, African Americans comprised more than a quarter of the city's residents by 1960.").

discrimination, including redlining and residential segregation. *See generally id.* at 33–56 (noting that appraisal maps of Detroit marked every "black section" of Detroit with its lowest rating, "flagging the area as unsuitable for federal loans and subsidies"). Federal policies that excluded African-American neighborhoods from home mortgage loans, in conjunction with the refusal of private lenders and real estate brokers to serve African-American clients, trapped Detroit's African-American residents "in the city's worst housing, in strictly segregated sections of the city" and "set into motion a chain reaction that reinforced patterns of racial inequality." *Id.* at 34.

B. Current Lending Discrimination Is Manifested in Racially Discriminatory High-Risk, Subprime Mortgages.

Congress responded to the above-described racially discriminatory practices by enacting the FHA, which, among other things, prohibited lending institutions from refusing to extend financing opportunities to communities of color. But redlining—i.e., the outright denial of credit to minority applicants—persisted in some shape or form for decades after the passage of the FHA,[5] and "it was not until 1992 . . . that the Federal Reserve System began monitoring statistical evidence of

[5] Despite express statutory prohibitions against redlining, home-loan rejections rates for African Americans and Latinos remained significantly higher than rejection rates for similarly-situated white applicants. *See, e.g.*, Stephen L. Ross & John Yinger, *The Color of Credit: Mortgage Discrimination, Research Methodology, and Fair-Lending Enforcement* 107–67 (2002) (studying mortgage data from 1991).

discrimination and, occasionally, referring patterns of discrimination to the Justice Department." Richard Rothstein, *A Comment on Bank of America/Countrywide's Discriminatory Mortgage Lending and Its Implications for Racial Segregation*, Briefing Paper No. 335, Econ. Pol'y Inst. 6 (Jan. 23, 2012) [hereinafter Rothstein, *Discriminatory Mortgage Lending*].

Following Congress's deregulation of the mortgage industry in the 1980s,[6] subprime loans—which, traditionally, were rare financing options for a distinctive class of high-income borrowers[7]—were repurposed into predatory loan products[8]

[6] "Among the statutes that deregulated the mortgage banking industry were the Depository Institutions and Monetary Control Act of 1980, P.L. 96-221, which preempted state usury statutes, and the Alternative Mortgage Transactions Parity Act of 1982, 12 U.S.C. §§ 3801 et seq., which expanded liberalized federal mortgage lending regulations to cover almost all state-regulated creditors." Ira Rheingold et al., *supra*, at 648 n.47 (citing Nat'l Consumer Law Ctr., *Cost of Credit* ch. 3 (2000)).

[7] Gene Amromin et al., *Complex Mortgages* 1-2, Stanford Inst. for Econ. Pol'y Research (May 2012) (explaining how subprime mortgage loans can serve as "a security design that benefits sophisticated borrowers" but acknowledging that these types of loans are also "pushed by financial institutions to take advantage of naive households").

[8] Subprime lending can be a legitimate practice in the financial services industry that gives borrowers deemed ineligible for prime financing the opportunity to achieve homeownership through higher-priced or otherwise inferior loan products. Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 Tex. L. Rev. 1255, 1258 (2002). A predatory loan, on the other hand, is not simply higher-priced, but also contains abusive terms and conditions that predictably harm the borrower—e.g., excessively high and inflatable interest rates, hidden fees, and undisclosed costs. Sumit

to exploit the market vacuum created by the lack of financing opportunities in historically underserved communities of color. Rheingold et al., *From Redlining to Reverse Redlining*, *supra*, at 648. In short, the move towards unregulated mortgage lending created an attractive market out of formerly excluded communities of color, and allowed housing discrimination to simply shift "from the outright denial of home loans to the systematic marketing of predatory loans to poor black and Hispanic households." Jacob S. Rugh & Douglas S. Massey, *Racial Segregation and the American Foreclosure Crisis*, 75 Am. Soc. Rev. 629, 632 (2010).

In a form of "reverse redlining,"[9] institutional lenders aggressively marketed high-risk, subprime loans, "offering easier and faster approvals" to unsuspecting borrowers of color while downplaying, if not outright concealing, the exorbitant costs that would later be exacted through inflatable interest rates, balloon payments, negative amortization features, and/or stricter repayment terms. *See* Rick Brooks & Ruth Simon, *Subprime Debacle Traps Even Very Credit-Worthy*, Wall Street J., Dec. 3, 2007, at A1. Thus, in five years, between 1994 and 1999, the

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Agarwal et al., *Predatory lending and the subprime crisis*, 113 J. Fin. Econ. 29, 29 (2014). In reality, however, predatory lending occurs most frequently in the subprime mortgage market. Engel & McCoy, *supra*, at 1261.

[9] "In contrast to 'redlining,' which is the practice of denying *prime* credit to specific geographic areas because of the racial or ethnic composition of the area, reverse redlining involves the targeting of an area for the marketing of deceptive, predatory or otherwise deleterious lending practices because of the race or ethnicity of the area's residents." Relman, *Foreclosures*, *supra*, at 636.

subprime mortgage market grew exponentially from $35 billion to $160 billion,[10] and by 2007, totaled approximately $650 billion, "roughly 25 percent of the overall mortgage market." Maurice Jourdain-Earl, *The Demographic Impact of the Subprime Mortgage Meltdown* 4, ComplianceTech, http://www.compliancetech.com/files/Demographic%20Impact%20of%20the%20Subprime%20Mortgage%20Meltdown.pdf.

The subprime lending crisis has had a disproportionate impact on neighborhoods of color "precisely because of the illegal reverse redlining practices of clearly identifiable financial institutions who targeted these communities as a means to maximize short term profits." Relman, *Foreclosures*, *supra*, at 630. During the housing bubble of the late 1990s through 2007, banks charged African-American homebuyers higher interest rates than similarly situated white homebuyers. Richard Rothstein, *Racial Segregation and Black Student Achievement, in Education, Justice and Democracy* 187 (Danielle Allen & Rob Reich eds., Univ. of Chi. Press 2013). By 2002, African Americans were three times as likely to receive a high-risk, subprime loan than their similarly-qualified white counterparts, *id.* at 188, and by 2008, 55 percent of African-American

[10] Rheingold et al., *supra*, at 651 ("If there is any question about where this lending is taking place, it has been answered by a series of recent studies, which supplied ample evidence that low- and moderate-income minority communities are being targeted and devastated by subprime lenders.").

mortgage holders nationwide had high-risk, subprime loans, compared with 17 percent of white mortgage holders. *Id.* at 189; *see also* Eric S. Belsky & Ren S. Essene, *Consumer and Mortgage Credit at a Crossroads: Preserving Expanded Access while Informing Choices and Protecting Consumers* 21–22, Harvard Univ. Joint Ctr. for Hous. Studies (2008) (describing "a dual market in which low-income and often minority areas are served primarily by one set of institutions, arrangements, and products and higher-income and white areas primarily by another").

Studies that control for income, credit score, and other risk variables consistently show that borrowers of color are disproportionately steered into predatory high-risk loans. *See, e.g.*, Robert G. Schwemm & Jeffrey L. Taren, *Discretionary Pricing, Mortgage Discrimination, and the Fair Housing Act*, 45 Harv. C.R.-C.L. L. Rev. 375, 399-400 (2010); Carolina Reid & Elizabeth Laderman, *The Untold Costs of Subprime Lending: Examining the Links among Higher-Priced Lending, Foreclosures and Race in California* 7, Inst. for Assets & Soc. Pol'y, Brandeis Univ. (2009). Indeed, as one moves up the income scale, the racial disparity grows increasingly more pronounced:

> Homeowners in low-income black communities are almost 3 times as likely as homeowners in low-income white communities to have subprime refinancing. For moderate income neighborhoods, black neighborhoods are 4 times as likely and in the upper income neighborhoods, black neighborhoods are six times as

> likely as white neighborhoods to have subprime financing.

Dept. of Housing & Urban Development, Subprime Lending Report, *Unequal Burden: Income and Racial Disparities in Subprime Lending in America* (Apr. 2000), http://archives.hud.gov/reports/subprime/subprime.cfm (last visited Nov. 12, 2015); *see also id.* ("Homeowners in high-income black neighborhoods are twice as likely as homeowners in low-income white neighborhoods to have subprime loans."). Similarly, while an African-American borrower with a credit score below 620 is 1.26 times more likely than a similarly qualified white borrower to receive a subprime loan, an African-American borrower with a credit score at 680 or above was 2.85 more likely to receive such a loan. Center for Responsible Lending, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages* 10–11 (May 31, 2006). Thus, racial disparities in subprime lending persist even after accounting for the characteristics of the applicant, loan, or property—with race providing the only plausible explanation. *See, e.g.*, Alan M. White, *Borrowing While Black: Applying Fair Lending Laws to Risk-Based Mortgage Pricing*, 60 S.C. L. Rev. 677, 681 (2009); Raul H. Ojeda et al., *The End of the American Dream for Blacks and Latinos* 18, William C. Velasquez Inst. (June 2009), http://wcvi.org/data/pub/wcvi_whitepaper_housing_june2009.pdf.

The predatory lending schemes that preyed on Detroit's residents are emblematic of those that took place nation-wide. In 2005, 65.4% of African-

American homebuyers in Detroit received high-risk loans, but only 20.6% of white homebuyers received similar loans. Harvard Sch. Of Public Health, Diversity Data Project, *Housing Opportunities Profile for Detroit-Warren-Livonia, Michigan* 3-4, http://www.diversitydata.org/pdfs/DiversityData_MetroAreaProfile_Detroit_Warren_Livonia_MI_Housing_Opportunities.pdf. Moreover, upper-income African-American borrowers in Detroit were more than twice as likely to receive high-risk loans as low-income white borrowers. *Id.* at 5.

II. Predatory Lending Practices Have Led to Racial Disparities in Homeownership and Wealth and Continuing Residential Segregation.

Over four decades ago, the Seventh Circuit observed:

> Through the medium of exorbitant prices and severe [subprime loan] terms, blacks are tied to housing in the ghetto and segregated inner-city neighborhoods from which they can only hope to escape someday without severe financial loss. . . . [T]he exploitation of the dual housing market assists in the relegation of blacks to a continuing position of social inequality and inferiority while those who exploit the dual housing market enjoy the benefits of enormous wealth exacted from black citizens.

Clark v. Universal Builders Inc., 501 F.2d 324, 331 & n.5 (7th Cir. 1974). The *Clark* court's observations are, unfortunately, equally true today. Predatory subprime lending forces African-American families into foreclosure and financial devastation, while solidifying residential segregation in cities and towns across the country. Rothstein, *Racial Segregation and Black Student Achievement*, *supra*, at

187. The resultant wealth disparity and entrenched racial segregation suffered by African Americans run contrary to the broad remedial goals of the FHA.

A. Racially Discriminatory Predatory Lending Devastates Wealth Accumulation in Communities of Color.

"Home ownership is without question the single most important means of accumulating [wealth]." Melvin Oliver & Thomas Shapiro, *Black Wealth White Wealth: A New Perspective on Racial Inequality* 8 (1995). And home equity "represents a much larger share of the net worth of the typical black or Hispanic homeowner (58 percent) than of the typical white homeowner (37 percent)." Joint Ctr. for Hous. Studies, Harvard Univ., *The State of the Nation's Housing: 2015*, at 17 (2015). Yet, widening wealth disparities along racial lines are "a direct consequence of discrimination in credit markets which [act] to both limit minorities' access to home ownership and to increase the cost of achieving home ownership." Charles Lewis Nier III, *The Shadow of Credit: The Historical Origins of Facial Predatory Lending and ITS Impact Upon African American Wealth Accumulation*, 11 U. Pa. J.L. & Soc. Change 131, 194 (2013).

Because, as detailed above, people of color bear a disproportionate share of the subprime debt burden, families in neighborhoods of color incur much higher housing costs than similarly situated families in white neighborhoods. *See* Ojeda et al., *supra*, at 18; *see also* Michael S. Barr et al., *Behaviorally Informed Home Mortgage Credit Regulation* 31, Harvard Univ. Joint Ctr. for Hous. Studies (2008).

These higher costs divest minorities of wealth and home equity, as they often require families with small incomes to scramble to meet higher interest rates and skyrocketing fees. *See* Lopez, *supra*, at 76 ("[R]everse redlining practices have milked the last drops of wealth from minority neighborhoods . . . ."). Predatory subprime lending thus forces "African Americans to devote more of their incomes to housing to the detriment of other basic necessities, including education, medical care, food, clothing, home improvements and recreation." Nier, *supra*, at 190.

"[S]ubprime loans are conclusively associated with high default and foreclosure rates." Lopez, *supra*, at 651-52. In the wake of the subprime bust, and amid a rapidly deteriorating foreclosure crisis, "the group with the smallest percentage of homeownership, African Americans, had the greatest dive in homeownership rates." Aleatra P. Williams, *Lending Discrimination, the Foreclosure Crisis and the Perpetuation of Racial and Ethnic Disparities in Homeownership in the U.S.*, 6 Wm. & Mary Bus. L. Rev. 601, 618 (2015). Inasmuch as racially segregated minority communities served as "a natural niche for subprime lending," whether a homebuyer lives in a segregated neighborhood holds "by far the greatest potential to predict foreclosures" on subprime mortgage loans. Rugh & Massey, *supra*, at 638.

As the subprime crisis unfolded, over 2.8 million homes were lost to foreclosure in 2009 alone—a "120 percent increase in total properties from 2007."

Daren Blomquist, *2009 Year end Foreclosure Report*, RealtyTrac, http://www.realtytrac.com/landing/2009-year-end-foreclosure-report.html (last visited Nov. 15, 2015); *see also* Katalina M. Bianco, *The Subprime Lending Crisis: Causes and Effects of the Mortgage Meltdown*, CCH Mortgage Compliance Guide & Bank Digest 12 (2008) ("The prevalence of subprime loans contributed to a 31-percent spike in foreclosure filings in the first half of 2006."). The massive increase in nationwide foreclosure filings correlates with the foreclosure rate on subprime loans, which soared "from 3.3% in 2005 to 15.6% in 2009." Rugh & Massey, *supra*, at 634. The financial consequences of these foreclosures have been devastating: high-risk subprime loans originated between 1999 and 2007 have cost borrowers of color collectively "between $164 billion and $213 billion." Melvin Oliver, *Subprime as a Black Catastrophe*, The American Prospect, http://prospect.org/article/sub-prime-black-catastrophe (Sept. 20, 2008).

Subprime-induced foreclosures have been directly linked to a nationwide reversal in African-American homeownership growth in recent years. Williams, *supra*, at 618; *see also* Rugh & Massey, *supra*, at 633 ("[S]egregation and the new face of unequal lending combined to further undermine black residential stability and erode any accumulated wealth."). According to the Secretary of Housing and Urban Development, the subprime lending crisis was particularly devastating to African-American wealth accumulation nationwide:

> "[B]etween 2005 and 2009, fully two-thirds of median household wealth in [communities of color] was wiped out. From Jamaica, Queens, New York, to Oakland, California, strong, middle class African American neighborhoods saw nearly two decades of gains reversed in a matter of not years—but months."

Shaun Donovan, *Prepared Remarks of Secretary Shaun Donovan During the Countrywide Settlement Press Conference*, U.S. Dep't of Hous. & Urban Dev., Press Room, (Dec. 21, 2011).

B. High Rates of Foreclosure from Predatory Lending Schemes Further Entrench Residential Racial Segregation.

Foreclosures impose financial and social harms on *neighboring* homes within the same community, including declines in property values, large drops in property tax revenue, additional costs for increased municipal services and expenditures needed to process foreclosed properties, massive drains of capital and home equity, and worsening patterns of entrenched racial segregation. *See* Relman, *Foreclosures*, *supra*, at 645-46; *see also* Ira Goldstein, *Bringing Subprime Mortgages to Market and the Effects on Lower-Income Borrowers* 22, Harvard Univ. Joint Ctr. for Hous. Studies (2004) ("Estimates of the impact of a mortgage foreclosure on surrounding [property] values can be as much as 20%.").

According to one study, the price of single-family homes decreases with every nearby foreclosure, on average, by 0.9 percent, and declines steadily further with each additional foreclosure. Dan Immergluck & Geoff Smith, *The External*

Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values, 17 Housing Pol'y Debate 57, 57 (2006) (estimating that foreclosures in Chicago in 1997 and 1998 "reduced nearby property values by more than $598 million, for an average of $159,000 per foreclosure"); *see also* W. Scott Frame, *Estimating the Effect of Mortgage Foreclosures on Nearby Property Values: A Critical Review of the Literature*, Econ. Rev., 2010, at 6 (noting that "properties in some stage of foreclosure depress sales prices" of neighboring non-foreclosed homes); Tammy Leonard & James Murdoch, *The neighborhood effects of foreclosure*, 11 J. Geographical Systems 317, 332 (2009) (finding that foreclosure within 250 feet causes a 0.5 decline in the value of neighboring homes in Dallas County, Texas); Zhenguo Lin et al., *Spillover Effects of Foreclosures on Neighborhood Property Values*, 38 J. Real Est. Fin. & Econ. 387, 407 (2009) (finding that foreclosure can cause as high as an 8.7 percent drop in the price of homes located within ten blocks of the foreclosed property).

The subprime foreclosure crisis has stripped thousands of African-American households of the much needed equity and capital that "would allow them to move out of poorer, segregated neighborhoods" and into integrated communities. Relman, *Foreclosures*, *supra*, at 650. Moreover, perceptions associated with foreclosures have deterred residential and capital investment in minority neighborhoods. *Id.* And, "an epidemic of foreclosures among African American

and Hispanic homeowners . . . exacerbat[es] racial segregation as displaced families relocate to more racially isolated neighborhoods or suffer homelessness." Rothstein, *Discriminatory Mortgage Lending*, *supra*, at 2.

The current crisis in residential segregation, therefore, is not merely a product of individual choice or poverty, but rather the direct result of a dual lending market that continues to deny African-American families the opportunity to live in integrated communities:

> [T]he low incomes of blacks are not the main source of either residential segregation or disparities in the resources of the neighborhoods where they live. A central new finding is that blacks' neighborhoods are separate and unequal not because blacks cannot afford homes in better neighborhoods, but because even when they achieve higher incomes they are unable to translate these into residential mobility.

John R. Logan, *Separate and Unequal: The Neighborhood Gap for Blacks, Hispanics and Asians in Metropolitan America* 8, Brown Univ. 15 (2011), http://www.s4.brown.edu/us2010/Data/Report/report0727.pdf.; *see also* Nancy A. Denton, *Segregation and Discrimination in Housing*, *in A Right to Housing: Foundation for a New Social Agenda* 61, 77 (Rachel Bratt et al. eds., 2006) ("Contemporary housing choices do not reflect preferences so much as they reflect a structural system that was built on racism.").

Almost 50 years have passed since the FHA was enacted, yet African-American families across the country—and thousands in Detroit—have fallen

victim to the exploitation and profiteering of financial institutions like Morgan Stanley. The segregating effects of the subprime mortgage crisis in Detroit are borne out in the fact that, in 2010, Detroit was the most segregated of the 50 metropolitan regions in the country with the highest African-American populations.[11] In addition, homeownership—a key component of household wealth—among African Americans in Detroit was 53% in 2006, three points below the 1970 rate of 56%. Kirwan Institute for the Study of Race & Ethnicity, *Opportunity for All: Inequity, Linked Fate & Social Justice in Detroit & Michigan* 7 (July 2008), http://www.kirwaninstitute.osu.edu/reports/2008/07_2008_MIRoundtableOppMap_FullReport.pdf.

Unless courts acknowledge and confront the social and economic forces that continue "to push poor black neighborhoods beyond the threshold of stability," African Americans cannot achieve the racial mobility requisite to integration. John P. Relman, *Finding a Home for the Occupy Movement: Lessons from the Baltimore and Memphis Wells Fargo Litigation*, *in From Foreclosure to Fair Lending: Advocacy, Organizing, Occupy, and the Pursuit of Equitable Credit* 105, 110 (Chester Hartman & Gregory Squires eds., 2013). Accordingly, the instant case is an important vehicle for holding private actors, like Morgan Stanley,

[11] John R. Logan et al., *The Persistence of Segregation in the Metropolis: New Findings from the 2010 Census* 5-6 (Mar. 24, 2011), http://www.s4.brown.edu/us2010/Data/Report/report2.pdf.

accountable for their substantial role in the predatory subprime mortgage industry in Detroit that has contributed to the persistence of residential segregation.

III. Class Actions Are Necessary for the Effective Enforcement of the Fair Housing Act to Redress Widespread and Racially Discriminatory Conduct in the Secondary Mortgage Market.

The FHA is "a broad based instrument to be utilized in eliminating all discrimination and the effects thereof in the ownership of property," *Clark*, 501 F.2d at 330, in order "to provide, within constitutional limits, for fair housing throughout the United States," 42 U.S.C. § 3601. The Act's "broad and inclusive" language requires "a generous construction" capable of giving relief to "all [those] who are injured by racial discrimination," *Trafficante v. Metro. Life Ins. Co.*, 409 U.S. 205 (1972), "from any sources whatever," *Jones v. Alfred H. Mayer Co.*, 392 U.S. 492, 423-24 (2014).

The District Court's denial of class certification in this case of egregious secondary mortgage market discrimination cannot be reconciled with the statute's primary purpose of "eliminat[ing] all traces of discrimination within the housing field." *Marr v. Rife*, 503 F.2d 735, 740 (6th Cir. 1974). As the *Clark* court recognized:

> [D]efendants cannot escape the reach of [the FHA] by proclaiming that they merely took advantage of a discriminatory situation created by others. We find repugnant to the clear language and spirit of the Civil Rights Act the claim that he who exploits and preys on the discriminatory hardship of a black man occupies a

> more protected status than he who created the hardship in the first instance. . . . Indeed, there is no difference in results between the traditional type of discrimination and defendants' exploitation of a discriminatory situation.

Clark, 501 F.2d at 330-31. Thus, the fact that Morgan Stanley did not *directly* issue any high-risk mortgages in the instant case does not relieve it of liability under the expansive reach of the FHA.[12] Rather, "[t]o give the [FHA] the scope that its origins dictate," it must have a "sweep as broad as its language." *Mayer Co.*, 392 U.S. at 437.

The FHA prohibits discrimination in any "residential real estate-related transaction," which includes the "purchasing of loans . . . secured by residential real estate." 42 U.S.C. § 3605(b)(1). Prohibited discrimination under the FHA includes any policy or practice that "actually or predictably results in a [racially] disparate impact" without a legitimate or "legally sufficient justification" for the policy or practice. 24 C.F.R. § 100.500. Here, Morgan Stanley purchased and securitized New Century loans with multiple high-risk factors. Because Morgan Stanley was New Century's principal trading partner and purchased the largest share of New Century's loans sold on the secondary market, New Century's

[12] Testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs identifies secondary-market mortgage purchasers like Morgan Stanley, which purchased and securitized mortgages for profit, as the driving force behind the subprime crisis. National Association of Mortgage Brokers, *Ending Mortgage Abuse: Safeguarding Homebuyers*, Testimony before Committee on Banking, Housing, & Urban Affairs, U.S. Senate 7-8 (June 26, 2007).

conduct was driven by the standards set forth by Morgan Stanley. These loans were disproportionately issued to African-American homebuyers in Detroit. Thus, Morgan Stanley's policies and practices on the secondary mortgage market had a clear disparate impact based on race in violation of the Fair Housing Act.

Financial institutions that, like Morgan Stanley, played such a significant role in the subprime mortgage crisis have, as detailed above, fostered widespread housing discrimination and racial segregation, deepened pre-existing racial wealth disparities, legitimized debt entrapment of African-American borrowers, and profited at the expense of people of color pursuing the American dream of homeownership, "whose lack of opportunities the [FHA] was designed to combat." *Otero v. N.Y. City Housing Authority*, 484 F.2d 1122, 1133-34 (2d Cir. 1973). Thus, consistent with both the Act's sweeping scope and "remedial intent," *Havens Realty Corp. v. Coleman*, 455 U.S. 363, 380 (1982), liability under the FHA must reach Morgan Stanley's discriminatory conduct in the secondary mortgage market in order to hold it accountable for the financial devastation, spatial segregation, and overall impoverishment of African-American families in Detroit.

Where—as here—the racially discriminatory conduct has far-reaching consequences and impacts thousands of victims who would not otherwise seek legal redress through individual litigation, class action suits are essential to

effectuate the FHA's expansive, remedial protections.[13] To separately litigate thousands of individual claims would be impractical given that any damage award would likely be offset by the prohibitive cost of litigation. *See In re U.S. FoodServ. Pricing Litig.*, 729 F.3d 108, 131 (2d Cir. 2013) ("Rule 23(b)(3) class actions can be superior precisely because they facilitate the redress of claims where the costs of bringing individual actions outweigh the expected recovery."). Class action litigation thus injects efficiency[14] and fairness into a lopsided playing field that, in the instant case, pits individual homeowners—many of whom face serious

[13] Moreover, the current regulatory regime has been ineffective in deterring predatory lending behavior due to inadequate funding and a broken federal fair-housing enforcement system. *See, e.g.*, Jorge A. Soto & Deidre Swesnik, Am. Constitution Soc'y, *The Promise of the Fair Housing Act and the Role of Fair Housing Organizations* 1, 17–18 (Jan. 2012) (noting U.S. Department of Housing and Urban Development issuing charges in "less than one percent" of reported incidences of housing discrimination" and private fair-housing organizations being underfunded despite receiving the vast majority of complaints filed); Ginny Hamilton, Testimony Before the House Financial Services Committee, *Rooting Out Discrimination in Mortgage Lending: Using HMDA as a Tool for Fair Housing Enforcement* 11-12 (July 25, 2007) (describing current enforcement efforts as "shameful" and calling for increased congressional funding for fair-lending oversight and enforcement).

[14] Streamlining litigation of this nature is in the interest of the court, as well as the litigating parties, because it conserves resources. *See Robinson v. Metro-North Commuter R.R.*, 267 F.3d 147, 164, 169 (2d Cir. 2001) (reversing district court certification denial because it failed to "appreciate the potential benefits" of class treatment in "achieving an appreciable measure of judicial economy"); *see also Gen. Tel. Co. of the Southwest v. Falcon*, 457 U.S. 147, 159 (1982) ("[E]fficiency and economy of litigation" are among the "principal" objectives of the class action procedure (quoting *Am. Pipe & Constr. Co. v. Utah*, 414 U.S. 538, 553 (1974)).

financial ruin—against a multi-billion-dollar investment bank. *See Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 809 (1985) ("Class actions . . . permit the plaintiffs to pool claims which would be uneconomical to litigate individually."); *In re Warfarin Sodium Antitrust Litig.*, 391 F.3d 516, 534 (3d Cir. 2004) (noting that class actions "facilitate[] spreading of the litigation costs among the numerous injured parties" and is especially appropriate where "each consumer has a very small claim in relation to the cost of prosecuting a lawsuit").

As this Court recently acknowledged, the class action vehicle—and Rule 23(b)(3) in particular—were created, in large part, to "vindicat[e] the rights of groups of people who individually would be without effective strength to bring their opponents into court at all." *Sykes v. Mel S. Harris & Assocs., LLC*, 780 F.3d 70, 79 (2d Cir. 2015) (quoting *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 617 (1997)). And, as in the employment context, "preventing [Plaintiffs] from recovering" damages for unremedied discriminatory harms "would result in rewarding [Defendants] for violating federal law." *Reich v. S. New Eng. Telecomms. Corp.*, 121 F.3d 58, 69 (2d Cir. 1997).

Indeed, class actions are plainly "superior to other available methods for the fair and efficient adjudication of the controversy," as required by Fed. R. Civ. P. 23(b)(3)(A), where, as here, they provide justice to victims whose injuries would otherwise go unrecognized. *See* Martha Minow, *Judge for the Situation: Judge*

Jack Weinstein, Creator of Temporary Administrative Agencies, 97 Colum. L. Rev. 2010, 2015 (1997); *see also* Deborah R. Hensler et al., *Class Action Dilemmas: Pursuing Public Goals for Private Gain* 49 (2000) (The class action procedure serves as "a means of enabling litigation that could not be brought on an individual basis, in pursuit of larger social goals, such as enforcing government regulations and deterring [discriminatory] and unfair business practices."); Abram Chayes, *Public Law Litigation and the Burger Court*, 96 Harv. L. Rev. 4 (1982) (discussing the role of the class action device in consumer and civil rights litigation); Anne Bloom, *From Justice to Global Peace: A (Brief) Genealogy of the Class Action Crisis*, 39 Loy. L.A. L. Rev. 719, 756-57 (2006) (noting "the historic role of class actions as a vehicle for justice" and calling for "restor[ing] the class action to its original and best use—expanding judicial access for litigants who would otherwise find it too expensive to pursue their claims"). This Court, therefore, should adhere to the guiding principle underlying Rule 23(b)(3): to promote fairness and efficiency by providing a means for putative class members to vindicate their civil rights through collective litigation when individual lawsuits would be too costly or burdensome to pursue.

CONCLUSION

This case presents important and urgent civil rights concerns pertaining to residential segregation, which, despite the passage of time, persists due to the

racially discriminatory and predatory lending practices within the subprime mortgage industry. It is, therefore, imperative for Plaintiffs-Appellants to pursue their claims as a certified class in order to vindicate the rights of thousands of African-American Detroit residents who have suffered serious economic harm. Accordingly, for the reasons set forth above and in Plaintiffs-Appellants' brief, the Court should reverse the decision of the District Court and allow certification of the putative class in this case.

Dated: New York, NY
November 19, 2015

Respectfully Submitted,

/s/ Jin Hee Lee_____

Jin Hee Lee
Deputy Director of Litigation
NAACP Legal Defense
& Educational Fund, Inc.
40 Rector Street, 5th Floor
New York, NY 10006
(212) 965-2200
jlee@naacpldf.org

Deborah N. Archer
Professor of Law
Director, Racial Justice Project
New York Law School
185 West Broadway
New York, NY 10013
(212) 431-2138

Counsel for Amici Curiae

CERTIFICATE OF COMPLIANCE WITH RULE 32(a)

Pursuant to Fed. R. App. P. 32(a)(7)(C)(i), I hereby certify that:

1. This brief complies with the type-volume limitations of Fed. R. App. P. 32(a)(7)(B), because this brief contains 6,805 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Office Word 2013 in Times New Roman 14-point font.

Dated: New York, NY
November 19, 2015

Respectfully Submitted,

/s/ Jin Hee Lee_____
Deputy Director of Litigation
NAACP Legal Defense
& Educational Fund, Inc.
40 Rector Street, 5th Floor
New York, NY 10006
(tel) 212-965-3702
(fax) 212-226-7592
jlee@naacpldf.org

Counsel for Amici Curiae

CERTIFICATE OF SERVICE

I HERBY CERTIFY that on November 19, 2015, I electronically filed the foregoing Brief of *Amici Curiae* the NAACP Legal Defense & Educational Fund, Inc., New York Law School Racial Justice Project, the Damon J. Keith Center for Civil Rights, and the Michigan Welfare Rights Organization in Support of Plaintiffs-Appellants with the Clerk of the Court for the United States Court of Appeals for the Second Circuit by using the appellate CM/ECF system. I further certify that all participants in this case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system

/s/ Jin Hee Lee_____
Deputy Director of Litigation
NAACP Legal Defense
& Educational Fund, Inc.
40 Rector Street, 5th Floor
New York, NY 10006
(tel) 212-965-3702
(fax) 212-226-7592
jlee@naacpldf.org

Counsel for Amici Curiae