UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

TERESA LOPEZ, WILFORD LONEY, JAMES ROBINSON, BERTHA CLINTON, MARY YOUNG, JUANITA EDWARDS, VIRGINIA WILLIAMS, and MURRAY LOWE, on behalf of themselves and all others similarly situated,

Plaintiffs,

- against -

DELTA FUNDING CORPORATION, DELTA FINANCIAL CORPORATION, ALL STATE CONSULTANTS, INC., a/k/a CITY MORTGAGE BANKERS, DOE CORPORATIONS 1 through X, DELTA FUNDING HOME EQUITY LOAN TRUST, BANKERS TRUST COMPANY OF CALIFORNIA, N.A., as trustee for the DELTA FUNDING HOME EQUITY LOAN TRUST, and NORWEST BANK MINNESOTA, NATIONAL ASSOCIATION, also as trustee for the DELTA FUNDING HOME EQUITY LOAN TRUST,

Defendants.

Index No. CV 98 7204 (CPS)

OBJECTIONS TO APPROVAL OF THE SETTLEMENT AGREEMENT BY LUCILLE HARDIN, ANNA MAE DAWSON, CHRISTINE NICOLL, PEARLINE BROWN, AND THE NEW YORK ASSOCIATION OF COMMUNITY ORGANIZATIONS FOR REFORM NOW (NY ACORN)

INTRODUCTION

This nationwide class action settlement releases Delta Funding Corporation, a notorious predatory lender, and the brokers who engaged in fraudulent and deceptive practices alongside Delta, in return for payments of as little as $1.56 to the borrowers, many of whom are in imminent risk of losing their homes to Delta in foreclosure proceedings. Lucille Hardin (145 East 38th Street in Flatbush, Brooklyn 1123l; Delta loan #20374), Anna Mae Dawson (211 Monroe Street in Bedford-Stuyvesant, Brooklyn 11216; Delta loan #3110016064) (by and through her guardian ad litem), Christine Nicoll (338 Van Brunt Street, Brooklyn, 11231; Delta loan #3110128968), and Pearline Brown (100-20 34th Avenue, Corona, Queens, 11368; Delta loan #22864), and the New York Association of Community Organizations for Reform Now

(NY ACORN), object to the proposed settlement on the ground that it places the vast majority of class members in a far worse position than they would have been had the litigation never been brought in the first place: the settlement strips class members of all their defenses and counterclaims in pending and future foreclosure proceedings. Moreover, many of the putative class members have limited education and are unsophisticated in legal and financial matters, and thus may fail to opt out of this class simply because they lack understanding of the scope of the rights they release against defendants. This Court should not approve a settlement that has the effect of barring homeowners from raising legal defenses to protect their homes in the event of foreclosure.

These objections are filed on behalf of three sets of objectors, all of whom have the same concerns with the settlement. First, the objections are filed on behalf of Anna Mae Dawson, Christine Nicoll, and Pearline Brown, all putative class members who have opted out in order to preserve the myriad federal and state claims and defenses they can assert against defendants, either affirmatively or as defenses to foreclosure. Although they are choosing to opt out, these putative class members nonetheless object to the settlement because they are injured by the compromise of a class action from which they had hoped to obtain significant relief for their injuries. Without objections voiced by opt-outs, this Court would be deprived of a balanced view of the settlement agreement, since the vast majority of class members who are able to contact an attorney other than class counsel will take their attorneys' advice and opt out rather than stay in the class and object to the settlement. These objectors would have remained in the class if their rights had been faithfully championed.

Second, the objections are filed on behalf of Lucille Hardin, an 84 year-old widow who

has chosen to remain in the class and object to the terms of this proposed settlement. See Declaration of Josh Zinner, Esq. of South Brooklyn Legal Services ("SBLS Decl."), ¶ 39-40.

Third, these objections are filed on behalf of NY ACORN and its members who are class members and who will be potentially harmed by the settlement. NY ACORN is an organization of 23,000 low and moderate-income New Yorkers which, like its parent organization ACORN, has made elimination of predatory lending one of its primary goals. NY ACORN Decl. ¶¶ 6-9. Based on NY ACORN's work with Delta borrowers, Ismene Speliotis, Director of NY ACORN Housing Corporation, a sister organization of NY ACORN, estimates that approximately 100 ACORN members are members of this class. Id. ¶ 11. NY ACORN is objecting on behalf of its members and the communities it serves because the settlement puts class members in a worse position than they would be in without the lawsuit, and because NY ACORN fears that class members will not realize the extent to which they lose their rights by failing to opt out of the settlement. Id., ¶¶ 13, 16.

I. BACKGROUND

A. Procedural Background

In 1998, plaintiffs filed a nationwide consumer class action against the finance company Delta Financial Corporation and its wholly owned subsidiary, Delta Funding Corporation (together "Delta"), challenging Delta's systematic efforts to induce low-income and/or elderly homeowners to enter into illegal mortgage loan transactions.[1] Also named as defendants were

[1] The putative class consisted of "all individuals who entered into mortgage loan transactions after November 18, 1992 with Delta, or with another lender whose loan was subsequently purchased by Delta, where the terms of the loan were illegal under federal and/or state law, and/or pre-closing or closing disclosures were not adequate under federal and/or state law, and/or Delta engaged in unfair or deceptive or unconscionable practices to induce the

two commercial banks that function as trustees for the various loan trusts that purchased the loans from Delta, the mortgage broker that arranged named plaintiff Teresa Lopez's loan, and unidentified "John Doe" mortgage brokers that refer loan business to Delta. The complaint charged defendants with deceiving low-income homeowners to take out mortgages with illegal terms and conditions, such as prepayment penalties and high rates of default interest, frequently resulting in Delta's foreclosure of the borrowers' homes. Specifically, plaintiffs asserted that defendants had violated 1) the Home Ownership and Equity Protection Act, 15 U.S.C. § 1639 ("HOEPA"); 2) the Truth in Lending Act, 15 U.S.C. § 1601 et seq. ("TILA"); 3) the New York State General Business Law § 349 and other states' unfair and deceptive trade practices statutes; and 4) state common-law doctrines of unconscionability. Third Amended Complaint ¶ 2.

HOEPA, which is codified in several sections of the TILA, is designed to address abusive and predatory practices within the mortgage industry, particularly selling "credit on unfair terms, . . . peddling high-rate, high-fee home equity loans to cash-poor homeowners." House Conf. Rep. No. 652, 103rd Cong., 2d Sess. 158 (1994); see Senate Rep. No. 169, 103rd Cong., 2d Sess. 21. HOEPA covers mortgage-secured loans made at high interest rates or that charge excessive closing costs and fees. 15 U.S.C. § 1602(aa). A covered, high-cost mortgage includes those in which "points and fees" exceed 8% or more of the "total loan amount." Id. Lenders who make such loans to homeowners are subject to additional pre-closing disclosure requirements, 15 U.S.C. § 1639(a)-(b), and to various substantive limitations on common abusive lending practices, 15 U.S.C. § 1639(c)-(i), including prohibitions against default interest rates, prepayment penalties, and lending based on the value of the house rather than on the consumer's

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individuals to enter into the mortgage loan transactions." Third Amended Complaint ¶ 217.

ability to repay the loan. Violations of either the statute's advance disclosure requirement or the substantive prohibitions give rise to civil liability under 15 U.S.C. § 1640(a), an extended right of rescission under 15 U.S.C. § 1635, and enhanced damages under 15 U.S.C. § 1640(a)(4). The statute provides that an assignee of a HOEPA mortgage "shall be subject to all claims and defenses with respect to [the] mortgage that the consumer could assert against the [original] creditor . . . ." 15 U.S.C. § 1640(d)(1).

TILA, 15 U.S.C. § 1601 et seq., is a disclosure statute designed to provide meaningful information to consumers about the cost of credit and other terms included in consumer loans. The disclosure regime is enforced through a strict liability, private attorney general mechanism that imposes statutory penalties, attorney fees, and mortgage rescission on lenders that violate the disclosure requirements. See Porter v. Mid-Penn Consumer Discount Co., 961 F.2d 1066 (3d Cir. 1992). Rescission under TILA can be raised against the assignee of a loan. 15 U.S.C. § 1641(c).

All but a handful of states have enacted unfair and deceptive practices acts. These laws prohibit businesses from engaging in consumer-oriented acts and practices that are unfair, deceptive, and contrary to public policy and generally recognized standards of business, and provide equitable and monetary relief to those injured by violations of the law. For example, the New York Deceptive Practices Act, General Business Law § 349, provides equitable relief and damages where an act or practice was misleading in a material respect; the consumer was injured; and the conduct complained of was "consumer-oriented". See Stutman v. Chemical Bank, 95 N.Y.2d 24, 29, 731 N.E.2d 608, 611 (N.Y. Ct. App. 2000).

The Complaint divides class members into four sub-classes: 1) the HOEPA Sub-Class

(individuals issued loans in violation of HOEPA); 2) the TILA Sub-Class (individuals issued loans in violation of TILA); 3) the State Law Sub-Class (individuals issued loans in violation of state unfair and deceptive trade practice laws); and 4) the Redemption Sub-Class (individuals upon whom Delta foreclosed, but who otherwise would have been entitled to rescind their loans as part of any relief offered to the HOEPA Sub-Class and the TILA Sub-Class). Third Amended Complaint ¶ 218.

If class members had prevailed in litigation, they would have been entitled to substantial relief. Prevailing HOEPA Sub-Class members would have a statutory right to damages and an extended right to rescind their mortgage loan transactions, including against assignees. Prevailing TILA Sub-Class members could also rescind their mortgages and obtain actual and statutory damages. Prevailing State Law Sub-Class members would be entitled to equitable and monetary relief. South Brooklyn Legal Services attorneys, who have raised these types of claims on behalf of clients in numerous cases, estimate that these claims can be worth tens of thousands of dollars to victimized borrowers. See SBLS Decl. ¶ 44.

As a result of its notorious lending practices, "Delta has become a symbol of predatory lending." See Joseph P. Fried, "Home Lender Offers to Settle Claims of Predatory Practices," New York Times, May 7, 2002, at A26. In 1999, the New York Attorney General's office filed a complaint against Delta and several mortgage brokers who do regular business with Delta for having "engaged in a pattern and practice of targeting low-income minority homeowners and inducing them to enter into illegal, discriminatory, and fraudulent high-cost mortgage loans, which defendants have reason to know these borrowers either cannot repay or can repay only

through extreme personal and financial privation."[2] See People of the State of New York v. Delta Funding Corp., Civ. No. 99-4951 (Sifton, J.) at ¶ 1, annexed to SBLS Decl. as Exhibit A. In March 2000, the U.S. Department of Justice filed a complaint against Delta asserting that Delta's lending practices violated numerous consumer protection and civil rights statutes, and had "exposed borrowers to unwarranted risk of default and foreclosure."[3] See United States v. Delta Funding Corp., 1872 CV 2000 (Sifton, J.) at ¶ 17, annexed to SBLS Decl. as Exhibit B.

B. Terms of Proposed Settlement Agreement

On March 2, 2002, plaintiffs filed a motion for preliminary approval of a settlement agreement. The class is defined more broadly in the settlement than it was in the complaint, encompassing "all individuals who entered into mortgage loan transactions [between November 19, 1992 and October 31, 1999] with Delta Funding or with another lender where the loan was subsequently purchased by Delta Funding." Proposed Settlement Agreement at ¶ 2. The proposed class consists of tens of thousands of borrowers. In fact, in 1998 alone, Delta funded at least 8,561 loans. See U.S. DOJ Complaint at ¶ 8. The settlement contains a General Release that insulates not only all of the named defendants, but also all of the brokers, assignees and other secondary market participants involved in the loans at issue. Proposed Settlement Agreement ¶ 12. The General Release covers any and all claims or defenses that could be asserted by a borrower with respect to all aspects of the origination or terms of the loan, even if

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[2] Specifically, the Attorney General alleged claims under HOEPA, TILA, the Real Estate Settlement Procedures Act ("RESPA"), 12 U.S.C. § 2607, the Equal Credit Opportunity Act ("ECOA"), 15 U.S.C. §§ 1691 et seq., and the New York State Human Rights Law (Executive Law § 296-a).

[3] The Department of Justice raised claims under the Fair Housing Act, the Equal Credit Opportunity Act, RESPA, the Federal Trade Commission Act, and the Truth in Lending Act.

the claims bear no relation to the allegations in the class action suit. Id. As described in greater detail below, the vast majority of class members will receive negligible monetary awards of well below $50 under the settlement. Although narrow categories of class members may be awarded more significant relief, it appears that only a very small number of class members will qualify for these benefits.

II. ARGUMENT

A. Standard of Review

Federal Rule of Civil Procedure 23(e) requires the district court to scrutinize carefully the settlement to determine its fairness, adequacy and reasonableness, and to ensure that it is not the product of collusion between the settling parties. D'Amato v. Deutsche Bank, 236 F.3d 78, 85 (2d Cir. 2001). Because this settlement was negotiated prior to class certification, it is "subject to a higher degree of scrutiny in assessing its fairness." Id.; County of Suffolk v. Long Island Lighting Co., 907 F.2d 1295, 1323 (2d Cir. 1990). Nine factors govern the district court's review of whether the settlement is fair, adequate, and reasonable:

(1) the complexity, expense and likely duration of the litigation;
(2) the reaction of the class to the settlement;
(3) the stage of the proceedings and the amount of discovery completed;
(4) the risks of establishing liability;
(5) the risks of establishing damages;
(6) the risks of maintaining the class action through the trial;
(7) the ability of defendants to withstand a greater judgment;
(8) the range of reasonableness of the settlement funding light of the best possible recovery; and
(9) the range of reasonableness of the settlement fund to a possible recovery in light of all the attendant risks of litigation.

City of Detroit v. Grinnell Corp., 495 F.2d 448, 463 (2d Cir. 1974). As shown below, this settlement falls woefully short under the Grinnell fairness analysis. Moreover, several key

characteristics of the settlement agreement present insurmountable legal obstacles to its approval apart from the Grinnell factors and warrant this Court's disapproval.

B. The Settling Parties Have Failed To Meet Their Burden Of Establishing that the Settlement is Fair, Adequate and Reasonable Because The Settlement Puts The Vast Majority Of Class Members In A Worse Position Than If No Lawsuit Been Filed And Because The Settlement Is Unlawful In Several Respects

Guided by the Grinnell factors, this Court must review the settlement to determine whether it is fair, adequate, and reasonable in light of the risks and rewards of litigation. Grinnell factors 7, 8 and 9 focus the court's review on the size of the recovery under the settlement. Here the Court's task is an easy one because this settlement leaves almost the whole class in a *worse* position than if class counsel had abandoned the litigation altogether.

1. The Benefits For The Class Are Minuscule

The rewards for the vast majority of class members are minuscule. Class members with HOEPA loans that do not qualify as Early Payment Default Loans will divide a $200,000 fund among themselves. Proposed Settlement Agreement ¶ 4(b). All other class members -- that is, the vast majority of the class -- will divide a $300,000 fund. Id. at ¶ 4(c). Class counsel for plaintiffs claim that there are more than 10,000 class members. Third Amended Complaint ¶ 219. With two exceptions, all of the dozens of class members who have approached South Brooklyn Legal Services thus far for advice about whether to accept the settlement have been offered sums between $1.56 and $23.76. (The two exceptions were classified as Disputed HOEPA Loans under the settlement and were offered less than $1000 each -- one of these borrowers has already lost her home in a Delta foreclosure.) SBLS Decl. ¶ 15. The settling parties cannot seriously contend that this amount of money is a meaningful --

nor fair, reasonable, or adequate -- benefit to the many low-income Delta mortgagors who are at serious risk of losing their homes.

Only a very narrow category of class members will receive anything more than a few dollars from the settlement. Class members whom Delta classifies as having "HOEPA Early Payment Default Loans" or "Disputed HOEPA Early Payment Default Loans" are entitled to some reduction of the principal and arrears of their loans.[4] HOEPA Early Payment Default Loans are defined as HOEPA loans for which the class member made fewer than six monthly payments and for which a foreclosure action is pending on the date of the settlement notice. Proposed Settlement Agreement ¶ 2(a). A Disputed HOEPA Early Payment Default Loan shares the same definition, except that it would not constitute a HOEPA loan unless the broker fee is considered a "finance charge" under 12 C.F.R. § 226.4 and any closing fee charged by William J. Horan is included in "points and fees" under 12 C.F.R. § 226.32(b)(1). Proposed Settlement Agreement ¶ 3(a). For these class members, Delta will establish a fund that will be used to: 1) reduce the unpaid balance on the scheduled principal of their loans by 10%; and 2) reduce the arrears on each loan pro-rata by 50%, or until the fund has been depleted.

Even for these categories of loans, the relief countenanced under the settlement is inadequate to forestall foreclosure. By definition, borrowers in the Early Payment Default category made fewer than six payments *in total*, and evidently could not afford their Delta mortgage payments from the outset. The proposed settlement relief does not cure this situation. Instead, the settlement terms require that these borrowers make two monthly payments — one of

[4] As discussed below, one of the insuperable legal obstacles to approval of this settlement is that *Delta*, not a neutral arbiter, determines whether class members fall into certain categories and the benefits each class member receives.

principal and one of accumulated arrears — that combined may actually exceed the original monthly mortgage payments. See, e.g., calculation of Anna Mae Dawson's would-be relief, SBLS Decl. ¶ 24. Thus, even for the narrow category of borrowers who are offered the maximum relief available under the settlement, the benefits of the settlement fail to outweigh the extraordinarily broad release of all claims against all defendants.

Moreover, the settlement eliminates additional class members from eligibility for these higher awards by requiring any Delta borrower who believes she has a disputed or undisputed HOEPA Early Default Loan to "submit[] a claim under oath stating that (s)he . . . did not suffer any personal or financial reverses after the date of the Covered Loan that materially adversely affected the DHEPD Class Members's ability to repay the Covered Loan." Proposed Settlement Agreement ¶ 2(e). For the mostly elderly and low-income homeowners that are typical Delta borrowers, this provision conditioning the right to receive redress for Delta's wrongs upon borrowers' ability to maintain consistent financial stability is patently unfair. For example, if there is a death in a family that has a DHEPD Delta loan, and a consequent reduction in household income, the surviving spouse would be barred from relief by the oath requirement.

The paltry sums awarded to class members under the settlement are particularly troubling because Delta has profited so greatly from its wrongdoing. The complaint filed by the New York Attorney General's office vividly describes how Delta has enriched itself through its predatory lending practices:

> At the foreclosure sale that follows default, Delta sometimes purchases the property that collateralized the mortgage loan when its analysis of the home's underlying value determines that Delta can do so profitably. Even when a party other than Delta purchases the home at a foreclosure sale, Delta's interest is usually oversecured; by Delta's policy of typically granting loans for less than 75% of the value of the home, Delta can minimize its losses on defaulted loans.

> In the calendar year 1997, while Delta foreclosed upon $85 million in loans, Delta's total losses on these loans were less than $5 million. By contrast, Delta's revenues during that same year exceeded $133 million.

NY Attorney General Complaint (Aug. 19, 1999) ¶ 60. Delta can afford to remedy the damages done to class members and should not be permitted to insulate itself from all future claims and defenses by paying a scant few dollars to injured class members. See, e.g., Grinnell (ability of defendants to pay is one factor to be reviewed in determining fairness, reasonableness and adequacy of settlement).

2. The Scope Of The Release Renders The Settlement Unlawful As Well As Unfair Under Grinnell

The most troubling aspect of this settlement is the sweeping release it grants to Delta and myriad other involved entities. Under the settlement's general release provision, class members forego:

> any and all claims, demands, suits and actions . . . relating to the origination of Covered Loans and/or the terms of Covered loans, and all claims, demands, suits and actions that could have been asserted. . . with respect to the Covered Loans

Proposed Settlement Agreement ¶ 12(c). Thus, the release purports to cover not simply the claims asserted in the class action complaint, but any and all claims related to the loans at issue. That release places class members in a far worse position than they would have been had the class action lawsuit never been brought. In return for the minimal relief described above, class members are stripped of all the rights and protections that federal and state law provide consumers who obtain home mortgages.

The breadth of the release renders the settlement unlawful. The settling parties cannot release claims for which they were never authorized to represent the class. Some class members may have been victimized in illegal kickback schemes in violation of the Real Estate Settlement

Procedure Act (RESPA), 12 U.S.C. § 2601 et seq., or an illegal conspiracy between a broker and Delta in violation of RICO, 18 U.S.C. § 1961 et seq. Others may have claims and defenses under the federal Fair Housing Act, 42 U.S.C. § 3601 et seq., the Equal Credit Opportunity Act (ECOA), 15 U.S.C. § 1691 et seq., and the New York State Human Rights Law, New York Executive Law § 296 (discrimination in housing) and § 296-a (credit discrimination). See U.S. DOJ Complaint ¶ 1 (bringing an action against Delta on the ground that it violated the Fair Housing Act and ECOA). Class counsel never purported to represent class members on these claims, and therefore cannot now execute a release of those claims. See National Super Spuds v. New York Mercantile Exchange, 660 F.2d 9, 18-20 (2d Cir. 1981) (Friendly, J.) (rejecting an attempt by the settling parties to release claims that were not asserted in the class action); Grimes v. Vitalink Communications Corp., 17 F.3d 1553, 1563 (3d Cir. 1994).

Startlingly, the broadly worded release not only bars class members from affirmatively bringing suit against the settling defendants, but also deprives Delta borrowers of their ability to defend against the foreclosure that too frequently results from Delta's predatory lending practices. Once sued in foreclosure, homeowners victimized by predatory lending practices are entitled to protect their homes by raising legal defenses under both federal and state law. SBLS Decl. ¶ 11-14. For example, homeowners can raise consumer protection claims under HOEPA, TILA, RESPA, RICO, N.Y. General Business Law § 349, the Fair Housing Act or ECOA, or common-law causes of action such as fraud and unconscionability. Id.

This settlement strips class members of every one of these legal protections in exchange for a pittance. For example, SBLS attorneys are representing objector Anna Mae Dawson in a foreclosure action and have raised defenses and third-party claims against the mortgage broker

under HOEPA, TILA, the N.Y. Deceptive Practices Act, and common law fraud, unconscionability, and breach of fiduciary duty. Ms. Dawson was unwittingly induced to enter into a Delta loan with monthly payments that exceeded her income; under the settlement she was offered only $15.47. SBLS Decl. ¶ 16-24. Likewise, 81-year-old widow Eunice Owens is in foreclosure and SBLS plans to raise defenses and third party broker claims under HOEPA, TILA, RESPA, ECOA, the N.Y. Deceptive Practices Act, and unconscionability. Ms. Owens was offered $16.96 under the settlement. SBLS Decl. ¶ 25-29. As one more example, SBLS is representing objector Christine Nicoll, a disabled woman who was pressured by a crooked broker to take out a Delta loan and fell into foreclosure almost immediately. SBLS has filed an answer to the foreclosure complaint, raising defenses and third party broker claims under the N.Y. Deceptive Practices Act, RESPA, HOEPA, TILA, fraud and unconscionability. Ms. Nicoll is entitled to $15.32 under the settlement. SBLS Decl. ¶ 30-35. The sweeping release may deprive homeowners of these rights and protections worth tens of thousands of dollars, and more importantly deprives them of the ability to defend against a foreclosure. SBLS Decl. ¶ 44. At the very least, this Court should not approve this settlement unless it allows homeowners to raise defenses to foreclosure.

The Court should also reject this settlement (and its unlawful release) because class members are unlikely to understand the consequences of remaining in the class. Although the notice informs class members that they release all their claims if they remain in the class, this information is buried in fine print on the third page of the notice. Many Delta borrowers have minimal or limited education, and have difficulty comprehending complex documents. SBLS Decl. ¶ 3. Many class members may not understand the legal terminology or, even if they do,

they may not realize that they will lose all their *defenses* to foreclosure as well as any right to assert their own claims affirmatively. For example, Anna Mae Dawson, Eunice Owens and Christine Nicoll had no understanding of the legal consequences of failing to opt out. SBLS Decl. ¶ 21, 29, and 34. In fact, not a single homeowner in contact with SBLS has understood that, by remaining in the class, he or she would waive defenses to foreclosure and affirmative claims related to the illegal loans. Id. ¶ 41. Thus, class members may simply accept the few dollars they are awarded under the settlement, believing that they are no worse off for doing so. This is particularly likely considering that this class is composed of low-income homeowners who were originally targeted by Delta precisely because of their vulnerability and lack of sophistication. See New York Attorney General Complaint ¶ 34.

To fully understand the scope of the proposed release, it is critical to recognize that many parties beyond the original mortgage lender are implicated in predatory lending schemes. The mortgage brokers who serve as middlemen between borrowers and lenders often engage in misrepresentations and other deceptive practices in order to induce homeowners to enter into a mortgage loan. In litigation, the lenders who profit from these practices virtually always respond that the broker is liable and not the lender. The sweeping settlement release would force borrowers to waive all claims against any mortgage broker involved in a Delta transaction.

Without question, the most important entities in a foreclosure action are the current noteholder and the loan servicer, which collects payments and brings foreclosure actions. In the subprime market, where loans change hands rapidly and frequently, the noteholder is usually a secondary market purchaser (assignee) or a securitization trust that packages mortgages for sale on the open market. The current note holder, not the originating lender such as Delta, is the

plaintiff in a foreclosure action — thus to prevent foreclosure and keep her home, a homeowner must be able to raise defenses against the assignee.

Especially in light of these multiple and shifting parties, it is surprising that Delta — and only Delta — has contributed to the proposed settlement. Through the proposed settlement, Delta is attempting to eliminate liability not only for itself, but also for secondary market purchasers/foreclosure plaintiffs, and any mortgage brokers involved in any challenged transaction. The settlement even eliminates liability for parties not named in the plaintiffs' complaint! By making negligible cash payments to thousands of borrowers, Delta is attempting to protect every mortgage transaction it closed over a seven-year period from all legal scrutiny.

3. It Is Unlawful To Force Class Members To Relinquish Defenses To Claims That Have Yet To Accrue

The settlement's overbroad release is unlawful for an independent reason. Delta seeks to release the class members' defenses and counterclaims with respect to *future* claims that have yet to be brought and that have yet to accrue. The settlement purports to bar class members from raising defenses to *future* foreclosure actions brought by Delta — not only foreclosure actions that have not been filed but actions that cannot be filed because the borrower's loan is not presently in default or otherwise subject to foreclosure. It violates class members' due process rights to force them to relinquish defenses to claims that have yet to accrue. See Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 628 (1997); Stephenson v. Dow Chemical Co., 273 F.3d 249, 259-61 (2d Cir. 2001) (settlement violated class members' rights to due process by purporting to relinquish their unaccrued future claims); see also Schweitzer v. Reading Co., 758 F.2d 936, 943 (3d Cir.) (rejecting argument that "a person who had no inkling that years in the future he would be killed by a product produced by the debtor would be required to file a claim

in the debtor's ... bankruptcy proceedings so as to preserve any rights that he might have in a future tort suit"), cert. denied, 474 U.S. 864 (1985); Foster v. Bechtel Power Corp., 89 F.R.D. 624, 626-27 (E.D. Ark. 1981) (future claims cannot satisfy Rule 23(a)'s typicality, commonality, or adequacy of representation requirements); Freeman v. Motor Convoy Inc., 68 F.R.D. 196, 200 (N.D. Ga. 1975) (class action could not include future plaintiffs because "overbroad framing of the class may operate to deprive absent members of due process") (citing Johnson v. Georgia Highway Express, Inc., 417 F.2d 1122, 1125-27 (5th Cir. 1969) (Godbold, J., concurring)); Note, "The Inclusion of Future Members in Rule 23(b)(2) Class Actions," 85 Colum. L. Rev. 397, 408 (1985) (certification of "futures" class violates due process because doing so requires courts to apply Rule 23 in a "factual vacuum," introducing "a substantial element of speculation, distortion, and confusion" into certification process).

As in Super Spuds, where the Second Circuit held that the class representatives did not have authority to represent class members regarding unliquidated potato futures contracts, 660 F.2d at 17-18, the class representatives here simply do not have the authority to relinquish future defenses before certain events (the events giving rise to a right to foreclose) have occurred. The concern is that class members not currently subject to foreclosure will not opt out and then, years later, when facing foreclosure by Delta, will find out that they have released all of their highly valuable defenses. Yandle v. PPG Industries, Inc., 65 F.R.D. 566, 572 (E.D. Tex. 1974) (rejecting release of future asbestos personal-injury claims because, before an injury has been sustained, "persons might neglect to 'opt-out' of the class, and then discover some years in the future that they have contracted asbestosis, lung cancer or other pulmonary disease"). The illegality here, as in Super Spuds, is greatly exacerbated, because "the notice of settlement did not adequately

apprise class members" that they would be giving up their valuable defenses to foreclosure, 660 F.2d at 16, thus making it impossible for the class members to intelligently exercise their opt-out rights.

Moreover, there is a more fundamental impediment to the release, by a federal court, of unaccrued defenses: Article III of the Constitution. Article III's case-or-controversy requirement prohibits adjudication of Delta's rights to foreclosure before the facts giving rise to foreclosure have occurred; necessarily, therefore, Article III also prohibits the release of defenses that may only be raised in a ripe foreclosure action. Georgine v. Amchem, Inc., 83 F.3d 610, 635-38 (3d Cir. 1996) (Wellford, J., concurring). Put differently, although this class action is formally a suit between plaintiffs and defendants with live claims and defenses, Delta's request for approval of the settlement is, in practical effect, a declaratory judgment action by which Delta seeks to adjust all of its unaccrued predatory loan-related liabilities, including those that could arise in future foreclosure proceedings. As such, there is no Article III case or controversy. See Keene Corp. v. Fiorelli, 14 F.3d 726, 730-33 (2d Cir. 1993). Delta's attempt to obtain such a judgment through Court approval of this settlement should therefore be rejected.

4. Delta's Role As Settlement Administrator Renders The Settlement Unlawful And Violates The Class Members' Due Process Rights And Is Another Reason To Reject The Settlement As Unfair Under Grinnell

The settlement is also seriously flawed in that it grants Delta the discretionary power to decide the type — and thereby the amount — of relief for which class members qualify. In many circumstances, Delta has an incentive to categorize class members' loans to avoid paying money under the settlement, and thus its role as decision maker operates to the class members' disadvantage. In addition, the settlement gives Delta the authority to decide when it can lawfully subject borrowers to a higher rate of default interest or prepayment penalties. Delta has been the

subject of many lawsuits precisely because of its demonstrated inability to obey the law, and there is no reason to think Delta will be any more reliable when asked to police itself under this settlement. To put it bluntly, the settlement creates a situation in which the fox is assigned the task of guarding the henhouse.

The first open-ended settlement provision concerns Delta's practice of charging higher "default interest" rates to class members holding HOEPA loans who fall behind in their mortgage payments. Class counsel's Third Amended Complaint, the U.S. Department of Justice Complaint, and the New York Attorney General's Complaint each allege that Delta has regularly engaged in such prohibited conduct. Judge Sifton, in his decision in this case granting a preliminary injunction to halt foreclosures, concluded that the class was likely to prevail on the issue of HOEPA default interest. Lopez v. Delta Funding Corp., 1998 U.S. Dist. LEXIS 23318, *21 (E.D.N.Y Dec. 23, 1998). Paragraph 1 of the Settlement Agreement provides that outstanding promissory notes are to be amended by the settlement so that: a) no default rate of interest applies for the first 120 days of default; and b) after 120 days, a default rate may be imposed *if permitted by law.* Thus, Delta is responsible for determining whether it can charge default interest rates. Ironically, paragraph 1 of the settlement merely states that Delta is not permitted to charge a default rate if such a rate is prohibited by law, but leaves that determination up to Delta, even though Delta has repeatedly ignored HOEPA's prohibitions against higher rates of default interest in the past.

A similarly disturbing provision concerns Delta's responsibility for categorizing class members to determine the benefits they will receive under the settlement. The settlement creates a $1.15 million "Paragraph 2 Reduction Fund" to be applied for the benefit of participating class

members with HOEPA Early Payment Default Loans and a "Paragraph 3 Reduction Fund" of an indeterminate amount to compensate class members with Disputed HOEPA Early Payment Default Loans. Delta is solely responsible for deciding whether class members qualify for awards under these Reduction Funds. Moreover, the Paragraph 3 Reduction Fund is not a capped, pre-set amount, but is instead the "aggregate amount required to make the payments and credits" set forth in the settlement. Proposed Settlement Agreement ¶ 3(b). Thus, Delta has a financial incentive to find that class members do not qualify for that fund. Class members have already been victimized by Delta; they should not be forced to rely on Delta's judgment regarding the degree to which they have been injured or the size of their award.

Delta has already proven itself incapable of categorizing class members accurately. For example, class member Anna Mae Dawson received notice of the proposed settlement offering her $15.47 under Section III.D of the notice. SBLS Decl. ¶ 21. In fact, Ms. Dawson should have received the far more substantial relief offered to class members with Disputed HOEPA Early Payment Default Loans because: 1) her loan constituted a HOEPA loan if the closing fee charged by William J. Horan is counted as "points and fees" under 12 C.F.R. § 226.32(b)(1), Proposed Settlement Agreement ¶ 3(a); 2) Ms. Dawson defaulted on that loan before making six payments; and 3) she is in foreclosure. SBLS Decl. ¶ 22. The misclassification by Delta of Ms. Dawson's loan, whether inadvertent or otherwise, highlights why defendant Delta should not have unilateral control over the determination of the kind and amount of relief to be provided class members.

Especially troubling is Delta's authority under the settlement to rely on *its own* records to determine class member eligibility for various types of relief, and the amount of class member

awards. Paragraph 24 of the proposed settlement states:

> Delta Records and Classification Practices. For all purposes under this Agreement: (a) Delta's computer records shall be deemed conclusively correct, absent manifest error; and (b) Delta's classifications and computations with respect to 12 C.F.R. § 226.32 shall be deemed conclusively correct.

Thus, Delta's records on the terms and conditions of the loan govern, absent "manifest error." Each category of financial recompense under the Settlement Agreement is intricately keyed to the definitions and amounts of terms such as "adjusted arrears" and "net profits," giving Delta free license to define these terms as it wishes. There is no evidence that class counsel attempted to ensure that Delta's records were accurate before agreeing to give those records, and Delta's unilateral interpretation of them, such authority.

Granting a defendant control over the size of class members' awards is fundamentally wrong. Typically, an independent adjudicatory body administers class action funds, and procedural safeguards guarantee due process to the claimants. See, e.g., Bowling v. Pfizer, Inc., 143 F.R.D. 147, 149-50 (S.D. Ohio 1992) (class benefits administered by independent claims administrator and scientific panel); In re Orthopedic Bone Screw Prods. Liab. Litig., 176 F.R.D. 158, 175, 176 (E.D. Pa. 1997); Breast Implant Settlement Agreement, In re: Silicone Gel Breast Implants Products Liability Litigation, MDL 926, Master File No. CV-92-P-10000-S, Case No. CV-94-P-11558-S at Part IV.A., p. 33 (filed March 29, 1994). The class members' rights to recovery against Delta are, of course, property subject to protection under the Due Process Clause. Logan v. Zimmerman Brush Co., 455 U.S. 422, 428-29 (1982). The fact that the class members' *self-interested litigation opponent* is charged with adjudicating the class members' rights under the settlement violates the class members' due process rights. This Court would not expect a criminal or civil defendant to be "fair" in evaluating the relief to be afforded its victims.

For the same reason, it should not expect Delta to put aside its interests and become a neutral arbiter of class claims. Cf. Ward v. Village of Monroeville, 409 U.S. 57 (1972) (invalidating a system in which mayor levied fines benefitting his municipality on the ground that mayor was biased as a result of his pecuniary interest in increasing revenue for municipality); Tumey v. Ohio, 273 U.S. 510, 518 (1927) (holding that it violates due process to allow judge to rule in a case in which he has "a direct, personal, substantial pecuniary interest in reaching a conclusion against [one party]"). In light of Delta's economic incentives to categorize class members so as to limit its own costs under the settlement, it should not be given such an unusual degree of authority in the administration of this settlement.

C. Plaintiffs Are Likely To Prevail In Litigation Against Defendants

If this Court agrees with objectors that the proposed settlement actually places class members in a *worse* position than had they never been part of a class action, then it need not proceed any further. If, however, if it believes the settlement has some positive value to class members, then it should weigh its valuation of the settlement against the risks and possible rewards of litigation through an examination of Grinnell factors 1-7.

The District Court's previous ruling in this case, and the evidence gathered by class counsel and by other attorneys, strongly indicate that plaintiffs would prevail if this case proceeded to litigation. In light of the strength of plaintiffs' case, the settlement cannot be considered fair, adequate and reasonable unless it provides class members with relief close to the relief they could obtain if they were successful in litigation.

Judge Sifton's previous ruling on plaintiffs' motion for a preliminary injunction demonstrates the strength of plaintiffs' position. On December 23, 1998, this Court granted

Plaintiffs' application for a preliminary injunction to prevent foreclosure on their homes after carefully reviewing the case and concluding that Plaintiffs had demonstrated a likelihood of success on the merits. First, the Court noted that "it is not disputed that the mortgage loans for [some plaintiffs] contain provisions for increased default interest rates and thus violate HOEPA, 15 U.S.C. § 1639(d), on the face of the loan documents." Lopez v. Delta Funding Corp., 1998 U.S. Dist. LEXIS 23318, *21 (E.D.N.Y Dec. 23, 1998). The only question was whether those loans qualified as "HOEPA loans" under 15 U.S.C. § 1602(aa) and thus were subject to the HOEPA restrictions. The Court concluded they did, because the total points and fees that the borrowers paid at or prior to closing exceeded 8% of their total loan amounts. Id.

Although the Court addressed only the HOEPA claims, the class claims under TILA and state common law are also well supported. As stated above, Delta's blatant violations of federal and state lending law have inspired the New York Attorney General's Office and the U.S. Department of Justice to file lawsuits against Delta, both ending in settlement. The terms of the respective settlements support the conclusion that Delta had engaged in unlawful conduct. In its settlement with the U.S. Department of Justice, Delta agreed to conform its behavior to the requirements of the Fair Housing Act, the Equal Credit Opportunity Act, HOEPA, and RESPA, to develop a new monitoring and compliance system designed to ensure uniform application of underwriting criteria and appropriate payment of mortgage broker fees, and to develop a fair lending training program for its employees. See U.S. DOJ Settlement, VI.A. The New York Attorney General's Office entered into a settlement with Delta in which Delta promised to comply with the law. These lawsuits by state and federal entities charged Delta with the same illegal conduct for which Delta is released by this proposed settlement.

Moreover, Delta's abusive and illegal lending practices are well-documented by those who work in the low-income communities that it targets. For example, South Brooklyn Legal Services has observed Delta's practices for many years. In 1998, SBLS founded the Foreclosure Prevention Project to address skyrocketing foreclosure rates against low-income homeowners throughout New York City. SBLS Decl. ¶ 1. Since then, SBLS has provided advice, referral services, and legal representation to over 1,000 at-risk homeowners, and thus became aware that a disproportionate number of these homeowners were victims of Delta's predatory practices. The declaration provided by SBLS attorney Josh Zinner provides a vivid description of Delta's conduct, which often violates HOEPA, TILA, RESPA, ECOA, the N.Y. Deceptive Practices Act, or common law fraud and unconscionability principles. These practices include the inducement of borrowers to enter into mortgage loans that are unaffordable from their inception; the inclusion of inflated closing costs, particularly excessive broker's fees; the payment of yield spread premiums to brokers for steering borrowers into higher interest loans; "loan flipping", or frequent refinancing, that strips equity; and the inclusion of default interest and other loan terms that violate HOEPA. SBLS Decl. ¶¶ 5-8. The declaration by Ismene Speliotis on behalf of NY ACORN chronicles similar violations. ¶¶. In sum, abundant evidence of Delta's illegal conduct supports the class members' claims.

Nonetheless, class counsel attempts to justify this settlement by arguing that plaintiffs' case was not a strong one. The proposed settlement declares that "the Named Plaintiffs and their attorneys ('Class Counsel') have concluded that substantial uncertainty exists as to the potential liability of Delta and the other Defendants in the Lawsuit and as to the nature, amount and collectability of relief, if any, to which the Named Plaintiffs and the Class Members may be

entitled in the Lawsuit if liability is imposed on Delta and/or other Defendants." Proposed Settlement Agreement at 2. Class counsel provides no support whatsoever for this conclusion.

Nor does Plaintiffs' Memorandum of Law in Support of their Motion Seeking Preliminary Approval of Settlement give the type of detailed explanation necessary to justify settlement of the class claims. The Memorandum is a scant 13 pages of boilerplate, and is devoid of the type of detailed evidence that must be produced to justify settlement of such a class action. Class counsel mouths the legal standards, without providing facts and information to back up its claim that this settlement meets those standards. For example, class counsel asserts in its Memorandum that the parties agreed to settle only after "Plaintiffs' counsel possessed sufficient information to make an informed judgment regarding the likelihood of success on the merits and the results that could be obtained through further litigation," Memorandum at 12, but fails to describe the information and why it led class counsel to the settlement table. In short, class counsel gives no reason for its lack of faith in its case against defendants, and that pessimism is unjustified in light of the district court's previous rulings and the strong evidence in plaintiffs' favor.

In addition, class counsel fails to establish its own qualifications to bring this class action. Class counsel's Memorandum in support of the settlement does not describe any previous experience in consumer class action litigation. The Abbey Gardy LLP firm resume reflects that although the firm has had many years of experience in corporate securities litigation, it apparently has none in the field of consumer class actions. The experience of class counsel is an important factor for the court to consider in reviewing the fairness of a settlement. Here, class counsel's evident lack of experience is yet another factor weighing against approval.

D. Class Counsel's Fees Are Excessive and Unjustified

Adding insult to injury, the settlement permits class counsel to request, and defendants agree to pay, exorbitant fees of up to $700,000, even as the vast majority of class members are provided with a few dollars. This so-called "clear sailing" fee arrangement should put this Court on heightened alert to the reasonableness of the award. Weinberger v. Great Northern Nekoosa Corp., 925 F.2d 518,525 (1st Cir. 1991) ("the inclusion of a clear sailing clause in a fee application should put a court on its guard"). Moreover, the fee issue is inextricably related to the fairness, adequacy, and reasonableness of the settlement as a whole because every dollar paid out in fees is a dollar less that is available to compensate class members. Here, class counsel's fee may be 43% of the $1.6 million awarded to the class, an amount that is excessive and unfair in light of the paltry sum promised to the class.

E. The So-Called Incentive Payments Accorded the Named Plaintiffs Underscore the Settlement's Failings and Further Demonstrate Class Counsel's Inadequacy.

Rather than throw pennies at the class representatives, as the settlement does for most class members, the settlement proposes to award the class representatives $10,000 each (to be credited against their Scheduled or Adjusted Unpaid Balances). Proposed Settlement Agreement, ¶ 8. The objectors believe that the class representatives should get far more than $10,000 to address their damages suffered at Delta's hands. But the size of the proposed incentive awards underscores the unfairness of the settlement and the inadequacy of class counsel. In light of the significant relief that *should* be available to the class members under HOEPA, TILA, and other legal principles, the disparate treatment of the named Plaintiffs dramatically highlights just how bad the class action settlement is for the vast majority of the

class members who will get almost nothing, but lose all of their claims and defenses.

Which brings us to class counsel's inadequacy. Would any impartial observer believe that class counsel could have obtained the named representatives' consent to the proposed settlement if the settlement offered them $5 or $10 and the release of all their defenses and counterclaims to foreclosure? To ask the question is to answer it. The proposed settlement, which strips thousands of borrowers of their ability to defend their homes against foreclosure in exchange for a pittance, is grossly unfair to the class and should be rejected by this Court.

III. CONCLUSION

For the foregoing reasons, this Court should deny final approval of the proposed class action settlement.

Dated: May 10, 2002

Respectfully submitted,

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