05-0607-cv

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

ELIJAH STACKHOUSE, Potential Class Member Seeking to Opt Out,
(see Doc. 141 and 142)

Plaintiff,

TERESA LOPEZ, on behalf of herself and all others similarly situated,

Plaintiff-Appellee,

ALL STATE CONSULTANTS, INC. also known as City Mortgage Bankers, BANKERS TRUST COMPANY and NORWEST BANK MINNESOTA NATIONAL ASSOCIATION, Trustee for the Delta Funding Home Equity Loan Trust,

Defendants,

DELTA FUNDING CORPORATION, DELTA FINANCIAL CORPORATION and DELTA FUNDING HOME EQUITY LOAN TRUST,

Defendants-Appellees,

v.

BERTHA MCKNIGHT, Objector Class Member, WARREN SHIRLEY, Objector Class Member, ETHEL FORREST, Objector Class Member, LUCILLE HARDIN, Objector to Settlement Agreement, ANNA MAE DAWSON, Objector to Settlement Agreement, CHRISTINE NICOLL, Objector to Settlement Agreement, PEARLINE BROWN, Objector to Settlement Agreement, and NY ACORN, Objector to Settlement Agreement,

*Objectors-Appellant*s.

ON APPEAL FROM THE U.S. DISTRICT COURT EASTERN DISTRICT OF NEW YORK
No. CV 98 7204 (CPS)(MDG)

REPLY BRIEF FOR OBJECTORS-APPELLANTS

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REPLY BRIEF OF OBJECTORS-APPELLANTS

This case is a stunning illustration of class action abuse. The court below allowed class counsel and the defendants to settle valuable homeownership claims for a pittance, leaving over 66,000 poor and unsophisticated victims of Delta's predatory lending practices worse off than if this lawsuit had never been filed. A nationwide class action settlement that benefits virtually no one but a handful of named plaintiffs, their lawyers, and the defendants, cannot stand.

The settling parties' responses do not provide meaningful answers to the central points raised in our opening brief. Confronted with overwhelming evidence that the settlement was substantively unfair and that the class was improperly certified, the settling parties offer boilerplate recitals of the law, together with broad and unsubstantiated assertions designed to make the settlement appear innocuous. The record belies these assertions. The settling parties allude to extensive discovery, (Pl. Br. 35), but provide no support in the record to show that such discovery was obtained. Nor do class counsel meaningfully dispute our assertions that class counsel's inexperienced associate presented no evidence at the fairness hearing, that class counsel undervalued plaintiffs' claims, and that they relied heavily on the defendants' self-interested analysis. Instead, as they do with many of the issues we raise, the settling parties fall back on parroting the magistrate judge's conclusion that the representation was adequate. Pl. Br. 35-37.

This reply brief addresses four issues. First, we show that, despite their best attempts (Pl. Br. 38-42, Defs. Br. 57-60), the settling parties cannot obscure the fact that the settlement rewarded class representatives at the expense of absent class members and allocated equal or superior relief to class members with time-barred claims. This harsh disparity in relief alone is sufficient to demonstrate both the substantive unfairness of the settlement and the inadequacy of the class representatives. Second, we show that plaintiffs' attempt to defend the magistrate judge's predominance decision falls far short of the rigorous analysis required. Indeed, even in their brief to this Court (Pl. Br. 47-52), class counsel have been entirely unable to present a coherent theory of class-wide liability, much less any method of generalized proof. Third, we show that defendants' contention that assignees did not bear liability under HOEPA (Defs. Br. 49-53) is simply wrong as a matter of law. And finally, we address the settling parties' sweeping contention that objectors to a class action settlement supervised by a magistrate judge should have no opportunity to exercise their constitutional right to an Article III forum.

I. THE SETTLEMENT UNFAIRLY REWARDED THE CLASS REPRESENTATIVES AT THE EXPENSE OF THE ABSENT CLASS MEMBERS.

Class counsel continue to assert that a settlement that provides only pocket change for the vast majority—over 66,000 class members—"represents an excellent recovery for the class, particularly given the risks and uncertainties

involved in this case, and, in particular, the risk of establishing liability and the risk that the class would receive absolutely nothing." Pl. Br. 8-9.

Contrary to the settling parties' broad assertions, the settlement has not been structured so that those "class members with the strongest claims that loans should not have been extended to them in the first place would receive the most significant benefits."[1] Pl. Br. 10; *see also* Defs. Br. 15-17. Instead, the settlement would deliver the bulk of its financial value—more than $1 million in relief—to at most 28 out of a class of 67,570. A1213-1218;A1375;A1505; *see also* Obj. Br. 10. Excluded from this relief are the hundreds or possibly thousands of class members who the parties define as having the strongest claims—because they defaulted after making five or fewer payments—simply because they either lost their home to foreclosure[2] or refinanced.[3] Despite their claim to equivalent relief, these most

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[1] While we assume for purposes of this argument that the settling parties' choice of class members who were unable to pay more than five payments are those most deserving of significant relief, we do not concede the correctness of this conclusion.

[2] Of these class members, those who lost their homes to foreclosure are technically eligible to receive "net" foreclosure proceeds, A1219, which, as Delta admits, are likely zero. Defs. Br. 58-59;*see also* A1874.

[3] Defendant's assertion that these class members were not "damaged" is simply wrong. Defs. Br. 59. Their injury and that of the DHEPD and HEPD class members is the same; it is the *legal* injury caused by violation of HOEPA that gives rise to enhanced statutory damages. *See* 15U.S.C. §§1639(c)&(h), 1640(a)(4); E8-10,14.

deserving class members' claims were discarded into a catch-all subclass where relief averages $10 each. A1213-1219.

In contrast, the eight class representatives, who, with two exceptions, appear to have made more than five payments on their loans, will each get a complete loan overhaul. *See* A581;A955-956;A965;A970;A977;A983-999. The $2,000 incentive reduction to their principal loan balance approved by the magistrate judge is only a small part of the relief offered exclusively to class representatives. *See* A1898-1899; *see also* A1220-1221;A1928. The class representatives' loans will also be *restructured* with new thirty-year, fixed-rate terms, with significantly reduced loan balances, new reduced interest rates, reduced loan payments and forgiveness or deferment of significant balances of accrued arrears and collection charges.[4] A1220-1221. *Compare In re Excess Value Ins. Coverage Litig.*, 2004U.S.Dist. LEXIS 14822,*54 (S.D.N.Y. 2004) (incentive compensation must be supported by "evidence describing in detail the assistance provided by each class representative"). Incredibly, this relief is offered to class representatives in addition to the relief they will receive as members of their (still unidentified) subclasses. A1220-1221. Only *twenty* or fewer HEPD and DHEPD classified

[4] The deferral of interest confers a huge benefit on class representatives. For example, the deferral of interest for Mr. Murray is equivalent to a new, interest-free loan of over $45,000, repayable in a lump sum at the end of 30 years. E26-27.

members—who do meet the parties' "most deserving" standard—will receive a comparable loan restructuring. A1505.

A slim group defined as HOEPA or disputed HOEPA subclass members are the only other class members who are eligible for more than a few dollars of relief. These subclass members, who numbered 1330 in 2002, must remain in their loans through the appeal and final approval date of the settlement or they will forego average mortgage credits of $170 and $400, respectively. A1213;A1216-1218; A1505;A1590. More than 66,000 other class members fall into the catch-all subclass; they are to receive a paltry sum, an average $10 reduction in their loan balance, or if they no longer have a Delta loan, $10 in cash. A1218-1219;A1505.

The stark contrast between the relief afforded class representatives and absent class members, and the irrational discrimination against class members with timely, viable claims, illuminates the failure of class representatives to fulfill their fiduciary duty to absent class members. *See Martens v. Thomann,* 273 F. 3d 159, 173 n. 10 (2d Cir. 2001); *Crawford v. Equifax Payment Servs., Inc.,* 201 F.3d 877, 880 (7th Cir. 2000). In failing to ensure that the certified representatives did not "further their personal interests at the expense of the Class," the magistrate judge abused her discretion. *Martens, supra*; *Blyden v. Mancusi,* 186 F. 3d 252, 267 (2d Cir. 1999) (failure to follow proper legal standards in class certification is abuse of discretion).

A. The Settlement Affords Disproportionate Relief to Four Class Representatives Who Have No Standing to Represent the Class.

Named plaintiffs who lack standing cannot serve as class representatives. *Akerman v. Oryx Commc'ns., Inc*., 609 F.Supp. 363, 377 (S.D.N.Y. 1984) ("a plaintiff 'may not use the procedural device of a class action to boot strap himself into standing he lacks under the express terms of the substantive law….'"); Obj. Br. 31-33; 4 *Newberg on Class Actions* §2.6 (4th ed. 2002); *In re Initial Pub. Offering Secs. Litig. (IPO Litig.),* 227 F.R.D. 65,*120; 2004 U.S. Dist. LEXIS 20497 (S.D.N.Y. 2004). Because Plaintiffs Edwards, Robinson, Loney and Clinton all entered loans with Delta several years before the Complaint was filed, their claims for statutory damages under HOEPA and TILA are time-barred by the one year statute of limitations.[5] Obj. Br. 31, n. 32; *see* 15U.S.C.§1640(e), E15; *In re Cmty Bank of N. Va. & Guar.,* 418 F. 3d 277, 304-305 (3d Cir. 2005); *Matthews v. New Century Mortgage,* 185 F. Supp. 2d 874, 883-884. (S.D.Ohio 2002) (statute of limitations runs from loan closing). Moreover, they failed to allege a fraudulent scheme to conceal necessary to toll their claims. Third Amended Complaint (TAC) A1000-1023; *see Weil v. Long Island Savings Bank, FSB,* 77 F.Supp.2d 313, 322 (E.D.N.Y. 1999). As a result, they lack standing to represent the class.

1. Equitable Tolling Must be Affirmatively Pled.

[5] Their only timely federal claim—for rescission—was extinguished by the Court's June 2000 decision. A922.

A colorable claim of equitable tolling of the one year statute of limitations under TILA/HOEPA typically requires a showing that the terms of the loan were suppressed by the defendants through fraud. "[I]n cases of fraudulent concealment, the statute of limitations can be tolled when the plaintiff demonstrates that: '(1) the defendant took affirmative steps to conceal the plaintiff's cause of action; and (2) the plaintiff could not have discovered the cause of action despite exercising due diligence.'" *Matthews,* 185 F. Supp. 2d. at 883 (plaintiffs unable to obtain loan documents or ascertain loan terms). In a class action, a claim of equitable tolling must be subject to generalized proof, such as through a fraudulent scheme to conceal. *See Jones v. TransOhio Sav. Ass'n,* 747 F.2d 1037, 1041 (6th Cir. 1984) (fraudulent concealment of loan terms); *McAnaney v. Astoria Fin. Corp.,* 357 F. Supp. 2d 578, 587 (E.D.N.Y. 2005) (complaint alleged fraudulent efforts to conceal the violation); *Weil,* 77 F.Supp.2d 313, 322 (fraudulent scheme to conceal affirmatively pled). No such allegations have been made in this case. TAC, A1000-1023.

2. Affirmative Defenses Must be Considered in Evaluating the Standing of Class Representatives.

Class counsel's remarkable assertion that it is inappropriate to inquire into affirmative defenses at the class certification stage,(Pl. Br. 31-32), and thereby ensure that the named plaintiffs' interests are aligned with those of absent class members, flies in the face of the Supreme Court's ruling in *Amchem. See Amchem*

Prods., Inc. v. Windsor, 521 U.S. 591 (1997); *see also, Wal-Mart v. Visa,* 396 F.3d 96, 113 (2d Cir. 2005) ("adequate representation of a particular claim is determined by the alignment of interests of class members"). Unless the district court is empowered to inquire into affirmative defenses that negate standing and destroy the alignment of interests between class representatives and absent class members, the court will be unable to protect absentees from class representatives whose significantly diminished interest in pursuing litigation on behalf of the class creates an incentive to agree to a fundamentally flawed settlement. *See Amchem,* 521 U.S. at 597; *In re IPO Litig.*, 227 F.R.D. at 90-91 & n.209; *Waste Mgmt. v. Mowbray,* 208 F 3d 288, 295 (1st Cir. 2001) (affirmative defenses warrant consideration). In a decision issued last month reversing certification of a settlement class in a predatory lending case, the Third Circuit identified this very concern. *In re Cmty. Bank of N. Va.*, 418 F. 3d at 307 (**"**Because the one-year statutory period for filing an affirmative TILA or HOEPA claim has lapsed for all named plaintiffs, the named plaintiffs appear to have no incentive to maximize such claims for the approximately 14,000 class members who may still retain this valuable cause of action".).

B. Each Subclass Is Entitled to Representation By an Identified Class Representative.

The magistrate judge treated virtually all Delta borrowers, except those fitting within the narrowly defined subclasses, as having identical interests. This

large, undifferentiated class includes borrowers still paying on their Delta loans; borrowers who refinanced; borrowers who lost everything in a foreclosure; borrowers living in states with strong anti-predatory lending laws; borrowers living in localities like Philadelphia, where Delta's brokers were engaged in discriminatory lending patterns;[6] borrowers who, at the time the complaint was filed had live TILA or HOEPA rescission claims; and borrowers who entered into their loans after the complaint was filed but before the October 31, 1999 cutoff date. As *Amchem* instructs, disparities like these in the sprawling class proposed are compounded further by differences in applicable state law. 521 U.S. at 624. The question should have been: Who among the putative class representatives had interests aligned with each disparate subgroup of Delta borrowers?

It is axiomatic that each absent class member is entitled to representation by a class representative whose interests are aligned; whenever a class is divided into multiple subclasses, a class representative must be appointed for each subclass.

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[6] A mortgage broker who procured loans for Delta was found to have engaged in an unlawful discriminatory scheme that targeted African American homeowners in Philadelphia for high-interest, unaffordable home equity loans. *Lucretia Taylor et al. v. McGlawn & McGlawn*, PHRC Nos. 200027668 and 200201787 (available at http://sites.state.pa.us/PA_Exec/PHRC/legal/finalorders/200027668+.pdf)(2004). The Pennsylvania Human Relations Commission valued damages to Hawthorne Brunson, one of five Delta borrowers who sustained substantial damages, at $60,280. Unfortunately, as an absent class member, Mr. Brunson's claims have been released, preventing him from recovering these funds from either the broker or Delta.

See Marisol v. Giuliani, 126 F. 3d 372, 379 (2d Cir. 1997). No subclass may be certified unless an appropriate class representative has been named for that subclass.[7]

Throughout this proceeding, the magistrate judge abused her discretion in permitting the settling parties to flaunt the identification requirement and evade their responsibility to the class. *See* A1340-1346; Remarks of Beck, A1572-1585; *see also,* Pl. Br. 9-15; Defs. Br. 14-26. Because not one of the appointed class representatives has been identified as a member of a particular subclass, the magistrate judge was not free to certify the class. *See Prado-Steiman ex rel. Prado v. Bush,* 221 F.3d 1266, 1279 (11th Cir. 2000) ("Thus, it is well-settled that prior to the certification of a class, and technically speaking before undertaking any formal typicality or commonality review, the district court must determine that at least one named class representative has Article III standing to raise each class subclaim."); *Keepseagle v. Veneman,* 2001 WL 34676944,*12 (D.D.C. 2001) ("this Court cannot ascertain whether the named representatives have standing to raise the claims of the proposed subclasses.").

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[7] "[T]he district court must engage in a rigorous analysis of the plaintiffs' legal claims and factual circumstances in order to ensure that appropriate subclasses are identified, that each subclass is tied to one or more suitable representatives, and that each subclass satisfies Rule 23(b)(2). Thus, it is imperative that the district court identify (1) the discrete legal claims which are at issue, (2) the named plaintiffs who are aggrieved under each individual claim at issue, and (3) the subclasses that each named plaintiff represents." *Marisol,* 126 F.3d at 378-379.

The disqualification of four of the eight approved class representatives compounds the magistrate judge's error. While class counsel blithely asserts that the settlement and certification can proceed even if only two class representatives remain, that is patently untrue. *See* Pl. Br. 32. A unitary class could survive with only one or two class representatives; however, the five subclasses in this case demand five class representatives. *See Amchem,* 521 U.S. at 627; *In re IPO Litig.,* 227 F.R.D. at 90 & n.209. With no representative identified for any subclass, class certification is defeated for all subclasses.

C. The Magistrate Judge Abused Her Discretion When She Approved A Settlement That Irrationally Placed Class Members With Time-Barred Claims In The Same Subclasses As Class Members With Viable Claims.

In a surprising revelation, the settling parties now assert that they *intentionally* included thousands of class members with time-barred claims — approximately 32,000—in the settlement subclasses.[8] Defs. Br. 59-60; Pl. Br. 22-26. Class members with timely claims, who have refinanced or foreclosed, will receive inferior relief, having been defined out of all subclasses but the catch-all. *See* Defs. Br. 59.

[8] "32,000 class members loans originated more than a year before this action was filed. Consequently, 50 percent of the class is outside the one-year statute of limitations of Section 1640E of TILA." Remarks of Martin Bryce, A1593.

Class counsel's reliance on *In re PaineWebber Ltd. P'ships Litig.,* to support this lopsided allocation is misplaced. Pl. Br. 39. *PaineWebber* bears no resemblance to the irrationally designed settlement in this case. In fact, *PaineWebber* recognized that "real and cognizable differences" that exist in the likelihood of success for different plaintiffs should drive the apportionment of a settlement, as in the case "where [as here] different plaintiffs have *substantially different vulnerabilities to statute of limitations defenses*." 171 F.R.D. 104, 133 (emphasis added).[9]

The Supreme Court recognized the very real risk that proponents of settlement classes would seek bloated class definitions that may serve the interests of the defendants but harm those of absent class members, particularly by diluting the value of their claims. *See Amchem,* 521 U.S. at 628; *id* at 622 (aspects of Rule 23 "designed to protect absentees by blocking unwarranted or overbroad class definitions . . . demand undiluted, even heightened, attention in the settlement context."). Class counsel's inclusion as class members, of thousands of persons with time-barred claims whose viability under an equitable tolling theory is highly

[9] Factors that distinguish the settlement in *PaineWebber* from this settlement are: prior class certification, extensive discovery (300 boxes), numerous expert opinions, *very substantial relief awarded to all class members*, and an assessment that all plaintiffs had meritorious claims that were unaffected by the statute of limitations issues. 171 F.R.D.104, 109-118, 122. In addition, substantial discovery was provided to objectors, and the "flipback" clause in an SEC consent order required reversion of $125 million in settlement funds to the SEC without prompt judicial approval of the class settlement. *Id.* at 115, 119.

speculative, and likely non-existent, implicates the concern that "class designation despite the impossibility of litigation" would disarm class counsel from using the threat of litigation to press for a better offer and that "settling parties . . . [might] achieve[] a global compromise with no structural assurance of fair and adequate representation for the diverse groups and individuals affected." *Amchem* at 621, 627.

The settling parties' assertions that they were free to place class members with time-barred claims in the same subclasses as class members with timely claims (Defs. Br. 59-60; Pl. Br. 23) are in direct conflict with this Court's ruling in *Nat'l Super Spuds, Inc. v. N.Y. Mercantile Exch.,* that class representatives cannot bargain away the rights of absent class members in which they have no stake. 660 F.2d 9, 16 (2d Cir. 1981) (Friendly, J.) ("The most fundamental principles underlying class actions limit the powers of the representative parties to the claims they possess in common with other members of the class."); *see also Ortiz v. Fibreboard,* 527 U.S. 815, 858-859 (1999). Here class representatives with time-barred claims bargained away the superior claims to relief of class members with timely claims in order to afford relief to themselves and other absent class members whose right to relief was either impaired or nonexistent.

Moreover, as we explained in our opening brief, not only was relief allocated equally to class members with time-barred claims, but in many cases,

these class members received greater relief than was afforded to absent class members with identical, but timely claims. Obj. Br. 37, 46. This irrational allocation plan cannot be explained and class counsel has made no attempt to address this very serious inequity. *See In re Cmty Bank,* 418 F.3d at 306-307 (intra-class conflict may be discernable from terms of settlement which in according greater relief to class members with loans less than one year old, fails to value rescission claims of class members whose loans are within 3 year rescission period).

II. THE MAGISTRATE JUDGE ABUSED HER DISCRETION IN CERTIFYING A CLASS WITHOUT REQUIRING CLASS COUNSEL TO ARTICULATE A COHERENT THEORY OF CLASSWIDE LIABILITY.

This Circuit requires district courts to undertake a "rigorous analysis" that the requirements of Rule 23 have been satisfied, placing the burden of proof squarely on the plaintiffs to make the necessary showing. *See Caridad v. Metro-North,* 191 F.3d 283, 290-291 (2d Cir. 1999). "In order to pass muster, plaintiffs . . . must make '*some showing.*' That showing may take the form of, for example, expert opinions, evidence (by document, affidavit, live testimony, or otherwise), or the uncontested allegations of the complaint." *In re IPO Litig.,*227 F.R.D. at 93. In the face of this requirement, class counsel provided no evidence in support of their motion for class certification and settlement whatsoever—no expert reports, no documents, no oral or written testimony or any other supporting information

other than billing records and a firm resume—and the magistrate judge, in reaching her decision, required none. *See generally* A809-864;A1089-1144;A1371-1385; A1866-1920; Remarks of Beck, A1572-1585, 1679-1680, 1699 ("We will rest on our papers, your Honor"); A1733-1736; Answer to TAC, A1051-1086; *see also Caridad,* 191 F.2d at 292 (statistical evidence and expert report); *Non-Trad. Empl. for Women v. Tishman Realty & Constr. Co.,* 1989 WL 101940,*2 (S.D.N.Y. 1989).

In seeking to defend the magistrate judge's decision on predominance, class counsel effectively prove objectors' case. Although class counsel acknowledge that courts should focus on the liability issue in deciding whether predominance is met (Pl. Br. 49), they have never presented a coherent theory of liability. Class counsel has never articulated, nor did the magistrate judge ever consider (A1882-1883), the elements necessary to prove liability on any of their claims and whether each of these elements was subject to generalized proof. *See In re VISA Check/Mastermoney Antitrust Litig.,* 280 F.3d 124, 136-140 (2d Cir. 2003) (theory of classwide proof necessary for each element of claim); *Weiss v. La Suisse,* 226 F.R.D. 446, 450-453 (S.D.N.Y. 2005); *In re Currency Conversion Fee Antitrust*

Litig. 224 F.R.D. 555, 564-569 (S.D.N.Y. 2004).[10] Instead, class counsel have adopted a scattershot approach toward predominance. *See* Pl. Br. 49-50.

Plaintiffs assert an ability to prove a laundry list of issues/facts by generalized proof without ever explaining the import of each of these items to proof of their claims. *Id.* *See also,* A1122-1123. They assert, for example, an ability to prove that Delta utilized standard form mortgage documents that included provisions for increased interest rates on default and prepayment penalties. They never explain the import of this fact, what claim it supports, or how it fits into proof of that claim.

Default interest and prepayment penalty terms are not universally prohibited by federal law, but are relevant to proof of violations of HOEPA.[11] *See* 15U.S.C. §1639(c) & (d). Thus, proof that loans are subject to HOEPA is the fundamental building block for this claim. *See* Mem. D&O, A326 ("To prevail on the merits of their HOEPA claims, plaintiffs . . . must first establish that their mortgage loans . . . are subject to the provisions of HOEPA"). A HOEPA claim is available only to

[10] Plaintiffs similarly provided no evidence in support of their earlier filed motion for class certification. A1089-1144.

[11] Although Delta asserts that its loans were not predatory or illegal (Defs. Br. 5-6, 19), Delta's standard default interest clause transformed its borrowers' loans upon any default—converting their interest rate to an eye popping 24%. *See e.g.* Clinton Note,&10,A41.

class members whose loans were made after the effective date of the law[12] and whose loans meet HOEPA's high cost triggers. 15 U.S.C.§§ 1602(aa), 1639; *see* Mem. D&O, A326; *In re Cmty Bank,* 418 F.3d at 304-305. Yet in no pleading that we can locate have class counsel even remotely satisfied their predicate obligation to prove the applicability of HOEPA to the class, much less any method of generalized proof. A1122-1123. Without a methodology to prove coverage by HOEPA, plaintiffs' class claim collapses like a house of cards. By allowing class counsel to dodge their responsibility to identify the elements necessary to prove their claims, the magistrate judge enabled them to skirt the most fundamental problems with their case: a failure to demonstrate that certain critical structural elements of their claims were provable with class-wide proof.

Class counsel's broad assertion that Delta engaged in a pattern and practice of unaffordable asset-based lending is similarly unsupported by an explanation of the elements of this claim or their ability to establish these elements by generalized proof. In fact, while this claim is asserted as both a federal HOEPA claim and a state-based unfair, deceptive acts and practices (UDAP) claim, no attempt has been made to separately identify the elements that may be used to prove the federal claim from those available for proof of the state law claim. *See* TAC; A1001, A1003, A1004, A1008, A1024,¶c., A1025,¶n., A1027,¶c., A1029,¶n.

[12] Class counsel limited their HOEPA subclass to borrowers with loans after Nov 18, 1995. A1000.

Class counsel's assertions and presumably the magistrate judge's findings that they could prove "underwriting policies, loan to value ratios, standard form mortgage documents and delinquency and default rates" with generalized proof mean nothing unless these comprise all of the elements of plaintiffs' claims. Pl. Br. 50; A1882-1883. As we now explain, they most assuredly do not.

In order to make out a HOEPA pattern and practice claim, plaintiffs must surmount the initial hurdle of using generalized proof to demonstrate that the relevant class members' loans are subject to HOEPA. *See* A326. Only loans made to HOEPA borrowers may be considered in evaluating whether a pattern and practice might be established. *See* 15 U.S.C. § 1639(h); *Bankers Trust Co. v. Payne,* 730 N.Y.S.2d 200, 206 (2001). Unaffordable, asset-based lending to borrowers with non-HOEPA loans may well violate state UDAP laws, but cannot be considered in assessing this violation under HOEPA. Therefore, not only were class counsel required to demonstrate that coverage by HOEPA was subject to generalized proof, they were also required to demonstrate how they would isolate claims of asset-based lending under HOEPA from those claims under state law. Since class counsel never identified the elements necessary to prove either their HOEPA or state law pattern and practice claims, the magistrate judge was hobbled in her predominance analysis. As the magistrate judge was prevented from ever assessing whether the claims were susceptible to class-wide proof in the first

instance, she was necessarily incapable of weighing whether class issues predominated over individualized issues.

As for the claim that disclosure documents and notices of right to rescind mandated by TILA and HOEPA were never provided, we have already explained that with respect to at least one element of this claim, individualized issues predominate over class-wide proof. *See* Obj. Br. 51-53. "Each plaintiff will have to testify about what happened to him, and when. And [Delta] will have to rebut as to each individual plaintiff. Therefore, the proposed class does not satisfy the Rule 23(b)(3) predominance standard." *Weiss v. La Suisse*, 226 F.R.D. 446, 454 (S.D.N.Y. 2005). *See In re Currency Conversion Fee Antitrust Litig.,*224 F.R.D. 555, 568 (S.D.N.Y. 2004) (citing *In re Linerboard Antitrust Litig.,* 305 F. 3d 145, 156 (3d Cir. 2002)) ("Clearly, if proof of the essential elements of the cause of action requires individual treatment, then there cannot be a predominance of questions of law and fact common to the members of the class.").

Finally, class counsel failed to establish the elements necessary to prove the broad array of deceptive practices alleged as a UDAP claim under N.Y. Gen. Bus. Law §349. TAC, A1023-1034. As defined by the New York Court of Appeals, the elements of a prima facie case include: a predicate showing that the defendant's acts have a broad impact on consumers at large, that defendant engaged in acts or practices that are materially deceptive or misleading to a reasonable consumer and

that the class members have suffered actual harm by reason of those acts or practices (causation). *Oswego Laborers' Local 214 Pension Fund v. Marine Midland Bank,* 85 N.Y.2d 20, 24-26 (1995).

The magistrate judge was required to consider whether these elements could be established class-wide by generalized proof. As with the other claims asserted in the complaint, class counsel failed even to identify the elements of the New York UDAP claim, and similarly failed to present evidence that each of the elements was subject to generalized proof. Moreover, the District Court's decision in *Currency Conversion Antitrust Litig.* suggests that even if they could establish class-wide proof of some elements of the claim, individual issues might well predominate in establishing causation under New York or other state UDAP laws, raising serious questions about the certification of this issue under Rule 23(b)(3). 224 F.R.D. 564-569. *Id.* at 568 ("Because a court must consider the elements of a claim and determine whether they can be satisfied by common class-wide proof, Plaintiffs' notion that the causation inquiry does not bear on class certification is without merit".).

Nor was this the end of the required inquiry. Class counsel sought to certify a state UDAP class, not only on behalf of New York homeowners, but also to assert claims under New York state law on behalf of homeowners throughout the country. A1026-1034. This required class counsel to surmount an additional

hurdle—that proof of the New York claims was sufficiently similar to claims of homeowners residing in other states to justify including them in a nationwide class. This they failed to do as well. A1125-1126. In the absence of this elemental proof, the magistrate judge's evaluation was necessarily impaired.

III. THE MAGISTRATE JUDGE'S MISUNDERSTANDING OF ASSIGNEE LIABILITY UNDER HOEPA CAUSED HER TO DEVALUE CLASS MEMBERS' CLAIMS.

Delta claims that assignees of HOEPA loans are only subject to borrowers' claims and defenses "if the loan is a HOEPA loan on its face." Defs. Br. 50. This is exactly wrong.[13]

HOEPA creates a presumption that assignees are fully liable for all claims and defenses. It puts the burden on assignees to prove, "by a preponderance of evidence, that a reasonable person exercising ordinary due diligence," could not have determined the loan was subject to HOEPA. 15U.S.C.§ 1641(d); E19-20.

What is required of a reasonable person exercising due diligence in this context? There is no definition of "due diligence" in HOEPA but a comparison of 15 U.S.C. §§ 1641(a), (d) & (e) plainly reveals that §1641(d) imposes a *higher* standard on assignees than §1641(a) or (e) (apparent on the face of the loan documents). E19-20. A comparison of the standards in these three subsections

[13] In addition to their liability for HOEPA damages under §1641(d), assignees under both HOEPA and TILA are directly and absolutely liable for any valid rescission claims. *See* 15 U.S.C.§ 1641(c); 15 U.S.C.§ 1635. E3-6, 19.

"demonstrates that ordinary due diligence must require at least more than a mere review of relevant loan documents and disbursements" required by the "apparent on the face" standard. *Cooper v. First Gov't Mort. & Invest. Corp.*, 238 F. Supp. 2d 50, 56 (D.D.C. 2002).

What is required beyond a facial review of the documents? Due diligence requires: (1) review of the documentation required by TILA, itemization of amount financed and other disclosure of disbursements (*e.g.*HUD-1); (2) an analysis of these items; and (3) whatever further inquiry is objectively reasonable given the results of the analysis. *Id.*

Delta derides the due diligence articulated by the *Cooper* court but makes no attempt to define what it means. Defs. Br. 51-52. At the very least, assignees are charged with knowing the law. *See Cooper,* 238 F. Supp. 2d at 57. Thus, an assignee charged with knowing HOEPA's triggers, cannot simply accept a lender's failure to identify a HOEPA loan, when by comparing the annual percentage rate (APR) on the disclosure statement with comparable Treasury rates, the assignee can easily identify an undisclosed HOEPA loan based on APR triggers. *See* 15 U.S.C. § 1602(aa)(1)(A); E1. Assignees were in control: they were in a position to tell Delta what documentation would satisfy them that the loans made to Delta borrowers were *not* subject to HOEPA. If Delta's assignees did not insist that the loan files they purchased provided adequate documentation necessary to assess a

loan's coverage by HOEPA, they could not establish the §1641(d) defense and are liable.

Delta denies that most loans included in the class action are subject to HOEPA. *See* Defs. Br. 20, 45-47. Given the minimal record before the Court, and the Magistrate's denial of discovery to Objectors, identification of Delta loans subject to HOEPA was a virtual impossibility for both the Objectors and the Magistrate. However, to the extent there are other unidentified HOEPA loans, there is a substantial risk of assignee liability.

Significant numbers of class members remained obligated on their Delta loans at the time the proposed settlement was noticed. A1505. Since all of these Delta loans are owned by assignees,[14] an accurate assessment of the extent of assignee liability was a critical factor in the magistrate judge's evaluation of predominance and fairness of the settlement under *Grinnell*. *Detroit v. Grinnell Corp*., 495 F.2d 448, 462-463 (2d Cir. 1977). The magistrate judge's failure to demand evidence to ensure an accurate count of HOEPA loans and to properly analyze assignee liability under HOEPA led her to conclude that assignees bore only a minimal risk. In dismissing assignee liability, the magistrate judge ceded far greater weight to Delta's financial health than was warranted in evaluating the fairness of the settlement under *Grinnell*. As a result, the magistrate judge

[14] Def. Br. Supp. Settlement, 5/02, at 14-15.

approved as fair the release of claims against the assignees, none of which had made a financial contribution to the settlement.

The magistrate judge's assessment was wrong. Class members, to a large extent, could look to the assignees for relief whether or not Delta survived the litigation,[15] making any risk to Delta's financial health at the time of the settlement a much less significant factor in evaluating its fairness. Under no circumstances was it fair to release the assignees from all liability in the absence of a significant financial contribution.

IV. THE MAGISTRATE JUDGE ERRED IN DENYING OBJECTORS AN ARTICLE III FORUM.

The requirement that litigants in federal court must provide consent before their dispute is submitted for final decision by a magistrate, 28 U.S.C. § 636(c)(1), is both "essential to the validity of the statutory system that allows a magistrate judge to make binding adjudications," *N.Y. Chinese TV Programs, Inc. v. U.EU. Enters.*, 996 F.2d 21, 24-25 (2d Cir. 1993), and grounded in fundamental constitutional principles. By limiting the authority of magistrate judges in this way, "Congress meant to preserve a litigant's right to insist on trial before an Article III district judge insulated from interference with his obligation to ignore

[15] *See e.g. Cooper*, where the lender's declaration of bankruptcy did not prevent plaintiffs from successfully pursuing claims against assignees and other parties. With or without Delta, these assignees would have the right to seek payment on the loans from class members and to foreclose on them in the event of default.

everything but the merits of a case." *Roell v. Withrow*, 538 U.S. 580, 588 (2003); *see also Rembert v. Apfel*, 213 F.3d 1331, 1334(11th Cir. 2000) ("But for the consent requirement, §636(c)'s grant of judicial power to magistrates would infringe on the constitutional rights guaranteed to litigants by Article III"). In the settling parties' view, however, objectors to a class action settlement should have *no opportunity to exercise that basic right*.

The objectors should have been able to vacate the reference without first having to intervene to achieve "party" status. The settling parties correctly note that *Devlin v. Scardelleti*, 536 U.S. 1, 10 (2002), holds that nonnamed class members "may be parties for some purposes and not for others," but they fail entirely to confront *Devlin*'s reasoning. Pl. Br. 55; Defs. Br. 70. *Devlin* supplies two important criteria for determining whether objectors should be deemed parties without having to intervene—both of which are satisfied here. The first is the binding effect of the settlement on the objector. 536 U.S. 10. The second is whether the objectors' interests diverge from the class representative, which is ordinarily evidenced by their objection at the fairness hearing. *Id.* Unless they are given an independent right to withhold consent, objectors have no ability to contest the class representatives' decision to waive adjudication by an Article III district judge—a decision by which they are bound, and which they believe is divergent

from their interests. *Devlin* holds that when these criteria are satisfied, as they are here, there is no need to require formal intervention. *Id.* at 12.

Moreover, even if intervention *is* required, then, under *Williams v. Gen. Elec. Capital Auto Lease*,159 F.3d 266 (7th Cir. 1998), on which the settling parties incongruously rely, the decision below must still be reversed. Pl. Br. 56; Defs. Br. 69-70. *Williams* emphasizes that "an unnamed class member who prefers an Article III forum" "may apply to the district court to intervene under Rule 24(a), become a party to the lawsuit, and then exercise her right to withhold her consent to proceed before the magistrate." 159 F.3d at 269. The settling parties contend that the magistrate judge was justified in denying intervention for this limited purpose, but, for the reasons we provided at length in our opening brief (Obj. Br. 66-73), their arguments on this score are entirely unconvincing. At the very least, under the law of this Circuit, the motion to intervene should have been decided by an Article III judge rather than by the magistrate judge herself. *N.Y. Chinese TV*, 996 F.2d at 25 ("Absent the 'intervenors'' consent, the magistrate judge was not authorized to enter a final order denying intervention").

CONCLUSION

Both in her decision to certify the settlement class and in her decision to approve the settlement, the magistrate judge abused her discretion. Not only did the magistrate judge certify a settlement class without any evidentiary support, she

failed to consider all of the relief awarded specifically to the class representatives in evaluating adequacy of representation and, as a result, certified a settlement class that enabled the class representatives to reward themselves with grossly disproportionate relief. The magistrate judge's additional failures to insist that class representatives have standing, to require rational subclasses and class boundaries, to demand that class counsel articulate the elements of their claims and demonstrate an ability to prove them by generalized proof, and to analyze those elements herself in order to assure predominance, all resulted in certification of a class that cannot be justified.

For the reasons stated above and in our opening brief, this Court should reverse the certification and approval of the class settlement, grant Appellant-Objectors' motion for discovery, grant Appellant-Objectors' motions to vacate the reference or intervene, and remand to the district court for further proceedings.

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Respectfully submitted,

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