UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

JOSEPH WASHINGTON, ST. CLAIR BLACKETT, LUCILLE MASON, and MELISSA TROTMAN on behalf of themselves and all others similarly situated, Plaintiffs, -against- UNITED STATES DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, BENJAMIN CARSON in his official capacity as secretary of HUD, BRIAN MONTGOMERY in his official capacity as commissioner of the Federal Housing Administration, CALIBER HOME LOANS, INC., and U.S. BANK TRUST, N.A., as Trustee for LSF9 Master Participation Trust, Defendants.	REPORT & RECOMMENDATION 16-CV-3948 (ENV) (SMG)

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GOLD, STEVEN M., U.S. Magistrate Judge:

INTRODUCTION

Plaintiffs Joseph Washington, St. Clair Blackett, Lucille Mason, and Melissa Trotman (collectively, "plaintiffs") financed home purchases with mortgages insured by the Federal Housing Administration ("FHA") and later defaulted. Plaintiffs bring this action challenging various actions taken by defendants in response to their defaults that, they claim, unlawfully altered their status as FHA mortgagors. *See* First Amended Complaint ("FAC"), Dkt. 11.[1] Specifically, plaintiffs challenge the manner in which the United States Department of Housing and Urban Development and its officers named in their official capacity[2] (together, "HUD") designed and implemented a "note sale program" that allowed HUD to take title to and ultimately sell their notes and mortgages—stripped of certain benefits and protections previously afforded to them as FHA mortgagors—to a private entity, Caliber Home Loans, Inc. (with U.S. Bank Trust, N.A. as Trustee for LSF9 Master Participation Trust, the "Caliber defendants"). HUD's program, they contend, denied them due process, breached an implied contract, and violated the Fair Housing Act.

HUD has moved to dismiss the FAC pursuant to Rule 12 of the Federal Rules of Civil Procedure, and plaintiffs have moved for leave to amend the FAC. United States District Judge

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[1] The Court uses the following abbreviations herein: First Amended Complaint ("FAC" or "complaint"), Dkt. 11; Mem. of Law in Supp. of the Federal Defs.' Mot. to Dismiss Pls.' Am. Compl. ("Defs.' Mem."), Dkt. 56-5; Pls.' Mem. of Law in Opp'n to Federal Defs.' Mot. ("Pls.' Mem."), Dkt. 57; Reply in Supp. of the Federal Defs.' Mot. to Dismiss ("Defs.' Reply"), Dkt. 58; Pls.' Mem. of Law in Supp. of Mot. for Leave to File Second Am. Compl. ("Pls.' Rule 15 Mem."), Dkt. 68; Federal Defs.' Opp'n to Pls.' Mot. for Leave to File Second Am. Compl. ("Defs.' Rule 15 Mem."), Dkt. 70; Pls.' Reply Mem. of Law in Further Supp. of Mot. for Leave to File Second Am. Compl. ("Pls.' Rule 15 Mem."), Dkt. 71; Tr. of Civil Cause for Hr'g dated Mar. 6, 2018 ("Tr."), Dkt. 73; Federal Defs.' Letter dated Mar. 13, 2018 ("Defs.' Mar. 13 Letter"), Dkt. 74; Pls.' Letter dated Mar. 19, 2018 ("Pls.' Mar. 19 Letter"), Dkt. 76.

[2] The FAC names Julián Castro as secretary of HUD and Edward Golding as commissioner of the FHA. The caption above reflects the current holders of these offices, Benjamin Carson and Brian Montgomery, respectively. *See* Fed. R. Civ. P. 25(d).

Eric N. Vitaliano referred the motions to me for Report and Recommendation by orders dated October 5, 2017 and January 22, 2018, respectively. Oral argument on the motions was held on March 6, 2018. *See* Min. Entry dated Mar. 6, 2018, Dkt. 72; Tr., Dkt. 73. The parties subsequently submitted letter briefs in further support of their respective positions. *See* Defs.' Mar. 13 Letter; Pls.' Mar. 19 Letter.

For the reasons described below, I respectfully recommend that HUD's motion to dismiss be granted and that plaintiffs' motion for leave to amend be denied.[3]

FACTUAL BACKGROUND[4]

Plaintiffs are African-American homeowners living in predominantly African-American neighborhoods in New York City who took out FHA-insured, mortgage-backed loans to finance their purchases of homes. FAC ¶¶ 17–20, 196–197, 260–261, 301–302, 343–345. As described in greater detail below, an FHA mortgage loan provides a borrower certain benefits both during the course of the loan and in the event of default.

Each of the plaintiffs eventually fell into default. FAC ¶¶ 204, 267, 308, 351. The notes and mortgages of three of the plaintiffs were then sold pursuant to a HUD note sale program ("NSP"),[5] under which the agency took title to their loans, bundled them with others from around the country, and sold them to private entities such as, in this case, the Caliber defendants. FAC ¶¶ 6, 221–222, 277, 320. As a result, these plaintiffs are no longer entitled to the benefits they

[3] The FAC also asserts claims against the Caliber defendants for violating the Fair Housing Act and state and federal consumer protection laws. The Caliber defendants moved to dismiss, Dkt. 59, and for partial summary judgment, Dkt. 79, 81. However, the Caliber defendants and plaintiffs have since reached agreements in principle to resolve plaintiffs' claims. Letter of Benjamin R. Nagin dated Apr. 22, 2019, Dkt. 105.

[4] The facts set forth in the text are drawn primarily from the First Amended Complaint.

[5] HUD states that the NSP is properly referred to as the Distressed Asset Stabilization Program ("DASP"). Defs.' Mem. at 1. For ease of reference, the term "note sale program" and abbreviation NSP are used in this Report and are intended as references to DASP.

once enjoyed as FHA mortgagors. FAC ¶ 6. Rather, defendant Caliber Home Loans, Inc. ("Caliber") began servicing each loan after the sale and, in that role, became responsible for considering plaintiffs' applications for loan modifications and for sending plaintiffs certain notices required by statute and regulation. Caliber, though, is neither insured by the FHA nor subject to the requirements and limitations imposed on FHA-insured lenders.

A. The FHA Mortgage Program

Congress has tasked HUD with implementing "the goal of a decent home and a suitable living environment for every American family, thus contributing to the development and redevelopment of communities and to the advancement of the growth, wealth, and security of the Nation." 42 U.S.C. § 1441. One means by which HUD seeks to achieve this goal is by insuring lenders who offer loans to borrowers with less wealth and lower credit scores than would ordinarily be required to obtain a loan to purchase a home. FAC ¶¶ 30–31. The insurance is provided through the FHA, a part of HUD. FAC ¶¶ 28, 30. If a borrower defaults on an insured loan and the lender proceeds to foreclosure, HUD will pay any remaining unpaid principal and a portion of the delinquent interest to the lender. FAC ¶ 32. With some of the risk of default and eventual foreclosure thus covered, lenders are willing to offer loans to less credit-worthy borrowers who would otherwise be unable to obtain the financing required to purchase a home.

The FHA maintains the Mutual Mortgage Insurance Fund (the "Insurance Fund"), which is the source of the funds it uses to pay lenders any principal remaining due and that portion of the delinquent interest covered by the insurance after a foreclosure sale. FAC ¶ 33. Homebuyers contribute to the fund though an Up-Front Mortgage Insurance Premium ("UFMIP") paid as a percentage of their FHA-insured loan amount at closing. FAC ¶ 34. Homeowners also pay an Annual Mortgage Insurance Premium ("MIP") in an amount that is spread over twelve monthly payments and billed in a homeowner's monthly mortgage statement. FAC ¶ 35. Both the UFMIP and the MIP are paid to the loan's servicer, who then remits payment to HUD; that is, the homeowner does not pay the premium directly to HUD. *See* 24 C.F.R. § 203.259.

An FHA-insured mortgage affords a borrower several benefits not typically made available to individuals who obtain traditional mortgage financing in the private market. Plaintiffs specifically identify five benefits that FHA-insured mortgages provide a borrower.

First, as described above, FHA loans are made available to borrowers with less ability to make down payments and lower credit scores than those typically required by private lenders. FAC ¶¶ 43–44. Individuals who would otherwise be unable to afford a home are thus able to obtain financing allowing them to purchase one.

Second, when a borrower defaults or is likely to default, an FHA-insured lender must engage in pre-foreclosure loss mitigation assistance actions designed to provide the borrower an opportunity to avoid foreclosure. FAC ¶ 45; *see also* 12 U.S.C. § 1715u. HUD has issued regulations and guidance that together set out procedures that FHA-insured loan servicers must follow before foreclosing on a defaulted loan. *See* FAC ¶ 47. For example, the servicer must not consider a payment late until fifteen days after it was due; at specified points, must attempt to contact a delinquent borrower by phone, through the mail, and in person to discuss loss mitigation options; must notify a borrower about the availability of HUD-approved counseling agencies; and must send the defaulting borrower a HUD-created pamphlet entitled "Save Your Home - Tips to Avoid Foreclosure." FAC ¶¶ 48–52.

Third, an FHA loan servicer must evaluate a borrower in default to identify appropriate loss-mitigation options within three months of the first missed payment and on a monthly basis thereafter, and may not initiate foreclosure proceedings until three months of payments are unpaid and overdue. FAC ¶¶ 53–54; *see also* 24 C.F.R. §§ 203.606(a). Common loss mitigation options include mortgage modifications "lowering the interest rate, extending the term, forbearing a portion of the unpaid principal balance so that it comes due at the end of the mortgage, or a combination of these options." FAC ¶ 59. Another common modification is a period of special forbearance during which payments are reduced or suspended while a homeowner goes through a short-term hardship, such as a period of disability or unemployment. FAC ¶ 62.

Fourth, FHA borrowers who have been current on their mortgage for at least one year are eligible for what is referred to as a "Streamline Refinance" benefit. FAC ¶¶ 71–76. This benefit allows homeowners to refinance their loan when interest rates go down, with minimal documentation and without the need for an appraisal.

Fifth, and finally, FHA-insured mortgages are freely assumable by any other buyer who meets FHA's minimum credit score requirement. FAC ¶ 77. As the operative complaint asserts, "[t]he ability to sell the property more quickly, and potentially earn a premium, can enable delinquent FHA homeowners to avoid foreclosure." FAC ¶ 80.

B. The Note Sale Program

The 2008 financial crisis severely depleted the Insurance Fund; between 2007 and 2009, the amount held by the Insurance Fund declined from $21 billion to $4 billion and its capital reserves fell far below a congressionally mandated floor. FAC ¶¶ 98–99. In response, HUD implemented a program to sell off delinquent mortgages that it determined to be beyond rescue. FAC ¶ 100. Several different specific programs fall within the general description of the NSP, but certain essential features are common to all of them. *See* FAC ¶¶ 101–122. The NSP allows a mortgage servicer to submit an insurance claim prior to foreclosure on a defaulted loan. FAC

¶¶ 106–107. A servicer may submit such a claim when a loan has been in default for at least six months, and the servicer has engaged in all HUD-required loss mitigation actions and determined that there is no home-saving solution available. FAC ¶ 117. HUD relies upon a certification from the mortgage servicer that these preconditions have been satisfied and does not independently verify a servicer's representation that it properly and completely engaged in loss mitigation. FAC ¶¶ 118–119. Homeowners are not notified in advance that their loans will be sold pursuant to the NSP. FAC ¶ 128.

A servicer who makes a claim through the NSP recovers from HUD the remaining unpaid principal on the loan as well as a HUD-determined number of months of delinquent interest. FAC ¶¶ 108–109. Title to the note and mortgage is then transferred to HUD, which pools notes and mortgages from around the country and auctions off the pool. FAC ¶¶ 120, 122. The notes reflecting the indebtedness of plaintiffs Washington, Blackett, and Mason were each sold as part of the NSP in or about June or July of 2014. FAC ¶¶ 154, 221–222, 277, 334.

A borrower whose note has been sold in the NSP no longer has access to the benefits associated with holding an FHA-insured mortgage. FAC ¶ 127. For example, until April of 2015, HUD did not require purchasers who acquired loans through the NSP to offer homeowners any specific loan modifications, or any modification program at all. FAC ¶ 137. On April 24, 2015, though, HUD published a press release indicating that "[i]n an effort to better serve homeowners looking to avoid foreclosure, loan servicers will now be required . . . to evaluate all borrowers for the Home Affordable Modification Program (HAMP) or a similar loss mitigation program." FAC ¶ 137; Press Release, U.S. Dep't of Hous. & Urban Dev., HUD Announces

Changes to Distressed Asset Stabilization Program (April 24, 2015), https://archives.hud.gov/news/2015/pr15-048.cfm.[6]

C. Caliber's Role as Purchaser and Servicer of the Plaintiffs' Loans

LSF9 Master Participation Trust ("Lone Star") is a private firm that purchased the pooled mortgages included in HUD's June 11, 2014 sale. FAC ¶¶ 153–154. Lone Star owns Caliber, which services the mortgages Lone Star has purchased from HUD. FAC ¶ 157. When plaintiffs whose mortgages were sold in 2014 received Notices of Ownership Change mandated by the Truth in Lending Act ("TILA"), the notices identified the new owner of their notes as U.S. Bank Trust, as trustee for LSF9 Master Participation Trust, and added that the transfer of ownership "does not affect any term or condition of the mortgage instruments or the servicing of your mortgage loan." FAC ¶¶ 159–161.

Plaintiffs contend, however, that the terms or conditions of the sold mortgages did in fact change, because Caliber will not consider them for a HAMP or HAMP-like loan modification and in fact represents that it offers no such modification. FAC ¶¶ 162–163. Instead, Caliber offers these borrowers only two types of modifications, and each creates an interest-bearing balloon payment due at the end of the mortgage, maintains the term of the note, does not preserve the assumability of the mortgage, charges an above-market interest rate for a period of time, and eventually increases monthly payments by $500 to $1,600. FAC ¶¶ 166–175.

[6] The FHA's Single Family Housing Policy Handbook ("Handbook") defines HAMP as "a Loss Mitigation Option using a Loan Modification and/or Partial Claim to allow the Mortgage to be reinstated, by establishing an affordable monthly payment and providing for principal deferment as needed." Fed. Hous. Admin., FHA Single Family Housing Policy Handbook, v. 4000.1 (2017), https://www.allregs.com/tpl/Home/GetIndex?Id=62ab7b5e-4613-45e7-b5a8-dddb8f34a66c. Plaintiffs explain that a "partial claim" is a claim made by a mortgage servicer, who may request that HUD pay as much as 30% of the unpaid principal balance to the servicer so that an affordable, modified monthly payment can be achieved. The partial claim amount is not forgiven but becomes a second mortgage that the homeowner owes HUD. The amount does not bear interest and does not become due until the end of the life of the modified mortgage. FAC ¶ 65.

Prior to 2015, HUD did not impose any loss mitigation requirements on NSP purchasers. FAC ¶¶ 137–140. Any such requirement, plaintiffs acknowledge, would be imposed only in the contract a purchaser entered into with HUD, and the contract HUD entered into with Lone Star for the 2014 Note Sale—which included mortgages belonging to Washington, Blackett, and Mason—contains no requirement that the purchaser offer a HAMP or HAMP-like modification. FAC ¶ 140.

D. Individual Plaintiffs

1. Plaintiff Joseph Washington

Joseph Washington purchased a home in St. Albans, Queens on October 31, 2011. FAC ¶ 196. Washington financed the purchase with an FHA-insured mortgage in the amount of $326,987 and paid a UFMIP of about 1%. FAC ¶¶ 197, 199. At the time, his monthly principal and interest payments were $1,656.80; with the addition of taxes, homeowner's insurance, and an MIP of $307.99, Washington's monthly payment totaled $2,281.47. FAC ¶¶ 200–201. His loan servicer at the time was LoanCare Servicing Center, Inc. ("LoanCare"). FAC ¶ 202.

Washington defaulted on the loan about two years later. FAC ¶ 204. LoanCare neither steered him toward free HUD-approved counseling services, sent him HUD's pamphlet entitled "Save Your Home - Tips to Avoid Foreclosure," nor contacted him to arrange a personal meeting. FAC ¶¶ 206–208. Washington then hired an unnamed company to negotiate a loan modification on his behalf. FAC ¶ 209. LoanCare responded by informing Washington that he did "not meet Investor requirements," and so did not qualify for loss mitigation assistance. FAC ¶ 210. LoanCare's letter did not mention FHA's loss mitigation programs and did not explain why Washington was denied the opportunity to participate in one. FAC ¶ 210.

When Washington called LoanCare to learn more about his request, he learned that LoanCare had never heard of the unnamed company he had engaged to negotiate on his behalf, and he stopped working with that company. FAC ¶¶ 210–212. Around the same time, LoanCare offered Washington a modified payment plan under which his new payment would have been virtually identical to his old one and explained that he did not qualify for a HAMP modification. FAC ¶ 213. Because the required monthly payment was about the same, the proposed modification was of no real help, and Washington therefore declined the offer and submitted another modification application two months later. FAC ¶¶ 214–215.

Although LoanCare eventually offered Washington a forbearance plan that would have lowered his monthly payments by about $800, Washington was in fact ineligible for that plan under applicable HUD regulations. FAC ¶¶ 217–218. Then, in a letter dated August 25, 2014, Caliber informed Washington that his loan had been sold to Lone Star and that the "assignment, sale or transfer of the mortgage loan does not affect any term or condition of the mortgage instruments or the servicing of your mortgage loan." FAC ¶¶ 221, 225.

Shortly thereafter, Washington submitted a new loss-mitigation application, this time to Caliber. FAC ¶ 226. Washington also began making payments consistent with the forbearance plan that LoanCare had offered before Caliber bought Washington's note, and Caliber accepted those payments. FAC ¶ 228. On March 6, 2015, Caliber sent Washington another letter, this time offering a Trial Period Plan that would require three monthly payments of $1,706.87; the letter did not indicate whether Caliber had reviewed Washington for any other modifications. FAC ¶¶ 232–233. Washington made those payments, and on July 6, 2016, Caliber informed him that he was approved for a "5 Year Interest Only" modification. FAC ¶¶ 236–237.

Under the terms of this modification, which Washington and Caliber eventually both signed, the total repayment period of Washington's note remained unchanged (twenty-one more years), but Washington was permitted to make interest-only payments of $1,280.99, based on a 4.8% interest rate, for five years. FAC ¶¶ 237, 244. After five years, Washington's payment will again include a principal component, and the interest rate will drop to 4.5%, resulting in monthly payments of $1,933.09, with a balloon payment of $30,342 due at the end of the loan period in 2041. FAC ¶¶ 239, 241. Washington is in his mid-fifties now and will be seventy-eight when the balloon payment becomes due. FAC ¶¶ 240–241.

Washington has never been the subject of a foreclosure action. Tr. at 109:10–13. Washington alleges, however, that had Caliber offered him a HAMP-like modification rather than the modification it did offer, Washington's loan term would have been thirty years, his interest rate would have been fixed at 4.5% for the remaining life of the loan, and his monthly payment would have remained fixed at $1,239.25. FAC ¶ 248. Under this modification, Washington would have been subject to a Partial Claim of $94,999.13 on which he would neither make payments nor accrue interest, but which he would be required to repay in a lump sum at the end of the loan term. FAC ¶¶ 246, 248.

2. <u>Plaintiff St. Clair Blackett</u>

St. Clair Blackett purchased a home in Laurelton, Queens, on June 29, 2011. FAC ¶ 260. Blackett took out a thirty-year FHA-insured mortgage for $384,975 and paid a UFMIP of about 1%. FAC ¶¶ 261–263. At the time, his monthly principal and interest payments were $2,125.85; with the addition of taxes, homeowner's insurance, and an MIP of $362.94, Blackett's monthly payment totaled $2,861.50. FAC ¶¶ 264–266. His loan servicer at the time was Continental Home Loans, Inc. ("Continental"). FAC ¶ 261.

Blackett defaulted on the loan approximately nine months later. FAC ¶ 267. At that point, Continental neither informed Blackett of any opportunity to modify his mortgage, alerted him to the existence of free housing counseling agencies, invited him to apply for a modification, sent him HUD's pamphlet entitled "Save Your Home - Tips to Avoid Foreclosure," nor contacted him to arrange a personal meeting. FAC ¶¶ 268–270. Blackett conducted his own internet research and learned that he could apply for a modification that might let him keep his home, and also began working with a consultant to apply for one. FAC ¶¶ 271–272.

On August 2, 2013, Continental sent Blackett a letter containing a 90-day pre-foreclosure notice and a list of housing counseling agencies. FAC ¶ 273. Blackett continued his efforts to obtain a modification throughout the following year, but Continental brought a foreclosure action against Blackett while that process was underway. FAC ¶¶ 274–276.

Blackett's note was sold in HUD's June 11, 2014 Note Sale and acquired by Lone Star; as a result, Caliber became Blackett's loan servicer. FAC ¶ 277. In December of 2014, Caliber offered and Blackett accepted a standard modification, which lowered Blackett's monthly principal and interest payment by about $100 for five years, but subjected him to a $174.93 increase thereafter. FAC ¶¶ 264, 282, 284. A little over a year after accepting the modification, Blackett began missing payments again, and on June 22, 2016 Caliber sent a new modification offer, which Blackett accepted on June 24, 2016. FAC ¶¶ 285, 291.

Under this second modification, Blackett makes interest-only payments of $1,281.77 for five years at a rate of 4.125%. FAC ¶ 285. At the end of the five-year period, Blackett's payments will again include a principal component and his interest rate will revert to the original note rate of 5.25%, resulting in monthly payments that will total $2,512.61. FAC ¶¶ 286–287. At the end of the life of the loan, in 2041, another $63,907 will be due as a balloon payment.

FAC ¶ 290. Moreover, under the terms of this modification, Blackett may not sell his home and allow the buyer to assume his mortgage. FAC ¶ 292. At oral argument, plaintiffs clarified that, presumably as a result of the modification, Blackett is no longer subject to active foreclosure proceedings. Tr. at 109:21–25.

The complaint alleges that, had Caliber offered Blackett a HAMP-like modification, his loan term would have been thirty years; his interest rate would have been lower; and his monthly principal and interest payment would have been $1,701.85. FAC ¶¶ 281, 293. Blackett also would have been subject to a Partial Claim of $106,614, on which he would neither make payments nor accrue interest, but which he would be required to repay in a lump sum at the end of the loan term. FAC ¶¶ 281, 293.

3. Plaintiff Lucille Mason

On January 20, 2010, Lucille Mason refinanced the mortgage on her three-family home in Canarsie, Brooklyn. FAC ¶ 302. Mason took out a thirty-year FHA-insured mortgage in the amount of $529,627 and paid a UFMIP of about 1.75%. FAC ¶¶ 302–303. At the time, her monthly principal and interest payments were $2,843.15; with the addition of taxes, homeowner's insurance, and an MIP of $242.75, Mason's monthly payment totaled $3,478.39. FAC ¶¶ 304–305. Her loan servicer at the time was J.P. Morgan Chase ("Chase"). FAC ¶ 306.

Mason began to miss mortgage payments in August of 2012. FAC ¶ 308. She later tried to submit her missed payments to Chase, but Chase sent her a letter on January 8, 2013 rejecting at least some of those payments and sending back the money she had attempted to pay. FAC ¶ 309. Although Mason was now in default, Chase neither sent her HUD's pamphlet entitled "Save Your Home - Tips to Avoid Foreclosure," contacted her to arrange a personal meeting, informed her in writing of any opportunity to modify her mortgage, nor alerted her to the existence of free housing counseling agencies. FAC ¶¶ 310–312.

Mason began working with a constituent advocate she found through her councilman's office, who informed her of various modification options. In March of 2013, the advocate submitted a modification application to Chase on Mason's behalf. FAC ¶¶ 313–314.

Mason never received a decision from Chase on her modification application. FAC ¶ 317. On April 17, 2013, while that application was pending, Chase brought a foreclosure action against Mason in the Supreme Court of New York, Kings County. FAC ¶ 315. After her note was sold in the June 11, 2014 Note Sale, Caliber became her new mortgage servicer and continued prosecuting the foreclosure action. FAC ¶ 320.

In February of 2016, Mason submitted another modification application to Caliber, and Caliber offered her a three-month interest-only Trial Period Plan. FAC ¶¶ 323–324. The plan is comparable to what Caliber offered Washington, and Mason expects that the final modification offered by Caliber would provide for five years of interest-only payments and include terms comparable to those offered to Washington and Blackett. FAC ¶¶ 325–329. Mason rejected Caliber's offer. FAC ¶ 330. Finally, like Washington and Blackett, Mason met with an attorney in June of 2016 who advised her that her mortgage servicers had misled her and should have offered her more favorable modification options. FAC ¶ 333. At oral argument, however, plaintiffs noted that at some point since filing the complaint in this action, Mason "has in fact received a HAMP-like modification." Tr. at 118:1–2. Moreover, as a result of that modification, the foreclosure action against Mason has been dismissed. Tr. at 109:14–16.

4. Plaintiff Melissa Trotman

After Melissa Trotman and her sister inherited their parents' St. Albans, Queens home in 2008, Trotman decided to take out a thirty-year FHA-insured mortgage to purchase her sister's interest. FAC ¶¶ 344–345. On March 26, 2010, Trotman procured an FHA-insured mortgage in the amount of $167,850 and paid a UFMIP of about 1.72%. FAC ¶¶ 345–346. At the time, her monthly principal and interest payments were $953.03; with the addition of taxes, homeowner's insurance, and an MIP of $68.31, Trotman's monthly payment totaled $1361.61. FAC ¶¶ 347–348. The loan was serviced by Hartford Funding, Ltd. ("Hartford"). FAC ¶ 349.

Trotman eventually fell behind on her mortgage payments and applied for an FHA mortgage modification with Hartford. FAC ¶¶ 350–352. On or about October 30, 2014, Trotman entered into a permanent modification,[7] the terms of which increased her principal balance by capitalizing arrears, lowered her interest rate, increased her monthly principal and interest payment, and extended the term of her loan to thirty years. FAC ¶ 354. She continues to pay a monthly MIP, now in an increased amount of $84. FAC ¶ 355.

Trotman eventually also fell behind on the payments required pursuant to her 2014 modification. FAC ¶ 356. Although she applied to Hartford for a new modification, Hartford brought a foreclosure action against her on September 10, 2015 in the Supreme Court of New York, Queens County. FAC ¶ 358. At oral argument, plaintiffs noted that since the First Amended Complaint was filed, Trotman has caught up on her note and is now no longer in default, and that the foreclosure action filed against her has been discontinued. Tr. at 110:3–15.

[7] The FAC notes that, for reasons unknown to Trotman, LoanCare signed her modification rather than Hartford, even though her monthly statements had always come from Hartford. FAC ¶ 353. The FAC further alleges that in a settlement conference in Trotman's foreclosure action, Hartford's attorney informed her that modification documents should be submitted to a different entity named Cenlar. FAC ¶ 360. These representations are somewhat confusing, but they are not material to the pending motions.

Plaintiffs acknowledge that Trotman was ineligible for another modification until August of 2016, and that her note is now ineligible for sale because she is not in default. FAC ¶ 363; Pls.' Mar. 19 Letter at 1.

E. Class Allegations

Pursuant to Rule 23 of the Federal Rules of Civil Procedure, plaintiffs bring this action on behalf of both themselves and a putative class consisting of "all African-American New York City homeowners whose mortgages were auctioned through one of HUD's Note Sales or who are at risk of having their mortgage sold through one of HUD's Note Sales." FAC ¶ 369. Plaintiffs also identify a putative overlapping subclass consisting of "all African-American New York City homeowners whose mortgages were auctioned to Lone Star Defendants or who are at risk of having their mortgages sold to Caliber Defendants through one of HUD's Note Sales." FAC ¶ 373.

Discussion

To survive a motion to dismiss, a complaint must contain sufficient factual material that, if accepted as true, would "state a claim to relief that is plausible on its face." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.* When deciding a motion brought under Rule 12(b), a court may consider "(1) facts alleged in the complaint and documents attached to it or incorporated in it by reference, (2) documents 'integral' to the complaint and relied upon in it, even if not attached or incorporated by reference, (3) documents or information contained in defendant's motion papers if plaintiff has knowledge or possession of the material and relied on it in framing the complaint, . . . and (5) facts of which judicial notice may properly be taken under Rule 201 of the Federal Rules of Evidence." *Abiuso v. Donahoe*, 2015 WL 3487130, at *3 (E.D.N.Y. June 3, 2015) (citation omitted); *see also Carlin v. Davidson Fink LLP*, 852 F.3d 207, 212 (2d Cir. 2017) (noting that a court may also consider documents attached to a complaint or incorporated in it by reference).

I. Justiciability

HUD raises two issues related to justiciability. First, in its original briefing, HUD challenges plaintiffs' standing to pursue their claims. Defs.' Mem. at 12–22. Second, after certain facts came to light during oral argument on the pending motions, HUD argued that plaintiffs' claims are now moot. *See generally* Tr.; Defs.' Mar. 13 Letter; Pls.' Mar. 19 Letter. I address these justiciability issues in turn, beginning with standing.

A. Standing

Standing is a threshold issue that must be resolved before reaching the merits of a claim because "putative plaintiffs lacking standing are not entitled to have their claims litigated in federal court." *Lower E. Side People's Fed. Credit Union v. Trump*, 289 F. Supp. 3d 568, 575 (S.D.N.Y. 2018) (quoting *Shearson Lehman Hutton, Inc. v. Wagoner*, 944 F.2d 114, 117 (2d Cir. 1991)). "If a dispute is not a proper case or controversy, the courts have no business deciding it, or expounding the law in the course of doing so." *Town of Chester, New York v. Laroe Estates, Inc.*, 137 S. Ct. 1645, 1650 (2017) (quoting *DaimlerChrysler Corp. v. Cuno*, 547 U.S. 332, 341 (2006)). Accordingly, "when a defendant moves to dismiss both for lack of subject matter jurisdiction and on other grounds . . . the Court must address the issue of subject matter jurisdiction first." *Thompson v. Donovan*, 2014 WL 5149037, at *5 (S.D.N.Y. Oct. 14, 2014).

"To satisfy the irreducible constitutional minimum of standing, a plaintiff must have (1) suffered an injury in fact, (2) that is fairly traceable to the challenged conduct of the defendant, and (3) that is likely to be redressed by a favorable judicial decision." *John v. Whole Foods Mkt. Grp., Inc.*, 858 F.3d 732, 736 (2d Cir. 2017) (internal quotation marks omitted) (quoting *Spokeo, Inc. v. Robins*, 136 S. Ct. 1540, 1547 (2016)). Each of these three elements must be met; "a failure of any of the three elements deprives a plaintiff of standing to maintain an action in federal court." *Trump*, 289 F. Supp. 3d at 575 (quoting *Dickerson v. Feldman*, 426 F. Supp. 2d 130, 134 (S.D.N.Y. 2006)).

First, "[t]o establish injury in fact, a plaintiff must show that he or she suffered 'an invasion of a legally protected interest' that is 'concrete and particularized.'" *Spokeo*, 136 S. Ct. at 1548 (quoting *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560 (1992)). To be particularized, "the injury must affect the plaintiff in a personal and individual way." *Lujan*, 504 U.S. at 560 n.1. To be concrete, an injury must be real, not abstract; put another way, "it must actually exist." *Spokeo*, 136 S.Ct. at 1548. "Although tangible injuries are perhaps easier to recognize, . . . intangible injuries can nevertheless be concrete." *Id.* at 1549.

To rise to the level of an injury-in-fact sufficient for standing, a plaintiff's injury must be "actual or imminent, not conjectural or hypothetical." *Id.* at 1548 (quoting *Lujan*, 504 U.S. at 560). "This does not mean, however, that the risk of real harm cannot satisfy the requirement of concreteness." *Id.* at 1549 (citing *Clapper v. Amnesty Int'l USA*, 568 U.S. 398, 410 (2013)). "An allegation of future injury may suffice if the threatened injury is 'certainly impending,' or there is a 'substantial risk' that the harm will occur." *Trump*, 289 F. Supp. 3d at 575 (quoting *Susan B. Anthony List v. Driehaus*, 573 U.S. 149, 158 (2014)).

The Second Circuit has recognized that an increased risk of injury may be sufficient to satisfy the injury-in-fact requirement. *See, e.g.*, *Nat. Res. Def. Council, Inc. v. U.S. Food & Drug Admin.* (*NRDC v. FDA*), 710 F.3d 71, 83 (2d Cir. 2013), *as amended* Mar. 21, 2013

("'[I]ncreased health-related uncertainty' . . . [is] a form of injury that this Court has recognized as sufficient to constitute an injury in fact." (quoting *N.Y. Pub. Interest Research Grp. v. Whitman*, 321 F.3d 316, 325 (2d Cir. 2003))). Two types of exposure allegations may be sufficient to establish injury-in-fact: "(1) 'uncontested exposure to a potentially harmful substance,' . . . and (2) 'potential exposure to an undisputedly dangerous contaminant.'" *Id.* (quoting *Baur v. Veneman*, 352 F.3d 625, 634 n.8 (2d Cir. 2003)). Because exposure-to-risk cases depend on statistical proofs to demonstrate the increased threat of harm, "allegation of a credible risk may be sufficient at the pleading stage without further factual confirmation or quantification of the precise risk at issue. Adopting a more stringent view of the injury-in-fact requirement . . . would essentially collapse the standing inquiry into the merits." *Baur*, 352 F.3d at 642.

By the same token, "it [may be] tempting, from the perspective of judicial efficiency, to treat a meritless claim—one in which a plaintiff's theory of liability comes up short—as a claim in which the plaintiff has not been injured in the first instance. But where the legislature has created a framework that offers injured plaintiffs an opportunity to seek redress, '[courts] must avoid conflating the requirement for an injury in fact with the validity of [a plaintiff's] claim' to constrain the scope of judicial authority and ensure that legislative decisions are left to the legislature." *Dubuisson v. Stonebridge Life Ins. Co.*, 887 F.3d 567, 573–74 (2d Cir. 2018) (third alteration in original) (citation omitted).

The second showing required for standing is that the injury complained of be fairly traceable to the challenged conduct of the defendant. To establish that an injury is "fairly traceable" to a defendant's conduct, the plaintiff must allege a causal connection that is not severed by "the independent action of some third party not before the court." *Carter v.*

HealthPort Techs., LLC, 822 F.3d 47, 55 (2d Cir. 2016) (quoting *Lujan*, 504 U.S. at 560). The requirement of traceability does not impose "an onerous standard" but rather one even "lower than that of proximate causation." *Id.* at 56 (citing *Rothstein v. UBS AG*, 708 F.3d 82, 91–92 (2d Cir. 2013)). Injuries may be fairly traced even where a defendant's conduct harms another person only indirectly, and even when a third party's conduct also contributed to the harm. *See id.* at 55–56 ("A defendant's conduct that injures a plaintiff but does so only indirectly, after intervening conduct by another person, may suffice for Article III standing."); *see also Nat. Res. Def. Council v. Nat'l Highway Traffic Safety Admin.* (*NRDC v. NHTSA*), 894 F.3d 95, 104 (2d Cir. 2018) ("[F]or standing purposes, petitioners need not prove a cause-and-effect relationship with absolute certainty; substantial likelihood of the alleged causality meets the test. This is true even in cases where the injury hinges on the reactions of the third parties . . . to the agency's conduct." (quoting *Competitive Enter. Inst. v. Nat'l Highway Traffic Safety Admin.*, 901 F.2d 107, 113 (D.C. Cir. 1990))). If "the defendants have engaged in conduct that may have contributed to causing the injury, it would be better to recognize standing." *NRDC v. FDA*, 710 F.3d at 85.

With respect to the final element, redressability, "it must be likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision." *Carter*, 822 F.3d at 55 (quoting *Lujan*, 504 U.S. at 560–61); *see also Spokeo*, 136 S. Ct. at 1547 ("[A] plaintiff must have . . . suffered an injury . . . that is likely to be redressed by a favorable judicial decision.")

Plaintiffs bear the burden of establishing the three elements of standing discussed above and, at the pleading stage, must "clearly allege facts demonstrating each element." *Ross v. AXA Equitable Life Ins. Co.*, 680 F. App'x 41, 44 (2d Cir. 2017) (summary order) (quoting *Spokeo*, 136 S. Ct. at 1547); *accord Residents & Families United to Save Our Adult Homes v. Zucker*, 2018 WL 1175152, at *4 (E.D.N.Y. Mar. 6, 2018), *appeal dismissed per stipulation*, 2018 WL 3454963 (2d Cir. July 9, 2018). Still, "[a]t the pleading stage, general factual allegations of injury resulting from the defendant's conduct may suffice, for on a motion to dismiss we presum[e] that general allegations embrace those specific facts that are necessary to support the claim." *Carter* 822 F.3d at 56 (quoting *Lujan*, 504 U.S. at 561); *see also Harry v. Total Gas & Power N. Am., Inc.*, 889 F.3d 104, 110–11 (2d Cir. 2018) ("While the pleading of a cause of action must possess enough heft to show that the pleader is entitled to relief, to plead standing, the pleader need only show that allowing her to raise her claim in federal court would not move so beyond the court's ken as to usurp the power of the political branches." (citing *Clapper*, 568 U.S. at 408)). While a court may require an increased showing from plaintiffs as a case proceeds, general factual allegations suffice at this early stage in litigation because "[f]undamentally, standing simply means that the plaintiff is entitled to walk through the courthouse door and raise his grievance before a federal court." *Baur*, 352 F.3d at 643 (internal quotation marks and citation omitted).

When considering a dispute over standing, courts must bear in mind that "standing is not dispensed in gross." *Town of Chester,* 137 S. Ct. at 1650 (quoting *Davis v. Fed. Election Comm'n*, 554 U.S. 724, 734 (2008)). Rather, to proceed, plaintiffs "must demonstrate standing for each claim and form of relief sought." *Carver v. City of New York*, 621 F.3d 221, 225 (2d Cir. 2010) (quoting *Baur*, 352 F.3d at 642 n.15); *see also Nicosia v. Amazon.com, Inc.*, 834 F.3d 220, 239 (2d Cir. 2016) ("For each form of relief sought, a plaintiff 'must demonstrate standing separately.'" (quoting *Friends of the Earth, Inc. v. Laidlaw Envtl. Servs. (TOC), Inc.*, 528 U.S. 167, 185 (2000))). Moreover, plaintiffs must establish that they, and not merely members of any putative class described in the FAC, have standing; "[t]hat a suit may be a class action . . . adds nothing to the question of standing, for even named plaintiffs who represent a class must allege and show that they personally have been injured, not that injury has been suffered by other, unidentified members of the class to which they belong and which they purport to represent." *Simon v. E. Ky. Welfare Rights Org.*, 426 U.S. 26, 40 n.20 (1976); *accord Dodge v. County of Orange*, 103 Fed. App'x 688, 690 (2d Cir. 2004) (summary order).

I now consider whether plaintiffs have established standing to bring each of the claims asserted against HUD in the First Amended Complaint.

1. Injury-in-Fact

Counts I and IV of the FAC assert due process and breach of contract claims, respectively, against HUD based upon the sale of plaintiffs' notes and mortgages pursuant to the NSP. FAC ¶¶ 381–395; 414–422. More specifically, Washington, Blackett, and Mason allege that they were at one time entitled to a variety of benefits as FHA mortgagors, including (1) the opportunity to obtain financing to purchase a home despite lower credit scores and less money available for a down payment than private lenders typically require, FAC ¶¶ 43–44; (2) a "pre-foreclosure assistance system" whereby mortgage servicers promptly reach out to homeowners who have fallen behind on mortgage payments in an effort to avoid foreclosure, FAC ¶¶ 45–57; (3) a requirement that the FHA-insured mortgage servicer consider various loss mitigation options—including special forbearance, a repayment plan, a standard loan modification, or a HAMP modification—and not commence foreclosure proceedings until three months of mortgage payments are unpaid and overdue, FAC ¶¶ 58–70; (4) a "Streamline Refinance" benefit that affords homeowners the opportunity to refinance after a decrease in interest rates with minimal supporting documentation and without requiring a home appraisal, FAC ¶¶ 71–76; and (5) the ability of a prospective buyer who also meets FHA's creditworthiness requirements to assume the FHA mortgage and all its benefits when purchasing the home from the original mortgagor, and the resulting ability of the original mortgagor to avoid foreclosure by selling the home quickly and possibly at a premium, FAC ¶¶ 77–80.

Plaintiffs allege that these benefits were taken from them as a consequence of the sale of their notes and mortgages pursuant to HUD's NSP. In their due process claim, with respect to which they seek declaratory and injunctive relief, plaintiffs allege that HUD denied them due process by taking these benefits from them without notice and an opportunity to be heard. FAC ¶¶ 392–395. In their breach of contract claim, with respect to which they seek compensatory damages, plaintiffs contend that HUD breached an implied-in-fact contract when it deprived them of the benefits they enjoyed as FHA mortgagors. FAC ¶¶ 420–422.

While plaintiffs may have fully realized some of the benefits of their status as FHA mortgagors prior to the sale of their notes and mortgages, they allege that they were stripped of others. For example, plaintiffs' mortgages were freely assumable prior to being sold but not after. In addition, as set forth in detail above, Washington, Blackett, and Mason allege that the loan modifications they obtained after their notes and mortgages were sold have more onerous terms and require higher monthly payments than the modifications they claim they were entitled to pursuant to their original FHA mortgages. These plaintiffs contend that, as a result, their risk of defaulting in the future was significantly increased by the sales of their notes and mortgages. This alone suffices for standing, because "threatened harm in the form of an increased risk of future injury may serve as injury-in-fact for Article III standing purposes," provided the risk is real and not merely speculative. *Baur*, 352 F.3d at 633; *cf. Preserve at Connetquot Homeowners Ass'n v. Costco Wholesale Corp.*, 2019 WL 337093, at *6 (E.D.N.Y. Jan. 28, 2019) (remarking that injury-in-fact encompasses future harms but concluding that plaintiff, who merely alleged one clog in a sewage system six years prior, "failed to plead facts that establish a likelihood of future harm from clogging because of flushable wipes").

Accordingly, plaintiffs Washington, Blackett, and Mason have alleged a sufficiently concrete injury-in-fact to establish their standing to assert their due process and breach of contract claims. The same cannot be said, however, of plaintiff Melissa Trotman. Unlike the other plaintiffs, Trotman's note has never been sold, and her mortgage continues to afford her the FHA benefits the other plaintiffs claim they no longer have. In the complaint, plaintiffs contend that "because she is almost two years behind on her mortgage, is African-American and lives in Southeast Queens, [Trotman] stands the very real risk that her mortgage will be sold." FAC ¶ 363. During oral argument, plaintiffs' counsel reported that Trotman has come up to date on her mortgage and that her note and mortgage were "no longer at risk of being sold." *See* Tr. at 110:3–22. Before Trotman could suffer the injuries described in the complaint, then, she would have to default on her mortgage, her mortgagee would have to seek relief under HUD's NSP, and her note and mortgage would have to be selected by HUD as part of a pool of notes and mortgages to be sold. Under these circumstances, Trotman's injuries are neither actual nor imminent, but are instead conjectural and hypothetical. *See Spokeo*, 136 S. Ct. at 1548.

Counts II and III assert claims under the Fair Housing Act. "Under the [Fair Housing Act], a plaintiff need only allege 'injury in fact' within the meaning of Article III of the Constitution . . . ." *Winfield v. City of New York*, 2016 WL 6208564, at *3 (S.D.N.Y. Oct. 24, 2016) (citing *LeBlanc-Sternberg v. Fletcher*, 67 F.3d 412, 424 (2d Cir. 1995)). "In other words, there are no prudential limits on standing under the [Fair Housing Act]." *Fair Hous. in Huntington Comm. Inc. v. Town of Huntington, New York*, 316 F.3d 357, 362 (2d Cir. 2003) (citing *Havens Realty Corp. v. Coleman*, 455 U.S. 363, 372 (1982)).

The precise contours of Count II of the FAC are not entirely clear; the FAC appears to bifurcate Count II, alleging "a racially discriminatory impact on African-American homeowners in New York City *or* on predominantly African-American neighborhoods in New York City." FAC ¶ 399 (emphasis added). Plaintiffs' briefing, though, clarifies that the thrust of Count II is that the NSP creates or maintains racial segregation in violation of a legal duty not to. The point heading that introduces the discussion of Count II in plaintiffs' brief claims: "HUD VIOLATED ITS STATUTORY DUTY TO AFFIRMATIVELY FURTHER FAIR HOUSING BY FAILING TO CONSIDER THE IMPACT OF THE NOTE SALE PROGRAM *ON RACIAL SEGREGATION*." Pls.' Mem. at 14 (emphasis added). The duty plaintiffs say § 3608(e)(5) imposes on HUD is the duty "to assess whether its actions advance racially open housing or further segregation and to respond appropriately." *Id.* at 14–15. Thus, it is clear from plaintiffs' own construction of Count II that it is meant to allege that HUD failed to consider its affirmative obligation to further fair housing when it adopted a note sale program that creates or maintains segregation.[8]

I note at the outset that Count II does not explicitly allege an injury. Rather, Count II alleges that HUD has a duty to affirmatively further the Fair Housing Act's policies, FAC ¶ 397, and, in particular, to consider whether HUD's policies and actions are creating or maintaining segregation, FAC ¶ 398. Count II further alleges that HUD failed to fulfill this duty when it implemented the NSP. FAC ¶ 399. It also alleges that, owing to this alleged breach of HUD's duty, "[p]laintiffs have a claim for relief . . . because of the Federal Defendants' abuse of discretion and otherwise acting contrary to law in creating, authorizing, permitting and supporting the [NSP], including identifying the specific loans to sell out of the FHA Mortgage

[8] Count II of the FAC stands in contrast to plaintiffs' third claim which, as discussed below, alleges that the NSP has had a racially disparate impact.

Program." FAC ¶ 401. Nowhere in this language or elsewhere in Count II itself is a particular injury to plaintiffs alleged.

Reading the FAC as a whole, though, and construing it as discussed above in light of plaintiffs' briefing, it appears that the injury plaintiffs seek to claim in Count II is that HUD's implementation of the NSP gave rise to or perpetuated segregation in their communities. Injuries of this type are cognizable under the Fair Housing Act. "Supreme Court cases make plain that a plaintiff sufficiently establishes standing to bring suit under the FHA by alleging that a defendant's acts impinge on the plaintiff's right to live in an integrated community." *Fair Hous. in Huntington*, 316 F.3d at 362 (collecting cases); see also *Havens Realty Corp.*, 455 U.S. at 377 (finding standing sufficient to survive motion to dismiss where individual plaintiffs generally alleged loss of "social, professional, business and economic, political and aesthetic benefits of interracial associations that arise from living in integrated communities free from discriminatory housing practices"). Accordingly, plaintiffs have stated injuries-in-fact sufficient to establish their standing to bring Count II. This conclusion applies to plaintiff Trotman as well; the fact that she is no longer in default and is no longer facing foreclosure does not preclude her from alleging that HUD's implementation of the NSP has impaired her ability to live in an integrated community.

As for Count III, the FAC claims that the NSP has a disparate impact on African-American homeowners in New York City, such as plaintiffs, by making homeownership less available to them and by threatening the stability of their neighborhoods. FAC ¶¶ 408–410. Count III seeks declaratory and injunctive relief. FAC ¶ 413. Because each plaintiff owns a home allegedly affected in this way, plaintiffs have also pleaded injuries-in-fact sufficient to support standing to bring Count III. This conclusion also extends to plaintiff Trotman, who alleges that the NSP may adversely affect the stability of the community in which she lives. Trotman has stated an injury that suffices for standing purposes, at least to the extent she alleges that the stability of her community is threatened by note sales conducted pursuant to the NSP that strip her neighbors of their FHA benefits.

2. Traceability

While traceability is an indispensable element of standing, it is viewed generously at the pleading stage. *See Rothstein*, 708 F.3d at 92 ("'[P]articularly at the pleading stage, the "fairly traceable" standard is not equivalent to a requirement of tort causation' and . . . 'for purposes of satisfying Article III's causation requirement, we are concerned with something *less than the concept of proximate cause*.'" (quoting *Connecticut v. Am. Elec. Power Co.*, 582 F.3d 309, 346 (2d Cir. 2009), *rev'd on other grounds*, 564 U.S. 410 (2011))).

HUD asserts that there are breaks in the causal chain connecting the NSP and plaintiffs' injuries that are attributable both to plaintiffs themselves and plaintiffs' original mortgage servicers. *See* Defs.' Mem. at 15 ("Plaintiffs' own failure to make their mortgage payments and the independent determinations of Plaintiffs' original mortgage servicers that no further loss mitigation options were available and the loans should be submitted for sale through DASP sever any purported link between the Federal Defendants' operation of DASP and Plaintiffs' alleged injury."). Plaintiffs counter that "the *injuries* that give rise to Plaintiffs' claims against HUD—the loss of the FHA Benefits, the higher out-of-pocket costs of inferior loan modifications, the unequal treatment by the government, the denial of the benefits of integrated living, and the harm to African Americans' ability to accumulate wealth through sustainable homeownership—do not arise from Plaintiffs being in default or from servicers submitting a claim to HUD." Pls.' Mem. at 7.

HUD's contention that plaintiffs' failure to remain current on their mortgage payments breaks the chain of causation plainly lacks merit. In support of its position, HUD relies on *NRDC v. FDA*, which holds that "an injury is self-inflicted so as to defeat the causation necessary to establish standing . . . 'only if . . . the injury is so completely due to the plaintiff's own fault as to break the causal chain.'" 710 F.3d at 85 (quoting *St. Pierre v. Dyer*, 208 F.3d 394, 402 (2d Cir. 2000)). Yet, the Second Circuit in *NRDC v. FDA* itself found that a veterinary technician's exposure to an FDA-regulated soap ingredient was not self-inflicted so as to defeat standing to complain that the FDA did not take further action to restrict sale of soaps containing the ingredient, even though the technician used the soap repeatedly and declined to take action beyond raising her concerns about the soap with her employer for fear of being perceived as a problematic employee. *Id.* at 76–77, 85.

The injuries complained of here are similarly not self-inflicted. To be sure, defaulting on a mortgage results in certain self-inflicted injuries, vulnerability to foreclosure proceedings and harm to one's credit rating among them. The injuries giving rise to plaintiffs' claims here, though, go beyond these, and are alleged to be uniquely caused by HUD's operation of the NSP. In other words, plaintiffs do not claim that HUD breached a contract or violated due process or the FHA simply because they suffered consequences by virtue of their defaults; rather, plaintiffs' claims are based upon the particular consequences of having their notes and mortgages sold to a lender without FHA insurance and not subject to the requirements and limitations that apply to FHA-insured lenders. Plantiffs' FHA claims are also based on the impact of the NSP upon the predominantly African-American communities where they reside. *See, e.g.*, FAC ¶ 95 ("[I]n designing and implementing the Note Sale Program, HUD has not reviewed the impact of its changes to the Note Sale Program on African-American homeowners in New York City or on predominantly African-American neighborhoods in New York City."); *see also* Tr. at 44:22–25 ("HUD designed the program in such a way that if the servicer merely said hey, we did everything we could, HUD decided to accept that representation at face value and to just proceed.").

Nor is HUD's assertion that the original mortgage servicers' actions broke the chain of causation persuasive. Indeed, "a plaintiff need not allege that 'the defendant's actions [were] the very last step in the chain of causation' to demonstrate that the defendant's actions cause the claimed injury. It suffices that the defendant's actions had a 'determinative or coercive effect upon the action of someone else' who directly caused the injury." *Carver*, 621 F.3d at 226 (alterations in original) (internal citations omitted) (quoting *Bennett v. Spear*, 520 U.S. 154, 169 (1997)). "Thus, causation turns on the degree to which the defendant's actions constrained or influenced the decision of the final actor in the chain of causation." *Id.* (comparing *Bennett*, 621 F.3d at 169 with *Simon*, 426 U.S. at 28, 42–43). Here, HUD certainly "influenced the decisions" of the original mortgagees by offering them the option to obtain an early insurance payout by selling their notes. And even assuming that the Caliber defendants—having purchased the notes and accompanying mortgages following the original mortgagees' decision to relinquish the mortgages back to HUD—are the "final actor" as purchasers of the sold mortgages, HUD certainly "influenced the decision" of the Caliber defendants as well by offering these mortgages for sale without the FHA homeowner protections that would make them less desirable in the eyes of a potential buyer.

As noted above, "[f]or standing purposes, petitioners need not prove a cause-and-effect relationship with absolute certainty; substantial likelihood of the alleged causality meets the test. This is true even in cases where the injury hinges on the reactions of the third parties . . . to the agency's conduct." *NRDC v. NHTSA*, 894 F.3d at 104 (quoting *Competitive Enter. Inst.*, 901 F.2d at 113). Accordingly, plaintiffs' allegations surpass the low bar applicable to traceability at the pleading stage.[9]

3. Redressability

I now turn to the third and final element of standing: redressability. "In determining whether an injury is redressable, [courts] examine whether each aspect of the relief requested . . . would redress [plaintiff's] asserted injury." *Allco Fin. Ltd. v. Klee*, 805 F.3d 89, 93–94 (2d Cir. 2015) (citing *Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83, 105–09 (1998)), *as amended* Dec. 1, 2015. I therefore consider, in turn, each type of relief plaintiffs seek.

Declaratory relief. Plaintiffs seek declaratory relief with respect to Counts I, II, and III. FAC ¶¶ 395, 403, 413. In particular, the declaratory relief sought is "[a] judgment declaring that Defendants have committed the violations of law alleged in this action." FAC Prayer for Relief. Plaintiffs base their entitlement to declaratory relief on the availability of such relief where it has "implications for practical enforcement upon the parties." Pls.' Mem. at 9 (quoting *S. Jackson & Son, Inc. v. Coffee, Sugar & Cocoa Exch. Inc.*, 24 F.3d 427, 431 (2d Cir. 1994)).

With respect to Count I—plaintiffs' due process cause of action—the injury plaintiffs assert is that they were not afforded notice and an opportunity to be heard before being stripped of certain benefits they were entitled to as homeowners with FHA mortgages. Plaintiffs claim in their opposition memorandum that "a declaration that HUD's conduct was unlawful could result in past Note Sales being invalidated." Pls.' Mem. at 10. However, plaintiffs nowhere in the

[9] I have not addressed traceability in a claim-by-claim fashion, as I have above with respect to injury-in-fact and below with respect to redressability, because it is not necessary to do so. The above reasoning applies to the injuries asserted as arising from both Counts I and IV—the loss of FHA benefits—and the injuries asserted as arising from Counts II and III—the impingement of plaintiffs' rights to have HUD adopt policies that support minority homeownership and stable, integrated communities. Plaintiffs' theory of traceability with respect to all of these injuries is the same—that HUD, by influencing the original mortgagees' decisions to sell plaintiffs' notes pursuant to the NSP, caused the injuries that resulted from those sales.

FAC seek invalidation of the past sales of their respective notes and mortgages. *See generally* FAC Prayer for Relief. Nor do plaintiffs explain how a declaration that certain conduct was unlawful would have the effect of nullifying and undoing the sale of their notes and mortgages. Rather, in addition to a declaration that the prior note sales violated the law, plaintiffs seek monetary damages under their breach of contract claims and prospective injunctive relief that does not entail an unwinding of the prior sale of their mortgages and notes. In these circumstances, the retrospective declaration plaintiffs seek would do nothing to redress their asserted due process injuries—the loss of certain FHA mortgage benefits without notice and an opportunity to be heard.

The injuries asserted under Counts II and III are an impairment of plaintiffs' rights to enjoy the benefits of residing in an integrated, stable community and of homeownership. However, "[a] judgment declaring that [HUD has] committed the violations of law alleged in this action" would not redress these claimed injuries any more than it would redress the alleged deprivation of plaintiffs' FHA mortgage benefits without due process of law. HUD contends that, because plaintiffs are seeking redress for past rather than future harms, a declaratory judgment is not available. Defs.' Mem. at 18–19. Here, plaintiffs seek a judgment declaring that past actions by HUD violated the Fair Housing Act. The retrospective declaratory relief plaintiffs seek, though, would not redress the alleged violation of their rights to live in integrated communities or enjoy the benefits of homeownership. Because the declaratory judgment plaintiffs seek would not redress the injuries they attribute to HUD's violations of their due process rights or the Fair Housing Act, plaintiffs lack standing to seek such relief.

Injunction. Plaintiffs seek "[a]n order enjoining Federal Defendants from continuing to harm Plaintiffs and members of the Class by conducting future Note Sales," and they further seek "[a]n order enjoining and directing Federal Defendants . . . to . . . [r]eview the racial impact of prior Note Sales on African-American homeowners and communities in New York City[,] . . . ensure that [any future note sales that are permitted] are in accordance with the Fair Housing Act[,] and . . . ensure that homeowners whose mortgages are contemplated to be sold in [any future note sales that are permitted] are provided sufficient notice and an opportunity to be heard." FAC Prayer for Relief. As with the declaratory relief they seek, plaintiffs seek this injunctive relief in connection with the alleged breaches of their due process rights, FAC ¶ 395, and the Fair Housing Act, FAC ¶¶ 403, 413.

The injunctive relief plaintiffs seek would no more remedy the injuries they attribute to a breach of their due process rights than would the declaratory judgment discussed above. For instance, directing HUD to review the racial impact of prior note sales would do nothing to remedy plaintiffs' loss of the benefits that flow from an FHA mortgage. Even assuming HUD undertook such a review and determined that the prior note sales had an adverse impact on African-American homeowners and communities, that would not change the fact that plaintiffs' notes and mortgages were sold and are now owned and serviced by private entities without FHA insurance that are not obligated to provide FHA benefits. The remainder of the injunctive relief plaintiffs seek—orders requiring HUD to ensure that future permissible note sales comply with the Fair Housing Act and to provide homeowners with notice and an opportunity to be heard before their notes and mortgages are sold—is prospective in nature, rather than retrospective. This is an odd match for the retrospective harms plaintiffs attribute to the alleged violations of their due process rights. Plaintiffs do not seek a judgment declaring the sale of their notes and resulting loss of benefits null and void, and the injunctive relief plaintiffs do seek would not, if granted, redress the allegedly wrongful stripping of their FHA mortgage benefits from them without notice and an opportunity to be heard.[10] Because this injury would not be redressed by any of the relief plaintiffs seek, declaratory or injunctive, plaintiffs lack standing to assert the due process claim alleged in Count I of the FAC.

Nor is one of the injuries asserted under Count III—plaintiffs' increased risk of default—redressable by the injunctive relief requested. Count III may be understood as alleging, at least in part, that plaintiffs themselves—or at a minimum plaintiffs Washington, Blackett, and Mason—were subjected to a greater likelihood that their notes would be sold, and their FHA benefits lost, because of their race or because they own homes in communities that are largely African-American. However, as with plaintiffs' due process claim, the requested injunction will not restore plaintiffs' FHA benefits or otherwise redress any injury plaintiffs claim they sustained by virtue of the sale of their notes pursuant to the NSP. Accordingly, to the extent that plaintiffs Washington, Blackett, and Mason contend that they were directly affected by the alleged disparate impact of the NSP when *their* notes were sold, they lack standing to assert the claim asserted in Count III.

However, the injunctive relief plaintiffs seek *would* at least arguably redress the other injuries they allege in Counts II and III. As noted above, plaintiffs' contention is that they suffer ongoing injury as a result of the past note sales because the NSP impairs the stability of their neighborhoods and promotes segregation. An injunction mandating that HUD review the racial impact of prior note sales and ensure that any future note sales be conducted in compliance with the law would, plaintiffs allege, promote integration and restore stability to predominantly

[10] Plaintiffs do seek to amend their prayer for relief in their separate motion to amend the FAC, adding a prayer that this Court nullify the subject note sales. Proposed Second Am. Compl. ("Proposed SAC") Prayer for Relief ¶ iv, Dkt. 67-1. However, that motion is understood by the Court and the parties alike to be for the singular purpose of adding a ninth cause of action, which generally alleges that HUD failed to engage in notice-and-comment rulemaking, which they were allegedly bound to do when establishing the NSP. Because the motion to amend is made for that singular purpose, it would be improper to construe the prayer for relief, so amended, to apply to the claims asserted in the FAC.

African-American neighborhoods, including the ones where they reside. These harms, as alleged by plaintiffs, are ongoing and made worse by each subsequent note sale. Accordingly, were future note sales conducted in a way that does not promote increased racial segregation or neighborhood instability, those injuries might be ameliorated. Counts II and III, therefore, allege injuries that are redressable by means of injunctive relief, at least to the extent that those counts claim that HUD's implementation of the NSP promotes segregation and destabilizes neighborhoods.

HUD contends that the Court cannot redress even these injuries through the injunctive relief sought for two reasons: first, enjoining future note sales will not benefit plaintiffs whose notes were already sold and, second, judicial review of agency action in this arena is statutorily precluded. Defs.' Mem. at 19–21. Both of these contentions miss the mark.

First, it is true that plaintiffs' notes have already been sold, and that the injunctive relief sought would do nothing to unwind those sales. It is for this reason that Count III does not assert an injury redressable with injunctive relief, at least to the extent it claims that the NSP has increased the likelihood that plaintiffs will lose their homes because it subjects them to more onerous loan terms. However, as discussed above, the gravamen of Counts II and III goes beyond that. Plaintiffs assert in these counts that they are being injured by the continued operation of the NSP *in toto*, because the sale of other homeowners' notes and mortgages pursuant to a program that is unfair to African-American mortgagors impairs the stability of plaintiffs' communities and maintains or perpetuates their segregated character.

HUD's argument that 12 U.S.C. 1715u(d) precludes review in this action is no more persuasive. On its face, the effect of subsection (d) is limited to the section in which it appears. *See* 12 U.S.C. § 1715u(d) ("No decision by the Secretary to exercise or forego exercising any authority *under this section* shall be subject to judicial review." (emphasis added)). The substantive portions of § 1715u address loss mitigation, payments of partial claims, and assignments and modifications of mortgage loans. The First Amended Complaint does not allege, though, that HUD administers the NSP pursuant to § 1715u, instead invoking the National Housing Act of 1934 § 204, 12 U.S.C. § 1710. FAC ¶ 107 ("In 1999, Congress amended Section 204 of the NHA to permit HUD to pay claims on defaulted mortgages prior to a foreclosure auction. It is through these 1999 amendments that HUD administers the Note Sale Program . . . ."). Moreover, the relief that plaintiffs seek does not ask the Court to "require HUD to operate a mandatory loss mitigation program" under § 1715u(a), a result not permitted by § 1715u(d). *See Ferrell v. U.S. Dep't of Hous. & Urban Dev.*, 2002 WL 1998310, at *3 (N.D. Ill. Aug. 28, 2002). Plaintiffs claim instead that HUD, having already independently decided to operate the NSP, must now do so lawfully. In any event, with respect to standing, "[w]hat matters is that a plaintiff must clearly allege facts sufficient to constitute an injury in fact, but those allegations 'need not be capable of sustaining a valid cause of action.'" *Dubuisson*, 887 F.3d at 573 (quoting *Denney v. Deutsche Bank AG*, 443 F.3d 253, 264 (2d Cir. 2006)).

Monetary damages. With respect to their breach of contract claim, plaintiffs seek money damages—not to exceed $10,000 per plaintiff—and reasonable attorney's fees and costs. FAC ¶¶ 421–422. There can be no question that a monetary award in the amount of plaintiffs' actual damages would provide plaintiffs with redress. Indeed, other than with respect to plaintiff Trotman, HUD does not appear to challenge plaintiffs' standing to pursue their breach of contract claims or the redressability, through an award of monetary damages, of the injuries they allegedly sustained as a result of HUD's breach. Because her note and mortgage were never sold, Trotman of course did not incur damages from any alleged breach.

For the reasons described above, I conclude that plaintiffs Washington, Blackett, and Mason have standing to pursue Count IV, as well as Counts II and III to the extent they allege threats to neighborhood stability and the promotion of segregation. These plaintiffs, though, lack standing to pursue Count I, or to pursue Count III to the extent it alleges that their ability to remain homeowners has been impaired. I further conclude that plaintiff Trotman has standing to pursue Count II and Count III to the extent it alleges threatened neighborhood stability or the promotion of segregation, but that she lacks standing to pursue Counts I and IV, as well as Count III to the extent it alleges an impaired ability to remain a homeowner.

B. Mootness

During the oral argument held on March 6, 2018, plaintiffs' counsel represented to the Court that (1) foreclosure proceedings were never commenced against plaintiff Washington, Tr. at 109:10–13, (2) foreclosure proceedings against plaintiffs Mason and Trotman were discontinued, Tr. at 109:13–16, 110:3–7, and (3) foreclosure proceedings were commenced but, as of March 6, 2018, had not proceeded against plaintiff Blackett, causing his counsel to report that he was "not in active foreclosure proceedings at this time." Tr. at 109:21–25. Plaintiffs' counsel also represented that plaintiffs Mason and Trotman had received loan modifications since filing this action, Tr. at 109:13–16, 110:3–7, and that plaintiff Trotman in particular was, as of March 6, 2018, current on her mortgage payments and no longer in default, Tr. at 110:12–22.

In a letter following the oral argument, HUD asserted that these factual developments mooted all four plaintiffs' claims. In particular, HUD argues that the claims of plaintiffs Mason and Trotman are moot in light of the discontinuance of foreclosure proceedings against them and the subsequent "HAMP or HAMP-like" loan modifications they have received. Defs.' Mar. 13 Letter at 2. While plaintiffs' counsel did not represent that either Washington or Blackett have received loan modifications, HUD argues that the absence of active foreclosure proceedings against these plaintiffs moots their claims as well, because their claims "are based primarily on their concern that they would lose their respective homes in foreclosure proceedings after the sale of their defaulted mortgage loans in the Note Sale Program." *Id.*

Plaintiffs submitted a response arguing, among other things, that the FAC alleges that plaintiffs "are worse off for having their notes sold out of the FHA Mortgage Program," any lack of active foreclosure proceedings notwithstanding. Pls.' Mar. 19 Letter at 1. They particularly cite the loss of FHA benefits sustained by plaintiffs Washington, Blackett, and Mason and the inferior modifications, higher out-of-pocket costs, and greater risk of foreclosure in the future—particularly when the interest-only periods provided by their modifications come to an end—faced by plaintiffs Washington and Blackett. *Id.* at 2.

"A case becomes moot—and therefore no longer a 'Case' or 'Controversy' for purposes of Article III—'when the issues presented are no longer "live" or the parties lack a legally cognizable interest in the outcome.'" *Already, LLC v. Nike, Inc.*, 568 U.S. 85, 91 (2013) (citing *Murphy v. Hunt*, 455 U.S. 478, 481 (1982) (per curiam)). "No matter how vehemently the parties continue to dispute the lawfulness of the conduct that precipitated the lawsuit, the case is moot if the dispute 'is no longer embedded in any actual controversy about the plaintiffs' particular legal rights.'" *Id.* (citing *Alvarez v. Smith*, 558 U.S. 87, 93 (2009)). "[S]tanding doctrine evaluates a litigant's personal stake as of the outset of litigation." *Klein ex rel. Qlik Techs. Inc. v. Qlik Techs., Inc.*, 906 F.3d 215, 221 (2d Cir. 2018) (alteration in original) (citation omitted). However, "[m]ootness doctrine determines what to do '[i]f an intervening circumstance deprives the plaintiff of a personal stake in the outcome of the lawsuit, at any point during litigation' after its initiation." *Id.* (quoting *Genesis Healthcare Corp. v. Symczyk*, 569 U.S. 66, 72 (2013)).

The factual developments that plaintiffs' counsel acknowledged at the motion hearing do not "deprive[] the plaintiff[s] of . . . personal stake[s] in the outcome of the lawsuit." Although allegations in the FAC concerning pending or imminent foreclosure proceedings provided girth to the claims of all four plaintiffs, being subject to foreclosure proceedings is not the only harm plaintiffs claim to have suffered as a result of the NSP. As plaintiffs point out, for example, the unavailability of more favorable loan modifications available to FHA mortgagors is not completely remedied, in the case of Washington, Blackett, and Mason by less favorable modifications that may have been offered by the Caliber defendants, even if plaintiffs accepted those modifications. Moreover, as a result of the sales of their notes and mortgages, plaintiffs Washington, Blackett, and Mason no longer hold assumable mortgages. Plaintiffs' breach of contract claim seeks compensation for losses like these, and the absence of foreclosure proceedings does nothing to moot that claim. Plaintiffs' Fair Housing Act claims are likewise based upon harms separate and apart from any pending foreclosure proceedings; as discussed above, these counts include claims concerning threats to neighborhood stability and the promotion of segregation. For example, plaintiffs allege that "HUD's Note Sale Program has caused and continues to cause direct injury to African-American homeowners and predominantly African-American neighborhoods in New York City by increasing the likelihood of African-American homeowners losing their homes to foreclosure and threatening neighborhood stability." FAC ¶ 412.

For all these reasons, plaintiffs' claims are not rendered moot by events subsequent to the filing of their complaint.

I now turn to the merits of those claims I conclude are justiciable.

II. HUD's Motion to Dismiss for Failure to State a Claim

In addition to challenging the justiciability of plaintiffs' claims, HUD moves to dismiss each of them under Rule 12(b)(6) of the Federal Rules of Civil Procedure for failure to state a claim. I now consider whether those causes of action I have determined to be justiciable sufficiently state a claim upon which relief may be granted.

A. Count II: Segregated Communities Under the Fair Housing Act

1. <u>Legal Standard</u>

Plaintiffs' second cause of action is brought pursuant to a provision of the Fair Housing Act that requires the Secretary of HUD to "administer the programs and activities relating to housing and urban development in a manner affirmatively to further the policies" of the Act. 42 U.S.C. § 3608(e)(5). Plaintiffs allege that HUD failed to consider that its housing policies, and the NSP in particular, would "maintain racial segregation." FAC ¶ 398.

Plaintiffs' second cause of action invokes the Administrative Procedure Act (the "APA") as well as the Fair Housing Act, and in particular a section of the APA that provides that "[a] person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof." 5 U.S.C. § 702. A court conducting such a review is empowered and directed, *inter alia*, to "compel agency action unlawfully withheld or unreasonably delayed," *id.* § 706(1), and to "hold unlawful and set aside" agency action that it finds to be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law," *id.* § 706(2). A claim challenging agency inaction under § 706(1) "can proceed only where a plaintiff asserts that an agency failed to take a *discrete* agency action that it is *required to take*." *Norton v. S. Utah Wilderness All.* (*SUWA*), 542 U.S. 55, 64 (2004). As for claims asserted under § 706(2), although "arbitrary and capricious" is a "narrow" standard of review, the Supreme Court has held that an agency has a duty to examine "the relevant data" and to articulate "a satisfactory explanation" for its action, "including a rational connection between the facts found and the choice made." *Dep't of Commerce v. New York*, 139 S. Ct. 2551, 2569 (2019) (quoting *Motor Vehicle Mfrs. Ass'n of the U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)).

2. Application

Plaintiffs allege that HUD identified notes for sale through the NSP "without knowing whether their decisions would have a racially discriminatory impact" on African-American homeowners and predominantly African-American neighborhoods in New York City. FAC ¶ 399. Plaintiffs claim that this constitutes a violation of the Fair Housing Act, 42 U.S.C. § 3608(e)(5), and that they may assert a claim for relief for this violation under the Administrative Procedure Act, 42 U.S.C. §§ 702, 706. FAC ¶¶ 400–401.

Whether brought as a challenge to agency inaction under § 706(1) or as a challenge to arbitrary and capricious agency action not taken in accordance with law under § 706(2),[11] the FAC simply lacks the factual content to support the claim Count II asserts. Count II rests upon the contention that HUD, after failing to conduct an analysis of the impact the NSP would have on segregation in New York City, adopted the NSP, which created or maintained segregation in New York City. But the FAC contains no allegations plausibly asserting that the NSP has affected the racial makeup of plaintiffs' neighborhoods. *See Iqbal*, 556 U.S. at 679 ("While legal conclusions can provide the framework of a complaint, they must be supported by factual allegations.").

[11] Plaintiffs make clear in their briefing that their claim seeks to challenge agency action pursuant to § 706(2). Pls.' Mem. at 16.

Plaintiffs appear to be claiming that the NSP disproportionately impacted neighborhoods that were heavily African-American prior to the NSP's implementation. *See* FAC ¶¶ 86–93 (detailing the practice of "redlining" in the decades following FHA's creation in 1934, which resulted in racial segregation that persists up to the present day);[12] FAC ¶ 178 (alleging that "HUD's Note Sales conducted between 2012 and 2014 have disproportionately included mortgages in African-American communities" and providing a map illustrating this allegation); FAC ¶ 180 (asserting that "[m]ore than 61% of all New York City mortgages sold in the Note Sales from 2012 to 2014 were for homes located in predomina[nt]ly African-American neighborhoods"); FAC ¶ 182 (noting that the six neighborhoods in New York City with the most notes sold had black populations of 86.9%, 85.4%, 88.9%, 64.9%, 85.5%, and 92.2%, respectively). The FAC alleges that, as a result of the greater number of notes sold in these predominantly African-American neighborhoods, "these African-American homeowners and the neighborhoods in which they reside, are more susceptible to foreclosure, and the resultant blight, in five years," FAC ¶ 186, and "will become less stable as a result of the disproportionate number of their FHA mortgages being sold," FAC ¶ 187.

Plaintiffs' second claim fails because plaintiffs do not plausibly allege that the NSP has had or will have any impact on the racial composition of their communities and neighborhoods. Plaintiffs do allege that homes secured by notes sold pursuant to the NSP are more likely to be foreclosed upon than those whose owners maintain their FHA benefits. FAC ¶ 186. But they do not allege facts that suggest that these foreclosures will impact the racial composition of the communities where plaintiffs reside. For example, plaintiffs do not allege that foreclosed homes are more likely to be purchased by individuals of a particular race, or that the degree of

[12] The practice of "redlining" is presented as context for the racial wealth gap that remains today, rather than as a basis for HUD's liability in this case.

integration or segregation of plaintiffs' communities has changed since the NSP was implemented or because of it. Simply put, plaintiffs allege no facts from which it might plausibly be inferred that the NSP is causing or maintaining segregation.

For these reasons, I respectfully recommend that Count II be dismissed. Because I recommend dismissal for the reasons set forth above, I do not reach the other arguments in support of dismissal urged by HUD.

B. Count III: Disparate Impact Under the Fair Housing Act

1. Legal Standard

Plaintiffs bring their third cause of action pursuant to the Fair Housing Act, 42 U.S.C. § 3604. Section 3604(a) makes it unlawful, as pertinent here, "[t]o . . . make unavailable or deny[] a dwelling to any person because of race, color, religion, sex, familial status, or national origin." Section 3604(b) similarly makes it unlawful, as pertinent here, "[t]o discriminate against any person in the terms, conditions, or privileges of sale . . . of a dwelling, or in the provision of services . . . in connection therewith, because of race, color, religion, sex, familial status, or national origin."

Plaintiffs' § 3604 claim alleges that the NSP disparately impacts African-Americans who purchased their homes with FHA mortgages. FAC ¶ 408. A disparate impact claim "challenges practices that have a disproportionately adverse effect on minorities and are otherwise unjustified by a legitimate rationale." *Tex. Dep't of Hous. & Cmty. Affairs v. Inclusive Communities Project, Inc.* (*ICP*), 135 S. Ct. 2507, 2513 (2015). The Supreme Court has clearly established that disparate impact claims are cognizable under the Fair Housing Act. *Id.* at 2525.

Although the Second Circuit had previously applied a more traditional burden-shifting test to disparate impact claims, in 2016 it adopted a slightly different test drawn from a 2013

HUD regulation. *MHANY Mgmt., Inc. v. County of Nassau*, 819 F.3d 581, 617 (2d Cir. 2016). Under this newer test, initially "the plaintiff . . . has the burden of proving that a challenged practice caused or predictably will cause a discriminatory effect." 24 C.F.R. § 100.500(c)(1). Once this burden is met, "the . . . defendant has the burden of proving that the challenged practice is necessary to achieve one or more substantial, legitimate, nondiscriminatory interests of the . . . defendant." *Id.* § 100.500(c)(2). Finally, if the defendant meets this burden, "the . . . plaintiff may still prevail upon proving that the substantial, legitimate, nondiscriminatory interests supporting the challenged practice could be served by another practice that has a less discriminatory effect." *Id.* § 100.500(c)(3).

While it recognized in *ICP* that disparate impact claims could be brought under the Fair Housing Act, the Supreme Court, in dicta, at the same time strongly cautioned lower courts addressing such claims: "[D]isparate-impact liability has always been properly limited in key respects to avoid serious constitutional questions that might arise under the [Fair Housing Act], for instance, if such liability were imposed based solely on a showing of a statistical disparity." *ICP*, 135 S. Ct. at 2522. Accordingly, the Court held that plaintiffs asserting disparate impact must satisfy a "robust causality requirement" and noted that "[a] plaintiff who fails to allege facts at the pleading stage or produce statistical evidence demonstrating a causal connection cannot make out a prima facie case of disparate impact." *Id*. at 2523. The *ICP* Court went on to point out that "[g]overnmental . . . policies are not contrary to the disparate-impact requirement unless they are 'artificial, arbitrary, and unnecessary barriers'" to housing, and stressed that "[c]ourts should avoid interpreting disparate-impact liability to be so expansive as to inject racial considerations into every housing decision." *Id.* at 2524 (quoting *Griggs v. Duke Power Co.*, 401 U.S. 424, 431 (1971)). Nevertheless, noting that the requirements for establishing a prima facie case set an evidentiary standard and not a pleading requirement, at least one court has subsequently concluded that "*ICP* did not alter the plausibility standard for pleading, which requires only the plaintiff plead allegations that plausibly give rise to an inference that the challenged policy causes a disparate impact." *Winfield*, 2016 WL 6208564, at *6 (citing *Vega v. Hempstead Union Free Sch. Dist.*, 801 F.3d 72, 87 (2d Cir. 2015) and *Iqbal*, 556 U.S. at 678). Thus, "at the pleading stage, [p]laintiffs are merely required to plausibly plead disparate impact; they are not required to prove causation or disparate impact through statistical evidence at the pleading stage." *Id.*

2. Application

The FAC asserts that "by auctioning FHA mortgages to private investors that refuse to offer HAMP or HAMP-like mortgage modifications, and that only offer more expensive and unsustainable modification products, HUD violates sections 3604(a) and 3604(b) of the Fair Housing Act by making housing unavailable to African-American homeowners, imposing less favorable terms, conditions and privileges of sale, and providing discriminatory services in connection with the sale of a dwelling." FAC ¶ 410. The FAC accuses HUD of veering from its § 3604 obligations by "fail[ing] to employ practices . . . with a less discriminatory effect, including ensuring that the FHA homeowners receive the benefits to which they are entitled and working with the homeowner before selling the loans through the Note Sale Program." FAC ¶ 411. Furthermore, the FAC asserts that it is HUD's responsibility also to "ensur[e] that every homeowner with an FHA mortgage who qualifies for a HAMP modification be provided with an affordable HAMP modification." FAC ¶ 411.

Plaintiffs' contention that HUD's administration of the NSP disparately impacts African Americans is based on certain statistical data included in the FAC. Plaintiffs allege that, while

African Americans comprised 36% of New York City homeowners who obtained an FHA mortgage during 2012 through 2014, 61% of New York City mortgages sold pursuant to the NSP during this time were secured by homes in predominantly African-American neighborhoods. FAC ¶¶ 179–180. Plaintiffs also assert that, in the six New York City neighborhoods with the largest number of mortgages sold through the NSP, African Americans comprise between 64.9% and 92.2% of the population. FAC ¶ 182. Based upon this data, plaintiffs allege that the sale of mortgages as part of the NSP "makes housing unavailable to African-American homeowners in New York City in violation of section 3604(a)." FAC ¶ 409. The mortgage sales make housing unavailable, plaintiffs contend, because "[o]ver a third of all the mortgages sold through the Note Sale Program result in foreclosure post-sale and only 7% of mortgages sold through the Note Sale Program have resulted in a home-saving solution, such as a modification." FAC ¶ 409.

HUD challenges the data upon which plaintiffs base their disparate impact claim as incongruent: "Plaintiffs compare the percentage of homes sold through [the NSP] that were located in African-American neighborhoods with the percentage of FHA borrowers who are African-American and allege that the resulting statistic demonstrates a disparity based on race. . . . [T]o allege a disparity based on race . . . , Plaintiffs need to show that, among borrowers holding [sale]-eligible loans, the loans sold through [the NSP] were disproportionately held by African-American borrowers (compared with non-African-American borrowers)." Defs.' Mem. at 34.

The incongruity HUD points out is troubling. Certainly, a direct comparison of the percentage of African American homeowners who have defaulted on FHA mortgages with the percentage of those whose notes and mortgages were sold under the NSP would provide a far more compelling indication of whether African Americans have been disparately impacted by the NSP. Plaintiffs, moreover, do not explain why they elected to compare the race of *individuals* who hold FHA mortgage loans with the racial makeup of the *neighborhoods* where homes secured by mortgage loans that are ultimately sold under the NSP are located. To this point, it is particularly concerning that the FAC defines "predominantly African-American neighborhoods" as those comprised of as little as 50.1% individuals who identify as African-American or black. FAC ¶ 180 n.6. By this definition, it is certainly possible that some, perhaps even many, of the homeowners in those neighborhoods whose notes have been sold under the NSP are not African-Americans.

Although there are substantial weaknesses in plaintiffs' statistical showing, they must be considered in light of the current procedural posture of this case. It is not plaintiffs' burden at the Rule 12 stage to *establish* their prima facie case. Rather, it is plaintiffs' burden to plead facts, including statistical data, that make their prima facie showing plausible. The weaknesses in the FAC's statistical comparisons go more to probability than plausibility. *See Iqbal*, 556 U.S. at 678 (clarifying that "[t]he plausibility standard is not akin to a 'probability requirement,' but it asks [only] for more than a sheer possibility that a defendant has acted unlawfully"). Several courts considering allegedly flawed statistical comparisons have similarly concluded that weaknesses in underlying data do not necessarily warrant dismissal. *See, e.g.*, *Nat'l Fair Hous. All. v. Fed. Nat'l Mortg. Assoc.*, 294 F. Supp. 3d 940, 948 (N.D. Cal. 2018) ("[S]pecific contentions about alleged deficiencies in methodology go to the weight of the evidence and are not dispositive of the determination whether Plaintiffs have adequately pled discrimination at this [motion to dismiss] procedural stage."); *Brown v. City of New York*, 2017 WL 1102677, at *6 (E.D.N.Y. Mar. 23, 2017) ("[S]tatistics that may ultimately prove insufficient can nevertheless support a plausible inference of disparate impact on a motion to dismiss."); *Adkins v. Morgan*

Stanley, 2013 WL 3835198, at *10 (S.D.N.Y. July 25, 2013) ("Plaintiffs' statistical allegations need not definitely establish causation at [the pleading] stage. Rather, Plaintiffs' allegations . . . are sufficient to give notice to [defendant] of a plausible claim of disparate impact. Whether those statistics may prove insufficient at a later date is not now a question before this court."); *Jenkins v. N.Y.C. Transit Auth.*, 646 F. Supp. 2d 464, 469 (S.D.N.Y. 2009) ("It would be inappropriate to require a plaintiff to produce statistics to support her disparate impact claim before plaintiff has had the benefit of discovery.").

Here, while there is a disconcerting apples-and-oranges aspect to the data presented by plaintiffs, the discrepancy suggested by the data is stark: 36% of FHA mortgagors vs. 61% of notes and mortgages sold pursuant to the NSP. Furthermore, there are other facts alleged in the FAC that buttress the inference plaintiffs seek to draw from the limited statistical data they provide. For instance, the FAC alleges that while the disparity between these two figures for African-Americans is 26 percentage points, it is far less (or even inverse) for other racial groups. *See* FAC ¶ 181 (showing that, from 2012 to 2014, 27% of FHA borrowers in New York City were white, while only 15.5% of notes sold were secured by homes in predominantly white neighborhoods; that 19% of FHA borrowers were Hispanic, while only 19.9% of notes sold were secured by homes in predominantly Hispanic neighborhoods; and that 9% of FHA borrowers were Asian, while only 3.5% of notes sold were secured by homes in predominantly Asian neighborhoods). Additionally, although it is possible under the FAC's definition of "predominantly African-American" that African-Americans in a community barely constitute a majority, that does not appear to be the case in the six neighborhoods that represent the most notes sold during the relevant time period. *See* FAC ¶ 182 (identifying "(i) Springfield Gardens with a black population of 86.9%; (ii) Canarsie with a black population of 85.4%; (iii) St. Albans with a black population of 88.9%; (iv) Jamaica with a black population of 64.9%; (v) Rosedale with a black population of 85.5%; and (vi) Laurelton with a black population of 92.2%").

The statistical data advanced in the FAC makes a very thin showing of disparate impact. Nevertheless, the allegations in the FAC appear to be sufficient, if just barely, to "nudge[] [plaintiffs' disparate impact] claims across the line from conceivable to plausible." *Twombly*, 550 U.S. at 570.

For the reasons discussed below, though, I nevertheless recommend that Count III be dismissed. As discussed in Section I.A.3 above, plaintiffs' third claim has two distinct aspects. First, it appears that plaintiffs are contending that the disparate impact of the NSP results in higher foreclosure rates that in turn increase instability in the largely African-American communities where plaintiffs reside, causing them injury. Second, plaintiffs' third cause of action may be understood as alleging that plaintiffs Washington, Blackett, and Mason were subjected to a greater likelihood that their notes would be sold, and their FHA benefits lost, because of their race or the racial makeup of their communities. I concluded in Section I.A.3 that plaintiffs lack standing to assert this latter claim because the relief they seek—declaratory and injunctive relief—would not redress this latter aspect of the injury claimed in Count III.

As for the former aspect—that the NSP has had a disparate impact by destabilizing predominantly African-American neighborhoods—although I have determined above that plaintiffs have standing to assert this aspect of their third claim, I now conclude that they fail to allege sufficient facts showing that the NSP causes this aspect of the injuries for which Count III seeks relief. First, plaintiffs fail to allege that the number of foreclosures in their communities has in fact been affected by the NSP; no data about actual foreclosures in plaintiffs' neighborhoods is provided in the FAC. Even if the facts alleged did give rise to a plausible inference that mortgages on homes in plaintiffs' communities secured by notes sold through the NSP are more likely to be foreclosed upon, plaintiffs have failed to allege facts showing that any increase in foreclosures has caused the blight or instability in their neighborhoods that is the gravamen of this aspect of their claim. Plaintiffs have not alleged, for example, that foreclosed homes in their communities remain vacant and unsold for long periods of time, or that retail food markets or drug stores have left their neighborhoods because so many homes are unoccupied that the customer base has declined. Without such allegations, plaintiffs' contention that a greater number of note sales in their largely African-American neighborhoods results in instability in those neighborhoods is merely conclusory and insufficient to defeat a motion to dismiss. *See Iqbal*, 556 U.S. at 678. I therefore respectfully recommend that HUD's motion to dismiss Count III be granted.

C. Count IV: Breach of Implied-in-Fact Contract

1. Legal Standard

Plaintiffs' fourth cause of action is for breach of an implied-in-fact contract with HUD. FAC ¶¶ 415–422. Plaintiffs' claim for breach is governed by federal common law. *See EEOC v. Fed. Express Corp.*, 268 F. Supp. 2d 192, 204 (E.D.N.Y. 2003) ("[C]ontracts with the federal government are governed by federal common law, which incorporates 'the core principles of the common law of contract[s] that are in force in most states.'" (internal citation omitted) (quoting *United States v. Nat'l Steel Corp.*, 75 F.3d 1146, 1150 (7th Cir. 1996))). Under federal common law, "[a]n implied-in-fact contract is one 'founded upon a meeting of the minds, which, although not embodied in an express contract, is inferred, as a fact, from conduct of the parties showing, in the light of the surrounding circumstances, their tacit understanding.'" *City of Cincinnati v. United States*, 153 F.3d 1375, 1377 (Fed. Cir. 1998) (quoting *Balt. & Ohio R.R. Co. v. United*

States, 261 U.S. 592, 597 (1923)). "An implied-in-fact contract with the Government requires proof of (1) mutuality of intent, (2) consideration, (3) an unambiguous offer and acceptance, and (4) 'actual authority' on the part of the Government's representative to bind the Government in contract." *Turping v. United States*, 913 F.3d 1060, 1065 (Fed. Cir. 2019) (citation omitted).

2. Application

Plaintiffs' contention that HUD has implied contractual obligations to them rests on plaintiffs' payments of the UFMIP and monthly MIP. The FAC alleges that these payments, coupled with plaintiffs' initial choice to obtain an FHA mortgage, demonstrate plaintiffs' intent to contract with HUD, FAC ¶ 416, that these payments were made as consideration for the benefits of the FHA mortgage program, FAC ¶ 415, and that "[o]ffer and acceptance is unambiguous through Plaintiffs' tendering of [these payments] and Federal Defendants' acceptance of [them]," FAC ¶ 418. The FAC finds evidence of HUD's intent to contract with plaintiffs in the regulations, Handbook, mortgagee letters, and other HUD-published guidance with respect to the UFMIP and monthly MIP, the incorporation of these payments in closing and monthly mortgage statements, and the determination of eligibility for FHA benefits. FAC ¶ 417. As for the fourth element—actual authority to bind the government—the FAC alleges that the authority of the Secretary of HUD and the FHA Commissioner is manifested in their pronouncement of the regulations, Handbook provisions, mortgagee letters, and guidelines implementing the FHA mortgage program. FAC ¶ 419.

Plaintiffs further contend in their motion papers that "all relevant parties have, as a matter of fact, treated the mortgage insurance premiums paid by Plaintiffs as payments to HUD in consideration for the FHA Benefits." Pls.' Mem. at 28. "In short," plaintiffs argue, "the [F]AC alleges that, notwithstanding Congressional intent or regulatory text, HUD's conduct objectively manifests its expectation that borrowers will pay FHA mortgage insurance premiums to HUD." *Id.* at 29. The "[m]ost important" indicia of this allegedly mutual understanding, in plaintiffs' view, is that "the standard form FHA mortgage contract prepared by HUD and used by all FHA lenders treats the mortgage insurance premium as the borrower's responsibility." *Id.* at 29. Plaintiffs point to the allegation in the FAC that "[p]aragraph 3 of FHA's form mortgage contract requires the loan owner to apply payment to MIP first from the homeowner's monthly payment on the account." FAC ¶ 38. This, plaintiffs urge, "confirms HUD's understanding that the premiums will as a matter of course be paid out of borrowers' money to HUD." Pls.' Mem. at 29.

The thrust of HUD's argument is that no implied-in-fact contract existed for them to breach. HUD argues, first, that *United States v. Neustadt*, 366 U.S. 696 (1961), holds that no legal relationship exists between HUD and FHA mortgagors like plaintiffs. Defs.' Mem. at 25. Second, HUD asserts that the FHA benefits, which plaintiffs claim to be consideration due to them for their UFMIP and monthly MIP payments, are actually intended to benefit the government, as the provider of mortgage insurance, rather than plaintiffs. *Id.* at 25–26. Finally, HUD argues that the text of the National Housing Act, its implementing regulations, and Supreme Court precedent undercut plaintiffs' assertion that an implied-in-fact contract was formed. *Id.* at 26.

Plaintiffs argue that whether there is an implied-in-fact contract is a question of fact that cannot be resolved on a motion to dismiss. Pls.' Mem. at 29–30. However, their assertion that, because mortgagees pay insurance premiums to HUD with funds received from homeowner borrowers, an implied contractual relationship arises between homeowners and HUD, is a legal conclusion. It is well-established that "the tenet that a court must accept as true all of the allegations contained in a complaint is inapplicable to legal conclusions." *Iqbal*, 556 U.S. at 678. Here, a review of the pertinent statutes, regulations and case law belies plaintiffs' contention that homeowners are legally responsible for paying insurance premiums to HUD.

I note at the outset that HUD's contention that *Neustadt* controls is, at a minimum, overstated. The question presented in *Neustadt* was "whether the United States may be held liable, under the Federal Tort Claims Act . . . to a purchaser of residential property who has been furnished a statement reporting the results of an inaccurate FHA inspection and appraisal, and who, in reliance thereon, has been induced by the seller to pay a purchase price in excess of the property's fair market value." 366 U.S. at 697–98. After examining the legislative history of the National Housing Act, the Court found "that the primary and predominant objective of the appraisal system was the 'protection of the Government and its insurance funds'; that the mortgage insurance program was not designed to insure anything other than the repayment of loans made by lender-mortgagees; and that 'there is no legal relationship between the FHA and the individual mortgagor.'" *Id.* at 709 (quoting H.R. Conf. Rep. No. 2271, 83d Cong., 2d Sess., pp. 66–67). Because *Neustadt* was decided in the context of a claim brought under the Federal Tort Claims Act, whether it applies to a claim of breach of an implied-in-fact contract is unclear. *See Vaughn v. Consumer Home Mortg., Inc.*, 293 F. Supp. 2d 206, 213 (E.D.N.Y. 2003) (finding *Neustadt* inapposite where plaintiffs' claim arose out of the Administrative Procedure Act rather than the Federal Tort Claims Act); *Bailey v. Romney*, 359 F. Supp. 596, 600 (D.D.C. 1972) (holding that "*Neustadt* held simply that there was no remedy under the Tort Claims Act for the complaint involved in that case" and finding it inapplicable to the Section 235 Existing Home Program provisions of the National Housing Act). *Neustadt*, moreover, involved the accuracy of an appraisal and inspection; these events typically occur before a mortgage and note are executed, and accordingly before a homeowner would be called upon to pay any of the mortgage insurance premiums that plaintiffs assert give rise to an implied-in-fact contract.

Although *Neustadt* may not be controlling, the relevant statutes, regulations and case law demonstrate that plaintiffs' contentions regarding premium payments are insufficient to impose any contractual obligation on HUD. The section of the National Housing Act that authorizes HUD to insure mortgage loans provides that insurance premium charges "shall be payable by the mortgagee." 12 U.S.C. § 1709(c)(1); *see also* 12 U.S.C. § 1710(a)(7) (referring to circumstances under which "[t]he obligation of the mortgagee to pay the premium charges for insurance shall cease"). Indeed, the FAC acknowledges as much. FAC ¶ 38. Accordingly, the explicit language of the statute provides no basis for inferring that homeowners with FHA mortgages have any obligation to pay premiums to HUD.

The regulations governing the MIP further support this conclusion in that they explicitly state that the MIP must be paid by the mortgagee. *See* 24 C.F.R. § 203.259 (providing that "[t]he payment of any MIP . . . shall be made to the Commissioner by the mortgagee"); *id.* § 203.251(k) (defining MIP as "the mortgage insurance premium paid *by the mortgagee* to the Commissioner in consideration of the contract of insurance" (emphasis added)). With respect to plaintiffs' contention that mortgagees merely pass on insurance payments they receive from homeowners, it is particularly noteworthy that these same regulations nowhere indicate that the mortgagee's obligation to pay premiums ceases upon a mortgagor's default. *See* 24 C.F.R. §§ 203.259–203.288. To the contrary, the governing statute articulates circumstances under which a mortgagee's obligation to pay premiums terminates, and a homebuyer's default is not among them. 12 U.S.C. § 1710(a)(7). The regulations likewise appear to provide that the mortgagee's responsibility to pay insurance premiums to HUD terminates only upon the termination of the contract of insurance itself. 24 C.F.R. § 203.321.

It is also clear from the regulations that a mortgagor's default does not, by operation of law, terminate the contract of insurance. For instance, the regulations provide that "[i]f after default and prior to the completion of foreclosure proceedings the mortgagor shall cure the default, the insurance shall continue as if a default had not occurred, provided the mortgagor pays to the mortgagee such expenses as the mortgagee has incurred in connection with the foreclosure proceedings and the mortgagee gives written notice of reinstatement to the Commissioner." 24 C.F.R. § 203.333. By providing that insurance will "continue" rather than be "restored" or "reinstituted," the regulations clearly contemplate that a mortgagor's default does not itself impact the contract of insurance. This underscores the notion that the obligation to pay MIP rests with the mortgagee, not the homebuyer, regardless of whether the homebuyer-mortgagor remits funds to the mortgagee that the mortgagee in turn uses to satisfy that obligation. It is accordingly clear that the contract of insurance is between HUD and the mortgagee and does not give rise to an implied contract between HUD and the mortgagor.

Nor is there any logical basis for concluding that a lender's use of funds remitted by a borrower to pay a fee gives rise to an implied contract between the payee and the borrower. An analogy in the context of purchasing a home makes the point. Typically, when a homebuyer pays for settlement services at a closing, the lender's attorney is essentially paid with funds derived from closing costs paid by the homebuyer.[13] It is self-evident, however, that this

[13] Under the Real Estate Settlement Procedures Act ("RESPA"), the Director of the Consumer Financial Protection Bureau is directed to develop "a booklet to help consumers applying for federally related mortgage loans to understand the nature and costs of real estate settlement services," and to "distribute such booklets to all lenders that make federally related mortgage loans." 12 U.S.C. § 2604(a). The booklet must include "a good faith estimate of the amount or range of charges for specific settlement services the borrower is likely to incur in connection with the settlement as prescribed by the Bureau." *Id.* § 2604(c). "Settlement services" is a term of art, which, under RESPA, includes "services rendered by an attorney." *Id.* § 2602(3).

circumstance does not create an attorney-client relationship between the lender's attorney and the homebuyer or otherwise place them in contractual privity. So too here, even on the facts as alleged in the FAC, there is no logical basis to conclude that the language of the standard form FHA mortgage contract puts HUD and the homebuyer in privity with one another.

The applicable case law, though sparse, is consistent with this reading of the statute and regulations. While as discussed above *Neustadt* may not be controlling authority, the Supreme Court did in that case review the legislative history of the National Housing Act, and described that legislative history as "repeatedly emphasiz[ing] . . . that there is no legal relationship between the FHA and the individual mortgagor." 366 U.S. at 709 (internal quotation marks omitted).

Moreover, although plaintiffs rely on *Cason v. United States*, 381 F. Supp. 1362 (W.D. Mo. 1974), *aff'd sub nom. Summers v. United States*, 510 F.2d 123 (8th Cir. 1975), their reliance is misplaced; upon close reading, it becomes clear that *Cason* supports HUD's position, not the argument made by plaintiffs. In fact, the portion of the opinion relied upon by plaintiffs is not the reasoning of the *Cason* court, but rather a quotation by the court from the *Cason* plaintiffs' briefing. The argument made by plaintiffs in *Cason* went as follows: "The mortgagor takes on the purchase of the home as the down payment is lowered by having the FHA insure the mortgage. The mortgagor as part of his monthly payment pays an FHA insuring premium. Surely the exchange of consideration between the mortgagor-purchaser and the FHA e[s]tablishes an expressed contract as well as an implied contract which falls within the purview of the Tucker Act." 381 F. Supp. at 1366 (quoting from *Cason* Plaintiffs' Suggestions on Defendants' Motion to Dismiss). The court in *Cason* responded to this argument by stating that "[t]he invalidity of plaintiffs' premises fatally flaws their contract theories" primarily because "the mortgagor does not pay the insurance premium; it is paid by the mortgagee." *Id.* at 1367. In so holding, the court relied upon the statutory and regulatory framework in its then-current form, *id.* at 1367 n.35, just as HUD does here in support of its motion to dismiss. *Cf. United States v. Chelsea Towers, Inc.*, 295 F. Supp. 1242, 1247 (D.N.J. 1967) (noting, albeit in a different context, that "[n]either the [National Housing] Act, nor the FHA regulations implementing it . . . created any legal relationship between the Government, or the FHA, and the individual mortgagors").

While *Cason*, a decision by an out-of-circuit district court, is not binding authority, the court's reasoning in that case is persuasive. Nor do plaintiffs point to any contrary authority supporting their contention that, because the homebuyer, at least if not in default, is typically the *source* of the funds used by the lender to pay the MIP to HUD, a mutual intent to contract is formed between that homebuyer and HUD.

For these reasons, I respectfully recommend that HUD's motion to dismiss Count IV be granted.

III. Plaintiffs' Motion to Amend

By separate motion, Dkt. 66, plaintiffs seek leave to file a second amended complaint, Decl. of Douglas Lieb Ex. A ("Proposed SAC"), Dkt. 67-1, that would alter the FAC by adding a cause of action ("Proposed Count IX") under the APA. The APA requires agencies to follow certain procedures, including publishing proposed rules in the Federal Register and providing interested persons an opportunity to comment on them. *See* 5 U.S.C. § 553. The procedures required by § 553 apply to substantive and legislative rules, but not to "interpretive rules, general statements of policy, or rules of agency organization, procedure, or practice." 5 U.S.C.

§ 553(b)(A). Substantive or legislative rules are "those that 'create new law, rights, or duties, in what amounts to a legislative act.'" *Sweet v. Sheahan*, 235 F.3d 80, 91 (2d Cir. 2000).

Proposed Count IX alleges that HUD unlawfully failed to engage in notice-and-comment rulemaking before implementing the NSP. HUD opposes plaintiffs' motion in large part by arguing that Proposed Count IX is time-barred. For the reasons described below, I respectfully recommend that plaintiffs' motion to amend be denied.

A. Relevant Facts

The following facts, relevant solely to plaintiffs' motion to amend and therefore not presented above, are drawn from the Proposed SAC and assumed to be true. *See Quintanilla v. Suffolk Paving Corp.*, 2012 WL 4086805, at *6 (E.D.N.Y. Sep. 17, 2012) ("[O]n a motion to amend, the Court must accept the facts in the proposed amended complaint as true." (citing *Aetna Cas. & Sur. Co. v. Aniero Concrete Co.*, 404 F.3d 566, 604 (2d Cir. 2005))).

The parties dispute the legal significance of the events that gave rise to the NSP, but agree in general terms that several key statutory developments and publications in the Federal Register frame the Court's analysis. *Compare* Pls.' Rule 15 Mem. at 1–3 (describing events preceding the NSP as it existed in 2014), *with* Defs.' Rule 15 Mem. at 1–4 (same).

HUD is authorized to conduct "such programs of research, studies, testing, and demonstration relating to the mission and programs of the Department as [the Secretary] determines to be necessary and appropriate." 12 U.S.C. § 1701z-1. In 1999, Congress amended the National Housing Act to permit HUD to pay claims to mortgagees on defaulted FHA-insured mortgages prior to foreclosure and sale, in return for assignment of the mortgage, and it is pursuant to this authority that HUD conducted the note sales plaintiffs challenge in this lawsuit. Proposed SAC ¶ 107; 12 U.S.C. § 1710.

According to an audit issued by HUD's inspector general in 2017, HUD established a "demonstration program" pursuant to which it conducted four note sales between 2002 and 2005. Inspector General's Audit, 2017-KC-0006, Proposed SAC Ex. A ("Audit") at 3, Docket Entry 67-1.[14] One year after the last sale under the demonstration program, HUD published a notice of proposed rulemaking that solicited comment on an Accelerated Claim and Asset Disposition Program ("ACD Program"), which plaintiffs describe as a precursor to the NSP. Proposed SAC ¶ 198; Accelerated Claim and Asset Disposition (ACD) Program; Advance Notice of Proposed Rulemaking ("ANPRM"), 71 Fed. Reg. 32392 (June 5, 2006). The ANPRM contains language that unambiguously demonstrates its preliminary character, in that it seeks comments "before HUD issues a proposed rule to codify the requirements for the ACD program. When codified, the ACD program will become a permanent part of HUD's single family mortgage insurance programs." ANPRM at 32392. No proposed rule was ever issued, however, and no period for public comment was established. Proposed SAC ¶ 198. Moreover, in a public notice published in 2007, HUD announced that it had withdrawn the ANPRM. *See* Unified Agenda, 72 Fed. Reg. 22694 (Apr. 30, 2007). Nonetheless, and without any further notice-and-comment rulemaking, HUD implemented the NSP on September 22, 2010. Proposed SAC ¶ 100.

In its 2017 Audit, HUD's Inspector General makes reference to the demonstration program held between 2002 and 2005, and points out that, "[a]fter a nearly 5-year pause, HUD continued the note sales program referring to it as the Single Family Loan Sales program." Audit at 3. Later, the Audit adds that in 2012, "the name of the program was changed to the Distressed Asset Stabilization Program (DASP)." *Id.* The Audit reports that HUD sold 108,616 loans representing more than $18 billion in unpaid principal between 2010 and 2016. *Id.*

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[14] The Audit is attached as an exhibit to the Proposed SAC and therefore properly considered in deciding plaintiffs' motion for leave to amend.

The Audit's purpose was "to determine whether HUD conducted rulemaking for its single-family note sales program." *Id.* at 4. The Audit concluded that HUD had not done so, and that "[w]e believe DASP is a substantive rule, which would be subject to . . . Administrative Procedure Act rulemaking requirements." *Id.* at 5. The Audit observes that "[a]s a result of HUD's not conducting rulemaking . . . participants were not given the opportunity to provide comments for a more than $18 billion program." *Id.* at 6. The Inspector General recommends in the Audit that HUD "complete the rulemaking process and develop formal guidance for administering the program." *Id.* at 7.

Plaintiffs seek to bring Proposed Count IX pursuant to APA § 553, predicated on HUD's failure to engage in notice-and-comment rulemaking before implementing the NSP. *See* Proposed SAC ¶¶ 478–485. Specifically, plaintiffs contend that the NSP amounts to a substantive rule for which the notice-and-comment rulemaking procedure was required, and that the agency's failure in that regard renders unlawful all of the note sales HUD has conducted. *Id.* ¶ 481. Plaintiffs contend in the alternative that even if not *all* aspects of the NSP are unlawful, at least the version of the program that began in 2012—DASP, through which plaintiffs' loans were sold—is unlawful. *Id.* ¶ 482. The additional relief plaintiffs seek for the first time in the Proposed SAC (and presumably in connection with Proposed Count IX) is "[a]n order nullifying, vacating, and setting aside the sale by Federal Defendants of Plaintiffs' and Class members' mortgage notes." *Id.* at 89.

B. Legal Standards Governing Motions for Leave to Amend

Rule 15(a)(2) of the Federal Rules of Civil Procedure provides that leave to amend should be given "freely . . . when justice so requires." Nevertheless, leave should not be granted "in instances of futility, undue delay, bad faith or dilatory motive, repeated failure to cure deficiencies by amendments previously allowed, or undue prejudice to the nonmoving party." *Burch v. Pioneer Credit Recovery, Inc.*, 551 F.3d 122, 126 (2d Cir. 2008) (per curiam).

HUD challenges plaintiffs' proposed amendment primarily on grounds of futility and bears the burden of establishing that amendment would be futile. *See Arnold v. Research Found. for State Univ. of N.Y.*, 216 F. Supp. 3d 275, 283 (E.D.N.Y. 2016). "Amendment is futile where the 'proposed amended complaint would be subject to immediate dismissal.'" *Coal. for a Level Playing Field, L.L.C. v. Autozone, Inc.*, 813 F. Supp. 2d 557, 565 (S.D.N.Y. 2011) (quoting *Jones v. N.Y. State Div. of Military & Naval Affairs*, 166 F.3d 45, 55 (2d Cir. 1999)). "[T]he legal standard for futility is identical to the standard for dismissing a claim pursuant to Rule 12(b)(6), [and] a court evaluating a motion to amend a pleading must [therefore] take the allegations of the complaint as true and draw all reasonable inferences in favor of the plaintiff." *Steele v. Paypal, Inc.*, 2006 WL 3612852, at *1 (E.D.N.Y. Dec. 11, 2006) (internal quotation marks and citation omitted). Ultimately, "[t]he decision to grant or deny a motion to amend lies within the sound discretion of the district court." *UMG Recordings, Inc. v. Lindor*, 2006 WL 3335048, at *1 (E.D.N.Y. Nov. 9, 2006) (citing *Foman v. Davis*, 371 U.S. 178, 182 (1962)).

C. Standing

HUD first challenges plaintiffs' motion to amend as futile on the ground that plaintiffs lack standing to assert Proposed Count IX. As noted above, Proposed Count IX alleges that HUD failed to publish rules for the NSP and allow public comment about those rules as required by 5 U.S.C. § 553.

Whether plaintiffs have standing to pursue Proposed Count IX is determined by the same standard applicable to plaintiffs' other claims and discussed at length earlier in this Report. To recap briefly, to have standing, a plaintiff must have "(1) suffered an injury in fact, (2) that is fairly traceable to the challenged conduct of the defendant, and (3) that is likely to be redressed by a favorable judicial decision." *John*, 858 F.3d at 736 (internal quotation marks omitted) (quoting *Spokeo*, 154 S. Ct. at 1547). With respect to Proposed Count IX in particular, "an alleged procedural violation can by itself manifest concrete injury where Congress conferred the procedural right to protect a plaintiff's concrete interests and where the procedural violation presents a 'risk of real harm' to that concrete interest." *Strubel v. Comenity Bank*, 842 F.3d 181, 190 (2d Cir. 2016) (quoting *Spokeo*, 154 S. Ct. at 1549). Moreover, "[f]or standing purposes, petitioners need not prove a cause-and-effect relationship with absolute certainty; substantial likelihood of the alleged causality meets the test. This is true even in cases where the injury hinges on the reactions of the third parties . . . to the agency's conduct." *NRDC v. NHTSA*, 894 F.3d at 104 (quoting *Competitive Enter.*, 901 F.2d at 113); *see also Sierra Club v. EPA*, 699 F.3d 530, 533 (D.C. Cir. 2012) (finding a concrete and redressable injury where EPA's failure to engage in notice-and-comment rulemaking resulted in club being unable to present its case for more stringent standards directly to the agency).

Proposed Count IX alleges that plaintiffs are among those whose mortgage notes were sold "without observance of procedure required by law." Proposed SAC ¶¶ 481–482. The injuries sustained by plaintiffs when their notes were sold and their FHA benefits lost are discussed in detail above in this Report. Accordingly, plaintiffs' Proposed Count IX asserts an injury sufficient for purposes of standing.

Plaintiffs' asserted injury under Proposed Count IX is also fairly traceable to HUD, which allegedly implemented a note sale program without completing the rule-making process required by law. Had HUD provided notice and sought comments, it might have been persuaded to alter the NSP to provide, for example, that homeowners would retain some or all of their FHA benefits even after their notes and mortgages were sold.

Finally, plaintiffs' injuries are redressable through the relief they seek: to have the sales of their notes unwound. Proposed SAC Prayer for Relief ¶ iv. If the Court were to grant this relief, plaintiffs' notes would be returned to the FHA mortgage insurance program and plaintiffs' benefits under the program would be restored. Plaintiffs' alleged injury—exposure to more onerous loan terms and a heightened risk of foreclosure—would as a result be redressed.

For these reasons, I conclude that plaintiffs have standing to assert Proposed Count IX.

D. Timeliness

HUD next asserts that amending would be futile because Proposed Count IX is untimely. It is undisputed that the applicable statute of limitations is six years. *See* Pls.' Rule 15 Mem. at 12; Defs.' Rule 15 Mem. at 7; *see also* 28 U.S.C. § 2401(a) (barring "every civil action commenced against the United States . . . unless the complaint is filed within six years after the right of action first accrues"); *Manners v. U.S. Gov't Sec'y of Def.*, 242 Fed. App'x 723, 725 (2d Cir. 2007) (summary order) (pointing out that actions under the APA are subject to the limitations period set out in § 2401). The parties' disagreement centers on when plaintiffs' Proposed Count IX accrued.

Where a plaintiff brings a challenge under the APA to the manner in which a regulation was promulgated, "the cause of action accrues when the final regulation is published in the Federal Register." *Air India v. Brien*, 261 F. Supp. 2d 134, 138 (E.D.N.Y. 2003), *motion for relief from judgment granted on other grounds*, 239 F.R.D. 306 (E.D.N.Y. 2006), *rev'd sub nom. United Airlines Inc. v. Brien*, 588 F.3d 158 (2d Cir. 2009); *see also Sai Kwan Wong v. Doar*, 571 F.3d 247, 263 (2d Cir. 2009) (collecting cases). Where a final regulation has not been published, agency action may still be considered sufficiently final for review under the APA. *See, e.g.*, *Franklin v. Massachusetts*, 505 U.S. 788, 797 (1992) (holding that "[t]he core question is whether the agency has completed its decisionmaking process, and whether the result of that process is one that will directly affect the parties"); *Sai Kwan Wong*, 571 F.3d at 263 ("Under the APA, the statute of limitations begins to run at the time the challenged agency action becomes final." (citations omitted)); *Preminger v. Sec'y of Veterans Affairs*, 517 F.3d 1299, 1307 (Fed. Cir. 2008) (same).

The Supreme Court has held that there are essentially two conditions that must be met for an agency action to be considered final under the APA. "First, the action must mark the consummation of the agency's decisionmaking process—it must not be of a merely tentative or interlocutory nature. And second, the action must be one by which rights or obligations have been determined, or from which legal consequences will flow." *U.S. Army Corps of Eng'rs v. Hawkes Co.*, 136 S. Ct. 1807, 1813 (2016) (quoting *Bennett*, 520 U.S. at 177–78 (1997)); *see also Salazar v. King*, 822 F.3d 61, 82 (2d Cir. 2016) (same). Moreover, "if an agency has issued a 'definitive statement of its position, determining the rights and obligations of the parties,' the agency's action is final notwithstanding '[t]he possibility of further proceedings in the agency' on related issues, so long as 'judicial review at the time [would not] disrupt the administrative process.'" *Sharkey v. Quarantillo*, 541 F.3d 75, 89 (2d Cir. 2008) (alterations in original) (quoting *Bell v. New Jersey*, 461 U.S. 773, 779–80 (1983)).

1. <u>Independent Timeliness of Proposed Count IX</u>

Plaintiffs assert that Proposed Count IX accrued in 2014 when plaintiffs' notes were sold and they sustained cognizable injuries as a result. Pls.' Rule 15 Mem. at 15–17. HUD counters that the cause of action accrued in 2002, upon commencement of its demonstration program. Defs.' Rule 15 Mem. at 9–10.

Although the case law on accrual is not entirely clear, courts have tended to hold that while a substantive or as-applied challenge may accrue when the plaintiff is injured, a procedural challenge accrues when the challenged rule or policy is put in place. In *Wind River Mineral Corp. v. United States*, the court held that a claim "challeng[ing] a mere procedural violation in the adoption of a regulation or other agency action," or one that is "a policy-based facial challenge to the government's decision," must be brought within six years of the decision. 946 F.2d 710, 715 (9th Cir. 1991). The *Wind River* court explained:

> The grounds for such challenges will usually be apparent to any interested citizen within a six-year period following promulgation of the decision; one does not need to have a preexisting mining claim in an affected territory in order to . . . discover procedural errors in the adoption of a policy. The government's interest in finality outweighs a late-comer's desire to protest the agency's action as a matter of . . . procedure.

Id. In contrast, the court noted that a claim that "contests the substance of an agency decision as exceeding constitutional or statutory authority," may be brought "later than six years following the decision by filing a complaint for review of the adverse application of the decision to the particular challenger." *Id.*; *see also Parkdale Int'l, Ltd. v. United States*, 508 F. Supp. 2d 1338, 1347 (Ct. Int'l Trade 2007) (noting that "[a] claim raising procedural objections accrues at the time that the rule goes into effect because the relevant harm has already been inflicted: an interested party has lost the opportunity to alter the agency's decision through full participation in the regulatory process").

Plaintiffs here do not challenge HUD's constitutional or statutory authority to implement the NSP, nor does Proposed Count IX assert a claim about the manner in which the NSP was applied to plaintiffs. Rather, plaintiffs allege a procedural violation in the adoption of the NSP;

in Count IX, plaintiffs assert that "all of the note sales conducted by Federal Defendants as part of the Note Sale Program, including the sale of Plaintiffs' mortgage notes, are agency actions conducted without observance of procedure required by law." Proposed SAC ¶ 481. Accordingly, plaintiffs' claim accrued when HUD finally decided to conduct note sales as part of the NSP.

The Proposed SAC alleges that HUD published a 2006 notice of proposed rulemaking that contemplated what plaintiffs themselves characterize as a "precursor" to the NSP. Proposed SAC ¶ 198. After failing to take public comments on the precursor program or promulgate a final rule, the Proposed SAC alleges that HUD "created" the NSP in 2010, which began with the first note sale on September 22, 2010, again without seeking public comment or promulgating a final rule. *Id.* ¶¶ 100, 198–199. The September 2010 note sale meets the first prong of the Supreme Court's test for finality; as alleged in the Proposed SAC, and as a matter of common sense, that note sale marked the consummation of HUD's plan to restore its insurance fund to solvency through the sale of distressed notes. The second prong is met as well, because the note sale created rights and obligations that had legal consequences: here, most significantly, the stripping of FHA benefits from those homeowners whose notes were sold.

In short, the agency action that is the target of Proposed Count IX is the implementation of the NSP without having conducted notice-and-comment rulemaking beforehand. *Id.* ¶ 481. Accordingly, based on plaintiffs' allegations, the final agency action that started the limitations clock was HUD's sale of notes pursuant to the NSP on September 22, 2010, and that is when, I conclude, the claim asserted in Proposed Count IX accrued.

I note that this is not a case where plaintiffs could not have known that HUD failed to provide notice and an opportunity for comments before implementing the NSP, and there is accordingly no equitable basis upon which to find Proposed Count IX timely. Plaintiffs' letter motion seeking a premotion conference in anticipation of moving to amend indicates that HUD's Office of the Inspector General published the Audit on July 14, 2017, and that "[a]s a result of the July Audit Report, Plaintiffs now seek to amend the FAC." Letter of Elizabeth M. Lynch dated Sep. 20, 2017, at 1, Dkt. 62. Plaintiffs, though, filed their initial complaint on July 15, 2016 (less than six years after September 22, 2010), and knew or at least could have known at that time that HUD had implemented the NSP without undertaking notice-and-comment rulemaking. The Audit, it seems, merely triggered the idea for a claim based on the APA's rulemaking requirements, and that is of course not sufficient to start a new limitations period. Plaintiffs had access to the relevant facts when they filed their original complaint and when they filed the FAC on August 12, 2016 (also less than six years after September 22, 2010).

Plaintiffs' Proposed Count IX pleads in the alternative that DASP—what plaintiffs themselves describe as a "subset of the Note Sale Program that began in 2012"—itself constitutes a substantive rule that required its own notice-and-comment rulemaking. Proposed SAC ¶ 482. But the implementation of DASP did not amount to a new rule or policy. Plaintiffs identify nothing "tentative or interlocutory" about the creation of the NSP in 2010. *See Hawkes Co.*, 136 S. Ct. at 1813. Nor do plaintiffs identify any substantial new "rights or obligations" created by DASP in 2012 that were not already a feature of the NSP in September of 2010. *Id.* The sole distinction alleged in the Proposed SAC between the Single Family Loan Sale program ("SFLS")[15] and DASP is that DASP "included two types of sales, a national sale and a Neighborhood Stabilization Outcome ("NSO-DASP") sale, which required purchasers to achieve certain outcomes for a portion of the mortgages they purchased." Proposed SAC ¶ 103. While

[15] According to plaintiffs, HUD referred to the NSP as the "Single Family Loan Sale" program, or SFLS, from 2010 to 2011. SAC ¶ 101.

the Proposed SAC discusses NSO-DASP sales at some length, it acknowledges that mortgages encumbering properties in New York City were never sold through NSO-DASP sales. *Id.* ¶¶ 141–148. The Audit, moreover, states that HUD conducted the SFLS program in 2010, and that "the name of the program was changed" to DASP in 2012. Audit at 3. Accordingly, the implementation of DASP was not a new final agency action requiring its own notice-and-comment rulemaking.

Accordingly, for statute of limitations purposes, the implementation of the NSP on September 22, 2010 is when plaintiffs' cause of action for a failure to engage in rulemaking accrued. Because plaintiffs' motion for leave to file the Proposed SAC was not brought within six years of that date, the Proposed SAC is not independently timely.

2. Relation Back Under Rule 15(c)

Plaintiffs argue in the alternative that the Proposed SAC is timely because it relates back to the FAC, which was filed within six years of September 22, 2010. Pls.' Rule 12 Mem. at 17. An amendment relates back when, as pertinent here, "the amendment asserts a claim or defense that arose out of the conduct, transaction, or occurrence set out—or attempted to be set out—in the original pleading." Fed. R. Civ. P. 15(c)(1)(B).

Rule 15(c)(1)(B) "relaxes, but does not obliterate, the statute of limitations; hence relation back depends on the existence of a common 'core of operative facts' uniting the original and newly asserted claims." *Mayle v. Felix*, 545 U.S. 644, 659 (2005).[16] "For a newly-added claim to relate back under Rule 15(c)(1)(B), 'the basic claim must have arisen out of the conduct set forth in the original pleading.'" *ASARCO LLC v. Goodwin*, 756 F.3d 191, 202 (2d Cir. 2014)

[16] Although *Mayle* discusses what was then denominated Rule 15(c)(2), it was referring to a previous version of Rule 15 in which (c)(2) was identical in every material respect to what is now Rule 15(c)(1)(B). *See* Fed. R. Civ. P. 15(c)(2) (2005); *Mayle*, 545 U.S. at 655 (quoting then Rule 15(c)(2)).

(quoting *Slayton v. Am. Express Co.*, 460 F.3d 215, 228 (2d Cir. 2006)). "[T]he central inquiry is whether adequate notice of the matters raised in the amended pleading has been given to the opposing party within the statute of limitations by the general fact situation alleged in the original pleading." *Id.* (alteration in original) (quoting *Slayton*, 460 F.3d at 228). Accordingly, "even where an amended complaint tracks the legal theory of the first complaint, claims that are based on an entirely distinct set of factual allegations will not relate back." *Lehman XS Trust v. Greenpoint Mortg. Funding, Inc.*, 916 F.3d 116, 128 (2d Cir. 2019) (quoting *Slayton*, 460 F.3d at 228).

In *Mayle*, the Supreme Court considered when a claim arises out of the "conduct, transaction, or occurrence" set out in the original pleading in the context of a habeas corpus petition. Felix, the petitioner in *Mayle*, filed a timely petition claiming that the admission of videotaped testimony from a witness at his trial violated his confrontation clause rights. *Mayle*, 545 U.S. at 648. Felix then filed an out-of-time petition claiming that his post-arrest statements were coerced and that their admission at trial violated his right against self-incrimination. *Id.* at 649. The Supreme Court held that Felix's second petition did not relate back because it asserted "a new ground for relief supported by facts that differ[ed] in both time and type from those the original pleading set forth." *Id.* at 650. Relation back, the Court determined, "depends on the existence of a common 'core of operative facts' uniting the original and newly asserted claims." *Id.* at 659. Felix's second petition did not meet this test; it challenged "an extrajudicial event, *i.e.*, an out-of-court police interrogation," whereas his original petition challenged events that took place entirely during the course of his trial. *Id.* at 661.

As in *Mayle*, plaintiffs' Proposed Count IX arises from facts other than those raised by claims in the FAC. Proposed Count IX concerns the failure of HUD to engage in notice-and-comment rulemaking before implementing the NSP in 2010; the claims in the FAC concern note sales conducted as part of the NSP once the program was underway.

Sierra Club v. Penfold, 857 F.2d 1307 (9th Cir. 1988), a Ninth Circuit decision cited approvingly by the Supreme Court in *Mayle*, is instructive.[17] There, the Ninth Circuit addressed circumstances analogous to those presented here. The district court had ruled that a procedural challenge to rulemaking was barred by the six-year statute of limitations, though at the same time it permitted a timely claim challenging the application of the same regulations to go forward. *Mayle*, 857 F.2d at 1310–11. On appeal, plaintiff argued *inter alia* that its procedural challenge related back to its originally pleaded as-applied challenge. *Id.* at 1315. The Ninth Circuit disagreed, distinguishing a case in which it "allow[ed] a claim for interference with employment relations to relate back to a former claim for slander." *Id.* (citing *Santana v. Holiday Inns, Inc.*, 686 F.2d 736, 739 (9th Cir. 1982)). In reasoning equally applicable to plaintiffs' Proposed Count IX, the court explained:

> *Santana* does not control here. This is because Sierra Club's amendment goes beyond alleging a different theory of recovery. It alleges a new claim for relief. The original challenge based on [the Bureau of Land Management]'s [("BLM")] "policy and practice" requires evidence showing how BLM conducts Notice mine review. The new claim alleging invalidity of the Notice regulations requires evidence of the procedures used in adopting the regulations. The original claim was premised on a theory of unlawful application of the five-acre rule. The new procedural challenge Sierra Club attempted to add is based upon a theory of invalidity of the regulations as adopted. In short, the procedural challenge does not arise out of the same conduct or transaction. It arises out of BLM's conduct in adopting the regulations rather than BLM's "policy and practice" in Notice mine review. Because of this, BLM did not have notice of the substance of what was sought to be added by the amendment. Rule 15(c) does not and should not allow an amended complaint to relate back where the conduct, transaction or occurrence alleged is different. Otherwise, claimants such as Sierra Club could challenge regulations at a much later time, e.g., when administered by the federal agency, rather than when adopted.

[17] *Mayle* criticized the Ninth Circuit's "capacious" definition of "conduct, transaction, or occurrence" *in the habeas context*. The Supreme Court, however, relied upon the Ninth Circuit's holding in *Penfold*, a non-habeas civil case, in adopting a narrower construction in the habeas context. 545 U.S. at 659.

Id. at 1316.

So too here, the facts that support Proposed Count IX are not the same "core of operative facts" that support Counts I through IV against HUD. While Counts I through IV concern the impact of activities conducted pursuant to a program that was up and running, Proposed Count IX concerns the failure to follow certain procedures before the program was put in place. This is clear from the absence of any allegation in the FAC that HUD failed to seek public comment before implementing the NSP, other than a fleeting statement in a footnote concerning a completely different agency action.[18] Indeed, the only references to the Administrative Procedure Act at all in the FAC are in that footnote and as a basis for this Court's jurisdiction with respect to Count II. FAC ¶¶ 14, 55 n.2, 401–402.[19]

Accordingly, Proposed Count IX does not relate back to the FAC and is therefore time-barred. An amendment adding Proposed Count IX would therefore be futile.

3. Failure to Join Indispensable Parties

Even if Proposed Count IX were timely, its assertion would be futile for a second, independent reason. Plaintiffs' Proposed Count IX seeks to set aside the sales of plaintiffs' notes and mortgages. When a plaintiff seeks to set aside a contract, though, all parties to the contract must be joined. *See Kulawy v. United States*, 917 F.2d 729, 736 (2d Cir. 1990) ("No procedural principle is more deeply imbedded in the common law than that, in an action to set aside . . . a contract, all parties who may be affected by the determination of the action are indispensable."

[18] In that footnote, the Proposed SAC claims that HUD, in or around June 2015, removed language about pre-foreclosure assistance from its form FHA note and mortgage contract without notice and comment. FAC ¶ 55 n.2. However, the FAC did not assert a cause of action for this failure, nor is Proposed Count IX premised on this alleged failure to seek public comment.

[19] Proposed Count IX is expressly brought under 5 U.S.C. § 553, Proposed SAC ¶¶ 479, 482, which specifically concerns agency rulemaking procedure. Section 553 is nowhere mentioned, with respect to Count II or otherwise, in the FAC.

(quoting *Crouse-Hinds Co. v. InterNorth, Inc.*, 634 F.2d 690, 701 (2d Cir. 1980)); *Sunset Homeowners Ass'n, Inc. v. DiFrancesco*, 2019 WL 2808284, at *5 (W.D.N.Y. July 3, 2019).

Generally, when a party who is indispensable has not been joined, and a plaintiff fails to advance compelling reasons for the nonjoinder, dismissal is proper. *See Viacom Int'l, Inc. v. Kearney*, 212 F.3d 721, 725 (2d Cir. 2000), *overruled on other grounds as recognized in Merrill Lynch & Co. Inc. v. Allegheny Energy, Inc.*, 550 F.3d 171, 178–79 (2d Cir. 2007); *Roldan v. Second Dev. Servs., Inc.*, 2018 WL 1701938, at *4 (E.D.N.Y. Mar. 30, 2018). In the alternative, and where feasible, the court may join the indispensable party. *Roldan*, 2018 WL 1701938, at *4.

Plaintiffs have neither joined their original FHA-insured lenders—the mortgagees who sold their notes and mortgages pursuant to the NSP—nor explained why it would not be feasible to do so. Moreover, as discussed above, plaintiffs have advised the Court that they are in the process of finalizing a settlement agreement with the Caliber defendants, the parties who acquired those notes and mortgages. Letter of Benjamin R. Nagin dated Apr. 22, 2019. Any amendment seeking to undo the sales of plaintiffs' notes and mortgages that does not include the original mortgagees or the parties that purchased those notes and mortgages would be subject to dismissal for failure to join required parties. Plaintiffs' Proposed SAC, at least as proposed and not further amended to join these parties, is accordingly futile on this basis as well.

For all the reasons stated above, I respectfully recommend that plaintiffs' motion to amend the First Amended Complaint be denied.

CONCLUSION

For the reasons stated in this Report and Recommendation, I respectfully recommend that HUD's motion to dismiss the First Amended Complaint be granted, and that plaintiff's motion for leave to amend the First Amended Complaint be denied. In so doing, I make the following findings:

(a) that all plaintiffs lack standing to pursue Count I of the First Amended Complaint;

(b) that all plaintiffs have standing to pursue Count II of the First Amended Complaint;

(c) that all plaintiffs have standing to pursue Count III of the First Amended Complaint to the extent they allege threats to neighborhood stability and the promotion of segregation, but lack standing to pursue Count III to the extent they allege an impairment of their ability to remain homeowers;

(d) that plaintiffs Washington, Blackett, and Mason have standing to pursue Count IV of the First Amended Complaint;

(e) that plaintiff Trotman lacks standing to pursue Count IV of the First Amended Complaint;

(f) that Count II fails to state a claim upon which relief can be granted;

(g) that Count III fails to state a claim upon which relief can be granted;

(h) that Count IV fails to state a claim upon which relief can be granted;

(i) that all plaintiffs have standing to pursue Proposed Count IX of the Proposed Second Amended Complaint; and

(j) that amending the First Amended Complaint to include Proposed Count IX would be futile.

Any objections to the recommendations made in this Report must be made within fourteen days after the filing of this Report and Recommendation and, in any event, on or before August 12, 2019. *See* 28 U.S.C. § 636(b)(1); Fed. R. Civ. P. 72(b)(2). Failure to file timely objections may waive the right to appeal the District Court's order. *See Small v. Sec'y of Health*

& Human Servs., 892 F.2d 15, 16 (2d Cir. 1989) (discussing waiver under the former ten-day limit).

/s/
STEVEN M. GOLD
United States Magistrate Judge

Brooklyn, New York
July 29, 2019

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