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DJ 188-12C-8

SEP 21 1995

Lawsuit Recommendation:
Long Beach Mortgage Company,
et al. (M.D. Cal.)
FAIR HOUSING ACT OF 1968, AS AMENDED,
and EQUAL CREDIT OPPORTUNITY ACT

Deval L. Patrick
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I agree with the attached recommendation that we file a pattern or practice action against Long Beach Mortgage Company, which until October 1994 was a federally chartered thrift institution known as Long Beach Bank. This matter was referred to the Attorney General by the Office of Thrift Supervision for possible prosecution of "pattern or practice" violations. This is our third mortgage lending investigation in which we have focused on discrimination in the terms and conditions rather than the processing of loans.[1]

Long Beach's principal place of business is in Orange, California, and until its 1994 expansion into the national market, it did the vast majority of its home loan business in California, with over 40% in Los Angeles County. During the time pertinent to this recommendation, the lender has operated both a retail and wholesale residential mortgage business. In its retail business, Long Beach solicits applications for residential mortgages through its own employees in branch offices. In its wholesale business, the lender solicits mortgage brokers to submit to Long Beach applications on behalf of persons seeking mortgage loans. In both instances, Long Beach underwrites and funds the loans. In the complaint, we allege that Long Beach, through both its retail and wholesale operations, has systematically discriminated on the basis of race, national origin, age and sex in the pricing of home mortgage loans, in violation of the Fair Housing Act, 42 U.S.C. §§ 3601-3619, and the Equal Credit Opportunity Act, 15 U.S.C. §§ 1691-1691f.

Our expert's extensive analysis of Long Beach's loan data and our review of its loan files show that the lender charges

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[1] The first case was United States v. First National Bank of Vicksburg (S.D. Miss.); the complaint and consent order in the case were filed on January 21, 1994. The other investigation concerns the practices of the Security State Bank of Pecos of charging higher interest rates to Hispanic borrowers than the rates charged to non-Hispanic; that matter is in presuit negotiation.

African-American, Hispanic, female and older customers higher loan prices than similarly situated white males who are under the age of 55. For most of the victims, the differences in price were primarily the result of differences in the points charged borrowers, but African-Americans paid higher points and higher interest rates. Statistical analysis shows that the odds that these differences could have occurred at random are about 2,500 to 1 in the case of Hispanics and one in several million in the case of the other protected groups.

Long Beach participates in what is known as the "B/C" mortgage market, which means that it specializes in making loans to high-risk borrowers at premium rates. It has positioned itself between the "A" (or mainstream) market and the finance companies, which charge such borrowers even higher rates. Increased points paid by customers make the loans particularly expensive, because loans in the B/C market rarely last more than a few years.

The evidence in this case also reveals that Long Beach's loan officers and its wholesale brokers have concentrated their marketing efforts on low- or moderate-income and minority residential neighborhoods, particularly on homeowners who are known or believed to have substantial equity in their homes. Such customers are able to borrow from the lender the points that will be paid from the loan proceeds at the time of closing, thus making these transactions particularly lucrative for both Long Beach and its correspondent brokers. During the period under review, Long Beach allowed its employees and brokers the discretion to set the loan price at up to 12% of the loan amount above the minimum price upon which the Long Beach based its expectation of profitability and to retain all or a portion of the difference or "overage" as a commission.

It is important to note that this will be a case of first impression as to a lender's liability for loans initiated by independent brokers. This position will likely cause consternation among mortgage bankers and their trade associations. The attached memorandum has an extensive discussion of the bases for our position. Mortgage bankers may well take the same position that Long Beach has taken in our preliminary discussions: that they are not responsible for the prices of the wholesale loans that they fund, even if they know that they are charging minorities, women, or older persons more than they are charging younger Anglo males.

We believe it appropriate to provide the defendants with an opportunity to resolve the case through entry of a consent order to be filed simultaneously with the complaint. Counsel for Long Beach is aware that we are going to recommend the filing of a Complaint. Counsel recently sent us a detailed letter (also attached to this memorandum) responding to some of the issues in

this case. We have addressed the more serious points raised in the attached recommendation. Long Beach has also expressed interest in settling this matter. To this end, we have prepared a notice letter to Long Beach counsel and will begin formal settlement negotiations upon your approval of the complaint.

APPROVED _____

DISAPPROVED _____

OTHER _____

COMMENTS:

cc: Records Chron Hancock Ross Cass Dowell T.File

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RECOMMENDED ACTION

We recommend that the Department authorize the filing of the attached Complaint against the Long Beach Mortgage Company (herein referred to as "Long Beach" or "the lender"), alleging that it discriminated against black, Hispanic, female, and older persons to whom it made home mortgage loans during the period January 1991 through at least June 1994, in violation of the Fair Housing Act of 1968, as amended, 42 U.S.C. §§ 3601-3619, and the Equal Credit Opportunity Act, as amended, 15 U.S.C. §§ 1691-1691f. The gravamen of the complaint is that the lender engaged in a pattern or practice of discrimination by intentionally charging persons in these protected categories higher loan prices than similarly situated white males who were under the age of 55.

I. FACTUAL BACKGROUND

A. THE DEFENDANT, THE REFERRAL FROM THE OFFICE OF THRIFT SUPERVISION, AND THE INVESTIGATION

1. The Proposed Defendant -- the Long Beach Mortgage Company

Prior to December 1994, what is now the Long Beach Mortgage Company conducted its business as a bank. It operated under the name of Long Beach Bank as a federally chartered thrift institution, subject to the regulatory authority of the Office of Thrift Supervision ("OTS"). With respect to the allegations of the Complaint, the proposed defendant's operations were essentially the same before and after the change.

During at least the last five years, the lender has operated both a retail and a wholesale residential mortgage business. In its retail business Long Beach solicits applications for residential mortgages through its own employees (loan officers)

who work in branch offices located in the major cities of California and elsewhere. In its wholesale business, the lender solicits mortgage brokers (or "correspondent brokers") to submit to Long Beach applications on behalf of persons seeking mortgage loans, such applications to be underwritten by and, if approved, funded by Long Beach.[1]

Long Beach's main office is in Orange, California, and until its 1994 expansion into the national market,[2] it did the vast majority of its home loan business in California, with over 40% in Los Angeles County.

2. Long Beach Specializes in Making Home Equity and Refinancing Loans to High-Risk Borrowers

Long Beach participates in what is known as the "B/C" mortgage market, which means that it specializes in making loans to high-risk borrowers at premium rates (two to eight percentage points above the "A" or mainstream mortgage market.)[3] Most of its loans are six-month adjustable rate ARM's and most are home equity or refinancing loans. The lender prices its loans by risk levels that are based on a combination of the borrower's credit history and debt load and the ratio of the loan to the value of the property ("LTV").

Long Beach has positioned itself between the "A" market and the finance companies, which charge high-risk borrowers even higher interest rates and up to 25 points.[4] In California, "B/C" lenders are predominant in low- and moderate-income or minority neighborhoods, particularly in Oakland and Los Angeles. A slight majority of Long Beach's borrowers are white.

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[1] During the 42-month period for which we have examined Long Beach's lending activity (January 1991 through June 1994), approximately 60% of its loans have been wholesale.

[2] Long Beach now has branches in 14 states and is licensed to do business in 40 states and the District of Columbia.

[3] The "B/C" mortgage market derives its name from its participants' dealing in "B" and "C" (sometimes even "D") paper, as compared to the more liquid "A" paper that underlies the much larger "A" market. Loans made in the "B/C" market are called "nonconforming" loans, because they do not conform to the underwriting guidelines promulgated by the secondary mortgage market. See Appendix C to this memorandum, which describes the "B/C" market in detail and sets forth its relationship to the "A" market and to the secondary mortgage market.

[4] Lenders occupying this niche are often referred to as "hard-money lenders" or "lenders of last resort."

3. The Office of Thrift Supervision Referred This Matter to the Department of Justice in January 1994

The OTS referred this case to us in February 1994 on the basis of findings by its examiners that Long Beach Bank had been charging black and Hispanic borrowers higher loan origination fees (discount "points") than it had been charging white borrowers.

During their March 15 through July 17, 1993, fair lending review, OTS examiners determined that Long Beach had a sliding price scale related to borrower risk level. The lender classified its borrowers (from lowest to highest risk) as "A-," "B+," "B," "B-," "C," and "C-." From a list of the loans that Long Beach had closed in the first quarter of 1993, the examiners selected the files of 108 borrowers in the same risk category ("A-"), all of whom had paid the same interest rate for their loans. A comparison of the points paid by the borrowers showed that minority borrowers had paid more than had white borrowers:[5]

Average Number of Points Paid
OTS Sample, January Through March 1993

	Wholesale Loans	Retail Loans
Whites	3.88	4.57
Minorities	5.93	6.14

The OTS ascertained that Long Beach provided its loan officers opportunity for incentive compensation by allowing them to charge each borrower up to 10 points above the minimum price the lender set for each risk level. Similarly, the lender allowed its wholesale brokers to charge an extra 10 points, plus "fees" of up to $2,500, with the total of points and fees not to exceed 12% of the loan amount.[6]

4. Our Initial Investigation

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[5] Our analysis of loans made during the entire period from January 1991 through the middle of 1994 shows a narrower gap between the points paid by white and minority borrowers, but the difference is still highly significant -- so much so that it is virtually impossible that the differences could have occurred by chance.

[6] We have learned that the extra loan cost (above Long Beach's required minimum) can be in the form of points or interest rate or a combination of the two. In practice, the loan officers and wholesale brokers obtain their extra commission from extra points more than from extra interest rate. Borrowers do not need to raise any cash from savings -- they borrow the points (which are added to the loan amount).

In May 1994, we notified Long Beach of the OTS referral and that we were initiating an investigation. We asked the lender to supply us with computerized data that showed loan price and risk level data for each borrower, as well as the information required to be maintained by lenders under the Home Mortgage Disclosure Act. In response, the lender provided us with a record for each loan it had originated in 1992 and 1993. Each loan record included the following fields:

HMDA Data	Additional Data
•Loan amount	•Risk level
•Borrower income	•Retail points to Long Beach
•Location (Census tract)	•Wholesale points to Long Beach
•Borrower(s) race/ethnicity	•Wholesale points to broker
•Borrower(s) sex	•Fees (lender or broker)
	•Starting interest rate
	•Margin (for adjustables)
	•Annual Percentage Rate (APR)[7]

We employed an expert, Dr. Leonard Cupingood of the Center for Forensic Economic Studies, to analyze this data.[8] He concluded in his initial report that there were loan price differences between black and white borrowers that were highly significant. He found differences between white and Hispanic borrowers that were statistically significant but less so than the white-black differences.

5. On-Site Investigation in December 1994

In December 1994 we spent a week in California reviewing Long Beach files and interviewing its employees. The approximately 100 files we examined proved revealing. We had

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[7] Long Beach had not maintained the annual percentage rate for each loan in its database. It recalculated the APR for each loan, using a standard internal rate of return formula that takes into account the interest rate (or "start rate" in the case of adjustable rate loans), points, fees, and the contract amortization period (most commonly 30 years).

[8] Dr. Cupingood is an associate of Dr. Bernard Siskin, who was our expert in the Decatur Federal case. The analysis that he is doing for us in this case is not as controversial as that in Decatur. Here, the basic task is to determine whether, after controlling for the variables supplied to us by Long Beach, the observed differences in loan cost between white (or younger) borrowers and members of the classes protected under the Equal Credit Opportunity Act and the Fair Housing Act could have occurred by chance.

selected a group of black, Hispanic, and white borrowers from among those who had paid the highest prices for their loans within their risk level. File documents showed the following:

- There was little if any relationship between borrowers' risk categories and the price of the loan.

- Many of the borrower risk levels assigned by Long Beach appeared to be less favorable than justified by the borrower's credit history, debt ratios, or loan-to-value ratio.[9]

- A surprising proportion of the borrowers who had high-cost loans (including whites) were over age 55 and were widows.

- There was little evidence that price bargaining had taken place between the borrower and the loan officers or wholesale brokers. Virtually all changes in risk level, interest rate, points, or fees reflected in the files were the result of interchanges between Long Beach's underwriting department and the loan officer who submitted the loan -- or between Long Beach employees and the wholesale brokers.

- Several of the borrowers the lender had listed as white in its HMDA reports had identified themselves as minorities on the forms in the files.

We interviewed several of Long Beach's loan officers and their supervisors. These employees were for the most part candid. From them, we learned that:

- Their incentive compensation is based on periodic volume of loan activity (both with respect to number of loans and total loan amount) and the extent to which loan prices exceed the minimum required by Long Beach.[10]

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[9] For a comparison of Long Beach's borrower credit-worthiness requirements, see Appendix C, which compares the standards of the "B/C" market with those of the mainstream (or "A") mortgage market.

[10] From 1987 until July 16, 1993, Long Beach's retail officers used a computerized price model to calculate their incentive compensation or "overage" on a given loan based on the pricing the officer was able to obtain. After the OTS investigation, Long Beach stopped using the price model and compensated retail officers based only on the actual volume of

(continued...)

- On occasion in the past few years, the lender's minimum prices have been included in rate sheets provided to loan officers, but for the most part, the minimums have been placed in a computerized "price model" to which each loan officer has on-line access.

- Long Beach has incorporated into its rate sheets and price model a "point-rate" exchange, which means that in pricing the loan, the loan officer may exchange a set number of discount points for one percentage point of interest on the loan.[11]

- In soliciting home-owners by telephone, the loan officers use lists of names and numbers supplied to them by Long Beach's marketing office. They obtain additional leads from collection agencies, home improvement contractors, delinquent tax liens, providers of bail bonds, and other sources of names of persons who may be either in the market for a home equity or refinancing loan, in need of cash in an emergency, or both.[12]

- The loan officers (and the direct mail solicitation materials Long Beach uses) emphasize monthly payment amount when they are attempting to convince a potential borrower.[13] Once they have the prospect interested in

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[10](...continued)
loan activity. However, beginning in early 1995, Long Beach returned to a policy of compensating its personnel based on both loan amount and volume.

[11] For example, with a 2:1 point/rate exchange, a 9% start rate with 6 discount points paid at closing would be the equivalent of a 10% start rate with 4 points. (See detailed discussion of the importance of the point/rate exchange in Part I. B 3b, below, pages 24-25.)

[12] See Part 9a, below, page 10, for a discussion of the lender's emphasis on low-income and minority homeowners for its intensive marketing activities.

[13] It appears that unsophisticated borrowers, particularly low-income borrowers (and often older, female, or minority) with a great deal of equity in their homes, are susceptible to the suggestion that they pay the points to get a lower monthly payment. They are taken in by the "lower monthly payment" pitch, even though (1) the real cost of the loan increases as points are exchanged for interest rate and (2) the lower payment may represent no more than an extension of the period of amortization of their debts.

a particular figure, they make a written proposal within three days. Only then are specific interest rates and points set forth.

- The loan officers concede that they try for the highest price they think the borrower will pay (within the incentive compensation, or "overage," limits set by the lender). They also concede that if the borrower appears able to qualify for a lower loan price elsewhere, they do not so advise the borrower.

6. Studies Conducted by Long Beach Consultant

During our visit, counsel provided us with two studies done by a consultant, purporting to show that for the periods from October 1993 through February 1994 and April through June 1994 there was no significant difference in the prices charged white and minority borrowers, measured in terms of annual percentage rate.[14] The study covers a period after the activities that formed the basis of the OTS referral. The study is flawed by its aggregation of all minority borrowers (including a substantial number of borrowers of Asian descent, who paid about the same prices as white borrowers). Further, the study does not take into account the impact of points on the cost of loans that are likely to turn over quickly.[15]

7. Analysis of Additional Computerized Data

While in California, we learned that the lender maintains in its database the following information on each loan in addition to that listed above:

- Age of borrower and co-borrower

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[14] We also learned that John Daurio, Long Beach's Vice-President and General Counsel has conducted a number of statistical studies of the lender's loan prices. Counsel for the lender have made an initial claim of privilege as to Mr. Daurio's studies, but we believe from previous conversations with Mr. Daurio that his initial findings were similar to ours.

[15] The report covering the first period (October 1993 through February 1994) has accompanying tables that show substantial differences between whites and "minorities" at each credit risk level in the number of points paid, but the consultant failed to take the necessary next step, measuring the impact of points when the loans turn over quickly. See Part _, below. Another noteworthy aspect of these reports is the consultant's aggregation of wholesale and retail loans for the analysis. See Part II.B, below.

- Front- and back-end debt ratios[16]
- "Fully indexed" rate[17]

We provided this new information to Dr. Cupingood and asked him to identify and describe any differences in loan price related to the borrower's age or sex (again controlling for all the other variables). We asked him to exclude from the analysis a group of loans (under 5% of the total) that involved several miscellaneous loan products that Long Beach rarely uses.[18] For the largest comparison group (age) there were 25,157 loans made during the period January 1991 through June 1994, slightly more than 60% of which were wholesale. Table I on the following page shows the totals for the major comparison groups:

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[16] The term "front-end ratio" refers to the borrower's monthly mortgage payment divided by gross monthly income, and "back-end ratio" refers to all monthly debt over monthly gross income.

[17] This term is useful in identifying which borrowers obtained "teaser" rates on their adjustable-rate loans. The fully indexed rate is used to calculate borrowers' true annual percentage rate when the teaser rate (which usually remains in effect for the first adjustment period of six months) would produce an artificially low APR.

[18] The main reason for excluding these loans was that Long Beach officials were unable to provide accurate information with which to recalculate the loan prices without a file-by-file review. Most of these loans had a fixed rate for a period of time (but not all for the same period) with an option to convert to an adjustable rate thereafter.

Table I
Number of Records Analyzed
By Borrower Category

	Retail	Wholesale	Total
Over 55	3,328	3,496	6,824
55 and under	6,466	11,867	18,333
Black	1,823	2,223	4,046
Hispanic	2,130	3,158	5,288
White	4,818	7,929	12,757
Male	7,088	11,700	18,788
Female	2,703	3,659	6,362 [19]

The analysis of the age and sex variables confirmed what we suspected from our file reviews: Dr. Cupingood's report indicates that women pay more than men for both retail and wholesale loans and that the difference is statistically significant. It also shows that borrowers age 55 and over pay a statistically significant higher amount than younger borrowers for wholesale loans but not for retail loans.

8. Marketing and Direct Mail Solicitation that Targets Minority and Low-Income Neighborhoods

After our December 1994 trip, we obtained maps from Long Beach showing its volume of business (shown separately for retail and wholesale) by ZIP Code for each of its California branch offices for the year ending August 31, 1993. These maps and our own mapping of loans in Los Angeles (by Census tract for each year from 1991 through 1993) show that Long Beach's lending activities and those of its wholesale brokers are very concentrated and cover the same places. In Los Angeles and the rest of the state, the lender's retail and wholesale loans have been made in heavily black or Hispanic or low- or moderate-income areas.

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[19] Not all records contained complete data. For example, the male plus female borrower total was seven less than the total for age. For the final statistical analysis, we asked Dr. Cupingood to assign characteristics to each file by using the person in the borrower position when there also was a co-borrower. He had experimented with various other ways of assigning the characteristics when there was a co-borrower and determined that, due to the large number of files, there was virtually no difference in result. (Obviously, the presence of a co-borrower may make a difference when we have to identify the individual victims.)

Counsel also provided us with samples of the lender's direct mail solicitation materials and of the requests it had made to a service that provides names, addressees and telephone numbers of homeowners for a fee. These requests made reference to the lender's "priority ZIP Codes," but did not identify the ZIP Codes or include the criteria for selecting them.[20]

9. Additional Investigation

We returned to Orange in June 1994 in order to learn more about Long Beach's marketing of its home loans and the relationship between the lender and its wholesale brokers. We also made further inquiry about Long Beach's use of a "point/rate exchange" for compensating its employees and setting prices -- information that we believe is essential to measure the differences in loan prices between groups of borrowers.

a. Marketing to minority and low-income borrowers

We developed no direct evidence that Long Beach, in choosing where to concentrate its marketing activities, selected minority or low-income neighborhoods because of the race or income level of the residents. We obtained a list of the lender's "priority ZIP Codes." Although these ZIP Codes appear to have been selected on the basis of the predominance of minority or lower income home-owners within them, Long Beach's explanation for the geographic concentration is as follows: They direct their solicitation efforts to the areas where finance companies and their competitors in the "B/C" market are active. While Long Beach has a contractual obligation to its investors not to attempt to turn over the loans it has originated, the lender's goal is to take business away from its competitors who, by their nature, have customers that fit the "B/C" profile. As a result, Long Beach solicits in the same areas in which its competitors (including the wholesale brokers for whom it originates loans) are operating.

b. Point/Rate Exchange -- Long Beach's expectation that its loans will turn over in less than four years

According to the lender's officers and employees, the intense competition in the "B/C" market, at least in California, has a direct bearing on Long Beach's point/rate exchange. The

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[20] We later obtained marketing materials that Long Beach used in 1994 and is using now. The lender has decided to reduce its budget for newspaper advertising and to concentrate on direct mail solicitation, thereby further concentrating its attention on those who reside in the "Priority ZIP Codes."

exchange formula that the lender uses is directly related to its estimates of how long (on average) the loans are going to last. One employee told us that at some time in 1992 or 1993, the lender had assured its secondary market investors that the average loan life would be five years but that it had turned out to be less than three years. An exchange rate of 3:1 translates to an expectation of average turnover in less that four years; one of 2.5:1 means a shorter period. In its January 1994 pricing sheet, Long Beach used an exchange rate of 1.5:1.

This explanation of Long Beach's use of a low point/rate exchange ratio confirmed our belief that in this case the proper way to measure the impact on loan price of points paid by the borrower at closing is to use an internal rate of return formula that is based on an average loan life of four years.

c. Long Beach's relationship with its wholesale brokers

Long Beach funds loans for borrowers brought to it by more than 2,000 wholesale brokers.[21] Most of these brokers are small and place no more than one to five loans with Long Beach each year. A few larger brokers placed up to 200 loans with Long Beach during the three and one-half year period we examined.

A broker is first contacted in person by one of Long Beach's "account representatives" (of whom there are approximately 70).[22] The representative delivers rate sheets and other information about Long Beach's "B/C" practices. Long Beach provides brokers with no written policy regarding the caps placed on loan prices; rather, the caps are communicated strictly by word of mouth. The representative acts, in effect, as a customer service agent with the broker once loan packages are submitted by brokers to Long Beach's underwriting department and receives as remuneration a percentage of Long Beach's points on the wholesale loan.

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[21] Long Beach provided us with a broker list with more than 4,000 names. Some are inactive; some have lost their licenses; and others have probably gone out of business for other reasons. It is clear that most of these brokers shop their applicants to mortgage bankers other than Long Beach. We have no way of knowing what portion of any broker's overall business is done with Long Beach, but Long Beach's limit on the points that can be charged may limit its share of each broker's business.

[22] The number of account representatives has more than doubled in the last three years indicating the quick expansion of Long Beach's wholesale operation.

Before doing business with Long Beach, brokers are required to sign broker agreements, which are contracts between Long Beach and the brokers.[23] The broker's status under the Agreement is that of "an originator[24] of loans" who receives a fee from Long Beach for packaging the loan and "submitting" it to Long Beach for funding, if approved. The broker is only to be paid "for its actual services rendered in packaging the loan application and not as a commission or any other type of consideration."[25] The fee is to be paid by Long Beach directly to the borrower.

A broker usually "shotguns" a particular loan application to other lenders (usually to not more than five or six) at the same time as it does so to Long Beach. While the broker initially negotiates the terms of a loan with the borrower, Long Beach cannot always agree to such terms. Long Beach officials told us, however, that they usually try to give the broker the company's

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[23] Brokers must also furnish a broker application form (which requests general information about the broker's company and business references), a copy of their state license, a current financial statement, a corporate resolution form and tax information. The account representative also runs a credit report on each broker. If a broker cannot properly explain any derogatory credit on the credit report or if a broker's license has expired or been suspended, according to Long Beach's guidelines, the broker's application must be rejected. All decisions regarding whether or not to approve broker applications are made by senior management.

We were told that Long Beach deals only with brokers who are licensed, but OTS's March 1993 compliance review of Long Beach revealed that Long Beach has dealt in the past with unlicensed brokers, which is a violation of state law.

[24] The term "originator" seems to have a variety of meanings in home mortgage lending. Here, it seems to refer to the act of obtaining an application. In other contexts, the one that provides the funds "originates" the loan, and under HMDA the originator of the loan is the entity that makes the credit decision.

[25] In previous versions of the Agreements (prior to December 1994), the brokers were referred to as "representatives" of Long Beach who "referred" loans to Long Beach for fees. This language was changed to that in the above text after OTS's investigation in the spring of 1993 (during which it found certain fees paid to Long Beach's brokers were structured as "referral fees" in violation of Section 8 of the Real Estate Settlement Procedures Act ("RESPA"), 12 U.S.C. §2607) and our December 1994 visit during which we were looking closely at Long Beach's wholesale operations,

best offer up front because of the extremely competitive nature of the wholesale business.[26] Once the loan is accepted, Long Beach's underwriters reverify the information provided in the loan package. The number of points a broker will receive is negotiated by Long Beach and the broker during the credit approval process. It was evident from the files we reviewed that during this process, the number of points each will receive often changes, usually in favor of the broker, for no documented reason. All wholesale loans are ultimately underwritten according to Long Beach's guidelines.[27]

The brokers do not use Long Beach's marketing materials, but they solicit the same neighborhoods and home-owners. In practical terms then, the activities of the wholesale brokers are indistinguishable from those of Long Beach's loan officers. Both gather the same kinds of qualifying information and submit it to Long Beach's employees for an underwriting decision. Both earn extra compensation to the extent they can persuade the borrower to pay more than Long Beach's minimum price. Long Beach shares in most extra earnings, and it funds all the loans and packages them together to sell to investors.

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[26] When asked whether Long Beach has done any compliance monitoring of its wholesale brokers with respect to the discrimination laws, a Long Beach official stated that it has not done so because (1) Long Beach does not do business with a large enough sampling of loans from any one broker to do a meaningful analysis, (2) brokers are independent entities of Long Beach, and (3) there are government agencies that monitor the brokers and Long Beach relies on them. Long Beach, however, added a provision to its Broker Agreement in December 1994 that affirmatively states that:

> "Broker shall be familiar with the Federal Fair Housing Act and the Federal Equal Credit Opportunity Act which prohibit discrimination on certain bases in any aspects of a credit transaction. Broker acknowledges that the prohibitions extend to, among other things, imposing different rates or charges on members of a protected class or employing different negotiating strategies with such persons on a prohibited basis."

[27] The underwriting fee is the only fee that is permitted to be shared by both Long Beach and the broker. All other fees are distributed to either Long Beach or the broker.

B. **LONG BEACH HAS DISCRIMINATED AGAINST SEVERAL GROUPS OF PERSONS PROTECTED BY THE EQUAL CREDIT OPPORTUNITY ACT AND THE FAIR HOUSING ACT BY CHARGING THEM HIGHER PRICES FOR HOME MORTGAGE LOANS THAN IT HAS CHARGED SIMILARLY SITUATED WHITE MALES WHO ARE UNDER 55 YEARS OLD.**

As we will show below in Table IV and the accompanying text, the higher loan prices that have been paid by Long Beach's black, Hispanic, female, and older borrowers are substantial and are unlikely to have been the result of random occurrences. We believe that the lender's loan officers and wholesale brokers have engaged in deliberate discrimination by seeking higher prices from members of these protected groups than they do for similarly situated whites, men, and younger borrowers. We draw this inference not only from the differences themselves but also the following:

- The lender has allowed its employees and its correspondent brokers the discretion to set the loan price at up to 12% of the loan amount above the minimum price upon which the lender bases its expectation of profitability.[28]

- The Long Beach loan officers we interviewed admit that they ask as high a price as they think the borrower will pay.

- The loan files we reviewed contain almost no evidence that the loan prices were the result of negotiation by borrowers.

- Long Beach's loan officers and its wholesale brokers concentrate their marketing efforts on low- or moderate-income and minority residential neighborhoods.

- The lender has not offered a non-discriminatory explanation for the price differentials other than speculation that minority borrowers do not negotiate as well as white borrowers.

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[28] Prior to the 1993 OTS examination, Long Beach had a policy of allowing its retail officers and wholesale brokers to charge no more than 10 points and $2,500 in fees (with the total not to exceed 12% of the loan). After OTS issued its compliance examination report, Long Beach's new limits were lowered to 6 points and no more than $1,869 in fees. In 1995, Long Beach raised its limits to 8 points. Total fees for Long Beach's wholesale operations may not exceed $2,174 for the West Coast and $1,874 for the East Coast. Maximum fees for its retail operations were raised from $574 to $995.

1. Measuring the Price Differences Between Groups of Borrowers

a. Finding a way to capture the impact of points on the overall price of the loan

Our expert's analysis of the data that Long Beach provided to us confirmed what the Office of Thrift Supervision had found: Differences in points paid has accounted for most of the variations in loan cost among the groups of Long Beach borrowers. However, any analysis that is limited to the differences in points presents an incomplete picture. The other components of price (fees and interest rate) may offset the differences in points in such a way that there is no difference in overall price. Annual Percentage Rate (APR) is a common method of measuring the overall cost of a home mortgage loan, but APR, as required by the Truth in Lending Act (TILA), has limited value. TILA allows lenders to disclose loan cost as an annual percentage rate based on the assumption that the loan will remain in effect for the duration of the contracted-for amortization period. This formula severely understates the cost of a loan when borrowers pay points up front and refinance or sell long before paying off the loan.

In searching for a way to measure the impact of points on loan cost, we had to look no further than the "point/rate exchange" that Long Beach uses to measure its profitability (and loan officer/broker compensation) with various and complex combinations of points and interest rate. The importance of the point/rate exchange for purposes of this suit recommendation is in measuring the true cost to the borrower of a loan that involves a large number of points up front when that loan is likely to turn over in three or four years -- even though it has a nominal amortization period of 30 years.

Appendix A to this memorandum contains selected summaries of the Long Beach loan files we reviewed in December 1994. Summary # 23, Loan #0722703, illustrates the lender's use of its point/rate exchange:

A black male, age 48, and a black female, age 44, borrowed $97,500 at 11.75% and 7 points (all paid to the wholesale broker). It was an adjustable rate loan with a 30-year amortization period. Their debt ratios were 15/31, and the LTV was 75%.

Long Beach assigned the borrowers a risk level of "C," based on their having had several accounts with multiple 30-day lates and a judgment of $1,500 four years earlier.

The rate sheet maximum interest rate for credit risk level "C" with no points would have been 11.75%. The borrowers paid an overage of 7 points (almost $7,000).

This file shows a subtle but consistent aspect of the interrelationship of Long Beach's point-rate exchange and the borrower's LTV. Here, the borrowers' LTV was at the maximum the lender allowed without an exception (75%); thus, the most the wholesale broker could collect was the 7.0 points it took -- there simply was no equity left to drain. The file shows that originally Long Beach was to get 1.25 points and that the loan was classified as step 4 on the following point-rate exchange chart: (We adapted this chart from an October 1992 Long Beach rate sheet and added (1) a calculated APR for each line, based on a 30-year amortization and (2) a column showing the actual point-rate exchange built into the price sheet at each level within the "C" classification.)

Table II
"Point/Rate Exchange"
(October 1992 Rate Sheet)

Class	Rate	Points	[APR]	[P/R Exchange]
C1	9.95%	3.25	10.3458%	
C2	10.25%	2.5	10.5580%	2.5
C3	10.50%	1.75	10.7174%	3.0
C4	11.25%	1.25	11.4116%	0.67
C5	11.75%	0.0	11.7500%	2.5

Each of the five lines represents roughly the same return to Long Beach. The point-rate exchange is not the same from line to line because the lender has chosen for the most part to use 1/4- and 1/2-point increments, but the average for the entire rate sheet is a point/rate exchange of less than 2.5:1.

When borrowers want net loan proceeds that cause the loan to approach the maximum allowable LTV, there is little room for borrowing the money to pay the points. The file in this case shows that initially the borrowers were in class "C4," meaning that they were to pay 1.25 points to Long Beach, with a rate of 11.25%, and were to pay the wholesale broker 7 points. However, Long Beach had to drop its 1.25 points in order to get the LTV down to exactly 75%, but it exchanged the 1.25 points for an increase in the interest rate from 11.25% to 11.75%. This meant a somewhat higher monthly payment for the borrowers, which was no problem since their debt ratios were so low (15% and 31%).

b. Method of analysis -- "APR4"

We initially asked our expert, Dr. Cupingood, to analyze the overall price differences under several alternative assumptions as to the average life of Long Beach's loans (ten, seven, and four years). After we ascertained that the average life of Long

Beach's loans was in fact less than four years, we decided to use the four-year life ("APR4") as a conservative standard measure. Using the APR4 method provides both a clear description of the differences in the mean from group to group and a more accurate measure of the damages suffered by those against whom Long Beach discriminated.[29]

The next table (Table III) illustrates the "real" cost of loans that turn over quickly. Each pair of loans carries the same interest rate, but in each pair one borrower paid more points. The monthly principal and interest payments are the same for each borrower in the pair (because the loan amounts and interest rates are the same), but the one with the higher points has a higher APR because more of the loan proceeds went toward paying points. Finally, in every case the points cause the APR4 to be higher than the APR30, and the difference increases dramatically at the number of points increases.[30]

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[29] The tables in Appendix B also show the loan costs based on assumptions of seven- and ten-year loan life. We consulted Alan Dombrow at the OCC, who is regarded by the bank regulatory agencies as the outstanding government expert on annual percentage rates. He agrees that our "APR4" approach is valid way to measure the expected loan cost to the borrower when we can show that four years or less is the expected average term of the loans.

[30] Table 9M in Appendix B sets out the unadjusted (actual) and adjusted (predicted) means for points paid by the comparison groups. The most extreme comparison is between white males and black females who obtained wholesale ARM loans:

	Actual Mean	Expected Mean
White Male	3.96 points	4.10 points
Black Female	5.37 points	4.67 points

Thus, white men paid .14 less than expected and black females paid .70 more.

Table III
Comparison of 30-Year APR ("APR30") to "APR4"
Adjusted APR Based on Assumption of four-year Loan Life
- $100,000 Loan with a 30-Year Amortization Schedule -

Start %	Points	Monthly Payment	APR30	APR4	[Difference] [APR4-APR30]
7.95%	0.5	$730.28	8.0026%	8.0989%	.0963%
7.95%	2.0	$730.28	8.1633%	8.5524%	.3891%
8.5%	1.0	$768.91	8.6093%	8.8021%	.1928%
8.5%	2.5	$768.91	8.7769%	9.2617%	.4848%
10.25%	1.25	$896.10	10.4023%	10.6394%	.2371%
10.25%	2.5	$896.10	10.5579%	11.0337%	.4758%
10.5%	0.5	$914.74	10.5613%	10.6556%	.0943%
10.5%	1.75	$914.74	10.7174%	11.0407%	.3233%

We also asked our expert to measure the differences between groups in the components of price -- starting interest rate, points, fees, and margin (in the case of adjustable-rate loans). Appendix B contains a series of tables setting forth the mean and adjusted mean[31] for APR4, APR7, APR10, and for each of the separate price components for the following groups:

Basic Comparison Groups	Additional Groups
Age 55 or Under	Mixed Sex
Over age 55	Black Female
Black	White Male
White	Hispanic Female
Hispanic	
Female	
Male	

[31] The adjusted mean is based on a regression model that controls for the other variables contained in the data provided to us by the lender. Therefore, the adjusted mean for a group is a prediction as to what the mean would be for that group "all other things being equal."

c. The statistical significance of the differences between groups

After calculating the (actual) mean and the adjusted (or expected) mean for each group, Dr. Cupingood analyzed the differences between these borrower group pairs:[32]

Borrower Class	(# of loans)		Comparison Group	(# of loans)
Over age 55	(6,824)	><	Age 55 or Under	(18,335)
Black	(4,046)	><	White	(12,747)
Hispanic	(5,288)	><	White	(12,747)
Female	(6,362)	><	Male	(18,788)

The degree of statistical significance (in units of standard deviation) of the major comparisons are set forth in Table IV on the next page. A standard deviation of 3.0 or more (shown in **bold** type) is considered highly significant (i.e., unlikely to have occurred by chance).[33]

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[32] Appendix B also contains Dr. Cupingood's analysis of these additional pairs of borrower groups:

Female	><	Mixed Sex
Black Female	><	White Male
Black Female	><	Mixed Sex
Hispanic Female	><	White Male
Hispanic Female	><	Mixed Sex

The group differences appear to reflect the differences found in the basic comparisons discussed in the text.

[33] As will be discussed in greater detail in the legal section below (Part II. A), in the Ninth Circuit, standard deviations of greater than two may support an inference of discrimination if the statistical data is bolstered by anecdotal evidence. For instance, the "APR10" for the elderly has a statistical significance of 2.43 standard deviations; assuming that we needed to prove price differences for loans that lasted for an average of 10 years, if we are able to bolster our statistical analysis with some testimony from victims about the way they were treated, we could succeed in showing discrimination. We have chosen to highlight categories that have greater than three units of standard deviations because the Ninth Circuit has indicated that District Courts may accept statistical proof of greater than three units of standard deviation as making out a prima facie case even without anecdotal support. See the handwritten entries in the last set of tables in Appendix B, where the units of standard deviation are converted to probabilities.

TABLE IV
Differences Between Borrower Groups Measured by Units of Standard Deviation
(All Loans, January 1991 Through June 1994)

Groups Compared	Factor	Difference
Over age 55 and Age 55 or Under	APR10	2.43
	APR7	**3.38**
	APR4	**5.35**
	Points	**10.87**
	Start Rate	-2.36
	Fees	2.61
	Margin*	-2.00
Black and White	APR10	**10.04**
	APR7	**11.22**
	APR4	**13.50**
	Points	**14.89**
	Start Rate	**3.57**
	Fees	**6.57**
	Margin*	-1.16
Hispanic and White	APR10	2.41
	APR7	2.77
	APR4	**3.56**
	Points	**4.34**
	Start Rate	-0.25
	Fees	**7.15**
	Margin*	-1.06
Female and Male	APR10	**3.52**
	APR7	**4.01**
	APR4	**4.99**
	Points	**6.67**
	Start Rate	0.27
	Fees	0.81
	Margin*	0.73

* The margin figure applies to ARM's only, which made up about 84% of the total number of loans. (See Appendix B for additional details, including a comparison of Long Beach's differential pricing as a whole and its differential pricing in Los Angeles County, which represents about 40% of the total.)

The figures in the right-hand column of Table IV illustrate several important aspects of our expert's analysis. First, it can be seen that the overall differences (any of the "APR" figures) are being driven by the differences between groups in the points paid. Each of the differences in points is more significant than the differences in the other price components. This explains why the statistical significance increases with

each decrease in the assumed average life expectancy of the loans (from APR10 to APR7 to APR4) -- the faster the loan turns over, the more expensive the points paid up front are to the borrower. Note that borrowers over the age of 55 had an average start rate that was lower than the rate for those 55 and under. The difference in points was so severe that the overall loan price was significantly higher for the older group.[34]

2. The Contrast Between Retail and Wholesale Price Discrimination

The group-to-group loan cost differences described in the previous section are for Long Beach's retail and wholesale loans combined. While we believe that the lender's legal responsibility not to discriminate in loan terms runs to all of its borrowers, without regard to the source of the loans, we have also analyzed the price differentials separately for wholesale and retail loans. The separate data reveal interesting consistencies and contrasts in treatment of certain borrower classes by the Long Beach loan officers and the wholesale brokers. They also show the substantial likelihood that Long Beach discriminated against several protected groups in the funding of its retail loans -- even if they are considered separately.

a. The differences between groups were more severe for loans Long Beach funded through its wholesale brokers

Appendix B sets forth separate comparisons between borrower groups for retail and wholesale loans. When the data is dis-aggregated in this manner, the differences between groups lose some degree of statistical significance. This occurs mostly because the number of observations is smaller, but, with the exceptions discussed below, it does not change the strong implication that the differences can be explained only by protected class status. The broad comparisons between pairs of borrower groups is shown in Table V on the next page:

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[34] Initially, Dr. Cupingood did not make any comparisons between the loan prices charged black males and those charged white males. In order to eliminate the theoretical possibility that the age and sex of black borrowers were driving the apparent racial differences, we asked him to make this comparison. Not surprisingly (considering the other differences), the new analysis showed that black males paid significantly more than did white males. These data have been added to Appendix B.

TABLE V
Significance of the Differences ("APR4") Between Groups Overall, Wholesale, and Retail
- Units of Standard Deviation -[35]

Groups Compared	Overall	Wholesale	Retail
Over age 55 and Age 55 or Under	**5.35**	**8.35**	0.29
Black and White	**13.50**	**11.31**	**7.11**
Hispanic and White	**3.56**	1.64	**3.00**
Female and Male	**4.99**	**3.76**	**3.94**

The figures on bold type denote a high degree of statistical significance.

b. Wholesale borrowers in all classes paid more than their retail counterparts

Without regard to the group comparisons, the data show that among similarly qualified borrowers wholesale loans were much more expensive than retail.[36] The overall differences between prices paid by Long Beach borrowers who made application directly to Long Beach and those whose loans were first processed by wholesale brokers can be seen in Appendix B, Table 8M. For

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[35] Table V includes data on wholesale ARMs only. The overall number of borrowers (of ARMs and fixed-rate loans) in each comparison group is shown above in Table I. The breakdown for Table V is:

	Wholesale ARM	Retail ARM	Total ARM
Over Age 55	2,997	2,697	5,694
Age 55 or Under	10,298	4,659	14,957
Black	1,912	1,440	3,352
White	7,061	3,684	10,745
Hispanic	2,776	1,643	4,419
Male	10,183	5,310	15,493
Female	3,111	2,045	5,156

[36] However, the higher wholesale prices are not driving the differences in price -- a higher proportion of white borrowers than borrowers in the protected classes had wholesale loans.

example, the unadjusted mean APR4 for the various groups show these differences for adjustable rate loans:

TABLE VI
Differences in Loan Costs Between Wholesale and Retail Loans (APR4)

Group	Wholesale ARM	Retail ARM
Age 55 or Under	11.48%	10.11%
Over age 55	11.65%	9.96%
Black	11.82%	10.17%
White	11.45%	9.97%
Hispanic	11.66%	10.12%
Female	11.72%	10.13%
Male	11.46%	10.03%
Black Female	11.96%	10.22%
White Male	11.38%	9.94%
Hispanic Female	11.73%	10.20%

These unadjusted (or actual) mean figures are presented to illustrate the differences between wholesale and retail prices for the various groups. When analyzing the differences between groups, as in section c, below, it is necessary to take into account that in almost all cases, the adjusted (or expected) mean for the protected class was lower than the actual mean, whereas for the comparison group, the adjusted mean was higher than the actual mean.

c. Black borrowers paid consistently higher loan prices that any other group -- without regard to whether the loans were retail or wholesale

Table VI in the preceding text shows that blacks as a group, and black females in particular, had the highest APR4 rates in both the retail and wholesale columns. Appendix B sets forth the actual mean and the expected mean for each borrower group for the various price components we analyzed. For example, for those wholesale borrowers who obtained adjustable rate loans, the actual mean APR4 for white borrowers was 11.45%, which was .05% less than the expected mean of 11.50%. In contrast the actual mean for black borrowers was 11.82%, which was .22% more than the expected mean of 11.60%, making the overall difference between whites and blacks .27%.

The comparable figures for retail borrowers who obtained adjustable rate loans were as follows: The actual mean APR4 for white borrowers was 9.97%, which was .06% less than the expected mean of 10.03%. The actual mean for black borrowers was 10.17%, which was .13% more than the expected mean of 10.04%, making the overall difference between whites and blacks .19%

These difference are extremely significant, in light of the large numbers of borrowers in each of the groups under comparison -- 1,912 blacks and 7,061 whites had wholesale ARM loans. Expressed in statistical terms, the difference for whites and blacks who obtained wholesale ARMs -- in units of standard deviation -- is 8.19, which means that there was a probability of one in several million that this racial difference occurred by chance.

The average price of retail ARMs was less for all borrowers, and the difference between the means for whites and blacks was smaller. However, there were 1,440 blacks and 3,684 whites with retail ARMs, and the difference between them in units of standard deviation for APR4 was 5.07 -- still very highly significant.

d. Female borrowers paid significantly higher rates than any group other than blacks, without regard to whether the prices were set by Long Beach's loan officers or by wholesale brokers.

The prices differences (measured in units of standard deviation) set forth above in Table V show a consistent pattern of discrimination against female borrowers for retail and wholesale loans. The statistical significance of the differences is not as extraordinarily high as it is for black borrowers, but it is still high (3.76 and 3.94 units of standard deviation for wholesale and retail loans, respectively). These numbers translate into probability that the differences occurred by chance of less than one in three thousand.

e. Older borrowers (those over age 55) have paid significantly higher rates than younger borrowers for loans originated by Long Beach on the basis of prices set by wholesale brokers.

Table V shows overwhelming differences in the wholesale prices paid by older compared to younger borrowers (8.35 units of standard deviation), but the differences were not significant for Long Beach's retail loans. However, if all loans are analyzed together, the difference is highly significant (5.35 units of standard deviation).

f. Hispanic borrowers have paid significantly higher prices than Anglo borrowers for loans originated by Long Beach on the basis of prices set by Long Beach's loan officers.

The subdivision in Table V of loans to Hispanics by wholesale and retail shows the reverse of the data for older borrowers. The differences are significant for retail loans (3.00 units of standard deviation) and all loans together (3.56 units of standard deviation), but not for wholesale only.

g. Even if the loans submitted by the wholesale brokers are excluded from the analysis, it remains clear that Long Beach discriminated in funding of its retail loans

Our view of the lender's discriminatory conduct in this case is that, in funding its loans, it charged protected class members higher prices, without regard to the source of the loan application. Counsel for Long Beach have argued that the lender cannot be held responsible for the acts of the wholesale brokers. In the unlikely event that a fact-finder would agree with Long Beach's position, we submit that Long Beach has discriminated on its own, through its own employees, its loan officers. Table V, above, demonstrates that for retail loans only, there are highly significant differences in the prices charged blacks, Hispanics, and female (but not older) borrowers by Long Beach.

3. The Results of the Statistical Analysis Are Consistent With Evidence of Loan-Selling Techniques Described in Interviews With Long Beach Loan Officers and With What We Have Learned About the Lender's Marketing Practices

The overall results of our expert's analysis appear to confirm that the wholesale brokers and Long Beach loan officers tailored loan prices to their perceptions of the borrowers' vulnerability and susceptibility to being overcharged.

John Daurio, Long Beach Vice-President and General Counsel, told us that he believes that the lender's loan price differences are probably the result of minority borrowers' relatively lesser ability to negotiate. On one occasion he put it this way: "What if it turns out that whites will more frequently say the price is too high? What is the loan officer supposed to do -- walk away or lower the price?" Our first response to this hypothetical question is that the loan files contain virtually no evidence that borrowers negotiated (or even had any idea that they could negotiate). Beyond this, the loan officers we talked to freely admitted that they size up the prospect and quote prices based on what they think the prospect will pay. Further, the lender's marketing practices strongly imply that it believes that minority, older, and lower-income borrowers are vulnerable.

a. Interviews with loan officers

We interviewed several Long Beach loan officers and their supervisors regarding solicitation of borrowers, negotiating practices, compensation, pricing of loans, and general procedures related to the preparation and packaging of loans. These employees were for the most part candid in response to our inquiries.

A typical branch office is composed of a branch manager, two assistant branch managers (or loan officers) and a document processing worker, who is responsible for putting a loan application together once it is negotiated and sending it to the main office in Orange for underwriting.[37]. In the initial stages of negotiating the terms of a loan with a prospective borrower, loan officers quote an initial loan price based on unverified credit information provided to them by the customer. This price sometimes changes if the credit information provided by the customer is incorrect and a risk category is adjusted.

b. Loan officers' use of the "point/rate exchange"

Long Beach has incorporated its point/rate exchange into its rate sheets and price model. This means that in pricing the loan, the loan officer may exchange a set number of discount points for one percentage point of interest on the loan.[38] Loan officers concede that they try for the highest price they think the borrower will pay (within the overage limits set by the lender).[39] One loan officer freely admitted that prior to the time that lower caps were placed on the total number of points

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[37] When they first begin their employment with Long Beach, most loan officers participate in a four day training program sponsored by Long Beach which reviews Long Beach's loan products, underwriting guidelines and sales skills. The loan officers we spoke to had not participated in this training program and stated that they had instead received informal training from their office managers, which consisted primarily of sales techniques.

[38] For example, with a 2:1 point/rate exchange, a 9% start rate with 6 discount points (i.e, 6% of the loan amount) paid at closing would be the equivalent of a 10% start rate with 4 points.

[39] The computerized price model (during the times it was in use) or the rate sheets allow the loan officers to calculate the proportion of the overage Long Beach will pay them as incentive compensation.

and fees charged by Long Beach, he would, depending on the customer, often begin the negotiation process at 10 points regardless of the credit rating of the borrower.

Moreover, if a borrower's credit rating was upgraded during the underwriting process from that initially determined by the loan officer (e.g., from a "B" to "A-"), the terms at which the loan was originally priced would not automatically be adjusted. In other words, unless the borrower takes the initiative to renegotiate the terms of the loan based on the new credit rating, loan officers at Long Beach would not necessarily change the pricing to match the enhanced credit risk level.[40] They also concede that if the borrower appears able to qualify for a lower loan price somewhere other than with a "B/C" lender, they do not so advise the borrower.

c. Selling on the basis of a low monthly payment

Loan officers consistently stated that the most important consideration to a borrower in setting the terms of a loan is the amount of the monthly mortgage payment the borrower would have to pay. Thus, the loan officers (and the direct mail solicitation materials Long Beach uses) emphasize monthly payment amounts when they are attempting to convince a potential borrower to secure a loan with Long Beach. Once they have the prospect interested in a particular figure, they make a written proposal within three days. Only then are specific interest rates and points set forth.

By the time of the written proposal, the loan officer knows what the potential borrower's LTV is and can thus tell whether there is sufficient equity in the property to be mortgaged to allow for borrowing money to pay points up front. On its face the idea of paying the points and lowering the APR30 and the monthly payment is attractive to the borrower. Borrowing the points does lower the monthly payment, but this costs the borrower more money if the loan turns over in less than seven years. Long Beach's loans turn over, on average, in under four years.[41]

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[40] There is no indication from our review of the loan files that a borrower would even be informed that the credit rating had been changed.

[41] Two different loans of the same amount and identical APR30 would not be identical in cost to the borrower if one involved points and the other did not. Similarly, as shown in Table III, above, a quote of two identical monthly payments can (continued...)

d. Loan underwriting

Upon receipt of a loan application from a branch office, one of Long Beach's underwriters (approximately 50 in number) attempts to verify the information on the application. Based on the information provided and additional information obtained by independent verification, through credit reports, employment information etc., the underwriter determines whether to approve, modify or reject a loan as proposed by the loan officer. No loan officers ever interact or communicate directly with the underwriters. All communications between the underwriters and branch offices are handled by an account manager, who is the middle person, in the main office in Orange.

e. Marketing practices

Long Beach markets its home loan services to the public through newspaper advertising, flyers sent to real estate related businesses, and through direct mail solicitation. In these marketing materials Long Beach states that it specializes in home equity loans and refinancing and that it serves potential borrowers who do not qualify for loans in the "A" mortgage market. It does so by implying that "A" lenders require perfect credit and by use of such statements as "[i]f you've been turned down elsewhere, you may not have to go to a high interest finance company" and "[w]hile other banks look for ways to say no, we look for ways to say 'yes'."

Long Beach's direct mail solicitations take two forms: corporate mailings from its central office and supplemental mailings from loan officers located in its branch offices. Long Beach obtains names and addresses for direct mail solicitation from one or more services that provide real estate information for a fee. Long Beach and its loan officers use selected Postal ZIP Codes, designated by Long Beach as "priority ZIP Codes," to aim their direct mail solicitation at lower income and minority households. The lender accomplishes this prioritization by tailoring its requests for names and addresses to homeowners who reside in Postal ZIP Codes known by Long Beach to contain high proportions of households that have current liens with finance

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[41](...continued)
mean substantial differences in actual cost of the loan, measured by APR30 or APR4 (with greater differences in the latter case), depending on the extent that points are involved. The file review summaries in Appendix A contain numerous examples of borrowers who paid a high number of points even though their debt ratios were extraordinarily low, meaning that they could easily have afforded an increased mortgage payment of a few dollars per month for loans that would have been substantially cheaper had they not been taken in by the "lower monthly payment" ruse.

companies or other of Long Beach's competitors in the "B/C" mortgage market.[42] Both forms of direct mail solicitation, but in particular the larger, corporate mailings, are sent repeatedly to the same households, as often as four to six times in one year.[43]

In summary, the lender uses a variety of techniques to take advantage of borrowers who are members of classes of persons protected by the fair lending laws by charging them higher loan prices that similarly situated younger white males:

- In none of its advertising or direct mail solicitation does Long Beach state the cost of its loans or that the cost of its loans is substantially higher than the prices charged by "A" mortgage lenders;

- In none of its advertising or direct mail solicitation does Long Beach inform potential borrowers of the differences between its underwriting standards and those of the "A" mortgage market (as described in

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[42] Long Beach is able to engage in this precise marketing technique in California because the service from which Long Beach purchases names and addresses provides it with the name of the lien-holder at each address and a code showing whether the lien-holder is a "B/C" lender, a finance company, or a "hard money" lender. (This last term refers to lenders, also called "lenders of last resort," that make loans at extraordinarily high interest rates to borrowers who are unable, or who believe they are unable, to obtain loans in the "A" or "B/C" markets.) These priority ZIP Codes are thus known by the lender and its employees to contain relatively high proportions of households that are under-served by the "A" mortgage market.

[43] In addition, Long Beach concentrates its direct mail solicitation on homeowners who are known or believed by the lender to have substantial equity in their homes. The purpose of this form of selective marketing is to reach homeowners who are able to borrow from the lender the points that will be paid from the loan proceeds at the time of closing. These borrowers are better able to pay off their current debts without creating an unacceptable loan-to-value ratio (above 75%). Such targeted borrowers are known by Long Beach to have owned their homes for a sufficient number of years to have built up equity in their homes by a combination of appreciation in value of their homes and repayment of prior mortgages. Consequently, such potential borrowers are known by Long Beach as more likely to be elderly than homeowners in general and persons who have little or no financial assets other than the equity in their homes.

Appendix C) or the ways in which Long Beach's loan prices are related to credit history or debt ratios;

- Long Beach, through its loan officers, sells borrowers on lower monthly payments by encouraging them to borrow the money for the points, without explaining that this will raise the overall loan cost if the loan turns over quickly;

- In none of its advertising, direct mail solicitation, telephone solicitation, or in-person sales attempts does Long Beach inform potential borrowers that credible explanations for their poor credit histories or other offsetting factors, such as a very low loan-to-value ratio, could qualify them for the substantially lower mortgage credit prices offered by lenders in the "A" mortgage market.[44]

C. ISSUES AFFECTING RELIEF

1. Estimates of the Total Number of Victims

During the period January 1, 1991, through June 30, 1994, Long Beach made home mortgage loans to 25,127 borrowers. Approximately 7,055 were white males under the age off 55. (Appendix B)[45] This leaves about 18,072 borrowers who were in one or more of the protected classes.[46] In theory, every one of these borrowers was presumptively the victim of discrimination. Even those who paid less than the mean price paid by younger white males would have paid less but for their protected class status.

A less expansive view of this issue might limit the victim class to protected borrowers who paid more than the mean price paid by similarly situated younger white males. If "similarly situated" is defined as being in the same credit level category,

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[44] Many of the direct mail solicitation materials imply that "perfect credit" is required by "A" lenders and that Long Beach has "A" prices. Two of the common phrases are: "[m]ajor banks look for people with perfect credit," and "[o]ur broad lending guidelines also include loans to customers who would qualify for bank financing."

[45] There were 9,680 white males in all, and a little over 27% of all borrowers were 55 and over.

[46] The sum of the four protected classes is 22,520 (see Table I, above), which means that about 4,448 were members of two or more protected classes.

at least 60% of the total of 18,072 (or 10,843) would be classified as victims.

Another question arises when the borrower is a member of a protected class and the co-borrower is not. For the sake of consistency, we should assign class status on the basis of the characteristics of the borrower in the first position.

Some borrowers are in two or three protected classes; others are in a protected class and an unprotected class. Statistical analysis is of limited value in sorting out the relative impact of these combinations, but it seems clear that older black females paid higher rates and paid high rates more frequently than all others. Beyond that, our subjective impression from the file reviews was that persons who were in more than one protected class were treated worse than others. This conclusion is consistent both with the statistical data set out in Appendix B and with the inferences we draw about the loan officer attitudes and behavior that underlie the discriminatory treatment of the protected group members.

2. The Amount of Out-of-Pocket Damages per Victim

For those borrowers whose loans have been paid off, out-of-pocket expenses could be based on the amount paid that was above the amount that would have been paid had the borrower received the same terms as the price for younger white males. The amounts would range from as little as $100 to well over $1,000 per year of the loan's duration, depending on the loan size and the extent to which the cost exceeded the mean for the comparison group.

3. Fashioning Relief for Borrowers Whose Loans are Still Outstanding

This group of victims would have the same kind of out-of-pocket expenses but would also face the prospect of continuing to pay a higher amount that is discriminatory. Reformation of their loan contracts seems to be an obvious form of relief, but this raises a difficult question of what the new terms should be.

4. Other Damages

We have only our prior cases to guide us on what the additional compensatory damages should be. In the Vicksburg case, the defendant agreed to total awards of $4,000 per victim. There the loan amounts and out-of-pocket losses were substantially less than they are here.

Our seeking substantial punitive damages in this case would be consistent with the Attorney General's policies. Long Beach did not begin to take effective remedial steps with respect to retail loans until six months after the OTS investigation (and

another six months later for wholesale loans). However, punitive damages in line with our settlements might literally break the bank. At $10,000 per victim, the total of over $100 million would be more than three times Long Beach's net worth.[47]

5. Alternative Relief

In response to questions about the extent of its liability, we have told Long Beach representatives that we did not desire to put the lender out of business. One possible alternative to damage awards that would be terminal for the lender is reform measures that could have an impact on the "B/C" mortgage market in general. One reform measure we would recommend is an educational campaign seeking to assist borrowers in distress to make more informed borrowing decisions. If Long Beach responds to our notice letter by seeking settlement, we should be prepared to discuss this and any other reasonable reform measures that may be effective.

II. LEGAL DISCUSSION

The facts detailed above clearly demonstrate that Long Beach has engaged in a pattern or practice of discrimination on the basis of race, national origin, sex, and age in the terms and conditions in the differential pricing of home equity and mortgage loans. Such discrimination violates both the Fair Housing Act, as amended, 42 U.S.C. § 3601 et seq. ("FHA"), and the Equal Credit Opportunity Act, 15 U.S.C. § 1691 et seq. ("ECOA").[48]

There is much overlap between the FHA and the ECOA and the claims we are bringing under them.[49] For example, each statute recognizes that a pattern or practice of discrimination, as opposed to and in addition to an individual act of discrimination, is a violation of the respective statute. There

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[47] Long Beach has approximately one hundred and forty million dollars in total assets. It has total liabilities of just under one hundred and ten million dollars. Its net worth in mid-1995 was $32,464,500.

[48] Unlike the Fair Housing Act, the ECOA includes age as a protected category. Thus, claims of age discrimination are brought solely under the ECOA and not under the FHA.

[49] Section 706(i) of the ECOA recognizes the possibility of claims which fall under both the FHA and the ECOA, and prohibits individuals from pursuing actions under both statutes. See 15 U.S.C. § 1691e(i). This prohibition does not affect a pattern or practice case brought by the Attorney General.

is, however, very little pattern or practice case law under the ECOA. Thus, it is important to look to case law developed under the FHA and other civil rights laws to interpret the ECOA. To that end, a pattern or practice of discrimination is to be determined from examining the totality of the circumstances, including all direct and all circumstantial evidence. This totality of the circumstances approach allows intent to be inferred from statistical evidence. As will be discussed below, in this case, the overwhelming statistical evidence alone is sufficient to infer intentional discrimination.

It should also be noted that Long Beach has attempted to differentiate its wholesale program from its retail program. Our reading of both the FHA and the ECOA leave no room for such a distinction.

A. Long Beach engaged in a pattern or practice of discrimination in violation of the FHA and the ECOA

The Attorney General is authorized to initiate litigation when she has reasonable cause to believe there has been a pattern or practice that denies any of the rights granted by the Fair Housing Act, 42 U.S.C. § 3614(a) or the Equal Credit Opportunity Act, 15 U.S.C. § 1691e(h).

To prove a pattern or practice of purposeful discrimination, we must show that it was a regular, rather than the unusual, practice of the defendant to act with a discriminatory intent. International Brotherhood of Teamsters v. United States, 431 U.S. 324, 336 (1976). The practice need not be uniform. United States v. Yonkers Board of Education, 624 F. Supp. 1276, 1293 (S.D.N.Y. 1985), aff'd, 837 F.2d 1181 (2d Cir. 1987), cert. denied, 486 U.S. 1055 (1988). The United States does not have to show that a defendant always discriminates, United States v. Lansdowne Swim Club, 894 F.2d 83, 89 (3d Cir. 1990) (Title II); United States v. Real Estate Development Corp., 347 F. Supp 776, 783 (N.D. Miss. 1972) (Fair Housing Act), and there is no minimum number of incidents which must be proven as a prerequisite to finding a pattern or practice, United States v. Ramsey, 331 F.2d 824, 837 nn. 19 & 20 (Rives, J., concurring in part, dissenting in part) (5th Cir. 1964). The extent and duration of the pattern, like the question of whether a pattern exists, "is a factual finding" to be made by the factfinder. United States v. Balistrieri, 981 F.2d 916, 930 (7th Cir. 1992), cert. denied 114 S.Ct. 58 (1993).

The factfinder must view the evidence related to proving a pattern or practice of discrimination as a whole, because "[t]he character and effect of a general policy is to be judged in its entirety, and not by dismembering it as if it consisted of unrelated parts. Even intrinsically lawful acts may lose that character when they are constituent elements of an unlawful

scheme." United States v. City of Parma, Ohio, 494 F. Supp. 1049, 1055 (N.D. Ohio 1980), aff'd, 661 F.2d 562 (6th Cir. 1981), cert. denied, 456 U.S. 926 (1982) (citations omitted). Both direct and circumstantial evidence are relevant to a finding of discriminatory purpose and "[i]nvidious discriminatory purpose may often be inferred from the totality of relevant facts." Washington v. Davis, 426 U.S. 229, 242 (1976); Village of Bellwood v. Dwivedi, 895 F.2d 1521, 1533-34 (7th Cir. 1990) (under the FHA, intent can be shown by either direct or circumstantial evidence). Cf. Moore v. United States Department of Agriculture, 55 F.3d 991, 995 (5th Cir. 1995) (under ECOA, if direct evidence is available, court does not need to go through McDonnell Douglas burden shifting that is required by circumstantial evidence).

Proof of a pattern or practice of discrimination does not require a showing that race (or national origin, sex, and age) was the sole motive for the defendant's actions. Village of Arlington Heights v. Metropolitan Housing Development Corporation, 429 U.S. 252, 265-66 (1977). Rather, if any or all of these protected categories is a "motivating factor" in the actions, illegal discrimination exists. Id. Proof of discriminatory intent requires a "sensitive inquiry into such circumstantial and direct evidence of intent as may be available." Id.

The discriminatory effect of conduct over a prolonged period that is "unexplainable on grounds other than race" may warrant an inference of purposeful discrimination. Arlington Heights, 429 U.S. at 266. Statistics alone, if the treatment of protected classes is significantly different than the treatment of non-protected classes, may make out a prima facie case of intentional discrimination. Cf. Hazelwood School District v. United States, 433 U.S. 299, 307-08 (1977) (gross statistical disparities can make out a prima facie case in a Title VII action); Bernard v. Gulf Oil Corp., 841 F.2d 547, 568 (5th Cir. 1988) ("great disparities" can make out a prima facie case under Title VII); E.E.O.C. v. Anderson's Restaurant, 666 F.Supp. 821, 840 (W.D. N.C. 1987), aff'd in relevant part, 872 F.2d 417 (4th Cir. 1989) ("[Under Title VII, a] plaintiff may establish a prima facie case of a pattern or practice of disparate treatment by statistics alone if the statistics show a gross disparity in the treatment of applicants based on race.").[50]

The Ninth Circuit has refused to "posit a quantitative threshold above which statistical evidence of disparate racial impact is sufficient as a matter of law to infer discriminatory

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[50] "The elements of [discrimination under the FHA] follow closely the elements of employment discrimination [under Title VII]." Kormoczy v. H.U.D., 53 F.3d 821, 823-24 (7th Cir. 1995).

intent." Gay v. Waiters' and Dairy Lunchmen's Union, 694 F.2d 531, 551 (9th Cir. 1982) .[51] In cases in which the units of standard deviation are less than three, the Ninth Circuit requires plaintiffs to "bolster" their case with anecdotal evidence of discriminatory conduct. Id.[52] However, statistical differences of greater than three units of standard deviation have been sufficient to make out a prima facie case without the need of bolstering the statistics with anecdotal evidence. See Stender v. Lucky Stores, 803 F.Supp. 259, 323 (N.D. Cal. 1992) (citing with approval Hillery v. Pulley, 563 F.Supp. 1228, 1244 (E.D. Cal. 1983)).

In this case, the Long Beach loan files show that between 1991 and 1994, Long Beach consistently charged blacks, Hispanics, women and elderly borrowers more than similarly situated younger, white, male borrowers. The statistical analysis of the loan files reveals that the difference in rates charged to protected classes persisted over some twenty-five thousand loans during the three and a half years that we examined. While the exact parameters of what constitutes a pattern or practice are not precise, it is certain that a practice that persisted for over three years and which affected over ten thousand members of protected classes constitutes a "pattern or practice" for purposes of the FHA and the ECOA. Moreover, the statistical analysis of the loan files reveals a disparity between the rates charged to protected classes and those charged to non-protected classes of greater than three units of standard deviation.[53] Thus, we can establish a prima facie case of a pattern or

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[51] The Supreme Court has said that "[a]s a general rule for such large numbers, if the difference between the expected value and the observed number is greater than two or three standard deviations," then the hypothesis under examination would be suspect. Castaneda v. Partida, 430 U.S. 482, 497, n. 17 (1977); Hazelwood School District, 433 U.S. at 309, n. 14.

[52] In fact, the Gay court stated that "courts should be 'extremely cautious' of drawing any inferences from standard deviations in the range of 1 to 3." Gay, 694 F.2d at 551 (citing EEOC v. American National Bank, 652 F.2d 1176, 1192 (4th Cir. 1981)).

[53] The statistical analysis in this case suggests that the possibility that the excess rate that was charged to members of protected classes was due to chance was less than one in 100 for the "close" comparisons (those with a difference of between 2.5 and 3 units of standard deviation) and between one in three thousand and one in several million for the larger differences. (See the last set of tables in Appendix B.)

practice of discrimination exclusively through presentation of our statistical evidence.[54]

B. Long Beach is liable for discriminatory loans for which it provided the funds

Our statistical analysis shows that protected classes paid more for the loans they received from Long Beach than did non-protected classes. Under the ECOA and the FHA, Long Beach is responsible for loans which it funds.

1. Long Beach violated the Fair Housing Act by funding loans made to members of protected classes at higher rates than loans made to non-protected classes

The Fair Housing Act provides:

> It shall be unlawful for any person or other entity whose business includes engaging in residential real estate-related transactions to discriminate against any person in making available such a transaction, or in the terms or conditions of such a transaction, because of race, color, religion, sex, handicap, familial status, or national origin.

42 U.S.C. §3605(a).

In interpreting the Fair Housing Act, courts have repeatedly declared that the provisions of the Act are "broad and inclusive" in protecting against conduct which interferes with fair housing rights, and are subject to "generous construction." Trafficante v. Metropolitan Life Insurance Co., 409 U.S. 205, 209, 212 (1972); United States v. City of Edmonds, 115 S.Ct. 1776, 1780 (1995); United States v. California Mobile Home Park, 29 F.3d 1413, 1416 (9th Cir. 1994).

In enacting the FHA, Congress has explicitly made it unlawful for a lending institution, such as Long Beach, to discriminate in the pricing of home mortgage loans. See Harrison v. Otto G. Heinzeroth Mortgage Co., 430 F.Supp. 893, 896 (N.D. Ohio 1977) (mortgage company and its employees violated § 3605 by refusing to offer racially neutral financing terms for the purchase of a house located in a racially mixed neighborhood); see also Harper v. Union Sav. Ass'n, 429 F.Supp. 1254, 1257-58

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[54] We suspect that we will be able to bolster our statistical evidence with anecdotal evidence from people who have had loans from Long Beach. In Appendix A, we have included a short description of some of the terms offered to Long Beach borrowers which most clearly demonstrate the difference in treatment of members of protected classes.

(N.D. Ohio 1977) (upholding claim that mortgage company had not been equally aggressive in foreclosing against delinquent white borrowers stated a cause of action under § 3605); Laufman v. Oakley Building & Loan Co., 408 F.Supp. 489, 493 (S.D. Ohio 1976).

Long Beach is subject to the FHA's prohibition against discrimination. The FHA prohibits invidious discrimination by entities that engage in residential real-estate related transactions. The FHA defines a "residential real-estate related transaction" as "[t]he making or purchasing of loans or providing other financial assistance ... secured by residential real estate." 42 U.S.C. § 3605(b)(1)(B). Virtually all of the loans funded by Long Beach that are the subject of this recommendation were secured by borrowers' homes which are residential real estate. Therefore, Long Beach is an "entity whose business includes engaging in residential real estate-related transactions" within the meaning of the FHA, and is subject to the anti-discrimination provisions of the FHA. 42 U.S.C. § 3605(a).

The interest rate, up-front points and fees related to a home equity or mortgage loan are "terms or conditions" of a "real estate-related transaction" under the FHA. 24 C.F.R. § 100.130(b)(2).

Thus, the higher prices, in the form of higher interest rate, higher up-front points or higher fees, charged for home mortgage loans by Long Beach to its black, Hispanic and female borrowers through its retail loan officers and wholesale mortgage brokers constitute a clear violation of the Fair Housing Act.

2. Long Beach violated the ECOA by funding loans made to members of protected classes at higher rates than loans made to non-protected classes

The ECOA provides:

> It shall be unlawful for any creditor to discriminate against any applicant, with respect to any aspect of a credit transaction --
>
> (1) on the basis of race, color, religion, national origin, sex or marital status, or age ...

15 U.S.C. § 1691(a).

As with the FHA[55], the ECOA is to be interpreted liberally

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[55] The ECOA, in conjunction with Title VII and Title VIII, is "one more tool to be used in our vigorous national effort to (continued...)

so as to best effectuate the purpose of eradicating discrimination in credit transactions and to prevent creditors from profiting from invidious discrimination. See Brothers v. First Leasing, 724 F.2d 789 (9th Cir.), cert. denied, 469 U.S. 832 (1984)[56]; Silverman v. Eastrich Multiple Investor Fund, 51 F.3d 28, 32-33 (3d Cir. 1995)[57]. Cf. United States v. Landmark

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[55](...continued)
eradicate invidious discrimination 'root and branch' from our society." Brothers, 724 F.2d at 794. As such, it is appropriate to look to the caselaw developed under Title VII and Title VIII to interpret the ECOA. See Mercado Garcia v. Ponce Federal Bank, 779 F.Supp. 620, 628 (D.P.R. 1991), aff'd, 979 F.2d 890 (1st Cir. 1992) ("Courts which have interpreted ECOA have used the same analytical framework as that used in action pursuant to Title VII of the Equal Employment Opportunity Act."); Gross v. United States Small Business Administration, 669 F.Supp. 50, 52 (N.D. N.Y. 1987), aff'd, 867 F.2d 1423 (2nd Cir. 1988) ("other courts have generally required proof in ECOA cases to conform to the traditional Title VII tests"); Moore v. United States Department of Agriculture, 857 F.Supp. 507, 513 (W.D. La. 1994), reversed on other grounds 55 F.3d 991 (5th Cir. 1995) (applying the McDonnell Douglas burden-shifting scheme to ECOA). Thus, like the FHA under Trafficante, the ECOA should be interpreted generously.

[56] In Brothers, the Ninth Circuit held that the ECOA applied to lease contracts as well as straight credit contracts. In so doing, the court stated:

> Although 'credit transactions' might in some contexts lend itself to a narrow interpretation, we cannot give it such a construction in the ECOA in view of the overriding national policy against discrimination that underlies the Act ... We must construe the literal language of the ECOA in light of the clear, strong purpose evidenced by the Act and adopt an interpretation that will serve to effectuate that purpose.
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> * * *
>
> [to interpret the ECOA as defendants suggest] would be inconsistent with the broad purpose of the statute and the liberal construction we must give it.

724 F.2d at 793-94.

[57] In Silverman, the Third Circuit determined that violations of ECOA could be raised as defenses to collection actions even after the ECOA statute of limitations had run. In arriving at that holding, the court stated:

> Congress -- in enacting the ECOA -- intended that creditors not affirmatively benefit from proscribed acts of credit
>
> (continued...)

Financial Services, Inc., 612 F.Supp. 623, 628 (D. Md. 1985) (in deciding to allow the FTC discretion to bring civil actions under the ECOA, the court relied upon the congressional history that said "the Committee believed that strong enforcement of this Act is essential to accomplish its purpose"); N.C. Freed Co., Inc. v. Board of Governors, 473 F.2d 1210, 1214 (2d Cir.) (remedial statutes are to be construed liberally and the Consumer Credit Protection Act is remedial, so it should be construed liberally), cert. denied, 414 U.S. 827 (1973). But see Evans v. First Federal Savings Bank of Indiana, 669 F.Supp. 915, 922, n. 3 (N.D. Ind. 1987) (ECOA's standing requirements are stricter than the standing requirements under the Fair Housing Act). The primary goal of Congress in enacting § 1691, part of the Equal Credit Opportunity Act Amendments of 1976, was to provide citizens legal redress for the discriminatory activities of creditors. S.Rep. No. 589, 94th Cong.2d Sess., at 3, 13, reprinted in 1976 U.S. Code Cong. & Ad. News at 403, 405, 415.

Long Beach is subject to the ECOA's prohibition against discrimination. The ECOA prohibits invidious discrimination by creditors. The ECOA defines "creditor" as "any person who regularly extends, renews or continues credit ..." 15 U.S.C. § 1691a. See also 12 C.F.R. 202.2(l). Long Beach was in the business of loaning money to borrowers. Therefore, Long Beach is a creditor within the meaning of the ECOA and is subject to its anti-discrimination provisions.

The terms of a loan are an "aspect of a credit transaction" under ECOA. 12 C.F.R. § 202.2(m). By charging higher points and rates to those persons protected by the Act, through both its retail and wholesale residential mortgage operations, Long Beach has clearly violated the ECOA.[58]

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[57](...continued)
discrimination. To permit creditors -- especially sophisticated credit institutions -- to affirmatively benefit by disregarding the requirements of the ECOA would seriously undermine the Congressional intent to eradicate gender and marital status based credit discrimination.

51 F.3d at 33 (quoting Integra Bank v. Freeman, 839 F.Supp. 326, 329 (E.D. Pa. 1993)).

[58] In addition to the ECOA violations related to discriminatory pricing, OTS found various ECOA violations during its March 1993 compliance review related to incomplete documentation within the loan files. For example, in a review of several rejected mortgage loan files, Long Beach had not notified the applicant of the action taken within 30 days of receipt of a complete\incomplete application as required by 12 C.F.R.
(continued...)

3. There is no legal distinction between the loans that Long Beach funded through its wholesale loan program and those loans funded through its retail program

Our statistical analysis encompassed both Long Beach's retail and wholesale loan programs. Without conceding liability for the loans initiated by the retail loan officers, Long Beach's counsel has suggested that Long Beach should not be held responsible for the loans initiated by the wholesale brokers. Long Beach's counsel has argued that the brokers are the entities that set the terms of the loan, and as such, the brokers, not Long Beach, should be held liable for any discrimination in the loans.

Long Beach's attempt to draw a distinction between its potential liability for the loans initiated by the loan officers and those initiated by the brokers is misdirected. The Complaint alleges that Long Beach discriminated in its loan program as a whole. There is no legal distinction related to Long Beach's liability that Long Beach can draw between the loans initiated by the brokers and the loans initiated by the retail officers. Under both the ECOA and the FHA, Long Beach, as the provider of funds, is liable for loans which it made. Both the FHA and the ECOA place the burden of complying with the law upon the provider of funds.[59] This burden makes Long Beach directly, rather than vicariously, liable for any violation of the respective statute.[60]

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[58](...continued)
202.9(a)(1)(i) and (ii). Several files also lacked evidence that an adverse action notice was sent to the applicant contrary to 12 C.F.R. 202.9(a) and the record retention provisions of 12 C.F.R. 202.12(b).

[59] The ECOA also places a burden upon brokers. See 15 U.S.C. § 1691a(e) (the definition of "creditor" includes "any person who regularly arranges for the extension ... of credit"); 12 C.F.R. § 202.2(l) (the definition of "creditor" includes those who "regularly refer[] applicants to creditors"). But this burden on brokers is in addition to, rather than in stead of, the burden placed upon the lenders.

[60] We have chosen not to pursue a theory of vicarious liability for two primary reasons. First, as will be discussed further below, it is possible that the brokers did not discriminate. If the brokers did not discriminate, then there is no basis for holding Long Beach liable for the actions of the brokers.

(continued...)

a. Long Beach is responsible for ensuring that it complies with other aspects of the federal credit laws, and, hence, is responsible for complying with the non-discrimination provisions of the federal credit laws

A lender is responsible for ensuring compliance with other requirements under federal credit laws and regulations whether or not a third party is involved in the transaction. For example, under ECOA, the **lender** is required to send out an adverse action letter if a loan is not approved. See 15 U.S.C. § 1691(d); 12 C.F.R. §§ 202.2(b)(1), 202.9. Similarly, under TILA, the **lender** is responsible for making sure all the necessary disclosures are made. See 15 U.S.C. §§ 1602, 1638; 12 C.F.R. 226.2(17). "Certainly, abolishing discrimination in the affording of credit is at least as important as compelling the disclosures of information regarding finance charges." Brothers, 724 F.2d at 794.

b. Long Beach has a non-delegable duty to its borrowers to ensure that the loans are non-discriminatory

Long Beach has indicated that it will argue that since the broker, rather than Long Beach, negotiates with the customer, the broker is the responsible party. The negotiations between the consumer and the broker, however, are irrelevant to Long Beach's liability.[61] Under the FHA and the ECOA, Long Beach has a non-delegable duty to not discriminate on the basis race, national origin, gender and age which runs from Long Beach to the

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[60](...continued)
Second, even if the brokers were discriminating, it would be difficult if not impossible to prove that they were discriminating. Most of the brokers referred only one or two loans a year to Long Beach and the small numbers of loans precludes statistical analysis. Moreover, Long Beach dealt with thousands of brokers. It would be prohibitively expensive to investigate each of the thousands of brokers.

[61] Note that this will be a case of first impression as the first case in which a lender will be held directly liable for loans initiated and negotiated by a third party. All discrimination cases brought under ECOA that we have looked at involved lenders who engaged in interaction directly with the customer. See e.g. United States v. American Future Systems, Inc., 743 F.2d 169 (3rd Cir. 1984); Miller v. American Express Co., 688 F.2d 1235 (9th Cir. 1982).

borrower.[62] That duty includes the responsibility to recognize that accepting a loan which disfavors a protected class violates the federal civil rights laws, and to reject loans with terms which discriminate against protected borrowers.[63]

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[62] Under Title VII and Title VIII, employers and property owners have a "non-delegable duty" to not discriminate. See Walker v. Crigler, 976 F.2d 900, 904-05 (4th Cir. 1992); Phiffer v. Proud Parrot Motor Hotel, Inc., 648 F.2d 548, 552 (9th Cir. 1980); Marr v. Rife, 503 F.2d 735, 741 (6th Cir. 1974); Saunders v. General Services Corp., 659 F.Supp. 1042, 1059 (E.D. Va. 1987); Harrison v. Otto G. Heinzeroth Mortgage Co., 430 F.Supp. 893, 897 (N.D. Ohio 1977); United States v. Youritan Construction Co., 370 F.Supp. 643, 649 (N.D. Cal. 1973), aff'd in relevant part 509 F.2d 623 (9th Cir. 1975); United States v. Gorman Towers, 857 F.Supp. 1335, 1341 (W.D. Ark. 1994).

No court has considered whether a non-delegable duty to not discriminate exists under ECOA. As discussed supra, n. 55, courts should look to Title VII and Title VIII to interpret the ECOA. Since the non-delegable duty to not discriminate is well established in the Title VII and Title VIII context, we have a strong argument that ECOA has created a similar non-delegable duty.

Under the non-delegable duty doctrine, the party upon whom the duty falls may not escape liability by attempting to transfer its non-delegable responsibility to another person.

> The concept of nondelegable duty imposes upon the principal not merely an obligation to exercise care in his own activities, but to answer for the well-being of those persons to whom the duty runs. The duty is not discharged by using care in delegating it to an independent contractor. Consequently, the doctrine creates an exception to the common-law rule that a principal normally will not be held liable for the tortious conduct of an independent contractor. So understood, a nondelegable duty is an affirmative obligation to ensure the protection of the person to whom the duty runs.

General Building Contractors Association v. Pennsylvania, 458 U.S. 375, 395-96 (1982) (citations omitted).

[63] Alternatively, there is evidence to suggest that Long Beach, in fact, has control over the wholesale brokers and over the terms of the loans that the broker initiated. For example:

> a. a clause in the Broker Agreement read "Lender may, in its sole discretion, decide whether or not to make a loan to

(continued...)

c. There is no practical difference between the loans initiated by the retail loan officers and the loans initiated by the wholesale brokers

Long Beach has indicated that, while it denies any wrongdoing on the part of its retail loan officers, it understands that, if there was wrongdoing on the part of the retail officers, it may be held liable. In contrast, Long Beach specifically denies any liability for any of the loans initiated by the wholesale brokers even if the brokers violated the law. Long Beach argues that it had no control over the actions of the brokers and, hence, should not be held liable for the brokers' conduct.

There is no practical difference, however, between loans initiated by Long Beach's retail agents and those initiated by the independent brokers: under both scenarios, loan-proposals are submitted to Long Beach's underwriting department; under both scenarios, Long Beach's "offers" are priced according to Long Beach's underwriting guidelines; under both scenarios, there are negotiations between Long Beach and the agent/broker regarding fees, points and rate; and, under both scenarios, the underwriter who decides whether or not Long Beach will fund the loan does not deal directly with the customer. Therefore, to the extent that Long Beach concedes that it may be held responsible for the loans

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[63](...continued)
an applicant and may determine the terms and conditions of any such loan";
b. a clause in the Broker Agreement stated that the broker was to prepare and submit applications for loans "which shall meet the requirements established by Lender";
c. Long Beach shared in the profits of the higher prices and, hence, had the power to, at least, give up their profits for the benefit of the customer;
d. Long Beach was able to impose a rate/fee cap in 1993, and was able to alter the cap in subsequent years, suggesting that it had some unilateral control over the prices that the brokers charged;
e. Long Beach had a point/rate-exchange system in place, but encouraged points rather than rate; and
f. Long Beach provided a range of prices to fund identically qualified applicants, suggesting that Long Beach, itself, considered factors other than the applicant's qualifications when negotiating with the broker.
Thus, we can show that Long Beach had sufficient control over the terms and conditions of the loan initiated by the wholesale brokers to be able to make the terms and conditions non-discriminatory. Long Beach's failure to neutralize the discriminatory terms and conditions of the loans is hence, a violation of both ECOA and the FHA.

initiated by the retail officers, it should also recognize potential liability for the loans initiated by the brokers.

d. Long Beach is the only actor who has the knowledge and capacity to identify discriminatory loans

Long Beach is the only actor in this case who can monitor the loans initiated by the wholesale brokers and compare them to loans initiated by the retail loan officers. Long Beach is the only one who has the knowledge or the capacity to accurately see the discrimination that is occurring in the loans which it funds. An individual broker is incapable of comparing the isolated loans it refers to Long Beach to the other loans which Long Beach funds.

To frame the theory of direct liability, it helps to consider a situation in which there is no discrimination by a broker and yet a minority customer winds up with a loan that is more expensive than a loan given to a similarly situated white customer. Such a situation may arise when one broker deals exclusively with minority clients. Assume that such a broker was not illegally discriminating; the broker would treat a white applicant the same way it treats a black applicant, but the broker deals exclusively with black applicants. If such a broker consistently charges its customers more than the Long Beach average for similarly situated whites, and if Long Beach funds the broker's loans, then Long Beach's black customers wind up with loans that are more expensive than the loans for similarly situated whites.[64] The broker, however, was not discriminating, hence there is no basis for vicarious liability. In such a situation, Long Beach, by agreeing to fund the loan, has turned a non-discriminatory loan into a discriminatory loan. Long Beach should be directly liable for this discriminatory action.

If Long Beach is not held directly liable under these circumstances, then it is possible that no one may be held liable, and discrimination which appears to pervade the "B/C" credit markets will be allowed to continue. The individual brokers do not generally do a large enough volume of loans to generate valid statistical data. Thus, unless the brokers leave smoking guns in their files, it will be extremely difficult to prove a case of discrimination against individual brokers. Additionally, bringing suit against individual brokers will do little to affect the actions of the other individual brokers who

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[64] If there is a non-discriminatory business justification for the difference in price, Long Beach has not suggested what that justification might be. Further, if there were a claim of business justification, it would have to explain the differences from one wholesale loan to another, not just the difference between wholesale and retail prices.

will be willing to play the odds against their being selected for investigation from amongst the thousands of brokers. Since we do not have the resources to investigate every broker, it is likely that many victims of discrimination will go without relief. In contrast, by holding Long Beach liable for loans which they funded, we indirectly reach all the brokers with whom Long Beach dealt, and we are able to compensate all the victims who had loans with Long Beach.

C. The two-year statute of limitations under the ECOA is no bar to the bringing of this suit

We anticipate that Long Beach may try to argue that this action is barred by the statute of limitations. Such an argument will not succeed.

First, under the Fair Housing Act, there is no statute of limitations for pattern or practice cases brought by the attorney general. See United States v. City of Parma, 494 F. Supp. 1049, 1094 n.63 (N.D. Ohio) (under a predecessor statute, 42 U.S.C. § 3613, pattern or practice cases brought by Attorney General not subject to a statute of limitations), aff'd, 661 F.2d 562 (6th Cir. 1981), cert. denied, 456 U.S. 926 (1982); United States v. Yonkers Bd. of Educ., 624 F. Supp. 1276, 1374 n.72 (S.D. N.Y. 1985), aff'd, 837 F.2d 1181 (2nd Cir. 1987), cert. denied, 486 U.S. 1055 (1988). But see United States v. Incorporated Village of Island Park, 791 F. Supp. 354, 364-67 (E.D.N.Y. 1992) (differentiating between statute of limitations for injunctive relief and statute of limitations for damages). To hold otherwise would render the enforcement powers of the Attorney General ineffectual:

> [T]he policies and practices challenged by the government can not be limited to a single incident occurring at a specific time. To establish a pattern or practice, the government must be able to challenge decisions which have been made over a period of time. The practical effect of accepting [defendant's] position would be to limit the Attorney General to patterns and practices which existed no longer than [18 months] prior to the filing of a lawsuit. Such a position is clearly inconsistent with a broad construction of the Fair Housing Act. See Trafficante v. Metropolitan Life Ins. Co., 409 U.S. 205, 93 S.Ct. 364, 34 L.Ed.2d 415 (1972).

City of Parma, 494 F. Supp. at 1094 n.63. Thus, the claims brought under the Fair Housing Act are protected from any statute of limitations challenge.

The ECOA, on the other hand, specifically provides for a two-year statute of limitations. 15 U.S.C. § 1691e(f). This two

year statute of limitations applies to actions commenced by the Attorney General.[65] 15 U.S.C. § 1691e(h). Cf. United States v. Blake, 751 F.Supp. 951 (W.D. Okla. 1990) (an FTC action under § 1691(d) has a different statute of limitations from the two year statute of limitations applicable to actions brought under § 706). Since age is not a protected category under the Fair Housing Act, our claim of age discrimination is wholly reliant upon the ECOA. Therefore, it is important to address potential statute of limitations concerns under the ECOA.

For statute of limitations purposes, the essential fact that must be established in order to determine when the statute begins to run is when (if at all) the pattern or practice of discrimination ended. Havens Realty Corp. v. Coleman, 455 U.S. 363, 380-81 (1982). See also Spann v. Colonial Village, Inc., 899 F.2d 24, 34 (D.C. Cir.), cert. denied, 498 U.S. 980 (1990); Gorman Towers, 857 F.Supp. at 1340; Wolf v. City of Chicago Heights, 828 F.Supp. 520, 523 (N.D. Ill. 1993).[66]

Our expert's statistical analysis shows that the black/white and Hispanic/white differentials lasted through December 1993 for retail loans and through at least June 1994 (the last month for which we have data) for wholesale loans. Hence, for the discrimination against blacks, the statute of limitations did not begin to run until June 1994, and will not expire until June 1996.

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[65] The two year statute of limitations listed in sub-section (f) applies to "[a]ny action under **this section**," meaning, § 1691e. 15 U.S.C. § 1691e(f) (emphasis added). Actions brought by the Attorney General are brought under § 1691e. 15 U.S.C. § 1691e(h). Therefore, the two year statute of limitations applies to actions brought by the Attorney General.

[66] In amending the Fair Housing Act in 1988, Congress specifically affirmed and adopted the continuing violation theory as applicable to the FHA:

> [the amendments are] intended to reaffirm the concept of continuing violations, under which the statute of limitations is measured from the date of the last asserted occurrence of the unlawful practice.

Gorman Towers, 857 F.Supp. at 1340 (quoting H.R. Rep. 711, 100th Cong. 2d Sess. at p. 33 (1988), reprinted in U.S. Code Cong. & Admin. News 1988 at pp. 2173, 2194). See also Community Interaction-Bucks County, Inc. v. Township of Bensalem, 1994 WL 276476, *5 (E.D. Pa. 1994) (quoting same passage from H.R. Rep.).

Long Beach has engaged in a comprehensive pattern or practice of discrimination against four different and overlapping protected classes. We have not yet asked the expert to do a month-by-month analysis of the price differences by age and sex, but we note that his findings to date are for the entire 42-month period ending June 30, 1994. We doubt that any court would entertain a contention that the defendant engaged in four separate patterns of discrimination, thus necessitating a separate statute of limitations analysis for each. Moreover, should a court require such separate proof, we anticipate that the discrimination against each of the protected classes, including the discrimination against older applicants, persisted until June 1994.

Should the court require a separate analysis of each protected class for pattern or practice purposes, and should the pattern of discrimination against some of the protected classes not have persisted until 1994, then we would raise the equitable tolling doctrine of diligent discovery.[67] The doctrine of diligent discovery holds that a "plaintiff may avoid the bar of the statute of limitations if despite all due diligence he is unable to obtain vital information bearing on the existence of his claim." Cada v. Baxter Healthcare Corp., 920 F.2d 446, 451 (7th Cir.), cert. denied, 501 U.S. 1261 (1991). Cf. 28 U.S.C. § 2416(c) (under Title 28, the statute of limitation on an action brought by the United States for money damages is tolled as long as "facts material to the right of action are not known and reasonably could not be known by an official of the United States charged with the responsibility to act in the circumstances...").

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[67] The doctrine of diligent discovery, an equitable tolling doctrine, should not be confused with the "discovery rule," a mandatory accrual doctrine. Under the discovery rule, the accrual date for a cause of action

> is not the date on which the wrong that injures the plaintiff occurs, but the date -- often the same, but sometimes later -- on which the plaintiff discovers that he has been injured.

Cada v. Baxter Healthcare Corp., 920 F.2d 446, 451 (7th Cir.), cert. denied, 501 U.S. 1261 (1991). See also Tolle v. Carroll Touch, Inc., 977 f.2d 1129, 1139 (7th Cir. 1992); Colonial Penn Ins. Co. v. Market Planners Ins. Agency, Inc., 1 F.3d 374 (5th Cir. 1993); Gorman Tower Apartments, 857 F.Supp. at 1340. The discovery rule "is read into statutes in federal question cases ... in the absence of a contrary directive from Congress." Cada, 920 F.2d at 450. Courts have applied the discovery rule in cases involving the ECOA. See Jones v. Citibank Federal Savings Bank, 844 F.Supp. 437 (N.D. Ill. 1994).

In this case, we can argue that the statistical analysis of the loan application files was a necessary step for us to obtain "vital information bearing on the existence of our claim." Until we obtained an accurate statistical analysis, we could not know if Long Beach was engaging in illegal conduct. Hence, we can argue that the statute of limitations should be tolled for the length of time it took us to collect the data from Long Beach and conduct a statistical analysis on the data.

To bolster this equitable tolling argument, we can point to the fact that Long Beach held all the data in their files. We could not access their loan files, or the other information vital to our claims, without their cooperation and permission. Long Beach, while not uncooperative, has been less than speedy in their compliance with our requests for information. Moreover, on at least two occasions, counsel for Long Beach has requested that we refrain from filing our complaint.[68] Equitable estoppel can be used to toll a statute of limitations "if the defendant takes active steps to prevent the plaintiff from suing in time, as by promising not to plead the statute of limitations." Cada, 920 F.2d at 450. Equitable estoppel is "grafted on to federal statutes of limitations." Id. at 451. In this case, Noto's request that we not file implicitly suggested that he would not plead statute of limitations. Thus, we can argue that Long Beach is equitably estopped from pleading the statute of limitations.

E. Every member of a protected class who received a loan from Long Beach is entitled to monetary damages

1. Victims of illegal discrimination are entitled to actual damages

Under both the Fair Housing Act and ECOA, victims of discrimination are entitled to actual damages, including out-of-pocket monetary losses, injury to credit reputation, and mental anguish, humiliation or embarrassment. 42 U.S.C. 3614(d) and 15 U.S.C. § 1691e(a) & (b). See Anderson v. United Finance Co., 666 F.2d 1274, 1277-78 (9th Cir. 1982).

Once the United States has proved a pattern or practice of discrimination against a protected class, all members of the protected class who received loans funded by Long Beach are

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[68] Tom Noto, counsel for Long Beach, first requested that we delay filing our action immediately after his move from his old firm to Kirkpatrick & Lockhart in early July, 1995. At that time, Noto requested a meeting with us on August 7, 1995, and asked that we refrain from filing until after the meeting. The second request came during our meeting on August 1, 1995, at which Noto again requested that we refrain from filing until September 1, 1995.

presumed to have been victims of discrimination no matter what the actual terms of the loan were. See Craik v. Minnesota State University Bd., 731 F.2d 465, 469-71 (8th Cir. 1984) (citing Teamsters, 431 U.S. at 359); Wooldridge v. Marlene Industries Corp., 875 F.2d 540, 545-47 (6th Cir. 1989); United States v. City of Chicago, 853 F.2d 572, 575 (7th Cir. 1988); Holden v. Burlington Northern, Inc., 665 F.Supp. 1398, 1413 (D. Minn. 1987). This presumption, while rebuttable, not only shifts the burden of production to the defendants, but also shifts the burden of proof. Craik, 731 F.2d at 470. Thus, once we have shown a pattern or practice of discrimination, all members of the protected class are presumed to be entitled to relief even if they received loan terms which were better than the non-protected average.

Moreover, because this case involves a continuing violation, any victim of discrimination during the pattern or practice is entitled to recover irrespective of when the victim received the loan. Under the continuing violation doctrine, "recovery may be had for all violations, on the theory that they are part of one, continuing violation." Hendrix v. Yazoo City, 911 F.2d 1102, 1103 (5th Cir. 1990). See Also EEOC v. Occidental Life Ins. Co., 535 F.2d 533, 537 (9th Cir. 1976), aff'd, 432 U.S. 355 (1977) (under Title VII, the statute of limitations could not limit money damage awards to aggrieved persons because money damages served a public purpose by acting as a "spur or catalyst" forcing employers to change their practices). But see United States v. Georgia Power Co., 474 F.2d 906 (5th Cir. 1973) (disagreeing with Occidental Life).

Moreover, the ECOA specifically provides that when the Attorney General brings a pattern or practice suit,

> then any applicant who has been a victim of discrimination which is the subject of such proceeding or civil action may bring an action under this section not later than one year after the commencement of that proceeding or action.

15 U.S.C. 1691e(f)(2). A private action, therefore, may be brought against Long Beach for the same violations of the ECOA within one year after we file our lawsuit. Given that private causes of action are still viable, it would be inappropriate to limit the Attorney General's ability to recover damages on behalf of the individuals.[69]

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[69] The legislative history of the ECOA is relevant here and consistent with the principle behind the discovery rule. In recommending the change from one year to two years and giving private individuals an extra year to file under the ECOA after

(continued...)

Thus, we should be allowed to recover damages on behalf of all victims of Long Beach's pattern or practice of discrimination irrespective of when the victim actually initiated his or her loan.

2. Victims of discrimination are also entitled to punitive damages

Punitive damages are also available under the FHA and the ECOA. See Anderson, 666 F.2d at 1277-78; Fischl v. General Motors Acceptance Corp., 708 F.2d 143, 148 (5th Cir. 1983). Under the ECOA, the Ninth Circuit has held that punitive damages may be awarded if (1) the creditor wantonly, maliciously or oppressively discriminates against an applicant, or (2) the creditor acts in "reckless disregard of the requirements of the law," even though there was no specific intention to discriminate on unlawful grounds. Anderson, 666 F.2d at 1278 (citing Shuman v. Standard Oil Co., 453 F.Supp. 1150, 1155 (N.D.Cal. 1978)). This determination is to be made by considering all the relevant factors, including "the amount of any actual damages awarded, the frequency and persistence of failures of compliance by the creditor, the resources of the creditor, the number of persons adversely affected, and the extent to which the creditor's failure of compliance was intentional." Id. (citing 15 U.S.C. § 1691e(b)(1976)).

Similarly, under the Fair Housing Act,

> [p]unitive damages are appropriate in cases of "reckless or callous disregard for the plaintiff's rights, [or] intentional violations of federal law. . . ." Smith v. Wade, 461 U.S. 30, 51 (1983); see also Newport v. Fact Concerts, Inc., 453 U.S. 247, 266-67 (1981) (punitive damages are appropriate where a

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[69](...continued)
the Attorney General files, the Committee stated:

> ...where it is likely that individual applicants may only learn of potential violations through publicity surrounding the government's action, we believe the affected applicant should have a reasonable additional time to bring his or her private action.

S. Rep. No. 94-589, 94th Cong., 2nd Sess. 415 (1976). Thus, Congress was aware that private individuals who are victims of discrimination under the ECOA were unlikely to learn of this fact absent action by the Attorney General. Thus, borrowers who took out loans from Long Beach prior to 1993 may be entitled to money damages.

> wrongful act is "intentional or malicious"). This does not mean that the defendant had to know he was violating the law. As we stated in McKinley v. Trattles, 732 F.2d 1320, 1327 (7th Cir. 1984), "[u]nder Smith, if the conduct upon which liability is founded evidences reckless or callous disregard for the plaintiff's rights or if the conduct springs from evil motive or intent, punitive damages are within the discretion of the jury."

Balistrieri, 981 F.2d at 936. See also Wulf v. City of Wichita, 883 F.2d 842, 867 (10th Cir. 1989); Asbury v. Brougham, 866 F.2d 1276, 1282 (10th Cir. 1989).

Thus, under either the ECOA or the FHA, it is not necessary that defendants' actions were motivated by hostility or malice toward the complainants, but only that defendants intentionally took the actions that constituted violations of the Act.

Note that the ECOA specifically limits the amount of punitive damages that are available to an aggrieved borrower to $10,000 an to an aggrieved class in a class action to $500,000. See 15 U.S.C. § 1691e(b).[70] There is very little caselaw interpreting the limitation on punitive damages under the ECOA, and no court has considered the question of whether a pattern or practice case brought by the Attorney General is subject to the limitation.

There is no limitation on punitive damages under the Fair Housing Act. During settlement discussions with Long Beach, we

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[70] Section 1691e(b) provides in relevant part:

> Any creditor ... who fails to comply with any requirement imposed under this title shall be liable to the aggrieved applicant for punitive damages in an amount no greater than $10,000, in addition to any actual damages provided in subsection (a), except that in the case of a class action the total recovery under this subsection shall not exceed the lesser of $500,000 or 1 per centum of the net worth of the creditor. In determining the amount of such damages in any action, the court shall consider, among other relevant factors, the amount of any actual damages awarded, the frequency and persistence of failures of compliance by the creditor, the resources of the creditor, the number of persons adversely affected, and the extent to which the creditor's failure of compliance was intentional.

15 U.S.C. § 1691e(b).

will not distinguish between damages sought under the ECOA and damages sought under the Fair Housing Act.

3. The United States is entitled to receive civil penalties

Finally, the United States is entitled to an award of a civil penalty in an amount not to exceed $50,000 from the defendant. 42 U.S.C. 3614(d).[71]

4. The United States should avoid putting Long Beach out of business

In response to a question from counsel about the extent of Long Beach's potential liability, we said that we had no desire to seek damages that would put the lender out of business. Punishing Long Beach overly harshly may ultimately harm the people whom this action is supposed to protect, namely minority borrowers with limited options. It is certainly true that Long Beach, by focusing on the "B/C" market, is serving a market that has been heretofore ignored by the mainstream lenders. Long Beach does provide a cheaper alternative than the hard-money lenders that have historically dominated the "B/C" market.

That Long Beach is providing cheaper loans than are otherwise available to borrowers in the "B/C" market does not legally or morally excuse its practice of discrimination, but it does suggest that we should proceed with caution. Should we seek damages which are fatal to Long Beach or otherwise discourage quality "B/C" lenders from serving minority communities, we must recognize that a void will appear in the credit options available to those communities. We must further recognize that this void will likely be filled by hard money lenders rather than the regulated "A" money lenders. Moreover, even if "A" lenders attempt to fill the void, it is unlikely that they will completely succeed, for a fairly high percentage of Long Beach's clientele will not qualify for conforming loans.

F. Injunctive and Other Relief

Violations of remedial statutes such as those in this case call for broad relief. The Supreme Court has held:

> [T]he purpose of Congress in vesting broad equitable powers . . . was "to make possible the 'fashion[ing] [of] the most complete relief possible,'" and that the district courts have "'not merely the power but the duty to render a decree which will so far as possible

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[71] The ECOA is silent on the issue of whether the Attorney General may obtain civil penalties against a defendant.

eliminate the discriminatory effects of the past as well as bar like discrimination in the future.'"

Teamsters, 431 U.S. at 364 (Title VII), (quoting Albemarle Paper Co. v. Moody, 422 U.S. 405, 421, 418 (1975)). Both the Fair Housing Act and the ECOA provide for injunctive relief. 42 U.S.C § 3614(d) and 15 U.S.C. § 1691e(h).

Assuming that our notice letter leads to a period of negotiations towards a consent decree, we have been considering other affirmative relief in addition to the usual prohibitory injunctive relief.

1. Modifications of Long Beach's Practices

Early in our investigation, a Long Beach official told us that Long Beach had entered the "B/C" mortgage market in an attempt to station itself between the "A" lenders and the "hard-money" lenders (characterized by Long Beach as preying on troubled borrowers by charging them exorbitant loan prices). Even though we have found discriminatory practices in Long Beach's retail operations, Long Beach is a great deal "better" than the worst players in this market.[72] This is evident from the substantial differences which exist between the average loan prices for Long Beach's wholesale and retail loans. In most cases, the Annual Percentage Rate (calculated on an anticipated four-year loan life) is more than one and one-half percentage points higher for wholesale loans. This is due in part to the caps placed by Long Beach on the number of points which can be charged on the loans it funds.

Because Long Beach's wholesale operation has grown to the point that approximately 60% of its loans are currently initiated by brokers, Long Beach's role in the market has become similar to that of the hard money lenders. Our remedial aims in this lawsuit should be geared towards pulling Long Beach back into the more central position in the market that it originally envisioned for itself.

In light of this and other goals, the affirmative relief we seek should include the following:

a. A plan to eliminate discriminatory pricing practices by loan officers and mortgage brokers;

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[72] Several of the loan files we reviewed showed that the borrowers were replacing loans they had obtained from hard-money lenders at rates substantially higher than those charged by Long Beach (even accounting for the drop in interest rates that was occurring at the time).

b. Establishment of additional retail offices in areas within which Long Beach is presently doing business to directly solicit and service mortgage loans;

c. An advertising campaign promoting Long Beach's more competitive pricing policies, explaining to customers that they do not have to pay the exorbitant prices for loans that are being charged by wholesale brokers and lenders of last resort;

d. Establishment of an effective monitoring system to prevent continued discriminatory pricing;

e. Establishment and maintenance of training programs to inform Long Beach's mortgage lending personnel of the requirements of the consent order;

f. A reporting provision through which Long Beach would keep the Department apprised of its implementation of and progress under a consent order;

g. Appropriate relief for identified victims of Long Beach's disparate treatment of mortgage applicants because of race, national origin, sex and age; and

h. A civil penalty.

III. Conclusion

For the reasons set out above, we ask that you sign the attached Complaint and forward this recommendation to Mr. Patrick for his approval.

cc: Records Chron Hancock Ross Cass Gavin