Notes

Equitable Access: Examining Information Asymmetry in Reverse Redlining Claims Through Critical Race Theory

Charles Falck*

I. INTRODUCTION

The economic collapse of 2008 affected an extraordinary number of Americans.[1] The implosion of the mortgage-backed securities market,

* Thank you to the editors of the *Texas Journal on Civil Liberties & Civil Rights* for their extraordinary help in preparing this Note for publication. I especially want to thank Professor Zipporah Wiseman for her guidance in developing this Note.

[1] Michael D. Hurd & Susann Rohwedder, *Effects of the Financial Crisis and the Great Recession on American Households* 21 (Nat'l Bureau of Economic Research, Working Paper No. 16407, 2010), *available at* http://www.nber.org/papers/w16407 (finding that the 2008 recession caused widespread financial distress among American households, with 40 percent of households surveyed affected by unemployment, negative home equity, arrears on mortgage payments, or

which accelerated the recession, was rooted in the American subprime loan market. Lending institutions made high-priced, dangerous loans to individuals whose credit profiles and incomes indicated that they were likely to default. As defaults mounted and housing prices fell, the worth of the complex financial instruments plummeted, as did the Wall Street institutions that used the instruments to leverage themselves with debt many times greater than their operating capital. The financial crisis exposed Wall Street as a house of cards, and much of the regulatory conversation in the years since has focused on preventing Wall Street institutions from so cavalierly mishandling the vast amounts of money the public entrusts to them.[2] Yet while chief executives and financial officers face closer scrutiny in the eyes of the law and public opinion, a graver reality confronts the borrowers who signed mortgages they were unlikely to ever pay off.

Some of these borrowers have turned to courts for redress. As a theoretical matter, these lawsuits straddle a precarious line: though the terms of these mortgages were unfavorable, could the borrowers seek compensation despite willingly accepting these unfavorable terms? Part II of this Note focuses on lawsuits alleging that banks engaged in predatory lending—that is, offering subprime loans to individuals who either could have qualified for a fairly administered loan or who should not have qualified for any loan. Plaintiffs have brought claims of this nature under the Fair Housing Act (FHA), the Truth in Lending Act, and the Equal Credit Opportunity Act. This Note will focus on claims alleged under the FHA.

The author will argue that courts should adopt a test for stating a prima facie claim of reverse redlining that does not penalize plaintiffs disadvantaged by information asymmetry. The tests used by courts have, to an extent, depended upon the plaintiffs showing the unfairness and discrimination in their loan terms by examining the loan terms of non-minority borrowers, even though such terms are quite complex and rarely available. Consequently, plaintiffs have to obtain, interpret, and explain loan terms that lenders have created, organized, and have easier access to.

In order to alleviate the information asymmetry, judges should first utilize a test for stating a reverse-redlining claim that allows plaintiffs, whenever possible, to make out a prima facie case by producing information from their own records or publicly available sources. Second, where statistical analysis of documents not belonging to plaintiffs is required, judges should clearly identify which statistics could be used to make out a prima facie claim.

---

foreclosure).

[2] *See, e.g.*, Timothy Geithner & Lawrence Summers, Op.-Ed, *A New Financial Foundation*, Wash. Post, June 15, 2009, at A15, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2009/06/14/AR2009061402443.html ("This current financial crisis had many causes. . . . But it was also the product of basic failures in financial supervision and regulation.").

In Part III, the Note will explore its thesis from Part II through critical race theory and neoclassical economics. The counter-arguments utilize notions of efficiency and rationality within the housing market, both before and after the 2008 crisis. In response, the Note will criticize several assumptions underlying the neoclassical approach, focusing on the realities disadvantaged minority plaintiffs face and detail attributes that make courts well suited to serve as institutions for reform. The Note will conclude by endorsing a more active role on the part of judges in addressing the information asymmetry faced by plaintiffs who bring reverse-redlining claims.

II. REVERSE-REDLINING CLAIMS

A. Evidence that Minority Borrowers Suffered More, the Fair Housing Act, and Reverse-Redlining Plaintiffs

Overwhelming evidence supports the notion that minority borrowers have suffered more from unfavorable loans than white borrowers. In 1998, during the early stages of the subprime bubble, borrowers in upper-income Black neighborhoods were more than six times as likely as borrowers in upper-income white neighborhoods to have refinanced a mortgage with a subprime loan, and more than twice as likely as borrowers in low-income white neighborhoods to have done so.[3] In 2006, at the height of the subprime bubble, Black borrowers were nearly twice as likely, and Latino borrowers were 50% more likely, than white borrowers to have a subprime loan—even when controlling for some borrowing and lending characteristics.[4] Black homeownership fell from 49% in 2005 to 46% in 2009 after the bubble burst.[5] Racial disparities manifested even in the terms of the subprime loans themselves: Black and Latino borrowers were more likely to have higher-priced subprime loans than similarly situated white borrowers.[6] Consequently, the loss of wealth suffered by Black and Latino communities has been immense, even when compared to the loss felt by white communities. As a result of the crisis, spillover costs from

---

[3] Raymond Brescia, *Tainted Loans: The Value of a Mass Torts Approach in Subprime Mortgage Litigation*, 78 U. CIN. L. REV. 1, 30–31 (2009) (citing U.S. DEP'T OF HOUS. & URBAN DEV. & U.S. DEP'T OF TREASURY, CURBING PREDATORY HOME MORTGAGE LENDING: A JOINT REPORT 22–23 (2000), *available at* www.huduser.org/publications/pdf/treasrpt.pdf).

[4] *Id.* at 31 (citing Robert B. Avery et al., *The 2006 HMDA Data*, 93 FED. RES. BULL. A73, A95 (2007), *available at* http:// www.federalreserve.gov/pubs/bulletin/2007/pdf/hmda06final.pdf).

[5] Robert G. Schwemm & Jeffrey L. Taren, *Discretionary Pricing, Mortgage Discrimination, and the Fair Housing Act*, 45 HARV. C.R.-C.L L. REV. 375, 381 (2010). White homeownership fell in the same period from 76% to 74.5%. *Id.* at 381 n.43.

[6] Brescia, *supra* note 3, at 31–32 (citing Robert B. Avery et al., *The 2006 HMDA Data*, 93 FED. RES. BULL. A73, A95 (2007), *available at* http:// www.federalreserve.gov/pubs/bulletin/2007/pdf/hmda06final.pdf).

foreclosures in Black and Latino communities were enormous—$194 billion and $177 billion respectively between 2009 and 2012.[7]

Redlining is the practice of refusing to lend because of race or other protected trait.[8] Section 3605 of the FHA prohibits redlining, making it unlawful for any person or 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." [9] A redlining case traditionally involves a minority plaintiff who has been denied a loan despite having similar qualifications as white borrowers who received similar loans.[10]

By contrast, reverse-redlining claims are brought by plaintiffs who received loans but allege that they were intentionally given unfavorable loans on account of their race—thus, the "reverse" of the redlining cases. Like redlining plaintiffs, reverse-redlining plaintiffs have also sued under FHA § 3605; in addition, reverse-redlining plaintiffs have sued under § 3604(b), which prohibits discrimination "against any person in the terms, conditions, or privileges of sale or rental of a dwelling . . . because of race, color, religion, sex, familial status, or national origin."[11]

The recognition of reverse-redlining claims under the same FHA provisions used to prohibit redlining might seem contradictory, given that the statute broadly aimed to increase access to credit for minorities.[12] However, as this Note will discuss, the tests that courts have used in reverse-redlining cases come from Title VII, which is part of "a coordinated scheme of federal civil rights laws enacted to end discrimination[,] . . . construed expansively to implement that goal."[13]

---

[7] Charles L. Nier III & Maureen R. St. Cyr, *A Racial Financial Crisis: Rethinking the Theory of Reverse Redlining to Combat Predatory Lending Under the Fair Housing Act,* 83 TEMP. L. REV. 941, 950 (2011) (citing DEBBIE GRUENSTEIN BOCIAN ET AL., CTR. FOR RESPONSIBLE LENDING, FORECLOSURES BY RACE AND ETHNICITY: THE DEMOGRAPHICS OF A CRISIS 11 (2010), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosures-by-race-and-ethnicity.pdf).

[8] Redlining in the strict sense means refusal to give credit based on geography and without regard to actual creditworthiness. Richard A. Givens, *The "Antiredlining" Issue: Can Banks Be Forced to Lend?*, 95 BANKING L.J. 515, 515 (1978). But there is a "tremendous overlap between redlining and lending discrimination." Anthony D. Taibi, *Banking, Finance, and Community Economic Empowerment: Structural Economic Theory, Procedural Civil Rights, and Substantive Racial Justice*, 107 HARV. L. REV. 1463, 1487 (1994). According to Raymond Brescia, the term comes from "lending practices where bankers would literally draw a red line on maps, identifying the communities—typically communities of color—where the bank would not extend credit." Raymond Brescia, *Subprime Communities: Reverse Redlining, The Fair Housing Act and Emerging Issues In Litigation Regarding the Subprime Mortgage Crisis*, 2 ALB. GOV'T L. REV. 164, 179 (2009).

[9] 42 U.S.C. § 3605(a) (2006).

[10] Nier III and St. Cyr, *supra* note 7, at 942.

[11] 42 U.S.C. § 3604(b) (2006).

[12] Dana Kaersvang, Note, *The Fair Housing Act and Disparate Impact in Homeowners Insurance*, 104 MICH. L. REV. 1993, 2000 (2006) (arguing that FHA sponsors aimed broadly to end discrimination in financial assistance for home ownership).

[13] Huntington Branch, NAACP v. Town of Huntington, 844 F.2d 926, 935 (2d Cir. 1988), *aff'd*, 488 U.S. 15 (1988) (quotations removed).

Given courts' broad construction of antidiscrimination laws to effectuate their remedial purpose, this apparent tension between the prohibitions against redlining and reverse redlining becomes less problematic.[14]

B. Varying Tests Adopted for Stating a Reverse-Redlining Claim

The 2008 collapse accelerated the rise of reverse-redlining cases in the district courts, where judges have struggled to find an appropriate legal test in the face of motions to dismiss. District courts construing the FHA in reverse-redlining cases have adopted different tests, depending in part on whether the plaintiffs assert a disparate treatment claim (that they were targeted because of their race) or assert a disparate impact claim (that, regardless of intent, reverse redlining disproportionately affected them because of their race). Arguably, none of these tests provide plaintiffs with a just and fair chance to prove their claims. The tests disadvantage plaintiffs by exacerbating their lack of access to, and knowledge of, the terms of other loans administered by defendants—an example of information asymmetry.

The Southern District of Ohio in *Matthews v. New Century Mortgage Corp.* evaluated a claim of disparate treatment.[15] The four *Matthews* plaintiffs, all single elderly women, sued for reverse redlining in violation of § 3605 of the FHA.[16] They alleged that New Century Mortgage Company gave them loans they never could have afforded, with high-priced and deceptive interest rates and terms that were kept from them.[17] They claimed that New Century intentionally targeted them for unfair loans on the basis of their sex and marital status.[18]

The Matthews court used an employment discrimination test from the U.S. Supreme Court's *McDonnell Douglas Corp. v. Green*[19] as its framework. Under *Matthews*, a prima facie case of reverse redlining requires showing "(1) that [the borrower] is a member of a protected class; (2) that [the borrower] applied for and was qualified for loans; (3) that the loans were given on grossly unfavorable terms; and (4) that the lender continues to provide loans to other applicants [outside the protected class] with similar qualifications, but on significantly more

---

[14] Benjamin Howell, Comment, *Exploiting Race and Space: Concentrated Subprime Lending as Housing Discrimination*, 94 CALIF. L. REV. 101, 137 (2006) ("Given the FHA's broad purpose and precedent supporting its expansive interpretation to remedy segregation's effects, novel arguments supported by strong empirical data regarding market conditions are important tools in combating the harmful effects of racially concentrated subprime lending.").

[15] 185 F. Supp. 2d 874 (S.D. Ohio 2002).

[16] *Id.* at 881.

[17] *Id.* at 877–82, 885–86.

[18] *Id.* at 887. *Matthews* is not a case of reverse redlining based on race; nonetheless, the framework it establishes applies equally to claims of reverse redlining based on race.

[19] 411 U.S. 792, 802–03 (1973).

favorable terms."[20] The *Matthews* court added that instead of meeting the fourth prong, a plaintiff could alternatively offer evidence that the lender intentionally targeted the plaintiff on the basis of a protected trait in order to state a claim.[21]

In denying the defendants' motion to dismiss, the *Matthews* court found that the plaintiffs satisfied each prong of the prima facie case.[22] However, the court failed to clearly define what types of evidence were needed to meet each prong, an omission that could disadvantage future reverse-redlining plaintiffs. First, the *Matthews* court failed to consider the obstacles facing plaintiffs by leaving ambiguous the definition of "qualified" under the test's second prong, which requires that plaintiffs show they were qualified for loans. In one sense, all reverse-redlining plaintiffs were "qualified" for a loan, in that they all were approved for one. However, only a portion of reverse-redlining plaintiffs were "qualified" in the sense that they could be expected to make their payments for a reasonable amount of time despite the unfavorable loan terms. The difference is crucial. If the test requires a showing that plaintiffs were "qualified" in the sense that they could be expected to make their payments, then plaintiffs who received loans that they could never afford in the first place would have a hard time surviving a motion to dismiss.

This concern is especially grave in cases where the plaintiffs assert that they could never afford any fairly administered loan. For reverse-redlining purposes, there is no practical distinction between plaintiffs who received less favorable loans than they qualified for and plaintiffs who should not have qualified for any fairly administered loan. In either context, the plaintiffs allege that they were targeted because of their protected trait for a loan designed to default. The second prong of the *Matthews* test precludes plaintiffs who should not have qualified for any fairly administered loan from surviving a motion to dismiss.

Second, the fourth prong disadvantages plaintiffs by requiring a showing that the lender "continues to provide loans to other applicants . . . on significantly more favorable terms."[23] Many plaintiffs rely on the theory that loan officers obscured the terms of the loans so that the plaintiffs think they are receiving one set of terms, when really they are receiving less favorable ones.[24] The *Matthews* court failed to define or offer examples of what constitutes "significantly more favorable terms."[25] Furthermore, the court does not explain how to acquire these

---

[20] *Matthews*, 185 F. Supp. 2d at 886.

[21] *Id.* at 886–87. The option of using evidence of intentional targeting to meet the fourth prong of the prima facie claim is explained further below.

[22] *Id.* at 887.

[23] *Id.* at 886.

[24] *See, e.g., Barkley v. Olympia Mortgage Co.*, Nos. 04 CV 875(RJD)(KAM), 05 CV 187(RJD)(KAM), 05 CV 4386(RJD)(KAM), 05 CV 5302(RJD)(KAM), 05 CV 5362(RJD)(KAM), 05 CV 5679(RJD)(KAM), 2007 WL 2437810 at *12 (E.D.N.Y. Aug. 22, 2007).

[25] *Id.*

loan terms offered by the same lenders to other borrowers—a significant hindrance, given that the documents are in the possession of the defendants.[26] The court does not consider these information asymmetry issues and leaves the plaintiffs with a lack of clarity as to how to satisfy this "significantly more favorable terms" prong.

The *Matthews* court did recognize an alternative to the fourth prong of the test.[27] Plaintiffs can instead present direct evidence of intentional targeting—that the lenders specifically sought out the plaintiffs on the basis of a protected trait.[28] However, the court again failed to illuminate how plaintiffs are supposed to tackle this information asymmetry problem and acquire this information.

The Eastern District of New York's standard for stating a prima facie reverse-redlining claim in *Barkley v. Olympia Mortgage Co.* more completely addresses the information asymmetry between reverse-redlining plaintiffs and lenders. In *Barkley*, the plaintiffs alleged that the lenders engaged in a property-flipping scheme where they bought houses in foreclosure auctions and artificially enhanced their market value.[29] They further alleged that the originators targeted the minority plaintiffs, as first-time homebuyers with limited financial means and knowledge, with loans that locked in the houses' enhanced value, so that originators could collect more on commission when the plaintiffs defaulted.[30] The court adopted the *Matthews* test for stating a prima facie claim of reverse redlining, but it interpreted the test to more equitably serve plaintiffs. First, the *Barkley* court resolved the ambiguity in the term "qualified" by holding that it requires only showing that the plaintiff qualify for a fairly administered loan.[31] Second, the *Barkley* court clarified how to use the "intentional targeting" alternative to the fourth prong.[32]

The *Barkley* court resolves the first ambiguity by rejecting the defendant's argument that the plaintiffs failed to satisfy the second *Matthews* prong.[33] The claim in *Barkley* specifically alleged that the plaintiffs could not afford the loans the originators coerced them into accepting.[34] The *Barkley* court only required the plaintiffs to show that they qualified for a fairly administered loan, not necessarily the loan terms at issue in the case.[35] Whether or not the plaintiffs could afford the

---

[26] Discovery, of course, is not available before one would need to defend against a motion to dismiss.

[27] *Matthews*, 185 F. Supp. 2d at 886–87.

[28] *Id.*

[29] *Barkley*, 2007 WL 2437810 at *2.

[30] *Id.* at *1–2.

[31] *Id.* at *15 (citation omitted).

[32] *Id.* ("The Court joins the other district courts to have considered reverse-redlining claims premised on targeting allegations and holds that plaintiffs may establish the fourth prong of their *prima facie* case with evidence of intentional targeting.").

[33] *Id.*

[34] *Id.* at *2.

[35] *Id.* at *15 (citing *Matthews v. New Century Mortgage Corp.*, 185 F. Supp. 2d 874, 887 (S.D. Ohio 2002)).

specific loan they received was immaterial; as long as they could show that they could afford another "fairly priced" mortgage available in the marketplace, they would satisfy the second prong.[36] This holding addresses the information asymmetry problem by not requiring plaintiffs to gain access to and decipher other loans that the defendant has created and sold. The ability to look at other loans in the marketplace increases the chance that the plaintiffs can find a "fairly administered" loan for which they would have qualified.

The *Barkley* court resolves the second ambiguity by clarifying how to show intentional targeting. The *Barkley* court does not require plaintiffs to present the terms of other loans offered by defendants, but only to show that the defendants targeted the faulty loans in question exclusively to the plaintiffs.[37] Thus, under *Barkley,* not only do plaintiffs not have to study any of the defendant's loans offered to other borrowers, but there need not even exist a comparative group of borrowers. This formulation makes sense within the context of the case because the lenders did not have white customers, and so there was no separate category of loans to evaluate.[38] Therefore, information asymmetry is much less of an issue under the *Barkley* formulation of the *Matthews* test.

Similar information asymmetry problems plague a test adopted for stating a disparate impact reverse-redlining claim.[39] The Northern District of California evaluated a disparate impact claim in *Ramirez v. GreenPoint Mortgage Funding, Inc.*[40] and, like *Matthews*, also drew its prima facie test from employment discrimination law. The plaintiffs in *Ramirez* brought a disparate impact claim alleging that GreenPoint's policy of allowing loan originators to impose subjective, discretionary charges and interest rate mark-ups on the loans resulted in an adverse disparate impact on minority borrowers because they paid higher fees and interest rates than similarly-qualified white borrowers.[41]

For a disparate impact reverse-redlining claim, the *Ramirez* court required the plaintiff to show "a significant disparate impact on a

---

[36] *Id.* Interestingly, the *Barkley* court attributed its interpretation to *Matthews*, even though the *Matthews* court merely concluded, without analyzing, that the plaintiffs were qualified for loans even though they could not afford the loans over which they filed suit. *Matthews*, 185 F. Supp 2d at 887.

[37] *Id.* at *14 ("In reverse-redlining cases, courts have justified allowing evidence of intentional targeting in lieu of evidence of disparate treatment or impact because to hold otherwise would allow predatory lending schemes to continue as long as they are exclusively perpetrated upon one racial group.").

[38] The plaintiffs alleged that the defendant "concentrated its business in minority census tracts and targeted minorities for the alleged scam by creating advertisements that featured minority homebuyers and selectively running these ads in minority communities." *Id.* at *2. As Raymond Brescia discusses, lenders can often deal exclusively with minorities, as the Barkley defendants allegedly did, or create affiliates to deal solely in minority communities. Brescia, *supra* note 8, at 200–01.

[39] Like Matthews, Ramirez adopted a standard for stating a prima facie case of reverse redlining in response to a motion to dismiss for failure to state a claim. *Ramirez v. GreenPoint Mortgage Funding*, 633 F. Supp. 2d 922, 927–29 (N.D. Cal. 2008).

[40] 633 F. Supp. 2d 922 (N.D. Cal. 2008).

[41] *Id.* at 924–25.

protected class caused by a specific, identified . . . practice or selection criteria."[42] Like in *Matthews*, the *Ramirez* court declines to explain the reasoning behind its choice of a test other than to say that courts generally use employment discrimination case law to construe the FHA.[43]

Similar to *Matthews*, plaintiffs face an information asymmetry problem under the *Ramirez* test for disparate impact reverse-redlining claims. The *Ramirez* test requires plaintiffs to identify a specific practice or selection criteria that caused the disparate impact, but again, the vast majority of necessary documentation is in the defendant's sole custody. Moreover, proving a significant disparate impact on a protected class can require use of a sophisticated statistical model, which will often require costly expert testimony.[44]

To the *Ramirez* court's credit, it did find that the showing that minority borrowers were almost twice as likely to have high-APR (annual price interest rate) loans as white borrowers was sufficient to show a significant disparate impact on a protected class and allow the claim to survive a motion to dismiss.[45] In adopting this standard, however, the court did not seem to anticipate potential difficulties the plaintiffs might face at trial in explaining loan terms to the jury. Furthermore, most individual plaintiffs will lack the resources of class action plaintiffs, so information asymmetry issues will be difficult to overcome.

C. Recommendations for Judges Deciding Reverse-Redlining Claims

When comparing all three of the aforementioned tests, the *Barkley* test goes the furthest toward limiting the information asymmetry problems discussed. Yet even the *Barkley* test does not address every type of potential reverse-redlining plaintiff. Cases may occur in which plaintiffs are not qualified for any fairly administered loan, but were given a predatory loan anyway. Such plaintiffs are no less damaged by the subprime crisis than those who do qualify for fairly administered loans but were given a subprime loan instead. Indeed, one might imagine that plaintiffs not qualified for loans left even worse off than those with more solid credit histories or income streams. No current legal test

---

[42] *Ramirez*, 633 F. Supp. 2d at 927 (quoting Stout v. Potter, 276 F.3d 1118, 1121 (9th Cir. 2002)) (quotations removed).

[43] *Id.* at 927 n.1 ("Although *Stout* was an employment discrimination case, the parties do not dispute that courts look to employment discrimination jurisprudence when interpreting claims under the FHA and ECOA.").

[44] *See* Nier III and St. Cyr, *supra* note 7, at 976 (noting that "a predatory loan is often the result of a combination of different factors that may be attributable to multiple policies or practices. . . . [that] can make it very difficult to trace disparities to a specific policy or practice.").

[45] *Ramirez*, 633 F. Supp. 2d at 928–29.

adequately addresses their plight.

A satisfactory legal test for a prima facie case of reverse redlining should focus less on analysis of the particular defendant's loans and policies, and more on information the individual plaintiff has equal access to. Such a test must be able to adapt to plaintiffs' unique circumstances. Courts should generally accept the *Barkley* treatment of the *Matthews* factors, emphasizing the utility of intentional targeting in proving the fourth prong. Intentional targeting need not necessarily be shown by analyzing the defendant's loans and policies offered to all potential borrowers; instead, a test should allow a showing of intentional targeting by pleading that the methods the defendant used to give access and market loans to a particular person were discriminatory. Such a test would ensure that plaintiffs need not amass specialized knowledge of non-party loans offered by defendant, as the first three prongs of the *Matthews* test can generally be satisfied through the plaintiff's own loan documents.[46]

Where plaintiffs allege that they were not qualified for any fairly administered loan, but that lenders duped them into accepting a subprime loan anyway, the second prong of the *Matthews* test—that the plaintiff applied for and was qualified for loans—should be omitted. In fact, it may be their lack of qualification that attracts predatory lenders to them in the first place. Nothing in the FHA excludes borrowers who should not have qualified for any loan from bringing a reverse-redlining action, and the legal standard for making out a prima facie claim should accommodate them accordingly. If plaintiffs assert that they could never have afforded any loan, even if administered on fair terms, as long as they show that the lenders led them to believe that they were so qualified, the second prong of the *Matthews* test need not apply.

Courts should take a more active role when they decide to use statistics to measure one or more of the *Matthews* prongs. Statistics are an accepted way of proving a reverse-redlining claim,[47] but courts do not always specify which statistics they will accept. The *Ramirez* court accepted one metric: Home Mortgage Disclosure Act data showing minorities who borrowed from GreenPoint between 2004 and 2006 were almost 50% more likely than whites to have received a high-APR loan to purchase or refinance their home.[48] However, there may not be publicly available statistics that are specific to the particular defendant. Under the *Ramirez* test, an originator might argue that there are many different factors that affect whether or not a loan achieves subprime status, making

---

[46] Andrew Lichtenstein, *United We Stand, Disparate We Fall: Putting Individual Victims of Reverse Redlining in Touch With Their Class*, 43 LOY. L.A. L. REV. 1339, 1348 (2010).

[47] Brescia, *supra* note 8, at 214 (describing using statistics to establish a prima facie case of reverse redlining).

[48] *Ramirez v. GreenPoint Mortgage Funding*, 633 F. Supp. 2d 922, 928–29 (N.D. Cal. 2008). The court also relied on allegations in the complaint that the individually-named plaintiffs were charged a disproportionately greater amount in non risk-related credit charges than similarly-situated whites. *Id.* at 929. *See* Lichtenstein, *supra* note 46, at 1351 (noting that Home Mortgage Disclosure Act data plays an important role in helping plaintiffs prove reverse redlining claims).

it much more difficult for a plaintiff to find a comparable loan to his own. Therefore, courts should come up with specific criteria for the plaintiffs to present that minimizes as much as possible the abilities of a defendant to distort the data. Whenever possible, courts should encourage plaintiffs to use data that will not require them to look at other loan terms. For example, courts have accepted eviction rates as evidence of the unfairness or disparate impact of the terms of plaintiffs' living arrangements compared to others outside of the plaintiffs' protected class.[49] With these changes, courts can begin to dissolve the informational asymmetry that plagues reverse-redlining litigation in the wake of the subprime crisis and give plaintiffs the day in court they deserve.

III. SUPPORTING THE NEW STANDARD THROUGH CRITICAL RACE THEORY

A. The Subprime Mortgage Collapse, Critical Race Theory, and Neoclassical Economics

Critical race theory is a movement by activists and scholars who study and hope to transform racial and power dynamics.[50] The movement is characterized by certain tenets and methodologies, one major theme being how the law operates to maintain the status quo of racial oppression rather than facilitate change.[51] Critical race theory examines the structures of institutions, including courts, to detect potential areas that unfairly disadvantage entire groups of individuals.[52] While there are many different branches of critical race theorists, it is hard to imagine that they would not embrace this Note's recommendations for addressing

---

[49] *See* Betsey v. Turtle Creek Associates, 736 F.2d 983, 988 (4th Cir. 1984) (holding that plaintiffs made out a prima facie case that an all-adult rental policy had a disparate impact on mostly black current tenants where they offered evidence that 54.3% of non-white tenants in the building received eviction notices compared to 14.1% of white tenants).

[50] RICHARD DELGADO & JEAN STEFANCIC, CRITICAL RACE THEORY: AN INTRODUCTION 3 (2d ed. 2012).

[51] *See* Alan David Freeman, *Legitimizing Racial Discrimination Through Antidiscrimination Law: A Critical Review of Supreme Court Doctrine*, 62 MINN. L. REV. 1049, 1050 (1978) (arguing that "as surely as the law has outlawed racial discrimination, it has affirmed that Black Americans can be without jobs, have their children in all-black, poorly funded schools, have no opportunities for decent housing, and have very little political power, without any violation of antidiscrimination law.").

[52] *See* Cassandra Jones Havard, *Democratizing Credit: Examining the Structural Inequities of Subprime Lending*, 56 SYRACUSE L. REV. 233, 270 ("The issue of access to credit is an indisputable exemplar of economic subordination as addressed by critical race theory. The search for economic justice for borrowers who are vulnerable in the marketplace raises issues of economic and racial privilege."); *see also* Angela P. Harris, *Foreword: The Jurisprudence of Reconstruction*, 82 CAL. L. REV. 741, 754 (1994) (stating that critical race theory "puts law's supposed objectivity and neutrality on trial, arguing that what looks like race-neutrality on the surface has a deeper structure that reflects White privilege.").

the information asymmetry issue previously discussed.

The subprime mortgage collapse facilitated institutional oppression of minorities. Credit rating agencies gave subprime securities good ratings, regardless of value.[53] These good ratings facilitated even more aggressive lending by lending institutions.[54] This way of lending operated to oppress entire groups of borrowers with limited financial means and know-how, and, as reverse-redlining claims allege, did so based upon the borrower's race (or age or other protected trait). The elimination of such oppression aligns with the goals of both critical race theory and the FHA's explicit ban on discrimination in real estate transactions.

The most direct challenge to critical race theory comes from neoclassical economics, which examines the efficiency of the decisions that individuals make.[55] Neoclassical economics analyzes the viability of market transactions based upon the notion of efficiency. A given transaction is efficient if it serves what Richard Posner, the architect of much law-and-economics theory, terms "wealth maximization," or the net amount of wealth between the parties to the transaction—including non-pecuniary value.[56] Therefore, if the result of a transaction is that one party's wealth increases by more than the other party's wealth decreases, then the transaction is efficient. The central assumption of neoclassical theory is that parties will always act rationally, or to serve their own wealth maximizing self-interest, in any given transaction.[57] Therefore, governments should impose as little regulation as possible on economic markets to ensure that as many people as possible will engage in rational, wealth-maximizing transactions.

Posner argues that judges have promoted, and should continue to promote, efficiency and wealth maximization through their decisions by protecting the common law rights of property and contract.[58] If judges use their expertise to protect the rights of property and contract through their decisions, they can rule efficiently. Neoclassical theory frowns upon any attempt by judges to redistribute wealth because judges lack the nuanced economic expertise to define the contours or appreciate the consequences of any given redistribution.[59]

Under the logic of neoclassical economic theory, reverse redlining

---

[53] Brescia, *supra* note 3, at 5.

[54] Eamonn K. Moran, *Wall Street Meets Main Street: Understanding the Financial Crisis*, 13 N.C. BANKING INST. 5, 46–47 (2009).

[55] *See generally* RICHARD A. POSNER, THE PROBLEMS OF JURISPRUDENCE 353–54 (1990) (stating that the basic assumption of neoclassical economics is that people act rationally to maximize their satisfaction).

[56] *Id.* at 356.

[57] *Id.* at 353.

[58] *Id.* at 360–61.

[59] *Cf.* Jonathan Klick, Francesco Parisi, *Wealth, Utility, and the Human Dimension*, 1 N.Y.U. J.L. & LIBERTY 590, 595 (2005) (advocating a functional school of law and economics because "judges and policymakers in many situations lack the expertise and methods for evaluating the efficiency of alternative legal rules").

should not be a cognizable claim for plaintiffs. Because people are responsible for their own actions, the argument follows that subprime borrowers should bear the consequences of accepting a loan. No one forced them to sign the papers against their will. Their decision to do so could have come from a number of influences: personal desire, advice from officers and rating agencies, pressure from family. But no matter what the terms of the loans were, neoclassical economics would support the idea that these borrowers are ultimately responsible for their own resources, and should be held accountable if they make a business deal that does not work out in their interest. The argument applies both to plaintiffs asserting they never could have afforded their loan and to those who assert that similarly situated borrowers outside of the protected class received better terms. Neoclassicists might argue that both groups should have ensured they were not being defrauded, even if that meant looking at loans of other lenders.

An extreme form of this argument (perhaps even a perversion) has come from the extreme political right. The argument is that judges should not take into account the information asymmetry that many subprime borrowers face because (1) those subprime borrowers are the chief cause of the recession and (2) legislation "forced" lenders to lend to these borrowers.[60] One neoclassical commentator has echoed this theory, noting that the public outcry concerning the banks' "equal opportunity lenient lending to all" was "ironic" considering that banks had recently been investigated for redlining.[61]

B. Efficiency: Discrimination, Informational Asymmetry, and the Neoclassical "Rational Actor"

Critical race theory flatly rejects using notions of efficiency to justify possible discrimination.[62] As Cass Sunstein argues, even in places

---

[60] Charles W. Murdock, *Why Not Tell the Truth?: Deceptive Practices And the Economic Meltdown*, 41 LOY. U. CHI. L.J. 801, 854–56 (2010). Murdock collects comments from the right illustrating this view; for example, conservative commentator Ann Coulter blamed the subprime mortgage crisis on "affirmative action lending policies." *Id.* at 854 (quoting Ann Coulter, *They Gave Your Mortgage to a Less Qualified Minority*, ANNCOULTER.COM (Sept. 24, 2008), http://www.anncoulter.com/columns/2008-09-24.html). Michael Aleo and Pablo Svirsky also cite Coulter and others to show how commentators tried to blame borrowers and the Community Reinvestment Act, which was designed to increase lending to minority communities, for the crisis. Michael Aleo & Pablo Svirsky, *Foreclosure Fallout: The Banking Industry's Attack on Disparate Impact Race Discrimination Claims Under the Fair Housing Act and the Equal Credit Opportunity Act*, 18 B.U. PUB. INT. L.J. 1, 10–13 (2008). They note that even more mainstream commentators adopted this view: *Washington Post* columnist Charles Krauthammer, for example, wrote that the CRA "led to tremendous pressure . . . to extend mortgages to people who were borrowing over their heads . . . . Were there some predatory lenders? Of course. But only a fool or a demagogue . . . would suggest that [predatory lending] is a major part of the problem." *Id.* at 12 (quoting Charles Krauthammer, Op.-Ed., *Catharsis, Then Common Sense*, WASH. POST, Sep. 26, 2008, at A23).

[61] Gary Becker, *The Subprime Housing Crisis*, THE BECKER-POSNER BLOG (Dec. 23, 2007), http://www.becker-posner-blog.com/2007/12/the-subprime-housing-crisis--becker.html.

[62] *See* CASS SUNSTEIN, FREE MARKETS AND SOCIAL JUSTICE, 151 (1997) (arguing that capital

like the subprime housing market where discrimination could be an efficient, rational, and rewarding choice for lenders, the negative effects it has outweigh its economic virtues.[63] No matter how efficient reverse redlining may be for lenders, discrimination imposes something of a caste system[64] that could keep a minority of subprime borrowers from utilizing the mobility that subprime loans promise. Alleviating information asymmetry in reverse-redlining actions would constitute a rejection of the status quo in which discrimination, though formally outlawed, may operate in the subprime housing market.

Even aside from the extreme view that reverse-redlining claims should not be cognizable, the neoclassical notions of efficiency and the rational actor challenge the proposed recommendation supported by critical race theory. The basic precept underlying the neoclassical perspective on this is that addressing any perceived informational asymmetry would not have protected borrowers during the crisis and would not protect them in the future. Rather, like lenders, the government, Wall Street executives, and everyone else, subprime borrowers "rode the bubble" up, and that was the rational choice given the circumstances.[65] Because of the incentives to continue to borrow and lend, neoclassicists argue it was unlikely that giving borrowers more information "would have been effective in warding off this crisis, or will be effective in preventing future crises."[66] Therefore, neoclassicists would not see a reason for courts to address the information asymmetry problem.

Neoclassical theory also implies that even if informational asymmetry does exist, that does not necessarily prevent efficient outcomes. Any outcome that positively serves wealth maximization is efficient, and if lenders increase their wealth by more than borrowers decrease theirs, the transaction is efficient. In that sense, information is a commodity, and those with better information reap the benefits of what they have invested to acquire that commodity. Even if the borrower accepts a loan while operating under information disadvantage, the lending institution's gain is greater than the borrower's loss—thus, the transaction is efficient and there is no need for courts to address the

---

markets will not prevent discrimination without regulation).

[63] *See id.* ("[T]he valuation of the market will be a reflection of prevailing norms and practices, and those norms and practices sometimes are what an antidiscrimination principle is designed to eliminate or reduce. When this is so, reliance on markets will be unsuccessful.").

[64] *Id.* at 163 ("Hence the antidiscrimination principle is best conceived as an anticaste principle . . . . The motivating idea behind an anticaste principle is that without very good reason, legal and social structures should not turn differences that are irrelevant from the moral point of view into social disadvantages. They certainly should not be permitted to do so if the disadvantage is systemic.").

[65] *See* Becker, *supra* note 61 ("Given the low interest rate lending atmosphere of the past few years, it is highly unlikely that borrowers would have turned down the mortgages they received if they had much better information about terms, or that lenders would have been more reluctant to originate or hold these mortgage assets if they had better information about the credit and other circumstances of borrowers.").

[66] *Id.*

information asymmetry.

Critical race theorists could answer these arguments with evidence that lenders' informational advantage was not earned by lenders, but was often a symptom of the "status quo" in a housing market that institutionalized discrimination.[67] Regardless of any net efficiency resulting from the information asymmetry, the societal costs of the discriminatory effect are too great.[68] Courts should alleviate that information asymmetry to help undo the status quo that has disadvantaged minority and subprime borrowers.

Posner argued that borrowers acted rationally during the subprime boom,[69] which would lead to the conclusion that judges need not alter the existing test for a prima facie case of reverse redlining. In the immediate aftermath of the economic crisis, Posner argued against regulation and reform because the subprime bubble was emblematic of the rationality of economic bubbles.[70] He uses the maxim that "if prices are rising, they are expected to continue to rise."[71] No one can truly predict when the bubble is about to burst, and so bubbles will remain inevitable. Therefore, lenders who responded to rising prices and favorable ratings and regulations rightly became more aggressive in their lending practices, and subprime borrowers accepted risky loans because "[t]here is a reluctance to act as if housing prices will not continue rising, for by doing so one is leaving money on the table."[72]

Several years later, Posner modified his view on government regulation of bubbles.[73] He asserted that individuals acting rationally could lead to negative, or irrational collective societal consequences.[74] However, Posner reiterated his position that subprime borrowers acted rationally.[75] He introduced a hypothetical subprime borrower who had been renting and was offered a subprime loan to own a home with no down payment but an adjustable interest rate,[76] one of the mechanisms by which loan originators make money despite initial terms that appear to favor the borrower. Posner argues that the borrower should, in a

---

[67] *See generally* Adam Gordon, Note, *The Creation of Homeownership: How New Deal Changes in Banking Regulation Simultaneously Made Homeownership Accessible to Whites and Out of Reach for Blacks*, 155 YALE L.J. 186 (2005).

[68] SUNSTEIN, *supra* note 62, at 163.

[69] Richard Posner, *The Subprime Mortgage Mess*, THE BECKER-POSNER BLOG (Dec. 23, 2007), http://www.becker-posner-blog.com/2007/12/the-subprime-mortgage-mess--posners-comment.html.

[70] *Id.*

[71] *Id.*

[72] *Id.*

[73] *Compare id.* (advocating that in response to bubbles the government should do "[i]n my opinion, nothing. There have always been bubbles. There will always be bubbles because of the factors that I have been discussing."), *with* RICHARD A. POSNER, A FAILURE OF CAPITALISM: THE CRISIS OF '08 AND THE DESCENT INTO DEPRESSION 106–07 (2009) (arguing that government regulation was necessary).

[74] POSNER, A FAILURE OF CAPITALISM: THE CRISIS OF '08 AND THE DESCENT INTO DEPRESSION 106–07.

[75] *Id.* ("Risky behavior of the sort I have been describing was individually rational during the bubble. But it was collectively irrational.").

[76] *Id.* at 101.

market of rising housing prices, accept the loan because if prices rise as expected, the borrower's wealth will increase with the equity of the home.[77] If prices fall and the borrower defaults, he has not lost much because he had little capital sunk into the home, and he can always return to the rental market.[78]

As both critical race theory and behavioral economics would suggest, Posner's hypothesis about subprime borrowers fails, because consumers operate according to various cognitive biases—not purely according to rationality. Behavioral economist Oren Bar-Gill argues that certain cognitive phenomena permeate consumer credit markets that lead credit card consumers to misperceive pricing systems and behave irrationally.[79] One such phenomenon is overestimation: if consumers are offered two credit cards, one with a low initial rate that switches to a high rate after six months and one with a flat rate, slightly higher than the low initial rate of the other card, consumers tend to pick the first card and then not switch cards when the rates switch.[80] Consumers tend to believe that they will efficiently take advantage of these and other "deals" but tend not to.[81] Sellers then recognize this misperception and package credit card offers to take advantage of consumers' misperceptions.[82] Consequently, consumers end up paying more.[83] Bar-Gill suggests that consumer misperceptions may well play a role in the subprime housing market as well.[84]

Richard Epstein, offering a neoclassical counterpoint to Bar-Gill's analysis, argues that learning can correct information asymmetry.[85] As consumers experience the negative effects of being on the wrong side of

---

[77] *Id.* at 102–03.

[78] *Id.* at 103.

[79] Oren Bar-Gill, *The Behavioral Economics of Consumer Contracts*, 92 MINN. L. REV. 749, 764 (2008).

[80] *Id.* at 762–64.

[81] *Id.* at 763. Bar-Gill argues that possible reasons for this mistake are that "consumers are optimistic about their future credit needs; about their future will power; about the likelihood that they will switch to a new card with a new, low introductory rate; or all of the above." *Id.* at 763. He also suggests that it may not be a mistake at all, and that consumers may be attempting to limit their own future borrowing by choosing a credit arrangement that would make it prohibitively expensive. *Id.* at 764.

[82] Bar-Gill argues that in the credit card industry, issuers take advantage of consumers' misperceptions by using multidimensional pricing, which allows them to "minimize the perceived total price by reducing price components that are more salient to consumers, and increasing price components that are less salient to consumers." *Id.* at 772. Introductory teaser rates are another way lenders trade on consumer mistakes. *Id.* at 780 (noting that "consumers are more sensitive to introductory rates than they are to long-term rates, despite the fact that most of the borrowing is done at the high long-term rates.").

[83] *Id.* at 786–87. Bar-Gill suggests that the financial harm to consumers from these mistakes is substantial, even without taking into account the cost of financial distress caused by unsafe financial products. *Id.* at 787.

[84] *Id.* at 768.

[85] Richard Epstein, *The Neoclassical Economics of Consumer Contracts*, 92 MINN. L. REV. 803, 811 (2008) ("[T]he neoclassical case for markets rests on the more qualified assumption that learning actually matters. To the extent that the issues that truly matter to them, people develop, if they do not already have them, good feedback mechanisms that lower the risk of loss, especially in standardized transactions where consumers are repeat players. People do so because they pay the price for their own error.").

information asymmetry, they will gradually gain knowledge and make more efficient decisions until they are in a level position with other actors.[86] Any sort of institutional aid to these actors is a disincentive to them to learn the correct information and gain capability on their own. When discussing the subprime lending crisis, Epstein claims that the negative consequences that lenders experienced was a result of taking huge lending risks and not of manipulating consumer misperceptions.[87]

Epstein's learner, just like Posner's rational borrower, is a construct that does not align with the circumstances that subprime borrowers face and that critical race theory may consider. If a subprime borrower accepts a bad loan and defaults on his home, there is no guarantee that he can easily re-enter the rental market. Rental markets are not impervious to a widespread decline in housing prices, and subprime borrowers often may not be able to seamlessly transition from one market to the other. A consumer's misperceptions of loan terms, misperceptions which Bar-Gill argues are endemic, could easily end up costing him everything in his possession.

The proliferation and variety of reverse-redlining claims that plaintiffs are utilizing indicate the creativity with which alleged predatory lenders may have been acting. In addition to discretionary pricing systems, like the ones alleged by plaintiffs in *Ramirez*, pre-payment penalties, closing penalties, yield spread premiums, and even credit scores are all areas in which lenders potentially discriminated against protected classes.[88] For example, yield spread premiums are additional fees the lenders tack onto loans as compensation for the work of mortgage brokers, who work for the lenders in convincing borrowers that the loan presented is the best loan the borrower could obtain.[89] Mortgage brokers can receive compensation by intentionally misleading borrowers, leaving them less able to make an efficient decision or learn from their mistake.

Even if several of Epstein and Posner's assumptions were true, subprime borrowers would still lack resources to overcome the information asymmetry. If subprime borrowers could instantly discover which terms made their loan a dangerous bet and they have the resources to invest again, there is no guarantee that lenders, with more resources and greater access to information, would not find new ways to capitalize on information asymmetry again. After all, such innovation is

---

[86] *Id.* at 813 ("[T]here is little hard evidence that consumers are impervious to knowledge, and studies . . . suggest that even in credit markets, people usually learn both from their own errors, and from the errors of others—bad news travels fast.").

[87] *Id.* at 832 ("[T]he simplest explanation remains the best. [Mortgage lenders] took large risks on their loan portfolio and now have to pay the price when the market turned bad. The reversal does not suggest any irrationality. No one gets something for nothing, and the high failure rate is consistent with the high rates of return earlier on. None of their activity is driven by the ability of these mortgage companies to exploit pricing misperceptions, which could be handled under the current laws.").

[88] Brescia, *supra* note 8, at 211–15.

[89] *Id.* at 212.

presumably how they constructed such loans in the first place.

C. Judges as Actors for Combating Information Asymmetry

Although the problem of reverse redlining should be addressed, there are alternatives to reforming the prima facie test for stating a reverse-redlining claim under the FHA. Some commentators have suggested that the courts are not the proper forum for subprime reform. Oren Bar-Gill and Elizabeth Warren, for example, proposed creating a new regulating entity or division within an existing agency to regulate consumer credit products.[90] The proposal has since been adopted with the establishment of the Consumer Financial Protection Bureau (CFPB).[91]

Despite the establishment of the CFPB, courts remain well suited, according to a critical race perspective, to address individual cases of reverse redlining for three reasons. First, courts can focus on one plaintiff and one claim, while regulation often has to hedge and compromise on the issues it addresses. Regulation also has to generalize in accounting for prospective issues, while courts can focus on facts and circumstances of a past event.[92] Second, litigation can bring public attention to a case or cause that often gets lost in drawn out legislation.[93] Third, the costs of the changes to the test for stating a prima facie claim are much lower than the cost of passing, implementing, and enforcing legislation. Judges need only articulate the proper test, which does not add any costs to the task of alleviating information asymmetry.

IV. CONCLUSION

The 2008 financial crisis devastated the wealth of minorities in record numbers, and one of the contributing factors was the action of

---

[90] Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 98 (2008). In their article, Bar-Gill and Warren posit that the ex-post common law approach is not suited to regulating consumer credit markets and that "[c]oncerns about institutional competence, doctrinal limitations and procedural barriers justify the observed judicial restraint." *Id.* at 74.

[91] Jared Elosta, Recent Development, *Dynamic Federalism and Consumer Financial Protection: How the Dodd-Frank Act Changes the Preemption Debate*, 89 N.C. L. REV. 1273, 1273 (2011).

[92] *See* Brescia, *supra* note 3, at 72–73 ("Any new regulatory regime that Congress or state legislatures might put into place would be ill-equipped to engage in ex post facto controls on prior conduct. Thus, judicial responses are likely superior to regulatory controls of actions that took place in the past.").

[93] *See id.* at 73 ("[P]laintiffs' counsel would be in a strong position to make such information [about discriminatory lending practices] public, thereby alerting the general public to the information which, in turn, will both raise public awareness about the issue and likely encourage other potential plaintiffs to come forward.").

predatory lenders who engaged in reverse redlining. Plaintiffs bringing reverse-redlining claims are at a unique disadvantage in gaining access to information needed to state a prima facie claim of reverse redlining. The reading of the *Matthews* test in *Barkley* most completely compensates for information asymmetry. Critical race theory could support an additional effort on judges' part—they are in a unique position to alleviate information asymmetry in reverse-redlining cases by allowing plaintiffs to use a combination of public data and information possessed by the plaintiffs.

Neoclassical economics and conservative political pundits argue that information asymmetry need not be addressed and that subprime borrowers acted rationally on their own volition and deserve no special treatment. However, the realities of the subprime housing crisis revealed, consistent with a critical race perspective, that information asymmetry was institutionalized in that market to such a degree that subprime borrowers were competing in a rigged game that rewarded and encouraged discrimination and manipulation. Thus, information asymmetry must be addressed.

Addressing information asymmetry by reforming the test for stating a prima facie claim of reverse redlining could help rally public opinion to challenge the other areas that institutionalize and encourage information asymmetry, if not outright discrimination. As claims are advanced and more cases are filed, the chances increase that one plaintiff could win a reverse-redlining action against a major lender and garner attention to the plight of other victims.