The Fair Housing Act and Disparate-Impact – Is There a Bit of a Silver Lining in the Dark Cloud of a Recent U.S. Supreme Court Decision?

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The U.S. Supreme Court, in a 5-4 decision, held that discrimination claims based on disparate-impact are cognizable and may be brought under §§804(a) and 805(a) of the Fair Housing Act ("FHA"). The holding came in *Texas Department of Housing and Community Affairs et al. vs. Inclusive Communities Project, Inc. et al.* on June 25, 2015. This holding potentially exposes financial institutions to a higher degree of risk and scrutiny of their lending programs, policies and procedures by regulatory agencies and potential private sector plaintiffs, even though the decision is consistent with the position taken by the Department of Housing and Urban Development ("HUD") in its regulations issued in 2013 and with a series of Federal Courts of Appeals cases from the 1970s and 1980s.

FHA Protections
Section 804(a) of the FHA makes it unlawful:

To refuse to sell or rent after making of a bona fide offer, or to refuse to negotiate for the sale or rental of, or otherwise make unavailable or deny, a dwelling to any person because of race, color, religion, sex, familial status, or national origin.

Section 805(a) of the FHA provides:

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

There has never been any doubt that the FHA makes discrimination related to a protected characteristic based on discriminatory intent or motive (disparate treatment claims) unlawful and actionable.

In contrast, the disparate-impact theory of liability focuses on the consequences of actions and not on the intent or motive of the actor. It is a statistically based theory. It challenges practices that have a disproportionate adverse effect on a protected class under the FHA and that are otherwise unjustified by a legitimate rationale. Disparate-impact claims assert that policies and practices which are neutral and nondiscriminatory on their face but which cause unintended discriminatory effects violate the FHA.

Lower court cases and HUD have imported the theory of disparate-impact into the FHA from Title VII of the Civil Rights Act of 1964 ("Title VII") and the Age Discrimination and Employment Act of 1967 ("ADEA"). HUD regulations identify a practice that has a discriminatory effect as follows:

A practice has discriminatory effect where it actually or predictably results in a disparate-impact on a group of persons or creates, increases, reinforces, or perpetuates segregated housing patterns because of race, color, religion, sex, handicap, familial status, or national origin.

Possible Supreme Court Limitations on the Use of Disparate-Impact Claims
Despite a strong and arguably better reasoned dissent by four justices, the majority of the Court held that disparate-impact claims were permitted under the FHA. However, the majority also recognized the significance of its decision and the practical and constitutional issues that could arise from the use of the disparate-impact theory without reasonable constraints and limitations.

The Supreme Court relied heavily on its prior decisions interpreting and applying the disparate-impact theory under Title VII and the ADEA. Based on that reliance, the Supreme Court expressed the following limitations and guidance related to the analysis of disparate-impact claims:

- Drawing from the employment area cases, the Court noted that *...disparate-impact liability must be limited so employers and other regulated entities are able to make the practical business choices and profit-related decisions that sustain a vibrant and dynamic free enterprise system. And before rejecting a business justification – or, in the case of a government entity, an analogous public interest – a Court must determine that a plaintiff has shown that there is "an available alternative...practice that has less disparate-impact and serves the [entity's] legitimate needs*" [quoting from *Ricci vs. DeStefano, 557 US 557 (2009)*]
- *An important and appropriate means of ensuring that disparate-impact liability is properly limited is to give housing authorities and private developers leeway to state and explain the valid interest served by their policies. This step of analysis is analogous to the business necessity standard under Title VII and provides a defense against disparate-impact liability.*
- *Just as an employer may maintain a workplace requirement that causes a disparate-impact if that requirement is a 'reasonable measure[ment] of job performance'* [citing *Griggs vs. Duke Power Co. 401 US 424 (1971)*] *so too must housing authorities and private developers be allowed to maintain a policy if they can prove it is necessary to achieve a valid interest. To be sure, the Title VII framework may not transfer exactly to the fair-housing context, but the comparison suffices for present purposes.*
- *...a disparate-impact claim that relies on a statistical disparity must fail if the plaintiff cannot point to a defendant's policy or policies causing that disparity. A robust causality requirement insures that "[r]acial imbalance...does not, without more, establish a* prima facie *case of disparate-impact" and thus protects defendants from being held liable for racial disparities they did not create* [the Court was citing *Wards Cove Packing Co. vs. Atonio, 490US642 (1989)*].
- *A plaintiff who fails to allege facts at the pleading stage or produce statistical evidence demonstrating a causal connection cannot make out a* prima facie *case of disparate-impact.*
- Governmental or private policies are not contrary to the disparate-impact requirement unless they are "artificial, arbitrary, and unnecessary barriers." [the Court was citing *Griggs*]

HUD attempts to address the balancing concepts identified by the Court in its regulations addressing discriminatory effect found at 24CFR100.500. These were noted by the Supreme Court in its decision but not in a manner which directly approves or endorses them. In fact, the Supreme Court's language referencing the legal sufficiency of the justification component of a defense to a disparate-impact claim differs from that set forth in HUD's regulation.

HUD's provision reads as follows:

(b) Legally Sufficient Justification.

(1) A legally sufficient justification exists where the challenged practice:

(i) is necessary to achieve one or more substantial, legitimate, nondiscriminatory interests of the respondent, with respect to claims brought under 42 USC 3612, or defendant, with respect to claims brought under 42 USC 3613 or 3614; and
(ii) those interests could not be served by another practice that has a less discriminatory effect.

The Supreme Court addresses this concept by referring to it as a "valid interest" of a housing authority or a private developer. Is this standard of proof lower and, therefore, more favorable to those accused of discrimination based on disparate-impact than HUD's standard that the challenged practice be "...necessary to achieve one or more substantial, legitimate, nondiscriminatory interests of the respondent..."? The Supreme Court did not elaborate on the standard and provided no useful guidance on this point.

The dissenting opinion calls specific attention to the legal and practical weaknesses of the majority opinion as it relates to these purported protections. The following passages ably describe the concerns in this regard:

The Solicitor General's answer to such problems is that HUD will come to the rescue. In particular, HUD regulations provide a defense against disparate-impact liability if a defendant can show that its actions serve "substantial, legitimate, nondiscriminatory interests" that "necessary[ily]" cannot be met by "another practice that has a less discriminatory effect." 24 CFR §100.500 (b) (2014). (There is, of course, no hint of anything like this defense in the text of the FHA. But then, there is no hint of disparate-impact liability in the text of the FHA either.)

The effect of these regulations, not surprisingly, is to confer enormous discretion on HUD —without actually solving the problem. What is a "substantial" interest? Is there a difference between a "legitimate" interest and a "nondiscriminatory" interest? To what degree must an interest be met for a practice to be "necessary"? How are parties and courts to measure "discriminatory effect"?

These questions are not answered by the Court's assurance that the FHA's disparate-impact "analysis is 'analogous to the Title VII requirement that an employer's interest in an employment practice with a disparate impact be job related.'" ... The business-necessity defense is complicated enough in employment cases; what it means when plopped into the housing context is anybody's guess. What is the FHA analogue of "job related"? Is it "housing related"? But a vast array of municipal decisions affect property values and thus relate (at least indirectly) to housing. And what is the FHA analogue of "business necessity"? "Housing-policy necessity"? What does that mean?

Unfortunately, only additional litigation and the scope of future regulatory enforcement actions will provide a true understanding of the application of the Supreme Court's decision to disparate-impact claims under the FHA.

An Early Application of the *Inclusive Communities* Decision
On July 17, 2015, the U.S. District Court for the Central District of California in *City of Los Angeles vs. Wells Fargo & Co* issued one of the earliest lower court case decisions released after the decision in *Inclusive Communities* that addresses a disparate-impact claim. The Court in *Wells Fargo*, relying heavily on the language and what the District Court referred to as "recent guidance" from *Inclusive Communities*, found, in response to a motion for summary judgment, that the plaintiff, the City of Los Angeles, failed to establish a *prima facie* case against Wells Fargo for alleged violations of the FHA in making high cost loans and Federal Housing Authority loans.

The *Wells Fargo* decision emphasizes each of the cautionary standards mentioned in the *Inclusive Communities* case and adeptly applies them to the facts in the case before it.

The Court found a lack of quantitative evidence supporting the alleged disparate-impact claims. The statistics did not support the allegations.

The Court also found that the City failed to identify any artificial, arbitrary or unnecessary policy or policies of Wells Fargo that produced a significantly adverse disparate-impact. The Court noted that this failure, by itself, would defeat the City's claims.

The *Wells Fargo* Court, following guidance from the *Inclusive Communities* case, noted that it must review the City's claims with care and stated that "carelessness is determining whether an entire lending practice is adverse based on a single provision. To conduct the proper analysis, the Court must consider the benefits and purpose of USFHA loans". From the District Court's perspective, exercising care required the Court to consider all circumstances affecting the lender's practices.

Consequences of the *Inclusive Communities* Decision
Regulators already took the position that the disparate-impact theory of liability applied to discrimination claims under the FHA and their policies reflected that position. The *Inclusive Communities* decision now endorses this position and adds significant precedent for the use of disparate-impact to fight discrimination.

However, the split court and the cautionary language of the majority opinion establish some significant barriers to asserting disparate-impact cases based primarily on statistical evidence without further facts that would support a finding of causation between the Lender's policies and the discrimination alleged to exist as illustrated by the *Wells Fargo* decision.

As to private actions, the *Inclusive Communities* decision may have a chilling effect on the commencement of actions due to the need for the plaintiff to establish a strong *prima facie* case that relies on more than statistics and establishes a reasonable basis for asserting and ultimately proving the necessary causation factor.

Unfortunately, the disparate-impact theory survived Supreme Court scrutiny and as a result lenders will continue to be at risk for discrimination claims based on the discriminatory impact theory.

Since it is anticipated that in most cases a lender's policies will be based on reasonable business principles and non-discriminatory intent, plaintiffs will also need to be prepared to assert and prove that the lender's valid interests can be accomplished in a less discriminatory manner that does not unreasonably impair or infringe upon the legitimate, nondiscriminatory business conduct of the lender.

Whether the claims come from the private sector or regulatory bodies, lenders will be exposed to significant legal and expert witness expenses and will need to allocate significant officer and staff time in the defense of such claims if they are brought.

To mitigate these risks and costs, lenders must be diligent in establishing their lending policies, procedures and underwriting criteria. Lenders should be aware of how those items will impact protected classes under the FHA and how they will be perceived by those classes and the regulatory bodies charged with the responsibility of enforcing antidiscrimination laws.

Those performing compliance reviews of proposed or existing lending programs must be mindful of the elements of potential disparate-impact claims and ensure that steps are taken and actions and decisions are appropriately documented to support the appropriateness of the lender's programs in light of the nondiscrimination requirements of the FHA under both the intentional (disparate treatment) and disparate-impact theories of liability.