Disparate Impact Survives the High Court: Supreme Court Rules That Unintentional Discrimination May Give Rise to Fair Housing Claims

Consumer Finance Alert

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A Quick Summary

What?

- The United States Supreme Court decision in *Texas Department of Housing and Community Affairs, et al. v. Inclusive Communities Project, Inc., et al.*

Why Does It Matter?

- The Court confirmed that disparate impact claims are allowed under Fair Housing Act.

What Does That Mean?

- The Fair Housing Act prohibits both intentional discrimination **and** unintentional facially-neutral conduct or standards that results in a disparate impact on a protected group, and are not justified by a valid public policy or business justification.

Are There Any Limits To Disparate Impact?

- Yes. The Court articulated "safeguards" that it hoped would both protect defendants from meritless cases and avoid injecting race into all decision making or requiring racial quotas, all of which would raise constitutional concerns.
- The court specifically enumerated four safeguards:
  - Disparate impact liability may not be imposed based solely on a showing of a statistical disparity.
  - Plaintiff must allege facts at the pleading stage or produce statistical evidence showing a causal connection between the challenged policy and its disparate impact in order to make a prima facie case of disparate impact.
  - Courts must give housing authorities and private developers leeway to explain the valid interest served by their policies.
  - Policies do not violate disparate impact unless they are “artificial, arbitrary, and unnecessary barriers."

What About The Equal Credit Opportunity Act ("ECOA")?

- While ECOA is not mentioned and technically not a subject of the Court’s decision, it is difficult to imagine a successful argument that ECOA does not encompass disparate impact claims. However, the Court's "safeguards" should apply to ECOA defendants as well.

Is There Anything I Should Do In Response To This Case?

- If you work in the financial services industry, this case provides further incentive to continue to review, reevaluate, refine and implement a comprehensive Fair Lending compliance program, which should include monitoring of portfolios for disparate impact on protected groups.
- Contact **Bennet Koren** or **Lauren Campisi** for more information.

Detailed Analysis

The United States Supreme Court issued a somewhat surprising decision yesterday, holding that the Fair Housing Act ("FHA") provides for "disparate impact" liability, rejecting the petitioner's claim that intentional discrimination was required to violate the FHA. In *Texas Department of Housing and Community Affairs, et al. v. Inclusive Communities Project, Inc., et al. (PDF)*, 576 U.S. _____ (2015) (slip. op.), the Court ruled 5 to 4 that the FHA permits claims based on facially-neutral policies and practices that negatively impact minorities, without proof of intent to discriminate. The majority opinion was authored by Justice Kennedy, joined by Justices Ginsburg, Breyer, Sotomayor, and Kagan. Justice Alito filed a dissenting opinion joined by Chief Justice Roberts, Justice Scalia, and Justice Thomas, who filed his own separate dissent as well.

Although the outcome of this case was highly anticipated (primarily based on the conventional wisdom that the Court would find that the FHA did **not** contain a disparate impact provision), this ruling in large part reinforces the *status quo* as disparate impact theories of liability under the FHA have been recognized for years by every Circuit Court of Appeals to consider the question. The Supreme Court's decision solidifies the statutory interpretation that these claims may be brought under the FHA and provides some limited guidance to lower courts on the outer limits of disparate impact liability. Its ruling is clear: plaintiffs claiming discrimination against those engaged in the sale, rental, or financing of housing need not allege that discrimination is intentional in order to state a viable cause of action under the FHA. In view of this decision, it seems unlikely that similar language in the Equal Credit Opportunity Act ("ECOA") will be the subject of litigation in the near future.

The Case: Facts, History, and Ruling

The Texas Department of Housing and Community Affairs ("Department") administers federal low-income housing tax credits that are distributed to developers in Texas. The Inclusive Communities Project ("ICP") assists low-income families in obtaining affordable housing in suburban neighborhoods in the Dallas metropolitan area. In 2008, the ICP brought a disparate impact claim under the FHA against the Department, alleging that the Department created segregated housing patterns by allocating too many tax

credits to housing in predominately African-American, inner-city neighborhoods, while disproportionately withholding tax credits from predominantly white, suburban neighborhoods. Although the Department had no discriminatory intent, the ICP claimed that the results of the Department's policy confined minorities to segregated areas. The ICP argued that the court should require the Department to "modify its selection criteria in order to encourage the construction of low-income housing in suburban communities." Opinion at 3.

The District Court agreed with the ICP, ordering the Department to add new selection criteria for the tax credits. Analyzing statistical discrepancies, but not any allegations of intentional discrimination, the court concluded that the ICP stated a cause of action under the disparate impact theory. Specifically, over a 10-year span, the Department approved tax credits for 49.7% of proposed units in areas with a Caucasian population under 10% but approved only 37.4% of proposed units in areas with a Caucasian population greater than 90%. The Court of Appeals for the Fifth Circuit confirmed that disparate impact claims are cognizable under the FHA but remanded the case on the merits to the district court. As a result, the Department filed a petition for writ of certiorari to the United States Supreme Court, which took up the issue of whether disparate impact claims are cognizable under the FHA.

The Supreme Court affirmed the decision of the Fifth Circuit. In doing so, it held that the FHA encompasses otherwise lawful activities which, even though free of discriminatory intent, are found to have a disparate impact on minority groups.

Disparate Impact Versus Disparate Treatment

For the past four decades, the question of whether each of these civil rights statutes provides a disparate impact cause of action has been hotly contested. The Supreme Court has previously found that disparate impact claims are cognizable in cases under Title VII of the Civil Rights Act ("Title VII") and the Age Discrimination in Employment Act ("ADEA") under *Griggs v. Duke Power Co.*, 401 U. S. 424 (1971), and *Smith v. City of Jackson*, 544 U. S. 228 (2005), respectively, but has also found disparate impact claims not to be cognizable under other statutes.

The statutory text of the FHA and other federal civil rights laws such as the ADEA, Title VII, and ECOA clearly state that disparate treatment is prohibited. In a disparate treatment case, similarly creditworthy candidates of different races are compared. To succeed on his or her claim, the plaintiff must prove that the defendant had a discriminatory intent or motive—that is, the adverse action that is the subject of the claim was taken because of the plaintiff's race, gender, or other protected class.

However, the text of these federal laws is much less clear regarding disparate impact claims. The disparate impact theory provides that lenders and other defendants can be held liable for discrimination simply if a neutral practice has a discriminatory effect, even if the lender had no intent to discriminate. A plaintiff must only prove that a defendant's practices have a disproportionately adverse effect on a protected class and are otherwise unjustified by a legitimate rationale such as a reasonable job qualification related to the job in question or a business necessity.

In the case at hand, the Court was asked to decide whether claims brought under the FHA, which prohibits housing discrimination *because* of race, can be based on an allegation that a practice has a disparate impact. In other words, could a practice be prohibited under the FHA if it results in a discriminatory effect, even if the practice was not motivated by an intent to discriminate?

The Court drew parallels between the text of the FHA and its interpretations of the other anti-discrimination statutes in *Griggs* and *City of Jackson*. Conducting a detailed statutory analysis, the Court found that similar language in the FHA should be interpreted consistently with that in Title VII and the ADEA. As a result, the Court held that plaintiffs may state a cause of action for disparate impact under the FHA.

The Court's Opinion

In the majority opinion, Justice Kennedy wrote that disparate impact claims are cognizable under the FHA for four reasons: (1) the FHA's results-oriented, or "affects," language, which prohibits not only actions taken because of race (or protected class) but also actions that "otherwise" deny housing; (2) the Court's prior interpretations of arguably similar language in Title VII and the ADEA; (3) Congress' amendment to the FHA in 1988, which seemed to assume the viability of disparate impact claims by providing some narrow safe harbors from such claims; and (4) the statutory purpose of the FHA. Finding that disparate impact has long been established in fair housing cases, the court maintained the status quo as residents and policymakers have come to rely on the availability of disparate impact claims. However, the court established certain limits on the breadth of disparate impact claims.

Did the Court Limit the Scope of Disparate Impact?

The case resolves a long-standing question regarding the viability of disparate impact under the FHA and, by implication, similarly worded anti-discrimination statutes such as ECOA. By finding that, in drafting the FHA, Congress intended to prohibit not only intentional discriminatory conduct by those involved in the sale, rental, and financing of housing, but also to prevent nondiscriminatory conduct or policies that have the "effect" of discriminating based on race, the Court sent a message that disparate impact is here to stay. While the Court has never previously ruled on this issue, nearly every Federal Circuit Court that had addressed the issue had previously found that the "disparate impact" cause of action existed under the FHA. Accordingly, the opinion is in some ways a protection of legal *status quo*.

Although the Court's opinion upholds the availability of disparate impact causes of action under the FHA, it also articulates important limitations on the principle, directing lower courts to provide "housing authorities and private developers leeway to state and explain the valid interests served by their policies." Opinion at 18. Using the case before it as an example, as the plaintiffs sued under the theory that the Texas Department in question had approved more public housing projects in predominately minority communities, the court noted that "it seems difficult to say as a general matter that a decision to build low-income housing in a blighted inner-city neighborhood instead of a suburb is discriminatory or vice versa." Opinion at 20.

Justice Kennedy's opinion referenced a recent disparate impact case that the Court had agreed to hear (but never had the chance to as it abruptly settled before oral arguments) to serve as a warning that disparate impact cases should not be used to second guess policy decisions. In *Gallagher v. Magner* (PDF), 619 F. 3d 823 (8th Cir. 2010), *cert granted, Magner v. Gallagher*, 565 U.S. ___ (2011), the Eighth Circuit held that The City of St. Paul, Minnesota's good-faith efforts to prevent violations of the housing code and to ensure minimally acceptable housing for its poorest residents may still violate the FHA. In yesterday's opinion, Justice Kennedy noted that "*Magner* was decided without the cautionary standards announced in this opinion." Opinion at 22. It is implicit in Justice Kennedy's allusion to *Magner* that, with these safeguards in place, the enforcement of valid policies, such as housing, health and safety laws, will not create a viable disparate impact claim.

The Court went on to express its opinion that disparate impact liability mandates "the removal of artificial, arbitrary, and unnecessary barriers," not the displacement of valid governmental or private policies. Opinion at 18, citing *Griggs*, 401 U.S. at 431. Thus, the Court noted that "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 ensures that 'racial 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." Opinion at 19-20, citing *Wards Cove Packing Co. v. Atonio*, 490 U. S. 642, 653 (1989). Finally, the Court was skeptical of any interpretation of the FHA which would increase race-based considerations: "Courts should avoid interpreting disparate impact liability to be so expansive as to inject racial considerations into every housing decision." Opinion at 21. If a court's disparate impact analysis would result in the government or defendants effectively requiring racial quota, that would raise "serious constitutional questions." Opinion at 20.

The Court explained that defendants should not be held liable under a disparate impact theory based solely on a plaintiff's showing of statistical disparity. In fact, the Court stated that disparate impact liability only reaches defendants who enact policies that pose "artificial, arbitrary, and unnecessary barriers." Opinion at 18.

The Court further cautioned the government and lower federal courts that remedial orders in disparate impact cases that impose racial targets or quotas could be unconstitutional. Justice Kennedy mandated that these remedial orders "concentrate on the elimination of the offending practice that arbitrarily operates invidiously to discriminate on the basis of race." Opinion at 22, citing *Griggs*, 401 U.S. at 431. He stressed that orders that impose racial quotas might raise constitutional questions, so courts should eliminate disparities through race-neutral means.

Future Impact of Yesterday's Ruling

After yesterday's ruling, it is clear that disparate impact claims remain cognizable under the FHA. However, considering the limiting language in the second half of Justice Kennedy's majority opinion, defendants in disparate impact cases may have a few new arguments to raise. Although any argument that disparate impact theory is totally beyond the scope of the FHA is now foreclosed, Justice Kennedy's opinion will shift the argument to a determination of whether, like the decisions made by the Texas Department about whether to site housing developments, a "valid" choice that should not be second-guessed is involved, or whether, analogous to Griggs, the challenged practice or criteria creates an "artificial, arbitrary, and unnecessary" barrier based on race (or another prohibited basis), in which case disparate impact cases would be appropriate. Justice Kennedy's opinion emphasized that courts should apply the "safeguards" discussed in the case to make sure that only "artificial, arbitrary, or unnecessary" practices, rather than legitimate business choices, are subject to disparate impact litigation. While those terms are vague, future litigation will help flesh out how the concepts apply in the fair lending arena.

Moreover, this decision is also likely to bolster the use of the disparate impact theory by the Department of Justice ("DOJ") and the Consumer Financial Protection Bureau ("CFPB"), who have brought several enforcement actions against consumer financial services companies alleging that the companies' practices have a disparate impact against minorities or other protected classes. See *United States v. Ally Financial Inc.* (PDF) (E.D. Mich.) (December 2013); see also *United States v. Synchrony Bank, f/k/a GE Capital Retail Bank* (PDF) (D. Utah) (June 2014); see also *United States v. Long Beach Mortgage Co.* (C.D. Cal.) (September 1996). These enforcement actions have resulted in settlements worth millions of dollars, and nothing in the Court's ruling will likely dissuade the government from continuing to assert such claims.

The CFPB also released its Larger Participant Final Rule earlier this month, expanding its supervisory jurisdiction over the nonbank automobile finance market. Although the Court's decision does not directly impact auto finance companies, it will strengthen the CFPB's enforcement powers of disparate impact claims under ECOA. In the course of its upcoming examinations of covered auto finance companies, the CFPB will likely pursue disparate impact claims with respect to ECOA, consistent with its stance in the Ally Financial Consent Order.

Although the ruling does not greatly change the existing legal landscape, certain governmental entities will likely use it to support their examinations and investigations. Accordingly, lenders must maintain their current fair lending compliance programs and monitor whether their credit policies align with applicable law and regulatory expectations.

If you have further questions regarding the impact of the Supreme Court’s decision, please contact a member of our **Consumer Financial Services team**.