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Practice Groups:

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HUD's Approach to Disparate Impact Remains Under Fire—Lending Trade Associations Weigh In

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K&L Gates LLP recently presented the views of the major banking and lending trade associations, as *amici curiae*, in a federal challenge to HUD's Fair Housing Act disparate-impact rule.[1] The views expressed are those of the American Bankers Association, the American Financial Services Association, the Consumer Bankers Association, the Consumer Mortgage Coalition, the Financial Services Roundtable, the Independent Community Bankers of America®, and the Mortgage Bankers Association.[2]

The HUD rule challenge—now at the summary-judgment stage—is likely to have a far-reaching effect on the housing industry and affiliated sectors of the economy. The lending industry argued that the HUD rule fails to comply with binding Supreme Court precedent governing disparate-impact claims. Moreover, HUD—which lacks the power to legislate—impermissibly adopted a legal standard that Congress enacted for a different civil rights law. And compounding its error, HUD cherry-picked only the plaintiff-friendly portions of that standard while ignoring substantial limitations Congress had imposed. For these reasons, *amici* urged the court to overturn the disparate-impact rule.

Two insurance-industry trade associations—the American Insurance Association and the National Association of Mutual Insurance Companies (collectively, "AIA")—brought the challenge. *Amici* filed their brief in support of AIA to assist the trial court in understanding the full potential effect of the HUD rule.

AIA Brings Suit

Disparate-impact claims challenge policies that, while facially neutral, are nonetheless alleged to have a discriminatory effect on members of statutorily defined groups. AIA filed suit against HUD shortly after it promulgated its disparate-impact rule in 2013. The suit originally alleged that the Fair Housing Act did not recognize disparate-impact claims. In 2015, the Supreme Court held to the contrary in Texas Department of Housing and *Community Affairs v. The Inclusive Communities Project*.[3] At the same time, the Court imposed important limitations on Fair Housing Act disparate-impact claims, including, for example, that such claims cannot be based on a statistical disparity alone.[4]

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[1] *See Am. Ins. Assoc. v. U.S. Dep't of Hous. & Urban Dev.*, No. 13-966, (D.D.C. 2013), challenging Final Rule, *Implementation of the Fair Housing Act's Discriminatory Effects Standard*, 78 Fed. Reg. 11,460 (Feb. 15, 2013) (the "disparate-impact rule" or "rule").

[2] The full text of *amici*'s brief is available here.

[3] 135 S. Ct. 2507 (2015). AIA's suit was stayed pending the outcome of *Inclusive Communities*.

[4] *Id.* at 2523 ("[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 "[r]acial imbalance … does not, without more, establish a prima facie case of disparate impact.") (quoting *Wards Cove Packing Co. v. Atonio*, 490 U.S. 642 (1989)).

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AIA then amended its complaint and refocused its challenge, contending that HUD exceeded its authority under the Administrative Procedure Act by issuing a rule that contravenes binding Supreme Court precedent governing disparate-impact claims. In June 2016, AIA filed a motion for summary judgment on that basis. AIA asserted that the rule is unlawful because it (1) leads to the improper consideration of race and other characteristics in underwriting insurance policies, (2) ignores state law and thus violates the McCarran-Ferguson Act,[5] which commits insurance regulation to the states, (3) allows disparate-impact claims to proceed based entirely on statistics, and (4) improperly displaces valid business policies.

The Lending Industry Adds Its Voice

Filed in support of AIA, the lending industry's amicus brief explained in detail how HUD improperly disregarded the legal standard for disparate-impact claims established by the Supreme Court, including in decisions such as *Wards Cove Packing Co. v. Atonio.*[6] Although commenters to the proposed HUD rule outlined the proper legal standard for disparate-impact claims under the Fair Housing Act, HUD rejected those comments out of hand and without explanation.[7] Instead, HUD improperly grafted onto its rule a standard that it took an act of Congress to implement for disparate-impact claims brought under Title VII of the Civil Rights Act of 1964 (which governs employment discrimination claims).

Amici's brief outlined that the HUD disparate-impact rule improperly departed from binding Supreme Court precedent in at least five significant ways:

- ***First***, *Wards Cove* requires a plaintiff to "demonstrate that it is the application of a specific or particular . . . practice that has created the disparate impact under attack," 490 U.S. at 657, but HUD permits a plaintiff "to challenge the decision-making process as a whole," Disparate-Impact Rule, 78 Fed. Reg. at 11,469.
- ***Second***, *Wards Cove* requires that "each challenged practice has a significantly disparate impact," 490 U.S. at 657, but HUD made a "decision not to codify a significance requirement," Disparate-Impact Rule, 78 Fed. Reg. at 11,468.
- ***Third***, *Wards Cove* requires that the "ultimate burden of proving that discrimination against a protected group has been caused by a specific . . . practice remains with the plaintiff at all times," 490 U.S. at 659, but HUD "formalizes a burden-shifting test," Disparate-Impact Rule, 78 Fed. Reg. at 11,460.
- ***Fourth***, *Wards Cove* specifies "there is no requirement that the challenged practice be 'essential' or 'indispensable' to the . . . business for it to pass muster," 490 U.S. at 659, but HUD requires the "defendant to prove that the challenged practice is necessary to achieve one or more of its substantial, legitimate, nondiscriminatory interests," Disparate-Impact Rule, 78 Fed. Reg. at 11,460.

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[5] 15 U.S.C. §§ 1011, *et seq.*

[6] 490 U.S. 642 (1989).

[7] *See Encino Motorcars, LLC v. Navarro*, 579 U.S. ---, 2016 WL 3369424, at *7 (2016) ("One of the basic procedural requirements of administrative rulemaking is that an agency must give adequate reasons for its decisions;" "where the agency has failed to provide even [a] minimal level of analysis, its action is arbitrary and capricious and so cannot carry the force of law.").

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- ***Fifth***, *Wards Cove* requires that "any alternative practices . . . must be equally effective . . . in achieving [] legitimate [] goals," 490 U.S. at 661, but "HUD does not believe . . . the less discriminatory alternative must be 'equally effective,' or 'at least as effective,' in serving the respondent's or defendant's interests," Disparate-Impact Rule, 78 Fed. Reg. at 11,473.

Amici's brief also explained that even if HUD somehow had the authority (which it did not) to adopt the disparate-impact standard enacted by Congress for Title VII, HUD abused its authority by cherry-picking only those portions of the standard that HUD desired while omitting a crucial limitation imposed by Congress, namely that the standard would apply only to disparate-impact claims that did not seek monetary damages. While Congress required a Title VII plaintiff to show discriminatory intent to recover money damages, the HUD rule purportedly allows disparate-impact claims under the Fair Housing Act even if they focus solely on money damages.

What Happens Next?

HUD must respond to AIA's motion for summary judgment by August 30, 2016. The parties must complete briefing on AIA's motion, and any cross-motion that HUD may bring, by October 28, 2016. The trial court will likely schedule oral argument thereafter. K&L Gates will continue to monitor this matter and to provide updates.

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