

Disparate Impact Discrimination Remains In The Spotlight

Law360, New York (September 24, 2013, 12:16 PM ET) -- Currently, the government or private plaintiffs can seek to prove violations of the Fair Housing Act by showing either actual disparate treatment or a resulting disparate impact among protected groups. These are distinctly different standards of liability, and the current lack of clarity on how and when they may be applied to financial institutions will impact the offering and availability of credit.

Under the disparate treatment theory, discrimination may occur when there is differential treatment of similarly situated people to the detriment of members of a protected group. Under the disparate impact theory, violations of the FHA may also be proven, subject to a three-part burden shifting test, if it can be shown that the defendant's facially neutral policies had a disproportionate impact on a legally protected group, even in the absence of discriminatory intent.

Numerous courts of appeals have ruled that the disparate impact theory is available to prove violations of the FHA. But financial services industry groups are questioning the theory's applicability, arguing that there is no statutory basis for imposing liability on these grounds.

The Saint Paul Disparate Impact case

In early 2012, the U.S. Supreme Court was prepared to hear an appeal where the city of St. Paul, Minn., challenged a decision of the U.S. Court of Appeals for the Eighth Circuit that affirmed the use of disparate impact liability theory under the FHA. The case involved a group of landlords who were contesting the city's housing code enforcement policies claiming that St. Paul's enforcement of the housing code had a disparate impact among protected group renters.

The city's certiorari petition was granted by the Supreme Court, but St. Paul subsequently withdrew its appeal in February of 2012, allegedly as a result of an agreement with the U.S. Department of Justice.[1]

HUD Codifies Disparate Impact in Its Rulemaking

While the St. Paul case was pending in the Supreme Court, the U.S. Department of Housing and Urban Development published a proposed rule to codify in its FHA regulations the availability of disparate impact as a basis for FHA liability.[2]

Numerous representatives of the lending and insurance sectors submitted comments, among other things, arguing that the FHA cannot be interpreted to provide for disparate impact liability, requesting clarifications regarding the proposed rule's burden-shifting test, including seeking clarification as to the relationship of the rule to the ability to repay and qualified mortgage rules to be adopted by the Consumer Financial Protection Bureau under the Dodd-Frank Wall Street Reform and Consumer Protection Act.

In February 2013, the HUD issued a final rule, which implemented its proposal to codify disparate impact liability.[3] The HUD generally rebuffed industry requests for clarification, indicating, in effect, that the unique facts and circumstances of each case would be subject to judicial consideration under the burden-shifting test.[4]

Following the issuance of the HUD rule, two insurance industry trade groups, the American Insurance Association and the National Association of Mutual Insurance Companies, filed suit against the HUD, challenging the rule.[5]

The plaintiffs allege that liability for discrimination in providing homeowner's insurance under the FHA should be limited to intentional discrimination. They argue that the HUD rule would require insurers to provide and price insurance in a manner that is inconsistent with actuarial practice and applicable state insurance law. They also allege that the HUD rule is inconsistent with the McCarran-Ferguson Act.

However, the case has stayed pending the outcome of the Supreme Court's consideration of an FHA challenge filed by the township of Mount Holly, N.J.

Disparate Impact Returns to the Supreme Court in Mount Holly Township v. Citizens in Action

The Mount Holly case originated in New Jersey state court where the township was sued in 2003 by a nonprofit organization and a group of citizens who lived in Mount Holly Gardens, a public housing development located in the township.

The plaintiffs alleged that the township's decision that Mount Holly Gardens was a blighted area in need of redevelopment was racially discriminatory. After the plaintiffs were unsuccessful in state court, the citizens group filed suit in federal court alleging discriminatory treatment and discriminatory impact under the FHA by the township.[6]

In 2008, a U.S. District Court of New Jersey granted summary judgment in favor of the township on both the disparate impact and disparate treatment claims, holding that the plaintiffs failed to establish a prima facie case under either claim.

However, on appeal, the U.S. Court of Appeals for the Third Circuit reversed the lower court's decision regarding the disparate impact claim, finding that the evidence submitted by the plaintiffs established a disproportionate impact, thereby establishing a prima facie case.[7]

Following the Third Circuit's ruling, the township filed a petition for the Supreme Court to hear the case. It requested review of two issues: whether disparate impact claims are cognizable under the FHA and if so, whether they should be analyzed under a burden-shifting approach, a balancing test or by some other test.[8]

On June 17, 2013, the Supreme Court granted the township's petition only on the first issue. The township argues that nonintentional discrimination liability is not supported by the text of the FHA. Instead, it argues that the FHA "prohibits disparate treatment alone" as the text of the act "does not focus on 'effects' or 'consequences'" and that "the FHA's structure and history confirm that [the FHA] is targeted at purposeful discrimination alone." [9]

Significance of the Mount Holly Case on FHA Enforcement and Fair Lending

The Supreme Court's ruling will have significant consequences. A decision that the FHA does not provide for disparate impact liability will be welcomed by industry groups as it will remove major legal uncertainty in regard to their operations under facially neutral policies.

In the field of fair lending, government claims have been overwhelmingly based on disparate treatment theories. However, recently, agencies have shown an increasing interest in pursuing disparate impact theories, which presumably would be encouraged by a favorable Supreme Court ruling.

In 2012, the DOJ pursued a fair lending claim based on a disparate impact theory against Luther Burbank Savings.[10] The DOJ based its action on the institution's general \$400,000 minimum loan amount for single family loans policy that was in place from 2006 to 2011.

The DOJ asserted that because the minimum loan amount was so high, minority borrowers were largely precluded from accessing the institution's mortgages. Luther Burbank Savings settled with the DOJ and is now required to maintain its current minimum loan amount of \$20,000 and not raise it during the term of its agreement with the DOJ.

Additionally, the institution was required to set aside \$1.1 million to fund a special financing program designed to make available credit to persons seeking residential mortgages for loan amounts less than \$400,000.[11]

In April 2012, the bureau issued a bulletin reaffirming that the disparate impact theory would remain a tool for it to use in the exercise of its supervision and enforcement authority under the Equal Credit Opportunity Act, which has also been interpreted by federal agencies to provide for disparate impact liability.[12]

There are significant disparate impact issues associated with lenders' implementation of bureau's ability to repay and qualified mortgage rules (ATR rule) that become effective Jan. 10, 2014.[13] Disparate impact issues may be raised by, among other things, a decision by a lender to limit residential mortgage lending to loans that meet the requirements to be treated as qualified mortgages.[14]

Lenders will want to consider potential disparate impact issues and potential mitigating actions as they evaluate how to structure their mortgage operations under the ATR rule.

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[1] A joint staff report prepared by members of the House and Senate asserted that the DOJ entered into a quid pro quo arrangement with the City of St. Paul in which the DOJ declined to intervene in two qui tam cases in exchange for St. Paul withdrawing its FHA appeal before the Supreme Court. See DOJ's QUID PRO QUO WITH ST. PAUL: HOW ASSISTANT ATTORNEY GENERAL THOMAS PEREZ MANIPULATED JUSTICE AND IGNORED THE LAW, Joint Staff Report, U.S. Congress, 113th Congress, April 15, 2013, at 3, available at <http://oversight.house.gov/wp-content/uploads/2013/04/DOJ-St-Paul.pdf>.

[2] 76 Fed. Reg. 70921 (Nov. 16, 2011).

[3] 78 Fed. Reg. 11460 (Feb. 15, 2013).

[4] See our DechertOnPoint, U.S. Department of Housing and Urban Development Issues Final Rule Affirming Use of Disparate Impact to Establish Liability for Violations of the Fair Housing Act, (Feb. 2013).

[5] See American Insurance Association and National Association of Mutual Insurance Companies v. U.S. Dep't of Housing and Urban Development, No. 1:13-cv-00966-RJL, Compl. filed in D.D.C. June 26, 2013.

[6] See Citizens in Action v. Twp. Of Mt. Holly, 2007 WL 1930457 (N.J. Super Ct. App. Div. July 5, 2007), certif. denied, 937 A.2d 977 (N.J. 2007).

[7] Mt. Holly Gardens Citizens in Action v. Twp. of Mt. Holly, 658 F.3d 375 (3d Cir. 2011).

[8] The DOJ filed a brief arguing that disparate impact should be a basis for established FHA liability.

[9] Petitioner's Opening Brief at 15.

[10] See Justice Department Press Release (Sept. 12, 2012), available at, <http://www.justice.gov/opa/pr/2012/September/12-crt-1104.html>.

[11] See our DechertOnPoint, U.S. Department of Justice Turns Spotlight on Disparate Impact Discrimination Claims (PDF), (Sept. 2012).

[12] See CFPB Bulletin 2012-04, April 18, 2012.

[13] For a more detailed discussion of the ATR Rule, see our DechertOnPoint, U.S. Consumer Financial Protection Bureau Issues Rules on Qualified Mortgages and Ability to Repay, (Jan. 2013).

[14] For a more detailed discussion of the friction between federal agency fair lending policies and the qualified mortgage rule see Thomas P. Vartanian and Robert H. Ledig, Home Lenders' Fair-Lending Dilemma , American Banker, (March 4, 2013).

[15] American Bankers Association and Dechert LLP. (June 2013). A Strategic Guide to the ATR/QM Rules.