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Ojo v. Farmers Update: Texas Supreme Court Affirms Use of Credit Scoring to Price Homeowner Policies

Insurance Law Flash

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For two years at our Sedgwick Insurance Regulatory and Litigation seminars, we have tracked the important issue of whether reverse preemption under the McCarran-Ferguson Act (MFA) applies to insurance pricing. We now update our audience on the latest development—the Texas Supreme Court's May 27 decision in *Ojo v. Farmers Group, Inc.* --- S.W.3d ----, 2011 WL 2112778 (Tex., May 27, 2011). The court held that Texas law permits racially neutral credit scoring in pricing homeowners insurance. This holding, in conjunction with the Ninth Circuit Court of Appeals' 2010 *en banc* opinion in *Ojo*, applies MFA "reverse preemption" to preclude federal Fair Housing Act (FHA) claims. Under this pair of *Ojo* decisions, the MFA continues to have vitality 70 years after its passage!

We have focused on *Ojo* because it presents critical issues of whether the MFA reverse-preempts federal disparate impact claims premised on racially neutral rating practices that are comprehensively regulated by state statutes. At the time of our February 2011 seminar, we were awaiting a decision on the following question, which the Ninth Circuit had certified to the Texas Supreme Court:

> Does Texas law permit an insurance company to price insurance by using a credit-score factor that has a racially disparate impact that, were it not for the [MFA] would violate the federal Fair Housing Act, 42 U.S.C. §§ 3601-19, absent a legally sufficient nondiscriminatory reason, or would using such a credit-score factor violate Texas Insurance Code sections 544.002(a), 559.051, 559.052, or some other provision of Texas law?

Ojo v. Farmers Group, Inc., 600 F.3d 1201, 1204-05 (9th Cir. 2010) *(en banc) (per curiam).* On May 27, 2011, the Texas Supreme Court answered that question, holding that "Texas law prohibits the use of race-based credit scoring, but permits race-neutral credit scoring even if it has a racially disparate impact." *Ojo v. Farmers Group, Inc.,* Texas Supreme Court No. 10-0245.

In *Ojo*, an African-American Texas resident filed a putative class action against the insurer for disparate impact discrimination in violation of the FHA, alleging that the insurer's particular use of credit scoring resulted in charging minorities higher premiums for homeowners' insurance than the premiums charged to similarly situated Caucasian policyholders. The district court dismissed the case based on MFA reverse-preemption. The Ninth Circuit reversed, and then granted review *en banc.*

In its *en banc* opinion, the Ninth Circuit held that the FHA applies to homeowners insurance and prohibits racial discrimination in the denial and pricing of such insurance but that the FHA can be reverse-preempted by the MFA. But the Ninth Circuit punted to the Texas Supreme Court the ultimate issue of whether applying the FHA in this instance would invalidate, impair or supersede Texas insurance law (the test for MFA reverse-preemption).

In an 8-0 decision authored by Justice Paul W. Green, the Texas Supreme Court held that Ojo's disparate impact claim was reverse-preempted by Texas law under the MFA. The court determined that the Texas Insurance Code, which permits credit scoring, does not create a cause of action for a disparate racial impact. Further, the decision to allow or prohibit use of credit scoring to price insurance that results in a disparate impact is a question for the Legislature. Consequently, "[a]llowing a claim against Texas insurers for using completely race-neutral factors in credit scoring would frustrate the regulatory policy of Texas that the MFA is meant to protect, which is the continued regulation of the field of insurance by the states without unintentional congressional intrusion."

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