Client Alert

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HUD to Reconsider Disparate Impact Rule

By Angela E. Kleine and Donald C. Lampe

The U.S. Department of Housing and Urban Development (HUD) announced that it will "shortly" seek public comment on whether its controversial disparate impact rule is consistent with the Supreme Court's *Inclusive Communities* decision.[1] In *Inclusive Communities*, the Supreme Court held that disparate impact is a cognizable theory of discrimination under the Fair Housing Act (FHA). Thus, a defendant may be liable for a practice that is facially neutral but that nevertheless has a discriminatory impact, unless there is a legally sufficient justification for the practice. *Inclusive Communities* did not decide the standard for evaluating disparate impact claims; rather, it provided several guideposts for "necessary" "limitations." HUD's disparate impact rule is arguably inconsistent with those limitations and the Supreme Court's decision in several respects. The agency's announcement suggests it is now considering revising the rule to conform to the Supreme Court's holdings.

THE HUD RULE

HUD's 2013 disparate impact rule added a provision entitled "Prohibiting Discriminatory Effects" to existing FHA regulations. Under the new provision, a defendant may be liable for practices with a discriminatory effect, unless there is a legally sufficient justification. The showings and burdens of proof unfold as follows:

1. **"Discriminatory Effect"**: The government and private plaintiffs may challenge any practice that (i) "actually" or "predictably results" in a "disparate impact" on protected classes of individuals or (ii) "creates, increases, reinforces, or perpetuates segregated housing patterns." Thus, plaintiffs need not allege any *intent* to discriminate or any disparate *treatment* of borrowers. They need only allege that some neutral, non-discriminatory policy will have a disparate *impact* or "perpetuate" preexisting "segregated housing patterns."
2. **Business Justification**: The defendant then has the burden of proving that the challenged practice is "*necessary* to achieve one or more substantial, legitimate, nondiscriminatory interests."
3. **"Less Discriminatory" Alternatives**: Even if the defendant meets its burden under the second step, the plaintiff can still prevail by showing that the defendant's interests "could be served" by some other theoretical practice "that has a less discriminatory effect."

Each party's showing must be supported by evidence and may not be "hypothetical or speculative."

INCLUSIVE COMMUNITIES

As we detailed in 2015, *Inclusive Communities* approved the disparate impact theory but made clear that in stating a *prima facia* case, plaintiffs must articulate a specific policy that causes a perceived disparity, including demonstrating a "robust" causal link between the policy and the allegedly associated outcome. 135 S.Ct. at 2512.

[1] *Texas Department of Housing and Community Affairs v. Inclusive Communities Project, Inc.*, 576 U.S. __ , 135 S.Ct. 2507, 192 L.Ed.2d 514 (2015).

In other words, a racial imbalance, standing alone, is not sufficient, and where there are multiple factors underlying a decision, the causal link may be broken.

The *Inclusive Communities* decision also provides some insight into a defendant's justification for policies that produce an impact. The decision indicates that impact claims should apply to "artificial, arbitrary and unnecessary" policies and should avoid the displacement of "valid" ones. *Id.*. Defendants should be permitted to "state and explain the valid interest served by their policies" and adopt ones that are "necessary to achieve a valid interest." *Id.*

Finally, the holding suggests that remedial orders should concentrate on the elimination of offending practices and ensure that additional measures are designed to "eliminate racial disparities through race-neutral means." *Id.* at 2523.

Overall, the Court cautioned that in order to avoid the risk that disparate impact liability could "perpetuate race-based considerations," trial courts should "avoid interpreting disparate impact liability to be so expansive as to inject racial considerations into every housing decision." *Id.*

INITIAL ANALYSIS

Given *Inclusive Communities*, HUD's rule is subject to attack on several grounds. For example, permitting plaintiffs to show a "discriminatory effect" with evidence that merely exceeds the low bar of "hypothetical or speculative" appears to be inconsistent with the Supreme Court's indication that a plaintiff must allege adequate facts "or produce statistical evidence demonstrating a causal connection" between a challenged policy and the alleged disparate impact.

HUD's interpretation of the second prong of the inquiry, requiring a defendant to "prove" that a challenged practice is "necessary" to establish business justification, is also highly questionable. In its November 2011 proposed version of the rule, HUD posited that defendants must show that the challenged practice "has a necessary and manifest relationship to a legitimate business interest." In the final rule, HUD took that standard—which was an overly aggressive interpretation of the law—and "clarified" it into something that has already been affirmatively rejected in a series of cases.

The Supreme Court has addressed the proper business justification standard in the employment context, from which HUD's rule is drawn. In *Wards Cove Packing Co. v. Atonio*, 490 U.S. 642 (1989)—relied on extensively in *Inclusive Communities*—the Court held that a defendant need only show that a "challenged practice serves, in a significant way, the legitimate employment goals of the employer." The Court specifically rejected the notion that the defendant must prove its policy is "essential" or "indispensable." Congress later overrode *Wards Cove* with the Civil Rights Act of 1991, and required defendants to articulate a "business necessity" for the challenged practice. But Congress has never made any such amendment to the FHA. The more lenient standard articulated in *Wards Cove* should therefore continue to apply to FHA regulations and cases.

The concern is heightened by the fact that under the third prong, a plaintiff need only show that the defendant's interests "*could be served* by another" allegedly less discriminatory practice, suggesting that HUD and private plaintiffs have the option of using their own judgment to prioritize defendants' legitimate business interests.

In addition, HUD's shifting of the burden under both the second and third prongs of the disparate impact test onto

the defendant is inconsistent with legal authority. In *Wards Cove*, the Supreme Court held that while an employer bears the burden of *producing* a legitimate business reason, the burden of *persuasion* "remains with the disparate impact *plaintiff*." Again, Congress later legislatively overrode this portion of *Wards Cove*, but it made no such change to the FHA. There is therefore a strong argument that the burden of persuasion under the FHA ought to remain squarely on the plaintiff. Recent Supreme Court authority interpreting analogous language in the Age Discrimination in Employment Act supports that interpretation.

TAKEWAYS TODAY?

HUD's disparate impact rule was subject to criticism even before the Supreme Court decided *Inclusive Communities.* When HUD issues a notice soliciting comment on this subject matter, real estate and real estate finance industries no doubt will point this out in comments directed to HUD. Thus, industry comments may not be limited to *Inclusive Communities*. While some may say that HUD, under the current Administration, will seek to weaken the disparate impact doctrine, as a practical matter what is at stake is much-needed clarification of HUD's FHA rule. Also, *Inclusive Communities* was an FHA case and did not touch on disparate impact under the Equal Credit Opportunity Act (ECOA). It remains to be seen whether federal agencies with jurisdiction over ECOA, such as the Bureau of Consumer Financial Protection, will revisit the application of the disparate impact doctrine under ECOA.[2]

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[2] 12 CFR Part 1002 Supp. I Sec. 1002.6(a)-2.

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