Legal Backgrounder

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Inclusive Communities Project's Silver Linings: Assessing the High Court's 2015 Fair Housing Act Ruling

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In *Texas Department of Housing & Community Affairs v. The Inclusive Communities Project, Inc.* ("*Inclusive Communities*"), the Supreme Court narrowly upheld a plaintiff's ability to bring a disparate-impact claim under the Fair Housing Act (FHA).[1] At the same time, the Court imposed significant limitations on the application of disparate impact to FHA claims—which limitations are likely to provide an important benefit to financial services and insurance industry businesses in defending FHA litigation and enforcement matters.

This Legal Backgrounder discusses (1) the limitations the Supreme Court imposed on the use of disparate impact in FHA suits and lower courts' initial application of those limitations and (2) the differences between the Court's limitations on disparate impact and the standard of disparate impact in the 2013 rule promulgated by the Department of Housing and Urban Development (HUD).

The Supreme Court's Limitations on Disparate Impact Under the Fair Housing Act

Although recognizing that a plaintiff may bring a disparate-impact claim under the FHA, *Inclusive Communities* focused a substantial portion of its analysis on the "important and appropriate means of ensuring that disparate-impact liability is properly limited."[2] The Court warned that absent such limitations, "the specter of disparate-impact litigation" under the FHA could "undermine[] its own purpose as well as the free-market system."[3] An overbroad application of disparate impact "'would almost inexorably lead' governmental or private entities to use 'numerical quotas,'" in housing-related decisions.[4] Such consideration can arise where disparate impact is used "[w]ithout adequate safeguards at the prima facie stage" of a suit.[5] Thus, the Court emphasized that lower courts must "examine with care" disparate-impact claims "at the pleading stage" because "prompt resolution of these cases is important."[6]

In describing the requisite safeguards, the Supreme Court relied on *Wards Cove Packing Co. v. Atonio*, a Title VII employment-law matter.[7] *Wards Cove* held that a disparate-impact claim must identify the specific policy of the defendant and adequately plead that the policy is the actual cause of the negative effect about which the plaintiff complains. Applying *Wards Cove* to the FHA, *Inclusive Communities* held that a "racial imbalance does not, without more, establish a prima facie case of disparate impact," and that a plaintiff cannot maintain a disparate-impact claim by pleading a mere "statistical disparity."[8] Rather, a plaintiff must establish a "robust" causal link to an actual, specific policy implemented by the defendant. The Court recognized that in practice, causality "may be difficult to establish" because of the "multiple factors that go into … decisions" affecting housing.[9]

Additionally, the Court outlined the contours of an important defense to a disparate-impact claim, namely that "[g]overnmental or private policies are not contrary to the disparate-impact requirement unless they are artificial, arbitrary, and unnecessary barriers."[10] Businesses must be given "leeway to state and explain the valid

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interest served by their policies," and should be able "to make the practical business choices and profit-related decisions that sustain a vibrant and dynamic free-enterprise system."[11] Thus, *Inclusive Communities* articulated a standard in line with the business-justification defense of *Wards Cove*.

Finally, *Inclusive Communities* held that "even when courts do find liability under a disparate-impact theory," remedial orders must "concentrate on the elimination of the offending practice" through "race-neutral means."[12] Thus, the Court suggested that the relief available in a disparate-impact challenge under the FHA is properly limited to equitable relief and should not include punitive sanctions and monetary damages.

Federal Courts' Application of the *Inclusive Communities* Limitations on Disparate Impact

Federal courts have already begun to apply *Inclusive Communities* to weed out FHA disparate-impact claims. The District Court for the Central District of California was the first to do so. Its decision in *City of Los Angeles v. Wells Fargo Bank, N.A.*[13] articulates important defenses to disparate-impact claims. In that suit, the City of Los Angeles claimed that Wells Fargo's origination of discriminatory loans to minorities caused the borrowers to default, the loans to be foreclosed, and the City to suffer damages in the form of lost property-tax revenues and increased municipal-services expenditures at the foreclosed properties.[14] In granting summary judgment for Wells Fargo, the district court examined the City's evidence of a disparity between the percentages at which minorities and non-minorities received so-called "high-cost" loans—which were 0.0033% and 0.0008%, respectively.[15] Applying *Inclusive Communities*, the court found the difference between those percentages could not create "a genuine dispute regarding a prima facie case" because "the evidentiary disparities are negligible."[16] Ruling that "comparing thousandths of a percentage fails to meet the minimum threshold of *Inclusive Communities*," the court held that a disparate-impact plaintiff must "provide evidence of a *significantly* disproportionate effect" to avoid summary disposition.[17]

The district court also followed *Inclusive Communities* in ruling that the City had failed to articulate any specific Wells Fargo policy that had caused the purported harm, rejecting the City's argument that "a lack of a policy" could sustain a disparate-impact claim.[18] Further, the district court stated that the "[g]uidance from the Supreme Court [in *Inclusive Communities*] is unambiguous that disparate impact claims must solely seek to *remove* barriers" to equal treatment.[19] The court found that contrary to that goal, "the City is essentially advocating for racial quotas," the obverse of equal treatment.[20]

Finally, the court noted that that under *Inclusive Communities*, the City had the burden of proving a "disproportionately *adverse* effect on minorities."[21] The court rejected the City's evidence of a disproportionate origination of loans insured by the Federal Housing Administration to minorities, concluding that government loans *benefitted*, rather than harmed, minority borrowers. To reach this conclusion, the court observed that "*Inclusive Communities* instructs the court to analyze the claims 'with care,'" before conducting an analysis of the government loan program.[22] The court held that "[w]hen the benefits and purpose of [Federal Housing Administration] loans are considered, the Court fails to see how minorities are adversely affected."[23] Determining that government loans "are intended to help low-income borrowers," the court concluded that "Wells Fargo's compliance with federal programs and procedures cannot mean that Wells Fargo created an artificial, arbitrary, or unnecessary barrier" under *Inclusive Communities*.[24]

Courts of Appeals for the Third and Eleventh Circuits have also cited *Inclusive Communities* in the FHA context.[25] In particular, in *Shahin v. PNC Bank*, the Third Circuit affirmed the dismissal of FHA claims on the basis that under *Inclusive Communities*, an amendment to the complaint likely would be futile, "as it does not appear that [plaintiffs] will be able to provide any non-conclusory allegations that support an inference of discrimination."[26] Quoting *Inclusive Communities*, the Third Circuit stated, "[w]hile disparate impact claims are cognizable under the FHA, a plaintiff in such a case must show that the challenged practices 'have a disproportionately adverse effect on minorities and are otherwise unjustified by a legitimate rationale.' The Shahins' complaint does

not contain allegations such that one can infer that PNC's practices had or have a disproportionately adverse effect on minorities."[27]

Financial-services entities and insurers should monitor FHA matters for development of the law under, and application of the limitations articulated in, *Inclusive Communities*.

Differences Between *Inclusive Communities* and the 2013 HUD Disparate-Impact Rule

In promulgating its 2013 disparate-impact rule, HUD relied heavily on certain aspects of Title VII law but ignored other aspects of that body of law, including aspects of the Supreme Court's Title VII jurisprudence on which the Court later relied in limiting the scope of disparate impact under the FHA. Thus, significant portions of the HUD rule now stand in tension with the Court's ruling in *Inclusive Communities*.

Relying on *Wards Cove, Inclusive Communities* emphasized that a disparate-impact plaintiff must identify a specific policy and establish that the policy is the cause of the purported disparate impact.[28] By seemingly permitting a plaintiff to challenge an alleged disparate impact on a group of individuals *without* identifying the specific practice that allegedly caused that impact, the HUD rule appears to contravene a significant holding of the Supreme Court.[29]

Additionally, *Inclusive Communities* directed that "remedial orders" in disparate-impact cases should focus on eliminating the offending policy.[30] The Supreme Court strongly implied that as in Title VII,[31] and other anti-discrimination statutes, an FHA plaintiff must prove *intentional* discrimination to obtain punitive or compensatory damages and cannot obtain such damages by means of a disparate-impact claim. In promulgating its disparate-impact rule, however, HUD permitted the recovery of such damages through disparate-impact claims.[32]

Two pending insurance industry challenges to the HUD disparate-impact rule may resolve the tension between the Supreme Court's analysis and the HUD disparate-impact rule.

Last year, the U.S. District Court for the Northern District of Illinois granted partial summary judgment to an insurance industry trade group and "remanded" certain issues to HUD for further development.[33] In particular, the court held that HUD had not sufficiently addressed specific concerns that the trade group had submitted to HUD during the rulemaking process and directed HUD to issue new responses to the industry's comments.[34] On the other hand, the court concluded that HUD was entitled to judgment as to the claim that the rule's burden-shifting approach was contrary to law. Although the court ruled that the approach deviated from *Wards Cove*, it also ruled that the FHA is silent as to whether such deviation is permissible and applied *Chevron*-type deference.[35] Yet, as discussed above, this conclusion appears at odds with *Inclusive Communities'* reliance on *Wards Cove* and may be susceptible to challenge on further review.

A second insurance industry challenge to the HUD disparate-impact rule is pending in the U.S. District Court for the District of Columbia.[36] Last year, the district court vacated the HUD disparate-impact rule on the basis that the FHA did not recognize disparate-impact claims.[37] HUD appealed, and while the appeal was pending, the Supreme Court rendered its contrary decision in *Inclusive Communities*. The industry then moved the U.S. Court of Appeals for the District of Columbia Circuit to vacate the district court's judgment "in light of the Supreme Court's decision in *Inclusive Communities*," indicating that the industry would seek leave to amend its complaint on remand to challenge the rule as being "inconsistent with the decision in *Inclusive Communities*."[38] The circuit court granted the industry's motion.[39]

To date, the government has resisted any suggestion that *Inclusive Communities* had any negative bearing on the HUD rule. Rather, HUD and the U.S. Department of Justice have made public statements that *Inclusive Communities* reinforces standards that have always applied to disparate-impact claims and is entirely consistent with the government's enforcement of the FHA.

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Conclusion

Inclusive Communities has a silver lining—namely, the significant limitations it placed on disparate-impact claims brought under the FHA. Because it appears that enforcement agencies will continue to use the same enforcement theories as previously, businesses should continue to direct their compliance programs pursuant to government enforcement policies to reduce legal risk. But at the same time, business should be prepared to vigorously defend their practices under the proper legal standards if a matter reaches litigation.

Endnotes

[1] 135 S. Ct. 2507 (2015).
[2] *Id.* at 2522.
[3] *Id.* at 2524.
[4] *Id.* at 2523.
[5] *Id.* at 2523.
[6] *Ibid.*
[7] 490 U.S. 642 (1989).
[8] *Inclusive Communities*, 135 S. Ct. at 2523.
[9] *Id.* at 2523-24.
[10] *Id.* at 2524.
[11] *Id.* at 2518.
[12] *Id.* at 2524.
[13] No. 2:13-09007, 2015 WL 4398858, at *1 (C.D. Cal. July 17, 2015), *appeal filed* No. 15-56157 (9th Cir. July 29, 2015).
[14] *Id.* at *1-2.
[15] *Id.* at *7.
[16] *Ibid.*
[17] *Id.* at *7.
[18] *Id.* at *8.
[19] *Id.* (emphasis in original).
[20] *Id.*
[21] *Id*. at *9.
[22] *Ibid.*
[23] *Id.* at *10.
[24] *Id.* at *12.
[25] Additionally, in *County of Westchester v. U.S. Department of Housing & Urban Development*, the Second Circuit quoted with approval that portion of *Inclusive Communities* defining a plaintiff's prima facie burden. *See* 802 F.3d. 413, 425 (2d Cir. 2015) (*per curiam*). The U.S. Courts of Appeals for the First, Fourth, and Fifth Circuits have also cited *Inclusive Communities* outside of the FHA context.
[26] No. 15-1405, --- F. App'x ---, 2015 WL 4998392, at *2 (3d Cir. Aug. 24, 2015) (*per curiam*).
[27] *Id.* at *3 n.7 (internal citation omitted).
[28] *Inclusive Communities*, 135 S. Ct. at 2523.
[29] *See Implementation of the Fair Housing Act's Discriminatory Effects Standard*, 78 Fed. Reg. 11460, 11469 (Feb. 15, 2013) [hereinafter "HUD Rule"]. While Congress amended Title VII in reaction to *Ward Cove*, Congress never amended the FHA in such a manner. Accordingly, *Wards Cove* has not been superseded as to the FHA or other civil rights statutes.
[30] *Inclusive Communities*, 135 S. Ct. at 2524.
[31] *See* 42 U.S.C. §§ 1981a(1), 1981a(2).
[32] *See* HUD Rule at 11474.
[33] *See Property Cas. Insurers Ass'n of Am. v. Donovan,* 66 F. Supp. 3d 1018 (N.D. Ill. 2014).
[34] *Id.* at 1048-49. Specifically, HUD inadequately resolved the issue of whether application of the HUD Rule to homeowners insurance would violate the McCarran-Ferguson Act, 15 U.S.C. § 1011, *et seq.*
[35] *See id.* at 1052-54.
[36] *See American Ins. Ass'n v. U.S. Dept. of Hous. & Urban Dev.,* No. 1:13-00966 (D.D.C.).
[37] *See American Ins. Ass'n v. U.S. Dept. of Hous. & Urban Dev.,* 74 F. Supp. 3d 30 (D.D.C. 2014).
[38] Mot. by Appellees to Vacate and Remand, *American Ins. Ass'n v. U.S. Dept. of Hous. & Urban Dev.,* No. 14-5321 (D.C. Cir. July 15, 2015).
[39] *American Ins. Ass'n v. U.S. Dept. of Hous. & Urban Dev.,* No. 14-5321 (D.C. Cir. Aug. 25, 2015) (*per curiam*).

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