U.S. Supreme Court Agrees to Resolve Whether the FHA Provides for Disparate Impact Liability

Description

A major change to federal law governing mortgage lending may be on the horizon. On October 2, 2014, the United States Supreme Court agreed to decide whether the Fair Housing Act ("FHA") not only imposes liability for intentional discrimination, but also for actions taken without an intent to discriminate that may have a disproportionate effect on groups sharing certain characteristics, such as race, handicap, or gender ("disparate impact"). A ruling that disparate impact liability is not cognizable under the FHA would nullify a 2013 federal regulation that provides for such liability, thereby simplifying the mortgage lending industry's compliance with the FHA and other lending laws.

The Fair Housing Act And Disparate Impact Liability

The FHA makes it unlawful "for any person or other entity whose business includes engaging in residential real estate-related transactions to discriminate against any person in making available such a transaction, or in the terms or conditions of such a transaction because of race, color, religion, sex, handicap, familial status, or national origin." 42 U.S.C. § 3605. Residential mortgage lending falls within the purview of the FHA. *Id.* Unlike other federal civil rights statutes, the FHA prohibits intentional discrimination, but does not expressly provide for liability premised on the discriminatory "effect" of actions performed without discriminatory intent (*i.e.* disparate impact). Lower federal appellate courts to consider the issue, nonetheless, have agreed that the FHA provides for disparate impact liability. These courts have diverged, however, as to how such liability can be established.

HUD Interprets The FHA To Provide For Disparate Impact Liability

In 2013, the U.S. Department of Housing and Urban Development ("HUD") promulgated 24 C.F.R. § 100.500 (the "HUD Rule") to expressly interpret the FHA to provide for disparate impact liability and define the test that a claimant must satisfy to establish such liability. The HUD Rule provides: "Liability may be established under the Fair Housing Act based on a practice's discriminatory effect . . . even if the practice was not motivated by a discriminatory intent." 24 C.F.R. § 100.500. Under the HUD Rule, a practice has a "discriminatory effect" where "it actually or predictably results in a disparate impact on a group of persons or creates, increases, reinforces, or perpetuates segregated housing patterns because of race, color, religion, sex, handicap, familial status or national origin." *Id.* A practice shown to have a discriminatory effect may still be legal if it is supported by a "legally sufficient justification." "A legally sufficient justification exists where the challenged practice . . . [i]s necessary to achieve one or more substantial, legitimate, nondiscriminatory interests . . . [and] [t]hose interests could not be served by another practice that has a less discriminatory effect." *Id.*

Under the HUD Rule, disparate impact liability is established through a three-part test during which the burden of proof shifts from the claimant to the defendant and then back to the claimant. First, the claimant must show that the challenged practice caused or predictably will cause a discriminatory effect. *Id.* Second, if the claimant meets this burden, the defendant must then show that the challenged practice is necessary to achieve one or more substantial, legitimate, nondiscriminatory interests. *Id.* Finally, if the defendant makes this showing, the claimant can still establish disparate impact liability by proving that the substantial, legitimate, nondiscriminatory interests supporting the challenged practice could be served by another practice that has a less discriminatory effect. *Id.*

The Disparate Impact Dilemma for The Mortgage Lending Industry

The existence of disparate impact liability under the FHA, particularly as broadly defined as it is under the HUD Rule, presents mortgage lenders and those in related fields with a compliance quandary. The specter of disparate impact liability rears its head when the outcome of a business's decisions has different demographic effects, despite the business's use of neutral standards. Lenders, for example, employ generally-accepted credit assessment standards (*e.g.* debt-to-income requirements, down-payment requirements, *etc.*) to evaluate an applicant's eligibility for a mortgage loan. Indeed, in many instances federal and state law obligates lenders to apply such factors. Use of these standards, however, can produce outcomes that can be connected with race, religion, sex, *etc.* and can impact people within those categories differently. And there is the rub. If the differences produced by neutral, legally-required underwriting protocols are statistically significant (*i.e.* not the result of coincidence), the lender risks disparate impact exposure. Faced with such a threat, lenders may feel pressure to manage outcomes in their decision-making process and divert from neutral standards to curb potential disparate impact liability. Doing so, however, would arguably constitute unlawful intentional discrimination under the FHA, thus leaving lenders and the like in a compliance bind.

The Supreme Court Agrees To Decide Whether The FHA Provides For Disparate Impact

On October 2, 2014, the United States Supreme Court granted a petition for certiorari in *Texas Department of Housing and Community Affairs v. Inclusive Communities Project, Inc.*, to resolve whether disparate impact claims are cognizable under the FHA. The implications of a ruling against disparate impact liability are significant. Such a decision would invalidate the HUD Rule, as well as decades of lower federal court decisions that have interpreted the FHA to provide for disparate impact liability. Of equal importance, a decision against disparate impact liability would eliminate the quandary that the mortgage lending industry currently faces and significantly simplify its compliance with the FHA and other lending regulations. The Supreme Court has scheduled oral argument in *Inclusive Communities* for January 21, 2015, with a decision likely to be rendered by spring 2015. Stay tuned.

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