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GUEST COMMENTARY

A WIN FOR DISPARATE IMPACT, BUT NOT A TOTAL LOSS FOR LENDERS

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For those in the financial services industry subject to lawsuits and investigations based on "disparate impact" discrimination theories of liability, the most recent U.S. Supreme Court term began with a sense of optimism.

The Court had granted *certiorari* in *Texas Department of Housing and Community Affairs v. Inclusive Communities Project, Inc.* to decide whether the Fair Housing Act actually authorized discrimination claims based, not on any allegation of intentional discrimination, but on race-neutral policies or practices that had disproportionate effect, or "disparate impact," on racial minorities or other members of protected classes. Mortgage lenders, auto finance companies, and other consumer lenders have been subject to a wave of enforcement from the CFPB and the Department of Justice, much of it based, not on any allegation of discriminatory intent, but on analysis of spreadsheets and portfolios that might show, in the aggregate, a disparity among the terms offered among or between various groups of people of varying age, race, or ethnicity.

"Finally," some (including me) thought, "the Court might find that the FHA only prohibits intentional discrimination and does not authorize disparate impact claims, hopefully using logic that could equally apply to ECOA or in other contexts."

And there was reason for hope: although every federal Circuit Court to address the question had found that a disparate impact cause of action existed under the FHA, the fact that there was no circuit split was viewed as a *good* thing -- why else would the Court grant *certiorari* on a question where the circuit courts were unanimous if not to reverse?

Even the proponents of disparate impact theory, most notably the Department of Justice, seemed to agree, having settled FHA disparate impact cases during two previous terms, presumably to avoid, or at least delay, the Court's evisceration of their widely used but legally questionable, fair lending theory. This term promised to be different, though, as the Solicitor General of Texas, representing the petitioner and a political foe of both the current administration and the disparate impact theory, would be an unlikely candidate to "take one for the team" and settle the disparate impact question out from under the Court yet again.

Still looking good, but with a caution

Optimism was somewhat tempered after January's oral arguments, however. Justice Antonin Scalia's questions raised the possibility of whether he might provide an unexpected vote in support of an interpretation of the FHA as including disparate impact -- maybe it was Justice Scalia, not Justice Kennedy, who for once would be a swing vote?

Even after the argument, however, most predicted the disparate impact theory, at least under the FHA, would be dealt a blow -- the more common question asked was whether the Court would do so in a narrow ruling or in one that might have a broader effect on disparate impact claims under other statues, such as ECOA.

When the Court finally issued its decision, it was one of the few big cases this term where most prognosticators got it wrong. In a 5-4 decision written by Justice Anthony Kennedy, the Court *affirmed* the Fifth Circuit and held the FHA *does* authorize disparate impact claims. (*Texas Department of Housing and Community Affairs v. Inclusive Communities Project*, No. 13-1371 (U.S. 06/25/15).)

As you no doubt have read elsewhere, Justice Kennedy's opinion, joined by the Court's more liberal bloc of justices -- Ruth B. Ginsburg, Stephen Breyer, Sonia Sotomayor, and Elena Kagan -- looked to the text of the FHA, the legislative history of the 1988 Amendments to the FHA, and the purpose of the FHA to conclude that the FHA prohibits not only intentional discrimination but any "artificial, arbitrary, and unnecessary barriers" that create a racial (or other protected category) disparity. Disparate impact survived.

Some needed context

While the Court's ruling is certainly a "win" for advocates of disparate impact theory, it is necessary to put the decision in its proper context.

First, and most importantly, the decision largely maintains the *status quo*.

Disparate impact causes of action under the FHA were viable prior to the decision, and remain so after. While disparate impact skeptics would have preferred to see Justice Samuel Alito's dissent -- joined by Chief Justice John Roberts, and Justices Scalia and Clarence Thomas -- pick up a fifth vote and eliminate FHA disparate impact claims entirely, the reality is that the legal landscape for disparate impact defendants in the financial services industry is likely *more* favorable the week after the decision than it was the week before.

Why? Because the Court's discussion of disparate impact explicitly discussed some significant limitations on the theory and was clear that mere numerical disparities themselves are insufficient to support a claim.

Importantly, the Court adopted the language of *Griggs v. Duke Power Co.*, an employment case, in emphasizing that governmental or private policies are not contrary to the disparate impact requirement unless they are "artificial, arbitrary, and unnecessary barriers." (*Griggs v. Duke Power Co.*, 401 U. S. 424 (1971). In the employment context, race-neutral requirements that have a disparate impact are permitted if they are a "business necessity" or an employment practice "manifestly related" to job performance.

As the Court here recognized, these standards do not translate directly to the housing context, but the Court instructed lower courts to give "leeway" to government and private developers to explain the "valid interest" served by the policies they develop. Moreover, the Court highlighted that, for a disparate impact claim to survive the pleading stage, there must be a "robust causation requirement" clearly identifying the challenged practice and establishing that the specific practice "caused" the disparity (citing *Wards Cove Packing Co. v. Atonio*, 490 U.S. 642 (1989), *superseded by statute on other grounds*, 42 U.S.C. st2000e-2(k). Otherwise, the Court noted, both public and private entities might inexorably use "numerical quotas" or use race in a "pervasive" manner, which would "raise serious constitutional questions."

Which way will lower courts go?

Of course, it is impossible to determine how the lower courts will apply these standards in fair lending cases. This is particularly the case whether any particular lending policy (*e.g.*, pricing discretion by indirect lenders) will be viewed as a serving a "valid interest" or creating an "arbitrary, artificial, and unnecessary" barrier, as the Court was less than helpful in providing guidance to lower courts to determine whether a particular practice or policy fits in one category or the other. However, there can be no question that defendants will have arguments to make.

For example, I think that most lenders would feel comfortable articulating a “valid” or “legitimate” reason for their policies and standards with respect to lending. Moreover, because lenders want as many qualified borrowers or customers as they can handle , the situation differs markedly from employment context, where some barriers (*e.g.*, a high school diploma, prior experience) are intentionally established to “weed out” candidates and therefore the question of whether these criteria a truly job-related arises. It is hard to imagine creditworthiness criteria being determined to be “artificial, arbitrary, and unnecessary” barriers to consumers.

Moreover, in the lending context, could a court find that an underwriting policy or business practice is truly the “cause” of any portfolio disparity under a “robust” causation requirement? Or would allowing a case to proceed on that basis hold defendants responsible for a disparity it did not create, which the Court indicated it wants to avoid?

Furthermore, how does the current industry practice (and CFPB and DOJ oft required remedy) of monitoring portfolios of loans regularly to identify disparities and modify underwriting or other polices to eliminate or lessen disparities square with the Court's clear reluctance to have governmental or private parties use race “pervasively?” And how is a corporate policy, or a remedy imposed by the CFPB that requires constant monitoring of racial balance in a portfolio to keep any disparities within a certain number of basis points anything other than a “quota,” or at least the pervasive use of race that the Court clearly wants to avoid?

Hope remains

For those inclined to take on disparate impact itself in the ECOA context, having seen the FHA battle come to conclusion, there is some hope. The Court's textual analysis of the FHA found that the catch-all term “otherwise make unavailable” was the key phrase of Section 804(a) of the FHA that signaled Congressional desire to prohibit policies and practices that had the effect of creating a disparity. This broadened the provision from a prohibition of intentional discrimination only.

ECOA contains no similar language, and thus the textual argument that ECOA does not authorize disparate impact cases may still have some vitality (although the opinion creates other hurdles for such an argument).

Whatever the eventual answers to the above questions are, the Court has certainly given creative fair lending disparate-impact defendants something to work with. While disparate impact skeptics or defendants may still feel the sting of defeat, a focus on what the *Texas Department of Housing* case is, rather than what it might have been, may be cause for muted optimism.

Footnotes

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