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Global Finance ADVISORY ■

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Mount Holly Case Settled – Landmark Disparate Impact Case Not to Be Decided by the Supreme Court . . . At Least Not Yet

I. EXECUTIVE SUMMARY

On Thursday, November 14, 2013, the parties to the controversial *Township of Mount Holly v. Mt. Holly Gardens Citizens in Action, Inc. ("Mt. Holly")*[1] lawsuit voted to settle the matter rather than proceed with the appeal before the U.S. Supreme Court in December. *Mt. Holly* was viewed by many observers as a potential landmark case that would finally decide the extent to which—and under what parameters—disparate impact claims are recognized under the Fair Housing Act (FHA). Under FHA and the Equal Credit Opportunity Act (ECOA), plaintiffs have asserted fair lending discrimination claims, among other things, in instances where there is evidence of "disparate impact," when a lender allegedly applies a practice uniformly to all applicants, but the practice has a discriminatory effect on a prohibited basis and is not justified by business necessity. Regulatory agencies such as the Bureau of Consumer Financial Protection (CFPB) and the Department of Housing and Urban Development (HUD), along with several circuit courts of appeal, have previously recognized this "disparate impact" theory based solely on the allegedly discriminatory results of a facially neutral policy or developmental structure. A similar disparate impact appeal certified to the Supreme Court in 2010.[2]

II. BACKGROUND

Mt. Holly concerns a New Jersey township's plan to redevelop a 30-acre development known as the Gardens, which included 329 low- and moderate-income households. In 2002, Mount Holly Township issued a report that designated the housing complex as "blighted" and "crime ridden," and called for complete redevelopment of the Gardens based, in part, on noted deficiencies in the architecture and construction of the properties. After years of planning and negotiations, Mt. Holly adopted a plan to demolish the Gardens and replace it with 520 new residential units. However, only 56 such units were initially designated for "affordable housing."

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1 U.S. Supreme Court No. 11-150.

2 *Gallagher v. Magner,* 619 F.3d 823 (8th Cir. 2010).

Because the Gardens had a predominantly minority population, a coalition of residents filed suit to overturn the blight designation and to halt the redevelopment plan on the claim that it violated the FHA on a "disparate impact" theory. Initially, both the New Jersey state courts and the federal district court dismissed the disparate impact claims. However, on appeal, the U.S. Court of Appeals for the Third Circuit permitted the case to proceed. On appeal to the U.S. Supreme Court, both HUD and the CFPB filed amicus briefs arguing that disparate impact claims are viable under both the FHA and ECOA. Twenty other amici briefs were filed by banking and financial industry trade associations and consumer activist groups.

III. ALSTON & BIRD OBSERVATIONS

While technically the U.S. District Court for the District of New Jersey must approve the proposed settlement before it becomes final, this appears to be a foregone conclusion in this case. Accordingly, attention now turns to a little-known case making its way through the U.S. Court of Appeals for the District of Columbia Circuit in in which two insurance trade associations are challenging HUD's February 8, 2013, final rule authorizing "disparate impact" or "effects test" claims under the FHA. This case, *American Insurance Association and National Association of Mutual Insurance Companies v. HUD (AIA)*, has been stayed pending the U.S. Supreme Court's decision in *Mt. Holly*.

The plaintiff's in AIA are specifically challenging (1) HUD's assertion that disparate impact claims are cognizable under FHA and (2) HUD's codification of a three-step burden-shifting approach to determining liability for disparate impact. The February 8 HUD Rule formally extended FHA liability to the provision and pricing of homeowners insurance, thereby expanding the FHA disparate impact analysis to insurance for the first time. However, it is unclear whether the Court of Appeals for the District of Columbia Circuit will rule on the FHA portion of the claim because the business of insurance is regulated by the states, generally without federal interference, under the McCarran-Ferguson Act. Thus, it seems probable that the court may decide that preemption makes the underlying FHA claims moot.

The Supreme Court's decision in *Mt. Holly* was expected to clarify complex and conflicting rulings among the circuit courts and regulators who employ differing tests for disparate impact claims under the FHA.

How one feels about the settlement—and the resulting lack of clarification on the underlying issues—likely depends on how one thinks the High Court should have ultimately ruled. For now, we can count on other challenges to the HUD rule moving forward (along with lower court decisions), and at least we know that the Supreme Court is interested and willing to review some aspects of disparate impact analysis within the fair lending arena. It remains to be seen, now that a second case for which certiorari was granted settled at the eleventh hour, whether the High Court will be as willing to certify another.

On a related note, with the advent of the effective date of the "ability-to-repay/qualified mortgage" rule fast approaching (i.e., effective with respect to applications for loans taken on or after January 10, 2014), we are concerned that originators of residential mortgage loans and their assignees could be subject to fair lending claims under a "disparate impact" theory if the originators and their assignees either: (i) make and acquire only "qualified mortgage loans," or (ii) conversely, make and acquire a subset of non-"qualified mortgage loans," such as "interest-only" loans and jumbo prime loans with debt-to-income ratios greater than 43 percent. Simply stated, the rule will contract credit in a manner that disproportionally and adversely

affects protected classes of consumers. To many in the mortgage industry, the settlement of *Mount Holly* was unfortunate because it would have been useful for the Supreme Court to have determined whether the "disparate impact theory" could be used, and if so, under what parameters.

This advisory was written by Steve Ornstein and Scott Samlin.

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