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EXPERT ANALYSIS

DISPARATE-IMPACT LITIGATION TRENDS FOLLOWING *INCLUSIVE COMMUNITIES*

By Frank A. Hirsch Jr. and Ryan P. Ethridge

Frank A. Hirsch Jr. , co-head of ***Alston & Bird***'s financial services litigation team, is a partner in the firm's Raleigh, N.C., office, and ***Ryan P. Ethridge*** is a senior associate on that same team in the same office. They defend industry participants against various types of discriminatory lending claims including under FHA or ECOA, among other types of financial services litigation as well as enforcement actions, Reach them at *frank.hirsch@alston.com* and *ryan.ethridge@alston.com*.

Almost ten months have passed since SCOTUS handed down its noteworthy *Inclusive Communities* decision confirming that the Fair Housing Act permits "disparate impact" claims. This decision cured much of the uncertainty surrounding companies' potential liability for discrimination, absent proof of any conscious intent to discriminate. The decision confirmed that such liability is possible, but it set forth important restrictions that should protect defendants accused of unintentional discrimination.

The numerous federal district court cases addressing such claims in the wake of *Inclusive Communities* tell the story. They reveal that most attempts to invoke the disparate impact claim theory have failed to satisfy the "robust causality" required to state a *prima facie* claim. They also tell us that those claims that clear this first hurdle face significant barriers in the three-part burden shifting test impliedly endorsed by SCOTUS.

Should this heightened judicial scrutiny assuage consumer financial services industry concerns that the availability of disparate impact claims could open the floodgates to potential exposure? A survey of the cases decided so far indicates that there is reason for the industry to breathe a bit easier. But the legal and regulatory context suggests that there is yet more to come.

HUD creates a policy

The Department of Housing and Urban Development started the ball rolling in February 2013 when it issued a regulation interpreting the Fair Housing Act to encompass disparate-impact liability. At the same time, itannounced a three-part burden-shifting test for disparate impact claims under the FHA (*See* "Implementation of the Fair Housing Act's Discriminatory Effects Standard," 78 Fed.Reg. 11460-01 (Feb. 15, 2013).)

Under this framework, the plaintiff initially "bears the burden of proving its prima facie case that a practice results in, or would predictably result in, a discrimina-

tory effect on the basis of a protected characteristic." If the plaintiff can make a *prima facie* showing, then the burden shifts to the defendant "to prove that the challenged practice is necessary to achieve one or more of its substantial, legitimate, nondiscriminatory interests."

And, if the defendant satisfies this burden, then the plaintiff "may still establish liability by proving that the substantial, legitimate, nondiscriminatory interest could be served by a practice that has a less discriminatory effect."

Enter *Inclusive Communities*

Not too long after HUD's pronouncements, the U.S. Supreme Court issued its highly anticipated decision in *Texas Department of Housing and Community Affairs v. Inclusive Communities Project, Inc.*, 135 S. Ct. 2507 (2015). In a five-to-four majority opinion written by Justice Anthony Kennedy, the Court confirmed that disparate impact claims are cognizable under the FHA.

Without expressly endorsing HUD's interpretation, the Court set various restrictions on how such claims may be prosecuted, adopting many of the principles set forth in HUD's burden-shifting framework. The Court made clear that these restrictions apply both to the allegations that must be made at the pleadings stage and the type of evidence that a plaintiff must ultimately marshal to succeed on these claims.

After first concluding that the FHA encompasses disparate impact claims — based on an examination of two antidiscrimination statutes that preceded the FHA and its precedential cases interpreting those statutes — the Court set forth the limits of such claims, necessary to avoid "serious constitutional questions that might arise under the FHA." To begin, it made clear that liability cannot be "imposed based solely on a showing of a statistical disparity," and that a claim relying only on a statistical disparity "must fail if the plaintiff cannot point to a defendant's policy or policies causing that disparity."

The Court instructed that lower courts must ensure that disparate-impact claims "solely" seek to remove policies that are "artificial, arbitrary, and unnecessary barriers" and not to displace "valid governmental and private priorities." The Court held that a plaintiff must prove a "robust causality" between the policy and the statistical disparity to ensure "that '[r]acial imbalance ... does not, without more, establish a *prima facie* case of disparate impact' and thus protect [] defendants from being held liable for racial disparities they did not create."

The majority emphasized the need for "adequate safeguards" at the *prima facie* stage to ensure race is not used "in a pervasive way" and to prevent governmental and private entities from using "numerical quotas." Lower courts were cautioned to "examine with care whether a plaintiff has made out a *prima facie* case," which requires a plaintiff "to allege facts at the pleading stage or produce statistical evidence demonstrating a causal connection" between the defendant's policy and the statistical disparity.

Finally, the Court made clear that disparate impact claims should not be used to "second-guess which of two reasonable approaches a housing authority should follow in the sound exercise of its discretion — which must be applied in a way that provides "housing authorities and private developers leeway to state and explain the valid interest served by their policies."

Thus, if a plaintiff makes out a *prima facie* case, the burden-shifting framework kicks in and allows a defendant an opportunity to show that the challenged practice is "necessary to achieve a valid interest."

Courts apply *Inclusive Communities* rigorously

Less than one month after *Inclusive Communities* was handed down, the U.S. District Court, Northern District of California granted Wells Fargo's summary judgment motion after closely examining the evidence supporting Los Angeles' claims. (*City of Los Angeles v. Wells Fargo & Co.*, No. 13-09007, 2015 WL 4398858 (C.D. Calif. 07/17/15).)

This is one of several cases that have filed by municipalities alleging that banks' discriminatory lending practices resulted in urban blight. A threshold

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question in all of these cases was whether such allegations confer standing — Article III and/or statutory. Most courts have held that the cities have standing, as it was in the Los Angeles case. (But in one case, *County of Cook v. Wells Fargo & Co.*, the U.S. District Court, Northern District of Illinois held that the municipality did not have standing to bring such claims.)

Los Angeles alleged that Wells Fargo's discriminatory lending practices targeted minority borrowers with expensive mortgage loans, which resulted in foreclosures that caused the city to suffer damages. The disparate impact claims implicated the bank's lending practices in connection with two mortgage products: its high-cost loans and loans made under the U.S. Federal Housing Authority (USFHA) program.

The district court first found that the city lacked sufficient quantitative evidence to support its claims with respect to the high-cost loans. Of the 4,260 loans to minority borrowers during the limitations period, only twelve were high-cost loans covered by the FHA — with five issued to African-American borrowers, seven to Hispanic borrowers, and four to Caucasians.

In a mocking tone, the court noted that the "City's only evidence to prove a significant adverse effect is the blistering statistical comparison of '0.0033% likelihood' to '0.0008% likelihood,'" which both the court and the city's own expert found insignificant and unconvincing. Although it was precluded from "weighing the evidence at summary judgment," the court found that *Inclusive Communities* required it to examine the Los Angeles' *prima facie* evidence "with care," and this precluded the City's statistical disparity from creating a genuine fact dispute.

Notably, the City also failed to identify any policy that caused the disparity. The City had argued that the bank "failed to appropriately monitor relevant data to identify and correct the disproportionate issuance of High-Cost loans to minority borrowers." This fell flat. The court deemed this the absence of a policy, and commented that the City was "essentially advocating for racial quotas," in violation of *Inclusive Communities*.

With respect to the USFHA loans, the court found that the City had not shown that the loans created a disproportionately *adverse* effect on minorities when considering all costs and benefits of the loan program — a program that "allow[ed] borrowers with poor credit histories to obtain a home loan" because the federal government assumed the risk of default, and the required mortgage insurance minimized the down payment required to close.

Moreover, the court found that the racial disparities resulted from "purposeful federal government action," and that "Wells Fargo's passive participation in a program explicitly designed to give minority borrowers access to affordable loans" could not trigger liability in light of *Inclusive Communities*, which cautioned that "defendants are not 'held liable for racial disparities they did not create.'"

Disparate impact claims repelled in Miami

More recently, the U.S. District Court, Southern District of Florida granted several banks' motions to dismiss disparate impact claims similar to those at issue in the *City of Los Angeles* case. (*City of Miami v. Bank of America Corp., et al.*, 13-224506, 2016 WL 1072488 (03/17/16); *City of Miami v. Wells Fargo & Co.*, 13-24508, 2016 WL 1156882 (03/17/16); and *City of Miami v. JPMorgan Chase*, No. 14-22205 (S.D. Fla. 03/17/16).)

The courts in *Bank of America* and *Wells Fargo* had at first dismissed the city's FHA claims in July 2014, holding that the cities lacked statutory standing to sue under the FHA and that the claims were barred by the statute of limitations. On appeal, the 11 the U.S. Circuit Court of Appeals reversed that ruling on standing and remanded the case to allow the cities a chance to replead their FHA claims to attempt to cure the time-bar problem. (*See City of Miami v. Bank of America Corp.*, 800 F.3d 1262 (11th Cir. 2015); *City of Miami v. Wells Fargo & Co.*, 801 F.3d 1258 (11th Cir. 2015). The 11th Circuit also instructed that *Inclusive Communities* "may materially affect the resolution of this case."

On remand, the *Bank of America* and *Wells Fargo* courts concluded that the city's amendments did not save its claims. The new complaints alleged the existence of several property addresses that had discriminatory mortgage loans that closed during the 2-year limitations period, but the court found that the sole new complaint paragraph was "too conclusory to meet the *Twombly/Iqbal* pleading standard."

The district court thus found that the cities had not plausibly alleged that defendants violated the FHA within the limitations period with regard to the newly identified mortgage loans. The court observed that "the plaintiff does not even allege that these loans were made to minority borrowers, let alone (a) any borrower's specific minority status, *i.e.*, Hispanic, African-American, etc., (b) what type of loan was made, (c) how that loan was supposedly discriminatory, (d) when the loan closed, or (e) what basis the City has to claim the loan will default or enter foreclosure (and thus plausibly injure the City at some point)."

What a disparate impact claim must include

The court then analyzed the disparate impact claims under the *Inclusive Communities* framework. It noted that a disparate impact complaint must: (1)Show statistically-imbalanced lending patterns which adversely impact a minority group. (2)Identify a facially-neutral policy used by defendants. (3)Allege that such policy was "artificial, arbitrary, and unnecessary." (4)Provide factual allegations that meet the "robust causality requirement" linking the challenged neutral policy to a specific adverse racial or ethnic disparity.

The district court found that the plaintiff failed to satisfy the second, third or fourth of these pleading requirements.

First, the city's contentions that minority borrowers were "targeted," and that the banks engaged in a "pattern of steering minority borrowers into disadvantageous loans," constituted allegations of intentional discrimination, not "allegations that a neutral policy or policies produced a statistical imbalance."

Second, the court found that the city failed to allege facts demonstrating that the defendants' alleged policies constituted "artificial, arbitrary, and unnecessary barriers."

Finally, the court held that the city did not meet *Inclusive Communities*' "robust causality requirement," which requires the city to "allege facts at the pleading stage … demonstrating a causal connection" between the challenged policy and the alleged statistical disparity. As a result, the court dismissed Miami's FHA claims, but permitted them another opportunity to amend the complaints.

Landlords' claims fail in Minneapolis

The U.S. District Court, District of Minnesota recently found that landlords had failed to adequately allege facts demonstrating a causal connection between a challenged policy of the City of Minneapolis and the alleged disparity. (*Elllis v. City of Minneapolis*, No. 14-3045, 2015 WL 5009341 (D. Minn. 03/28/16).)

In *Ellis*, inner-city landlords alleged that the city implemented unlawful housing policies and heightened enforcement of those policies in a discriminatory manner. Specifically, they alleged the city revoked and/or threatened to revoke rental dwelling licenses without any legal justification, and applied heightened housing standards and enforcement to low-income protected class housing. They alleged these policies increased their operating costs, which they passed on to their tenants, thus increasing the cost of low-income housing in the city.

The court found that the plaintiffs failed to adequately allege facts that plausibly demonstrate a causal link between any of Defendants' purportedly unlawful policies and the alleged disparity. Specifically, the plaintiffs failed to allege, with sufficient factual support, that the defendants' purportedly unlawful policies actually prevented the plaintiffs from renting any of their units or that any tenants had been displaced as a result of the challenged policies.

As an example, the plaintiffs alleged that four of their rental units remained vacant for a year due to the defendants' "false and unclear claims of noncompliance with applicable codes." But the plaintiffs admitted that the units were not entirely up to code, and the city's inspection of one of the units was initiated by an existing tenant, the court observed. Thus, the court's careful examination of the pleadings revealed that the plaintiffs could not satisfy the "robust causality" requirement imposed by *Inclusive Communities*.

The district court declined to address the second and third prongs of the *Inclusive Communities* test. It dismissed the plaintiffs' disparate impact claims under Rule 12(c).

9th Circuit remands case

An Arizona case involved both disparate-impact and disparate-treatment FHA claims by two real estate developers, alleging that Yuma, Ariz.'s refusal to rezone land to permit higher-density development disproportionately deprived Hispanic residents of housing opportunities. At summary judgment, the city presented evidence of "similarly priced and modeled housing in other parts of Southeast Yuma" and argued before a federal district court that the availability of such housing precluded a finding of disparate impact.

The district court agreed and granted summary judgment for the city on the disparate-impact claims (a ruling that preceded *Inclusive Communities*). On appeal, a 9th Circuit appellate panel reversed and remanded, holding that "when a developer seeks to rezone land to permit the construction of housing that is more affordable, a city cannot defeat a showing of disparate impact on a minority group by simply stating that other similarly-priced and similarly-modeled housing is available in the general area" at issue. (*Avenue 6E Investments, LLC v. City of Yuma, Ariz.*, No. 13-16159, 2016 WL 1169080 (9th Cir. 03/25/16).)

The 9th Circuit opined that disparate impact liability under the FHA following *Inclusive Communities*. It stated that such liability is intended to address:

> ...historical racism and the continuing persistence of housing segregation not by interjecting racial quotas as the end goal of municipal zoning decisions, but rather by ensuring that municipalities making such decisions will base them on legitimate objectives rather than on discriminatory reasons, conscious or otherwise. Moreover, when such decisions may still cause a disparate impact, the municipality and the developer are instructed to attempt to minimize that impact by determining whether there is an alternative that accommodates both the city's legitimate objective and the developer's legitimate goals.

The 9th Circuit held that adopting the district court's ruling would undercut these principles and the "carefully constructed mode of analysis" established in *Inclusive Communities*. The district court had relied on *Hallmark Developers, Inc. v. Fulton County*, 466 F.3d 1276 (11th Cir. 2006), and "concluded that an adequate supply of comparably-priced and similarly-modeled homes in the area — that is, Southeast Yuma — foreclosed the possibility of any adverse impact resulting from the city's denial of developers' zoning application, thereby precluding Developers from pursuing a disparate-impact claim."

The appellate panel explained that finding the "availability of similar housing well outside of the zoned property does not affect the analysis whether a city's rejection of a zoning request caused a disparate impact by preventing a higher percentage of minority group members from purchasing homes." The panel instructed the court below that a showing "that truly comparable housing is available in close proximity to a proposed development" would be a relevant factor in the disparate impact analysis.

Such a showing would require a court to "determine not only the close proximity of such housing to that area but also the principal characteristics of the neighborhood that affect families' everyday lives" — including "factors such as similarly or better performing schools, comparable infrastructure, convenience of public transportation, availability of amenities such as public parks and community athletic facilities, access to grocery or drug stores, as well as equal or lower crime levels," the appellate panel said. This is in line with *Inclusive Communities*' mandate that lower courts closely examine the allegations and/or evidence underlying a plaintiff's *prima facie* case.

Finally, the court reiterated that its analysis only related to the first step in the three-step burden shifting framework discussed in *Inclusive Communities*. On remand, the developers would have an opportunity to establish their *prima facie* case by establishing that the rezoning denial resulted in a disparate impact on minorities.

If they met their burden, the city would then be required to "demonstrate that the action that creates an adverse effect on minorities is supported by adequate justification." Thus, the 9th Circuit's decision disagreed with the district court's position that its holding would "effectively place an affirmative duty on governing bodies to approve all re-zoning applications wherein a developer sought to build housing within a particular price range."

And that's not all

There have been several other district court decisions since *Inclusive Communities* was handed down that present a mixed bag of results in cases involving disparate impact claims. They include:

- *Rhode Island Comm'n for Human Rights v. Graul, et al.*, 120 F.Supp.3d 110, 2015 WL 4868904 (D.R.I. 08/13/15). Following the birth of a couple's first child, an apartment complex owner required them to either move into a larger apartment or leave the complex altogether. The owner did so based on an "unequivocally wrong" interpretation of the applicable building code, which the owner believed required a minimum of 170 sq. ft. for a family of three to occupy a one-bedroom apartment. The U.S. District Court, District of Rhode Island granted summary judgment for the renters, finding (1) their expert's analysis of census data established a *prima facie* case that the policy disparately impacted families with children, and (2) there was no legitimate business interest justifying the policy.
- *Merritt v. Countrywide Financial Corp., et al.*, 09-01179, 2015 WL 5542992 (N.D. Cal. 09/17/15). Borrowers alleged that a bank targeted minorities for subprime loans. The U.S. District Court, Northern District of California dismissed the disparate impact FHA claims on a 12(b)(6) motion because the statistics included in the borrowers' complaint failed to establish disparate impact on a protected class. The court explained that the two groups used to show the disparity were not mutually exclusive, and that the plaintiffs "did not identify a specific policy that is causally linked to this alleged disparity."
- *County of Cook v. Wells Fargo & Co.*, 115 F. Supp. 3d 909 (N.D. Ill. 2015). The U.S. District Court, Northern District of Illinois dismissed the plaintiff's complaint based on its conclusion that the plaintiff lacked statutory standing. The county's alleged injuries — urban blight and a

reduced property tax base — were found by the district court to be "purely derivative" of the injuries suffered by minority borrowers themselves; were not the type that the FHA was designed to protect and fell outside the statute's "zone of interests" for standing purposes.

- *County of Cook v. HSBC North America Holdings Inc., et al.*, No. 14-2031, 2015 WL 5768575 (N.D. Ill. 09/30/15). In a companion case to the one immediately above, alleging similar claims filed by the same plaintiff in the same court, the district court found that the *Wells Fargo* decision cited in the preceding note was "in tension with ... other 7th Circuit cases," concluded that the plaintiff had standing, and denied the defendant's motion to dismiss.
- *Mhany Management, Inc. v. County of Nassau, et al.*, 14-1634 & 14-1729, 2016 WL 1128424 (2d Cir. 03/23/16). Following a bench trial, a district court entered judgment for the plaintiff on its disparate-impact FHA claims. It did so based on the 2d Circuit's traditional burden-shifting test prior to *Inclusive Communities*. The Second Court reversed and remanded for further proceedings consistent with *Inclusive Communities*.
- *Abril-Rivera v. Johnson*, 806 F.3d 599 (1st Cir. 2015). The First Circuit affirmed an order granting summary judgment for the government on the plaintiffs' Title VII disparate-impact claims. The opinion contains fairly extensive analysis of *Inclusive Communities* in the context of Title VII discrimination claims.

Where all this has led

It is still early in the battle for the evolution of the disparate impact claim theory. However, the initial impact of the SCOTUS decision in *Inclusive Communities* appears to be positive for the financial services industry — at least when it comes to litigation proceedings. The three part burden-shifting test has allowed defendants to turn away lawsuits based on motions to dismiss, motions for judgment on the pleadings, and motions for summary judgment.

If litigants want to bring discrimination claims in the absence of any proof of intent to discriminate, then they must come armed and ready with some factual details and proof even at the pleadings stage. Time will tell as these standards announced by SCOTUS play out in the real world of practices employed by the financial services industry and challenges by plaintiffs.

Perhaps just an important as the judicial applications of principles announced in *Inclusive Communities* is the interpretation/application made by key government regulators such as HUD and the U.S. Department of Justice. When regulators decide to take action to stop practices deemed discriminatory, even absent intent, they may do so with a less rigorous filter.

Indeed, in the three public consent orders based on disparate-impact allegations announced since June of 2015 that we have been able to find, it appears that the regulators may view mere statistical evidence as sufficient to pursue enforcement actions. (*See U.S. v. Toyota Motor Credit Corp.*, No, 16-00725 (C.D. Cal., *settlement filed* 02/11/16); *U.S. v. American Honda Finance Corp.*, No. 15-05264 (C.D. Cal., *settlement filed* 07/16/15); and *U.S. v. Fifth Third Bank*, No. 15-626 (S.D. Ohio, *settlement filed* 10/01/15).)

Based on the allegations, the regulators do not feel obligated to even identify the policies that allegedly cause those statistical disparities. Alignment between the courts and the regulators in terms of disparate impact analysis may come, but it is an uncertain area of concern for the financial services industry to be watched closely and monitored regularly.

