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Proposed Changes to HUD Disparate Impact Rule Would Create New Burden-Shifting Framework to Reflect Inclusive Communities

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The Department of Housing and Urban Development is expected to soon release proposed revisions to its 2013 rule under which HUD or a private plaintiff can establish liability under the Fair Housing Act (FHA) for discriminatory practices based on disparate impact even if there is no discriminatory intent (Rule). The proposal has been submitted to Congress for review pursuant to the Congressional Review Act. Comments on the proposal will be due on or before 60 days after the date it is published in the *Federal Register.*

In 2018, HUD issued an advance notice of proposed rulemaking seeking comment on whether the Rule should be revised in light of the 2015 U.S. Supreme Court ruling in *Texas Department of Housing and Community Affairs v Inclusive Communities Project, Inc*. While the Supreme Court held in *Inclusive Communities* that disparate impact claims may be brought under the FHA, it also set forth limitations on such claims that "are necessary to protect potential defendants against abusive disparate impact claims." In particular, the Supreme Court indicated that a disparate impact claim based upon a statistical disparity "must fail if the plaintiff cannot point to a defendant's policy or policies causing that disparity" and that a "robust causality requirement" ensures that a mere racial imbalance, standing alone, does not establish a prima facie case of disparate impact, thereby protecting defendants

"from being held liable for racial disparities they did not create."

HUD's proposed revisions to the Rule include the following:

1. To reflect language in Inclusive Communities warning against the use of racial quotas, a statement that nothing in the Rule or elsewhere in Part 100 of HUD's regulations requires or encourages the collection of data with respect to protected characteristics and that the absence of such collection will not result in an adverse inference against any party.

2. To conform with language in Inclusive Communities, a statement that the remedy in an administrative proceeding should concentrate on eliminating or reforming the discriminatory practice so as to eliminate disparities and may include equitable remedies and, where pecuniary damage is proved, compensatory damages or restitution but (consistent with the FHA) not punitive or exemplary damages (HUD asks for feedback on the question of whether, and under what circumstances, punitive or exemplary damages may be appropriate in disparate impact litigation in federal court).

3. To reflect guidance in *Inclusive Communities*, revised language that makes clear that providing information which is inaccurate or different from that provided others because of protected characteristics does not violate the FHA if the information is not materially inaccurate or materially different from that provided others.

4. Based on *Inclusive Communities*, a new framework that requires the plaintiff to allege each of the following five elements to establish a prima facie case based on a claim that a specific, identifiable policy or practice has a discriminatory effect:

    A. That the challenged policy or practice is arbitrary, artificial, and unnecessary to achieve a valid interest or legitimate objective

    B. That there is a robust causal link between the challenged policy or practice and a disparate impact on members of a protected class which shows the specific policy or practice is the direct cause of the discriminatory effect

    C. That the alleged disparity caused by the policy or practice has an adverse effect on members of a protected class

    D. That the alleged disparity caused by the policy or practice is significant

    E. That there is a direct link between the disparate impact and the complaining party's alleged injury

5. In addition to alleging that a plaintiff has not alleged sufficient facts to support a prima facie case, a defendant can use one of the following two methods to establish that the plaintiff's allegations do not support a prima facie case:

    A. The defendant can show that its discretion is materially limited by a third

party, such as through a federal, state, or local law or binding court, arbitral or other order or administrative requirement

B. Where the cause of a discriminatory effect is alleged to be a model used by the defendant such as a risk assessment algorithm, the defendant can:

   i. Identify the material factors used in the model and shows that these factors are not substitutes for protected characteristics and that the model is predictive of credit risk or another similar valid objective

   ii. Show that a recognized third party that determines industry standards is responsible for producing, maintaining, or distributing the model, the inputs within the model are not determined by the defendant, and the defendant is using the model as directed by the third party

   iii. Show that the model has been validated by a neutral third party that found it to be empirically derived, that its inputs are not substitutes for protected characteristics, and that it is demonstrably and statistically sound and accurately predicts risk or other valid objectives.

With regard to the defenses for algorithmic models, HUD comments that such defenses "are intended to ensure that disparate impact liability is 'limited so employers and other regulated entities are able to make the practical business choices and profit-related decisions that sustain a vibrant and dynamic free-enterprise system.'" It comments further that the defenses "are not intended to provide a special exemption for parties who use algorithmic models, but merely to recognize that additional guidance is necessary in response to the complexity of disparate impact cases challenging these models." The proposal's preamble includes a discussion of how each of the defenses would operate and a request for comment on "the nature, propriety, and use of algorithmic models as related to the [three defenses.]" The proposal also includes a section containing a list of seven additional questions on which HUD seeks comment.

6. If the plaintiff is able to successfully allege a prima facie case, the proposal then sets forth the following approach:

   a. The plaintiff must prove by a preponderance of evidence, through evidence that is not remote or speculative, each of the elements set forth in 4.II through 4.V above; and

   b. If the defendant successfully rebuts the plaintiff's assertion that the policy or practice is arbitrary, artificial, and unnecessary to achieve a valid interest or legitimate objective, by producing evidence showing that the challenged policy or practice advances a valid interest or interests, the plaintiff must prove by a preponderance of the evidence that a less discriminatory policy or practice exists that would serve the defendant's identified interest in an equally effective manner without imposing materially greater costs on, or creating other material burdens for the defendant.

7. Further, the defendant may, as a complete defense:

    a. Prove any element identified under 5.I or 5.II above;

    b. Demonstrate that the plaintiff has not proven by a preponderance of the evidence any element identified under 6.I above;

    c. Demonstrate that the alternative policy or practice identified by the plaintiff under 6.II above would not serve the valid interest identified by the defendant in an equally effective manner without imposing materially greater costs on, or creating other materials burdens for, the defendant.

The Rule has been the subject of a lawsuit filed in D.C. district court by two industry trade associations whose members sell homeowners insurance. Initially filed in 2013, the plaintiffs filed an amended complaint following *Inclusive Communities* to allege that the Rule was inconsistent with that opinion. The lawsuit has been stayed in light of HUD's planned issuance of proposed revisions to the Rule. Apparently to address the lawsuit, the proposal also would add a section to the Rule that provides nothing in the Rule is intended to invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance. In the preamble, HUD notes that while this section would not be a safe harbor, the "proposed section and the complete defense where a defendant's discretion is materially limited by compliance with federal, state, or local law, would have a similar effect to a safe harbor, only in appropriate circumstances, by ensuring that parties are never placed in a 'double bind of liability' where they could be subject to suit under disparate impact for actions required for good faith compliance with another law."

In the preamble to its Fall 2018 rulemaking agenda, the CFPB indicated that the future activity being considered by the Bureau included "reexamining the requirements of the Equal Credit Opportunity Act (ECOA) in light of *Inclusive Communities* and the Congressional disapproval of a prior Bureau bulletin concerning indirect auto lender compliance with ECOA and its implementing regulations." The bulletin set forth the CFPB's disparate impact theory of assignee liability for so-called auto dealer "markup" disparities. In April 2019, the Bureau announced that it plans to hold a symposium on disparate impact and the ECOA.