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On October 25th, Massachusetts federal district court stays effective date of 2020 Disparate Impact Rule until final judgment of pending lawsuit challenging the 2020 Rule ([click here](#)).

To: Clients and Friends

From: David F. Dulock

Subject: Fair Housing Act Disparate Impact Regulation Revised

In the September 24, 2020, issue of the *Federal Register* (85 FR 60288, [click here](#)), the Department of Housing and Urban Development (HUD) published a Final Rule that amends the disparate impact standard regulation in 24 CFR §100.500 (“2013 Rule”) to better reflect the Supreme Court’s 2015 ruling in *Texas Department of Housing and Community Affairs v. Inclusive Communities Project, Inc.*, 135 S.Ct. 2507 (2015), which held that disparate impact claims are cognizable under the Fair Housing Act independent of the 2013 Rule.

The Final Rule (i) replaces the 2013 Rule’s burden-shifting test for determining whether a practice has an unjustified discriminatory effect with a more comprehensive burden-shifting test, (ii) establishes a uniform standard for determining when a housing policy or practice with a discriminatory effect violates the Fair Housing Act, (iii) provides clarification regarding the application of the disparate impact standard to State laws governing the business of insurance, and (iv) adds a remedies provision for discriminatory effect cases. The Final Rule also makes minor amendments to the discriminatory conduct provisions in 24 CFR §§100.5 and 100.70.

The Final Rule is effective October 26, 2020.

The text of the Final Rule’s revised disparate impact standard regulation in §100.500 is reprinted below.

§ 100.500 Discriminatory effect prohibited.

(a) General. Liability may be established under the Fair Housing Act based on a specific policy’s or practice’s discriminatory effect on members of a protected class under the Fair Housing Act even if the specific practice was not motivated by a discriminatory intent.

(b) Pleading stage. At the pleading stage, to state a discriminatory effects claim based on an allegation that a specific, identifiable policy or practice has a discriminatory effect, a plaintiff or charging party (hereinafter, “plaintiff”) must sufficiently plead facts to support each of the following elements:

(1) That the challenged policy or practice is arbitrary, artificial, and unnecessary to achieve a valid interest or legitimate objective such as a practical business, profit, policy consideration, or requirement of law;

(2) That the challenged policy or practice has a disproportionately adverse effect on members of a protected class;

(3) That there is a robust causal link between the challenged policy or practice and the adverse effect on members of a protected class, meaning that the specific policy or practice is the direct cause of the discriminatory effect;

(4) That the alleged disparity caused by the policy or practice is significant; and

(5) That there is a direct relation between the injury asserted and the injurious conduct alleged.

(6 pages)

(c) Burdens of proof in discriminatory effect cases. The burdens of proof to establish that a policy or practice has a discriminatory effect, are as follows:

(1) A plaintiff must prove by the preponderance of the evidence each of the elements in paragraphs (b)(2) through (5).

(2) A defendant or responding party (hereinafter, “defendant”) may rebut a plaintiff’s allegation under (b)(1) that the challenged policy or practice is arbitrary, artificial, and unnecessary by producing evidence showing that the challenged policy or practice advances a valid interest (or interests) and is therefore not arbitrary, artificial, and unnecessary.

(3) If a defendant rebuts a plaintiff’s assertion under paragraph (c)(1), the plaintiff must prove by the preponderance of the evidence either that the interest (or interests) advanced by the defendant are not valid or that a less discriminatory policy or practice exists that would serve the defendant’s identified interest (or interests) in an equally effective manner without imposing materially greater costs on, or creating other material burdens for, the defendant.

(d) Defenses. The following defenses are available to a defendant in a discriminatory effect case.

(1) Pleading stage. The defendant may establish that a plaintiff has failed to sufficiently plead facts to support an element of a prima facie case under paragraph (b), including by showing that the defendant’s policy or practice was reasonably necessary to comply with a third-party requirement, such as a:

- (i) Federal, state, or local law;
- (ii) Binding or controlling court, arbitral, administrative order or opinion; or
- (iii) Binding or controlling regulatory, administrative or government guidance or requirement.

(2) After the pleading stage. The defendant may establish that the plaintiff has failed to meet the burden of proof to establish a discriminatory effects claim under paragraph (c), by demonstrating any of the following:

(i) The policy or practice is intended to predict an occurrence of an outcome, the prediction represents a valid interest, and the outcome predicted by the policy or practice does not or would not have a disparate impact on protected classes compared to similarly situated individuals not part of the protected class, with respect to the allegations under paragraph (b). This is not an adequate defense, however, if the plaintiff demonstrates that an alternative, less discriminatory policy or practice would result in the same outcome of the policy or practice, without imposing materially greater costs on, or creating other material burdens for the defendant.

(ii) The plaintiff has failed to establish that a policy or practice has a discriminatory effect under paragraph (c).

(iii) The defendant’s policy or practice is reasonably necessary to comply with a third party requirement, such as a:

- (A) Federal, state, or local law;
- (B) Binding or controlling court, arbitral, administrative order or opinion; or
- (C) Binding or controlling regulatory, administrative, or government guidance or requirement.

(e) Business of insurance laws. Nothing in this section is intended to invalidate, impair,

or supersede any law enacted by any state for the purpose of regulating the business of insurance.

(f) Remedies in discriminatory effect cases. In cases where liability is based solely on a discriminatory effect theory, remedies should be concentrated on eliminating or reforming the discriminatory practice so as to eliminate disparities between persons in a particular protected class and other persons. In administrative proceedings under 42 U.S.C. 3612(g) based solely on discriminatory effect theory, HUD will seek only equitable remedies, provided that where pecuniary damage is proved, HUD will seek compensatory damages or restitution; and provided further that HUD may pursue civil money penalties in discriminatory effect cases only where the defendant has previously been adjudged, within the last five years, to have committed unlawful housing discrimination under the Fair Housing Act, other than under this section.

(g) Severability. The framework of the burdens and defenses provisions are considered to be severable. If any provision is stayed or determined to be invalid or their applicability to any person or circumstances invalid, the remaining provisions shall be construed as to be given the maximum effect permitted by law.

In order to give proper attribution, the following explanations of the Final Rule's amendments to the disparate impact standard in §100.500 are taken directly from HUD's preamble comments published with the Final Rule. These explanations comprise preamble comments reprinted without quotation marks, preamble comments edited by the author of this memorandum, and preamble comments combined and edited by the author:

Paragraph (a) of the Final Rule combines and revises the introductory paragraph and paragraph (a) of the 2013 Rule into a more concise paragraph (a). The reference to "specific policy" in paragraph (a) is meant to include the practice or policy that forms the basis of a disparate impact claim. While the Final Rule does not use the term disparate impact (except for subparagraph (d)(2)(i)) as does the 2013 Rule, the preamble to the Final Rule states that the Final Rule still recognizes disparate impact as a viable theory of discrimination, which can be used to hold violators accountable for discriminatory policies and practices. The preamble goes on to state that the Final Rule does not remove the availability of disparate impact claims to address Fair Housing Act violations, and provides greater clarity on the use of disparate impact to address alleged violations in a manner that increases the rule's effectiveness so as to best eliminate discriminatory practices.

Paragraph (b) of the Final Rule discusses the pleading stage. At the pleading stage, the plaintiff must allege facts that support a plausible disparate impact claim. Subparagraphs (b)(1) through (b)(5) lay out the elements that must be sufficiently pled to survive the pleading stage.

Subparagraph (b)(1)'s phrase "artificial, arbitrary, and unnecessary" is consistent with the language in *Inclusive Communities* ("Policies, whether governmental or private, are not contrary to the disparate-impact requirement unless they are 'artificial, arbitrary, and unnecessary barriers.' Griggs, 401 U.S., at 431, 91 S.Ct. 849. ... These limitations are also necessary to protect defendants against abusive disparate-impact claims." *Inclusive Properties* at 2512. "Disparate-impact liability mandates the 'removal of artificial, arbitrary, and unnecessary barriers,' not the displacement of valid governmental policies. *Inclusive Properties* at 2522.)

Subparagraphs (b)(2) and (b)(3) both require the plaintiff to show that the challenged policy or practice has an adverse effect on members of a protected class. Subparagraph (b)(2) requires this adverse effect to disproportionately affect protected class members and uses the word “disproportionately” to clarify that the plaintiff must show that protected class members are disproportionately more likely to be affected than similarly situated individuals outside the protected class. A plaintiff is not required to show that a policy or practice adversely affects the entire group of protected class members, only that the adverse effect is disproportionate on a clearly identifiable portion of the protected class. The size of the group and the disparity necessary to show that the adverse effect is ‘disproportionate’ are fact-specific questions which will vary from case to case. Subparagraph (b)(3) requires that the causal link between the challenged policy or practice and the adverse effect on members of a protected class be robust and clarifies that HUD intends “robust causal link” to be the same standard as “direct cause.” For example, *Inclusive Properties* stated: “A disparate impact claim relying on a statistical disparity must fail if the plaintiff cannot point to a defendant’s policy or policies causing that disparity. A *robust causality requirement* is important in ensuring that defendants do not resort to the use of racial quotas.” (Emphasis added) *Inclusive Properties* at 2512.

Subparagraph (b)(4) uses the word “significant” to clarify that where a disparity exists but is not material, a plaintiff has not stated a plausible disparate impact claim. The significance requirement is not exclusively a statistical test or a test of the amount of impact a policy has but can apply elements of both depending on the situation. Since a plaintiff must prove a prima facie case, which includes the burden to show that the disparity being challenged is sufficient to be legally cognizable—*i.e.*, the claim or controversy is within the power or jurisdiction of a particular court to adjudicate—the meaning of “significant” will vary from case to case and any attempt to define it would necessarily exclude fact-specific situations that the Final Rule does not intend to exclude.

Subparagraph (b)(5) codifies the language of *Bank of Am. Corp. v. City of Miami*, 137 S.Ct. 1296, 1306 (2017), (“proximate cause under the FHA requires ‘some direct relation between the injury asserted and the injurious conduct alleged.’”)

Paragraph (c) of the Final Rule contains the burden shifting test. Subparagraph (c)(1) establishes the plaintiff’s “prima facie” burden to prove by a preponderance of the evidence each of the elements in subparagraphs (b)(2) through (b)(5). The prima facie burden is the burden that the plaintiff must prove before the defendant is obligated to advance a valid interest or provide some other defense. Paragraph (c)(2) then provides the defendant with the opportunity to rebut plaintiff’s allegation under subparagraph (b)(1) by producing evidence that the challenged practice or policy advances a valid interest and, thus, is not “arbitrary, artificial, and unnecessary.” Under subparagraph (c)(3) the burden shifts back to the plaintiff to prove either that the interest is not valid or that a less discriminatory policy or practice exists that is equally effective in serving the interest without materially greater costs or burdens.

Paragraph (d) of the Final Rule identifies the defenses available to the defendant at the pleading stage and after the pleading stage.

Subparagraph (d)(1) identifies defenses that a defendant may raise at the pleading stage by relying on the plaintiff’s complaint or on any other material that would ordinarily be admissible at

the pleading stage under the applicable rules of procedure. At this stage a defendant may prove that the plaintiff has failed to sufficiently plead facts to support one of the elements of the prima facie case under paragraph (b). A defendant may also prove that the policy or practice is reasonably necessary to comply with a third-party requirement identified in subparagraph (d)(1). Under subparagraph (d)(1)(iii) this binding authority includes binding requirements promulgated by an agency and may include agency guidance because a defendant may be obligated to follow agency guidance when it is so binding, or guidance was incorporated into a binding authority, such as a contract. Also, to show that the policy or practice is reasonably necessary to comply with a binding authority, the defendant is not required to show that its policy or practice is the only possible way to comply with the third party requirement, so long as its policy is reasonably necessary. This means that there may be other reasons the defendant may have chosen the course of action, and there may have been other ways of complying with the binding authority, as long as the challenged action was reasonably necessary to comply with the binding authority. The preamble goes on to state that this defense should be permitted only when the policy or practice is legally mandated by a third party; that those third parties can create the mandates through a variety of methods other than statutes or binding court orders; and that defendants should be able to argue that their actions are required, regardless of the form of mandate the third party uses.

After the pleading stage, subparagraph (d)(2) provides defenses that are available using evidence appropriate for the stage of litigation. The defense in subparagraph (d)(2)(i) supplements the defense under paragraph (c)(2) regarding valid interests advanced by the defendant. Under this defense, HUD's preamble explains that policies or practices that predict outcomes, such as risk analysis, may lead to a result that appears, without taking into account external factors, to have a disparate impact because, due to factors outside the defendant's control, members of a protected class are disproportionately associated with a particular outcome, such as a higher risk pool. A defendant may show that the predictive analysis accurately assessed risk, the predictive analysis is a valid interest, and the outcome predicted by the policy or practice does not or would not have a disparate impact on the protected class compared to similarly situated individuals not part of the protected class. A defendant may also show that a predictive model is accurate by showing that it is not overly restrictive on members of the protected class. For example, if a plaintiff alleges that a lender rejects members of a protected class at higher rates than non-members, then the logical conclusion of such claim would be that members of the protected class who were approved, having been required to meet an unnecessarily restrictive standard, would default at a lower rate than individuals outside the protected class. But, if the defendant shows that default risk assessment leads to less loans being made to members of a protected class, but similar members of the protected class who did receive loans actually default more or just as often as similarly situated individuals outside the protected class, then the defendant could show that the predictive model was not overly restrictive.

The defense in subparagraph (d)(2)(ii) provides the defendant the opportunity to show that the plaintiff has failed to prove the prima facie case that the challenged policy or practice has a discriminatory effect.

The defense in subparagraph (d)(2)(iii) repeats the defense in paragraph (d)(1) regarding "reasonably necessary to comply with a third party requirement" because, while the defendant may bring this defense at the pleading stage, the defendant may also bring this defense after the pleading stage.

Paragraph (e) of the Final Rule clarifies that the disparate impact rule is not specifically related to the business of insurance. State laws regulating insurance will supersede the Fair Housing Act in a discriminatory impact case if the application of the Fair Housing Act in that case would invalidate, impair, or supersede State law regulating insurance. This is because the McCarran-Ferguson Act (15 U.S.C. 1011-1015) governs the applicability of Federal law to insurance industry practices. The McCarran-Ferguson preemption, insofar as it relates to the applicability of disparate impact liability, has to do only with whether Federal law impairs, invalidates, or supersedes State law. Thus, it will be for the courts in individual cases to decide if a particular application of disparate impact liability under the Fair Housing Act would invalidate, impair, or supersede State law regulating insurance.

Paragraph (f) of the Final Rule restricts HUD in the types of damages HUD will seek where HUD is the party bringing a discriminatory effects case and also adds an exception that allows HUD to seek civil money penalties in discriminatory effects cases where the defendant has a history of intentional housing discrimination. Paragraph (f) does not alter the remedies that may be awarded by administrative law judges in administrative proceedings, including civil money penalties, but clarifies that HUD generally will seek equitable remedies in disparate impact cases, in line with the Supreme Court's decision in *Inclusive Communities*.

In closing, the Final Rule does not create any new requirements, but merely provides clarification of how disparate impact liability is accomplished under the Fair Housing Act after the decision in *Inclusive Communities*, which held that disparate impact claims are cognizable under the Fair Housing Act, established guidelines and warned of constitutional limitations to the doctrine. These guidelines and warnings were not available when the 2013 Rule was drafted. Further, *Inclusive Communities* used standards with specific phrases such as "robust causal link" and "artificial, arbitrary, and unnecessary" which were not included in the 2013 Rule. The Final Rule is therefore more consistent with the now binding Supreme Court precedent than the 2013 Rule.

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