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To: Clients and Friends

From: David F. Dulock

Subject: Disparate Impact – HUD Proposes Amendments to 24 CFR Part 100

In the August 19, 2019, issue of the Federal Register (84 FR 42854, *click here*) HUD published a proposed rule to amend HUD's 2013 regulatory interpretation of the Fair Housing Act's disparate impact standard. HUD's 2013 regulatory interpretation is set forth in 24 CFR Part 100.

In the proposed rule HUD proposes to replace the current discriminatory effects standard in §100.500 with a new standard and incorporate minor amendments to §§100.5, 100.7, 100.70, and 100.120. These amendments are intended to bring HUD's disparate impact rule into closer alignment with the analysis and guidance provided in the United States Supreme Court's 2015 ruling in *Texas Department of Housing and Community Affairs* v. *Inclusive Communities Project, Inc.*, 135 S.Ct. 2507, and to codify HUD's position that its disparate impact rule is not intended to infringe upon any State law for the purpose of regulating the business of insurance.

HUD is inviting written comments on the proposed rule, which must be submitted no later than October 18, 2019, by either of the following methods:

1. *Submission of Comments by Mail.* Comments may be submitted by mail to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street SW, Room 10276, Washington, DC 20410–0500. HUD recommends that comments submitted by mail be submitted at least two weeks in advance of the public comment deadline because submission of comments by mail often results in delayed delivery.

2. *Electronic Submission of Comments.* Comments also may be submitted electronically through the Federal eRulemaking Portal at *https://www.regulations.gov/*.

Comments must refer to Docket No. FR–6111–P–02 and the title "HUD's Implementation of the Fair Housing Act's Disparate Impact Standard." In addition, HUD requests comments on the following questions:

1. How well do HUD's proposed changes to its disparate impact standard align with the decision and analysis in *Inclusive Communities Project, Inc.* with respect to the proposed prima facie burden, including:

i. Each of the five elements in the new burden-shifting framework outlined in paragraph (b) of §100.500.

ii. The three methods described in paragraph (c) of §100.500 through which defendants may establish that plaintiffs have failed to allege a prima facie case.

2. What impact, using specific court cases as reference, did *Inclusive Communities* have on the number, type, and likelihood of success of disparate impact claims brought since the 2015 decision? How might this proposed rule

further impact the number, type, and likelihood of success of disparate impact claims brought in the future?

3. How, specifically, did *Inclusive Communities*, and the cases brought since *Inclusive Communities*, expand upon, conflict, or align with HUD's 2013 final disparate impact rule and with this proposed rule?

4. How might the proposed rule increase or decrease costs and economic burden to relevant parties (*e.g.*, litigants, including private citizens, local governments, banks, lenders, insurance companies, or others in the housing industry) relative to HUD's 2013 final disparate impact rule? How might the proposed rule increase or decrease costs and economic burden to relevant parties relative to *Inclusive Communities*?

5. How might a decision not to amend HUD's 2013 final disparate impact rule affect the status quo since *Inclusive Communities*?

6. What impact, if any, does the addition of paragraph (e) to §100.500 regarding the business of insurance have on the number and type of disparate impact claims? What impact, if any, does the proposed paragraph (e) have on costs (or savings) and economic burden of disparate impact claims?

7. Is there any other data, information, or analysis the public can provide to assist HUD in assessing the impact of the proposed regulation relative to HUD's 2013 disparate impact final rule and the 2015 Supreme Court decision in *Inclusive Communities*?

In addition to the above questions for which HUD is seeking comment, HUD also is seeking feedback on the following questions:

- Under proposed §100.7, HUD is specifically seeking feedback on the question of whether, and under what circumstances, punitive or exemplary damages may be appropriate in disparate impact litigation in Federal court.

- Under proposed §100.500(c)(2), HUD is specifically soliciting comments on the nature, propriety, and use of algorithmic models as related to the defenses in (c)(2).

- Under proposed §100.500(d)(2), HUD is seeking input on whether it would be consistent with *Inclusive Communities* to provide a defense for housing authorities who can show that the policy being challenged is a reasonable approach and in the housing authority's sound discretion.

- Under proposed §100.500, HUD specifically seeks comments on the terms used in this section of the proposed rule and whether HUD should define those terms. Examples of terms that HUD would consider providing definitions to are "robust causal link," *(see (b)(2))* "evidence that is not remote or speculative," *(see (d)(1)(i))* "algorithmic model," *(see (c)(2))* and "material part" *(see (c)(2)(i) and (ii))*.

- HUD specifically invites comments regarding any less burdensome alternatives to this proposed rule that will meet HUD's objectives as described in the preamble to this proposed rule.

- HUD also requests comments on the potential burden or benefit the proposed regulations may have on potential claimants and the organizations that represent them, some of which are small businesses.

The following edited summaries of the proposed amendments to §§ 100.5, 100.7, 100.70, 100.120 and 100.500 are taken from the preamble published with the proposed rule:

§100.5 Scope. The proposed rule would revise the last sentence in paragraph (b) and add paragraph (d) to clarify that revised §100.500 includes available defenses and rebuttals to allegations of discriminatory effect and to clarify that neither the discriminatory effect standard, nor any other item in HUD's part 100 regulations, requires or encourages the collection of data with respect to protected classes and that the absence of such collection will not result in any adverse inference against a party.

§100.7 Liability for discriminatory housing practices. The proposed rule would revise paragraph (b) to clarify that there must be a principal-agent relationship under common law for there to be vicarious liability on the part of a person for a discriminatory housing policy or practice by that person's agent or employee. In addition, the proposed rule would add paragraph (c) to provide that in administrative proceedings dealing with discriminatory effect cases, the remedy should concentrate on eliminating or reforming the discriminatory practice so as to eliminate the discriminatory effect disparities by neutral means, and may include equitable remedies and, when proved, pecuniary damages or restitution; but it would clarify that punitive and exemplary damages are unavailable as an administrative remedy.

§100.70 Other prohibited sale and rental conduct. The proposed rule would revise paragraph (d)(5) to add that enactment or implementation of "building codes, permitting rules, policies, or requirements that restrict or deny housing opportunities or otherwise make unavailable or deny dwellings to" protected classes of persons should also be considered "other prohibited sale and rental conduct" under the Fair Housing Act.

§100.120 Discrimination in the making of loans and in the provision of other financial assistance. The proposed rule would revise that part of the example in paragraph (b)(1) that states providing information to protected classes of persons "which is inaccurate or different from that provided others" violates the Fair Housing Act, by amending "inaccurate or different from that provided others" to "materially inaccurate or materially different from that provided others" to clarify that informational disparities that are inconsequential do not violate the Fair Housing Act. The proposed rule would also add a clause to the end of paragraph (b)(1) clarifying that the Fair Housing Act is not violated when a person or entity provides "accurate responses to requests for information related to an individual's particular circumstances."

§100.500 Discriminatory effect prohibited. The proposed rule would substantively revise this section. The introductory paragraph would be amended and identified as paragraph (a) to

state, "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 policy or* practice was not motivated by a discriminatory intent." Existing paragraph (a) would be removed as its definition for discriminatory effect reiterated the elements of a disparate impact claim that HUD believes is now adequately defined in more detail in the later paragraphs, thus, making the definition unnecessary. New paragraphs (b) through (d) would provide a new burden-shifting framework and new paragraph (e) would address the application of this section to the business of insurance.

In paragraph (b), the proposed new burden-shifting framework would provide that to allege a prima facie case based on allegations that a specific, identifiable, policy or practice has a discriminatory effect on members of a protected class, a plaintiff must identify the particular policy or practice that causes the disparate impact and plead facts plausibly supporting the following five elements.

1) The first proposed element would require a plaintiff to plead that the challenged policy or practice is arbitrary, artificial, and unnecessary to achieve a valid interest or legitimate objective. Thus, the proposed rule would require plaintiffs to allege facts plausibly showing that the challenged practice is arbitrary, artificial, and unnecessary.

2) The second proposed element would require a plaintiff to allege a robust causal link between the challenged policy or practice and a disparate impact on members of a protected class that shows the specific policy or practice is the direct cause of the discriminatory effect. Claims relying on statistical disparities must articulate how the statistical analysis used supports a claim of disparate impact by providing an appropriate comparison that shows that the policy or practice is the actual cause of the disparity.

3) The third proposed element would require a plaintiff to allege that the challenged policy or practice has an adverse effect on members of a protected class and would require a plaintiff to explain how the policy or practice identified has a harmful impact on members of a protected class – i.e., this element would require the plaintiff to show that the policy or practice has the effect of discriminating against a protected class as a group.

4) The fourth proposed element would require a plaintiff to allege that the disparity caused by the policy or practice is significant. Where a disparity exists but is not material, a plaintiff will not have stated a plausible disparate impact claim. Thus, under this element, a plaintiff would be required to show that the statistical disparity identified is material and caused by the challenged policy or practice, rather than attributable to chance.

5) The fifth proposed element would require a plaintiff to allege that the complaining party's alleged injury is directly caused by the challenge policy or practice. This element seeks to codify the proximate cause requirement under the Fair Housing Act that there be some direct relation between the injury asserted and the injurious conduct alleged.

In paragraph (c), the proposed rule would provide a defendant with the following three methods through which to establish at the pleading stage that a plaintiff has not alleged a prima

facie case of disparate impact under paragraph (b).

1) Paragraph (c)(1) would provide that the defendant may show that its discretion is materially limited by a third party, such as through (i) a Federal, State or local law or (ii) a binding or controlling court, arbitral, regulatory, administrative order, or administrative requirement. This defense would allow a defendant to show that the complaining party has not shown a robust causality as required in paragraph (b)(2), by failing to show that the defendant's policy is the actual cause of the alleged disparate impact. This defense applies to any Federal, State, or local law that limits the defendant's discretion.

2) Paragraph (c)(2) would provide that where a plaintiff alleges a disparate impact is caused by a defendant's use of an algorithmic model, the defendant may defeat the claim by: (i) identifying the material factors that make up the inputs used in the model and showing that these factors are not substitutes or proxies for a protected characteristic and that the model is predictive of credit risk or other similar valid objective; (ii) showing that a recognized third party that determines industry standards created, maintained or distributed the model, that the defendant does not determine the model's inputs and methods, and that the defendant is using the model as intended by the third party; or (iii) showing that a neutral third party has analyzed the model and determined it was empirically derived and is a demonstrably and statistically sound algorithm that accurately predicts risk or other valid objectives, and that its inputs are not substitutes or proxies for a protected characteristic. Of course, a plaintiff may rebut these defenses. For example, a plaintiff may rebut the defense under (c)(2)(i) by showing that a factor used in the model is correlated with a protected class despite the defendant's assertion; and a plaintiff may rebut the defense under (c)(2)(ii) by showing that the plaintiff is not challenging the standard model alone, but the defendant's unique use or misuse of the model, as the cause of the disparate impact; and a plaintiff may rebut the defense under (c)(2)(iii) by showing that the third party is not neutral, that the analysis is incomplete, or that there is some other reason why the third party's analysis is insufficient evidence that the defendant's use of the model is justified. Paragraph (c)(2) is not intended to provide a special exemption for parties who use algorithmic models, but to recognize that additional guidance is necessary in response to the complexity of disparate impact cases challenging these models.

3) Paragraph (c)(3) would provide that a defendant may make any additional claims that the plaintiff has failed to allege sufficient facts to support a prima facie case under paragraph (b).

In paragraph (d), the proposed rule would provide that if a disparate impact case is not resolved at the pleading stage, the plaintiff's burden of proof to establish that a specific, identifiable policy or practice has a discriminatory effect are set out in paragraphs (d)(1)(i) and (ii).

1) Paragraph (d)(1)(i) would provide that that the plaintiff has the burden of proving by a preponderance of the evidence each of the elements in paragraphs (b)(2) through (b)(5), through evidence that is not remote or speculative.

2) Paragraph (d)(1)(ii) would provide that if the defendant produces evidence showing that the challenged policy or practice advances a valid interest, thereby rebutting plaintiff's allegation that the policy or practice is arbitrary, artificial, and unnecessary under paragraph (b)(1), the plaintiff must prove by a preponderance of the evidence that a less discriminatory policy or practice exists that would serve the identified interest in an equally effective manner without imposing materially greater costs on, or creating other material burdens for, the defendant.

In paragraph (d), the proposed rule would provide the defendant with a complete defense to a plaintiff's claims of disparate impact. This complete defense consists of three separate defenses set out in paragraphs (d)(2)(i), (ii), and (iii).

1) Paragraph (d)(2)(i) would provide that the defendant may, as a complete defense, prove any element identified under paragraph (c)(1) or (c)(2).

2) Paragraph (d)(2)(ii) would provide that the defendant may, as a complete defense, demonstrate that the plaintiff has not proven by a preponderance of the evidence an element identified under paragraph (d)(1)(i).

3) Paragraph (d)(2)(iii) would provide that the defendant may, as a complete defense, demonstrate that the alternative policy or practice identified by the plaintiff under paragraph (d)(1)(ii) would not serve the valid interest identified by the defendant in an equally effective manner without imposing materially greater costs on, or creating other material burdens for, the defendant.

In paragraph (e), the proposed rule would provide that nothing in §100.500 is intended to invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance. This codifies the general applicability of the "reverse preemption" provisions of the McCarran-Ferguson Act as it applies to the Fair Housing Act that is discussed more fully in this section of the preamble.

This second attempt by HUD to establish a regulatory interpretation of the Fair Housing Act's disparate impact standard is complex and contains ambiguities and undefined terms which need to be addressed. Clients interested in having a workable regulatory framework to resolve disparate impact claims should respond to HUD's request for written comment on this proposed rule.