

November 17, 2011

**Practice Group:****Mortgage Banking &  
Consumer Financial  
Products**

## Supreme Court vs. HUD: The Race to Decide “Impact or Intent”

**By: Paul F. Hancock, Melanie Hibbs Brody, David G. McDonough, Jr., Melissa S. Malpass, Tori K. Shinohara**

On November 7, 2011, the Supreme Court accepted a case to decide whether a violation of the Fair Housing Act<sup>1</sup> can be founded solely on the “impact” of a challenged policy or practice, thus relieving the plaintiff from having to demonstrate that the defendant intended to discriminate unlawfully. One week later, HUD announced that it is taking the matter into its own hands by proposing an amendment to an agency regulation that would establish “disparate impact” as a proper approach for establishing a violation of the Act, without any need to establish a discriminatory intent. HUD also seeks to define the approach for establishing a disparate impact. Why would HUD do this when the issue is pending before the Court? Who will prevail in this turf war?

This issue, of course, is of great significance to the lending industry. Home mortgage lenders are subject to the strictures of the Fair Housing Act and devote substantial resources to compliance. A final interpretation of the meaning of the Fair Housing Act likely will be applicable to the Equal Credit Opportunity Act, thus impacting all creditors, not merely those making housing related loans.

The obligation to prevent intentional discrimination is accepted and understood. The “disparate impact” approach is more controversial in that even the most basic lending standards, such as credit scores and LTV requirements, “impact” racial and ethnic groups differently. The more recent push of “disparate impact” to challenge subjective policies raises even greater concern in that it forces lenders to seek to avoid challenge by “managing the end numbers” even if the numbers are not caused by differential treatment on the basis of race or national origin.

### The Case Under Review by the Supreme Court

The case accepted by the Court, *Magner v. Gallagher*, presents an unusual application of the “disparate impact” approach to establishing a violation of the Fair Housing Act. Current or former owners of approximately 120 rental properties in St. Paul, Minnesota alleged that the city’s aggressive enforcement of its housing code, which requires that properties meet a number of maintenance and safety standards, has resulted in a disparate impact on minorities, who make up a disproportionate percentage of low-income rental housing residents. The Court of Appeals for the Eighth Circuit concluded that plaintiffs had produced enough evidence to support a *prima facie* case of disparate impact on minorities.<sup>2</sup> The appellate court accepted a racial outcome disparity as sufficient to meet the applicable legal standard. Defendants petitioned for *certiorari*, seeking that the Supreme Court resolve whether disparate impact claims are cognizable under the Fair Housing Act, and, if such claims are cognizable, the test that should be used to analyze these claims. On November 7, 2011, the Court agreed to hear the case.

<sup>1</sup> 42 U.S.C. §§ 3601 *et seq.*

<sup>2</sup> *Gallagher v. Magner*, 619 F.3d 832 (8th Cir. 2010).

## Supreme Court vs. HUD: The Race to Decide “Impact or Intent”

### The Long-Running Dispute Regarding Applicability of the Disparate Impact Approach Under the Fair Housing Act

The “disparate impact” approach was first recognized in the employment discrimination context by the Supreme Court in *Griggs v. Duke Power Co.*, and allows a finding of a violation of Title VII of the Civil Rights Act of 1964 even when there is no proof of an intent to discriminate.<sup>3</sup> Many federal appellate courts have found the “disparate impact” approach to be permissible under the Fair Housing Act simply because the approach is applicable under Title VII. The link between the two laws may be a bit strained since the laws were passed in different years by different Congresses.

Title VII is a part of the famous Civil Rights Act of 1964 which addressed a host of civil rights issues, such as discrimination in public accommodations (Title II), discrimination in public education (Title IV), and discrimination in employment (Title VII); Title VII is the only title among these three that authorizes an effects test. The original Fair Housing Act was Title VIII of the Civil Rights Act of 1968, a law that otherwise primarily addresses Indian civil rights issues. The Fair Housing Act arguably enjoys a closer relationship to Title II of the 1964 Act than it does to Title VII, in that Title II was designed to end discrimination by transient housing facilities such as hotels and motels; Title II requires proof of intentional discrimination to establish a violation.<sup>4</sup> To this point, however, the permissibility of the disparate impact approach under the Fair Housing Act has not been addressed by the Supreme Court.

The availability of the disparate impact standard under the Fair Housing Act has been a divisive issue for decades. In general, Republican administrations have opined that the Fair Housing Act requires proof of intentional discrimination, and that “disparate impact” is insufficient to establish a violation. Democratic administrations have contended that “disparate impact” can be a basis for a violation, with no need to offer any proof of intentional discrimination.

The United States Senate in 1968 rejected a floor amendment that would have required, in certain circumstances, proof of intentional discrimination to impose liability under the Fair Housing Act; some courts have cited this legislative history for the proposition that Congress envisioned the applicability of a discriminatory effects test to the Act.

Twenty years later, however, the United States Solicitor General, citing legislative history to the contrary, submitted an amicus brief before the Supreme Court in *Town of Huntington v. Huntington Branch, NAACP*,<sup>5</sup> arguing that a Fair Housing Act violation requires proof of intentional discrimination. Since the parties in that case had agreed to litigate under the disparate impact approach, the Court did not disturb the theory. But the Court specifically said: “[W]e do not reach the question whether that test is the appropriate one.”<sup>6</sup>

That same year, in signing the Fair Housing Amendments Act of 1988, which did not change the language of the relevant provisions of the Act, President Reagan issued a statement expressing the view that the Act requires proof of intentional discrimination to establish a violation.<sup>7</sup>

<sup>3</sup> 401 U.S. 424, 431 (1971) (holding that Title VII “proscribes not only overt discrimination but also practices that are fair in form, but discriminatory in operation”).

<sup>4</sup> See, e.g., *Gillard v. Northwestern University*, 366 F. App’x 686 (7th Cir. 2010) (“The statutes Gillard invoked all require proof that she was treated differently because of her race or a qualifying disability.”) (citing 42 U.S.C. § 2000a prohibiting discrimination in places of public accommodation “on the ground of race”).

<sup>5</sup> 488 U.S. 15 (1988).

<sup>6</sup> *Id.* at 18.

<sup>7</sup> President Ronald Reagan, *Remarks on Signing the Fair Housing Amendments Act of 1988* (Sept. 13, 1988) (“I want to emphasize that this bill does not represent any congressional or executive branch endorsement of the notion, expressed

## Supreme Court vs. HUD: The Race to Decide “Impact or Intent”

The Fair Housing Act authorizes HUD to issue rules to carry out the provisions of the Act, with a requirement that there be public notice and an opportunity to comment on any proposal. In 1989, HUD considered and adopted an expansive rule to implement the Fair Housing Amendments Act of 1988. The “Standard for Proving a Violation” was an important part of the debate at the time, but HUD declined to decide whether the Act allowed a disparate impact approach or required proof of intentional discrimination. The final Rule said: “[T]hese regulations are not designed to answer the question of whether intent is or is not required to show a violation.”<sup>8</sup>

In 1994, during the Clinton Administration, federal agencies issued a “Policy Statement on Discrimination in Lending,”<sup>9</sup> stating that a legal violation could be established under the disparate impact approach, while recognizing that “the precise contours of the law on disparate impact as it applies to lending discrimination are under development.” Unlike the Fair Housing Act Rule, the Policy Statement is not a “notice and comment regulation.”

### The New Proposal of HUD

One week after the Supreme Court agreed to consider the issue in *Magner*, HUD released a proposal to amend the 1989 Fair Housing Act Rule so as to decide the issue on which it punted in 1989.<sup>10</sup> The agency proposes to establish by Rule that proof of intentional discrimination is not necessary to establish a violation of the Fair Housing Act, and that a violation may be established under the disparate impact approach. The proposal also describes the procedures for establishing a disparate impact violation, including an allocation of burdens of proof.

Surprisingly, the HUD proposal does not even acknowledge that the Supreme Court has decided to address the same issue that the agency seeks to address by regulation. HUD contends that it “has long interpreted the Act to prohibit housing practices with a discriminatory effect even where there has been no intent to discriminate.” The agency notes further that, “[b]y the time that the Fair Housing Amendments Act became effective in 1989, nine of the thirteen United States Courts of Appeals had determined that the Act prohibits housing practices with a discriminatory effect even absent an intent to discriminate.”

HUD’s recent contention that it “has long interpreted the Act” to encompass a disparate impact standard is belied by the agency’s statutory interpretation history described above. The agency does not address why it did not find the decisions of the nine courts of appeals to be convincing when it issued the 1989 Rule that declined to decide the issue. At best, HUD has now “changed its mind” from the views expressed by both the agency and the President in 1988 and 1989. HUD has long had the authority to define the standards for proving a violation of the Fair Housing Act, but never before November 2011 has it exercised its regulation authority to state that a violation can be established by a disparate impact approach.

The only Supreme Court authority that HUD describes for its position on “impact” is the 1971 decision in *Griggs*. Since that time, however, the Court has issued important and relevant decisions holding that statutory language like that of the Fair Housing Act – prohibiting discrimination “because of” race or other impermissible factors – encompasses only intentional discrimination and cannot be

---

in some judicial opinions, that Title 8 violations may be established by a showing of disparate impact or discriminatory effects of a practice that is taken without discriminatory intent. Title 8 speaks only to intentional discrimination.”).

<sup>8</sup> 54 Fed. Reg. 3235 (Jan. 23, 1989).

<sup>9</sup> Interagency Task Force on Fair Lending, *Policy Statement on Discrimination in Lending*, 59 Fed. Reg. 18266 (April 15, 1994).

<sup>10</sup> 76 Fed. Reg. 70921 (Nov. 16, 2011).

## Supreme Court vs. HUD: The Race to Decide “Impact or Intent”

established by a “disparate impact” approach.<sup>11</sup> These decisions are not even recognized in the HUD proposal.

In situations in which the Supreme Court has found the “disparate impact” approach to be authorized, the Court has provided clear guidance as to how it should be effectuated.<sup>12</sup> None of these cases are even cited in the HUD proposal and, instead, the agency seeks to divine its own methodology for implementing the “disparate impact” approach.

For one, HUD proposes to place a burden on the defendant to seek to avoid liability under the Fair Housing Act by proving that any racial impact of a challenged policy “has a necessary and manifest relationship to a legitimate, nondiscriminatory interest.” This is contrary to Supreme Court precedent in two respects. The Court has held that the burden of proof remains with the plaintiff at all times and never switches to the defendant.<sup>13</sup> Also, the Supreme Court has said that the justification stage of disparate impact approach considers “whether a challenged practice serves, in a significant way, the legitimate . . . goals” of the business.<sup>14</sup> The Court has disclaimed any requirement that the practice be “essential” or “indispensable.”

Rather than relying on Supreme Court precedent regarding proper application of disparate impact, HUD states that its proposal “is consistent with the discriminatory effects standard confirmed by Congress in the 1991 amendments to Title VII.” Unfortunately for HUD, this is beside the point. The 1991 Amendments to Title VII, occasioned by the Civil Rights Act of 1991, were enacted for the specific purpose of establishing a standard different from the standard articulated by the Supreme Court. But Congress amended only Title VII, and that amendment has no impact on the Fair Housing Act. As the Supreme Court has said: “When Congress amends one statutory provision but not another, it is presumed to have acted intentionally.”<sup>15</sup> Thus, *Wards Cove*’s guidance for application of disparate impact remains in place for non-Title VII litigation, and HUD’s proposal violates that standard.

HUD’s proposal also makes clear the intention of the agency to apply this new approach to lenders. In describing policies “that may have a disparate impact,” the proposal includes: “mortgage pricing policies that give lenders or brokers discretion to impose additional charges or higher interest rates unrelated to a borrower’s creditworthiness”; and “credit scoring overrides provided by a purchaser of loans.” Of course, fair lending pricing concerns have been lessened by the new loan officer compensation rule, but HUD continues to consider challenges to past practices. The “credit score override” is an obvious reference to HUD’s publicly announced investigations regarding minimum FICO scores for FHA loans. If this Rule is adopted, lenders would face a significant burden to justify the policies.

### Why Is HUD Taking This Action in the Context of the Pending Supreme Court Case?

The question, of course, would need to be addressed to HUD. It is logical to surmise, however, that HUD is uncomfortable in leaving this important decision to the Supreme Court to decide. If HUD

<sup>11</sup> See, e.g., *Gross v. FBL Financial Services*, 129 S. Ct. 2343 (2009); *Ricci v. Destefano*, 129 S. Ct. 2658 (2009); *Smith v. City of Jackson*, 544 U.S. 228 (2005).

<sup>12</sup> See *Wards Cove Packing Company v. Antonio*, 490 U.S. 642 (1989); *Watson v. Fort Worth Bank & Trust*, 487 U.S. 977 (1988); *Wal-Mart Stores v. Dukes*, 564 U.S. \_\_\_ (2011).

<sup>13</sup> *Wards Cove*, 490 U.S. at 660.

<sup>14</sup> *Id.* at 659.

<sup>15</sup> *Gross*, 129 S. Ct. at 2349.

## Supreme Court vs. HUD: The Race to Decide “Impact or Intent”

was comfortable that the Court would conclude that the Fair Housing Act authorizes a “disparate impact” approach, there would be no need for this proposed regulation.

The agency has good grounds for concern. This Court places heavy emphasis on the plain language of the law to interpret the intent of Congress. The Court already has said that other statutes that prohibit discrimination “because of” a prohibited factor encompass only intentional action, and as such, a violation may not be established under a “disparate impact” approach. If the Court continues that type of statutory interpretation in *Magner*, the prospects for HUD’s view prevailing may not be bright, and the Court may determine that “disparate impact” is not applicable in any respect under the Fair Housing Act.

The Court’s recent decision in *Wal-Mart* severely cut back the use of “disparate impact” even under statutes that authorize the approach, and, in the context of *Wal-Mart*, it is difficult to determine how HUD could apply disparate impact in the manner it desires even if some use of “disparate impact” is authorized.

Federal courts often defer to an interpretation of a law that is articulated, after notice and comment, by the agency responsible for the law’s administration, and HUD may be seeking to put itself in that position. The long history of this issue, however, contradicts any allegation of a consistent approach by the federal government. The notice of a proposed regulation, after the Supreme Court had decided to consider the issue, also may be viewed as litigation posturing and not entitled to any deference. In fact, HUD’s effort here is so transparent that it may draw more criticism than deference.

HUD’s proposal certainly will not stop the Supreme Court from continuing its process to address the issue. When federal agencies have an interest in an issue before the Supreme Court, they typically ask the Solicitor General to submit a brief as *amicus curiae*. In fact, the Supreme Court often requests the Solicitor General to present the views of the United States on important issues, including civil rights issues. One might wonder why HUD did not follow that approach here.

HUD’s effort in proposing a Rule may result in little gain. The Supreme Court will decide whether the Fair Housing Act requires proof of discriminatory intent to establish a violation, and HUD, just like the rest of us, will be required to abide by that decision. Any Rule that HUD might adopt would itself be subject to judicial challenge to the extent that it violates the law.

### Conclusion

HUD has put itself in an unusual and awkward position by issuing the proposed amendment to the Fair Housing Act Rule. There is much to be concerned about with this proposal, some of which extends well beyond its substance. HUD’s action certainly can be viewed as an effort to usurp the authority of the Supreme Court, indicated further by the agency’s failure to even recognize the Supreme Court precedent that guides the implementation of the “disparate impact” approach under the laws, and in circumstances, in which it is authorized. HUD also seeks to act as the Congress by picking and choosing favorable terms from other laws and declaring them to be applicable under the Fair Housing Act.

The agency has allowed a sixty-day period, up to and including January 17, 2012, in which interested persons may comment on the proposal. The lending industry most certainly should weigh in, and we are available to help prepare comments on the proposed rule for those who may be interested.

It certainly will be interesting to watch all of this play out!

Supreme Court vs. HUD: The Race to Decide “Impact or Intent”

---

**Authors:**

**Paul F. Hancock**

paul.hancock@klgates.com  
+1.305.539.3378

**Melanie Hibbs Brody**

melanie.brody@klgates.com  
+1.202.778.9203

**David G. McDonough, Jr.**

david.mcdonough@klgates.com  
+1.202.778.9207

**Melissa S. Malpass**

melissa.malpass@klgates.com  
+1.202.778.9081

**Tori K. Shinohara**

tori.shinohara@klgates.com  
+1.202.778.9423

## Supreme Court vs. HUD: The Race to Decide “Impact or Intent”

K&L Gates’ Mortgage Banking & Consumer Financial Products practice provides a comprehensive range of transactional, regulatory compliance, enforcement and litigation services to the lending and settlement service industry. Our focus includes first- and subordinate-lien, open- and closed-end residential mortgage loans, as well as multi-family and commercial mortgage loans. We also advise clients on direct and indirect automobile, and manufactured housing finance relationships. In addition, we handle unsecured consumer and commercial lending. In all areas, our practice includes traditional and e-commerce applications of current law governing the fields of mortgage banking and consumer finance.

For more information, please contact one of the professionals listed below.

### LAWYERS

#### Boston

|                       |                               |                 |
|-----------------------|-------------------------------|-----------------|
| R. Bruce Allensworth  | bruce.allensworth@klgates.com | +1.617.261.3119 |
| Irene C. Freidel      | irene.freidel@klgates.com     | +1.617.951.9154 |
| Stanley V. Ragalevsky | stan.ragalevsky@klgates.com   | +1.617.951.9203 |
| Brian M. Forbes       | brian.forbes@klgates.com      | +1.617.261.3152 |
| Andrew Glass          | andrew.glass@klgates.com      | +1.617.261.3107 |
| Phoebe Winder         | phoebe.winder@klgates.com     | +1.617.261.3196 |

#### Charlotte

|                        |                          |                 |
|------------------------|--------------------------|-----------------|
| John H. Culver III     | john.culver@klgates.com  | +1.704.331.7453 |
| Amy Pritchard Williams | amy.williams@klgates.com | +1.704.331.7429 |

#### Chicago

|                      |                           |                 |
|----------------------|---------------------------|-----------------|
| Michael J. Hayes Sr. | michael.hayes@klgates.com | +1.312.807.4201 |
|----------------------|---------------------------|-----------------|

#### Dallas

|                |                            |                 |
|----------------|----------------------------|-----------------|
| David Monteiro | david.monteiro@klgates.com | +1.214.939.5462 |
|----------------|----------------------------|-----------------|

#### Miami

|                 |                          |                 |
|-----------------|--------------------------|-----------------|
| Paul F. Hancock | paul.hancock@klgates.com | +1.305.539.3378 |
|-----------------|--------------------------|-----------------|

#### New York

|                   |                            |                 |
|-------------------|----------------------------|-----------------|
| Philip M. Cedar   | phil.cedar@klgates.com     | +1.212.536.4820 |
| Elwood F. Collins | elwood.collins@klgates.com | +1.212.536.4005 |
| Steve H. Epstein  | steve.epstein@klgates.com  | +1.212.536.4830 |
| Drew A. Malakoff  | drew.malakoff@klgates.com  | +1.216.536.4034 |

#### San Francisco

|                        |                            |                 |
|------------------------|----------------------------|-----------------|
| Jonathan Jaffe         | jonathan.jaffe@klgates.com | +1.415.249.1023 |
| Elena Grigera Babinecz | elena.babinecz@klgates.com | +1.415.882.8079 |

#### Seattle

|                |                         |                 |
|----------------|-------------------------|-----------------|
| Holly K. Towle | holly.towle@klgates.com | +1.206.370.8334 |
|----------------|-------------------------|-----------------|

#### Washington, D.C.

|                        |                              |                 |
|------------------------|------------------------------|-----------------|
| Costas A. Avrakotos    | costas.avrakotos@klgates.com | +1.202.778.9075 |
| David L. Beam          | david.beam@klgates.com       | +1.202.778.9026 |
| Melanie Hibbs Brody    | melanie.brody@klgates.com    | +1.202.778.9203 |
| Krista Cooley          | krista.cooley@klgates.com    | +1.202.778.9257 |
| Daniel F. C. Crowley   | dan.crowley@klgates.com      | +1.202.778.9447 |
| Eric J. Edwardson      | eric.edwardson@klgates.com   | +1.202.778.9387 |
| Steven M. Kaplan       | steven.kaplan@klgates.com    | +1.202.778.9204 |
| Phillip John Kardis II | phillip.kardis@klgates.com   | +1.202.778.9401 |
| Rebecca H. Laird       | rebecca.laird@klgates.com    | +1.202.778.9038 |
| Laurence E. Platt      | larry.platt@klgates.com      | +1.202.778.9034 |
| Phillip L. Schulman    | phil.schulman@klgates.com    | +1.202.778.9027 |

## Supreme Court vs. HUD: The Race to Decide “Impact or Intent”

|                         |                                |                 |
|-------------------------|--------------------------------|-----------------|
| Nanci L. Weissgold      | nanci.weissgold@klgates.com    | +1.202.778.9314 |
| Kris D. Kully           | kris.kully@klgates.com         | +1.202.778.9301 |
| Morey E. Barnes         | morey.barnes@klgates.com       | +1.202.778.9215 |
| Kathryn M. Baugher      | kathryn.baugher@klgates.com    | +1.202.778.9435 |
| Emily J. Booth          | emily.booth@klgates.com        | +1.202.778.9112 |
| Holly Spencer Bunting   | holly.bunting@klgates.com      | +1.202.778.9853 |
| Andrew L. Caplan        | andrew.caplan@klgates.com      | +1.202.778.9094 |
| Rebecca Lobenherz       | becky.lobenherz@klgates.com    | +1.202.778.9177 |
| Melissa S. Malpass      | melissa.malpass@klgates.com    | +1.202.778.9081 |
| David G. McDonough, Jr. | david.mcdonough@klgates.com    | +1.202.778.9207 |
| Eric Mitzenmacher       | eric.mitzenmacher@klgates.com  | +1.202.778.9127 |
| Stephanie C. Robinson   | stephanie.robinson@klgates.com | +1.202.778.9856 |
| Tori K. Shinohara       | tori.shinohara@klgates.com     | +1.202.778.9423 |
| Kerri M. Smith          | kerri.smith@klgates.com        | +1.202.778.9445 |
| David Tallman           | david.tallman@klgates.com      | +1.202.778.9046 |

### PROFESSIONALS

#### Government Affairs Advisor / Director of Licensing

##### Washington, D.C.

|                  |                           |                 |
|------------------|---------------------------|-----------------|
| Stacey L. Riggin | stacey.riggin@klgates.com | +1.202.778.9202 |
|------------------|---------------------------|-----------------|

#### Regulatory Compliance Analysts

##### Washington, D.C.

|                    |                             |                 |
|--------------------|-----------------------------|-----------------|
| Dameian L. Buncum  | dameian.buncum@klgates.com  | +1.202.778.9093 |
| Teresa Diaz        | teresa.diaz@klgates.com     | +1.202.778.9852 |
| Robin L. Gieseke   | robin.gieseke@klgates.com   | +1.202.778.9481 |
| Brenda R. Kittrell | brenda.kittrell@klgates.com | +1.202.778.9049 |
| Dana L. Lopez      | dana.lopez@klgates.com      | +1.202.778.9383 |
| Patricia E. Mesa   | patty.mesa@klgates.com      | +1.202.778.9199 |
| Daniel B. Pearson  | daniel.pearson@klgates.com  | +1.202.778.9881 |
| Jeffrey Prost      | jeffrey.prost@klgates.com   | +1.202.778.9364 |

## K&L GATES

Anchorage Austin Beijing Berlin Boston Brussels Charlotte Chicago Dallas Doha Dubai Fort Worth Frankfurt Harrisburg Hong Kong London Los Angeles Miami Moscow Newark New York Orange County Palo Alto Paris Pittsburgh Portland Raleigh Research Triangle Park San Diego San Francisco São Paulo Seattle Shanghai Singapore Spokane Taipei Tokyo Warsaw Washington, D.C.

K&L Gates includes lawyers practicing out of 39 offices located in North America, Europe, Asia, Latin America, and the Middle East, and represents numerous GLOBAL 500, FORTUNE 100, and FTSE 100 corporations, in addition to growth and middle market companies, entrepreneurs, capital market participants and public sector entities. For more information about K&L Gates or its locations and registrations, visit [www.klgates.com](http://www.klgates.com).

This publication is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer.

©2011 K&L Gates LLP. All Rights Reserved.