IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA,	)	
Plaintiff,	)	Case No. 1:13-cv-08564
v.	)	Judge Amy J. St. Eve
BENJAMIN S. CARSON, SR., in his official capacity as Secretary of Housing and Urban Development, and UNITED STATES DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT,	)	
Defendants.	)	

MEMORANDUM IN SUPPORT OF THE PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA'S MOTION FOR SUMMARY JUDGMENT

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INTRODUCTION

This Court's 2014 Memorandum Opinion and Order concluded that the Department of Housing and Urban Development ("HUD") had acted arbitrarily and capriciously by failing to explain adequately its decision to apply its Fair Housing Act ("FHA") Disparate Impact Rule[1] to homeowners insurance. *See Prop. Cas. Ins. Ass'n of Am. v. Donovan*, 66 F. Supp. 3d 1018, 1046-51 (N.D. Ill. 2014) ("*PCI*"). Specifically, the Court held that HUD had not sufficiently addressed the impact of the McCarran-Ferguson Act on the application of the Rule to homeowners insurance. It further concluded that HUD had not adequately considered the effect of the Rule on the business of insurance and the application of the "filed-rate doctrine." After remand, HUD took almost two years to publish its revised explanation.[2] The new explanation is longer than the original, but it is no more adequate. Once again, HUD did not meaningfully address the significant concerns raised by the insurance industry—and this time by the Court as well. HUD's refusal to grant an exemption for risk-based pricing and underwriting of homeowners insurance was arbitrary and capricious.

BACKGROUND

I. Prior Proceedings Before This Court

Plaintiff Property Casualty Insurers Association of America ("PCI") initiated the present suit on November 27, 2013, challenging application of the Disparate Impact Rule to the provision and pricing of homeowners insurance. Plaintiff's Local Rule 56.1 Statement of Undisputed Material Facts ("SOF") ¶ 45. PCI's motion for summary judgment explained the numerous ways in which application of the Rule to homeowners insurance was contrary to law

[1] *Implementation of the Fair Housing Act's Discriminatory Effects Standard*, 78 Fed. Reg. 11460 (Feb. 15, 2013).

[2] *Application of the Fair Housing Act's Discriminatory Effects Standard to Insurance*, 81 Fed. Reg. 69012 (Oct. 5, 2016).

and arbitrary and capricious. Dkt. No. 21 & Dkt. No. 44. This Court dismissed as unripe PCI's claim that the Rule facially violates the McCarran-Ferguson Act. *See PCI*, 66 F. Supp. 3d at 1040-42. It also upheld the Rule's burden-shifting framework. *See id.* at 1052-53. The Court otherwise granted summary judgment to PCI, concluding that HUD's explanation was arbitrary and capricious in several respects. *See id.* 1046-52.

The Court first found that HUD had provided insufficient justification for preferring case-by-case adjudication of McCarran-Ferguson preclusion claims over rulemaking. *Id.* at 1048. The Court rejected HUD's contention that it could disregard the McCarran-Ferguson Act entirely. The Court also observed that HUD had made "no attempt" to determine how often McCarran-Ferguson preclusion would apply and whether it would bar entire categories of disparate impact claims against insurers, finding "HUD's lack of analysis … particularly glaring in light of the Seventh Circuit's reasoning in *[Doe v.] Mutual of Omaha*, 179 F.3d [557,] 563-64 [(7th Cir. 1999)], and the Eighth Circuit's similar recognition in *Saunders [v. Farmers Ins. Exch.]*, 537 F.3d [961,] 967 [(8th Cir. 2008)]." *PCI*, 66 F. Supp. 3d at 1048. The Court noted that HUD had "failed to even acknowledge *Mutual of Omaha* and *Saunders*, which called into question the viability of many (if not most) disparate impact claims against insurers in light of the McCarran-Ferguson Act." *Id.* at 1049. The Court also determined that HUD had inadequately examined whether the filed-rate doctrine would bar application of the Rule. *Id.* at 1050. Finally, the Court concluded that HUD had made "no effort to evaluate" the substance of the homeowners insurance industry's argument that the Rule would prevent the use of actuarially sound risk factors and thereby undermine the fundamental nature of the insurance business. *Id.* at 1051. Accordingly, the Court remanded to HUD for further explanation of these issues.

II. PCI's Post-Remand Comments

In September 2014, PCI informed HUD that it intended to submit additional comments addressing the issues that this Court had instructed HUD to address on remand. *See* Letter from PCI to HUD, at 1 (Sept. 25, 2014) (First Amended Complaint ("FAC") Ex. 3); SOF ¶ 53. PCI then submitted comments further explaining how the Disparate Impact Rule would invalidate, impair, or supersede states' regulation of insurance and distort the homeowners insurance market. *See* Letter from PCI to HUD (Jan. 26, 2015) (A.R. 4496-4513); SOF ¶ 54. PCI emphasized that the Rule's burden-shifting process would impose liability on homeowners insurers for providing and pricing insurance using actuarially sound methods. *Id.* at 8 (A.R. 4503); SOF ¶ 55. PCI explained that prohibiting those methods would violate the McCarran-Ferguson Act and the filed-rate doctrine, as well as harm the homeowners insurance industry. *See id.* at 9-18 (A.R. 4504-4513); SOF ¶¶ 55, 56, 57. PCI's comment also alerted HUD to the importance of the Supreme Court's upcoming consideration of *Texas Department of Housing and Community Affairs v. The Inclusive Communities Project, Inc.*, 135 S. Ct. 2507 (2015) (*"Inclusive Communities"*). *See* Letter from PCI to HUD, at 5-6 (Jan. 26, 2015) (A.R. 4500-4501); SOF ¶ 58.

III. The Supreme Court's Decision in *Inclusive Communities*

While this case was pending before HUD on remand, the Supreme Court issued its decision in *Inclusive Communities*. The Court held that disparate-impact discrimination claims are cognizable under the FHA. But, as discussed in more detail below, the Court also circumscribed the scope of those claims in important respects, making clear that the FHA is not intended to interfere with legitimate business decisions or hold defendants "liable for racial disparities they did not create." 135 S. Ct. at 2523.

IV. PCI's Post-*Inclusive Communities* Comment

Shortly after the Supreme Court issued its decision in *Inclusive Communities*, PCI submitted comments explaining that HUD must consider the Supreme Court's newly articulated limitations on disparate-impact liability. *See* Letter from PCI to HUD (July 29, 2015) (A.R. 4615-4621); SOF ¶ 61. PCI emphasized that *Inclusive Communities* prohibited application of the Rule to legitimate business practices, including risk-based homeowners insurance practices. *See* Letter from PCI to HUD, at 5-7 (July 29, 2015) (A.R. 4619-4621); SOF ¶¶ 61.

V. HUD's Supplemental Explanation

On October 5, 2016, HUD published its Supplemental Explanation. *See* 81 Fed. Reg. 69012. The Supplemental Explanation rejected insurers' request for an exemption from the Rule, concluding that exemptions would be "unworkable and inconsistent with" the objectives of the FHA and that insurers' concerns "can and should be addressed on a case-by-case basis." *Id.*

ARGUMENT

HUD's refusal to exempt risk-based pricing and underwriting of homeowners insurance from the Disparate Impact Rule was arbitrary and capricious. "[A]n agency must give adequate reasons for its decisions" and "must examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made." *Encino Motorcars, LLC v. Navarro*, 136 S. Ct. 2117, 2125 (2016) (internal quotation marks omitted). An agency decision is arbitrary and capricious if the agency has "entirely failed to consider an important aspect of the problem." *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983). As explained below, in several important respects the Supplemental Explanation fell short of these obligations.

I. The Supplemental Explanation Did Not Adequately Consider the Impact of the McCarran-Ferguson Act

This Court previously concluded that HUD had failed to address sufficiently the impact of the McCarran-Ferguson Act, noting that HUD had "made no attempt to evaluate how often McCarran-Ferguson preclusion would apply and whether it would bar entire categories of disparate impact claims against insurers" and that HUD had "failed to even acknowledge *Mutual of Omaha*." 66 F. Supp. 3d at 1048-49. The Supplemental Explanation fares no better.

A. The Supplemental Explanation Ignored the Key Holding of the Seventh Circuit's Controlling Decision in *Doe v. Mutual of Omaha*

The Seventh Circuit held in *Doe v. Mutual of Omaha Insurance Co.*, 179 F.3d 557, 564 (7th Cir. 1999), that "requir[ing] federal courts to determine whether [challenged insurance practices] are actuarially sound and consistent with state law" violates the McCarran-Ferguson Act. The Court explained that "[s]tate regulation of insurance is comprehensive and includes rate and coverage issues, so if federal courts are now to determine whether [particular insurance practices] are actuarially sound and consistent with principles of state law they will be stepping on the toes of state insurance commissioners." *Id.* (citation omitted). Indeed, this Court observed that "*Mutual of Omaha* supports PCI's argument that the McCarran-Ferguson Act bars any claims that require courts to determine whether an insurer's practices are actuarially sound and consistent with state law." 66 F. Supp. 3d at 1039; *see also id.* at 1028-29 (describing *Mutual of Omaha*). This Court rejected HUD's argument that the relevant language in *Mutual of Omaha* was dicta. *See id.* at 1039 n.6 ("*Mutual of Omaha* is binding on this Court.").

As applied to risk-based pricing and underwriting, the Disparate Impact Rule mandates exactly the kind of federal-court review that *Mutual of Omaha* forbids. It requires insurers to show in federal court that any use of actuarial risk factors that has a disparate impact is

"necessary to achieve one or more [of its] substantial, legitimate, nondiscriminatory interests," 24 C.F.R. § 100.500(c)(2)—in other words, to show that the practice is actuarially sound. Insurers would also have to defeat the plaintiff's efforts to demonstrate that "the challenged practice could be served by another practice that has a less discriminatory effect." *Id.* § 100.500(c)(3); *see also* Letter from PCI to HUD, at 14-15 (Jan. 26, 2015) (A.R. 4509-4510). HUD's only example of a less discriminatory alternative was an "alternative risk-based practice." 81 Fed. Reg. at 69017. Federal courts would thus impermissibly be required to assess the actuarial soundness of insurance practices at both the second and third prongs of HUD's burden-shifting test.

Despite this Court's emphasis on *Mutual of Omaha*, the Supplemental Explanation made no effort to address the decision's key holding. It mentioned *Mutual of Omaha* only once, and it did so simply to support the uncontroversial point that the McCarran-Ferguson Act bars application of disparate-impact liability only when it would conflict with state law. *See* 81 Fed. Reg. at 69015. HUD never addressed the clear holding of *Mutual of Omaha* that this Court noted and found applicable here: that the McCarran-Ferguson Act prohibits a federal court from determining whether an insurer's practices "are actuarially sound and consistent with state law." *Mutual of Omaha*, 179 F.3d at 564. HUD's failure to address this critical issue renders its Supplemental Explanation arbitrary and capricious. *See Motor Vehicle Mfrs.*, 463 U.S. at 43.

B. HUD's Rejection of an Exemption for Risk-Based Pricing and Underwriting Was Arbitrary and Capricious

In its prior motion for summary judgment and its comments to HUD, PCI demonstrated that state insurance laws uniformly permit risk-based pricing and underwriting. *See* Dkt. No. 21 at 8, 20-23; Dkt. No. 44 at 22 & n.12; Letter from PCI to HUD, at 9-10 (Jan. 26, 2015) (A.R.

4504-4505); SOF ¶ 55.[3] PCI also showed that almost all state laws expressly *require* the use of risk-based pricing. *See* Dkt. No. 21 at 9, 23-24; Letter from PCI to HUD, at 8-9 (Jan. 26, 2015) (A.R. 4503-4504); SOF ¶ 55; *see also PCI*, 66 F. Supp. 3d at 1039 (noting that "some states require insurers to use risk-based pricing" and that others "merely permit risk-based pricing"). PCI similarly observed that the vast majority of states require insurers to file insurance rates with state regulators for review and/or approval. *See* Dkt. No. 21 at 9, 24-25; Letter from PCI to HUD, at 12 (Jan. 26, 2015) (A.R. 4507); SOF ¶ 56.[4] PCI explained that HUD's Disparate Impact Rule would invalidate, impair, or supersede these laws, and thus contravene McCarran-Ferguson, because it would impose liability on any insurer using a valid actuarial risk factor that happens to have a disparate impact if some other, less effective factor could be used. *See* Dkt. No. 21 at 22-25; Letter from PCI to HUD, at 8-13 (Jan. 26, 2015) (A.R. 4503-4508); SOF ¶ 38. In the Supplemental Explanation, HUD's only response to insurers' showing that the McCarran-Ferguson Act requires an exemption for risk-based pricing and underwriting was to argue that insurers could defend their practices under the Rule's burden-shifting framework. *See* 81 Fed. Reg. at 69015, 69017. HUD's response was arbitrary and capricious for several reasons.

1. HUD Largely Failed to Address Whether to Grant an Exemption for Risk-Based Pricing and Underwriting

In response to insurers' request for an exemption, HUD first threw up its hands, claiming that it was "practically impossible . . . to define the scope of insurance practices covered by an

[3] On remand, HUD relies on *Lumpkin v. Farmers Group, Inc.*, No. 05-2868, 2007 WL 6996777 (W.D. Tenn. July 6, 2007). *See* 81 Fed. Reg. at 69016. In that case, the court correctly noted that, under Tennessee law, "[i]nsurance rates are not deemed to be unfairly discriminatory merely because different premiums are charged to insureds with like loss exposure but different expenses or to insureds with like expenses but different loss exposure, so long as the different rates reflect those differences reasonably accurately." *Id.* at *6. But the court failed to recognize that such a law permits risk differentiation. In any event, the court did not address Tenn. Code Ann. § 56-5-104(1), which affirmatively requires insurers to consider past and prospective loss experience, catastrophe hazards, and all other relevant factors.

[4] PCI's identification of the specific state laws at issue distinguishes this case from *Dehoyos v. Allstate Corp.*, 345 F.3d 290 (5th Cir. 2003). *But see* 81 Fed. Reg. at 69015 (continuing to rely on *Dehoyos*).

exemption or safe harbor with enough precision to avoid case-by-case disputes over its application." 81 Fed. Reg. at 69013. HUD noted concerns raised by insurers about application of the Rule to "sound actuarial underwriting principles" and "accurate risk-based pricing," which would "threaten[]" "accurate risk assessment" and "the sound actuarial standards underpinning the insurance market." 81 Fed. Reg. at 69014. But HUD responded by declining to exempt "*all* insurance or . . . underwriting practices." *Id.* (emphasis added); *see id.* at 69015 (exempting all insurance or underwriting practices "would necessarily be overbroad"); *id.* at 69017 (rejecting "broad exemption" for "*all* insurance practices or *all* underwriting decisions").

By focusing on whether to exempt *all* insurance practices, HUD side-stepped the key issue—whether to exempt risk-based pricing and underwriting of homeowners insurance. PCI's primary argument has been that the use of actuarial risk factors is required or permitted by state insurance laws and is central to the business of insurance. *See, e.g.*, Letter from PCI to HUD, at 1 (Jan. 17, 2012) (A.R. 553) (explaining that the issue is whether HUD can prohibit "non-racially motivated and sound actuarial underwriting principles recognized by state insurance regulators . . . that permit accurate risk-based pricing"); Dkt. No. 21 at 2 (noting state law permits insurers "to make rating and underwriting decisions on the basis of objective risk factors"); Letter from PCI to HUD, at 2 (Jan. 26, 2015) (A.R. 4497) (focusing on "neutral risk factors"); *PCI*, 66 F. Supp. 3d at 1034 (describing PCI's litigation as "seeking to invalidate the Disparate Impact Rule as it applies to the provision and pricing of homeowners insurance").

Most of HUD's arguments were therefore unresponsive to PCI's primary contention. Even if HUD concluded that *some* insurance practices should be considered on a case-by-case basis—and therefore that an exemption for *all* insurance practices was unwarranted—it was arbitrary and capricious to rely on that conclusion to deny an exemption for risk-based pricing

and underwriting.[5] It was not "practically impossible" to define the scope of an exemption. 81 Fed. Reg. at 69013. HUD should have exempted risk-based pricing and underwriting of homeowners insurance.

2. HUD's Reasoning Was Internally Inconsistent

With respect to whether to grant an exemption for risk-based pricing and underwriting, the Supplemental Explanation had almost nothing to say. HUD did not dispute that state law uniformly permits and often requires insurers to consider actuarial risk factors. *See* 81 Fed. Reg. at 69015. Rather, it "recognizes that risk-based decision making is an important aspect of sound insurance practice." *Id.* Even more significantly, HUD conceded that "nothing in the Rule prohibits insurers from making decisions that are in fact risk-based." *Id.* HUD's sole rationale for denying an exemption for the use of actuarial risk factors was that insurers can later justify using such factors on a case-by-case basis under the Rule's burden-shifting framework. *See id.*

That rationale was arbitrary in several respects. *See infra* at 10-14. As an initial matter, it was internally inconsistent. The Supplemental Explanation stated that "nothing in the Rule prohibits insurers from making decisions that are in fact risk-based." *Id.* at 69015. But the very next sentence asserted that "[u]nder the standard established by the Rule, practices that an insurer can prove are risk-based, *and for which no less discriminatory alternative exist*s, will not give rise to discriminatory effects liability." *Id.* (emphasis added) (citing 24 C.F.R. § 100.500(b)). HUD has indicated that a purportedly less discriminatory alternative need not be "equally effective" as the challenged practice. 78 Fed. Reg. at 11473 (A.R. 625). HUD has thus made

[5] *See Encino Motorcars*, 136 S. Ct. at 2125 (requiring "a rational connection between the facts found and the choice made"); *Clement v. SEC*, 674 F.2d 641, 647 (7th Cir. 1982) (vacating agency's explanation for rule change where it did not adequately address a prong of challenger's argument); *Illinois v. United States*, 666 F.2d 1066, 1080 (7th Cir. 1981) (agency must "fairly and adequately addresses the complex issues and arguments of the parties before it"); *Ass'n of Priv. Sector Colls. and Univs. v. Duncan*, 681 F.3d 427, 449 (D.C. Cir. 2012) (explanation was arbitrary and capricious where agency responded to question related to commenters' concerns, but "never really answered" commenters' precise questions).

clear that under its Rule disparate-impact liability does, in fact, extend to purely risk-based practices as long as there exists some other practice that produces less of a disparate impact, even if it is not "equally effective" as the challenged practice. HUD did not acknowledge the discrepancy in its logic, even though commenters identified this flaw. *See* Letter from PCI to HUD, at 8 (Jan. 26, 2015) (A.R. 4503) ("[T]he burden-shifting framework established by the Rule would result in insurers facing potential liability even for using actuarially justified risk factors. . . . [E]ven if every risk factor were proved necessary, plaintiffs could still prevail by showing [a less discriminatory alternative]."); Letter from NAMIC to HUD, at 5-6 (Jan. 17, 2012) (A.R. 376-377). By conceding that risk-based decision making is protected, but then stating that it is not, the Supplemental Explanation was internally inconsistent and thus arbitrary and capricious. *See Gen. Chem. Corp. v. United States*, 817 F.2d 844, 857 (D.C. Cir. 1987) (agency analysis "arbitrary and capricious" where explanation was "internally inconsistent and inadequately explained"); *Defs. of Wildlife v. E.P.A.*, 420 F.3d 946, 959 (9th Cir. 2005) ("[I]nternally contradictory agency reasoning renders resulting action arbitrary and capricious." (internal quotation marks omitted)), *rev'd on other grounds*, 551 U.S. 644 (2007).

3. HUD's Reliance on the Rule's Burden-Shifting Framework Was Arbitrary and Capricious

The Court previously found that "HUD made no effort to evaluate the substance of the insurance industry's concerns, disregarding them merely because insurers would have an opportunity to raise their arguments as part of the burden-shifting framework." *PCI*, 66 F. Supp. 3d at 1051; *id.* (holding that HUD had failed to "provide a reasoned explanation why case-by-case determinations of the insurers' arguments are preferable to rulemaking"). HUD's continued reliance on the burden-shifting framework on remand was thus inconsistent with this Court's decision. It was also arbitrary and capricious. The burden-shifting inquiry is not an adequate

substitute for an exemption to the Rule for at least three reasons:

First, for the reasons explained above, applying the burden-shifting framework to a challenge to risk-based pricing and underwriting would require a federal court to pass judgment on the actuarial soundness of the challenged practice. But that is precisely what *Mutual of Omaha* holds would violate the McCarran-Ferguson Act. *See supra* at 5-6.

Second, under the framework established by HUD, the FHA would invalidate, impair, and supersede state laws governing risk-based pricing and underwriting. The McCarran-Ferguson Act ensures that federal laws of general applicability do not "'invalidate, impair, or supersede' [a] State's law." *Humana, Inc. v. Forsyth*, 525 U.S. 299, 307 (1999). To invalidate means "to render ineffective," and to supersede is "to displace (and thus render ineffective) while providing a substitute rule." *Id.* (internal quotation marks omitted). This is exactly what happens at the third step of HUD's burden-shifting framework. Under the Rule, insurers can be held liable for using actuarially sound risk factors in any case where a plaintiff can identify an alternative factor that would merely "serve the defendant's legitimate business interests." *PCI*, 66 F. Supp. 3d at 1052. And in its rulemaking, HUD declined to require that the alternative practice be "equally effective" as the challenged practice. 78 Fed. Reg. at 11473 (A.R. 625).

The Rule would thus make homeowners insurers liable for risk-based pricing and underwriting practices they are permitted or required to use as a matter of state law. States permit insurers to discriminate between risk pools, prohibiting only "*unfairly* discriminatory" rates—that is, rates that discriminate between insureds posing the same risk. *See* Dkt. No. 21 at 8, 21-22. But the Rule prohibits distinctions based on actuarial risk, requiring courts to determine whether less predictive alternative factors would have less of a disparate impact than challenged factors. This displaces states' prohibition of only "unfairly" discriminatory rates with

a different federal standard under the FHA. At a minimum, it "impair[s]" state laws. *See Humana*, 525 U.S. at 309-310 ("The dictionary definition of impair is [t]o weaken, to make worse, to lessen in power, diminish, or relax, or otherwise affect in an injurious manner." (internal quotation marks omitted)). Application of the Rule to risk-based pricing and underwriting permitted or required as a matter of state law would not only directly conflict with state law but also "frustrate … declared state policy" and "interfere with a State's administrative regime." *Id*. at 310. In relying on the Rule's burden-shifting framework, HUD ignored this Court's warning that challenges to "rate classifications may usurp core rate-making functions of the State's administrative regime." *PCI*, 66 F. Supp. 3d at 1048-49.

PCI has repeatedly explained this objection to HUD. *See* Dkt. No. 44 at 33; Letter from PCI to HUD, at 17 (Jan. 26, 2015) (A.R. 4512); SOF ¶ 57. But HUD completely ignored it in the Supplemental Explanation. This failure even to respond is reason alone to find the Supplemental Explanation inadequate. *See St. James Hosp. v. Heckler*, 760 F.2d 1460, 1469 (7th Cir. 1985) (failure to respond to significant criticisms renders agency rulemaking inadequate).

Third, even if an insurer could successfully defend purely risk-based practices under the Rule's burden-shifting framework, HUD's denial of an exemption would still be arbitrary and capricious. Requiring insurers using risk-based pricing or underwriting to needlessly defend themselves under the burden-shifting framework in every case would impose significant and wholly unjustified expenses on the industry. Under HUD's approach, every insurer would have to defend each of the actuarial risk factors it uses, perhaps even on a region-by-region basis as different plaintiffs assert alleged disparate impacts among particular populations of insureds. HUD's only response was that an exemption for risk-based insurance pricing would not reduce insurers' costs because "[t]he arguments and evidence that would be necessary to establish

whether a practice qualifies for the requested exemption would effectively be the same as the arguments and evidence necessary for establishing a legally sufficient justification." 81 Fed. Reg. at 69017. HUD provided no basis, however, for its counterintuitive assumption that it would cost as much to demonstrate eligibility for an exemption for risk-based pricing and underwriting as it would to litigate the actuarial soundness of a challenged practice.

Moreover, as commenters explained, the Rule would require insurers to establish not merely that a practice is purely risk-based; it would also require insurers to litigate the third step of the burden-shifting approach, disputing that less discriminatory alternatives exist. *See* Letter from PCI to HUD, at 14 (Jan. 26, 2015) (A.R. 4509); Cracas Decl. ¶ 13; SOF ¶ 78. This would be especially difficult for insurers because they do not collect data on subscribers' race, ethnicity, or other protected characteristics and have no other means of anticipating disparities. Letter from NAMIC to HUD, at 12 (Jan. 17, 2012) (A.R. 383).[6] And assuming they could collect the necessary data to defend themselves, it would be very expensive and would intrude upon policyholders who would be required to self-report race and ethnicity data. Cracas Decl. ¶¶ 11–12; Dawdy Decl. ¶ 14; SOF ¶ 77. The Supplemental Explanation arbitrarily and capriciously failed to consider these added costs. *See Motor Vehicle Mfrs*, 463 U.S. at 54-55 (agency should weigh benefits and costs); *Clement*, 674 F.2d at 647 (agency erred in "refus[ing] to acknowledge that . . . economic reality" might constrain businesses' behavior). As this Court has recognized, case law HUD itself previously relied upon makes clear that there is no need to "engage in the Sisyphean task of working through the burden-shifting framework in each individual case when the plaintiff has no chance of success." *PCI*, 66 F. Supp. 3d at 1051 (quoting *Graoch Assocs.*

[6] *See also* Cracas Decl. ¶ 6; Dawdy Decl. ¶ 11; Zaleski Decl. ¶ 11; Amica Decl. ¶ 7. Insurers might not even be permitted to collect that data, given state prohibitions on "treating similar risks in a dissimilar manner." Letter from NAMIC to HUD, at 5, 12 (Jan. 17, 2012) (A.R. 376, 383); Cracas Decl. ¶ 10; Dawdy Decl. ¶ 11; *see also* Md. Code Ins. § 27-501 (prohibiting solicitation of information about protected characteristics).

#33, L.P. v. Louisville/Jefferson Cty. Metro Human Relations Comm'n, 508 F.3d 366, 375-76 (6th Cir. 2007)). In the Supplemental Explanation, however, HUD failed even to acknowledge *Graoch*.

C. HUD's Reliance on State Antidiscrimination Laws Was Arbitrary

HUD also argued that an exemption is inappropriate in light of certain state anti-discrimination laws that may apply to insurance. 81 Fed. Reg. at 69016. HUD reasoned that such an exemption would "deprive all states of federal support in addressing discriminatory insurance practices" and asserted that an exemption would therefore "be at odds with the purpose of [the] McCarran-Ferguson [Act]." *Id.* This reasoning was arbitrary and capricious.

The McCarran-Ferguson Act was not intended to promote "federal support" for state enforcement of state antidiscrimination laws. State antidiscrimination laws are irrelevant to the McCarran-Ferguson Act analysis, which asks only whether the application of federal law would invalidate, impair, or supersede state laws enacted "for the purpose of regulating the business of insurance." 15 U.S.C. § 1012(b). State antidiscrimination laws—which states may enforce themselves, if appropriate—are not enacted "for the purpose of regulating" insurance and thus have no bearing on whether application of the Disparate Impact Rule to risk-based pricing and underwriting would violate the McCarran-Ferguson Act.

Moreover, even if a state's fair-housing law were identical to the FHA and would permit a disparate impact challenge to risk-based pricing and underwriting in state court, any federal litigation under HUD's Disparate Impact Rule would still require federal courts applying federal law to second-guess the actuarial soundness of insurance practices regulated by state law—contrary to the express holding of *Mutual of Omaha*. *See* 179 F.3d at 564 ("Even if the formal criteria are the same under federal and state law, displacing their administration into federal

court—requiring a federal court to decide whether an insurance policy is consistent with state law—obviously would interfere with the administration of the state law.”). HUD’s reliance on snippets of discussion from out-of-circuit district court decisions and a state court decision, none of which addressed these issues,[7] provided no basis for disregarding the plain text of the McCarran-Ferguson Act and the Seventh Circuit’s controlling decision in *Mutual of Omaha*.

D. HUD Erroneously Relied on an Asserted Need for Factual Development

HUD also asserted in passing that “McCarran-Ferguson requires a fact-intensive inquiry.” 81 Fed. Reg. at 69016. It is not clear that HUD intended this to be a basis for denying a targeted exemption for risk-based pricing and underwriting—as opposed to an exemption for *all* insurance practices. But if it did, HUD offered no support for the proposition. Under *Mutual of Omaha*, and in light of the uniform state laws permitting or requiring the use of actuarial risk factors, factual development is unnecessary to exempt risk-based pricing and underwriting.

HUD relied on *Saunders v. Farmers Insurance Exchange (Saunders I),* 440 F.3d 940, 946 (8th Cir. 2006). But that court, reviewing a Rule 12(b)(1) motion to dismiss for lack of subject-matter jurisdiction, merely held that “the nature of the plaintiffs’ price discrimination claims, the specific relief they [sought],” and the “extent of Missouri’s insurance rate regulation” were not sufficiently clear “to decide the McCarran-Ferguson Act impairment issue.” *Id.* Nowhere did the Eighth Circuit indicate that the plaintiffs had raised a disparate-impact theory of liability. When the case returned to the Eighth Circuit and it was clear that the plaintiffs were relying on a disparate-impact theory, the court noted that “HUD has never applied a disparate impact analysis to insurers,” *Saunders v. Farmers Ins. Exch. (Saunders II)*, 537 F.3d 961, 964 n.3 (quoting *Nationwide Mut. Ins. Co. v. Cisneros*, 52 F.3d 1351, 1362 (6th Cir. 1995)), and thus

[7] *See* 81 Fed. Reg. at 69016 (citing *Viens v. Am. Empire Surplus Lines Ins. Co.*, 113 F. Supp. 3d 555, 573 n.20 (D. Conn. 2015); *Toledo Fair Hous. Ctr. v. Nationwide Mut. Ins. Co.*, 94 Ohio Misc. 2d 151, 157 (C.P. 1997); *Jones v. Travelers Cas. Ins. Co. of Am.*, No. C-13-02390, 2015 WL 5091908, at *5 (N.D. Cal. May 7, 2015)).

that there was "doubt" as to whether it could, *id.* at 964. The court ultimately held that the plaintiffs' FHA challenge was foreclosed by the McCarran-Ferguson Act because it would "frustrate[] and interfere[] with" Missouri's administrative regime. *Id.* at 968. This hardly counsels against a categorical exemption for the use of actuarial risk factors.[8]

II. The Supplemental Explanation Did Not Adequately Consider the Disparate Impact Rule's Effects on the Business of Insurance

This Court previously concluded that HUD had made "no effort to evaluate the substance of the insurance industry's concerns" that the Rule would prevent the use of actuarially sound risk factors and thereby undermine the fundamental nature of the insurance business. *PCI*, 66 F. Supp. 3d at 1051. HUD's Supplemental Explanation suffers from the same flaw.

As explained above, because of the way HUD has implemented the burden-shifting framework, the Disparate Impact Rule would prohibit purely risk-based practices. HUD noted that an insurer can be liable for using an actuarial risk factor if the plaintiff proves the existence of a less discriminatory "alternative risk-based practice." 81 Fed. Reg. at 69017. And HUD claims that an insurer would face liability even if such an alternative practice were not "equally effective" at measuring risk as the challenged practice. 78 Fed. Reg. at 11473 (A.R. 625). Comments in the record, however, explained that accurate risk assessment is critical to the business of insurance. *See* Letter from PCI to HUD, at 4 (July 29, 2015) (A.R. 4618) ("'[T]he foundation of the business of insurance, and in particular underwriting and rate-making, is classifying insurance applicants and policyholders by risk.'" (quoting A.R. 376)); SOF ¶ 16; *see also* Letter from PCI to HUD, at 2 (Jan. 26, 2015) (A.R. 4497). "To actuarially determine rates that most accurately measure loss potential, insurers identify relationships between factors and

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[8] The Supplemental Explanation also asserted that case-by-case adjudication is required due to variation in state laws. *See* 81 Fed. Reg. at 69016. HUD, however, did not dispute that every state either permits or requires the use of actuarial risk factors. Alleged variation in state law is thus no basis for denying a targeted exemption for risk-based pricing and underwriting, as opposed to a broader exemption for homeowners insurance generally.

risk of loss and allocate costs accordingly." Letter from NAMIC to HUD, at 5 (Jan. 17, 2012) (A.R. 376); SOF ¶ 74. As the Seventh Circuit and commenters have observed, failure to differentiate between risk levels generates market inefficiency and adverse selection. *See N.A.A.C.P. v. Am. Family Mut. Ins. Co.*, 978 F.2d 287, 290 (7th Cir. 1992) ("Putting young and old, or city and country, into the same pool would lead to adverse selection: people knowing that the risks they face are less than the average of the pool would drop out."); Letter from PCI to HUD, at 4 (July 29, 2015) (A.R. 4618) ("[T]o ensure compliance with the Rule and avoid the risk of damaging liability, insurers would have to avoid the use of actuarial risk factors in the underwriting and pricing process. PCI, Admin. R. at 377. This would cause adverse selection, motivating lower risk customers to forego insurance altogether and threatening insurers' viability …. *See id.* at 377-78."); Letter from PCI to HUD, at 2 (Jan. 26, 2015) (A.R. 4497) ("Lower-risk customers would be overcharged for insurance, while other customers would not pay a rate commensurate with their risk of fire and other hazards."); SOF ¶¶ 76-77.

HUD was thus on notice that a less predictive "alternative risk-based practice" is not an adequate substitute for a more predictive risk factor that causes a disparate impact. The alternative would not as effectively address the original risk, which would create a market inefficiency and drive some consumers from the market. *See* Zaleski Decl. ¶ 20 (eliminating factors in a risk and rate assessment "would compromise the actuarial soundness of the risk-based rating plans."). That would dramatically transform the homeowners insurance industry, preventing insurers from "mak[ing] the practical business choices and profit-related decisions that sustain a vibrant and dynamic free-enterprise system." *Inclusive Cmtys.*, 135 S. Ct. at 2518. HUD's failure to consider this "important aspect" of the problem caused by applying the Rule to homeowners insurance was arbitrary and capricious. *Motor Vehicle Mfrs.*, 463 U.S. at 43.

III. The Supplemental Explanation Did Not Adequately Explain Why the Disparate Impact Rule Would Not Violate the Filed-Rate Doctrine

HUD's Supplemental Explanation also did not adequately analyze whether the Disparate Impact Rule would violate the filed-rate doctrine when applied to the pricing of homeowners insurance. The filed-rate doctrine "forbids courts from invalidating or modifying rates that have been filed with regulatory agencies." *PCI,* 66 F. Supp. 3d at 1049 (quoting *Schilke v. Wachovia Mortg., FSB*, 820 F. Supp. 2d 825, 835 (N.D. Ill. 2011)); *see also Keogh v. Chicago & N.W. Ry. Co*., 260 U.S. 156, 161-165 (1922). HUD did not dispute that the doctrine applies to insurance rates filed with state insurance commissions.[9]

Instead, HUD argued first that the filed-rate doctrine does not apply to FHA claims because they "'do not challenge the reasonableness of the insurance rates,' but rather their discriminatory effect." 81 Fed. Reg. at 69018 (quoting *Lumpkin, v. Farmers Grp., Inc.*, No. 05-2868, 2007 U.S. Dist. LEXIS 98994, at *20-22 (W.D. Tenn. Apr. 26, 2007)). This argument fails for multiple reasons. An FHA claim that an insured is being charged more because of the insured's race seeks to "invalidat[e]" the rate charged and thus squarely implicates the filed-rate doctrine. *Schilke*, 820 F. Supp. 2d at 835. A claimed discriminatory effect would occur through disparate rates, and it is difficult to imagine how the Rule could remedy such an effect other than by causing insurers to change their rates. Moreover, a court resolving an FHA claim under the Rule would, in fact, have to consider the reasonableness of the challenged rate at step two of the burden-shifting framework. In any event, it is well established that the filed-rate doctrine bars claims that do more than simply challenge the "reasonableness" of rates.[10]

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[9] *See, e.g., Schermer v. State Farm Fire & Cas. Co.*, 721 N.W.2d 307, 311-19 (Minn. 2006) (filed-rate doctrine required dismissal of claim that higher prices for homeowners insurance for certain homes was racially discriminatory); *Schilke*, 820 F. Supp. 2d at 835 ("Numerous courts have held … filed-rate doctrine applies to … insurance.").

[10] *See, e.g., Square D. Co. v. Niagara Frontier Tariff Bureau, Inc.*, 476 U.S. 409, 415 & n.17 (1986) (filed-rate

HUD also argued that "the Supremacy Clause tips any legislative competition" between the Rule and state insurance regulations "in favor of the federal antidiscrimination statutes." 81 Fed. Reg. at 69018 (quoting *Saunders I*, 440 F.3d at 944). But HUD's position and the *Saunders* decision on which HUD relied are inconsistent with the weight of the case law holding that the filed-rate doctrine does bar *federal* challenges to rates filed with *state* agencies. *See, e.g., Wegoland*, v. NYNEX Corp., 27 F.3d 17, 20 (2d Cir. 1994) (finding RICO claim barred, noting "courts have uniformly held, and we agree, that the rationales underlying the filed rate doctrine apply equally strongly to regulation by state agencies"); *Taffet v. Southern Co.*, 967 F.2d 1483, 1494 (11th Cir. 1992) (en banc) (filed-rate doctrine "applies with equal force to preclude recovery under RICO whether the rate at issue has been set by a state rate-making authority or a federal one").[11] This is all the more clear in a case involving state regulation of insurance, where the McCarran-Ferguson Act "overturn[s] the normal rules of pre-emption." *PCI*, 66 F. Supp. 3d at 1025.

IV. The Supplemental Explanation Inadequately Addressed *Inclusive Communities*

The Supplemental Explanation also did not consider the impact of the Supreme Court's decision in *Inclusive Communities* on the applicability of disparate-impact liability to risk-based pricing and underwriting. *Inclusive Communities* detailed key limitations on FHA disparate-impact liability. The Court emphasized that regulated entities must be free to make "the practical business choices and profit-related decisions that sustain a vibrant and dynamic free-enterprise

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doctrine barred recovery of treble damages under antitrust laws even though antitrust claims do not challenge reasonableness of rates but rather method by which they were adopted); *Schilke*, 820 F. Supp. 2d at 836 (filed-rate doctrine foreclosed claims based on failure to disclose aspects of rates); *McCray v. Fidelity Nat'l Title Ins. Co.*, 682 F.3d 229, 235-42 (3d Cir. 2012) (filed-rate doctrine barred antitrust challenge to rates).

[11] *See also H.J. Inc. v. Nw. Bell Tel. Co.*, 954 F.2d 485, 495 (8th Cir. 1992) ("Allowing a RICO action . . . would similarly disrupt the state administrative process and constitute a 'collateral attack on a rate order,' contrary to state law.") (quoting *H.J., Inc. v. Nw. Bell Corp.*, 420 N.W.2d 673, 677 (Minn. Ct. App. 1988)); *Lifschultz Fast Freight, Inc. v. Consol. Freightways Corp. of Del.*, 805 F. Supp. 1277, 1296 (D.S.C. 1992).

system." 135 S. Ct. at 2518. And the Court cautioned that a rule encouraging the consideration of race "in a pervasive way" would raise serious constitutional questions. *Id.* at 2523.

For these reasons, the Court gave specific guidance on how disparate-impact claims may be litigated under the FHA. A disparate-impact claim may not be based "solely on a showing of statistical disparity." *Id.* at 2522. Instead, plaintiffs must satisfy a "robust causality requirement," pointing to specific policies that caused a disparity, to ensure that defendants are not "held liable for racial disparities they did not create." *Id.* at 2523. Defendants must have "leeway to state and explain the valid interest served by their policies" and "latitude to consider market factors" without plaintiffs second-guessing "which of two reasonable approaches" a defendant should follow. *Id.* at 2522–23. Under this regime, only policies that are "artificial, arbitrary, and unnecessary" should give rise to disparate-impact liability. *Id.* at 2524.

Despite the importance of *Inclusive Communities* and these constraints on disparate-impact liability, the Supplemental Explanation mentioned the decision only in a few footnotes that did not address these limitations. *See* 81 Fed. Reg. at 69013 nn.11&13, 69014 n.24, 69015 n.42. That the Supreme Court decided *Inclusive Communities* after this Court's remand did not permit HUD to ignore the decision, particularly where PCI submitted supplemental comments identifying how *Inclusive Communities* affected the Disparate Impact Rule. *See* PCI Letter to HUD (July 29, 2015) (A.R. 4615-4621). Ignoring *Inclusive Communities* and PCI's subsequent comments was arbitrary and capricious. *Motor Vehicle Mfrs.*, 463 U.S. at 43.

CONCLUSION

For the foregoing reasons, the Court should grant PCI's motion for summary judgment and vacate HUD's Disparate Impact Rule to the extent that it applies to risk-based pricing and underwriting of homeowners insurance.

Dated: September 8, 2017

Respectfully submitted,

PROPERTY CASUALTY INSURERS
ASSOCIATION OF AMERICA

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CERTIFICATE OF SERVICE

I hereby certify that, on September 8, 2017, I electronically filed the foregoing document with the Clerk of the Court for the U.S. District Court for the Northern District of Illinois using the CM/ECF system, which sent notification of such filing to counsel of record in this case.

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA,	)	
Plaintiff,	)	Case No. 1:13-cv-08564
v.	)	
BEN CARSON, in his official capacity as Secretary of Housing and Urban Development, and UNITED STATES DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT,	)	
Defendants.	)	

FIRST AMENDED COMPLAINT

Plaintiff Property Casualty Insurers Association of America alleges as follows:

NATURE OF THE ACTION

1. This is an action under the Administrative Procedure Act ("APA"), which provides that "[a] person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof." 5 U.S.C. § 702. Under the APA, "[t]he reviewing court shall . . . hold unlawful and set aside agency action, findings, and conclusions found to be [among other things] arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." *Id.* § 706. Agency action must stand or fall based on the explanation and rationale actually given by the agency in its notice or decision. *See SEC v. Chenery Corp.*, 332 U.S. 194, 196 (1947).

2. The agency action at issue here is the United States Department of Housing and Urban Development's ("HUD's") promulgation of a regulation purporting to "formalize" HUD's belief "that liability under the Fair Housing Act ("FHA") may arise from a facially neutral

practice that has a discriminatory effect" on a group of persons defined by race, color, religion, sex, handicap, familial status, or national origin—"regardless of whether there was an intent to discriminate," including the supplemental explanation for the regulation issued by HUD in response to this Court's 2014 remand order. 78 Fed. Reg. 11,460, 11,460 (Feb. 15, 2013) (the "Disparate Impact Rule" or the "Rule") (attached as Exhibit 1); *see id.* at 11,463 (listing protected classes); *see* 81 Fed. Reg. 69,012 (Oct. 5, 2016) (the "Supplemental Explanation") (attached as Exhibit 2). This lawsuit challenges HUD's application of this regulation to the underwriting, pricing, and provision of homeowners insurance and property and hazard insurance ("homeowners insurance") as arbitrary, capricious, an abuse of discretion, and otherwise contrary to law.

3. As a matter of state law, homeowners insurers are required to charge rates that are not excessive, inadequate, or unfairly discriminatory. Setting accurate and fair rates necessitates reliance on actuarial data from past losses that reveal differences in the risks posed by different pools of insureds. Using this data, homeowners insurers can engage in risk segmentation by classifying insureds based on their risk profile and charging them different premiums. Such risk-based underwriting and pricing is fundamental to the business of homeowners insurance, and the vast majority of states indeed mandate that insurers use actuarially significant risk factors. *See* PCI Letter to HUD (Jan. 26, 2015), at 1 (attached as Exhibit 4), at 8; *see also id.* at Table 1 (showing statutes requiring risk-based pricing, organized by state).

4. The Disparate Impact Rule would impair the ability of homeowners insurers to price and underwrite insurance based upon risk. Rather than allow insurers' decisions to be guided by objective actuarial risk data—as contemplated by state law—the Disparate Impact Rule would require insurers to attempt to determine whether their underwriting and pricing

decisions have a disparate impact on customers falling within a protected class and certain geography. Insurers would then have to adjust rates, possibly in violation of state law. The Rule would thus fundamentally change the business and regulation of insurance.

5. Application of the Disparate Impact Rule to homeowners insurance thus also cannot be reconciled with the McCarran-Ferguson Act. The McCarran-Ferguson Act, 15 U.S.C. §§ 1011- 1015, preserves the historic role of the states in regulating the business of insurance. It prohibits the application of federal laws that would "invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance" unless the federal law "specifically relates to the business of insurance." *Id.* § 1012(b). The provision of homeowners insurance is extensively regulated by the states to ensure that insurance rates and practices are fair and reasonable.

6. The Court previously concluded that HUD acted in an arbitrary and capricious manner by failing to respond adequately to comments submitted by the homeowners insurance industry during the rulemaking proceeding leading to promulgation of the Disparate Impact Rule. The Court explained that "HUD's response to the insurance industry's concerns that exposing them to disparate impact liability would undermine the fundamental nature of insurance was arbitrary and capricious. HUD made no effort to evaluate the substance of the insurance industry's concerns, disregarding them merely because insurers would have an opportunity to raise their arguments as part of the burden-shifting framework. The ability of insurers to raise their arguments on a case-by-case basis in subsequent proceedings, however, does not alleviate HUD of its obligation to consider the substance of the insurance industry's concerns raised during the notice-and-comment period." *Prop. Cas. Ins. Ass'n of Am. v. Donovan*, 66 F. Supp. 3d 1018, 1051 (N.D. Ill. 2014). The Court also concluded that "HUD's one-paragraph response

to the insurance industry's detailed concerns that applying the Disparate Impact Rule to homeowners insurance would violate the McCarran–Ferguson Act fails to provide a reasoned explanation to prefer case-by-case application of McCarran–Ferguson preclusion over rule-making." *Id.* at 1048. In addition, the Court held HUD did not adequately respond to the insurance industry's concerns that application of the rule to homeowners insurance would violate the "filed rate" doctrine, which precludes claims premised on rates that have been approved by a state regulator. The Court instructed HUD that "on remand, HUD must explain its decision regarding the filed-rate doctrine or institute a new rule, as it must with respect to the industry's McCarran–Ferguson comments." *Id.* at 1050. Accordingly, the Court ordered HUD to supplement its explanation of the Disparate Impact Rule by discussing the impact of the Rule on the homeowners insurance business and why they should not be exempted from its coverage.

7. After remand, PCI requested that HUD reopen the comment period so that PCI could submit additional comments addressing the issues identified in the Court's order. *See* PCI Letter to HUD (Sept. 25, 2014) (attached as Exhibit 3).

8. PCI next submitted to HUD a comment addressing the issues identified in the Court's order and reiterating the reasons why the Disparate Impact Rule was unlawful. *See* PCI Letter to HUD (Jan. 26, 2015) (attached as Exhibit 4). Among other points, the comment highlighted that 1) "the vast majority of states" require insurers to set rates based on "neutral actuarial factors," *id.* at 8; *see also id.* at Table 1; 2) the vast majority of states have expressly permitted insurers to group insureds based on risk, *id.* at 9; *see also id.* at Table 1; and 3) the vast majority of states "require insurers to file their rates with state insurance commissioners for review and approval," *id.* at 12; *see also id.* at Table 1. The Disparate Impact Rule therefore violated the McCarran-Ferguson Act and the filed-rate doctrine.

9. Before HUD supplemented its explanation, the Supreme Court narrowly defined the scope of disparate-impact liability under the Fair Housing Act in *Texas Department of Housing and Community Affairs v. The Inclusive Communities Project, Inc.*, 135 S. Ct. 2507 (2015). The Supreme Court emphasized that "disparate-impact liability must be 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." *Id.* at 2518. The Court also held plaintiffs must satisfy a "robust causality requirement" to establish a prima facie case beyond evidence of a mere statistical disparity. *Id.* at 2523. The Court specified that only "artificial, arbitrary, and unnecessary" practices should be eliminated by the Disparate Impact Rule. *Id.* at 2524. The Court warned against policies that would encourage the consideration of race "in a pervasive way," such as numerical quotas, as that would raise serious constitutional questions. *Id.* at 2523.

10. In light of this dispositive precedent, PCI submitted an additional comment to HUD explaining that homeowners insurers, due to their fundamental dependence on risk-based pricing, are precisely the types of actors whose practical business practices must be shielded from disparate-impact liability. *See* PCI Letter to HUD (July 29, 2015), at 2 (attached as Exhibit 5).

11. On October 5, 2016—nearly two years after this Court's remand order and over a year after the Supreme Court issued its decision in *Inclusive Communities*—HUD published its Supplemental Explanation. Yet the Supplemental Explanation offers no meaningful discussion of the intervening, controlling *Inclusive Communities* decision. This failure to take account of *Inclusive Communities* was arbitrary and capricious. Nor does the Supplemental Explanation make any mention of the comment letters PCI submitted after this Court's remand.

12. HUD's reaffirmed decision to apply the Disparate Impact Rule to risk-based pricing practices in the homeowners insurance industry remains arbitrary and capricious and otherwise contrary to law. HUD ignored the Court's instruction to evaluate how often McCarran-Ferguson preclusion would apply and whether it would bar entire categories of disparate-impact claims against insurers. Rather, HUD cited—without support—that such wholesale bars would contravene the purpose of the McCarran-Ferguson Act. Nor did HUD adequately address the filed-rate doctrine, ignoring cases in which courts found that doctrine to bar federal challenges to state insurance law.

13. Like the original reasoning that the Court found unlawfully insufficient, the Supplemental Explanation fails to provide an adequate "response to the insurance industry's concerns that exposing them to disparate impact liability would undermine the fundamental nature of insurance." *Donovan*, 66 F. Supp. 3d at 1051. For that reason, too, the Supplemental Explanation and the Rule it justifies are arbitrary and capricious. In the Supplemental Explanation, HUD gives insufficient consideration to commenters' arguments that these particular underwriting and pricing practices should be exempt. To the extent that the Supplemental Explanation considers these concerns at all, it addresses insurance practices more broadly, without paying attention to the particular concerns raised about homeowners insurance and about risk-based pricing and underwriting in particular. And to the extent that it addresses the risk-based pricing of homeowners insurance, it contradicts itself and ignores comments that avoiding statistical disparities would require homeowners insurers to depart from risk-based pricing. The Supplemental Explanation similarly fails to consider how application of a federal disparate-impact standard would affect the business of homeowners insurance, which is dependent on effective risk segmentation. Nor does it adequately explain why the cost, time, and

inconvenience of individualized litigation outweighed crafting an exception for the risk-based pricing of homeowners insurance. It also wholly disregards the costs homeowners insurance companies would incur in collecting data on race and other protected characteristics, which some states outlaw.

14. The Disparate Impact Rule is also contrary to law as established by *Inclusive Communities* in numerous respects. It compels the "pervasive" consideration of protected characteristics, stifles "practical business choices and profit-related decisions that sustain a vibrant and dynamic free-enterprise system," and burdens actors who provide housing. *Inclusive Communities*, 135 S. Ct. at 2518.

15. The burden-shifting provisions of the Disparate Impact Rule are also contrary to the limitations outlined in *Inclusive Communities* when applied to the homeowners insurance industry, which operates by classifying risks based on a broad range of actuarial data. For one, the Rule impermissibly permits plaintiffs to state a prima facie claim of disparate impact merely by pointing to a statistical disparity and without establishing a robust causal connection between a defendant's policies and a racial disparity. Second, the Rule requires homeowners insurers to show on a case-by-case basis that challenged underwriting or pricing practices are necessary to achieve a legitimate business goal. This ignores the fact that all actuarially based pricing and underwriting is necessary to the legitimate business of the private competitive market for insurance, as well as the fact that state law typically mandates the use of actuarially significant factors. The Rule thus would not simply invalidate those policies that are "artificial, arbitrary, and unnecessary," but would inhibit "profit-related decisions that sustain a vibrant and dynamic free-enterprise system." *Id.* at 2518, 2524.

16. Based on the facts set forth herein, the Court should declare that insofar as the

Disparate Impact Rule purports to apply to the risk-based pricing of homeowners insurance, it was promulgated in contravention of the APA.

PARTIES

17. Property Casualty Insurers Association of America ("PCI") is an Illinois not-for-profit corporation with its headquarters in Chicago, Illinois. It is a trade association of property and casualty insurers representing more than 1,000 member companies. In 2015, PCI's members wrote over $202 billion in annual premiums and constituted 27% of the U.S. homeowners insurance market. PCI's members sell homeowners insurance, subject to state insurance regulations, in every state of the United States. PCI's mission is to promote and protect the viability of a competitive private insurance market for the benefit of consumers and insurers. In bringing this lawsuit, PCI seeks to vindicate both its own interests and the interests of its members.

18. Defendant Department of Housing and Urban Development ("HUD") is an executive agency of the United States Government, 5 U.S.C. §§ 101, 105, established by the Department of Housing and Urban Development Act of 1965, 42 U.S.C. § 3531 *et seq.*, Pub. L. No. 89−117, 79 Stat. 451. HUD is headquartered at 451 Seventh Street SW, Washington, DC 20410.

19. Defendant Ben Carson is the Secretary of the Department of Housing and Urban Development and is being sued in his official capacity. Secretary Carson is charged with implementing the Fair Housing Act and is responsible for the Department's promulgation of the challenged regulations. His official address is 451 Seventh Street SW, Washington, DC 20410.

JURISDICTION AND VENUE

20. This action arises under the APA. This Court has subject-matter jurisdiction over this action pursuant to 28 U.S.C. § 1331 and is authorized to grant relief under 5 U.S.C. §§ 702,

705, 706.

21. Venue is proper in this district under 28 U.S.C. § 1391(e)(1)(C) because Plaintiff PCI resides in this district and no real property is involved in this action.

22. This Court can grant declaratory and injunctive relief pursuant to 5 U.S.C. § 706 and 28 U.S.C. §§ 2201, 2202.

ALLEGATIONS

I. THE PROVISION AND PRICING OF INSURANCE

23. Insurance is a means for transferring the risk of loss from one party, the insured, to another, the insurer. Insurers group insureds into separate risk pools based on differences in risk profile. In exchange for accepting an insured's risk, the insurer charges a rate appropriate for the insured's risk pool. The rate is based on numerous factors, including the probability and amount of potential loss, policy limits, deductibles, and the insurer's cost of doing business. *See, e.g.*, 1 Steven Plitt et al., *Couch on Insurance* § 1:6 (3d rev. ed. 2010). The probability and amount of potential loss is also central to underwriting decisions—*e.g.*, decisions about whether to insure a particular risk or class of risk. *Id.* at § 1:2.

24. Determinations about the probability and amount of potential losses are made by actuaries. Actuaries are credentialed professionals trained and skilled in the analysis, evaluation, and management of the financial implications of future contingent events, especially with respect to insurance. In setting property and casualty insurance rates, actuaries adhere to the Casualty Actuarial Society's Statement of Principles Regarding Property and Casualty Insurance Ratemaking: Adopted by the Board of Directors of the Casualty Actuarial Society, May 1988, *available at* http://www.casact.org/professionalism/standards/princip/sppcrate.pdf. These principles "provide the foundation for the development of actuarial procedures and standards of practice" and, as such, provide essential guidance for insurers. *Id.*

25. When forecasting the probability and amount of potential loss, insurers consider a host of actuarial factors that correlate with losses. *See* Michael J. Miller, *Disparate Impact and Unfairly Discriminatory Insurance Rates*, Casualty Actuarial Society E-Forum 276, 284 (Winter 2009). For homeowners insurance, these factors might include, among many others, exposure to certain perils such as wind or hail, the types of construction materials used to build a house, house size, history of previous losses, geographic location, and proximity to fire hydrants. In applying these factors, insurers thus consider risk, not race or other protected characteristics. As the United States Court of Appeals for the Seventh Circuit has explained, "[r]isk discrimination is not race discrimination." *NAACP v. Am. Family Mut. Ins. Co.*, 978 F.2d 287, 290 (7th Cir. 1992) (Easterbrook, J.); *see also id.* at 298 ("[C]lassification of risks is important to insurance, and assigning higher rates to greater risks differs from assigning rates by race.").

26. Reliance on neutral, actuarially justified factors to calculate the probability and amount of potential losses is fundamental to the ability of the insurance industry to correlate risks to rates. The insurance market operates most efficiently and fairly when each consumer pays a rate that accurately reflects the cost of providing insurance to that consumer and other similarly situated consumers. If insurers could not set rates based on neutral, actuarially justified factors and risk calculations, the insurance industry could not function. *See, e.g.,* Robert Detlefsen, *"Disparate Impact" Theory Provides No Support for Banning Credit Scoring in Insurance*, Legal Backgrounder, Apr. 8, 2005, at 1, *available at* http://www.wlf.org/upload/040805LBDetlefsen.pdf. If risk is not considered in setting prices, lower-risk customers are overcharged for insurance relative to the risk of loss that they pose. If this were to occur (notwithstanding state law discussed below), many lower-risk customers would choose not to purchase insurance rather than pay too much for it. This problem of adverse

selection would cause prices to rise. *See* Miller, *Disparate Impact and Unfairly Discriminatory Insurance Rates*, Casualty Actuarial Society E-Forum at 284; Ronen Avraham, *The Economics of Insurance Law—A Primer*, 19 Conn. Ins. L. J. 29, 44 (2012).

27. The Court of Appeals for the Seventh Circuit has noted this very phenomenon:

> Insurance works best when the risks in the pool have similar characteristics. For example, term life insurance costs substantially more per dollar of death benefit for someone 65 years old than for one 25 years old, although the expected return per dollar of premium is the same to both groups because the older person, who pays more, also has a higher probability of dying during the term. Auto insurance is more expensive in a city than in the countryside, because congestion in cities means more collisions. Putting young and old, or city and country, into the same pool would lead to adverse selection: people knowing that the risks they face are less than the average of the pool would drop out. A single price for term life insurance would dissuade younger persons from insuring, because the price would be too steep for the coverage offered; the remaining older persons would pay a price appropriate to their age, but younger persons would lose the benefits of insurance altogether. To curtail adverse selection, insurers seek to differentiate risk classes with many variables.

Am. Family Mut. Ins. Co., 978 F.2d at 290 (noting the difference between disparate treatment claims and disparate-impact claims in addressing application of the McCarran-Ferguson Act).

28. Additionally, if insurers were forced to disregard the actual risk of insuring a property (again, notwithstanding state law to the contrary), as would be required by the Disparate Impact Rule, it would severely disrupt the insurance market. Insurers who wanted to provide coverage for high-risk properties would not be permitted to charge adequate rates if they disproportionately affected insureds who met the criteria of a protected class. They would have to set their overall prices higher than those of their competitors, which could not be sustained in a competitive market. This would either jeopardize the insurer's solvency or result in a legitimate business decision not to offer such coverage.

29. The inability to set rates based on neutral, actuarially justified factors would also

create an artificial subsidy for the purchase of hazard-prone or poorly constructed houses. For example, insurance rates on houses made of easily flammable materials would be similar to rates on houses built of safer materials, due to characteristics of the policyholder that are not correlated to risk of a property loss. This would remove an incentive for the construction of safer houses and the maintenance of existing homes. *See, e.g.*, Avraham, *The Economics of Insurance Law—A Primer*, 19 Conn. Ins. L. J. at 66-67.

II. STATE REGULATION OF INSURANCE

30. Homeowners insurance is subject to extensive state regulation. State regulatory regimes typically mandate the use of risk-based pricing based on actuarially significant risk factors.

31. State law generally prohibits insurers from charging excessive, inadequate, or unfairly discriminatory insurance rates. For purposes of insurance law, rates are "unfairly discriminatory" if "premium differences . . . do not correspond to expected losses and average expenses or if there are expected average cost differences that are not reflected in the premium differences." Miller, *Disparate Impact and Unfairly Discriminatory Insurance Rates*, Casualty Actuarial Society E-Forum at 283 (internal quotation marks omitted). As further explained in Principle 4 of Casualty Actuarial Society Statement of Ratemaking Principles, "[a] rate is reasonable and not excessive, inadequate, or unfairly discriminatory if it is an actuarially sound estimate of the expected value of all future costs associated with an individual risk transfer." Statement of Principles Regarding Property and Casualty Insurance Ratemaking: Adopted by the Board of Directors of the Casualty Actuarial Society, May 1988, *available at* http://www.casact.org/professionalism/standards/princip/sppcrate.pdf.

32. The National Association of Insurance Commissioners ("NAIC") is a standard-setting and regulatory support organization created and governed by state insurance regulators.

NAIC establishes standards, model laws, and best practices, conducts peer review, and coordinates regulatory oversight. NAIC's model code makes clear that an insurer is guilty of unfair discrimination when it makes underwriting and rating distinctions "between individuals or risks of the same class and of essentially the same hazard" or when underwriting and rating decisions are not supported by "the application of sound underwriting and actuarial principles related to actual or reasonably anticipated loss experience." Unfair Trade Practices Act § 4(G)(3) (Model Regulation Service, July 2008).

33. Insurers therefore must take into account actuarially significant risk factors in making underwriting decisions and setting rates. These principles are consistently applied in state regulations and case law, as well as in model laws.

A. State Laws Permitting Consideration Of Actuarial Factors

34. State laws make clear that insurers are expected to consider actuarially significant risk factors. For example, Illinois law prohibits "any unfair discrimination *between individuals or risks of the same class or of essentially the same hazard and expense element* because of the race, color, religion, or national origin of such insurance risks or applicants." 215 Ill. Comp. Stat. 5/424(3) (emphasis added). Rates may differ on the basis of sex, sexual preference, or marital status if such "classification or differentiation is based upon expected claim costs and expenses *derived by applying sound actuarial principles* to relevant and reasonably current company or intercompany studies, claim costs and expense experience." Ill. Admin. Code tit. 50, § 2603.40 (emphasis added).

35. Similarly, Wisconsin law states: "One rate is unfairly discriminatory in relation to another in the same class if it clearly fails to reflect equitably the differences in expected losses and expenses. Rates are not unfairly discriminatory because different premiums result for policyholders with like loss exposures but different expense factors, or like expense factors but

different loss exposures, so long as the rates reflect the differences with reasonable accuracy." Wis. Stat. Ann. § 625.11(4).

36. West Virginia law specifies that risk-classification standards "may measure any differences among risks that can be demonstrated to have a probable effect upon losses or expenses." W. Va. Code § 33-20-3(c)(2). Virginia law provides that "[n]o rate shall be unfairly discriminatory if a different rate is charged for the same coverage and the rate differential (i) is based on sound actuarial principles or (ii) is related to actual or reasonably anticipated experience." Va. Code Ann. § 38.2-1904(A)(3). Maine law states that "[n]o risk classification may be based upon race, creed, national origin or the religion of the insured," Me. Rev. Stat. Ann. tit. 24-A, § 2303(1)(G), but a risk classification "based upon size, expense, management, individual experience, purpose of insurance, location or dispersion of hazard, or any other reasonable considerations" is not unreasonable or unfairly discriminatory "provided such classifications and modifications apply to all risks under the same or substantially similar circumstances or conditions," *id.* § 2303(2). *See also* Tenn. Code Ann. § 56-5-103(d) ("A rate is not unfairly discriminatory because different premiums result for policyholders with like loss exposures with different expenses, or like expenses but different loss exposures, so long as the rate reflects the differences with reasonable accuracy.").

37. Many other states' laws are to similar effect. *See* Alaska Stat. § 21.39.030; Colo. Rev. Stat. § 10-4-403(1)(a); Del. Code Ann. tit. 18, § 2503(b); Mich. Comp. Laws § 500.2109(1)(C); *Cole v. State Farm Ins. Co.*, 128 P.3d 171, 177 (Alaska 2006) ("Alaska has other statutes that specifically protect insurance customers from discrimination. These statutes forbid "'unfair discrimination between insureds or property having like insuring or risk characteristics in any ... of the terms and conditions of the insurance.'"); *Cain v. Fortis Ins. Co.*,

694 N.W.2d 709, 714 (S.D. 2005) ("SDCL 58-33-26 states in pertinent part: No insurer shall make or permit any unfair discrimination between insureds or property having like insuring or risk characteristics, in the premium or rates charged for insurance, or in the dividends or other benefits payable thereon, or in any other of the terms and conditions of the insurance."); *Ins. Comm'r for the State v. Engelman*, 692 A.2d 474, 480 (Md. 1997) ("One of the principal aims of the above-quoted provisions, and of the entire Code itself, is the prevention of excessive, inadequate, or unfairly discriminatory insurance rates. § 241. … Unfair discrimination, as the term is employed by the Insurance Code, means discrimination among insureds of the same class based upon something other than actuarial risk."); *Kuebler v. Equitable Life Assurance Soc. of the U.S.*, 555 N.W.2d 496, 500 (Mich. Ct. App. 1996) ("The antidiscrimination statute seeks to eliminate price discrimination based on considerations other than risk and expenses.").

B. State Laws Mandating Consideration Of Actuarial Factors

38. Many states expressly require insurance companies to consider past loss and other actuarially relevant factors in developing insurance rates. For example, Ind. Code Ann. § 27-1-22-3(a)(1) provides that "[d]ue consideration shall be given to the past and prospective loss experience within and outside this state … [and] to all other relevant factors, including trend factors, within and outside this state …."). Wisconsin law similarly provides:

> Due consideration shall be given to all of the following that apply:
>
> (a) Past and prospective loss and expense experience within and outside of this state.
>
> (b) Catastrophe hazards and contingencies.
>
> (c) Trends within and outside of this state.
>
> (d) Loadings for leveling premium rates over time or for dividends or savings to be allowed or returned by insurers to their policyholders, members or subscribers.

(e) Subject to s. 632.365, all other relevant factors, including the judgment of technical personnel.

Wis. Stat. Ann. § 625.12(1).

39. Numerous other states have similar laws. *See e.g.*, Ala. Code § 27-13-27(3)–(4) (requiring insurers to "[g]ive consideration to past experience within the state and without the state when necessary…[and to] all factors reasonably related to the kind of insurance involved"); Ariz. Rev. Stat. Ann. § 20-356(2) ("Due consideration shall be given to past and prospective loss experience within and outside this state, to catastrophe hazards, if any, to a reasonable margin for underwriting profit and contingencies, to dividends, savings or unabsorbed premium deposits allowed or returned by insurers to their policyholders, members or subscribers, to past and prospective expenses within and outside this state and to all other relevant factors within and outside this state."); Ark. Code Ann. § 23-67-209(a) ("Due consideration must be given to past and prospective loss and expense experience within and outside this state …."); Colo. Rev. Stat. § 10-4-403(1)(c) ("[U]nfair discrimination exists if, after allowing for practical limitations, price differentials fail to reflect equitably the differences in expected losses and expenses.); Del. Code Ann. tit. 18, § 2503(a)(3)(a) ("Due consideration shall be given to past and prospective loss experience within and outside the State"); Ga. Code Ann. § 33-9-4(4) ("Consideration shall be given to the extent applicable to past and prospective loss experience … and to all other factors, including judgment factors, deemed relevant within and outside this state"); Idaho Code § 41-1437(1) ("due consideration shall be given to past and prospective loss experience … and to all other relevant factors"); La. Rev. Stat. Ann. § 22:1454(B)(1) ("Due consideration shall be given to past and prospective loss and expense experience within and outside the state"); Me. Rev. Stat. Ann. tit. 24-A, § 2303(1)(C) ("Due consideration must be given … to past and prospective loss experience … [and] to all other relevant factors within and outside this State"); Md. Code Ann.,

Ins. § 11-205(c)(1), (8) (requiring insurers to consider "past and prospective loss experience" and "all … relevant factors within and outside the state"); Mich. Comp. Laws § 500.2110(1) ("In developing and evaluating rates … due consideration shall be given to past and prospective loss experience … to underwriting practice and judgment; and to all other relevant factors within and outside this state."); Minn. Stat. § 70A.05(1) ("Due consideration shall be given to past and prospective loss and expense experience within and outside this state, to a reasonable provision for catastrophe hazards and contingencies, to clearly discernible trends within and outside this state, ... and to all other relevant factors, including the judgment of underwriters and raters."); Miss. Code. Ann. § 83-2-3(2)(a) ("Due consideration shall be given to past and prospective loss and expense experience … and to all other relevant factors, including the judgment of the filer."); Mo. Rev. Stat. § 379.318(1) (requiring insurers to consider "past and prospective loss experience," "conflagration and catastrophe hazards," "past and prospective expenses," "a reasonable margin for underwriting profit and contingencies," and "all other relevant factors, including trend factors"); Ohio Rev. Code Ann. § 3935.03(C) ("Consideration shall be given to: (1) Past and prospective loss experience within and outside this state; … (6) All other relevant factors within and outside this state"); Or. Rev. Stat. § 737.310 ("(3) Rates for each classification of coverage shall be based on the claims experience of insurers within Oregon on that classification of coverage unless that experience provides an insufficient base for actuarially sound rates.…"). *See also* Mont. Code Ann. § 33-16-201(2)(a); Neb. Rev. Stat. § 44-7502; Nev. Rev. Stat. § 686B.060; N.H. Rev. Stat. Ann. § 412:15(II)(a); N.J. Stat. Ann. §§ 17:29A-4(c), -11; N.M. Stat. Ann. § 59A-17-7; N.Y. Ins. Law § 2304(a); N.C. Gen. Stat. § 58-40-25(1); N.D. Cent. Code § 26.1-25-03(1); Okla. Stat. tit. 36, § 985; R.I. Gen. Laws § 27-44-5(e)(1); S.D. Codified Laws § 58-24-6.1; Tenn. Code Ann. § 56-5- 104; Tex. Ins. Code Ann. § 2251.052; Utah Code

Ann. § 31A-19a-201; Wash. Rev. Code § 48.19.030.

C. State Filed Rate Requirements

40. In many states, proposed rates must be filed with state regulators for review and approval. *See*, *e.g.*, Ala. Code § 27-13-30; Alaska Stat. § 21.39.040(a), (c); Ark. Code Ann. § 23-67-211(a); Cal. Ins. Code § 1861.05(b), (c); Colo. Rev. Stat. §§ 10-4-404, 10-4-406; Del. Code Ann. tit. 18, § 2504; Haw. Rev. Stat. § 431:14-104(a); Ky. Rev. Stat. Ann. § 304.13-051; La. Rev. Stat. Ann. § 22:1451(B); Neb. Rev. Stat. § 44-7508; N.J. Stat. Ann. § 17:29A-6, -7; N.D. Cent. Code § 26.1-25-04; Ohio Rev. Code Ann. § 3935.04; Wash. Rev. Code § 48.19.060.

D. State Administrative Mechanisms For Reviewing Rates

41. In addition, many state regulatory regimes provide systems of administrative redress to review allegedly improper rates. For example, Indiana law provides for rate review by the insurance commissioner:

> (a) Upon the commissioner's motion, or upon written request by any insured affected thereby or by any licensed insurance producer or broker, if such request is made in good faith and states reasonable grounds, the commissioner, if the commissioner shall have reason to believe that any filing is not in compliance with the applicable provisions of section 3 of this chapter, or in the case of an alleged violation of section 6 of the chapter if the commissioner finds on the basis of the information on file with the department that there has been a prima facie showing of a violation of that section, shall hold a hearing upon not less than ten (10) days written notice to the rating organization or insurer which made the filing in issue, specifying the items and matters to be considered and stating in what manner and to what extent noncompliance is alleged to exist.
>
> * * *

> (b) If, after such hearing, the commissioner finds, based upon a preponderance of the evidence adduced at such hearing and made a part of the record thereof, that such filing is not in compliance with the provisions of section 3 of this chapter, the commissioner shall immediately issue a written order to the parties specifying in detail in what respects and upon what evidence such noncompliance exists and stating when, within a reasonable period thereafter, such filing shall be deemed no longer effective.

Ind. Code Ann. § 27-1-22-5(a)–(b).

42. Other states similarly permit review of insurance rates. *See* Ala. Code § 27-13-30 ("Whenever the commissioner shall find that rating systems theretofore approved by him, or which pursuant to Section 27-13-37 are effective without approval, provide for, result in or produce rates which are unreasonable or inadequate or which discriminate unfairly between risks in this state involving essentially the same hazards, he shall issue an order … directing that such rating systems be altered or revised …."); Alaska Stat. § 21.39.050(c); Ariz. Rev. Stat. Ann. § 20-358 (B) (includes a provision allowing "any person or organization aggrieved with respect to any filing or rating system which is in effect" to "make written application to the director" which may, after a hearing, result in disapproval of the rate); Del. Code Ann. tit. 18, § 2520 (permitting an appeal of filings by any aggrieved person or organization); Fla. Stat. § 627.0645(7); Ga. Code Ann. § 33-9-26; Haw. Rev. Stat. § 431:14-106(c), (e); Idaho Code § 41-1427; 215 Ill. Comp. Stat. 5/132.3; Iowa Code § 507.2; Md. Code Ann., Ins. § 11-208(d)-(e); Me. Rev. Stat. Ann. tit. 24-A, § 2306; Mich. Comp. Laws § 500.2416 (within thirty days); Minn. Stat. § 70A.11; Miss. Code. Ann. § 83-2-11; Mo. Ann. Stat. § 379.348; Mont. Code Ann. § 33-16-204; Neb. Rev. Stat. § 44-7508(13-15); N.H. Rev. Stat. Ann. §§ 412:19, 412:38; N.M. Stat. Ann. §§ 59A-17-13(B), 59A-17-30, 59A-17-33; N.Y. Ins. Law §§ 2319, 2320; N.C. Gen. Stat. § 58-40-100; N.D.

Cent. Code § 26.1-25-09; Ohio Rev. Code Ann. § 3937.04; Okla. Stat. tit. 36, §§ 989(B)–990; Or. Rev. Stat. §§ 737.215, 737.225(3), 737.235, 737.340; R.I. Gen. Laws § 27-44-14; S.C. Code Ann. § 38-73-1030; S.D. Codified Laws § 58-24-29; Tenn. Code Ann. §§ 56-5-109, 56-5-115; Tex. Ins. Code Ann. §§ 2251.105, 2251.1031, 2252.052; Utah Code Ann. §§ 31A-19a-217, 31A-19a-218; Va. Code Ann. § 38.2-1909 ("The Commission may investigate and determine, … whether rates in this Commonwealth for the classes of insurance to which this chapter applies are excessive, inadequate or unfairly discriminatory or whether loss experience and other factors within the Commonwealth are being properly used to determine the rates."); Vt. Stat. Ann. tit. 8, §§ 4700, 4704; Wash. Rev. Code § 48.19.310; W. Va. Code § 33-20-9; Wyo. Stat. Ann. § 26-14-106(d)-(g).

E. Laws Prohibiting Collection Of Data On Race and Other Protected Characteristics

43. In addition to other regulations concerning the provision of insurance, at least one state prohibits the collection of information about protected characteristics. *See* Md. Code Ann., Ins. § 27-501.

III. THE MCCARRAN-FERGUSON ACT

44. Historically, insurance was largely immune from federal regulation because the business of insurance was not considered "commerce" that could be regulated by Congress. *See Paul v. Virginia*, 75 U.S. (8 Wall.) 168 (1868). As a result, the states enjoyed a virtually exclusive domain over the insurance industry, which is today one of the most heavily regulated businesses in the country. In 1944, the Supreme Court determined in *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944), that the provision of insurance across state lines was interstate commerce that Congress could regulate. Congress responded in 1945 by enacting the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015, which ensured that the

Supreme Court's decision in *South-Eastern Underwriters* did not undermine state regulation of insurance. The extensive state regulation of the business of insurance discussed above is a result of this long history of exclusive state control of this area.

45. Section 1 of the McCarran-Ferguson Act, 15 U.S.C. § 1011, provides: "Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States."

46. Subsection 2(b) of the McCarran-Ferguson Act, 15 U.S.C. § 1012(b), provides: "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance." The Supreme Court has recognized that the McCarran-Ferguson Act "is, in effect, a clear-statement rule." *U.S. Dep't of Treasury v. Fabe*, 508 U.S. 491, 507 (1993). Federal law cannot invalidate, impair, or supersede state regulation of insurance unless Congress states its intention to do so clearly and expressly.

47. Under the McCarran-Ferguson Act, federal law is reverse-preempted if it "directly conflict[s] with state regulation" or when "application of the federal law would . . . frustrate any declared state policy or interfere with a State's administrative regime." *Humana Inc. v. Forsyth*, 525 U.S. 299, 310 (1999); *Doe v. Mut. of Omaha Ins. Co.*, 179 F.3d 557, 563 (7th Cir. 1999) ("Direct conflict with state law is not required to trigger this prohibition; it is enough if the interpretation would 'interfere with a State's administrative regime.'").

48. The Act applies where federal law would impose liability for conduct permitted

by state law. *See, e.g., Ojo v. Farmers Gr.*, 356 S.W.3d 421, 434-35 (Tex. 2011) (disparate-impact challenge to use of credit scores reverse-preempted under McCarran-Ferguson Act because Texas's insurance law permits the use of credit scoring, despite any disparate impact that the use of credit scoring will produce, so long as the factors used in credit scoring are not themselves based on race); *Saunders v. Farmers Ins. Exch.*, 537 F.3d 961, 968 (8th Cir. 2008) (disparate-impact claims under the Fair Housing Act impaired state law, which did not permit private cause of action for alleged discrimination by an insurer); *Riverview Health Inst. LLC v. Med. Mut. of Ohio*, 601 F.3d 505, 519 (6th Cir. 2010) ("We conclude that application of federal RICO in this case would impair Ohio's insurance regulatory scheme. The conduct at the heart of Plaintiff's' complaint implicates Ohio's law regarding payment of claims and the Ohio Department of Insurance is charged with administering the applicable state law. In this case, Plaintiffs have no common law remedy or private right of action. The state RICO statute is inapplicable and the damages available pursuant to federal RICO would far exceed the damages contemplated by the Ohio legislature when enacting its insurance regulatory scheme.").

49. The Seventh Circuit concluded in *NAACP v. American Family Insurance Co.* that the McCarran-Ferguson Act applies to the Fair Housing Act. *See* 978 F.2d at 293-95. Although the Court concluded that the McCarran-Ferguson Act does not reverse-preempt disparate *treatment* claims under the Fair Housing Act, the Court's analysis suggested that the outcome would be different for disparate-impact claims given "the nature of insurance" and its reliance on risk differentiation. *See id.* at 290 (describing problem of "adverse selection"); *id.* ("assum[ing] that the plaintiffs can establish disparate treatment and not just disparate impact of decisions made on actuarial grounds"); *id.* at 291 ("All we decide is whether the complaint states claims on which the plaintiffs may prevail if they establish that the insurer has drawn lines according to

race rather than actuarial calculations."); *id.* at 298 (noting difficulty applying "disparate impact paradigm" to insurance).

IV. THE FAIR HOUSING ACT

50. Enacted as Title VIII of the Civil Rights Act of 1968, 42 U.S.C. § 3601 *et seq.*, the Fair Housing Act ("FHA"), as amended, makes it unlawful, among other things, "[t]o discriminate against any person in the terms, conditions, or privileges of sale or rental of a dwelling, or in the provision of services or facilities in connection therewith, because of race, color, religion, sex, familial status, or national origin." 42 U.S.C. § 3604(b); *see also id.* § 3604(f)(2) (prohibiting discrimination because of "handicap").

51. The FHA does not reference homeowners insurance in any context. Congress was silent on the subject of homeowners insurance in the FHA.

V. THE DISPARATE IMPACT RULE

A. HUD's Proposed Rule

52. On November 16, 2011, HUD issued a proposed rule entitled "Implementation of the Fair Housing Act's Discriminatory Effect's Standard." *See* 76 Fed. Reg. 70,921 (Nov. 16, 2011). In the notice of proposed rulemaking, HUD explained that it "interpreted the [FHA] to prohibit housing practices with a discriminatory effect, even where there has been no intent to discriminate." *Id.* at 70,921. HUD asserted that the purpose of the proposed rule was "to establish uniform standards for determining when a housing practice with a discriminatory effect violates the Fair Housing Act." *Id.*

53. In the notice of proposed rulemaking, HUD cited "the provision and pricing of homeowner's insurance" as an "[e]xample[] of a housing policy or practice that may have a disparate impact on a class of persons delineated by characteristics protected by the Act." 76 Fed. Reg. at 70,924. The notice of proposed rulemaking did not reference the McCarran-

Ferguson Act, much less discuss how application of disparate-impact liability could possibly be reconciled with the historic consideration of actuarially significant risk-based factors in the pricing and underwriting of insurance.

B. Comments From The Insurance Industry

54. In response to HUD's unsupported assertion that its new Disparate Impact Rule would apply to the provision of homeowners insurance, the insurance industry submitted detailed comments explaining why doing so would be unlawful and ill-advised, including comments from PCI and two other insurance trade associations, the National Association of Mutual Insurance Companies ("NAMIC"), and the American Insurance Association ("AIA"). *See* Comments of the Property Casualty Insurers Ass'n of America, Docket No. FR-5508-P-01 (Jan. 17, 2012) ("PCI Comments"); Comments of the National Association of Mutual Insurance Companies, Docket No. FR-5508-P-01 (Jan. 17, 2012) ("NAMIC Comments"); Comments of the American Insurance Association, Docket No. FR-5508-P-01 (Jan. 17, 2011) ("AIA Comments"). The insurance industry commenters explained that application of disparate-impact liability to homeowners insurance is fundamentally inconsistent with consideration of actuarially sound risk-based factors and would violate the McCarran-Ferguson Act. For example, PCI's Comments noted that "[e]very state has extensive laws and regulations governing insurance underwriting practices and those laws naturally recognize the need for insurers to distinguish between different types and degrees of risk. Indeed, risk discrimination is the foundation of insurance underwriting and every state has considered at length the appropriate regulatory balance to prohibit unfair discrimination." PCI Comments at 2. Thus, imposing liability on insurers for their core practice of risk discrimination would be inappropriate and would impair state regulation of the insurance industry. *See id.* NAMIC's Comments further stated: "The foundation of the business of insurance, and in particular underwriting and rate-making, is

classifying insurance applicants and policyholders by risk. Insurers make decisions based on actuarial and business principles that group policyholders for the purpose of treating those with similar risk profiles similarly. Race or other protected class characteristics are not part of the risk assessment process." NAMIC Comments at 5. They further noted (at p. 5):

> To actuarially determine rates that most accurately measure loss potential, insurers identify relationships between factors and risk of loss and allocate costs accordingly. This practice is the very essence of risk-based pricing. Common homeowners insurance factors include claim history of applicant, construction material(s), distance from a fire station, dog/breed of dog owned, fire suppression devices, home-based business presence and type, lead paint potential (constructed pre-1978), loss history of property, roofing material, trampoline use, slab versus basement and the presence of an operational security system.

55. NAMIC added that the use of factors to calculate risk would be limited by the application of disparate-impact liability because any factor could affect protected groups differently:

> Under HUD's proposed rule, . . . common underwriting factors could be jeopardized, even though they do not intentionally discriminate, if they were found to have the "effect" of making unavailable or denying a dwelling to a certain percentage of a particular racial or ethnic group if that percentage is greater than the percentage of other groups that is similarly affected. To achieve a condition in which no statistical disparities exist in the average rate paid by different demographic groups, many if not most risk-based variables would have to be eliminated from the underwriting process. In other words, to avoid creating a disparate impact, an insurer would have to charge everyone the same rate, regardless of risk. This calls into question conclusions drawn simply from statistical samplings and underscores why the business of risk classification defies a disparate impact analysis.

NAMIC Comments at 5-6.

56. The commenters also explained that eliminating risk-based pricing would have significant negative consequences: "adverse selection will increase, and coverage availability

will suffer. Perversely, application of the proposed rule could in fact harm all insurance consumers, including the very groups it purports to protect." NAMIC Comments at 7.

57. The insurance industry further commented that because state laws expressly contemplate consideration of actuarially significant risk factors, the application of disparate-impact liability would violate the McCarran-Ferguson Act. The comments noted that "[c]lassifying people and property by the risks they present and treating similar risk profiles in a similar manner is a form of reasonable and fair discrimination that is at the very heart of the business of insurance." NAMIC Comments at 6; *see also* PCI Comments at 2. As a matter of state insurance law, the term "[u]nfair discrimination" has a "specific meaning": "a rate is reasonable and not excessive, inadequate, or unfairly discriminatory if it is an actuarially sound estimate of the expected value of all future costs associated with an individual risk transfer [in the insurance context]." *Id.* (quoting Principal 4 of Casualty Actuarial Society's Statement of Ratemaking Principles). The comments noted that courts have already held that the application of disparate-impact liability to insurers under the FHA would conflict with the laws of states such as Texas, Missouri, Nebraska, and Mississippi. *Id.* at 8-9.

58. In light of the inherent conflict between disparate-impact liability and actuarial risk based pricing and underwriting, the insurance comments requested that HUD exempt insurance underwriting and pricing from the Disparate Impact Rule. *See* PCI Comments at 3; NAMIC Comments at 9. In the alternative, commenters requested that HUD provide regulatory safe harbors for long-recognized actuarial risk factors, such as age and condition of a property or distance from a fire station. *See* NAMIC Comments at 9. Comments also requested that HUD exempt Fair Access to Insurance Requirements (FAIR) plans, which provide insurance to high-risk individuals who might otherwise be denied coverage. *See id.*

59. Finally, the insurance comments explained that HUD's "three-step burden-shifting" approach for resolving disparate-impact claims conflicted with the Supreme Court's decision in *Wards Cove Packing Co. v. Atonio*, 490 U.S. 642 (1989), in numerous respects relevant to the insurance industry. At the first step of the process, HUD improperly omitted the requirement that any disparate impact be "significant." At the second step, HUD improperly shifted the burden of proof to the defendant and required a defendant to show that the challenged practice is "necessary" to serve a legitimate interest. And at the third step, HUD erred by omitting the requirement that any proffered alternative practice be "equally as effective" as the challenged practice at serving the defendant's legitimate business interests. *See* NAMIC Comments at 10-11; AIA Comments at 4.

C. HUD's Final Rule

60. On February 15, 2013, HUD promulgated its final Disparate Impact Rule, which purports to "formalize[]" HUD's view that the FHA's prohibition on discrimination may be violated by practices that have a discriminatory effect in the absence of a discriminatory intent. 78 Fed. Reg. at 11,460.

61. The Disparate Impact Rule provides that "[a] practice has a discriminatory effect where it actually or predictably results in a disparate impact on a group of persons or creates, increases, reinforces, or perpetuates segregated housing patterns because of race, color, religion, sex, handicap, familial status, or national origin." *Id.* at 11,482. It further provides that a challenged "practice [with a discriminatory effect] may still be lawful if supported by a legally sufficient justification," *id.*, meaning that: (1) the challenged housing practice "[i]s necessary to achieve one or more substantial, legitimate, nondiscriminatory interests of the respondent" and (2) "[t]hose interests could not be served by another practice that has a less discriminatory effect," *id.*

62. Under the Rule, the plaintiff or charging party has the initial "burden of proving that a challenged practice caused or predictably will cause a discriminatory effect." *Id.* If the plaintiff or charging party meets that burden, "the respondent or defendant has the burden of proving that the challenged practice is necessary to achieve one or more [of its] substantial, legitimate, nondiscriminatory interests." *Id.* If the defendant or respondent meets its burden, the plaintiff or charging party "may still prevail upon proving that the substantial, legitimate, nondiscriminatory interests supporting the challenged practice could be served by another practice that has a less discriminatory effect." *Id.*

63. HUD rejected a "significance requirement" for disparate-impact liability. *Id.* at 11,468. HUD also declined to require that an alternative "practice that has a less discriminatory effect" be "equally effective" at serving the defendant's substantial, legitimate, nondiscriminatory interest. *Id.* at 11,473. Accordingly, disparate-impact defendants may be liable under the HUD Rule for failing to adopt an alternative practice even when that practice is not as effective at serving their substantial, legitimate, nondiscriminatory interests.

64. Nor did HUD offer any meaningful response to comments noting that the proposed burden-shifting rules are at odds with settled law. Most notably, HUD never explained how the burden-shifting standards set for the Disparate Impact Rule can be reconciled with the Supreme Court's decision in *Wards Cove Packaging Co. v. Antonio*, 490 U.S. 642 (1989), or can sensibly be applied to the business of insurance. HUD's failure to apply settled law on the burden of proof and the process for adjudicating a disparate impact claim deprives insurers of a viable opportunity to demonstrate even on case-by-case basis that risk-based underwriting and pricing is justified by legitimate, non-discriminatory business purposes.

VI. PCI'S CHALLENGE TO APPLICATION OF THE DISPARATE IMPACT RULE TO THE PRICING OF HOMEOWNERS INSURANCE

65. On November 27, 2013, PCI filed its original complaint, challenging the application of HUD's Disparate Impact Rule to the pricing of homeowners insurance as arbitrary and capricious and otherwise contrary to law. The parties cross-moved for summary judgment, and HUD also moved to dismiss for lack of jurisdiction, arguing that PCI lacked standing and that its claims were unripe.

66. In its September 3, 2014 decision, the Court granted summary judgment for PCI on its claims that HUD failed to adequately address several of the insurance industry's comments submitted during rulemaking. *See Donovan*, 66 F. Supp. 3d at 1048-51. The Court reasoned that HUD's one-paragraph response to the insurance industry's detailed comments failed to provide a reasoned explanation for preferring case-by-case adjudication of McCarran-Ferguson preclusion claims over rulemaking. *Id.* at 1048. The Court criticized HUD for making "no attempt" to determine how often McCarran-Ferguson preclusion would apply and whether entire categories of disparate-impact claims against insurers would be barred. *Id.* The Court reached the same conclusion with respect to HUD's response to comments regarding the operation of the filed-rate doctrine. The Court explained that HUD must, on remand, provide a reasoned explanation for preferring case-by-case adjudication over rule-making, which would involve determining whether the benefits of proceeding through case-by-case adjudications outweighed the benefits of including an exemption or safe harbors for insurers. *Id.* at 1048-49. The Court found arbitrary and capricious HUD's suggestion that insurers might defend their policies on a case-by-case basis as part of the burden-shifting framework of the Rule. *Id.* at 1051.

67. The court also concluded that HUD had acted in an arbitrary and capricious manner by failing to address the substance of the homeowners insurance industry's arguments

that the Rule would prevent the use of actuarially sound underwriting and risk assessment factors and thereby undermine the fundamental nature of the insurance business itself. The Court explained that "HUD's response to the insurance industry's concerns that exposing them to disparate impact liability would undermine the fundamental nature of insurance was arbitrary and capricious. HUD made no effort to evaluate the substance of the insurance industry's concerns, disregarding them merely because insurers would have an opportunity to raise their arguments as part of the burden-shifting framework. The ability of insurers to raise their arguments on a case-by-case basis in subsequent proceedings, however, does not alleviate HUD of its obligation to consider the substance of the insurance industry's concerns raised during the notice-and-comment period." *Id.*

68. The Court dismissed without prejudice as unripe PCI's claim that the Rule violates the McCarran-Ferguson Act. *Id.* at 1040-42. The Court granted summary judgment in HUD's favor on PCI's claim that the Rule violates the requirements for disparate-impact liability established in *Wards Cove Packaging Co. v. Atonio*, 490 U.S. 642 (1989). The Court held that the burden-shifting framework HUD adopted embodied a reasonable interpretation of the FHA, warranting deference under *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842 (1984). *See Donovan*, 66 F. Supp. 3d at 1052-53.

69. The Court remanded the case to HUD for further proceedings.

VII. POST-REMAND PROCEEDINGS

A. PCI's Submission of Supplemental Comments

70. Shortly after remand, PCI requested that HUD reopen the comment period. *See* PCI Letter to HUD (Sept. 25, 2014) (attached as Exhibit 3).

71. PCI next submitted to HUD a comment addressing the issues identified in the Court's order. *See* PCI Letter to HUD (Jan. 26, 2015) (attached as Exhibit 4). The comment

repeated PCI's request for an exemption for homeowners insurers because the Rule's application "would impair state regulation of insurance in violation of the McCarran-Ferguson Act, would fundamentally interfere with the provision of homeowners insurance, and would impose needless costs on providers of homeowners insurance and their customers." *Id.* at 1.

72. PCI particularly emphasized that calculating the risk of loss is fundamental to the business of insurance, *id.* at 2, 16–17, and that because the "vast majority of states" require insurers to set rates based on "neutral actuarial factors," the Disparate Impact Rule would violate the McCarran-Ferguson Act and "interfere with insurers' compliance with state law," *id.* at 8–9; *see also id.* at Table 1 (showing statutes requiring risk-based pricing, organized by state).

73. Likewise, forty-seven states have expressly permitted insurers to group insureds based on risk, and the Disparate Impact Rule interferes with that express permission. *Id*. at 9–10; *see also id.* at Table 1.

74. PCI also pointed out the flaws in HUD's assertion that state fair housing laws permit disparate-impact claims against insurers: namely, unless such state fair housing laws specifically displace insurance laws that require or expressly permit risk-based pricing and underwriting practices, the insurance laws remain valid and are shielded by the McCarran-Ferguson Act. *Id.* at 10–11.

75. The comment noted that forty-seven states and the District of Columbia "require insurers to file their rates with state insurance commissioners for review and approval." *Id.* at 12; *see also id.* at Table 1. The Disparate Impact Rule would therefore violate the McCarran-Ferguson Act by "substituting the judgment of a federal court for that of state regulators." *Id.* at 12–13. Similarly, the comment added that the Disparate Impact Rule would violate the filed-rate doctrine because it would allow "private lawsuits and government enforcement actions that

question the permissibility of a filed rate." *Id.* at 13.

76. Finally, PCI explained that to the extent HUD intends to apply the Disparate Impact Rule beyond the "provision and pricing of homeowners insurance" identified in the plain text of the Rule, this would also be prohibited by the McCarran Ferguson Act. *Id.* at 15–16. Homeowners insurance practices other than the provision and pricing of homeowners insurance "do not have a substantial enough effect on homeownership" to constitute discriminatory practices under the Fair Housing Act. *Id.* at 15 (citing 42 U.S.C. § 3604; *NAACP v. Am. Family Mut. Ins. Co.*, 978 F.2d 287, 301 (7th Cir. 1992) (Easterbrook, J.)). And because states regulate such practices, subjecting the practices to the Disparate Impact Rule would violate the McCarran-Ferguson Act. *Id.* at 16.

B. The Supreme Court's Decision in *Inclusive Communities*

77. While this matter was before HUD on remand, the Supreme Court affirmed the validity of disparate-impact liability under the FHA, but significantly narrowed its scope. *Tex. Dep't of Housing and Cmty. Affairs v. The Inclusive Communities Project, Inc.*, 135 S. Ct. 2507 (2015).

78. The Supreme Court observed that at the "heartland of disparate-impact liability" lie suits against practices "that function unfairly to exclude minorities from certain neighborhoods without sufficient justification." *Id.* at 2521–22. As such, it cautioned that the "FHA is not an instrument to force housing authorities to reorder their priorities." *Id.* at 2522. The Court explained that "[d]isparate-impact liability mandates the removal of artificial, arbitrary, and unnecessary barriers, not the displacement of valid governmental policies." *Id.* (internal quotation marks omitted). The Court noted that the "specter of disparate-impact litigation" could discourage businesses from undertaking the very activities that ensure a well-functioning housing market, which would undermine its very purpose as well as the free-market.

Id. at 2524. To that end, the Court emphasized the importance of limiting the scope of possible disparate-impact liability "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." *Id.* at 2518. The Court identified several other key limitations:

79. First, the Court concluded that the disparate-impact doctrine has been, and should continue to be, limited to avoid the serious constitutional questions that might arise under the FHA if "liability were imposed based solely on a showing of statistical disparity." *Id.* at 2522. Rather, plaintiffs must satisfy a "robust causality requirement" that "ensures that '[r]acial imbalance . . . does not , without more establish a prima facie case of disparate impact' and thus protects defendants from being held liable for racial disparities they did not create." *Id*. at 2523 (quoting *Wards Cove Packing Co. v. Antonio*, 490 U.S. 642, 653 (1989)). Plaintiffs must "point to a defendant's policy or policies causing th[e] disparity" so that defendants are not "held liable for racial disparities they did not create." *Id.*. Thus, showing "racial imbalance . . . without more" does not support a disparate-impact claim. *Id.*

80. Second, the Court emphasized that only policies that are "artificial, arbitrary, and unnecessary" should give rise to disparate-impact liability. *Id.* at 2524. The Court encouraged giving defendants "leeway to state and explain the valid interest served by their policies" and entrepreneurs the "latitude to consider market factors." *Id.* at 2252–53. This would avoid putting defendants "in a double bind of liability, subject to suit whether they choose to rejuvenate a city core or to promote new low-income housing in suburban communities." *Id.* at 2253. The Court instructed that plaintiffs should not be allowed to "second-guess which of two reasonable approaches" a defendant should follow. *Id.* at 2522.

81. Finally, in cabining FHA disparate-impact claims, the Court stressed the

importance of encouraging administrative efficiency while discouraging the consideration of race. The Court held that "adequate safeguards at the prima facie stage" are critical to avoid the use of race "in a pervasive way," such as the use of numerical quotas, which would raise serious constitutional questions. *Id.* at 2523; *see also id.* at 2524 (warning against interpreting disparate-impact liability to be "so expansive as to inject racial considerations into every housing decision," which would perversely tend to "perpetuate race-based considerations rather than move beyond them"). The Court also noted that "prompt resolution" of disparate-impact cases is important, *id.* at 2523, as is avoiding "onerous costs on actors who make housing available." *Id.* (internal quotation marks omitted).

C. PCI's Post-*Inclusive Communities* Submission of Supplemental Comments

82. In the wake of the Supreme Court's *Inclusive Communities* decision, PCI submitted an additional supplemental comment to HUD, requesting an exemption to the Disparate Impact Rule for homeowners insurers in accordance with *Inclusive Communities*. *See* PCI Letter to HUD (July 29, 2015) (attached as Exhibit 5).

83. PCI advised HUD that the Supreme Court's requirement of a "robust causality requirement" to state a disparate-impact claim precluded suits against homeowners insurers. *See id.* at 2. Because homeowners insurers are regulated by a "panoply" of state laws, their discretion is "substantially limit[ed]" and thus does not cause any disparate impacts. *Id.* PCI also noted that homeowners insurers exemplify the potential defendants that the Court had in mind when it required defendants to have "leeway to state and explain the valid interest served by their policy" and "latitude to consider market forces." *Id.* PCI explained that homeowners insurance markets, "with their dependence on actuarially sound, risk-based pricing, form a perfect example of the market forces the Court indicated must be respected in determining the scope of disparate-impact liability." *Id.*

84. PCI also reiterated its prior comments explaining that application of the Rule would disrupt the homeowners insurance industry and interfere with the provision of such insurance. To avoid liability for disparate impacts, insurers would have to avoid the use of actuarial risk factors in the underwriting and pricing process. This would cause adverse selection, "motivating lower risk customers to forego insurance altogether threatening insurers' viability, thus decreasing competition and the availability of insurance coverage." *Id.* at 4.

85. Finally, PCI noted that application of the Rule would impose needless costs on homeowners insurers. *Id.*

D. HUD's Supplemental Explanation

86. On October 5, 2016—nearly two years after the Court's remand order and more than a year after the Supreme Court's decision in *Inclusive Communities*—HUD published the Supplemental Explanation, titled, "Application of the Fair Housing Act's Discriminatory Effects Standard to Insurance." 81 Fed. Reg. 69,012 (Oct. 5, 2016). HUD styled this document as an attempt "to supplement its responses to certain insurance industry comments to HUD's proposed rule." *Id.* at 69,012.

87. Despite conceding that "risk-based decision making is an important aspect of sound insurance practice," *id.* at 69,015, HUD refused to amend the Rule, concluding there should be no "categorical exemptions or safe harbors for insurance practices" and that "concerns regarding application of the discriminatory effects standard to insurance practices can and should be addressed on a case-by-case basis," *id.* at 60,912.

88. Like HUD's responses to comments from the insurance industry during the initial rulemaking, the Supplemental Explanation does not meaningfully address comments regarding the application of the disparate-impact standard to the risk-based pricing of homeowners insurance. The Explanation is arbitrary and capricious in numerous respects:

89. First, HUD fails entirely to examine the impact of the Supreme Court's decision in *Inclusive Communities* on the continuing validity of the application of the Disparate Impact Rule to the risk-based pricing of homeowners insurance. The Supplemental Explanation makes no mention of the broad limitations on FHA disparate-impact liability recognized by the Supreme Court. Indeed, it only cites *Inclusive Communities* in a few footnotes.

90. Second, nowhere in the Supplemental Explanation does HUD respond to this Court's observation that HUD had previously "made no attempt to evaluate how often McCarran-Ferguson preclusion would apply and whether it would bar entire categories of disparate impact claims against insurers." *Donovan*, 66 F. Supp. 3d at 1048. Rather, HUD claims that it was "impossible . . . to define the scope of insurance practices covered by an exemption or safe harbor with enough precision to avoid case-by-case disputes over its application." 81 Fed. Reg. at 69,014. Thus, HUD ignores the Court's instructions on remand to determine whether there are any business practices for which disparate-impact challenges are wholly barred by McCarran-Ferguson preclusion, acknowledging instead that "[s]ome discriminatory effects claims against insurers will survive a McCarran-Ferguson defense depending on a host of case-specific variables." *Id.* at 69,015.

91. Moreover, HUD speculates that creating exemptions or safe harbors would "be at odds with the purpose of [the] McCarran-Ferguson [Act]." 81 Fed. Reg. 69,016. HUD reasons that such exemptions would "deprive all states of federal support in addressing discriminatory insurance practices—even those states that welcome or depend on such support." *Id.* HUD, however, cites no authority to show that a purpose of the McCarran-Ferguson Act is to provide states with federal support for their various anti-discrimination laws that might affect insurers. In fact, the Disparate Impact Rule could easily conflict with state insurance laws that prohibit

discrimination in the provision or pricing of insurance or that require insurers to rely on neutral, actuarial factors.

92. Third, HUD provides an inadequate response to industry comments about how the filed-rate doctrine is inconsistent with disparate-impact challenges to state insurance laws. HUD claims that "applying the filed rate doctrine to prioritize *state* ratemaking over a federal statute would seem to stand the Supremacy Clause on its head." *Id.* at 69,018 (internal quotation marks omitted). In support, HUD cites *Saunders v. Farmers Ins. Exch. (Saunders I)*, 440 F.3d 940 (8th Cir. 2006). HUD fails to acknowledge, however, that in subsequent proceedings, the *Saunders* court in fact found that Missouri's filed-rate doctrine barred a disparate-impact claim under the FHA. And HUD overlooks a number of decisions that have found no Supremacy Clause problems in holding that the filed-rate doctrine bars federal challenges to state rate statutes. *See, e.g., Taffet v. S. Co.*, 967 F.2d 1483, 1494 (11th Cir. 1992); *H.J. Inc. v. Nw. Bell Tel. Co.*, 954 F.2d 485, 495 (8th Cir. 1992); *Lifschultz Fast Freight, Inc. v. Consol. Freightways Corp. of Del.*, 805 F. Supp. 1277, 1296 (D.S.C. 1992); *see also Wegoland Ltd. v. NYNEX Corp.*, 27 F.3d 17 (2d Cir. 1994).

93. Fourth, much of the Supplemental Explanation only addresses insurance practices in general, rather than explaining why HUD could not create an exemption for the risk-based pricing of homeowners insurance. For example, HUD declines to issue "a broad exemption for all insurance practices or all underwriting decisions . . . because doing so would immunize a host of potentially discriminatory insurance practices that *do not* involve actuarial or risk-based calculations." 81 Fed. Reg. at 69,017 (emphasis added). Even if true, this statement does not explain why HUD declined to exempt pricing practices that are demonstrably actuarial or risk-based. The Rule's burden-shifting framework not only targets non-actuarial factors, but also

allows plaintiffs to force homeowners insurers to replace purely risk-based practices—which HUD concedes are legitimate—with "alternatives" that may not be as economically effective.

94. Fifth, when HUD does attempt to narrow its analysis to risk-based homeowners insurance practices, its responses are internally inconsistent and fail to address the commenters' precise concerns. HUD insists, for example, that "nothing in the Rule prohibits insurers from making decisions that are in fact risk-based." *Id.* at 69,015. But in the very next sentence, HUD states that "practices that an insurer can prove are risk-based, *and for which no less discriminatory alternative exists*, will not give rise to discriminatory effects liability." *Id.* (emphasis added). This reaffirms that the Rule *will* prohibit homeowners insurers from making risk-based decisions whenever a plaintiff can force them to adopt an alternative practice. HUD fails to acknowledge that its burden-shifting approach would undermine the very risk-based pricing practices it agrees are legitimate.

95. Similarly, the Supplemental Explanation ignores comments explaining that insurers would have to curtail or even abandon risk-based pricing in order to prevent statistical disparities in homeowners insurance rates across protected groups. *See* NAMIC Comments at 6 ("To achieve a condition in which no statistical disparities exist in the average rate paid by different demographic groups, many if not most risk-based variables would have to be eliminated from the underwriting process. *In other words, to avoid creating a disparate impact, an insurer would have to charge everyone the same rate, regardless of risk.* This calls into question conclusions drawn simply from statistical samplings and underscores why the business of risk classification defies a disparate impact analysis." (emphasis added)).

96. Finally, the Supplemental Explanation inadequately addresses the ample comments concerning the burdens homeowners insurers would face if forced into case-by-case

adjudication for every risk-based pricing practice allegedly linked to a disparate impact. Commenters contended that such adjudication would be costly, particularly given the burdens associated with collecting racial data. HUD's only response is that "the arguments and evidence that would be necessary to establish whether a practice qualifies for the requested exemption would effectively be the same as the arguments and evidence necessary for establishing a legally sufficient justification." 81 Fed. Reg. at 69,017. This ignores the fact that the Rule's burden-shifting framework would require homeowners insurers not only to defend the legitimacy of their practices, but also to demonstrate that no less discriminatory alternative for those practices exists.

97. HUD did not consider that case-by-case adjudication could proceed in multiple forums and that collecting the necessary data would expose insurers to liability under state antidiscrimination statutes. Although HUD recognizes the "variation in state insurance laws" across jurisdictions and time, it merely used this fact as a justification for not granting an exemption for specific insurance practices. 81 Fed. Reg. at 69,016.

98. Rather, HUD defends its decision not to create an exception for homeowners insurance by concluding that "discriminatory effects liability has proven workable in other contexts involving risk-based decisions . . . without the need for exemptions or safe harbors." *Id.* But HUD identifies no support for the one example it cites: that of disparate-impact claims against mortgage lenders. *See id.* HUD relies on a 1994 "Policy Statement on Discrimination in Lending," which merely announced HUD's decision to apply disparate-impact liability to risk-based lending practices. *See* 59 Fed. Reg. 18,266 (Apr. 15, 1994). It said nothing of the decision's ultimate effect on homeowners or the mortgage lending industry. Next, HUD points to a document providing standard procedures for financial regulatory agencies to follow when

reviewing whether lenders engage in discriminatory practices. *See* OFFICE OF THE COMPTROLLER OF THE CURRENCY ET AL., INTERAGENCY FAIR LENDING EXAMINATION PROCEDURES (2009). This guide presents no information about the "workability" of disparate-impact liability in the mortgage lending context. Finally, the Explanation quotes a HUD official's assertion that in order to investigate discrimination in insurance practices, the agency will use the same techniques that it has used in other contexts. *See Homeowners' Insurance Discrimination: Hearings Before the S. Comm. on Banking, Housing & Urban Affairs*, 103d Cong. (1994), at 20. Like the other sources HUD cites, this document does not support the assertion that applying disparate-impact liability to risk-based pricing has proven "workable" for consumers, industries, or regulators.

VIII. THE DISPARATE IMPACT RULE IS INCONSISTENT WITH THE LIMITATIONS ON DISPARATE-IMPACT LIABILITY UNDER THE FAIR HOUSING ACT RECOGNIZED IN *INCLUSIVE COMMUNITIES*

99. The Rule is inconsistent with the limitations on disparate-impact liability recognized in *Inclusive Communities*.

100. First, the reasoning in HUD's Supplemental Explanation confirms that the Rule will be applied to a variety of risk-based practices, which will discourage businesses from undertaking the very activities that ensure a well-functioning housing market.

101. Second, the Supplemental Explanation confirms that in order to comply with the Rule and avoid costly case-by-case adjudication, homeowners insurers must collect racial data, often in violation of state law, to defend against disparate-impact claims.

102. This ignores the limitation on disparate-impact liability to avoid the "serious constitutional questions" that will arise when race is "used and considered in a pervasive way and . . . inexorably lead governmental or private entities to use numerical quotas." *Inclusive Communities.*, 135 S. Ct. at 2523 (internal quotation marks omitted). Nor is it consistent with

the Court's determination that disparate-impact liability should not be "so expansive as to inject racial considerations into every housing decision," which would perversely tend to "perpetuate race-based considerations rather than move beyond them." *Id.* at 2524. Moreover, this burdensome requirement conflicts with the Supreme Court's admonition against "impos[ing] onerous costs" on providers of housing and for "prompt resolution" of disparate-impact cases. *Id.* 2523.

103. Third, under the burden-shifting test, a plaintiff may state a prima facie claim of disparate impact by identifying a statistical disparity or by challenging a homeowners insurer's entire decision-making process as creating a disparate impact. Indeed, the Rule provides that a plaintiff need only show that the challenged practice "caused or predictably will cause" a disparate impact.

104. This runs afoul of the Supreme Court's construction of disparate-impact liability under the Fair Housing Act in *Inclusive Communities*. The Court emphasized that disparate-impact claims may not be premised on the simple existence of a racial disparity and must be subject to "a robust causality requirement." *Id.* at 2522–23. Plaintiffs must point to a defendant's specific policy or policies causing a disparity to state a prima facie claim. Thus, HUD's rule permitting plaintiffs to bring claims based on the mere existence of a statistical disparity or a lax causal connection between a defendant's actions and a disparity is contrary to law.

105. Fourth, the Rule indicates that a defendant cannot defeat a disparate-impact challenge by pointing to a bona fide business justification for an insurance pricing practice. Once a prima facie case is established, the Rule requires the defendant to show that "the challenged practice is necessary to achieve one or more substantial, legitimate,

nondiscriminatory interests." Accordingly, the defendant's policy might give way to another, less discriminatory alternative.

106. This exceeds the limitations that the Supreme Court placed on disparate-impact claims in *Inclusive Communities*. The Court limited liability to policies that were "artificial, arbitrary, and unnecessary." *Id.* at 2524. The Court also instructed that housing authorities and private developers should have "leeway to state and explain the valid interest served by their policies" and entrepreneurs the "latitude to consider market factors." *Id.* at 2252–53. As the Rule invalidates policies that are not merely "artificial, arbitrary, and unnecessary" and does not give defendants latitude to explain why they support a valid interest, it is contrary to law.

107. Similarly, under the Administrative Procedure Act, "[e]xcept as otherwise provided by statute, the proponent of a rule or order has the burden of proof." 5 U.S.C. § 556(d); *see also Steadman v. SEC*, 450 U.S. 91 (1981). Because a charge brought by HUD under the FHA may be heard in either an administrative or judicial proceeding, the burden-shifting standards established in the Disparate Impact Rule must satisfy the Administrative Procedure Act requirement that the proponent of a proposed "order"—here, a proposed finding of a violation of the FHA—bear the burden of proof.

IX. PCI AND ITS MEMBERS CONTINUE TO BE INJURED BY THE DISPARATE IMPACT RULE

108. As the Court previously determined, "PCI's members have suffered an 'injury in fact' because the Disparate Impact Rule increases their exposure to disparate impact liability under the FHA." *Donovan*, 66 F. Supp. 3d at 1043. Indeed, the Court recognized that the "compliance costs reported by PCI's members alone are sufficient to satisfy the 'injury in fact' requirement of Article III standing." *Id.* at 1044.

109. The Rule, as supplemented, continues directly to regulate PCI's member

companies and to rewrite the rules of risk-based pricing and underwriting without any exemptions or safe harbors. The Rule thus continues to generate substantial uncertainty in the industry and requires PCI's member companies to expend substantial resources assessing how the Rule could possibly apply to the business of insurance. Moreover, to even attempt to comply with the Rule, PCI member companies must still spend enormous amounts of money and time (and possibly subject themselves to liability) (a) retrospectively and prospectively collecting data that they do not currently obtain about whether their customers fall within a protected class, (b) analyzing their pricing and underwriting criteria in light of the newly collected data to try to identify factors that could have a disparate impact, and (c) adopting entirely new underwriting and pricing practices. If PCI members are forced to disregard actuarial risk data in favor of protected class data, they will be unable to price insurance as accurately and competitively as they currently do, resulting in lost business, decreased availability of insurance, and potential insolvency.

110. Application of the Rule to risk-based pricing and underwriting by PCI members continues to place those members in an impossible position of either complying with state law regarding the pricing and underwriting of insurance or complying with the Rule. It is not possible, for example, to comply with state laws that require that insurers take into consideration past loss and other actuarially relevant factors in developing insurance rates while simultaneously disregarding any risk factor that happens to correlate with any of the classifications covered by the Rule. This compliance exposure would injure PCI members.

111. In addition, since the final Disparate Impact Rule was promulgated and supplemented, PCI has been required to devote a significant amount of time and resources—separate from time spent relating to this lawsuit—responding to the Rule for the benefit of its

members and educating members about possible impacts of the Rule.

COUNT I

(Application of The Disparate Impact Rule To Homeowners Insurance Is Arbitrary, Capricious, Or An Abuse of Discretion Because Defendants Did Not Adequately Address The Supreme Court's Decision in *Texas Department of Housing and Community Affairs v. The Inclusive Communities Project, Inc.*)

112. Plaintiff incorporates the preceding paragraphs as if fully set forth herein.

113. The Disparate Impact Rule and HUD's Supplemental Explanation constitute final agency action.

114. In responding to comments from representatives of the insurance industry, the Supplemental Explanation does not adequately consider the impact of the Supreme Court's decision in *Texas Department of Housing and Community Affairs v. The Inclusive Communities Project, Inc.*, 135 S. Ct. 2507 (2015), on the applicability of disparate-impact liability to risk-based pricing practices in the homeowners insurance context.

115. HUD's failure to address the impact of this intervening, controlling precedent in the Supplemental Explanation was arbitrary, capricious, and an abuse of discretion, in violation of 5 U.S.C. § 706(2)(A).

COUNT II

(Application Of The Disparate Impact Rule To Homeowners Insurance Is Arbitrary, Capricious, Or An Abuse of Discretion Because Defendants Did Not Adequately Address The Conflict Between The Rule And The McCarran-Ferguson Act)

116. Plaintiff incorporates the preceding paragraphs as if fully set forth herein.

117. The Disparate Impact Rule and HUD's Supplemental Explanation constitute final agency action.

118. Comments submitted to HUD explained that extension of disparate-impact liability to insurance practices would interfere with state regulation of insurance in violation of

the McCarran-Ferguson Act.

119. HUD failed to address this issue in the Disparate Impact Rule. It did not consider whether its Rule would invalidate, impair, or supersede state laws regulating the business of insurance. HUD instead asserted that the McCarran-Ferguson Act applies only to courts, not federal agencies. 78 Fed. Reg. at 11,475. There is no support for this assertion, and HUD cited none.

120. The Court criticized HUD for not evaluating "how often McCarran-Ferguson preclusion would apply and whether it would bar entire categories of disparate impact claims against insurers." *Donovan*, 66 F. Supp. 3d at 1048. Yet HUD does not address this concern in its Supplemental Explanation, claiming that it is "impossible . . . to define the scope of insurance practices covered by an exemption or safe harbor with enough precision to avoid case-by-case disputes over its application." 81 Fed. Reg. at 69,014. Instead, the Supplemental Explanation asserts, without citing any support, that creating exemptions or safe harbors for entire categories of claims would "be at odds with the purpose of [the] McCarran-Ferguson [Act]." *Id.* at 69,016.

121. HUD was bound to comply with the McCarran-Ferguson Act and was required to consider statutory limits on its authority when issuing the Disparate Impact Rule.

122. HUD's failure to adequately address whether the Disparate Impact Rule violates the McCarran-Ferguson Act was arbitrary, capricious, and an abuse of discretion, in violation of 5 U.S.C. § 706(2)(A).

COUNT III

(Application Of The Disparate Impact Rule To Homeowners Insurance Is Arbitrary, Capricious, Or An Abuse of Discretion Because Defendants Failed To Address The "Filed Rate" Doctrine)

123. Plaintiff incorporates the preceding paragraphs as if fully set forth herein.

124. The Disparate Impact Rule and HUD's Supplemental Explanation constitute final

agency action.

125. Comments submitted to HUD explained that application of the Disparate Impact Rule to homeowners insurance would violate the "filed rate" doctrine.

126. HUD acknowledged these comments but failed to address whether application of the rule would violate the "filed rate" doctrine.

127. The Court instructed HUD to "explain its decision regarding the filed-rate doctrine or institute a new rule." *Donovan*, 66 F. Supp. 3d at 1050.

128. But HUD's Supplemental Explanation inadequately analyzes how the filed-rate doctrine affects disparate-impact challenges under the FHA to state insurance laws. The Explanation argues that barring federal challenges to state insurance laws under the filed-rate doctrine would "seem to stand the Supremacy Clause on its head." 81 Fed. Reg. at 69,018. However, the Supplemental Explanation fails to address a number of cases that have found that the Supremacy Clause poses no bar to finding that the filed-rate doctrine prohibits federal challenges to state rate statutes.

129. HUD's failure to adequately address whether the filed rate doctrine might bar federal challenges to state insurance laws was arbitrary, capricious, and an abuse of discretion, in violation of 5 U.S.C. § 706(2)(A).

COUNT IV

(Application Of The Disparate Impact Rule To Homeowners Insurance Is Arbitrary, Capricious, Or An Abuse Of Discretion Because Defendants Did Not Adequately Consider The Rule's Impact On Insurers And The Business of Insurance)

130. Plaintiff incorporates the preceding paragraphs as if fully set forth herein.

131. The Disparate Impact Rule and HUD's Supplemental Explanation constitute final agency action.

132. Comments submitted to HUD explained that the use of actuarial risk factors is

critical to pricing and underwriting of homeowners insurance. Comments further explained that applying disparate-impact liability to the pricing and underwriting of homeowners insurance would limit insurers' ability to engage in risk-based pricing and underwriting.

133. HUD failed to adequately address these concerns in the Disparate Impact Rule. HUD did not dispute that risk-based pricing and underwriting is of critical importance or that imposition of disparate-impact liability would prevent use of risk-based pricing and underwriting absent further justification. It stated only that insurers could attempt in case-by-case litigation to show that they have a legitimate business justification for their practices.

134. The Court found arbitrary and capricious HUD's response to the insurance industry's concerns that exposing them to disparate-impact liability would undermine the fundamental nature of insurance. It criticized HUD for disregarding the arguments merely because insurers could reraise arguments on a case-by-case basis in subsequent proceedings. *Donovan*, 66 F. Supp. 3d 1051.

135. The Supplemental Explanation does not respond to these concerns. It primarily addresses the Rule's broad effects on the insurance industry, rather than tailoring its analysis to risk-based pricing practices in the homeowners insurance context.

136. To the extent that the Supplemental Explanation does respond to commenters' concerns about the applicability of the Rule to risk-based pricing practices in the homeowners insurance context, its reasoning is internally inconsistent and does not address the commenters' precise arguments that avoiding statistical disparities would require homeowners insurers to depart from risk-based pricing.

137. The Supplemental Explanation does not adequately consider commenters' concerns about how applying disparate-impact liability to the risk-based pricing of homeowners

insurance would affect the homeowners insurance business, which depends on effective risk segmentation. It thus does not consider the related impacts on homeowners insurers, consumers, and the free market.

138. Nor does the Supplemental Explanation explain why the cost, time, and inconvenience of individualized litigation—including the expense of collecting racial data—outweighs crafting an exception for risk-based pricing of homeowners insurance. Rather, the Explanation repeats without support that "an exemption for all provably risk-based factors would offer little added value for insurers." 81 Fed. Reg. at 69,017.

139. None of the sources HUD cites in its Supplemental Explanation shows that applying disparate-impact liability to risk-based pricing has proven "workable" in other contexts.

140. HUD's continued failure to adequately address commenters' concerns about the impact of the Disparate Impact Rule on the business of insurance was arbitrary, capricious, and an abuse of discretion, in violation of 5 U.S.C. § 706(2)(A).

PRAYER FOR RELIEF

WHEREFORE, Plaintiff prays that this Court:

141. Declare invalid the application of the Disparate Impact Rule to the pricing and provision of homeowners insurance..

142. Enjoin HUD and its officers from applying the Disparate Impact Rule to pricing and underwriting of homeowners insurance.

143. Award Plaintiff its costs and reasonable attorneys' fees as appropriate; and Grant any such other relief that this Court deems just and appropriate.

Dated: June 27, 2017 Respectfully submitted,

PROPERTY CASUALTY INSURERS
ASSOCIATION OF AMERICA

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA,	)	
Plaintiff,	)	
v.	)	No. 13 C 8564
SHAUN DONOVAN, in his official capacity as Secretary of Housing and Urban Development, and UNITED STATES DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT,	)	
Defendants.	)	

MEMORANDUM OPINION AND ORDER

AMY J. ST. EVE, District Court Judge:

In 2013, the United States Department of Housing and Urban Development ("HUD") issued a final rule formalizing its recognition that liability under the Fair Housing Act ("FHA") may arise from a facially neutral practice that has discriminatory effects on certain groups of people, regardless of whether discriminatory intent exists (the "Disparate Impact Rule"). *See* Implementation of the Fair Housing Act's Discriminatory Effects Standard, 78 Fed. Reg. 11460 (Feb. 15, 2013) (to be codified at 24 C.F.R. pt. 100). In addition to recognizing the availability of discriminatory effects (*i.e.*, "disparate impact") liability under the FHA, the Disparate Impact Rule also establishes a three-step burden-shifting approach to deciding disparate impact claims. Plaintiff Property Casualty Insurers Association of America ("PCI") argues that HUD's refusal to build exclusions or safe harbors for homeowners insurance into the Disparate Impact Rule violates the McCarran-Ferguson Act and is arbitrary and capricious. PCI asks the Court to

invalidate the Rule as it relates to homeowners insurance under the Administrative Procedure Act and to enjoin HUD from applying the Rule to the homeowners insurance industry.

Before the Court are PCI's motion for summary judgment (R. 20) and Defendants' motion to dismiss or for summary judgment (R. 30). For the following reasons, the Court grants in part and denies in part PCI's motion, and grants in part and denies in part Defendants' motion.

BACKGROUND

This Administrative Procedure Act case involves the intersection between two important federal policies, the policy of ensuring that regulation of the insurance industry rests primarily with the states and the policy of providing for fair housing throughout the United States, which are reflected in the McCarran-Ferguson Act, 59 Stat. 33 (1945) (codified as amended at 15 U.S.C. §§ 1011, *et seq.*), and the Fair Housing Act ("FHA"), Pub. L. No. 90-284, 82 Stat. 81 (1968) (codified as amended at 42 U.S.C. §§ 3601-19), respectively. The Court, therefore, provides a brief overview of these two federal statutes before turning to HUD's Disparate Impact Rule.

I. The McCarran-Ferguson Act

Congress enacted the McCarran-Ferguson Act in response to the Supreme Court's decision in *United States v. South-Eastern Underwriters Ass'n,* 322 U.S. 533, 64 S. Ct. 1162, 88 L. Ed. 1440 (1944), in which the Court held that insurance transactions were subject to federal regulation under the Commerce Clause. *See United States Dep't of Treasury v. Fabe,* 508 U.S. 491, 499, 113 S. Ct. 2202, 124 L. Ed. 2d 449 (1993); *SEC v. Nat'l Secs. Inc.,* 393 U.S. 453, 458, 89 S. Ct. 564, 21 L. Ed. 2d 668 (1969). Prior to *South-Eastern Underwriters,* "it had been assumed . . . that [i]ssuing a policy of insurance is not a transaction of commerce" and, consequently, "the States enjoyed a virtually exclusive domain over the insurance industry."

Fabe, 508 U.S. at 499 (internal quotation marks and citations omitted). Congress reacted quickly to *South-Eastern Underwriters*, passing the McCarran-Ferguson Act within a year of the decision to allay fears that the decision threatened the states' power to tax and regulate the insurance industry. *See id.* at 499-500.

Congress expressed the purpose of the McCarran-Ferguson Act in Section 1 of the Act:

> Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

15 U.S.C. § 1101; *see also Autry v. Northwest Premium Servs., Inc.,* 144 F.3d 1037, 1040 (7th Cir. 1998). To accomplish this purpose, Congress "transformed the legal landscape by overturning the normal rules of pre-emption" and "creating a clear-statement rule . . . that state laws enacted 'for the purpose of regulating the business of insurance' do not yield to conflicting federal statutes unless a federal statute specifically requires otherwise. *Fabe,* 508 U.S. at 507. Specifically, the McCarran-Ferguson Act provides that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically related to the business of insurance[.]" 15 U.S.C. § 1012(b).

Over the years, courts have developed a three-part inquiry for determining whether the McCarran-Ferguson Act preempts application of a particular federal statute. First, courts inquire whether the federal statute at issue "specifically relate[s] to the business of insurance." *Autry,* 144 F.3d at 1040-41 (quoting *Fabe,* 508 U.S. at 501). Second, courts ask whether the state statute was enacted "for the purpose of regulating the business of insurance." *Id.* Finally, courts determine whether application of the federal statute will "invalidate, impair or supersede" the

state law. *Id.* If the court answers all three inquiries in the affirmative, the federal statute must give way to state law. *Id.*

In *Humana Inc. v. Forsyth,* 525 U.S. 299, 119 S. Ct. 710, 142 L. Ed. 2d 753 (1999), the Supreme Court rejected the view that the McCarran-Ferguson Act created "any sort of field preemption" as well as the "polar opposite view . . . that Congress intended a green light for federal regulation whenever the federal law does not collide head on with state regulation." *Id.* at 309. The Court, instead, construed the Act as adopting a middle-ground, holding that "[w]hen federal law does not directly conflict with state regulation, and when application of the federal law would not frustrate any declared state policy or interfere with a State's administrative regime, the McCarran-Ferguson Act does not preclude its application." *Id.* at 310. Accordingly, if a federal statute complements or duplicates a state's regulation of the insurance industry and does not interfere with a state's policies or administrative regime, McCarran-Ferguson preclusion does not apply. *See id.* at 313 (finding that the McCarran-Ferguson Act did not preclude the plaintiff's RICO claims because "RICO's private right of action and treble damages provision appears to complement Nevada's statutory and common-law claims for relief"); *NAACP v. American Family Mut. Ins. Co.,* 978 F.2d 287, 295 (7th Cir. 1992) ("Duplication is not conflict."); *Ojo v. Farmers Grp., Inc.,* 600 F.3d 1205, 1209-10 (9th Cir. 2010) (recognizing that the McCarran-Ferguson Act would not reverse-preempt the FHA where the FHA "complement[s]—rather than displace[s] and impair[s]" state law).

II. The Fair Housing Act

Congress enacted the FHA in 1968 "to provide, within constitutional limits, for fair housing throughout the United States." *See* 42 U.S.C. § 3601. The FHA makes it unlawful to, among other things, refuse to sell, rent, or "otherwise make unavailable or deny" housing to any

person "because of race, color, religion, sex, familial status, . . . national origin[,]" or handicap. 42 U.S.C. § 3604(a), (f)(1). The FHA also makes it unlawful "[t]o discriminate against any person in the terms, conditions, or privileges of sale or rental of a dwelling, or in the provision of services or facilities in connection therewith" because of the person's race, color, religion, sex, familial status, national origin, or handicap. *See id.* § 3604(b), (f)(2). The FHA empowers HUD to enforce the Act and to issue regulations implementing the Act. *See id.* §§ 2612, 3614a.

A. Disparate Impact Claims Under the FHA

HUD has long interpreted the FHA as prohibiting not only intentional discrimination on the basis of a person's protected characteristics, but also practices that have unwarranted discriminatory effects on minorities or other persons protected by the Act, regardless of whether there was an intent to discriminate. *See* 78 Fed. Reg. 11460-62 nn.12-27 (Feb. 15, 2013) (collecting examples). Put differently, HUD interprets the FHA as providing for both discriminatory intent and disparate impact liability. *See id.* All eleven circuit courts to have addressed this issue, including the Seventh Circuit, have agreed that the FHA provides for disparate impact liability at least in some cases. *See, e.g., Metropolitan Hous. Dev. Corp. v. Village of Arlington Heights*, 558 F.2d 1283, 1290 (7th Cir. 1977) ("We therefore hold that at least under some circumstances a violation of section 3604(a) can be established by showing a discriminatory effect without a showing of discriminatory intent.").[1] Neither the Supreme Court

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[1] *See also Langlois v. Abington Hous. Auth.*, 207 F.3d 43, 49 (1st Cir. 2000); *Huntington Branch, NAACP v. Town of Huntington*, 844 F.2d 926, 935-36 (2d Cir. 1988); *Resident Advisory Bd. v. Rizzo*, 564 F.2d 126, 146 (3d Cir. 1977); *Smith v. Town of Clarkton*, 682 F.2d 1055, 1065 (4th Cir. 1982); *Hanson v. Veterans Admin.*, 800 F.2d 1381, 1386 (5th Cir. 1986); *Arthur v. City of Toledo*, 782 F.2d 565, 574-75 (6th Cir. 1986); *United States v. City of Black Jack*, 508 F.2d 1179, 1184-85 (8th Cir. 1974); *Halet v. Wend Inv. Co.*, 672 F.2d 1305, 1311-12 (9th Cir. 1982); *Mountain Side Mobile Estates P'ship v. Secretary of Hous. & Urban Dev.*, 56 F.3d 1243, 1251 (10th Cir. 1995); *United States v. Marengo Cnty. Comm'n*, 731 F.2d 1546, 1559 n.20 (11th Cir. 1984).

nor the Circuit Court for the District of Columbia, however, has weighed in on whether the FHA allows for disparate impact liability.

B. Liability of Insurers Under the FHA

HUD also has long interpreted the FHA as prohibiting discrimination in the provision of homeowners insurance. In 1989, HUD issued a regulation expressly stating that prohibited acts under the FHA include "[r]efusing to provide . . . property or hazard insurance for dwellings or providing such services or insurance differently because of race, color, religion, sex, handicap, familial status, or national origin." *See Implementation of the Fair Housing Amendments Act of 1988,* 54 Fed. Reg. 3232, 3285 (codified at 24 C.F.R. § 100.70(d)(4)). Several circuit courts, deferring to HUD's interpretation, have similarly interpreted the FHA as prohibiting intentionally discriminatory practices related to the provision and pricing of homeowners insurance. *See, e.g., NAACP v. American Family Mut. Ins. Co.*, 978 F.2d 287, 301 (7th Cir. 1992), *cert. denied,* 508 U.S. 907 (1993) ("Section 3604 applies to discriminatory denials of insurance, and discriminatory pricing, that effectively preclude ownership of housing because of the race of the applicant."); *Ojo v. Farmers Grp. Inc.*, 600 F.3d 1205, 1208 (9th Cir. 2010) (*en banc*) (deferring to HUD's interpretation of the FHA as prohibiting discrimination in the provision of homeowner's insurance); *Nationwide Mut. Ins. Co. v. Cisneros,* 52 F.3d 1351, 1359-60 (6th Cir. 1995) (same). *But see Mackey v. Nationwide Ins. Cos.*, 724 F.2d 419, 423-25 (4th Cir. 1984), *cert. denied* 516 U.S. 1140 (1996) (concluding that claims against the hazard insurance industry do not fall within the scope of the FHA).

As the Seventh Circuit explained in *American* Family, discrimination against minorities or other protected groups in the provision of homeowners insurance can make housing unavailable to those groups. *American Family*, 978 F.2d at 300. Put succinctly, "[l]enders

require their borrowers to secure property insurance. No insurance, no loan; no loan, no house; lack of insurance thus makes housing unavailable." *See id.* at 297. Discrimination in the provision of homeowners insurance can also raise the cost of housing to minorities and other protected groups and frustrate their ability to live in integrated neighborhoods so that "[e]ven if they achieve their goal, they pay extra." *See id.* at 290. For these reasons, the Seventh Circuit recognized in *American Family* that the FHA allows for claims against homeowners insurers who intentionally discriminate against individuals based on protected characteristics.

C. Disparate Impact Liability of Insurers Under the FHA

Although almost all circuit courts have recognized that the FHA allows for disparate impact liability and several circuit courts have separately recognized that the FHA allows for claims against homeowners insurers, few courts have addressed whether the FHA allows for disparate impact claims—as opposed to disparate treatment claims—against homeowners insurers. In the same case in which the Seventh Circuit recognized that the FHA allows for claims against insurers who intentionally discriminate against individuals on the basis of a protected characteristic, the Seventh Circuit questioned whether the FHA would also allow for disparate impact liability against insurers. *See id.* The Seventh Circuit explained the issue as follows:

> Insurance works best when the risks in the pool have similar characteristics. For example, term life insurance costs substantially more per dollar of death benefit for someone 65 years old than for one 25 years old, although the expected return per dollar of premium is the same to both groups because the older person, who pays more, also has a higher probability of dying during the term. Auto insurance is more expensive in a city than in the countryside, because congestion in cities means more collisions. Putting young and old, or city and country, into the same pool would lead to adverse selection: people knowing that the risks they face are less than the average of the pool would drop out. A single price for term life insurance would dissuade younger persons from insuring, because the price would be too steep for the coverage offered; the remaining older persons would pay a price appropriate to their age, but younger persons would lose the benefits of

> insurance altogether. To curtail adverse selection, insurers seek to differentiate risk classes with many variables.
>
> Risk discrimination is not race discrimination. Yet efforts to differentiate more fully among risks may produce classifications that could be generated by discrimination. . . . No insurer openly uses race as a ground of ratemaking, but is a higher rate per $1,000 of coverage for fire insurance in an inner city neighborhood attributable to risks of arson or to racial animus?

Id. at 290-91. Because of the difficulties that imposing disparate impact liability on insurers may create, the Seventh Circuit made clear in *American Family* that its interpretation of the FHA as applying to insurers extended only to disparate treatment liability, and it made no comment on whether the FHA also allows for disparate impact liability against insurers. *See id.* at 291 ("All we decide is whether the complaint states claims on which the plaintiff may prevail if they establish that the insurer has drawn lines according to race rather than actuarial calculations.").

The Seventh Circuit's decision in *Doe v. Mutual of Omaha,* 179 F.3d 557 (7th Cir. 1999), also calls into question the viability of disparate impact claims against insurers, albeit in a different context and for different reasons than those at issue in *American Family.* In *Mutual of Omaha,* the Seventh Circuit considered whether an insurer violated the Americans with Disabilities Act by including lower lifetime benefits limits for AIDS and AIDS-related conditions than for other conditions. *See id.* at 558. The Seventh Circuit ultimately concluded that the insurer-defendant had not violated the Americans with Disabilities Act because the Act did not require the insurer to alter its policies to make them equally valuable to the disabled and nondisabled. *See id.* at 563. The court also held that even if its interpretation of the Americans with Disabilities Act was wrong, the plaintiff's claim against the insurer "must fail anyway, because it is barred by the McCarran-Ferguson Act." *Id.* According to the Seventh Circuit, interpreting the Americans with Disabilities Act as the plaintiff desired—*i.e.,* as regulating the

content of insurance policies—would "interfere with a State's administrative regime" regulating insurance and, therefore, violate the McCarran-Ferguson Act. *See id.* at 563.

As the Seventh Circuit explained, "[s]tate regulation of insurance is comprehensive and includes rate and conversion issues, . . . so if federal courts are now to determine whether caps on disabling conditions (by no means limited to AIDS) are actuarially sound and consistent with principles of state law they will be stepping on the toes of state insurance commissioners." *Id.* In finding that the McCarran-Ferguson Act barred the plaintiffs' claim, the Seventh Circuit drew a distinction between discriminatory intent claims and disparate impact claims against insurers:

> It is one thing to say that an insurance company may not refuse to deal with disabled persons; the prohibition of such refusals can probably be administered with relatively little interference with state insurance regulation . . . . It is another thing to require federal courts to determine whether limitations on coverage are actuarially sound and consistent with state law. Even if the formal criteria are the same under federal and state law, displacing their administration into federal court—requiring a *federal* court to decide whether an insurance policy is consistent with *state* law—obviously would interfere with the administration of the state law. The states are not indifferent to who enforces their laws.

Id. at 564 (emphasis in original).

In addition to the Seventh Circuit, the Eighth Circuit also has questioned the viability of disparate impact claims against insurers, noting that "at least with respect to insurers, the question [of whether the FHA provides for disparate impact liability] is not free from doubt." *See Saunders v. Farmers Ins. Exch.*, 537 F.3d 961, 964 (8th Cir. 2008). Other courts, however, have recognized—either implicitly or explicitly—that the FHA allows for disparate impact claims against insurers. *See Ojo*, 600 F.3d at 1208-10; *Nat'l Fair Hous. Alliance, Inc. v. Prudential Ins. Co. of Am.*, 208 F. Supp. 2d 46, 60 (D.D.C. 2002) (rejecting the defendants' argument that disparate impact liability does not apply to the insurance industry because of the availability of the "business justification" defense and because the defendants pointed to nothing in the FHA that would justify carving out an exception for a particular type of organization).

The Ninth Circuit's decision in *Ojo* is particularly relevant to the present case. In *Ojo,* the plaintiff, an African-American resident of Texas, claimed that a homeowners insurance company and its affiliates based their rates on a number of credit-score factors that disparately impacted minorities in violation of the FHA. *See Ojo,* 600 F.3d at 1207. The Ninth Circuit, sitting *en banc,* held as a matter of first impression that the FHA prohibits racial discrimination in the denial and pricing of homeowners insurance. *See id.* at 1208. In doing so, the Ninth Circuit made no distinction between disparate treatment claims and disparate impact claims. Because the plaintiff based his claim entirely on the discriminatory effects of the defendants' policies and did not claim that the defendants intentionally discriminated against him, however, the Ninth Circuit implicitly held that disparate impact claims against insurers are cognizable under the FHA.

The Ninth Circuit then went on to address whether the McCarran-Ferguson Act nonetheless precluded the plaintiff's claim. The Ninth Circuit identified the issue as

> whether application of the FHA to [the plaintiff's] case might invalidate, impair, or supersede the provisions of the Texas Insurance Code that authorize insurance companies to use credit scoring in setting insurance rates. If Texas law permits insurance companies to use credit scores even if the factors used to compute scores may have a racially disparate impact, then allowing [the plaintiff] to sue [d]efendants under the FHA for this practice would impair Texas law. On the other hand, if Texas law prohibits the use of credit-score factors that would violate the FHA on the basis of a disparate-impact theory, then the FHA would complement—rather than displace and impair—Texas law, and [the plaintiff's] FHA disparate-impact suit would not be reverse-preempted by the [McCarran-Ferguson Act].

See id. at 1209-10. Because the Ninth Circuit determined that this question of Texas law was unsettled, it certified the question to the Supreme Court of Texas. The Supreme Court of Texas, after performing an extensive review of the relevant provisions of the Texas Insurance Code, their legislative history, and similar provisions in other areas of Texas law, determined that Texas law permits race-neutral credit scoring even if it has a racially disparate impact. *See Ojo*

v. Farmers Grp., Inc., 356 S.W.3d 421, 422-34 (Tex. 2011). Accordingly, the Texas Supreme Court concluded that allowing a claim against Texas insurers for using completely race-neutral factors in credit scoring would frustrate Texas's regulatory policies.[2] *See id.*

III. HUD's Disparate Impact Rule

A. The Proposed Rule

The above discussion provides the backdrop for the parties' dispute regarding HUD's Disparate Impact Rule. HUD issued a Notice of Proposed Rulemaking regarding the Disparate Impact Rule on November 16, 2011. *See Implementation of the Fair Housing Act's Discriminatory Effects Standard*, 76 Fed. Reg. 70921 (Nov. 16, 2011). In the Notice of Proposed Rulemaking, HUD traced the development of discriminatory effects liability under the FHA, noting that Congress intended the FHA's prohibition of housing discrimination to be "broad and inclusive" and that HUD and all eleven circuits to have addressed the issue had determined that the FHA allows for liability based on discriminatory effects without the need for a finding of intentional discrimination. *Id.* at 70922-23. HUD recognized, however, that "[w]hile the discriminatory effects theory of liability under the [FHA] is well established, there is minor variation in how HUD and the courts have applied that theory." *See* 76 Fed. Reg. at 70922-23. According to the Notice, the purpose of the Disparate Impact Rule was to "establish[] a uniform standard of liability for facially neutral housing practices that have a discriminatory effect." *Id.* at 70921.

To that end, the proposed rule set forth a three-step burden-shifting framework for evaluating disparate impact claims. In the first step, the plaintiff bears the burden of proving that

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[2] The parties settled their remaining disputes and dismissed the pending appeal shortly after the Texas Supreme Court issued its opinion. *See Ojo v. Farmers Grp., Inc.*, No. CV-05-05818-JFW (9th Cir.), at R. 69, Order Granting the Parties' Stipulated Motion to Dismiss with Prejudice (June 24, 2011).

a housing practice either has a disparate impact on individuals with a protected characteristic or perpetuates segregation in the housing market. *See id.* at 70923-24. In the second step, the burden shifts to the defendant to prove that the challenged practice "has a necessary and manifest relationship to one or more of the defendant's . . . legitimate, nondiscriminatory interests." *See id.* at 70924. If the defendant satisfies this burden, the plaintiff may still establish liability in the third step by proving a less discriminatory method of serving the same interests. *See id.* HUD explained in the Notice of Proposed Rulemaking that it had adopted this framework because it is consistent with the discriminatory effects standard Congress adopted for Title VII cases and it prevents either party from having to prove a negative. *See id.*

The proposed rule defined discriminatory effects liability as applying "where a facially neutral housing practice actually or predictably results in a discriminatory effect on a group of persons (that is, a disparate impact), or on the community as a whole (perpetuation of segregation)." *Id.* at 70924. HUD specified that "[a]ny facially neutral action, e.g. laws, rules, decisions, standards, policies, practices, or procedures, including those that allow for discretion or the use of subjective criteria, may result in a discriminatory effect actionable under the [FHA] and [the Disparate Impact Rule]." *Id.* HUD then provided examples of housing policies or practices that may have a disparate impact on protected groups. *See id.* Among the examples HUD provided was "the provision and pricing of homeowner's insurance." *Id.* HUD cited the Ninth Circuit's opinion in *Ojo*, 600 F.3d at 1207-08, in support of this example.

B. Comments from the Insurance Industry

HUD received nearly 100 public comments from various individuals and entities about the proposed rule. Three trade associations representing the homeowner's insurance industry, including PCI, were among those that submitted comments to HUD. (*See* Pl. L.R. 56.1 Stmt.

¶ 21; *see also* Admin. R. 372, 455, 553.) The insurance industry's concerns regarding the proposed rule fell into four categories.

First, the insurance industry disputed that § 3604 of the FHA allows for disparate impact liability in any context. The commenters noted that § 3604 proscribes conduct relating to the sale or rental of dwellings that is undertaken "because of" an individual's membership in a class protected under the statute. According to the commenters, this language prohibits only *intentional* discrimination against protected individuals. (*See* Admin. R. 374, 457-58, 554.)

Second, the insurance industry contended that application of the Disparate Impact Rule to homeowners insurance would violate the McCarran-Ferguson Act. (*See id.* at 379-80, 456-57, 554.) According to the commenters, suits challenging the disparate impact of industry-wide classifications would frustrate state policies or interfere with core rate-making functions of states' administrative regimes regulating the insurance industry. (*See id.*) One commenter argued that application of the Disparate Impact Rule to the homeowners insurance would similarly violate the common-law "filed rate" doctrine (*see id.* at 378), which bars private claims against insurers that rest on the alleged unreasonableness of a rate that the insurer filed with the state regulatory agency. *See generally* 44 C.J.S. *Insurance* § 117 (West 2014).

Third, the insurance industry expressed concern that applying disparate impact liability to homeowners insurance is fundamentally incompatible with the use of actuarially sound insurance principles essential to risk-based pricing. As one commenter put it, "[c]lassifying people and property by the risks they present and treating similar risk profiles in a similar manner is a form of reasonable and fair discrimination that is at the very heart of the business of insurance." (*See* Admin. R. at 377; *see also id.* at 554 ("[R]isk discrimination is the foundation of insurance underwriting . . . .").) Furthermore, the commenters argued that the Disparate Impact Rule

would require insurers to disregard the predictive value of valid risk factors, which, in turn, would put insurers in the untenable position of risking violation of state regulations prohibiting price discrimination among individuals with similar risk profiles. (*Id.* at 377-78.) The commenters also claimed that the Disparate Impact Rule may actually harm consumers by increasing adverse selection and, consequently, causing coverage to suffer. (*Id.*)

Fourth, the insurance industry commented that the three-step burden-shifting approach HUD adopted in the Rule was inappropriate. Two commenters argued that the burden-shifting framework the Supreme Court adopted in *Wards Cove Packing Co. v. Antonio,* 490 U.S. 642 (1989), should apply rather than the framework set forth in the proposed rule. (*See* Admin. R. at 381, 458-59.) One commenter also noted the difficulties that shifting the burden of proof to insurers would impose because insurers do not collect data on the race and ethnicity of insureds and, thus, could not assess whether facially neutral underwriting and rating factors would have a disparate impact on protected classes. (*See id.* at 383.)

For these reasons, the insurance industry requested that HUD either exempt insurance underwriting and pricing from the Disparate Impact Rule altogether or build safe harbors into the Rule for long-recognized actuarial risk factors, such as the age and condition of the property.[3] (*See id.* at 380, 383, 459, 554-55.)

C. The Final Rule

HUD issued its final Disparate Impact Rule on February 15, 2013. *See* Final Rule, 78 Fed. Reg. at 11460 (Feb. 15, 2013). HUD acknowledged and responded to the insurance

[3] The insurance industry also urged HUD to withdraw the proposed rule pending the Supreme Court's decision in *Magner v. Gallagher,* 619 F.3d 823 (8th Cir. 2010), *cert. granted,* No. 10-1032 (2011), regarding whether disparate impact claims are cognizable under the FHA. The Supreme Court scheduled oral argument in *Magner* to take place shortly after the notice-and-comment period for the proposed rule. The case, however, settled before the Supreme Court issued a decision.

industry's comments in the preamble to the Final Rule. HUD did not, however, make any changes to the Final Rule in response to their comments. Instead, HUD determined that the framework it had adopted was flexible enough to accommodate the insurance industry's concerns on a case-by-case basis.

To begin with, HUD dismissed as contrary to well-established law the insurance industry's and others commenters' argument that the FHA does not provide for disparate impact liability. HUD reiterated that both HUD and all eleven circuit courts to have addressed the issue had long interpreted the FHA to allow for discriminatory effects as well as discriminatory intent liability. *See id.* at 11465-67. HUD also noted that courts regularly borrow from Title VII standards in interpreting the FHA, and it is well-established that Title VII allows for discriminatory effects liability. *See id.* at 11466. Finally, HUD contended that the legislative history of the FHA supported its interpretation of the Act as providing for discriminatory effects liability. *See id.* at 11467.

Next, HUD determined that the insurance industry's concerns that application of the Disparate Impact Rule to the insurance industry would violate the McCarran-Ferguson Act or the filed-rate doctrine were unfounded because the Rule did not alter the analysis courts already employed in evaluating FHA claims against homeowners insurers. *See id.* at 11474-75. Specifically, HUD provided the following, brief response to the industry's concerns that the Disparate Impact Rule would violate the McCarran-Ferguson Act and the filed-rate doctrine:

> HUD has long interpreted the [FHA] to prohibit discriminatory practices in connection with homeowner's insurance, and courts have agreed with HUD, including in *Ojo v. Farmers Group*. Moreover, as discussed above, HUD has consistently interpreted the Act to permit violations to be established by proof of discriminatory effect. By formalizing the discriminatory effects standard, the rule will not, as one commenter suggested, "undermine the states' regulation of insurance." The McCarran-Ferguson Act provides that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State

> for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance." McCarran-Ferguson does not preclude HUD from issuing regulations that may apply to insurance policies. Rather, McCarran-Ferguson instructs courts on how to construe federal statutes, including the Act. How the Act should be construed in light of McCarran-Ferguson depends on the facts at issue and the language of the relevant State law "relat[ing] to the business of insurance." Because this final rule does not alter the instruction of McCarran-Ferguson or its application as described in *Ojo v. Farmers Group,* it will not interfere with any State regulation of the insurance industry.

Id. at 11475 (footnotes omitted).[4]

In a similar vein, HUD also determined that the industry's concerns that the nature of insurance made the Disparate Impact Rule's application to the insurance industry inappropriate were "misplaced" because of the ability of an insurer to establish that the practice at issue has a legally sufficient justification. *See id.* HUD explained:

> HUD believes that these concerns are misplaced. First, they presume that once a discriminatory effect is shown, the policy at issue is per se illegal. This is incorrect. Rather as § 100.500 makes clear, the respondent or defendant has a full opportunity to defend the business justifications for its policies. This "burden-shifting framework" distinguishes "unnecessary barriers proscribed by the [FHA] from valid policies and practices crafted to advance legitimate interests." Thus, even if a policy has a discriminatory effect, it may still be legal if supported by a legally sufficient justification.

Id. at 11475 (footnote omitted) (citing *Groach Assocs. #33, L.P. v. Louisville/Jefferson Cnty. Metro Human Relations Comm'n,* 508 F.3d 366, 374-75 (6th Cir. 2007)). HUD went on to deny the insurance industry's request for exemptions or safe harbors related to insurance as unnecessary because "insurance practices with a legally sufficient justification will not violate the [FHA]." *Id.* Moreover, HUD explained, "creating exemptions beyond those found in the [FHA] would run contrary to Congressional intent." *Id.* (footnote omitted).

[4] HUD cited *Ojo,* 600 F.3d at 1208, *American Family,* 978 F.2d at 297-301, and *Nationwide Mut. Ins. Co. v. Cisneros,* 52 F.3d 1351, 1355-60 (6th Cir. 1995), in support of its assertion that courts have agreed that the FHA prohibits discriminatory practices in connection with homeowners insurance. *See id.* at 11475 n.139. HUD noted that the Fourth Circuit found in *Mackey v. Nationwide Ins. Cos.,*724 F.2d 419, 423-25 (4th Cir. 1984), that the FHA does not cover insurance. *See id.*

Finally, HUD rejected the commenters' argument that the burden-shifting framework adopted in the Disparate Impact Rule is unfair for insurers because they do not collect data on race and ethnicity. *See id.* In response to this concern, HUD stated:

> The burden of proof is not more difficult for insurers than for a charging party or plaintiff alleging that an insurance practice creates a discriminatory effect. The charging party or plaintiff must initially show the discriminatory effect of the challenged practice using appropriate evidence that demonstrates the effect. If the charging party or plaintiff makes that showing, the burden shifts to the insurer to show that the challenged practice is necessary to achieve one or more of its substantial, legitimate, nondiscriminatory interests.

Id. HUD also rejected the commenters' request for HUD to adopt the burden-shifting framework used in *Wards Cove* for proving disparate impact claims. *See id.* at 11469-73. HUD found that the framework it adopted, which it borrowed from Title VII cases, is appropriate and fairly balances the interests of all parties. *See id.*

IV. Procedural History

On November 27, 2013, PCI filed the present suit seeking to invalidate the Disparate Impact Rule as it applies to the provision and pricing of homeowners insurance. (*See* Compl. at 39.) PCI claims that the Disparate Impact Rule is invalid under the Administrative Procedure Act for a number of reasons. First, PCI argues that application of the Disparate Impact Rule to the insurance industry would violate the McCarran-Ferguson Act. (*See id.* at Count I.) Second, PCI argues that HUD's issuance of the Disparate Impact Rule was arbitrary and capricious because HUD failed to adequately consider the Rule's conflict with the McCarran-Ferguson Act, the filed rate doctrine, and the nature of insurance. (*See id.* at Counts II-IV.) Finally, PCI challenges the three-step burden-shifting framework HUD adopted in the Disparate Impact Rule as arbitrary, capricious, and not in accordance with law. (*See id.* at Counts V-VI.)

PCI moved for summary judgment on its claims (*see* R. 20, PCI Mot.), and HUD filed a cross-motion seeking dismissal of PCI's claims for lack of subject matter jurisdiction or, in the

alternative, summary judgment in HUD's favor on all claims. (*See* R. 30, HUD Mot.) The Court heard oral argument on the parties' motions on August 19, 2014.[5]

LEGAL STANDARD

The Administrative Procedure Act ("APA"), 5 U.S.C. § 551, *et seq.*, sets forth the extent of judicial authority to review federal agency actions. *See F.C.C. v. Fox Tele. Stations, Inc.*, 556 U.S. 502, 513-14, 129 S. Ct. 1800, 173 L. Ed. 2d 738 (2009); *J.N. Moser Trucking, Inc. v. U.S. Dep't of Labor*, 306 F. Supp. 2d 774, 781 (N.D. Ill. 2004). Section 10(e) of the APA instructs that a reviewing court shall "hold unlawful and set aside agency action, findings, and conclusions found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." *See* 5 U.S.C. § 706(2); *Little Co. of Mary Hosp. v. Sebelius*, 587 F.3d 849, 856 (7th Cir. 2009). Judicial review of agency action under the APA is "narrow," and courts must limit their review of the agency's action to the administrative record before the agency. *See Judulang v. Holder*, --- U.S. ---, 132 S. Ct. 476, 483, 181 L. Ed. 2d 449 (2011); *Association of Private Sector Colls. & Univs. v. Duncan*, 681 F.3d 427, 441 (D.C. Cir. 2012). A reviewing court "is not to substitute its judgment for that of the agency." *Judulang*, 132 S. Ct. at 483.

[5] The Court acknowledges and appreciates the *amicus curiae* who submitted briefs in this action. The American Civil Liberties Union, American Civil Liberties Union of Illinois, Chicago Area Fair Housing Alliance, Chicago Lawyers' Committee for Civil Rights Under Law, Inc., LatinoJustice PRLDEF, Lawyers' Committee for Civil Rights Under Law, National Association for the Advancement of Colored People, NAACP Milwaukee Branch, NAACP Legal Defense & Educational Fund, Inc., National Community Reinvestment Coalition, National Consumer Law Center, National Fair Housing Alliance, National Housing Law Project, Poverty & Race Research Action Council, and Sherman Park Community Association submitted a joint brief in support of HUD's motion. (*See* R. 33.) The State of Illinois also submitted an *amicus curiae* brief in support of HUD's motion. (*See* R. 80.) The State of Oklahoma, through its Insurance Commissioner, submitted an *amicus curiae* brief in support of PCI's motion (*see* R. 48), and the insurance commissioners of the States of Alabama, Louisiana, Mississippi, and Nevada joined Oklahoma's brief. (*See* R. 64.) The American Financial Services Association, the Consumer Mortgage Coalition, the Independent Community Bankers of American, and the Mortgage Bankers Association also submitted a joint *amicus curiae* brief in support of PCI's motion. (*See* R. 59-1.)

ANALYSIS

I. Subject Matter Jurisdiction

Before the Court can address the merits of PCI's claims, it must assure itself that it has subject matter jurisdiction over those claims. *See Aljabri v. Holder,* 745 F.3d 816, 818-19 (7th Cir. 2014) (federal courts must "consider subject-matter jurisdiction as the first question in every case, . . . and must dismiss [a] suit if such jurisdiction is lacking"). Of particular relevance here, the Court must determine whether PCI has standing to assert its claims and whether PCI's claim that the Disparate Impact Rule violates the McCarran-Ferguson Act is ripe. The Court turns to the ripeness issue first.

A. Ripeness

"Ripeness is a justiciability doctrine designed 'to prevent the courts through avoidance of premature adjudication, from entangling themselves in abstract disagreements over administrative policies, and also to protect the agencies from judicial interference until an administrative decision has been formalized and its effects felt in a concrete way by the challenging parties.'" *Nat'l Park Hospitality Ass'n v. Dep't of Interior,* 538 U.S. 803, 807-08, 123 S. Ct. 2026, 155 L. Ed. 2d 1017 (2003) (quoting *Abbott Labs. v. Gardner,* 387 U.S. 136, 148-49, 87 S. Ct. 1507, 18 L. Ed. 2d 681 (1967)). The ripeness doctrine stems "both from Article III limitations on judicial power and from prudential reasons for refusing to exercise jurisdiction." *Nat'l Park Hospitality Ass'n,* 538 U.S. at 808 (quoting *Reno v. Catholic Social Servs., Inc.,* 509 U.S. 43, 57 n.18, 113 S. Cr. 2485, 125 L. Ed. 2d 38 (1993)). In *Abbott Laboratories*, the Supreme Court announced a two-factor test for evaluating the prudential aspects of whether agency action is ripe for judicial review. *See Abbott Labs.,* 387 U.S. at 149. Under the *Abbott Laboratories* test, courts evaluate "(1) the fitness of the issues for judicial

decision and (2) the hardship to the parties of withholding court consideration" in assessing the ripeness of the issue for judicial review. *Nat'l Park Hospitality Ass'n,* 538 U.S. at 808 (citing *Abbott Labs. v. Gardner,* 387 U.S. at 149).

1. The Nature of PCI's McCarran-Ferguson Claim

Before turning to the ripeness factors, the Court must address the parties' disagreements regarding the nature of PCI's McCarran-Ferguson claim. PCI argues that its McCarran-Ferguson claim presents an as-applied challenge to the Disparate Impact Rule because PCI challenges the Rule only as it applies to a subset of conduct (*i.e.,* the provision and pricing of homeowners insurance), not as a whole. HUD, on the other hand, contends that PCI's claim presents a facial challenge to the Disparate Impact Rule because the claim does not turn on particular facts or require the Court to consider a specific application of the Rule to insurers. The parties also disagree on the standard the Court should apply if it finds that PCI's McCarran-Ferguson claim presents a facial challenge to the Rule. HUD argues that to succeed on a facial challenge, PCI must show that "no set of circumstances exists under which the regulation would be valid," (*see* Defs. Reply Br. at 7 (quoting *Reno v. Flores,* 507 U.S. 292, 301, 113 S. Ct. 1439, 123 L. Ed. 2d 1 (1993)); *see also* R. 97, Defs. Supp. Br. at 5-8), whereas PCI contends that the appropriate standard is whether the regulation has a "plainly legitimate sweep." (*See* R. 96, Pl. Supp. Br. at 3-7.)

The Court agrees with HUD that PCI's McCarran-Ferguson claim presents a facial challenge to the Disparate Impact Rule. PCI does not challenge a particular, concrete application of the Rule to any of its members. Rather, it categorically challenges a broad range of potential applications of the Rule without relying on the facts of any particular application. Although PCI does not seek to invalidate the Rule outside the homeowners insurance context, its challenge is

more akin to a facial challenge than to an as-applied challenge, especially considering that the McCarran-Ferguson Act itself only applies to the business of insurance. *See Peick v. Pension Ben. Guar. Corp.*, 724 F.2d 1247, 1261 n.16 (7th Cir. 1983) ("The parties have argued vigorously as to whether this is an 'as applied' or 'facial' challenge to the Act. Given the minimal or nonexistent record with respect to the actual operation of the MPPAA in the situation presented in this case, we do not think that the case can properly be considered an 'as applied' challenge."); *Alliance of Auto Mfrs., Inc. v. Currey,* 984 F. Supp. 2d 32, 46-47 (D. Conn. 2013) (finding that the plaintiff presented a facial challenge because the plaintiff had not alleged "any unconstitutional application of the law apart from the general applicability of the law to all manufacturers who transact business with in-state dealers").

The precise standard that applies to facial challenges remains a matter of dispute. *See United States v. Stevens,* 559 U.S. 460, 130 S. Ct. 1577, 176 L. Ed. 2d 435 (2010); *A Woman's Choice-E. Side Women's Clinic v. Newman,* 305 F.3d 684, 687 (7th Cir. 2002). The Supreme Court first announced the "no set of circumstances" standard in *United States v. Salerno,* 481 U.S. 739, 107 S. Ct. 2095, 95 L. Ed. 2d 697 (1987), stating that a law will be held unconstitutional in a facial challenge only when "no set of circumstances exists under which the Act would be valid." *See id.* at 745. The "no set of circumstances" standard was not the decisive factor in *Salerno*, however, and the Supreme Court has not always applied this standard in evaluating facial challenges to the constitutionality of statutes or regulations. *See Newman,* 305 F.3d at 687. Faced with "irreconcilable directives" from the Supreme Court, the Seventh Circuit determined in *Newman* that the language of *Salerno*—which a subsequent Supreme Court decision referred to as a "suggestion," *see Troxel v. Ganville,* 530 U.S. 57, 85 n.6, 120 S. Ct.

2054, 147 L. Ed. 2d 49 (2000)—must give way to the Supreme Court's later holdings in which the Court did not apply the *Salerno* standard. *See Newman,* 305 F.3d at 687.

Since *Newman,* the Seventh Circuit has applied the "no set of circumstances" standard to a facial challenge to an interagency coordination agreement. *See Home Builders Ass'n of Greater Chi. v. U.S. Army Corps of Eng'rs,* 335 F.3d 607, 619 (7th Cir. 2003) ("[T]o prevail on a facial challenge, [the plaintiff] 'must establish that no set of circumstances exists under which the [regulation] would be valid.'" (quoting *Reno,* 507 U.S. at 301)); *see also Fields v. Smith,* 653 F.3d 550, 557 (7th Cir. 2011) (applying the "no set of circumstances" standard to a facial challenge to the constitutionality of a statute). More recently, the Court of Appeals for the District of Columbia also applied the "no set of circumstances" standard in evaluating facial challenges to agency regulations, noting that this standard applied to "both the constitutional challenges and the statutory challenge[s]." *Association of Private Sector Colls. & Univs. v. Duncan,* 681 F.3d 427, 442 (D.C. Cir. 2012) (alteration in original) (quoting *Reno,* 507 U.S. at 301); *see also Sherley v. Sebelius,* 644 F.3d 388, 397 (D.C. Cir. 2011) (applying the "no set of circumstances" standard to the plaintiff's claim that the National Institutes of Health's guidelines for stem cell research were facially invalid under the Dickey-Wicker Amendment barring funding for research in which a human embryo is destroyed). HUD argues that the takeaway from these cases is that the "no set of circumstances" standard continues to govern facial, non-constitutional challenges to a regulation. (*See* Defs. Supp. Br. at 5-6.)

The Court finds that the "no set of circumstances" standard is the appropriate standard for evaluating PCI's claim that the McCarran-Ferguson Act precludes disparate impact claims based on the provision and pricing of homeowners insurance. *See Wisconsin Cent., Ltd. v. Shannon,* 539 F.3d 751, 761 (7th Cir. 2008). In *Wisconsin Central,* the plaintiff, an interstate railroad

company, argued that the federal Railway Labor Act and, more generally, Congress's vast regulation of the railways preempted the overtime provisions in Illinois's Minimum Wage Law. *See id.* at 755. The Seventh Circuit held that the plaintiff's preemption challenge under the Railway Labor Act was not ripe because the Act only precludes claims that depend on an interpretation of a collective bargaining agreement's terms and, although it was clear that the court would need to consult the collective bargaining agreements to decide the plaintiff's claim, it was not yet clear whether the court would need to *interpret* the terms of the agreement. *See id.* at 759-61.

In reaching this conclusion, the Seventh Circuit stated that "if it is evident that the result of a process must lead to . . . preemption, it would defy logic to hold that the process itself cannot be preempted and that a complaint seeking that result would not raise a ripe issue." *Id.* at 761 (quoting *NE Hub Partners, L.P. v. CNG Transmission Corp.*, 239 F.3d 333, 348 (3d Cir. 2001)). The Seventh Circuit further explained that where the circumstances at issue "would not invariably lead to a finding of preemption," the plaintiff's claim was not ripe for consideration. *See id.* at 761. Accordingly, the Seventh Circuit held that because "scenarios exist where it would be unnecessary for the [collective bargaining agreements] to be interpreted in order to resolve the claim . . . the district court lacked jurisdiction to rule on [the plaintiff's] counts concerning preemption under the [Railway Labor Act]." *Id.* The Seventh Circuit found that the plaintiff's field preemption claim, on the other hand, was ripe for review because it presented a purely legal issue and, if the court found that field preemption applied, it would completely bar all enforcement of Illinois's overtime regulations against the plaintiff. *See id.* at 761-62.

Under this reasoning, the Court finds that the appropriate standard under which to evaluate PCI's McCarran-Ferguson Act claim is essentially identical to the "no set of

circumstances" standard applied in *Home Builders Association of Greater Chicago v. U.S. Army Corps of Engineers* and *Association of Private Sector Colleges and Universities v. Duncan*. PCI can succeed on its facial challenge only if the McCarran-Ferguson Act would invariably preempt application of the Disparate Impact Rule to the provision and pricing of homeowners insurance. In other words, it can succeed only if no set of circumstances exists under which the regulation would be valid. *Cf. Wisconsin Cent.*, 539 F.3d at 761. With this standard in mind, the Court now turns to consideration of *Abbott Laboratories*' two-factor test for ripeness.

2. Ripeness Test

a. Fitness of the Issue for Judicial Decision

Where judicial review of an agency's action "involves purely legal claims in the context of a facial challenge to a final rule, a petition is 'presumptively reviewable.'" *Owner-Operator Ind. Drivers Ass'n, Inc. v. Federal Motor Carrier Safety Admin.*, 656 F.3d at 586 (quoting *Sabre, Inc. v. Department of Transp.*, 429 F.3d 1113, 1119 (D.C. Cir. 2005)). Despite this presumption, however, an issue is not fit for judicial decision where it rests upon "contingent future events that may not occur as anticipated, or indeed may not occur at all." *Texas v. United States*, 523 U.S. 296, 300, 118 S. Ct. 1257, 140 L. Ed. 2d 406 (1998) (quoting *Thomas v. Union Carbide Agric. Prods. Co.*, 473 U.S. 568, 580-81, 105 S. Ct. 3325, 87 L. Ed. 2d 409 (1985)). Nor is an issue fit for judicial decision if "further factual development would 'significantly advance [the court's] ability to deal with the legal issues presented.'" *Nat'l Park Hospitality Ass'n*, 538 U.S. at 812 (quoting *Duke Power Co. v. Carolina Envtl. Study Grp., Inc.*, 438 U.S. 59, 82, 98 S. Ct. 2620, 57 L. Ed. 2d 595 (1978)). Under these standards, the issue of whether the McCarran-Ferguson Act precludes application of the Disparate Impact Rule to the provision and pricing of homeowners insurance is not yet fit for judicial review. Although this question is a "purely legal one," the

contours of the purported controversy are not sufficiently fleshed out to allow for judicial resolution of the issues at this time. *See Nat'l Park Hospitality Ass'n,* 538 U.S. at 808.

To begin with, the Supreme Court expressly rejected an interpretation of the McCarran-Ferguson Act as creating "any sort of field preemption" in *Humana. See Humana,* 525 U.S. at 309. Under *Humana,* McCarran-Ferguson preclusion applies only when (1) a federal law directly conflicts with state regulation, (2) application of a federal law would frustrate a declared state policy, or (3) application of a federal law would interfere with a State's administrative regime. *See id.* at 310. Courts that have considered McCarran-Ferguson challenges to housing discrimination claims since *Humana* have looked to the particular, allegedly discriminatory practices at issue and the particular insurance regulations and administrative regime of the state in which those practices occurred. *See, e.g., Ojo,* 600 F.3d at 1203-05 (certifying to the Supreme Court of Texas the question of whether Texas law permits an insurance company to price insurance using a credit-score factor that has a racially disparate impact); *Saunders v. Farmers Ins. Exch.,* 537 F.3d 961, 965-68 (8th Cir. 2008) (analyzing Missouri's regulatory regime and the "precise federal claims asserted"—*i.e.,* that insurance companies charged higher premiums to homeowners in minority communities—in determining whether McCarran-Ferguson preclusion applied); *cf. AmSouth Bank v. Dale.* 386 F.3d 763, 781 (6th Cir. 2004) ("[W]hen assessing whether a general federal statute that creates a cause of action 'impairs' the operation of state law, the proper inquiry is whether the particular suit being brought would impair state law."). As these cases demonstrate, the McCarran-Ferguson analysis is more akin to the case-by-case analysis required for finding preemption under the Railway Labor Act than to the categorical analysis that applies in cases of field preemption. *Cf. Wisconsin Cent.,*539 F.3d at 755-60.

PCI argues, however, that even though the McCarran-Ferguson Act does not establish field preemption, the Act does preclude all disparate impact claims based on the provision and pricing of homeowners insurance because federal adjudication of those claims would necessarily interfere with states' administrative regimes for regulating insurance. PCI relies heavily on *Doe v. Mutual of Omaha Ins. Co.*, 179 F.3d 557 (7th Cir. 1999), in support of this argument. In *Mutual of Omaha,* the Seventh Circuit found that permitting federal courts to determine whether caps on coverage in a health insurance policy are actuarially sound and consistent with principles of state law would result in them "stepping on the toes of state insurance commissioners." *See id.* at 564. Accordingly, the Seventh Circuit stated that even if the formal criteria for determining whether limitations on coverage are actuarially sound and consistent with state law, "displacing their administration into federal court—requiring a *federal* court to decide whether an insurance policy is consistent with *state* law—obviously would interfere with the administration of state law. The states are not indifferent to who enforces their laws." *Id.* (emphasis in original.)

According to PCI, it follows from *Mutual of Omaha* that the McCarran-Ferguson Act bars all claims brought under the Disparate Impact Rule because the second step of the Rule's burden-shifting approach requires courts to evaluate whether the challenged practice "is necessary to achieve one or more substantial, legitimate, nondiscriminatory interests" of the defendant and whether those interests could be served by another practice with a less discriminatory effect. *See* 24 C.F.R. § 100.500. PCI argues that, in the insurance context, this analysis will necessarily require courts to determine whether the challenged practices are actuarially sound and consistent with state law—something that *Mutual of Omaha* prohibits federal courts from doing.

Although *Mutual of Omaha* supports PCI's argument that the McCarran-Ferguson Act bars any claims that require courts to determine whether an insurer's practices are actuarially sound and consistent with state law,[6] it does not necessarily establish that PCI's broad facial challenge is fit for judicial decision. A myriad of insurance practices may affect the provision and pricing of homeowners insurance, and some of those practices may have a disparate impact on protected groups under the FHA. In the absence of an actual, concrete application of disparate impact liability to the homeowners insurance industry, the Court can only speculate about what types of disparate impact claims HUD or private plaintiffs may assert against insurers and whether the McCarran-Ferguson Act will preclude those claims. Variations among state regulatory regimes, moreover, provide an additional variable that may complicate any hypothetical McCarran-Ferguson analysis. While some states require insurers to use risk-based pricing, other states merely permit risk-based pricing, but do not require it. Accordingly, some insurance practices in some states may rest on business justifications rather than actuarially sound principles or state law requirements. Under *Mutual of Omaha*, the McCarran-Ferguson Act would not necessarily preclude claims based on these practices because it is not clear that such claims would raise the question of whether the insurer's practices are actuarially sound and

[6] During oral argument, HUD argued that the language at issue in *Mutual of Omaha* is dicta because the Court's holding turned on a statutory interpretation issue with respect to the Americans with Disabilities Act, not on the application of McCarran-Ferguson preclusion. The Court disagrees. The Seventh Circuit's decision in *Mutual of Omaha* rested *both* on its interpretation of the Americans with Disabilities Act *and* its determination that interpreting the Americans with Disabilities Act "as regulating the content of insurance policies is barred by the McCarran-Ferguson Act." *See Mutual of Omaha,* 179 F.3d at 564. HUD also argued that reading *Mutual of Omaha* as holding that McCarran-Ferguson preclusion bars any claim that would require the court to evaluate whether an insurer's practices are actuarially sound and consistent with state law—rather than just the specific claim at issue in that case—would conflict with *Humana*. The Seventh Circuit's opinion, however, plainly establishes that the court intended its holding to bar more than just the specific claim at issue. Indeed, the actual claims at issue in *Mutual of Omaha* did not require the Seventh Circuit to determine whether the defendant's practices were actuarially sound and in accordance with state law because the defendant stipulated that they were not. *Id.* at 564. *Mutual of Omaha* is binding on this Court.

consistent with state law. As matters now stand, there are simply "too many imponderables" to allow the Court to determine whether the McCarran-Ferguson Act categorically applies to all disparate impact claims that may fall within the scope of PCI's McCarran-Ferguson challenge. *See Clean Air Implementation Project v. EPA,* 150 F.3d 1200, 1205 (D.C. Cir. 1998).

Under the circumstances, "further factual development would 'significantly advance [the Court's] ability to deal with the legal issues presented'" in PCI's McCarran-Ferguson claim. *See Nat'l Park Hospitality,* 538 U.S. at 812. Similar to the situation in *National Park Hospitality,* both parties here rely on examples of challenges to specific insurance practices to which McCarran-Ferguson preclusion applies and point to specific state insurance laws to support their respective arguments. *See id.* Accordingly, the Court finds that judicial resolution of whether McCarran-Ferguson preclusion applies to disparate impact claims should await a concrete dispute regarding a particular insurance practice. *See id.* (finding that an APA claim asserting that the National Park Service's regulations regarding the concession management program for national parks violated the Contract Disputes Act of 1978 was not ripe because the parties' arguments depended in part on the characteristics of certain types of concession contracts and the respondents acknowledged that some (but not all) types of the contracts might fall within the scope of Contract Disputes Act); *see also Toilet Goods Ass'n, Inc. v. Gardner,* 387 U.S. 158, 163-64, 87 S. Ct. 1520, 18 L. Ed. 2d 697 (1967) (holding that the petitioner's challenge to the regulations promulgated by the Commissioner of Food and Drugs exceeded his statutory authority where the regulation served notice only that the Commissioner may under certain circumstances order inspection of certain facilities and data and "[a]t this junction we have no idea whether or when such an inspection will be ordered and what reasons the Commissioner will give to justify his order"); *Texas v. United States,* 523 U.S. 296, 301, 118 S. Ct. 1257, 140 L.

Ed. 2d 406 (1998) ("Determination of the scope . . . of legislation in advance of its immediate adverse effect in the context of a concrete case [often] involves too remote and abstract an inquiry for the proper exercise of the judicial function." (quoting *Longshoremen v. Boyd,* 347 U.S. 222, 224, 74 S. Ct. 447, 98 L. Ed. 650 (1954))); *Wisconsin Cent.,* 539 F.3d at 760 (finding that the question of whether the RLA and the Labor Management Relations Act preempted a state law was not fit for judicial decision because it required a "case-by-case factual analysis to determine the extent to which a state law claim will require interpretation of a [collective bargaining agreement]."); *Clean Air Implementation Project,* 150 F.3d at 1205 ("Given the universe of all possible evidence that might be considered 'credible,' it is impossible for us to decide now what impact the [EPA's rule permitting the use of 'credible evidence' to prove or disprove violations of the Clean Air Act] will have.").[7]

[7] In addition to *Mutual of Omaha,* PCI also cites several out-of-circuit cases in which courts decided as a purely legal question that McCarran-Ferguson preclusion applied in support of its ripeness argument. In each of those cases, however, the court considered a challenge to particular conduct in a particular state (or states), and, as a result, the court was able to evaluate whether resolution of the plaintiff's particular claim would invalidate, impair, or supersede the state's insurance regulations. *See American Bankers Ins. Co. of Fla. v. Inman,* 436 F.3d 490 (5th Cir. 2006) (holding that McCarran-Ferguson preclusion applied where application of the Federal Arbitration Act would invalidate a Mississippi statute prohibiting the arbitration of disputes regarding uninsured motorist coverage); *La Barre v. Credit Acceptance Corp.,* 175 F.3d 640 (8th Cir. 1999) (finding that the McCarran-Ferguson Act precluded application of RICO to the activities of two defendants but not to the activities of a third defendant); *Datacor, Inc. v. Heritage Warranty Ins. Risk Retention Grp., Inc.,* No. 4:09-CV-1123 (CEJ), 2009 WL 5062137 (E.D. Mo. Dec. 16, 2009) (concluding that a Nebraska statute exempting arbitration provisions found in insurance contracts from the rule favoring enforcement of agreements to arbitrate precluded application of the Federal Arbitration Act to compel arbitration of plaintiff's insurance-related claim); *In re Managed Care Litig.,* 185 F. Supp. 2d 1310 (S.D. Fla. 2002) (holding that the McCarran-Ferguson Act barred the RICO claims of the plaintiffs residing in California, Florida, New Jersey, and Virginia because those states did not allow for private causes of action by victims of insurance fraud). These cases do not support a finding that PCI's McCarran-Ferguson claim, which is divorced from any concrete application of the Disparate Impact Rule, is ripe for review. *See Wisconsin Cent.,* 539 F.3d at 759 ("[C]ases are unripe when the parties point only to hypothetical, speculative, or illusory disputes as opposed to actual, concrete conflicts." (quoting *Lehn v. Holmes,* 364 F.3d 862, 867 (7th Cir. 2004))).

b. Hardship to the Parties of Withholding Court Consideration

Turning to the second ripeness factor under *Abbott Labs.*, PCI also fails to establish that withholding judicial determination of its McCarran-Ferguson claim will cause its members hardship. *Abbott Labs.*, 387 U.S. at 149; *Nat'l Park Hosp.*, 538 U.S. at 808. There is no dispute that the McCarran-Ferguson Act, where it applies, trumps any claims brought under the Disparate Impact Rule—just as it trumped any disparate impact claims brought against insurers before HUD issued the Rule. Accordingly, even though the Disparate Impact Rule may expand the exposure of PCI's members to disparate impact liability generally, it does nothing to prevent PCI's members from challenging disparate impact claims as preempted by the McCarran-Ferguson Act. Nor does it change the analysis that courts apply in deciding whether the McCarran-Ferguson Act precludes a specific claim.

Accordingly, the only hardship that PCI's members might suffer from the Court withholding a decision on the merits here is the burden of having to challenge disparate impact claims under the McCarran-Ferguson Act on a case-by-case basis rather than in one fell swoop. As a general rule, the additional burden to a litigant of case-by-case adjudication is not a sufficient hardship to justify judicial review of an otherwise unripe claim. *See Ohio Forestry Ass'n, Inc. v. Sierra Club,* 523 U.S. 726, 734-35, 118 S. Ct. 1665, 140 L. Ed. 2d 921 (1998) (although it would be "easier, and certainly cheaper," for the respondent to mount one legal challenge to an agency's plan rather than several challenges to specific decisions made pursuant to that plan, "the Court has not considered this kind of litigation cost saving sufficient by itself to justify review in a case that would otherwise be unripe"); *Clean Air Implementation Project,* 150 F.3d at 1205 ("If the [EPA's] credible evidence rule has in fact altered [emission standards], petitioners can raise that as a defense in an enforcement action. The burden of participating in

future proceedings does not 'constitute sufficient hardship for the purposes of ripeness.'" (quoting *Florida Power & Light Co. v. EPA,* 145 F.3d 1414, 1421 (D.C. Cir. 1998))). To the contrary, the ripeness doctrine already "reflects a judgment that the disadvantages of a premature review that may prove too abstract or unnecessary ordinarily outweigh the additional costs of—even repetitive—post-implementation litigation." *Ohio Forestry Ass'n,* 523 U.S. at 735 (collecting cases).[8]

In *Wisconsin Central,* the Seventh Circuit recognized that, in the preemption context, the plaintiff may satisfy the hardship requirement by establishing a "possibility that it will need to defend itself in an enforcement action ultimately preempted." *See* 539 F.3d at 761. The Seventh Circuit also explained that this type of hardship makes a preemption claim ripe only when the circumstances at issue "would invariably lead to a finding of preemption." *Id.* As discussed above, the Court is not in a position to determine whether the McCarran-Ferguson Act will necessarily preempt all disparate impact claims based on the provision or pricing of homeowners insurance. PCI, therefore, has not established that withholding consideration of its McCarran-Ferguson claim will cause its members hardship under the analysis in *Wisconsin Central.*

In sum, the Court finds that judicial determination of whether McCarran-Ferguson preclusion applies to the broad range of potential claims that may fall within PCI's McCarran-Ferguson challenge is best left for a concrete dispute challenging a particular insurance practice,

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[8] PCI claims that, unlike in the *Ohio Forestry Association* and *Clean Air Implementation Project* cases, its members face the additional hardship of having to "either cease engaging in the core insurance practices of state-regulated risk-based pricing and underwriting or risk substantial liability under the Disparate Impact Rule." (*See* Pl. Resp. Br. at 18.) This argument, however, has no merit with respect to PCI's McCarran-Ferguson claim because the Disparate Impact Rule does not alter the application or effect of McCarran-Ferguson preclusion. *Cf. Toilet Goods Ass'n,* 387 U.S. at 164-65 (finding no hardship where the petitioners already had a statutory duty to permit inspections of their factories and "no irremediable adverse consequences flow from requiring a later challenge to [the] regulation by a manufacturer who refuses to allow this type of inspection).

and withholding judicial decision until that time will not impose a hardship on PCI's members. Accordingly, PCI's claim that the Disparate Impact Rule violates the McCarran-Ferguson is not ripe, and the Court lacks jurisdiction to decide it.

B. Standing

Next, the Court considers whether PCI has standing to assert its remaining claims.[9] The question of standing "involves both constitutional limitations on federal-court jurisdiction and prudential limitations on its exercise." *Bennett v. Spear,* 520 U.S. 154, 162, 117 S. Ct. 1154, 137 L. Ed. 2d 281 (1997). To establish constitutional standing, a plaintiff must show (1) an "injury in fact" that is concrete and particularized and actual or imminent, not conjectural or hypothetical, (2) a causal connection between the plaintiff's injury and the complained-of conduct, and (3) a likelihood that a favorable decision will redress the plaintiff's injury. *See Lujan v. Defenders of Wildlife,* 504 U.S. 555, 560-61, 112 S. Ct. 2130, 119 L. Ed. 2d 351 (1992); *Clapper v. Amnesty Int'l USA,* --- U.S. ----, 133 S. Ct. 1138, 185 L. Ed. 2d 264 (2013). Apart from the constitutional limitations on standing, federal courts have also created self-imposed prudential limits on their exercise of federal jurisdiction. *See, e.g., G&S Hldgs. LLC v. Continental Cas. Co.,* 697 F.3d 534, 541 (7th Cir. 2012). Unlike constitutional standing requirements, however, "prudential limitations on standing can be waived." *Korte v. Sebelius,* 735 F.3d 654, 668 (7th Cir. 2013). Here, HUD has raised objections only to PCI's constitutional standing, not its prudential standing. The Court, therefore, limits its discussion to the constitutional requirements for standing.[10]

[9] Because the Court has determined that PCI's McCarran-Ferguson claim is not ripe, the Court need not determine whether PCI has standing to assert that claim.

[10] Although the Court has discretion to overlook HUD's waiver, the Court sees no reason to do so in this case.

An organization such as PCI has standing to sue on behalf of its members even if the organization itself has not suffered an injury if it can show that "its members would otherwise have standing to sue in their own right, the interests at stake are germane to the organization's purpose, and neither the claim asserted nor the relief requested requires the participation of individual members in the lawsuit." *See Friends of the Earth, Inc. v. Laidlaw Envtl. Servs. (TOC), Inc.*, 528 U.S. 167, 181, 120 S. Ct. 693, 145 L. Ed. 2d 610 (2000). Only the first requirement of associational standing—that PCI's members have standing to sue in their own right—is at issue here. To meet this requirement, PCI must show that at least one of its members has standing to assert the claims PCI has brought. *See Warth v. Seldin,* 422 U.S. 490, 511, 95 S. Ct. 2197, 45 L. Ed. 2d 343 (1975); *see also Consumer Fed'n of Am. v. Federal Commc'ns Comm'n,* 348 F.3d 1009, 1012 (D.C. Cir. 2003) ("It is enough [for associational standing] if just one member of the groups has standing.").

As an initial matter, when the plaintiff is "an object of the action (or forgone action) at issue . . . there is ordinarily little question that the action or inaction has caused him injury." *See Owner-Operator Ind. Drivers Ass'n, Inc. v. Federal Motor Carrier Safety Admin.*, 656 F.3d 580, 586 (7th Cir. 2011) (quoting *Lujan,* 504 U.S. at 561-62); *Fund for Animals, Inc. v. Norton,* 322 F.3d 728, 733-34 (D.C. Cir. 2003) (a party's standing to seek judicial review of administrative action is generally "self-evident" when the party is an object of the action at issue). This case is no exception. PCI's member companies, which provide homeowners insurance across the United States (*see* Pl. L.R. 56.1 Stmt. ¶ 2), are among the "objects" of the Disparate Impact Rule, and, as explained below, they satisfy the requirements for constitutional standing.

1. Injury in Fact

First, PCI's members have suffered an "injury in fact" because the Disparate Impact Rule increases their exposure to disparate impact liability under the FHA. Although the Disparate Impact Rule simply confirmed preexisting legal standards in some circuits, it went beyond established law in others. The Seventh and Eighth Circuits, for example, had expressly declined to decide whether disparate impact liability applies to the insurance industry under the FHA, *see American Family,* 978 F.2d at 290; *Saunders,* 537 F.3d at 964, and neither the Supreme Court nor the Court of Appeals for the District of Columbia has decided whether the FHA allows for disparate impact claims before HUD issued the Disparate Impact Rule. The increased exposure of PCI's members to disparate impact claims under the Rule satisfies the "injury in fact" requirement of Article III standing. *Cf. Johnson v. Allsteel, Inc.,* 259 F.3d 885, 888 (7th Cir. 2001) (granting increased discretion to an ERISA plan administrator increased the plan participant's risk of having his claim for benefits denied, and "[t]he increased risk the participant faces as a result is an injury-in-fact").

Additionally, officers of several of PCI's member companies submitted declarations averring that, as a practical matter, the Disparate Impact Rule will require the company to begin collecting and reviewing information regarding applicants' race, color, ethnicity, national origin, religion, and disability status to monitor their compliance with the Rule. The declarants represented that doing so will cause their companies to incur costs related to determining what additional data they need and how to obtain it, collecting the data in accord with federal and state laws, and monitoring the data to ensure compliance with the Rule. (*See* R. 44-2, Cracas Decl. ¶¶ 6-12; R. 44-3, Dawdy Decl. ¶¶ 11-14; R. 44-4, Zaleski Decl. ¶¶ 10-13, 18-20; R. 44-5, Drogan Decl. ¶¶ 7, 10-12.) HUD has put forward no evidence rebutting the declarations PCI submitted,

so the Court accepts the declarants' representations as true. The compliance costs reported by PCI's members alone are sufficient to satisfy the "injury in fact" requirement of Article III standing. *See Virginia v. Am. Booksellers Ass'n, Inc.,* 484 U.S. 383, 392, 108 S. Ct. 636, 98 L. Ed. 2d 782 (1988) (holding that the plaintiffs had suffered an injury in fact where "the law is aimed directly at plaintiffs, who, if their interpretation of the statute is correct, will have to take significant and costly compliance measures or risk criminal prosecution"); *Association of Private Sector Colls. & Univs. v. Duncan,* 681 F.3d 427 (D.C. Cir. 2012) ("If states bend to the Department's will, [Appellant's] members are harmed because they will face even greater compliance costs." (alteration in original)); *Keller v. City of Fremont,* 719 F.3d 931, 947 (8th Cir. 2013) (recognizing that a party has standing to challenge a law that "imposes compliance burdens on those it regulates or controls, and compliance is coerced by the threat of enforcement" (internal quotations omitted)).

2. Causation

Second, the injuries PCI's members have suffered are fairly traceable to the Disparate Impact Rule. PCI and others in the insurance industry urged HUD to exempt insurers from the Disparate Impact Rule or at least build safe harbors into the Rule for insurers' consideration of long-recognized actuarial risk factors. HUD refused to do so, and as a result, PCI's members now face exposure to disparate impact liability in jurisdictions that had not previously recognized disparate impact claims against insurers. Furthermore, as the declarations PCI submitted establish, its members' increased exposure to disparate impact liability will cause them to incur additional costs collecting, analyzing, and monitoring data to ensure their compliance with the Disparate Impact Rule. (*See* Cracas Decl. ¶¶ 6-12; Dawdy Decl. ¶¶ 11-14; Zaleski Decl. ¶¶ 10-13, 18-20; Drogan Decl. ¶¶ 7, 10-12.)

HUD argues that any injuries PCI's members suffered "are the result of the longstanding administrative and judicial recognition of disparate impact liability under the FHA and the coverage of insurers under the FHA," not HUD's issuance of the Disparate Impact Rule. (*See* Def. Resp. Br. at 13-15.) As explained above, however, the Disparate Impact Rule did more than merely confirm preexisting legal requirements; it exposed PCI's members to disparate impact claims in some jurisdictions where the circuit court had not yet recognized the viability of such claims. Accordingly, the present case is distinguishable from *National Association of Home Builders v. U.S. Army Corps of Engineers,* 663 F.3d 470 (D.C. Cir. 2011), upon which HUD relies, where the "only alteration of the baseline circumstances was in favor of [the plaintiffs]." *See id.* at 474. Here, the Disparate Impact Rule works *against* PCI's members by increasing their exposure to disparate impact liability, not in their favor.

Additionally, as the Court of Appeals for the District of Columbia recognized in *National Association of Home Builders,* "the historical baseline is not the only possible measure of injury." *See id.* at 475. The D.C. Circuit recently confirmed that plaintiffs "need not show that [an agency directive] rendered them worse off than the status quo ante" to establish Article III standing; "[t]hey may alternatively show that, had the [agency] taken the course of action that they claim the law required, they would have been better off." *See Nat'l Envtl. Dev. Ass'n Clean Air Project v. EPA,* 752 F.3d 999, 1006 (D.C. Cir. 2014). Under this approach, "[t]he consequences of the agency's action must, for causation purposes, be assessed not by reference to the status quo ante but instead to other actions [the agency] could have taken." *Id.* Because PCI's members would have been better off if HUD had exempted homeowners insurers from the Disparate Impact Rule, created safe harbors in the Rule for long-recognized actuarial risk factors, and/or adopted the insurance industry's proposed burden-shifting framework for proving

disparate impact claims—as PCI claims HUD should have done—PCI has satisfied the causation requirement of Article III standing. *See id.*

3. Redressability

Third, PCI's members satisfy the redressability requirement of Article III standing. In its remaining claims, PCI argues (1) that HUD's decision that the Disparate Impact Rule applies to homeowners insurance was arbitrary and capricious because HUD did not give adequate consideration to comments from PCI and other insurance industry members regarding the inappropriateness of applying disparate impact liability to insurers, and (2) the burden-shifting framework HUD adopted is contrary to law. The first argument presents a procedural challenge to the Disparate Impact Rule. In the context of procedural challenges, the plaintiff does not need to show that the agency would alter its rules upon following the proper procedures in order to establish redressability. *See Iowa League of Cities v. EPA,* 711 F.3d 844, 871 (8th Cir. 2013) (collecting cases); *see also Lujan,* 504 U.S. at 572 n.7 ("The person who has been accorded a procedural right to protect his concrete interests can assert that right without meeting all the normal standards for redressability and immediacy."). The plaintiff need only demonstrate "some possibility that the requested relief will prompt the injury-causing party to reconsider the decision that allegedly harmed the litigant." *See Iowa League of Cities,* 711 F.3d at 871 (quoting *Massachusetts v. EPA,* 549 U.S. 497, 518, 127 S. Ct. 1438, 167 L. Ed. 2d 248 (2007)). Because there is "some possibility" that granting PCI's requested relief—namely remanding the case to HUD to explain its decision or adopt changes to the Disparate Impact Rule—will prompt HUD to reconsider its decision that the Rule applies to homeowners insurers, PCI has satisfied the redressability requirement of Article III standing with respect to its procedural claim. *See id.*; *Massachusetts v. EPA,* 549 U.S. at 518; *see also Sugar Cane Growers Co-op. of Fla. v.*

Veneman, 289 F.3d 89, 94-95 (D.C. Cir. 2002) ("A plaintiff who alleges a deprivation of a procedural protection to which he is entitled never has to prove that if he had received the procedure the substantive result would have been altered. All that is necessary is to show that the procedural step was connected to the substantive result.").

PCI also satisfies the redressability requirement with respect to its challenge to HUD's burden-shifting framework. PCI argues that HUD should have adopted the burden-shifting framework applied in *Wards Cove*. A ruling in PCI's favor on this issue will result in a more favorable burden of proof to PCI's members, thereby decreasing their exposure to disparate impact liability. This potential is sufficient to demonstrate redressability.

II. Merits of PCI's Remaining Claims

Having found that PCI has standing to assert its remaining claims, the Court now turns to the merits of those claims. First, PCI challenges HUD's determination that the Disparate Impact Rule applies to homeowners insurance as arbitrary and capricious because HUD did not give adequate consideration to various substantive comments from the insurance industry. Second, PCI argues that the burden-shifting framework HUD adopted is contrary to law. The Court addresses PCI's argument that application of the Disparate Impact Rule to homeowners insurance was arbitrary and capricious first.

A. Was HUD's Application of the Disparate Impact Rule to Homeowners Insurers Arbitrary and Capricious?

1. Standard of Review

Review of an agency's action under the arbitrary and capricious standard is narrow and highly deferential. *See Indiana Forest Alliance, Inc. v. U.S. Forest Serv.,* 325 F.3d 851, 858-59 (7th Cir. 2003); *Cassell v. Napolitano,* No. 12-cv-9786, 2014 WL 1303497, at *6 (N.D. Ill. Mar. 31, 2014). To determine whether an agency action is arbitrary or capricious, a reviewing court

must determine "whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment." *See Indiana Forest Alliance,* 325 F.3d at 858-59 (quoting *Marsh v. Oregon Natural Res. Council,* 490 U.S. 360, 378, 109 S. Ct. 1851, 104 L. Ed. 2d 377 (1989)). Courts will not vacate an agency's decision unless the agency

> has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausibly that it could not be ascribed to a difference in view of the product of agency expertise.

Nat'l Ass'n of Home Builders v. Defenders of Wildlife, 551 U.S. 644, 658, 127 S. Ct. 2518, 168 L. Ed. 2d 467 (2007) (quoting *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.,* 463 U.S. 29, 43, 103 S. Ct. 2856, 77 L. Ed. 2d 443 (1983)).

A reviewing court must ensure that the agency "examine[d] the relevant data and articulate[d] a satisfactory explanation for its action, including a rational connection between the facts found and the choice made." *Motor Vehicle Mfrs. Ass'n of U.S.,* 463 U.S. at 43; *see also F.C.C. v. Fox Television Stations, Inc.,* 556 U.S. 502, 513, 129 S. Ct. 1800, 173 L. Ed. 2d 738 (2009). The court, however, may not substitute its judgment for the judgment of the agency. *See Fox Television Stations,* 556 U.S. at 513; *see also Environmental Law & Policy Ctr. v. U.S. Nuclear Regulatory Comm'n,* 470 F.3d 676, 682 (7th Cir. 2006). With these standards in mind, the Court turns to PCI's specific challenges to HUD's actions as arbitrary and capricious.

2. HUD's Consideration of the McCarran-Ferguson Act

First, PCI argues that HUD failed to adequately consider the insurance industry's comments that application of the Disparate Impact Rule to homeowners insurance would violate the McCarran-Ferguson Act. (*See* Admin. R. 372-83, 553-56.) HUD provided the following response to the insurance industry's comments regarding the McCarran-Ferguson Act:

> HUD has long interpreted the [FHA] to prohibit discriminatory practices in connection with homeowner's insurance, and courts have agreed with HUD, including in *Ojo v. Farmers Group*. Moreover, as discussed above, HUD has consistently interpreted the Act to permit violations to be established by proof of discriminatory effect. By formalizing the discriminatory effects standard, the rule will not, as one commenter suggested, "undermine the states' regulation of insurance." The McCarran-Ferguson Act provides that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by the State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance." McCarran-Ferguson does not preclude HUD from issuing regulations that may apply to insurance policies. Rather, McCarran-Ferguson instructs courts on how to construe federal statutes, including the Act. How the Act should be construed in light of McCarran-Ferguson depends on the facts at issue and the language of the relevant State law "relat[ing] to the business of insurance." Because this final rule does not alter the instruction of McCarran-Ferguson or its application as described in *Ojo v. Farmers Group*, it will not interfere with any State regulation of the insurance industry.

Final Rule, 78 Fed. Reg. at 11475. In short, HUD determined that the question of whether McCarran-Ferguson preclusion applies should be left to a case-by-case basis determination based on the facts at issue and the relevant state laws.

As an initial matter, the Court notes that its determination that PCI's McCarran-Ferguson claim is not ripe for judicial review does not necessarily mean that HUD's decision to leave application of McCarran-Ferguson preclusion for a case-by-case determination was not arbitrary and capricious. Federal agencies, unlike federal courts, have rule-making authority, and they can address issues through rule-making that federal courts cannot because of constitutional or prudential limitations on their jurisdiction. *See SEC v. Chenery Corp.*, 332 U.S. 194, 202, 67 S. Ct. 1575, 91 L. Ed. 1995 (1947) ("Since the [SEC], unlike a court, does have the ability to make new law prospectively through the exercise of its rule-making powers, it has less reason to rely upon ad hoc adjudication to formulate new standards of conduct . . . ."). Indeed, "[r]ule-making is an essential component of the administrative process and . . . is often the preferred procedure for the evolution of agency policies." *Trans-Pac. Freight Conference of Japan/Korea v. Fed.*

Mar. Comm'n, 650 F.2d 1235, 1244-45 (D.C. Cir. 1980); *see also Chenery,* 332 U.S. at 202 ("The function of filling in the interstices of [a statute] should be performed, as much as possible, through this quasi-legislative promulgation of rules to be applied in the future.").

> Rule-making has several advantages over piecemeal adjudication:
>
> Rule-making permits more precise definition of statute standards than would otherwise arise through protracted, piecemeal litigation of particular issues. It allows all those who may be affected by a rule an opportunity to participate in the deliberative process, while adjudicatory proceedings normally afford no such protection to nonparties. And because rule-making is prospective in operation and general in scope, rather than retroactive and condemnatory in effect, interested parties are given advance notice of the standards to which they will be expected to conform in the future, and uniformity of result is achieved.

See Trans-Pac. Freight Conference of Japan/Korea, 650 F.2d at 1244-45. Rule-making, however, is not always the best method for creating standards. *See Chenery,* 332 U.S. at 202. When a problem arises that that agency could not have reasonably foreseen, for example, or when the agency does not have "sufficient experience with a particular problem to warrant rigidifying its tentative judgment into a hard and fast rule," case-by-case determinations may be more beneficial than rule-making. *See id.* at 202-03. The same is true when a problem is "so specialized and varying in nature as to be impossible of capture within the boundaries of a general rule." *See id.* at 203.

The decision of whether to address an issue through general rule-making or case-by-by determinations lies largely within the agency's discretion. *See Shays v. Federal Election Comm'n,* 424 F. Supp. 2d 100, 113 (D.D.C. 2006) (citing *Chenery,* 332 U.S. at 203). An agency's reliance on case-by-case adjudication, however, can amount to an abuse of discretion in some cases. *See id.* Furthermore, an agency's failure to provide a reasoned explanation for relying on case-by-case adjudication may render its decision arbitrary and capricious. *See id.* at 116; *see also Williams Natural Gas Co. v. F.E.R.C.,* 872 F.2d 438, 450 (D.C. Cir. 1989)

("Issuance of the [Notice of Proposed Rulemaking] . . . oblige[d] the agency to consider the comments it received and to articulate a reasoned explanation for its decision.").

HUD's one-paragraph response to the insurance industry's detailed concerns that applying the Disparate Impact Rule to homeowners insurance would violate the McCarran-Ferguson Act fails to provide a reasoned explanation to prefer case-by-case application of McCarran-Ferguson preclusion over rule-making. To begin with, the fact that the McCarran-Ferguson Act does not preclude HUD from issuing regulations that may apply to insurance policies does not mean that HUD can simply disregard the likelihood that McCarran-Ferguson preclusion will apply in promulgating its regulations. *Cf. Shays,* 424 F. Supp. 2d at 116 ("The question . . . is not whether the Commission has statutory authority to bring enforcement actions, but whether it acted rationally here by refusing to promulgate a rule in favor of its purported preference for piecemeal adjudications . . . .").

Furthermore, although HUD recognized that application of McCarran-Ferguson preclusion depends on the facts at issue and the relevant State laws, it made no attempt to evaluate how often McCarran-Ferguson preclusion would apply and whether it would bar entire categories of disparate impact claims against insurers. In other words, HUD made no attempt to determine whether the benefits of proceeding by case-by-case adjudications outweighed the benefits of including an exemption or safe harbors for insurers in the Disparate Impact Rule. HUD's lack of analysis is particularly glaring in light of the Seventh Circuit's reasoning in *Mutual of Omaha,* 179 F.3d at 563-64, and the Eighth Circuit's similar recognition in *Saunders,* 537 F.3d at 967, that "a suit challenging the racially disparate impact of industry-wide rate classifications may usurp core rate-making functions of the State's administrative regime." Based on the record, HUD has failed to consider this important aspect of the issue.

Finally, HUD's statement that the Disparate Impact Rule would not alter the McCarran-Ferguson analysis performed in *Ojo v. Farmers Group* does not explain why case-by-case adjudication is more appropriate than rule-making. Courts do not have rule-making authority; unlike agencies, they can only decide issues through case-by-case adjudications. Moreover, while HUD cited *Ojo* to support its position that case-by-case adjudication is appropriate, it failed to even acknowledge *Mutual of Omaha* and *Saunders*, which called into question the viability of many (if not most) disparate impact claims against insurers in light of the McCarran-Ferguson Act.

Although HUD had discretion to decide whether to proceed by case-by-case adjudication or rule-making, it needs to provide a reasoned explanation for preferring case-by-case adjudication over rule-making. HUD's failure to do so was arbitrary and capricious. *See Shays*, 424 F. Supp. 2d at 116 (the Federal Election Committee's lack of explanation for its conclusion that adjudication is preferable to rulemaking for specific groups rendered its purported preference for piecemeal adjudications an abuse of discretion); *see also Chamber of Commerce of U.S. v. Federal Election Comm'n*, 69 F.3d 600, 606 (D.C. Cir. 1995) (holding that the agency's regulation was arbitrary and capricious because the agency failed to provide a reasoned explanation for including certain exemptions). The Court, therefore, remands this case to HUD for further explanation.

3. HUD's Consideration of the Filed-Rate Doctrine

Second, PCI claims that HUD failed to adequately consider whether the Disparate Impact Rule violated the filed-rate doctrine. The filed-rate doctrine "forbids courts from invalidating or modifying rates that have been filed with regulatory agencies." *See Schilke v. Wachovia Mortgage, FSB*, 820 F. Supp. 2d 825, 835 (N.D. Ill. 2011) (citing *Goldwasser v. Ameritech*

Corp., 222 F.3d 390, 402 (7th Cir. 2000); *Arsberry v. Illinois,* 244 F.3d 558, 562 (7th Cir. 2001)). Put differently, the doctrine "bars courts from altering filed rates, and, by extension, prohibits a court from awarding a plaintiff damages based on the difference between a filed rate and an allegedly lawful rate." *Id.*

During the notice-and-comment period, National Association of Mutual Insurance Companies ("NAMIC") expressed concern that applying the Disparate Impact Rule to homeowners insurance would violate the filed-rate doctrine. (*See* Admin. R. at 378.) In its Final Rule, HUD grouped NAMIC's comment regarding the filed-rate doctrine with the insurance industry's comments regarding the McCarran-Ferguson Act. *See* Final Rule, 78 Fed. Reg. at 11474 ("Some commenters stated that application of the disparate impact standard would interfere with state regulation of insurance in violation of the McCarran-Ferguson Act . . . or the common law 'filed rate doctrine.'"). In its response to those questions, however, HUD referenced only the McCarran-Ferguson Act; it did not mention the filed-rate doctrine.

HUD's failure to separately discuss the filed-rate doctrine, on its own, does not render the Disparate Impact Rule's application to homeowners insurers arbitrary and capricious. The purpose of the filed-rate doctrine is very similar to the purpose of the McCarran-Ferguson Act—preventing courts from interfering with state's regulatory regimes, and where the filed-rate doctrine applies, the McCarran-Ferguson Act almost certainly applies too. Accordingly, HUD's response (or lack thereof) to NAMIC's filed-rate doctrine argument alone does not make its actions arbitrary and capricious. *See Alaska Dep't of Envtl. Conservation v. EPA,* 540 U.S. 461, 497, 124 S. Ct. 983, 15 L. Ed. 2d 967 (2004) ("Even when an agency explains its decision with 'less than ideal clarity,' a reviewing court will not upset the decision on that account 'if the agency's path may reasonably be discerned.'" (quoting *Bowman Trasp., Inc. v. Arkansas-Best*

Freight Sys., Inc., 419 U.S. 281, 286, 95 S. Ct. 438, 42 L. Ed. 2d 447 (1974))). In failing to give adequate consideration to the insurance industry's comments regarding the McCarran-Ferguson Act, however, HUD also failed to give adequate consideration to NAMIC's comments regarding the filed-rate doctrine. Accordingly, on remand, HUD must explain its decision regarding the filed-rate doctrine or institute a new rule, as it must with respect to the industry's McCarran-Ferguson comments.

4. HUD's Consideration of the Nature of Insurance

Third, PCI claims that HUD did not adequately address the effect the Disparate Impact Rule would have on the insurance industry due to the nature of insurance. During the notice-and-comment period, members of the insurance industry raised several concerns about the inappropriateness of applying disparate impact liability to insurers based on the fundamental nature of insurance. The commenters noted that "[t]he foundation of the business of insurance, and in particular underwriting and rate-making, is classifying insurance applicants and policyholders by risk. Insurers make decisions based on actuarial and business principles that group policyholders for the purpose of treating those with similar risk profiles similarly." (*See* Admin. R. at 376); *see also American Family,* 978 F.2d at 290 ("Insurance works best when the risks in the pool have similar characteristics."). The very essence of risk-based pricing involves "identify[ing] relationships between factors and risk of loss and allocate[ing] costs accordingly." (*See* Admin. R. at 376.) The insurance industry argued that applying disparate impact liability to insurers could jeopardize their use of actuarially sound underwriting factors that are "at the very heart of the business of insurance."[11] (*See id.* at 376-77.) Additionally, the insurance industry

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[11] Factors commonly used in pricing homeowners insurance include "claim history of the applicant, construction material(s), distance from a fire station, dog/breed of dog owned, fire suppression devices, home-based business presence and type, lead paint potential (constructed pre-1978), loss history of

argued that preventing insurers from classifying people and properties by the risks they present and treating similar risk profiles in a similar way—regardless of the disparate impact this may have on certain groups—would increase adverse selection and decrease the availability of coverage. (*See id.* at 377-78.)

HUD provided the following response to these comments:

> HUD believes that these concerns are misplaced. First, they presume that once a discriminatory effect is shown, the policy at issue is per se illegal. This is incorrect. Rather, as § 100.500 [of the Disparate Impact Rule] makes clear, the respondent or defendant has an opportunity to defend the business justifications for its policies. This "burden-shifting framework" distinguishes "unnecessary barriers proscribed by the Act from valid policies and practices crafted to advance legitimate interests." Thus if a policy has a discriminatory effect, it may still be legal if supported by a legally sufficient justification.

Final Rule, 78 Fed. Reg. at 11475. HUD went on to state that "[c]reating exemptions or safe harbors related to insurance is unnecessary because, as discussed above, insurance practices with a legally sufficient justification will not violate the Act. Moreover, creating exemptions beyond those found in the Act would run contrary to Congressional intent." *Id.* (citing *Groach Associates #33, L.P. v. Louisville/Jefferson Cnty. Metro Human Relations Comm'n,* 508 F.3d 366, 374-75 (6th Cir. 2007)).

HUD's response to the insurance industry's concerns that exposing them to disparate impact liability would undermine the fundamental nature of insurance was arbitrary and capricious. HUD made no effort to evaluate the substance of the insurance industry's concerns, disregarding them merely because insurers would have an opportunity to raise their arguments as part of the burden-shifting framework. The ability of insurers to re-raise their arguments on a case-by-case basis in subsequent proceedings, however, does not alleviate HUD of its obligation

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property, roofing material, trampoline use, slab versus basement and the present of an operational security system." (*See* Admin. R. at 376.)

to consider the substance of the insurance industry's concerns raised during the notice-and-comment period. *See State Farm Mut. Auto. Ins. Co.,* 463 U.S. at 43 (an agency rule is arbitrary and capricious where the agency "entirely failed to consider an important aspect of the problem").

HUD relies on *Groach* to justify its decision not to create categorical exemptions to disparate impact liability. *See* Final Rule, 78 Fed. Reg. at 11475 nn.140-41. In *Groach,* however, the Sixth Circuit expressly found that "if *no* disparate-impact challenge to a particular practice ever could succeed under the burden-shifting framework, then a court categorically may bar *all* disparate-impact challenges to that practice." *See* 508 F.3d at 375 (emphasis in original). Indeed, the Sixth Circuit saw "no reason to require courts to engage in the Sisyphean task of working through the burden-shifting framework in each individual case when the plaintiff has no chance of success . . . ." *Id.* at 376. *Groach,* therefore, supports the insurance industry's argument that HUD should include exemptions from the Disparate Impact Rule or create safe harbors in the Rule for insurance practices that plaintiffs would have no chance of successfully challenging under the burden-shifting framework. *See id.*

The insurance industry properly raised its concerns about the application of disparate liability to insurers during the notice-and-comment period, and HUD had an obligation to respond to the substance of those concerns or, alternatively, provide a reasoned explanation why case-by-case determinations of the insurers' arguments are preferable to rule-making. *See Shays,* 424 F. Supp. 2d at 116; *Williams Natural Gas Co.,* 872 F.2d at 450. HUD's failure to do so makes the Disparate Impact Rule's application to homeowners insurance arbitrary and capricious. *See Shays,* 424 F. Supp. 2d at 116. Accordingly, the Court remands this case to HUD for further explanation.

B. Is HUD's Burden-Shifting Approach Contrary to Law?

Finally, PCI contests HUD's adoption of the three-step burden-shifting approach outlined in the Disparate Impact Rule as contrary to law. Specifically, PCI argues that HUD's burden-shifting approach is contrary to the approach the Supreme Court adopted for disparate impact claims in *Wards Cove Packing Co. v. Antonio,* 490 U.S. 642, 109 S. Ct. 2115, 104 L. Ed. 2d 733 (1989).[12]

HUD's burden-shifting approach, like the *Wards Cove* approach, consists of three steps: the first step centers on whether a practice has a disparate impact on protected groups; the second step concerns whether the defendant has a legitimate business reasons for engaging in the practice; and the third step evaluates whether a less discriminatory alternative would also serve the defendant's legitimate business interests. Several differences, however, exist between the two approaches. First, the *Wards Cove* approach requires the plaintiff to challenge a *particular* practice, whereas HUD has indicated that a plaintiff may be able "to challenge the decision-making process as a whole." *See* 78 Fed. Reg. at 11469. Second, *Wards Cove* requires the plaintiff to show that the challenged practice creates a "significant" disparate impact, whereas HUD's framework does not require a showing that the alleged disparate impact is "significant." Third, under the *Wards Cove* approach, the burden of proof always remains with the plaintiff, and only the burden of production shifts to the defendant. In HUD's framework, on the other hand, the defendant bears the burden of proof—not just the burden of production—in the second step. Fourth, *Wards Cove* does not require the defendant's legitimate business interest to be

[12] In 1991, Congress established a statutory framework for proving disparate impact claims in the Title VII context that was less burdensome on plaintiffs than the *Wards Cove* standard. *See* 42 U.S.C. § 2000e-2(k); *see also Smith v. City of Jackson, Miss.,* 544 U.S. 228, 240, 125 S. Ct. 1536, 161 L. Ed. 2d 410 (2005). The Supreme Court, however, has continued to apply the *Wards Cove* framework outside the Title VII context. In *Smith,* for example, the Supreme Court held that the *Wards Cove* standard continues to govern age discrimination claims brought under the Age Discrimination in Employment Act ("ADEA"). *See* 544 U.S. at 240-41.

"essential" or "indispensable" for it to pass muster in the second step, but HUD's framework requires the defendant to prove that its business interest was "necessary." Fifth, in *Wards Cove,* the Supreme Court held that any alternative practice the plaintiff offered in the third step must be "equally effective" as the challenged practice. HUD, on the other hand, has determined that an "equally effective" standard is inappropriate.

Pursuant to *Chevron v. U.S.A. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43, 104 S. Ct. 2778, 81 L. Ed. 2d 694 (1984), courts must defer to agency interpretation of a statute where Congressional intent is unclear, and a statute affords an agency authority under the statute.[13] A two-step analysis applies for determining whether *Chevron* deference applies. In the first step of the *Chevron* analysis, the court must determine whether "the intent of Congress is clear" regarding the precise question at issue. *See Barnhart v. Walton,* 535 U.S. 212, 218, 122 S. Ct. 1265, 152 L. Ed. 2d 330 (2002) (citing *Chevron,* 467 U.S. at 842-43). If "the statue speaks clearly 'to the precise question at issue,' [a court] 'must give effect to the unambiguously expressed intent of Congress.'" *Id.* If, on the other hand, "the statute is silent or ambiguous with respect to the specific issue," the Court proceeds to the second step of the *Chevron* analysis, in which the Court defers to any reasonable agency interpretation of the statute. *See Castro v. Chicago Hous. Auth.,* 360 F.3d 721, 727 (7th Cir. 2004). With respect to the first step of the *Chevron* analysis, the FHA is silent regarding how the FHA or a private plaintiff should prove a housing discrimination claim. Accordingly, resolution of this issue rests on the second step of the *Chevron* analysis, and the Court must uphold HUD's adoption of the three-step burden-shifting framework as long as it is a reasonable interpretation of the FHA.

[13] There is no dispute here that Congress authorized HUD to implement and administer the FHA. *See* 42 U.S.C. § 3614a.

The burden-shifting framework HUD adopted in the Disparate Impact Rule reflects HUD's reasonable accommodation of the competing interests at stake—*i.e.*, the public's interest in eliminating discriminatory housing practices and defendants' (including insurer-defendants') interest in avoiding costly or frivolous litigation based on unintentional discriminatory effects of their facially neutral practices. HUD's framework is largely consistent with the framework courts have developed on their own for analyzing disparate impact claims. Although the approaches adopted in each circuit varied before the Disparate Impact Rule, the most recent decisions applied the same approach adopted by HUD. *See Inclusive Communities Project, Inc. v. Texas Dept. of Hous. & Comm'ty Affairs,* 747 F.3d 275, 281-82 (5th Cir. 2014) (collecting cases). Additionally, the approach HUD adopted is similar to the statutory approach Congress adopted for Title VII disparate impact cases. *See* 42 U.S.C. § 2000e-2(k). Courts have repeatedly turned to Title VII precedent for guidance evaluating disparate impact liability under the FHA (Title VIII) and vice versa. *See, e.g., Kyles v. J.K. Guardian Sec. Servs., Inc.,* 222 F.3d 289, 295 (7th Cir. 2000) ("Courts have recognized that Title VIII is the functional equivalent of Title VII, . . . and so the provisions of these two statutes are given like construction and application." (citations omitted)); *Inclusive Communities Project,* 747 F.3d at 282. Under these circumstances, HUD's adoption of the three-step burden-shifting approach outlined in the Disparate Impact Rule was reasonable and the Court defers to it. *See, e.g., Castro,* 360 F.3d at 727; *see also United States v. Boyle,* 469 U.S. 241, 246 n.4, 105 S. Ct. 687, 83 L. Ed. 2d 622 (1985) (finding that an agency's interpretation that is "consistent with Congress' intent, and over 40 years of case law" merits deference); *Inclusive Communities Project,* 747 F.3d at 282.

Additionally, although PCI raises challenges to specific aspects of HUD's framework, HUD considered and responded to those challenges during the notice-and-comment period.

Unlike HUD's responses to several of the insurance industry's other concerns, HUD provided reasoned explanations for rejecting the commenters' challenges to HUD's burden-shifting approach. *See* Final Rule, 78 Fed. Reg. at 11469, 11471-74. In sum, PCI has provided no basis for the Court to invalidate HUD's burden-shifting approach.[14]

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[14] PCI argues in its briefs that HUD's burden-shifting approach violates the APA's requirement that the proponent of a proposed "order"—*i.e.*, a proposed finding of a violation of the FHA—must bear the burden of proof. *See* 5 U.S.C. § 556(c). Neither PCI nor the other members of the insurance industry that commented on the proposed Disparate Impact Rule, however, raised this issue during the notice-and-comment period. PCI contends that, although insurance industry commenters did not cite 5 U.S.C. § 556(d), their argument that the burden of persuasion must remain with the plaintiff at each step of the disparate impact analysis was sufficient to preserve the § 556(d) issue. The Court disagrees. The insurance industry's comments regarding HUD's burden-shifting framework dealt exclusively with its appropriateness in light of *Wards Cove*. Those comments failed to put HUD on notice of PCI's argument under § 556(d) and give HUD an opportunity to pass on it. The issue is therefore waived. *See Koretoff v. Vilsack,* 707 F.3d 394, 398 (D.C. Cir. 2013) ("We require 'the argument [petitioner] advances here' to be raised before the agency, not merely the same general legal issue.'" (quoting *Nuclear Energy Inst., Inc. v. EPA,* 373 F.3d 1251, 1291 (D.C. Cir. 2004) (per curiam)).

CONCLUSION

For the reasons explained above, the Court grants in part and denies in part PCI's motion for summary judgment, and grants in part and denies in part HUD's motion to dismiss or for summary judgment. The Court dismisses PCI's McCarran-Ferguson claim for lack of subject matter jurisdiction. With respect to PCI's remaining claims, the Court grants summary judgment to PCI on its claims that HUD's application of the Disparate Impact Rule to homeowners insurance was arbitrary and capricious, and grants summary judgment to HUD on PCI's challenge to HUD's burden-shifting framework. The Court remands this case to HUD for further proceedings consistent with this Memorandum, Opinion and Order.

DATED: September 3, 2014

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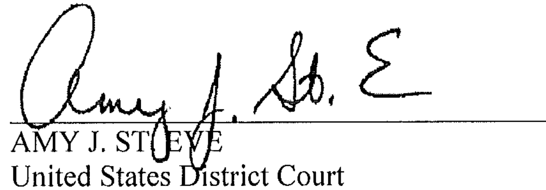

AMY J. ST. EVE
United States District Court