



“Disparate Impact” Finally Gets Its Due

U.S. Supreme Court’s Grant of Certiorari in Case from the Fifth Circuit Squarely Places the Doctrine at Issue

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A definitive Supreme Court ruling concerning the viability of the disparate impact theory under the Fair Housing Act has proven elusive. In recent years, the Court granted certiorari in two cases squarely presenting this issue, namely *Magner v. Gallagher*, 132 S. Ct. 548 (2011) and *Township of Mount Holly, N.J. v. Mt. Holly Gardens Citizens in Action, Inc.*, 133 S. Ct. 2824 (2013). However, both cases settled prior to oral argument. On October 2, 2014, the Court granted certiorari to resolve this question in a case arising out of the Fifth Circuit, with perhaps far-reaching consequences for the existing fair lending regulatory framework.

In *The Inclusive Communities Project, Inc. v. Texas Department of Housing and Community Affairs et al.*, No. 12-11211 (5th Cir., Mar. 24, 2014), the Fifth Circuit addressed the appropriate legal standard to be applied in disparate impact claims under the Fair Housing Act. In this case, The Inclusive Communities Project (ICP) sued the Texas Department of Housing and Community Affairs (TDHCA) on grounds that the process by which the TDHCA allocates low-income housing tax credits violates the Fair Housing Act, the Fourteenth Amendment and 42 U.S.C. §§ 1981 *et seq.* Specifically, ICP argued that the formulas for distributing tax credits, which involve some disputed level of discretion, have resulted in the TDHCA disproportionately approving tax credit units in heavily minority neighborhoods and disapproving tax credits in predominantly white areas. The purportedly skewed allocation process allegedly resulted in a dearth of low-income housing units in non-minority areas, thereby maintaining and perpetuating segregated housing patterns. Notably, ICP’s claims were premised largely on statistical data, drawn from Texas House committee reports, TDHCA records and selected Housing and Urban Development (HUD) studies.

Following a bench trial, the district court ruled that ICP failed to establish intentional discrimination violative of federal law. Regarding ICP’s disparate impact claim, however, the district court concluded that the defendants had not produced evidence sufficient to meet their burden to show that there were no less discriminatory alternatives to the challenged tax credit allocations. As a result, it ruled in favor of ICP on its disparate impact claim under the Fair Housing Act.



Acknowledging that it has previously recognized the disparate impact theory under the Fair Housing Act in 1996 and again in 2009, a three-judge panel of the Fifth Circuit refused to revisit that central question during the pendency of the *Mount Holly* and *Gallagher* certiorari petitions. The Fifth Circuit, instead, addressed only whether the district court erred in imposing the burden on defendants to present sufficient evidence concerning the absence of a less discriminatory alternative, viewing the predicate question as settled law in the circuit. Noting the variations in standards adopted by sister circuits, the court adopted the burden-shifting approach set forth in HUD-issued regulations, 24 C.F.R. § 100.500, which expressly shift the burden to defendants to prove that “the challenged practice is necessary to achieve one or more substantial, legitimate, nondiscriminatory interests.” The appellate court reversed the judgment of the district court and remanded the case, noting that it was unnecessary to resolve other issues raised by the defendants on appeal.

This decision is significant both for the Fifth Circuit’s adoption of the burden-shifting standards codified in HUD regulations, as well as for the court’s decision not to revisit the disparate impact theory. Controversy rages around disparate impact given the current breadth of its application in the mortgage lending, insurance and student loan regulatory contexts. Significantly, the Consumer Financial Protection Bureau’s guidance on fair lending, along with its investigative focus, is rooted firmly in the disparate impact framework.

A central question of policy, rather than law, is the apparent motivation behind the appeal, *i.e.* whether the government must seek the elimination of racial disparities in the distribution of housing subsidies, a focus which is at variance with the Texas Legislature’s intention to revitalize low-income areas through its low-income tax credit program. The TDHCA, however, requested that the U.S. Supreme Court directly address the viability of disparate impact under the Fair Housing Act. That request was joined by Frazier Revitalization, Inc., an intervenor in the underlying case, as well as a number of amici.

By granting the TDHCA’s certiorari petition in this case, the Court has signaled its clear determination to resolve this long-debated predicate question. However, the impact of its ruling may be immediate, and result in a substantial reworking of the fair lending regulatory framework governing the nation’s financial institutions.

For more information on the matters discussed in this *Locke Lord QuickStudy*, please contact the authors.

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