INCLUSIVE COMMUNITIES ONE YEAR LATER: WHAT DOES IT MEAN FOR UNDERWRITING POLICIES AND PROCEDURES?

July 21, 2016

John A. Houlihan and Raymond M. Ripple

In one of the seminal decisions of last year's term, the U.S. Supreme Court in a five to four decision written by Justice Kennedy, held that plaintiffs may rely on a disparate impact theory to establish a violation of the Fair Housing Act ("FHA").[1] Unlike direct discrimination claims, disparate impact liability does not require any evidence of intentional discrimination by a defendant. Historically, plaintiffs established liability or at least compelled defendants to entertain plaintiff friendly settlements by relying almost exclusively on statistical evidence to show that a facially-neutral policy was discriminatory because of the negative impact that it had on a protected class. In the years leading up to the *Inclusive Communities* decision, both the plaintiffs' bar and the Department of Housing and Urban Development ("HUD") increased their efforts to utilize disparate impact analysis to challenge insurance underwriting practices that many in the industry long thought to be beyond the scope of the FHA. As a result of the *Inclusive Communities* decision, the door remains open for such challenges, but over the course of the past year, a new landscape has started to emerge that presents real challenges for plaintiffs who attempt to employ disparate impact allegations within the broad framework outlined by the *Inclusive Communities* Court.

Disparate Impact Claims

The Court's *Inclusive Communities* holding left the door open for disparate impact claims in FHA cases, but it also raised the pleading bar for such claims. The Court grounded its analysis on the observation that disparate impact liability "mandates the 'removal of artificial, arbitrary and unnecessary barriers' … not the displacement of valid … policies."[2] In order to prevent disparate impact liability from imperiling valid governmental or business interests, the Court broadly outlined an approach to resolving disparate impact claims that begins with the requirement that the plaintiff plead facts sufficient to demonstrate that the defendant had a concrete policy that caused a disparate impact on a protected class, but also permits the defendant to establish a "valid interest" in the subject policy that, at least in some circumstances, will outweigh the negative impact on the protected class.

At first glance, the Court's outline looks distressingly similar to the test proposed by HUD in its earlier rule making exercise. However, the Court also stated that "… a disparate-impact claim that relies on a statistical disparity *must fail* if the plaintiff cannot point to a defendant's policy or policies causing that disparity."[3] Justice Kennedy then instructed trial courts to apply a "robust causality requirement" and to "… examine with care whether a plaintiff has made out a prima facie case of disparate impact."[4] In the Court's view, focusing on the causal link between a specific policy and the alleged disparate impact "protects defendants from being held liable for racial disparities they did not create" and prevents disparate-impact liability from using race "in a pervasive way" that "would almost inexorably lead governmental or private entities to use 'numerical quotas,'" a development that, in the Court's view, would raise "serious constitutional questions."[5]

The Results Post-*Inclusive Communities*

The results over the year since the Court issued its *Inclusive Communities* decision suggest that trial courts have taken the Court's admonition to heart. For example, in *City of Los Angeles v. Wells Fargo & Co.*;[6] *Ellis v. City of Minneapolis*;[7] and *Cobb County v. Bank of America Corp.*,[8] the trial courts focused on Justice Kennedy's requirement that the plaintiff prove a "robust causality" between a challenged policy and a statistical disparate impact on a protected group. Although the procedural settings varied slightly, in each case the trial court, at an early stage in the proceedings, disposed of FHA claims because the plaintiff failed to identify a facially neutral policy that *caused* harm to a protected group. Taken together, the *City of Los Angeles, Ellis*, and *Cobb County* cases demonstrate the challenge posed to FHA plaintiffs by the *Inclusive Communities* decision.

The City of Los Angeles case is particularly interesting. In that case, the plaintiff City argued that '"[the Bank's] inadequate monitoring policies' caused the disparate impact."[9] The court noted that the City's argument did not "actually identify any policy that created an artificial, arbitrary, or unnecessary barrier."[10] Instead, the City argued that "a *lack* of a policy produced the disparate impact."[11] The court rejected the City's argument, because there was "no authority that suggests that disparate impact claims are designed to impose new policies on private actors. Guidance from the Supreme Court is unambiguous that disparate claims must solely seek to *remov*e barriers."[12] According to the trial court, by arguing that the bank caused a disparate impact by failing to "employ a policy that would 'monitor relevant data' and 'correct the disproportionate issuance' of high cost loans to minorities," the City was "essentially advocating for a racial quota."[13]

Heightened Scrutiny

Clearly the early returns from trial courts indicate that as a result of the *Inclusive Communities* decision, FHA plaintiffs will face heightened scrutiny at the pleading stage. This heightened level of scrutiny will necessarily impact the extent to which the pre-*Inclusive Community* trend of expanded litigation against insurers continues or abates. Prior to the *Inclusive Communities* decision, resourceful plaintiff's counsel attempted to develop data purporting to link facially neutral underwriting criteria – such as an insured's or insured's tenants' source of income, an insured's tenant mix or the age of the insured premises – to an alleged lack of availability of certain insurance products in minority communities or to an alleged increase in the cost of the insurance that was available. Now plaintiffs must do more. Not only must a plaintiff advance credible evidence of a statistical disparity relating to an insurance product, now, as a result of the *Inclusive Communities* decision, a plaintiff must allege and point to specific statistical evidence to support the allegation that a specific underwriting policy actually caused the negative disparate impact. The burden will then fall to the defendant company to show a "valid interest" in the form of a necessary connection between the underwriting policy or practice at issue and a reasoned analysis of the degree of risk associated with the hypothetical loss that a particular insurance product is designed to cover. While this may sound simple enough, producing admissible evidence of a business interest in a specific underwriting practice could prove to be challenging. Relevant material would include: industry or company studies linking the challenged underwriting practice to a risk of loss, the date of any such studies, the manner in which any such studies were conducted, countervailing data if any, and the defendant's internal records relating to the specific policy or practice. In order to establish a "valid interest" the available memoranda and data will need to demonstrate that the defendant's focus was on the business interest of accurately assessing the risk of loss, but even if a company succeeds in establishing a "valid interest" in maintaining its existing underwriting policies and procedures, the plaintiff could still prevail by showing that other reasonable and less discriminatory alternatives could gauge the risk of loss with equal or greater accuracy.

Conclusion

Largely because of the evidentiary challenges it will present for defendant companies, the Court's discussion of the ability to defend disparate impact claims by establishing a "valid interest" in maintaining existing policies and procedures will likely have less impact on the development of FHA law, than will Justice Kennedy's emphasis on the importance of establishing a causal link between the challenged practice and the alleged discriminating impact. It is one thing to present statistical evidence demonstrating that a particular demographic is underserviced by the insurance industry or that certain groups tend to pay more than others for similar coverage. However, it is another thing altogether to establish that a particular underwriting policy or procedure caused a minority community to be underserviced or overcharged. Focusing on the need for such a causal connection will likely prove to be the most effective line of defense in the wake of the I*nclusive Communities* decision. Nevertheless, prudence suggests that companies review their underwriting policies and procedures to identify potentially problematic practices and consider whether alternative approaches might be equally effective at gauging the risk of loss without creating the appearance of discrimination by disproportionately impacting protected groups.

Notes

[1] *Texas Department of Housing and Community Affairs v. Inclusive Communities Project, Inc.*, 135 S. Ct. 2507 (2015).

[2] *Inclusive Communities*, 135 S. Ct. at 2522, quoting *Griggs v. Duke Power Co.*, 401 U.S. 424, 431 (1971).

[3] *Inclusive Communities* 135 S. Ct. at 2523 (emphasis added).

[4] *Id.*

[5] *Id.*

[6] 2015 U.S. Dist. LEXIS 93451 (C.D. Cal. July 17, 2015).

[7] 2015 U.S. Dist. Lexis 111389 (D. Minn. Aug. 24, 2015).

[8] 2016 U.S. Dist. LEXIS 70268 (N.D. Ga. May 2, 2016).

[9] City of Los Angeles, 2015 U.S. Dist. LEXIS 93451 at 26.

[10] *Id.* at 26-27.

[11] *Id.* at 27.

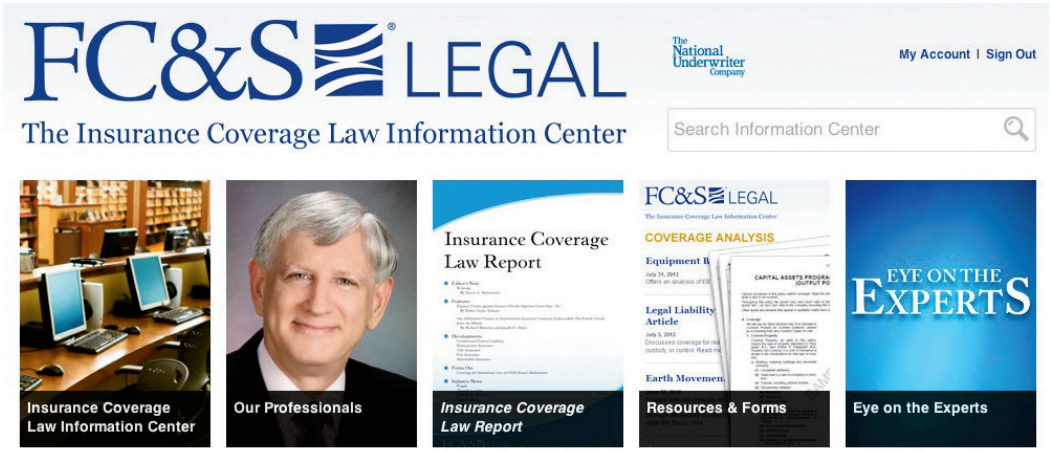
[12] *Id.*

[13] *Id.*

About the Authors

John A. Houlihan is a partner in **Locke Lord LLP**'s Boston office, where he is co-chair of the Banking and Financial Institutions Litigation Practice Group. Mr. Houlihan may be reached at john.houlihan@lockelord.com.

Raymond M. Ripple is senior counsel in **Locke Lord LLP**'s Providence office focusing his practice on commercial and financial services litigation. Mr. Ripple may be contacted at raymond.ripple@lockelord.com.



For more information, or to begin your free trial:

- Call: 1-800-543-0874
- Email: customerservice@nuco.coms
- Online: www.fcandslegal.com

FC&S Legal guarantees you instant access to the most authoritative and comprehensive insurance coverage law information available today.

This powerful, up-to-the-minute online resource enables you to stay apprised of the latest developments through your desktop, laptop, tablet, or smart phone —whenever and wherever you need it.