COVINGTON

COVINGTON & BURLING LLP

ADVISORY | Financial Institutions

February 14, 2013

HUD ISSUES FINAL DISPARATE IMPACT RULE UNDER THE FAIR HOUSING ACT

On February 8, 2013, the Department of Housing and Urban Development ("HUD") issued a final rule under title VIII of the Civil Rights Act of 1968, the Fair Housing Act ("Act"), prohibiting practices that have an unjustified disparate impact on a constitutionally-protected class regardless of whether there was an intent to discriminate. The final rule memorializes the department's interpretation of the Act asserted over time in administrative actions, litigation, and congressional proceedings. The final rule takes into consideration comments received by HUD during the public comment period that followed issuance of the proposed rule on November 16, 2011.

BACKGROUND

The Fair Housing Act was enacted in 1968 and prohibits a person or entity, the business of which includes residential real estate-related transactions (*e.g.*, making mortgage loans), from discriminating against any person in making available such transactions, or in the terms or conditions of such transactions, because of race, color, religion, sex, handicap, familial status, or national origin.[1] HUD historically has interpreted the Act broadly to include not only acts or practices reflecting discriminatory intent but also facially-neutral acts or practices that have a discriminatory effect (known as a disparate impact). The final rule codifies HUD's interpretation.

The preamble to the final rule recites the history of HUD's interpretation of the Act to cover disparate impact, including in internal enforcement materials, formal adjudications, policy statements, congressional testimony and correspondence, litigation, and other housing-related regulations. Moreover, 11 federal courts of appeals have held that the Act supports a disparate impact theory of discrimination.[2]

To evaluate disparate impact claims, HUD's final rule establishes a burden-shifting test that has been used by HUD and most federal courts in the past. HUD issued the rule to standardize the disparate impact framework, both because small variations in the test have developed over time in federal courts and to give parties engaged in residential real estate-related transactions clarity and predictability for disparate impact liability.

HUD'S FINAL RULE

HUD's final rule establishes a three-part burden shifting test for determining whether a defendant is liable for discrimination under the disparate impact theory:

---

[1] *See* 42 U.S.C. § 3605(a).

[2] There nonetheless remains considerable debate whether the Act supports a disparate impact theory of discrimination, as reflected in many of the comments summarized in the final rule's preamble. The U.S. Supreme Court has never held that the Act permits a disparate impact theory of discrimination. Other titles of the Civil Rights Act of 1968, such as title VII, the Age Discrimination in Employment Act, contain language acknowledging a disparate impact theory of discrimination, whereas the Act does not contain equivalent language. Finally, secondary sources such as presidential signing statements and U.S. government amicus briefs suggest that the Act does not support disparate impact.

1. The government enforcement agency or plaintiff has the burden of proving that the defendant's practice 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. If the agency or plaintiff satisfies this burden, the burden shifts to the defendant.
2. After the agency or plaintiff satisfies its initial burden, the defendant has the burden of proving that the challenged practice is necessary to achieve one or more substantial, legitimate, nondiscriminatory interests of the defendant. If the defendant satisfies this burden, the burden shifts back to the agency or plaintiff.
3. Finally, the agency or plaintiff may prevail with a disparate impact claim by proving that the substantial, legitimate, nondiscriminatory interests of the defendant supporting the practice could be served by another practice that has a less discriminatory effect.

The rule makes clear that this burden shifting test does not apply to claims of intentional discrimination. In addition, the rule adds illustrations of discriminatory housing practices in HUD's broad rule implementing the Act, including making clear that determining the type of loan or fixing the loan's terms and conditions, such as interest rate, because of race, color, religion, sex, handicap, familial status, or national origin is prohibited. Similarly, providing or failing to provide loans in a manner that discriminates in their denial rate because of race, color, religion, sex, handicap, familial status, or national origin also is prohibited.

IMPLICATIONS

HUD's final rule will have significant implications. A plaintiff seeking to hold a lender liable using a disparate impact claim now has a clear framework formalized by HUD, the agency responsible under the Act for its administration. Similarly, federal courts' existing precedent supporting disparate impact claims under the Act will be bolstered in light of HUD's official interpretation. Finally, if the U.S. Supreme Court ever decides to rule on the validity of disparate impact claims under the Act, HUD's final rule will serve as an official interpretation of the Act that may be accorded deference by the Court.[3]

If you have any questions concerning the material discussed in this client advisory, please contact the following members of our financial institutions practice group:

John Dugan	+1.202.662.5051	jdugan@cov.com
Michael Nonaka (author)	+1.202.662.5727	mnonaka@cov.com
Keith Noreika	+1.202.662.5497	knoreika@cov.com
Mark Plotkin	+1.202.662.5656	mplotkin@cov.com
Stuart Stock	+1.202.662.5384	sstock@cov.com
D. Jean Veta (author)	+1.202.662.5294	jveta@cov.com
Edward Yingling	+1.202.662.5029	eyingling@cov.com

[3] The Court currently is considering whether to hear arguments in *Mount Holly v. Mt. Holly Gardens Citizens in Action*, No. 11-1507 (3d Cir. 2011), which would ask the Court to consider whether the Act supports disparate impact claims and, if so, how such claims are to be evaluated.