Preliminary Analysis of HUD's Final Disparate Impact Rule

National Low Income Housing Coalition
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As reported in *Memo* on September 8, an advance version of HUD's final changes to the 2013 Disparate Impact rule was obtained by a fair housing advocate late Friday, September 4. As of September 11, the final rule has not been informally announced by HUD or published in the *Federal Register*. The final rule, like the proposed rule, is designed to make it virtually impossible for people experiencing various forms of discrimination to challenge the policies and practices of businesses, governments, and housing providers. HUD's drastic changes to the 2013 rule discards the well-crafted and time-tested three-part burden shifting standard (see Background section below), replacing it with a set of tests that place all of the burden on people in the Fair Housing Act's protected classes who are experiencing housing discrimination.

Disparate impact allows people to show that a housing policy or program has a discriminatory impact on them because of their race, national origin, sex, disability, family status (have children), or religion – even if the policy or program appears on its face to apply to everyone equally. HUD's final rule tips the scale in favor of businesses, governments, and housing providers that are accused of discrimination, shifting all of the burden of proof to the victims of discrimination.

Prohibitions on discriminatory conduct under the Fair Housing Act have long been in federal regulations at 24 CFR part 100, including since 2013 provisions pertaining to the disparate impact standard. The most significant changes HUD has made to the disparate impact standard are at §100.500 "Discriminatory effect prohibited."

Additional analysis may follow upon conversations with fair housing advocates.

Specific Problems with the Final Rule

Omission of Perpetuation of Segregation Theory

HUD's revision of §100.500(a) eliminates the definition of "discriminatory effect" as presented in the 2013 rule, which included a clause explicitly defining "discriminatory effect" to include a practice that "creates, increases, reinforces, or perpetuates *segregated* housing patterns." (emphasis added) By attempting to erase liability under the perpetuation of segregation theory, HUD eviscerates an essential clause designed to address the very core problem that the Fair Housing Act intended to eliminate – segregation.

Removing perpetuation of segregation theory from the rule is one more attack on the Fair Housing Act and its intent to foster and realize integration. This, along with HUD's attempt to suspend the Small Area FMR rule and HUD's actual gutting of the Affirmatively Furthering Fair Housing rule (see *Memo* 7/27) marks HUD's abdication of its responsibility to help eradicate housing segregation – much of which is the result of federal policies from previous decades.

Virtually Insurmountable Barriers to Presenting a Prima Facie Case

The first step in the 2013 rule's three-step burden shifting standard, establishing a prima facie case, [at §100.500(c)(1)] called for the plaintiff (the party alleging disparate impact) to prove that a challenged practice caused or predictably will cause a discriminatory effect. This first step under the 2013 rule had already proven to be a formidable obstacle for many plaintiffs.

HUD's new §100.500(b) requires a plaintiff to allege a prima facie case based on facts supporting five new required elements. This provision dramatically increases the standard for a prime facie case at the pleading stage, before the benefit of discovery which could provide the plaintiff with information necessary to present a sufficiently robust challenge.

Element (b)(1) requires people experiencing a discriminatory policy or practice to demonstrate that a specific policy or practice "is arbitrary, artificial, and unnecessary to a achieve a valid interest or legitimate objective such as a practical business, **profit**, policy consideration, or requirement of law." (emphasis added)

At this early stage of the process of challenging a policy or practice, this element of the final rule compares very unfavorably with the "legally sufficient justification" of the 2013 rule at §100.500(b) [deleted from the final rule] by removing the defendant's burden to provide a legally sufficient justification, instead placing the heavy burden on the plaintiff. The 2013 rule [§100.500(b)(1)] required the **defendant** to demonstrate that the challenged policy or practice is "necessary to achieve one or more [of its] *substantial*, legitimate, *nondiscriminatory*, interests" and that "those interests could not be served by another policy or practice that has a *less discriminatory* effect." (emphases added)

Final (b)(1) weakens the language to a mere "valid" interest – not a "substantial" interest. It also eliminates the need for a defendant to address the discriminatory character of a business interest. Furthermore, the addition of the word "profit" without a modifier implies that a defendant could claim later in the process [at (c)] that an exorbitant profit is their valid, legitimate objective, and that a "reasonable" profit would not be in the defendant's interest. A businesses' desire for excessive profit would thus supersede consideration of a less discriminatory policy or practice that still resulted in reasonable profits.

The four other elements are:

Paragraph (b)(2) The policy or practice has a disproportionately adverse effect on members of a protected class.

Paragraph (b)(3) There is a robust causal link between the policy or practice and the adverse effect on members of a protected class, meaning that the specific policy or practice is the direct cause of the discriminatory effect.

Paragraph (b)(4) The disparity is significant.

Paragraph (b)(5) There is a direct relation between the injury asserted and the injurious conduct alleged.

<u>Overwhelming Burdens on Plaintiffs to Prove Discriminatory Effect</u>

If a plaintiff overcomes the staggering obstacles presented during the pleading stage at §100.500(b), even without the benefit of information that could be provided through discovery, the final rule at §100.500(c) erects yet more overwhelming obstacles.

Paragraph (c)(1) requires a plaintiff to prove by the **preponderance** of the evidence, each of the elements in paragraphs (b)(2) through (5) listed above – for which the plaintiff has already "sufficiently" provided facts at the pleading stage. Notably, the word "preponderance" is only used in reference to the plaintiff, further placing a thumb on the scale in favor of the defendant.

Paragraph (c)(2) allows a defendant to rebut a plaintiff's allegation under the first element of (b) that the policy or practice is "arbitrary, artificial, and unnecessary," by producing evidence showing that the policy or practice advances the defendant's valid interest (or interests). Note again that the defendant merely has to produce evidence (not a "preponderance" of evidence) showing the challenged policy or practice advances a valid interest. In comparison, the second step of the 2013 rule's burden shifting process [§100.500(c)(2)] placed a more rigorous burden of proof on the defendant to prove "the challenged practice is necessary to achieve one or more *substantial*, legitimate, *nondiscriminatory* interests." – not merely a valid interest. The final rule places the burden on those experiencing the harmful impact of a defendant's policy or practice.

Paragraph (c)(3) sets up yet another obstacle to people who are experiencing a discriminatory effect. If a defendant rebuts a plaintiff's assertion under paragraph (c)(1) [that the plaintiff has proved the other four elements of paragraph (b)], the plaintiff must prove by the **preponderance** of the evidence either:

- The interest (or interests) advanced by the defendant are not valid, or
- That a less discriminatory policy or practice exists that would serve the defendant's identified interest (or interests) in an equally effective manner without imposing materially greater costs on, or creating other material burdens for, the defendant.

The third step in the 2013 rule's burden shifting standard at (c)(3) called for the plaintiff to identify alternative policies or practices that the defendant could use that would still meet the defendant's interests, but in a less discriminatory manner. The final rule requires the plaintiff to prove "by the preponderance of evidence" either that the defendant's discriminatory policy or practice is "valid" yet again, or that a less discriminatory policy or practice works just as well as the discriminatory practice and does not cost much or entail much effort on the part of the defendant. In other words, preventing or eliminating discrimination against people protected by the Fair Housing Act should be cost free. In addition, the heavy weight placed on the plaintiff by the final rule's (c)(3) forces the plaintiff (not the defendant who has far more knowledge of their own operations and options available to it) to guess the justifications a defendant might pose and then refute them.

One of the listed defenses the proposed rule offered to defendants elaborated on models or algorithms that businesses use in the course of implementing policies and practices; that defense offered three options. The final rule [Section (d)(2)(i)] does not mention models or algorithms. Instead it camouflages the same harmful policies and practices, stating that a defendant can rely on a policy or practice not having a discriminatory effect if the "policy or practice is intended to

predict the occurrence of an outcome, the prediction represents a valid interest, and the outcome predicted by the policy or practice does not or would not have a disparate impact on protected classes compared to similarly situated individuals not part of the protected class, with respect to the allegations under paragraph (b)."

Finally, the new rule provides the insurance industry major cover, stating at Section (e) that "Nothing in this section is intended to invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance."

Background on Disparate Impact

For more than 45 years, HUD interpreted the Fair Housing Act to prohibit housing policies or practices that have a discriminatory effect, even if there was no apparent intent to discriminate. There are 13 U.S. Courts of Appeals, 11 of which have had disparate impact cases before them and all of which have upheld disparate impact and applied a "burden shifting standard." Because there were minor variations in how the courts and HUD applied the concept of discriminatory effects over the years, a proposed rule in 2011 offered a standard for comment, culminating in a final Disparate Impact rule on February 15, 2013. That final regulation established uniform standards for determining when a housing policy or practice with a discriminatory effect violates the Fair Housing Act. It is the February 15, 2013 final rule that the present HUD has drastically overhauled.

The three-step burden shifting standard in the current rule is very simple:

1. The plaintiff (the party alleging disparate impact) has the burden of proving that a policy or practice caused or predictably will cause a discriminatory effect.

2. If the plaintiff satisfies that burden of proof, the burden shifts to the defendant (the business, government, or other entity) to prove that the challenged policy or practice is necessary to achieve one or more of the defendant's substantial, legitimate, nondiscriminatory interests.

3. If the defendant satisfies the above burden of proof, then the burden shifts again to the plaintiff to prove that the defendant's substantial, legitimate, nondiscriminatory interests could be served by another policy or practice that has a less discriminatory effect.

The U.S. Supreme Court upheld the use of disparate impact theory to establish liability under the Fair Housing Act on June 25, 2015 in *Texas Department of Housing and Community Affairs v. Inclusive Communities (ICP)*. The current HUD administration issued an advance notice of proposed rulemaking (ANPR) in the *Federal Register* on June 20, 2018 (see *Memo*, 6/25/18). HUD acknowledged then that the Supreme Court upheld the use of disparate impact theory, but HUD asserted that the Court "did not directly rule upon it [the disparate impact rule]." Advocates and attorneys agree, however, that the Court implicitly endorsed the rule by not questioning it or challenging it. Since *Inclusive Communities*, courts have found that the rule is consistent with the Supreme Court's decision.

The advance version of the final disparate impact rule is at: https://bit.ly/354th5S

NLIHC's October 8, 2019 comment letter regarding the proposed disparate impact rule is at: https://bit.ly/2p8Fof5

More about disparate impact is on page 7-8 of NLIHC's *2020 Advocates' Guide*