

# HUD PROPOSAL WOULD IMPOSE “DISPARATE IMPACT” REGULATION ON PROPERTY INSURANCE

by  
Paul F. Hancock  
Andrew C. Glass  
Roger L. Smerage

The U.S Department of Housing and Urban Development (HUD) has proposed a Fair Housing Act rule that would increase the legal risk of housing providers, lenders, and providers of housing-related services. The proposal would impose liability for policies and practices that although benign in purpose, impact minority and nonminority persons or residential areas differently. It endorses a “disparate-impact” theory, which allows plaintiffs to bring Fair Housing Act claims without any evidence of discriminatory intent.<sup>1</sup> HUD would create a difficult burden for companies to demonstrate the business necessity of the challenged policy or practice needed for them to avoid liability. Even if defendants meet their burden, HUD’s proposal allows the government and private plaintiffs to second guess business decisions; plaintiffs can suggest their own alternative business practices that are alleged to be “less discriminatory.”

HUD, with support from federal courts, has long interpreted the Fair Housing Act as applicable to the actions of property insurance providers, and these businesses are clearly within the reach of the new disparate-impact proposal. The proposed rule notes that “the provision and pricing of homeowner’s insurance” is an example “of a housing policy or practice that may have a disparate impact on a class of persons delineated by characteristics protected by the Act.”<sup>2</sup> If the rule is finalized as proposed, and upheld by the courts, property insurance companies are likely to experience increased claims of unlawful discrimination under the Fair Housing Act. Successful challenges could alter risk-based business practices and lead to awards of compensatory and punitive monetary damages as well as civil penalties.

## *HUD’s Proposed Rule Would Likely Apply to the Insurance Industry*

The lynchpin issue is whether the disparate-impact approach is applicable to any type of claim

---

<sup>1</sup> 76 Fed. Reg. 70,921, 70,926-27 (Nov. 16, 2011) (“[I]liability may be established under this subpart based on a housing practice’s *discriminatory effect*, ... even if the housing practice is not motivated by a prohibited intent” (emphasis in original)).

<sup>2</sup> *Id.* at 70,924 (HUD commentary to proposed rule).

under the Fair Housing Act. This is important because it is much more likely that insurance practices will be challenged for their “impact” rather than on the basis that they are motivated by a racial or ethnic animus. HUD believes that a showing of intent is not necessary (and the agency has support from lower federal court decisions), but its view conflicts with the perspective of some prior federal administrations. The Reagan Administration, for example, opined in a Supreme Court filing that proof of intentional discrimination is a prerequisite to establishing a violation of the Act.<sup>3</sup> Even the current Fair Housing Act rule is silent on the controversial issue. *See* 24 C.F.R. §§ 100.1-100.400 (2011). And HUD itself previously took a position of neutrality on the issue in its commentary to that rule. 54 Fed. Reg. 3232, 3234-35 (Jan. 23, 1989).

In a transparent effort to forestall U.S. Supreme Court action, HUD released its new proposal after the Court had finally agreed to decide the required standard of proof under the Act. Unfortunately, the parties who were challenging the disparate-impact theory in the case before the Supreme Court, *Magner v. Gallagher*,<sup>4</sup> withdrew their petition shortly before the scheduled argument. Although the Obama Administration had expressed confidence in its belief that the Act encompasses disparate-impact claims, the media reported that the Administration pressured the petitioners, which included the City of St. Paul, Minnesota, into dropping their challenge.<sup>5</sup> As a result, the focus returns to HUD’s proposal.

HUD may be on firmer ground in contending that the Fair Housing Act encompasses the actions of property insurance companies, regardless of which standard of proof is applicable. The Act itself does not expressly mention insurance practices or providers, but HUD and the courts have regularly interpreted the Act to reach the industry. In particular, courts have concluded that the Act’s prohibition on discrimination extends to such insurance practices as denial of coverage and increased rates based on purported geographic redlining. *NAACP v. Am. Family Mut. Ins. Co.*, 978 F.2d 287, 297-98, 301 (7th Cir. 1992) (reasoning that “[n]o insurance, no loan; no loan, no house; lack of insurance thus makes housing unavailable”); *see Ojo v. Farmers Group, Inc.*, 600 F.3d 1205, 1208 (9th Cir. 2010).<sup>6</sup>

In addition, HUD has specifically interpreted the Act as applying to the insurance industry. Existing HUD regulations expressly state that “[r]efusing to provide ... property or hazard insurance for dwellings or providing such ... insurance differently because of race, color, religion, sex, handicap, familial status, or national origin” is an unlawful practice “relating to the provision of housing or of services and facilities in connection therewith.” 24 C.F.R. § 100.70(b), (d)(4). Federal courts have upheld these regulations, concluding that “HUD’s interpretation of the ... Act is reasonable in light of the direct connection of availability of property insurance and ability to purchase a house.” *Nationwide Mut. Ins. Co. v. Cisneros*, 52 F.3d 1351, 1359 (6th Cir. 1995); *see Ojo*, 600 F.3d at 1208; *NAACP*, 978 F.2d at 300. These earlier enactments did not address the issue of whether a violation could be established under the disparate-impact approach or whether a showing of discriminatory intent was necessary to establish a violation.

HUD has applied its enforcement powers under the Act to challenge insurers’ policy-writing and rate-setting practices. And HUD’s commentary to its proposed rule notes that “the provision and pricing of homeowner’s insurance” is an example “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. 70,921, 70,924 (Nov. 16, 2011). The proposed rule, contrary to the existing rule, firmly adopts the disparate-impact approach.

---

<sup>3</sup> *See* Brief for United States as Amicus Curiae, *Town of Huntington, N.Y. v. Huntington Branch, NAACP*, 488 U.S. 15 (1988) (No. 87-1961), available at <http://www.justice.gov/osg/briefs/1987/sg870004.txt>.

<sup>4</sup> No. 10-1032 (U.S.).

<sup>5</sup> *See, e.g., Mr. Perez Works the Phones*, WALL STREET JOURNAL A12, Mar. 28, 2012; Frederick Melo, *U.S. House Presses St. Paul over White House Role in Housing Case*, ST. PAUL PIONEER PRESS, Apr. 17, 2012.

<sup>6</sup> While one federal court rejected this analysis, relying upon the Fair Housing Act’s silence concerning insurance, *Mackey v. Nationwide Ins. Cos.*, 724 F.2d 419, 423-25 (4th Cir. 1984), that court’s decision predates HUD regulations (discussed below) interpreting the Act as reaching insurance practices.

In litigation, insurers have attempted to avoid liability under the Fair Housing Act by invoking the McCarran-Ferguson Act's inverse preemption doctrine. The doctrine prevents federal law from interfering with state insurance law in certain instances. Based on the particular nuances of certain state insurance law, some courts have accepted the application of the doctrine to Fair Housing Act claims. *See Ojo*, 600 F.3d at 1209-10 (certifying question to Texas Supreme Court to determine scope of Texas insurance law); *Saunders v. Farmers Ins. Exchange*, 537 F.3d 961, 966-68 & n.7 (8th Cir. 2008) (Missouri law prohibits private challenges to insurance rates; therefore, a Fair Housing Act claim would impair the applicable state law). Other courts have rejected application of this preemption doctrine, holding that because the Fair Housing Act "is an 'Act of Congress' that does not 'specifically relate ... to the business of insurance[,] [it] does not 'invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance.'" *NAACP*, 978 F.2d at 295; *see Cisneros*, 52 F.3d at 1363; *Dehoyos v. Allstate Corp.*, 345 F.3d 290, 297-99 (5th Cir. 2003); *Mackey*, 724 F.2d at 421.

In light of HUD's long-standing interpretation of the Act as extending to the insurance industry, and the mixed results in litigating the issue in the courts, members of the insurance industry should be prepared for courts to uphold the application of the Fair Housing Act to insurance practices and policies related to the provision of housing. If HUD's proposed rule is finalized and not overturned by courts, the disparate-impact approach to establish a violation will become firmly rooted.

### ***The Outlines of HUD's Proposed Rule***

As noted, under a disparate-impact theory, plaintiffs can challenge a neutral policy or practice, which itself does not express a discriminatory intent, on the basis that the policy or practice affects plaintiffs differently because of race, sex, or national origin, among other characteristics. In addition, HUD's proposed rule would set a higher bar for businesses in justifying their practices than the standard set by other anti-discrimination statutes. For instance, the Supreme Court has ruled that even if a Title VII employment discrimination plaintiff establishes a prima facie disparate-impact claim, the defendant can justify its challenged policy by articulating a "legitimate" business goal that the policy serves. *Wards Cove Packing Co. v. Atonio*, 490 U.S. 642, 658-59 (1989). Indeed, the Court held that the defendant does not have to demonstrate that the policy is "essential" or "indispensable" to the business.<sup>7</sup> *Id.* Under HUD's proposed Fair Housing Act rule, however, a defendant would have to demonstrate that the challenged policy "has a *necessary and manifest* relationship to one or more of the housing provider's legitimate, nondiscriminatory interests." 76 Fed. Reg. at 70,925 (emphasis added).

Further, under HUD's proposed rule, defendants would have the affirmative burden of demonstrating the "necessary and manifest" justification. This is in contrast to the usual situation where plaintiffs have to prove their case. For instance, the Supreme Court has stated regarding Title VII employment discrimination claims that "the ultimate burden of proving that discrimination against a protected group has been caused by a specific ... practice remains with the plaintiff *at all times*." *Wards Cove*, 490 U.S. at 659 (emphasis in original). Moreover, even where defendants satisfy their burden, the proposed rule would nevertheless allow the government or private plaintiffs to substitute their business judgment for that of defendants; plaintiffs can offer alternative business practices that they allege are "less discriminatory." 76 Fed. Reg. at 70,925.

The adoption of a rule like the one HUD proposes may inspire legal challenges that address distinct but somewhat overlapping issues. One would be whether the Fair Housing Act authorizes the disparate-impact approach in any respect. Or courts might conclude that the disparate-impact approach is applicable to some types of claims but not to others – it is difficult to predict where insurance practices might fall. But even if the theory is upheld, a question remains as to whether HUD exceeded

---

<sup>7</sup> In the Civil Rights Act of 1991, Congress amended this standard for future Title VII claims. No such amendment has been made to the Fair Housing Act.

its authority in applying the legal approach in a manner that is contrary to the guidance of the Supreme Court.

### ***The Likely Impact of HUD's Proposed Rule on the Insurance Industry***

As noted above, federal administrations have differed regarding the propriety of applying the disparate-impact approach under the Fair Housing Act. Thus, the insurance industry already has seen the types of actions that can result and the courts' seeming confusion in applying the law. For instance, in a 1992 decision, the U.S. Court of Appeals for the Seventh Circuit stated that "[n]o 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?" *NAACP*, 978 F.2d at 290-91. HUD's express recognition of the disparate-impact theory in its proposed rule certainly raises the stakes.

The proposed rule's burden-shifting and "necessary and manifest" standard could limit insurers' ability to make the types of risk assessments that allow insurers to streamline the policy-writing process. Indeed, accounting for factors that significantly impact risk, such as the age of a dwelling, nearby abandoned property, susceptibility to flooding, crime rates, and – as the Seventh Circuit noted – likelihood of fire, which have no facial connection to race, sex, or national origin, could have an impact on certain groups without insurers even knowing it. For instance, older dwellings may have a greater risk profile than newer dwellings, and thus owners of older dwellings may pay higher premiums. But because older dwellings are often concentrated in urban neighborhoods and because urban neighborhoods may have greater numbers of minorities, it may appear that minorities bear the brunt of the higher premiums. Under HUD's proposed rule, insurers would have to establish that their basis for assessing risk is essential to the process of insuring real estate, but still would remain vulnerable when the government or private plaintiffs assert a supposedly "less-discriminatory" method for achieving the insurers' goals. It is unclear how deeply enmeshed in private business practices the government will seek to become.

It is possible that HUD will address some of the flaws in its interpretation of the Fair Housing Act in finalizing the rule. Businesses can expect that the agency will remain committed to the disparate-impact approach, but HUD may tweak the standards for implementing that approach. Then it will be up to the courts to decide if HUD's interpretation is correct. The very fact that the Supreme Court granted *certiorari* in *Magner v. Gallagher* is an indication that some of the justices have doubts about the basic tenets embodied in the proposed rule.