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## ARTICLES

# FORECLOSURE FALLOUT: THE BANKING INDUSTRY'S ATTACK ON DISPARATE IMPACT RACE DISCRIMINATION CLAIMS UNDER THE FAIR HOUSING ACT AND THE EQUAL CREDIT OPPORTUNITY ACT

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### INTRODUCTION

The foreclosure crisis that plagues the United States disproportionately affects minority borrowers. African American and Latino borrowers with incomes and credit scores similar to those of white borrowers receive far less favorable loans, commonly referred to as subprime loans,<sup>1</sup> and are often charged exorbitant fees that lenders tend not to charge to white borrowers. These subprime loans typically begin with a reasonable interest rate, but then skyrocket, or, as the banking industry<sup>2</sup> euphemistically says, “adjust,”<sup>3</sup> to a far

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<sup>1</sup> For a definition of a subprime loan, *see infra* Part I.A. For a brief article describing subprime loans, *see* Lisa Smith, *Subprime Loans: Buyer Beware*, FORBES-INVESTOPEDIA, Aug. 27, 2007, available at [http://www.forbes.com/investoreducation/2007/08/27/subprime-credit-default-pf-education-in\\_ls\\_0827investopedia\\_inl.html](http://www.forbes.com/investoreducation/2007/08/27/subprime-credit-default-pf-education-in_ls_0827investopedia_inl.html).

<sup>2</sup> We use the term “Banking Industry” loosely to refer to the financial institutions that are involved with subprime lending and have attempted to undercut the availability of disparate impact claims under the Fair Housing Act and the Equal Credit Opportunity Act. We are aware that the banking industry is not a monolith and that not all financial institutions and mortgage brokers engaged in predatory or discriminatory lending. Many financial institutions have gone to great lengths not only to reform their own lending practices, but also to

higher rate, causing the borrower's monthly payments to soar.<sup>4</sup> As monthly payments increase, many borrowers quickly fall into default on their mortgages and eventually fall victim to foreclosure.<sup>5</sup>

A host of non-profit organizations, civil rights attorneys,<sup>6</sup> and government agencies have brought race discrimination claims against subprime lenders under the Fair Housing Act ("FHA") and the Equal Credit Opportunity Act ("ECOA"), arguing that lenders treated minority borrowers less favorably than white borrowers with similar risk-related credit characteristics.<sup>7</sup> Plaintiff borrowers have argued that the lenders' practices and policies, though neutral on

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pursue efforts to ameliorate the disastrous effects caused by the current foreclosure mess. Nonetheless, collaboration within the "Banking Industry" has been apparent and overt, and we feel comfortable using the phrase to characterize the behavior of the industry generally. See, e.g., Jeffrey P. Naimon, *The Rise and Fall (Hopefully) of the Disparate Impact Theory of Fair Lending Liability*, MORTGAGE BANKERS ASSOCIATION, <http://www.mortgagebankers.org/files/Conferences/2008/2008LIRC/LIRC08MAY5NEWJeffNaimonHotTopics.pdf> (last visited on August 21, 2008) (confusing recent Supreme Court precedent by stating that "neither the FHA nor ECOA contains the 'effects' language the Supreme Court identified as creating the disparate impact cause of action"); see also Paul F. Hancock, HMDA, Fair Lending, and ECOA Developments (September 25, 2007), <http://www.mortgagebankers.org/files/Conferences/2007/2007RegComp/12PaulHancockPresentation.pdf> (also discussing disparate impact under FHA and ECOA).

<sup>3</sup> Center for Responsible Lending, *Subprime "Exploding" ARMs Pose High Risks for Debt-Strapped Families* [hereinafter Center for Responsible Lending, *Subprime "Exploding" ARMs*], Sept. 20, 2006, <http://www.responsiblelending.org/press/releases/page.jsp?itemID=30373130>.

<sup>4</sup> See Zachary A. Goldfarb & Alec Klein, *The Bubble: How homeowners' missed mortgage payments set off widespread problems and woke up the Fed.*, WASH. POST, June 16, 2008, at A1.

<sup>5</sup> *Id.* Goldfarb and Klein provide a short vignette into the origins of the subprime lending crisis:

The mortgage executives who gathered in a blond-wood conference room in Southern California studied their internal reports with growing alarm. More and more borrowers were falling behind on their monthly payments almost as soon as they moved into their new homes, indicating that some of them never really had the money to begin with. "Nobody had models for that," said David E. Zimmer, then one of the executives at People's Choice, a subprime lender based in Irvine. "Nobody had predicted people going into default in their first three mortgage payments."

The housing boom had powered the U.S. economy for five years. Now, in early 2006, signs of weakness within the subprime industry were harder to ignore. People with less-than-stellar credit who had bought homes with adjustable-rate mortgages saw sharp spikes in their monthly payments as their low initial teaser rates expired. As a result, more lost their homes; data showed that 70 percent more people faced foreclosure in 2005 than the year before. Housing developers who had raced to build with subprime borrowers in mind now had fewer takers, leaving tens of thousands of homes unsold.

<sup>6</sup> Gary Klein, of Roddy Klein & Ryan, <http://www.rododykleinryan.com>, brought many of these lawsuits and lent us considerable assistance in researching these issues.

<sup>7</sup> See *infra* section I.F.

their face, have had an unjustifiably disparate impact on African American and Latino borrowers.<sup>8</sup> In response to these lawsuits, the banking industry has launched a concerted legal effort in the courts to defeat these claims, in part by arguing in Rule 12(b)(6) motions to dismiss that disparate impact claims are not cognizable under the FHA or the ECOA.<sup>9</sup>

In this Article, we argue that disparate impact claims have always been cognizable under the FHA and ECOA and that they should remain so. Section I provides an overview of the regulatory framework and market conditions that partially paved the way for the current foreclosure crisis. Section II briefly reviews the jurisprudence of disparate impact theory and the nature of the disparate impact claims that plaintiff borrowers are now bringing against subprime lenders. Section III analyzes and debunks the banking industry's and the defendant subprime lenders' attack on the availability of disparate impact claims under the FHA and ECOA, and section IV provides a detailed defense of the continued availability of disparate impact claims under the two acts.

## I. BACKGROUND

### A. *Subprime Mortgage Defined*

While nearly every American is likely familiar with the term “subprime,” no exact definition of a subprime mortgage exists. A subprime mortgage has two defining features: (1) the borrower, because of income and credit history, is more likely to default on the mortgage; and (2) the terms of the mortgage are less favorable than a typical, “prime” mortgage.<sup>10</sup>

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<sup>8</sup> *Id.*

<sup>9</sup> See *infra* section III.

<sup>10</sup> See Office of the Comptroller of the Currency, Bd. of Governors of the Fed. Reserve System, Fed. Deposit Ins. Corp., and the Office of Thrift Supervision, *Expanded Guidance for Subprime Lending Programs* (January 31, 2001), <http://www.federalreserve.gov/boarddocs/press/boardacts/2001/20010131/attachment.pdf> (see press release at <http://www.federalreserve.gov/boarddocs/press/boardacts/2001/20010131/default.htm>). More recently, these same four agencies, along with the National Credit Union Administration, released an *Interagency Statement on Subprime Mortgage Lending*, stating “that the reference to the subprime borrower characteristics from the 2001 *Expanded Guidance for Subprime Lending Programs* (Expanded Guidance) provides appropriate information.” *Interagency Statement on Subprime Mortgage Lending*, Office of the Comptroller of the Currency; Bd. of Governors of the Fed. Reserve System; Fed. Deposit Insurance Corp.; Office of Thrift Supervision; and Nat'l Credit Union Admin. *Press Release* (June 29, 2007), <http://www.federalreserve.gov/newsevents/press/bcreg/20070629a.htm>. While this definition is not exact, it is clearly still seen as accurate by the federal agencies that created it. In *Massachusetts v. Fremont Investment and Loan*, a case brought by the Massachusetts Attorney General, a Massachusetts court defined “structurally unfair” loans as having: (1) an adjustable rate with an introductory rate period of less than three years; (2) an introductory rate that is at least three percent lower than the fully indexed rate; (3) a debt-to-income ratio that would exceed fifty percent if determined under the fully indexed rate, rather than the introductory rate; and (4)

### 1. The Borrower

A subprime borrower generally has a credit history that indicates that the borrower is more likely to default on a loan.<sup>11</sup> Such a credit history often includes bankruptcies, payment delinquencies, and/or judgments against the borrower.<sup>12</sup> Subprime borrowers also usually have a “reduced repayment capacity as measured by credit scores, debt-to-income ratios, or other criteria that may encompass borrowers with incomplete credit histories.”<sup>13</sup> More specific factors that may indicate that a borrower poses an increased risk of default include:

- Two or more 30-day delinquencies in the last 12 months, or one or more 60-day delinquency in the last 24 months;
- Judgment, foreclosure, repossession, or charge-off in the prior 24 months;
- Bankruptcy in the last 5 years;
- A credit bureau risk score (FICO) of 660 or below (depending on the product/collateral), or other bureau or proprietary scores with an equivalent default probability likelihood; and/or
- Debt service-to-income ratio of 50% or greater, or otherwise limited ability to cover family living expenses after deducting total monthly debt-service requirements from monthly income.<sup>14</sup>

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either a loan-to-value ratio that is 100%, a substantial prepayment penalty, or a prepayment penalty past the introductory period. *Commonwealth of Mass. v. Fremont Inv. & Loan*, No. 08-J-118, 2008 WL 2312648 (Mass. App. Ct. May 2, 2008). As we explain in section I.E, real estate brokers and lenders do not always make their decision to issue prime or subprime mortgages solely based on risks; borrowers’ race and national origin plays a separate and discriminatory factor in this decision making process, which at times results in borrowers receiving subprime loans that their white counterparts would likely not have received.

<sup>11</sup> See Manny Fernandez, *Study Finds Disparities in Mortgages by Race*, N.Y. TIMES, Oct. 15, 2007, available at [http://www.nytimes.com/2007/10/15/nyregion/15subprime.html?\\_r=1&ref=NYregion&oref=slogin](http://www.nytimes.com/2007/10/15/nyregion/15subprime.html?_r=1&ref=NYregion&oref=slogin); see also *Interagency Statement on Subprime Mortgage Lending*, *supra* note 10.

<sup>12</sup> *Interagency Statement on Subprime Mortgage Lending*, *supra* note 10.

<sup>13</sup> *Id.*

<sup>14</sup> See *Id.* While mortgage lenders traditionally have preferred a DTI at or around 36%, and some government programs lend to borrowers with a DTI of up to 45%, subprime loans often feature DTI ratios above 36%. This characteristic can be partially hidden with an ARM since lenders sometimes calculate the DTI at the initial “teaser” rate rather than the average rate for the entire loan. Debt-to-income ratio describes the amount of a consumer’s monthly gross income spent on debt, including the subprime loan itself. For example, someone who earns \$10,000 a month and has \$3,000 in debt per month has a DTI of 30%. See Henry Savage, *Obtaining an Affordable Mortgage*, REALTY TIMES, June 14, 2002, [http://realtytimes.com/rtpages/20020614\\_affordablemtg.htm](http://realtytimes.com/rtpages/20020614_affordablemtg.htm). See also *Lesson Learned: Community and Economic Development Case Studies*, FED. RESERVE BANK OF CHI., Dec. 31, 2001, [http://www.chicagofed.org/community\\_development/lesle/community\\_development/normal\\_chicago.doc](http://www.chicagofed.org/community_development/lesle/community_development/normal_chicago.doc). See Gerri Detweiler, *Are you in over your head? Calculate your debt-*

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Ironically, because these borrowers are more likely to default on their loans, the banks, to compensate for that increased risk, issue these borrowers loans that feature more onerous financial obligations, thus increasing the likelihood of default.

## 2. The Loan

A subprime loan is a loan that features higher costs,<sup>15</sup> both upfront<sup>16</sup> and throughout the life of the loan.<sup>17</sup> The defining characteristic of subprime mortgages is a higher interest rate than prime loans.<sup>18</sup> A higher interest rate results in higher payments for the borrower, which of course makes keeping up with payments more difficult.<sup>19</sup>

A common feature included in most subprime mortgages is an adjustable interest rate instead of a fixed interest rate, which allows the interest rate to increase periodically over time and compounds borrowers' financial difficulties by causing their monthly payments to increase.<sup>20</sup> These adjustable rate mortgages ("ARMs") generally start with a reasonable introductory "teaser" rate for two or three years, which then skyrocket, or "adjust," to a much higher rate for the remainder of the term of the loan.<sup>21</sup> When the rate "adjusts," borrowers are suddenly faced with insurmountable payments.<sup>22</sup> In our limited experience at

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*to-income ratio*, U.S NEWS AND WORLD REP., available at <http://www.usnews.com/usnews/biztech/tools/modebratio.htm>.

<sup>15</sup> Souphala Chomsisengphet & Anthony Pennington-Cross, *The Evolution of the Subprime Mortgage Market*, 88 FED. RES. BANK OF ST. LOUIS REV. 31, 32, (2006) ("Very little data have been gathered on the extent of upfront fees and how they differ from prime fees" but it is safe to say that the "many factors, including borrower credit history and prepayment risk" have a large effect on the upfront costs).

<sup>16</sup> *Id.* (these can "include application fees, appraisal fees and other fees associated with originating a mortgage.")

<sup>17</sup> *Id.* (these "include mortgage insurance payments, principle and interest payments, late fees and fines for delinquent payments, and fees levied by a locality (such as property taxes and special assessments).")

<sup>18</sup> Chomsisengphet & Pennington-Cross, *supra* note 15, at 32.

<sup>19</sup> See Sue Kirchoff & Judy Keen, *Minorities hit hard by rising costs of subprime loans*, USA TODAY (April 25, 2007), available at [http://www.usatoday.com/money/economy/housing/2007-04-25-subprime-minorities-usat\\_N.htm](http://www.usatoday.com/money/economy/housing/2007-04-25-subprime-minorities-usat_N.htm) ("[Charles] Davis, 54, has struggled to stave off foreclosure on the brick ranch-style house where he lives with his wife, Valerie, and three teenage kids. He financed his home with a \$200,000 mortgage at 8.5% interest, and a second \$50,000 loan at nearly 12%. Those rates were fixed for only two years, and payments are escalating.")

<sup>20</sup> Center for Responsible Lending, *Subprime "Exploding" ARMs*, *supra* note 3.

<sup>21</sup> *Id.*

<sup>22</sup> Renae Merle, *Resets Peaking on Subprime Loans*, WASH. POST, July 1, 2008, at D1. The Center for Responsible Lending calculated that the rate change for a typical \$200,000 loan goes from \$1,311 per month at the initial rate to \$1,948 at the fully indexed rate. Josh Nassar, *Presentation at the Center for Responsible Lending's Foreclosure Community Im-*

the Lawyer's Committee, we have received reports from borrowers alleging that mortgage brokers deceitfully lured them into loans with adjustable rates by assuring them that the loans were safe and that they would be able to refinance their loans before their interest rate adjusted.<sup>23</sup> In reality however, because of poor credit, lack of equity, and prepayment penalties, these borrowers have generally not been able to refinance before their interest rates jumped.<sup>24</sup> Such representations by lenders and brokers have thus served to trap borrowers in loans that would inevitably result in default.<sup>25</sup>

Over the course of the past decade, these adjustable loans have proliferated in the market. In 1999 about half of all subprime mortgages featured adjustable rates; by 2006, the number of subprime mortgages with adjustable interest rates jumped to 80%.<sup>26</sup> Many industry analysts have identified these adjustable rates as the leading cause of the current foreclosure crisis.<sup>27</sup>

A factor that makes default on subprime mortgages more likely and more painful for both the borrower and the lender is that these loans tend to have higher loan-to-value ratios<sup>28</sup> ("LTV"), because the borrowers were unable to make a substantial down payment on their home.<sup>29</sup> When purchasing a home,

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*pact Summit: Overview of Mortgage Market: How We Got Here and Policy Responses* (July 23, 2008), available at <http://www.dhcd.virginia.gov/vfptf/PDFs/JoshNassar.pdf>.

<sup>23</sup> See, e.g., Rick Brooks & Ruth Simon, *Subprime Debacle Traps Even Very Credit-Worthy: As Housing Boomed, Industry Pushed Loans To a Broader Market*, WALL ST. J., Dec. 3, 2007, available at [http://online.wsj.com/article/SB119662974358911035.html?mod=hps\\_us\\_whats\\_news](http://online.wsj.com/article/SB119662974358911035.html?mod=hps_us_whats_news), ("Many borrowers figured they would refinance in a few years before the rate on their loan moved higher—but falling home prices and tighter credit standards in the past year have suddenly made that unrealistic in many cases.").

<sup>24</sup> *Id.*

<sup>25</sup> See, e.g., Complaint, Commonwealth of Mass. v. Fremont Investment and Loan, et al, No. 07-cv-4373, (Mass. Super. Ct. Oct. 4, 2007). Although questionable lending practices undoubtedly have played a central role in this crisis, we recognize that many lenders likely solicited loans that they should have known they could not afford – perhaps even participating in deceitful schemes to exaggerate their income so they could qualify loans that they would otherwise never have received. Nonetheless, we do not perceive borrower deception to be the leading cause of the crisis and it is not our concern here.

<sup>26</sup> ASS'N OF CMTY. ORGS. FOR REFORM NOW, FORECLOSURE EXPOSURE: A STUDY OF RACIAL AND INCOME DISPARITIES IN HOME MORTGAGE LENDING IN 172 AMERICAN CITIES 3 (2007).

<sup>27</sup> See James R. Hagerty, Foreclosures, *Overdue Mortgages Increase Again Troubles Extend Into Prime Loans Via Option ARMs*, WALL ST. J. ONLINE, September 6, 2008.

<sup>28</sup> The loan-to-value ratio describes the amount of a mortgage loan in relation to the total value of the property for which it is borrowed. For example, a loan of \$150,000 for a house worth \$175,000 would have a LTV of \$150,000/\$175,000 or 85%.

<sup>29</sup> *Mortgage Market Turmoil: Causes and Consequences Before the Senate Banking, Housing and Urban Affairs Committee* (2007) (statement of Sandra Thompson, Director of the Division of Supervision and Consumer Protection, Federal Deposit Insurance Corporation).

borrowers typically make a down payment that constitutes ten to twenty percent of the value of the property.<sup>30</sup> That down payment protects both the borrower and the lender by ensuring that the borrower has some equity in the home.<sup>31</sup> Having equity in the home makes refinancing easier for the borrower, and, in the case of default, makes it less likely that a lender will lose as much of its investment in the property.<sup>32</sup> Because the thousands of subprime loans that are currently being foreclosed on have such high LTV ratios, borrowers are losing their homes and lenders are losing their invested capital because they often cannot sell the foreclosed properties above the value of the loan.<sup>33</sup>

Another characteristic often found in subprime loans is a prepayment penalty, which fines borrowers for paying off their mortgage before the expiration of the mortgage's term.<sup>34</sup> Such a feature is particularly pernicious in subprime loans as these loans were often fraudulently marketed as "temporary" loans that borrowers could refinance before the interest rates would adjust upwards.<sup>35</sup> Thus prepayment penalties discourage subprime borrowers from refinancing before the rate adjustment, which locks them into the higher rate and increases the likelihood of default.<sup>36</sup>

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<sup>30</sup> See Lew Sichelman, *When an Average Home is \$300,000+*, MORTGAGE LINE (Oct. 12, 2005) available at <http://www.OriginationNews.com/plus/archive/?id=141416>.

<sup>31</sup> Kimberly Lankford, *Why You Need a Down Payment*, KIPLINGER, (July 24, 2006), available at <http://www.kiplinger.com/columns/ask/archive/2006/q0724.htm>. A down payment is especially important if prices go down. If a borrower makes no down payment, the price of her house drops and she is unable to pay her mortgage, the lender then has no way to recoup its loan. Making a down payment allows for a buffer in case house prices fall or if the borrower is unable to pay her mortgage.

<sup>32</sup> *Id.*

<sup>33</sup> See *The Anatomy Of Loss Severity Assumptions In U.S. Subprime RMBS*, STANDARD & POOR'S (May 7, 2008) available at [http://www2.standardandpoors.com/portal/site/sp/en/us/page.article\\_print/4,5,5,1,1204835910066.htmls](http://www2.standardandpoors.com/portal/site/sp/en/us/page.article_print/4,5,5,1,1204835910066.htmls)

Falling home prices create a wide swath of problems, one of the most pressing being rising foreclosure rates. And when a foreclosed home sells for less than what the borrower owed to the mortgage lender, the lender suffers a loss. The amount of that loss is known as the "loss severity," which includes the costs to foreclose and liquidate a home securing a defaulted mortgage, as well as any decline in property value.

<sup>34</sup> A prepayment penalty charges a borrower a specified percentage of the overall loan if the borrower pays off a significant portion of the loan before it is due. See Kent H. Roberts, *Prepayment Penalties in Texas: The Triumph Of Logic And the Need For Legislative Reform*, 45 BAYLOR L. REV. 585, 587 (1993).

<sup>35</sup> *How 'Predatory' Lenders Can Deceive; Unethical and Illegal Practices in Mortgage Industry*, CONSUMERS' RESEARCH MAGAZINE, July 1, 2000 at 10.

<sup>36</sup> See Andree Brooks, *Talking Prepayment; Avoiding Mortgage Penalties*, N.Y. TIMES, Nov. 18, 1984, § 8 at 1, available at <http://query.nytimes.com/gst/fullpage.html?res=9E0DE5DC1F39F93BA25752C1A962948260> ("Known as a prepayment penalty, it permits the lender to charge as much as \$6,000 or \$7,000 if the loan is closed out within the first year or two instead of being amortized in the normal fashion over the longer-term."); Ruth Simon, *The Unpleasant Surprise Of Prepayment Penalties*, WALL ST. J., available at <http://www>.

Lastly, subprime loans almost always come with much higher fees than prime loans.<sup>37</sup> From the lenders' perspective, the fees compensate for the added risk involved in extending mortgage loans to borrowers with undesirable credit histories.<sup>38</sup> For the borrowers, the fees become one more hurdle to face in attempting to purchase a home and make their mortgage payments.

### B. *Causes of the Mortgage Foreclosure Crisis*

A host of regulatory decisions have paved the way for the current subprime crisis.<sup>39</sup> The initial factors harken back to the early 1980s, when Congress passed the Depository Institutions Deregulation and Monetary Control Act ("DIDMCA") which preempted states from imposing interest rate caps on residential loans,<sup>40</sup> and the Alternative Mortgage Transaction Parity Act of 1982 ("AMTPA"),<sup>41</sup> which allowed many more lenders to employ adjustable interest rates. These two acts provided the legal framework for today's subprime market by banning caps on interest rates and encouraging lenders to implement

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realestatejournal.com/buysell/mortgages/20011218-simon.html ("John Stover quickly traded in his 4.5% adjustable rate mortgage for a 30 year mortgage with a fixed 6.5% rate. Then he was hit with a \$4,000 penalty for paying off his old mortgage early.").

<sup>37</sup> See Center for Responsible Lending, *Yield Spread Premiums: A Powerful Incentive for Equity Theft* [hereinafter Center for Responsible Lending, *Yield Spread Premiums*], (June 18, 2004), [http://www.responsiblelending.org/pdfs/ib011-YSP\\_Equity\\_Theft-0604.pdf](http://www.responsiblelending.org/pdfs/ib011-YSP_Equity_Theft-0604.pdf) (last visited October 10, 2008); Howell E. Jackson and Jeremy Berry, *Kickbacks or Compensation: The Case of Yield Spread Premiums*, 12 STAN. J. L. BUS. & FIN. 289 (2006–2007); see also discussion of excessive fees in section II.c.2.

<sup>38</sup> Center for Responsible Lending, *Yield Spread Premiums*, *supra* note 37.

<sup>39</sup> See Edmund L. Andrews, *Fed Shrugged as Subprime Crisis Spread*, N.Y. TIMES, Dec. 18, 2007, available at <http://www.nytimes.com/2007/12/18/business/18subprime.html>.

<sup>40</sup> See 12 U.S.C. § 1735f-7a (a)(1) ("The provisions of the constitution or the laws of any State expressly limiting the rate or amount of interest, discount points, finance charges, or other charges which may be charged, taken, received, or reserved shall not apply to any loan, mortgage, credit sale, or advance . . ."); see also Chomsisengphet & Pennington-Cross, *supra* note 15, at 38 ("Many factors have contributed to the growth of subprime lending. Most fundamentally, it became legal. The ability to charge high rates and fees to borrowers was not possible until the [DIDMCA] was adopted in 1980. It preempted state interest rate caps.").

<sup>41</sup> 12 U.S.C.S. § 3801 (1997). Congress enacted AMTPA in order to ensure competitive balance between federal and nonfederal housing creditors by "preempting state laws that banned state-chartered lenders from making certain types of nontraditional mortgage loans." See OCC Interpretive Letter 785, (June 3, 1997) (interpreting 12 U.S.C. § 3801). The Act permitted state banks to engage in "alternative mortgage transactions" as long as they operated under the same guidelines as the federal banks. These "alternative" loans included features "not common to traditional fixed-rate, fixed-term" loans. 12 U.S.C.S. § 3802(1)(C) (1997). The Office of the Comptroller of the Currency's regulation implementing the Act specifically mentions adjustable rate mortgages as being allowed. 12 C.F.R. § 34.24 (2008). See also Chomsisengphet & Pennington-Cross, *supra* note 15, at 38.



adjustable rate loans.<sup>42</sup> However, subprime loans did not become a viable national lending option until the Tax Reform Act of 1986 (“TRA”).<sup>43</sup> The TRA increased the demand for mortgage debt by allowing tax deductions for residential real estate mortgages, but not for other consumer loans.<sup>44</sup> As a result, interest payments on mortgage debt became less expensive than consumer debt for many homeowners, even when the mortgage debt was high-cost.<sup>45</sup> Thus the demand for mortgages increased, resulting in greater investments in adjustable rate loans.<sup>46</sup>

While statutory changes in the 1980s opened the door to subprime lending, market changes in the 1990s sparked the considerable increase in subprime loans leading to the current crisis. In the mid-1990s, interest rates increased, making prime loans more expensive and causing the prime market to suffer.<sup>47</sup> Lenders and brokers responded by increasing their marketing of subprime loans in order to remain competitive.<sup>48</sup> As lenders increased their focus on subprime loans, the mortgage market also experienced an infusion of capital from mortgage-backed securities,<sup>49</sup> which resulted in increased funding for high-rate

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<sup>42</sup> See Chomsisengphet & Pennington-Cross, *supra* note 15, at 38.

<sup>43</sup> Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986).

<sup>44</sup> See Chomsisengphet & Pennington-Cross, *supra* note 15, at 38.

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

<sup>48</sup> See *id.*

<sup>49</sup> See *id.* See also, Jo Anne Bradner, *The Secondary Mortgage Market and State Regulation of Real Estate Financing*, 36 EMORY L.J. 971, 981–82 (1987).

The mechanics of a typical mortgage securities market transaction are simple: a lender originates mortgages, pools them together (or sells them to another entity, often called a “conduit,” which forms a pool from mortgages originated by several primary lenders), and transfers the pool to a trustee. The trustee issues certificates representing either an equity or a debt participation in the pool. The certificates are then sold by the pooling entity or conduit (each of which is also called the “warehouse”) to investors. The warehouse may continue to service the mortgage loans comprising the pool or may contract with a loan servicing entity for the performance of this duty. The investors thus receive the benefits of investing in home loan mortgages without incurring the costs in efficiency associated with individual investors originating and servicing the loans, and without being forced to concentrate their risk in one loan or make a very large investment in order to diversify. The loan originator obtains the advantage of liquidity for its mortgage portfolio with the consequent ready availability of more capital to put back into the housing sector. The servicer charges as its fee a portion of the spread between the interest rate on the underlying mortgages and the coupon rate on the securities issued off the pool. The housing market (and, ultimately, the home buyer) benefits from the increased availability of mortgage money.

See also Jim Zarroli, *National Public Radio: Rise and Fall of Subprime Lenders Began on Wall St.*, (Aug. 27, 2008), available at <http://www.npr.org/templates/story/story.php?storyId=9248739>:

[I]n the mid-1990s, there was an explosion in mortgage-backed securities. Mortgages

loans.<sup>50</sup> By the end of the 1990s, interest rates had sunk to levels unseen in nearly forty years, creating relatively inexpensive access to home equity for many people.<sup>51</sup> During this time, housing prices soared, inflated in part due to the influx of inexpensive loans.<sup>52</sup> Brokers and lenders made record loans to less traditional, higher risk borrowers,<sup>53</sup> further inflating the housing market.<sup>54</sup> Many of these borrowers were pushed into subprime loans, in part because the borrowers posed greater risks and in part because subprime loans were, at least in the short term, more profitable than prime loans.<sup>55</sup>

Some analysts claim that the subprime crisis primarily developed not due to poor lending practices but to misguided anti-redlining legislation,<sup>56</sup> namely, the Community Reinvestment Act (“CRA”).<sup>57</sup> The CRA required federally insured banks and thrifts to offer credit throughout the neighborhoods from which they

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could now be repackaged as bond debt and sold to investors. Companies like Country-wide could now market and sell mortgages to their customers.

And that, in turn, led to spreading risk. But it also opened the door to a lack of certainty over borrowers’ ability to repay loans that had been pooled together and sold to investors like mutual funds.

“These loans get sliced and diced, securitized and spread to the wind,” former Federal Reserve Governor Edward Gramlich says, “and nobody has a clue who the ultimate — they know who the borrower is —but where the money comes from. It’s all around the world.”

Investors loved the securities, seeing them as a way to invest in mortgages when the housing market was strong. They even loved the risky subprime mortgages that came from customers with weak credit. Big banks like Wells Fargo and Citicorp started their own subprime divisions.

<sup>50</sup> See Zarroli, *supra* note 49.

<sup>51</sup> See Chomsisengphet & Pennington-Cross, *supra* note 15 at 41

<sup>52</sup> See *id.*; see also Brandon Cornett, *Subprime Mortgage Loans—A Borrower’s Guide to Subprime Lenders and Loans*, Home Buying Institute, available at, <http://www.homebuyinginstitute.com/mortgage-types-25.php>.

<sup>53</sup> Michael Kanell, *Many Foreclosures Don’t Go Through: Georgia Lenders Often Negotiate*, THE ATLANTA JOURNAL-CONSTITUTION, December 26, 2006, at 1C.

<sup>54</sup> National Standard For Subprime Loans Urged By Bankers, NATIONAL JOURNAL’S CONGRESS DAILY, March 30, 2004.

<sup>55</sup> See Cornett, *supra* note 52 (“The number of subprime mortgages rose dramatically through the mid 1990’s through early 2000’s, as increased competition (largely from online mortgage lenders) forced lenders to offer a broader range of mortgage products. Subprime lenders . . . tried to outmaneuver competitors by offering mortgage loans to borrowers that their competitors were turning away. [U]sually with a much higher interest rate.”).

<sup>56</sup> See Stan Liebowitz, *The Real Scandal: How Feds Invited the Mortgage Mess*, N.Y. POST, Feb. 5, 2008 at A3, available at [http://www.nypost.com/seven/02052008/postopinion/opedcolumnists/the\\_real\\_scandal\\_243911.htm?page=0](http://www.nypost.com/seven/02052008/postopinion/opedcolumnists/the_real_scandal_243911.htm?page=0). An instinctive consequence of the current subprime lending crisis on the part of lenders has been to “tighten lending standards.” See Sudeep Reddy, *More Banks Tighten Lending Standards*, WALL ST. J. at A3 (Aug. 12, 2008) (“About three out of four banks . . . said they tightened lending standards for prime mortgages.”).

<sup>57</sup> Community Reinvestment Act (CRA) of 1977, 12 U.S.C. § 2901 (1977). Congress

take deposits.<sup>58</sup> The Act also made CRA performance ratings public and factored these ratings into important decisions such as merger approvals,<sup>59</sup> thus requiring banks to comply. Banking industry critics claim that the CRA essentially forced banks to lend to high-risk individuals with little to no chance of repayment.<sup>60</sup>

Allegations that the CRA was the principle cause of the financial crisis grew very heated during the 2008 presidential race. For example, Ann Coulter wrote an article titled, “They gave your mortgage to a less qualified minority,” in which she argued that “[t]his crisis was caused by political correctness being forced on the mortgage lending industry in the Clinton era.”<sup>61</sup> She lamented that “[i]nstead of looking at ‘outdated criteria,’ such as the mortgage applicant’s credit history and ability to make a down payment, banks were encouraged to consider nontraditional measures of credit-worthiness, such as having a good jump shot or having a missing child named ‘Caylee.’”<sup>62</sup> Rush Limbaugh similarly told his listeners that “white guilt” was the cause of the current economic crisis, blaming the likes of then presidential candidate Senator Barack Obama, and accusing Obama of pressuring banks to make bad loans.<sup>63</sup> Invariably, these attacks supplemented the attacks waged against the Association of Community Organizers for Reform Now (“ACORN”) by Senator John McCain’s presidential campaign,<sup>64</sup> blaming ACORN for forcing the

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enacted the CRA to combat redlining, the practice of denying entire minority neighborhoods any chance of obtaining a loan.

<sup>58</sup> *Id.* at § 802(a)(2).

<sup>59</sup> See Federal Reserve Board, Application Filing Information, CRA and the Applications Process, <http://www.federalreserve.gov/generalinfo/applications/afi/cra.htm> (“When the Federal Reserve System . . . accepts an application, . . . the institution’s . . . CRA performance evaluation and rating is a particularly important and often a controlling factor in the consideration of an institution’s record of meeting the credit needs of its community . . . [and] may be the basis for denying or conditioning approval of an application.”).

<sup>60</sup> “The government *compels* banks to make loans in poor neighborhoods even if the applicants are not considered prime borrowers.” Jerry Bowyer, Op-Ed., *Don’t Blame the Markets*, N.Y. SUN, April 18, 2008, at 9 (emphasis added).

<sup>61</sup> Ann Coulter, *They Gave Your Mortgage to a Less Qualified Minority*, HUMAN EVENTS ONLINE, September 24, 2008, available at <http://www.humanevents.com/article.php?id=28714>.

<sup>62</sup> *Id.*

<sup>63</sup> Rush Limbaugh, *Obama, ACORN Pressured Banks to Make Unsafe Subprime Loans*, FREE REPUBLIC ONLINE, September 29, 2008, available at <http://www.freerepublic.com/focus/f-news/2093675/posts>.

<sup>64</sup> For example, in his stump speech, Senator McCain would make arguments as follows: Whatever the question, whatever the issues, there’s always a back story with Senator Obama . . . Our current economic crisis is a good case in point. The crisis started in our housing market in the form of subprime loans that were pushed on people who could not afford them.

Bad mortgages were being backed by Fannie Mae and Freddie Mac, and it was only a

banks' hands in making these ill-advised loans.<sup>65</sup>

More mainstream conservative voices joined the chorus. Charles Krauthammer argued that the CRA led to “bipartisan agreement to use government power to expand homeownership to people who had been shut out for economic reasons or, sometimes, because of racial and ethnic discrimination . . . [i]t led to tremendous pressure on Fannie Mae and Freddie Mac – which in turn pressured banks and other lenders – to extend mortgages to people who were borrowing over their heads.”<sup>66</sup> Krauthammer underscored the point by belittling the contention that lenders bore primary responsibility for the mortgage foreclosure crisis: “Were there some predatory lenders? Of course. But only a fool or a demagogue—i.e., a presidential candidate—would suggest that this is a major part of the problem.”<sup>67</sup> Villain Phil writing on behalf of the editors at the *National Review*, in a more measured tone, claimed that “bankers cannot blame CRA entirely; they made a lot of bad bets on rising home prices. But the CRA did influence lending standards across the banking industry, even in those insti-

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matter of time before a contagion of unsustainable debt began to spread,” McCain said during an event in Albuquerque, NM.

This corruption was encouraged by Democrats in Congress, and abetted by Senator Obama.

Carl Campanile, *Blame Barack For Me\$\$: Mac*, N.Y. POST, October 7, 2008 (describing McCain as going “nuclear on Barack Obama”), available at [http://www.nypost.com/php/friendly/print.php?url=http://www.nypost.com/seven/10072008/news/politics/blame\\_barack\\_for\\_me\\_\\_mac\\_132489.htm](http://www.nypost.com/php/friendly/print.php?url=http://www.nypost.com/seven/10072008/news/politics/blame_barack_for_me__mac_132489.htm).

<sup>65</sup> Limbaugh, *supra* note 63. Limbaugh, bloviating, told his listeners:

Obama’s fingerprints are over this, too, because his group ACORN is all involved. The Community Reinvestment Act “was meant to encourage banks to make loans to high-risk borrowers, often minorities living in unstable neighborhoods. That has provided an opening to radical groups like ACORN (the Association of Community Organizations for Reform Now), and a group that is constantly engaged in illegal voter registration, among other things.”

Other, more mainstream, conservative pundits drew similar parallels. See Stanley Kurtz, *Planting Seeds of Disaster: ACORN, Barack Obama, and the Democratic party*, NATIONAL REVIEW ONLINE, October 07, 2008, available at <http://article.nationalreview.com/print/?q=ZjRjYzE0YmQxNzU4MDJjYWE5MjIzMTMxMmNhZWQ1MTA=>.

<sup>66</sup> Charles Krauthammer, *Catharsis, Then Common Sense*, WASH. POST, Sept. 26, 2008, at A23, available at <http://www.washingtonpost.com/wp-dyn/content/article/2008/09/25/AR2008092503600.html>.

<sup>67</sup> *Id.* See also Darryl Fears and Carol D. Leonnig, *Activists Angered By Blame For Crisis*, WASH. POST, Oct. 3, 2008, at A15, available at <http://www.washingtonpost.com/wp-dyn/content/article/2008/10/02/AR2008100204115.html>, reporting:

Rep. Michele Bachmann (R-Minn.) lashed out against the act, reading from an Investor’s Business Daily article that said banks made loans “on the basis of race and little else.” Neil Cavuto, a business news anchor on Fox News, recently made a similar statement. In an exchange on television with Rep. Xavier Becerra (D-Calif.), Cavuto noted that the congressman pushed for more minority lending to “folks who heretofore couldn’t get mortgages” and asked, “Are you totally without culpability here? Are you totally blameless?”

tutions that are not strictly liable to its jurisdiction. The subprime debacle is in no trivial part the result of lending decisions in which political extortion trumped businesses' normal bottom-line concerns."<sup>68</sup>

The conservative critiques of the CRA were met with stern rebukes from liberal commentators. The President of the National Urban League called on Treasury Secretary Henry Paulson "to refute statements by conservative politicians and pundits that subprime mortgages provided to minorities led to the financial crisis and a \$700 billion federal rescue of Wall Street," calling such allegations a "big lie."<sup>69</sup> Daniel Gross responded, "Let me get this straight. Investment banks and insurance companies run by centimillionaires blow up, and it's the fault of Jimmy Carter, Bill Clinton, and poor minorities?"<sup>70</sup> Gross blamed the crisis on "stupid, reckless lending, of which Fannie Mae and Freddie Mac and the subprime lenders were an integral part."<sup>71</sup> As he saw it, "Investment banks created a demand for subprime loans because they saw it as a new asset class that they could dominate. They made subprime loans for the same reason they made other loans: They could get paid for making the loans, for turning them into securities, and for trading them—frequently using borrowed capital."<sup>72</sup>

Several aspects of the CRA belie the conservative pundits' theory that liberal lending mandates, as opposed to bad business decisions, were the cause of the mortgage foreclosure crisis. As a principal matter, a large number of subprime loans are not even covered by the CRA and thus could not have been coerced by CRA requirements.<sup>73</sup> In fact, by some estimates up to three-quarters of sub-

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<sup>68</sup> Villain Phil, By the Editors, NATIONAL REVIEW, Sept. 22, 2008, available at <http://article.nationalreview.com/print/?q=Mzk3MzFiYWY3NjUyNzUyNzA4MzYzNTk2ZDVhMDFiMWE=>. See also Liebowitz, *supra* note 56.

<sup>69</sup> See Fears and Leorning, *supra* note 67.

<sup>70</sup> Daniel Gross, Posted, Subprime Suspects: The right blames the credit crisis on poor minority homeowners. This is not merely offensive, but entirely wrong, NEWSWEEK, Oct. 7, 2008, available at <http://www.newsweek.com/id/162789>. Gross argues:

The Community Reinvestment Act applies to depository banks. But many of the institutions that spurred the massive growth of the subprime market weren't regulated banks. They were outfits such as Argent and American Home Mortgage, which were generally not regulated by the Federal Reserve or other entities that monitored compliance with CRA. These institutions worked hand in glove with Bear Stearns and Lehman Brothers, entities to which the CRA likewise didn't apply. There's much more. As Barry Ritholtz notes in this fine rant, the CRA didn't force mortgage companies to offer loans for no money down, or to throw underwriting standards out the window, or to encourage mortgage brokers to aggressively seek out new markets. Nor did the CRA force the credit-rating agencies to slap high-grade ratings on packages of subprime debt.

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

<sup>73</sup> About half came from mortgage companies who do not fall under the CRA at all and 30% percent came from bank subsidiaries and affiliates, which are regulated by the CRA to a lesser degree than the banks themselves. In other words, only 20% of subprime loans were "forced" as a result of the CRA's jurisdiction. See *The Community Reinvestment Act: Thirty*

prime loans fell outside the range of the CRA.<sup>74</sup> Tellingly, lenders covered by the CRA engage in high-cost loans at *lower rates* than those outside the CRA's reach.<sup>75</sup> Further, the subprime crisis did not begin until a quarter century after the enactment of the CRA,<sup>76</sup> and Congress weakened the CRA regulations in late 2004 to exclude small and mid-sized banks from its more stringent requirements - yet the subprime market continued to grow.<sup>77</sup> The number of high-cost loans provided to individuals who could not afford them seems then to stem more from a combination of bad business decisions on the behalf of lenders and a failure of the federal government to adequately regulate the residential mortgage market.<sup>78</sup>

We do not dispute that the CRA was likely enforced in an imperfect manner. We believe, however, that conservative pundits tend to make little effort to distinguish between pressure exerted by legislators to encourage, or even force lenders to increase lending to minority borrowers, and independent predatory lending practices by lenders, based not on undue pressure from legislators and community groups (i.e., ACORN), but on the lenders' own business interests and poor decision making. At any rate, rightly or wrongly, the deepening economic crisis appears likely to result in expanded regulation of lending practices.<sup>79</sup>

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*Years of Accomplishments, But Challenges Remain: Hearing Before the Comm. On Financial Services*, 110th Cong. (2008) (statement of Michael S. Barr, Professor of Law, University of Michigan Law School).

<sup>74</sup> *Id.*

<sup>75</sup> Independent mortgage companies made high-priced loans at more than double the rate of lenders covered by the CRA. See Janet L. Yellen, President and CEO, Fed. Reserve Bank of San Francisco, Opening Remarks to National Interagency Community Reinvestment Conference (Mar. 31, 2008); Center for Responsible Lending, *Subprime "Exploding" ARMs*, *supra* note 3.

<sup>76</sup> CRA started in 1977 and the subprime crisis did not begin until well after 2000. See Aaron Pressman, *Community Reinvestment Act Had Nothing to do with Subprime Crisis*, *BUS. WEEK*, Sept. 29, 2008.

<sup>77</sup> Robert Gordon, *Did Liberals Cause the Sub-Prime Crisis?*, *THE PROSPECT*, April 7, 2008, available at [http://www.prospect.org/cs/articles?article=did\\_liberals\\_cause\\_the\\_subprime\\_crisis](http://www.prospect.org/cs/articles?article=did_liberals_cause_the_subprime_crisis).

<sup>78</sup> See, e.g., DAN IMMERGLUCK, *CREDIT TO THE COMMUNITY: COMMUNITY REINVESTMENT AND FAIR LENDING POLICY IN THE UNITED STATES* 267 (2004) ("The problem of poor access to mortgage loans has been transformed into a problem of poor access to fairly priced credit and one of frequently unsustainable credit promoted by abusive lenders."); see also Benjamin Howell, *Exploiting Race and Space: Concentrated Subprime Lending as Housing Discrimination*, 94 *CAL. L. REV.* 101, 102 (2006) ("Unscrupulous lenders now prey on a history of racial redlining by aggressively marketing overpriced loan products with onerous terms in the same neighborhoods where mainstream lenders once refused to lend.") (citations omitted).

<sup>79</sup> The Housing and Economic Recovery Act of 2008, signed into law by President Bush, aims to address some of the economic woes caused by the foreclosure crisis. See Housing

### C. Subprime Lending Mushrooms and the Foreclosure Crisis Looms

All told, the statistical rise in subprime loans is staggering.<sup>80</sup> Statistics released by the Federal Reserve Board in 2004 show that subprime lending increased by 25% each year from 1994 to 2003, “making it the fastest-growing segment of the U.S. mortgage industry” during that timeframe.<sup>81</sup> The combined total of subprime fixed rate and adjustable rate loans increased from approximately 83,000 in 1995 to approximately 1,646,000 in 2003.<sup>82</sup> Subprime loans have proliferated equally through both the origination of new home-purchase loans and through the refinancing of existing loans.<sup>83</sup> Subprime refinancing has been particularly severe because those borrowers who refinanced from prime to subprime loans typically had some amount of equity invested in their homes, often constituting a significant portion of their families’ wealth.<sup>84</sup> In refinancing, many of these families wound up losing that equity, either by borrowing more from the banks, or by virtue of the bank “paying” for fees by

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and Economic Recovery Act of 2008 FAQ, U.S. Department of Housing and Urban Development, <http://www.hud.gov/news/recoveryactfaq.cfm> (last visited Aug. 8, 2008). Among other forms of relief, the Act will help certain homeowners with high cost loans to refinance into a more affordable mortgage. *Id.* The Act, whether wisely or not, largely depends on the cooperation of lenders. See Damian Paletta, *Housing Bill Relies on Banks To Take Loan Losses—Lawmakers Pressure Lenders to Pitch in to Curb Foreclosures*, WALL ST. J., July 28, 2008 at A3, available at [http://online.wsj.com/article\\_print/SB121719179401688061.html](http://online.wsj.com/article_print/SB121719179401688061.html). Many have noted the Act’s shortcomings. See, e.g., John F. Wasik, *With 2 million mortgages in peril, bailout will do little to stem foreclosures*, BOSTON GLOBE, August 8, 2008, available at [http://www.boston.com/business/personalfinance/articles/2008/08/08/with\\_2\\_million\\_mortgages\\_in\\_peril\\_bailout\\_will\\_do\\_little\\_to\\_stem\\_foreclosures/](http://www.boston.com/business/personalfinance/articles/2008/08/08/with_2_million_mortgages_in_peril_bailout_will_do_little_to_stem_foreclosures/).

<sup>80</sup> HMDA data, explained in section I.2.D, *infra*, does not classify loans as subprime or prime. Rather, it classifies loans as either “normal” or “high-rate.” The HMDA data classifies a loan as high-rate if its APR is at least three percentage points higher than the yield on a comparable-maturity Treasury security. While we cannot classify all of these high-rate loans as subprime, it is safe to say that the two classifications have many or most loans in common.

<sup>81</sup> Lisa Smith, *Subprime Loans: Buyers Beware*, FORBES, Aug. 27, 2007, available at [http://www.forbes.com/investoreducation/2007/08/27/subprime-credit-default-pf-education-in\\_ls\\_0827investopedia\\_inl.html](http://www.forbes.com/investoreducation/2007/08/27/subprime-credit-default-pf-education-in_ls_0827investopedia_inl.html).

<sup>82</sup> See Chomsisengphet & Pennington-Cross, *supra* note 15 at 41.

<sup>83</sup> According to 2006 HMDA data, there were 1,558,838 high-rate conventional home purchase loans and 1,602,448 high-rate conventional refinance loans as compared to 5,153,567 total conventional home purchase loans and 5,273,215 total conventional refinance loans. Robert B. Avery, Kenneth P. Brevoort, & Glenn B. Canner, *The 2006 HMDA Data* [hereinafter *The 2006 HMDA Data*], 93 Fed. Res. Bull. A73, A82 (2007), available at <http://www.federalreserve.gov/pubs/bulletin/2007/pdf/hmda06final.pdf>.

<sup>84</sup> E.g., RAKESH KOCHHAR, PEW HISPANIC CENTER, *THE WEALTH OF HISPANIC HOUSEHOLDS: 1996 TO 2002* 21 tbl. 10 (October 18, 2004), <http://pewhispanic.org/files/reports/34.pdf> (showing the home equity as a percentage of wealth at 61.6% for whites, 88.4% for Latinos and 88.1% for African Americans).

increasing the principal of the loan.<sup>85</sup>

Several different types of institutions originate subprime loans, including banks, mortgage brokers, and smaller banking affiliates.<sup>86</sup> Until recently, independent mortgage companies originated subprime loans at the highest rates,<sup>87</sup> but the tumult in the industry has forced many of these lenders to either restrain lending or declare bankruptcy.<sup>88</sup> Lenders have issued subprime loans across the country, but they tend to appear and negatively affect individuals most often in the “industrial Midwest and those states that saw the biggest housing bubble, particularly California, Nevada, Arizona and Florida.”<sup>89</sup> Refinanced loans in the Great Plains and the Southwest tend to feature the highest rates; Mississippi, Oklahoma, Alabama, Nebraska and Louisiana have the five highest interest rates.<sup>90</sup>

Not surprisingly, borrowers default on subprime loans at far higher rates than typical loans and lead to foreclosure far too often.<sup>91</sup> In 2008, the Mortgage Bankers Association (MBA) found that the rates of delinquency, foreclosure initiations, and loans in the process of foreclosure continue at record levels.<sup>92</sup> In the first quarter of 2008, seasonally adjusted<sup>93</sup> delinquency rates were 3.71%

<sup>85</sup> See Cornett, *supra* note 52.

<sup>86</sup> *The 2006 HMDA Data*, *supra* note 83, at A89.

<sup>87</sup> *Id.* In 2004 and 2005 independent mortgage companies originated 30% of all loans and over 50% of conventional first-lien loans for site-built homes.

<sup>88</sup> *The 2006 HMDA Data*, *supra* note 83, at A89 (in 2006 the numbers were 31.2% and 45.7% and the numbers for 2007 are expected to show a dramatic decrease).

<sup>89</sup> *The Geography of Recession*, THE ECONOMIST, Feb. 7, 2008 at 31. See also Federal Reserve Bank of New York, Dynamic Maps of Nonprime Mortgage Condition in the US, <http://www.newyorkfed.org/mortgagemaps> (last visited Oct. 11, 2008).

<sup>90</sup> ALLEN J. FISHBEIN AND PATRICK WOODALL, CONSUMER FEDERATION OF AMERICA, SUBPRIME LOCATIONS: PATTERNS OF GEOGRAPHIC DISPARITY IN SUBPRIME LENDING 3 (2006), <http://www.consumerfed.org/pdfs/SubprimeLocationsStudy090506.pdf> (“More than half (51.8 percent) of refinance loans in Mississippi were subprime. Rounding out the highest subprime refinance rates were Oklahoma with 44.3 percent subprime, Alabama with 41.6 percent, Nebraska with 41.4 percent and Louisiana with 40.0 percent.”).

<sup>91</sup> Les Christie, *Confessions of a Subprime Lender: 3 Bad Loans*, CNNMONEY.COM, July 15, 2008, [http://money.cnn.com/2008/07/15/real\\_estate/annals\\_of\\_subprime\\_lending/index.htm?postversion=2008071512](http://money.cnn.com/2008/07/15/real_estate/annals_of_subprime_lending/index.htm?postversion=2008071512) (Richard Bitner, a former owner of a small subprime lender, details three common types of “bad loans” in the industry, showing in large part why so many subprime loans were destined to fail).

<sup>92</sup> Press Release, Mortgage Banker’s Association, Delinquencies and Foreclosures Increase in Latest MBA National Delinquency Survey (JUNE 5, 2008), available at <http://www.mortgagebankers.org/NewsandMedia/PressCenter/62936.htm>.

<sup>93</sup> U.S. Census Bureau, Frequently Asked Questions on Seasonal Adjustment, (Feb.5, 2008), <http://www.census.gov/const/www/faq2.html#two>.

Seasonal adjustment is the process of estimating and removing seasonal effects from a time series in order to better reveal certain non-seasonal features. Examples of seasonal effects include a July drop in automobile production as factories retool for new models

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for prime loans and 18.79% for subprime loans,<sup>94</sup> while in 2007 the delinquency rates were 2.58% for prime loans and 13.77% for subprime loans.<sup>95</sup> Foreclosures follow similar trends; the foreclosure inventory rate in 2008 is 1.22% for prime loans and 10.74% for subprime loans, as compared to 0.54% and 5.10% in the first quarter of 2007.<sup>96</sup> Alarming, “while subprime . . . [adjustable rate mortgages] represent[ed] only 6 % of all loans outstanding,” they accounted for a whopping 39 % of foreclosures.<sup>97</sup> Fixed rate mortgage foreclosures for subprime loans are six times higher than prime loans,<sup>98</sup> while mortgage foreclosures for adjustable rate mortgages are over four times more likely for subprime than for prime loans.<sup>99</sup> Unfortunately, the situation continues to worsen. Two million adjustable-rate mortgages will reset to higher interest rates in 2008 alone,<sup>100</sup> and these loans will continue to adjust in 2009 and beyond.<sup>101</sup>

#### D. *The Home Mortgage Disclosure Act*

Discriminatory lending is much easier to track since Congress enacted the Home Mortgage Disclosure Act of 1975 (“HMDA”)<sup>102</sup> to help identify and

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and increases in heating oil production during September in anticipation of the winter heating season.

<sup>94</sup> Mortgage Bankers Ass’n, *supra* note 92.

<sup>95</sup> See Mortgage Bankers Ass’n, *supra* note 92. The increases in these rates of foreclosure for 2007 clearly indicate that the crisis has not yet hit its peak.

<sup>96</sup> *Id.* (it is noteworthy that with all these numbers the loans in the subprime category are at least five times higher than the prime loans).

<sup>97</sup> *Id.*

<sup>98</sup> *Id.* (1.80% for subprime FRMs vs. .29% for prime FRMs).

<sup>99</sup> *Id.* (6.35% for subprime ARMs vs. 1.55% for prime ARMs).

<sup>100</sup> Christine Daleiden, Understanding Subprime Mortgages, 12 HAW. B.J. 6, 6 (2008).

<sup>101</sup> Some commentators believe that, while this housing crisis has certainly been devastating, it may not last for many years to come. See, e.g., Jonathan R. Laing, *Bottom’s Up: This Real-Estate Rout May Be Short-Lived*, BARRON’S, July 14, 2008, at 1–2, available at <http://online.barrons.com/article/SB121581623724947273.html> (citing a rise in home prices “between March and April . . . in eight of the 20 markets covered by the [S&P/Case-Shiller] index.”); David Wessel, *Greenspan Sees Bottom In Housing, Criticizes Bailout*, WALL ST. J., Aug. 14, 2008, at 1 (“[T]he former Federal Reserve chairman . . . said he expects that U.S. house prices . . . will begin to stabilize in the first half of next year.”).

<sup>102</sup> Pub. L. No. 94-200, 89 Stat. 1125 (1975) (Section 302(a), Findings and Purpose, declares: “The Congress finds that some depository institutions have sometimes contributed to the decline of certain geographic areas by their failure pursuant to their chartering responsibilities to provide adequate home financing to qualified applicants on reasonable terms and conditions.”) (codified as amended at 12 U.S.C. §§ 2801–2810 (2000)). See Joseph T. Lynyak III, Regulation C And Fair Lending, Mortgage Bankers Association (May 14, 2004), [http://www.mortgagebankers.org/files/present2004/SUBPRIME/MBARegulationCandFairLendingPresentation-Final\\_v1.PPT.PPT](http://www.mortgagebankers.org/files/present2004/SUBPRIME/MBARegulationCandFairLendingPresentation-Final_v1.PPT.PPT) [hereinafter Lynyak, *Regulation C and Fair Lending*]; Naimon, *supra* note 4, at 4, (explaining that before “HMDA pricing data was added

eliminate redlining.<sup>103</sup> Congress amended HMDA in 1989 to include new disclosure requirements, most notably, the race of borrowers.<sup>104</sup> In 1998, the Federal Reserve Board began a new review of the HMDA requirements by publishing an Advance Notice of Proposed Rulemaking.<sup>105</sup> Two years later, the Federal Reserve Board published a proposal and began accepting comments.<sup>106</sup> By 2002, the Federal Reserve Board finalized the new requirements.<sup>107</sup> The proposed changes, commonly known as Regulation C, became effective on January 1, 2004, and the disclosure requirements under HMDA officially underwent their most important change: the mandatory release of certain limited information linked to the annual percentage rate (“APR”) of loans category.<sup>108</sup>

Starting with loans originated in 2004, HMDA requires lenders to divulge the “difference between the . . . [APR of certain] loan[s] and the yield on comparable U.S. treasury securities.”<sup>109</sup> More importantly, the class of loans requiring the release of this information includes first-lien loans with a difference of at least three percentage points, and subordinate liens, where the difference was at least five points.<sup>110</sup> For the first time, federal regulations required lenders to disclose the APR on high-rate loans.<sup>111</sup> In other words, as of 2004, lenders had to release pricing information on all of their high-cost loans, consisting mostly of subprime loans.<sup>112</sup>

The 2004 HMDA amendments also make it easier to track loans by race.

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and was made publicly available . . . “ the “Industry warned the Fed that the release of the new pricing data would bring a flood of baseless discrimination lawsuits . . . ,” and that “Industry was right.”).

<sup>103</sup> *Id.*

The Congress finds that some depository institutions have sometimes contributed to the decline of certain geographic areas by their failure pursuant to their chartering responsibilities to provide adequate home financing to qualified applicants on reasonable terms and conditions . . . . The purpose of this title is to provide the citizens and public officials of the United States with sufficient information to enable them to determine whether depository institutions are filling their obligations to serve the housing needs of the communities and neighborhoods in which they are located . . . .

See also Henry M. Jay, *Full Disclosure: How Should Lenders Respond to the Heightened Reporting Requirements of the Home Mortgage Disclosure Act?*, 10 N.C. BANKING INST. 247, 248–49 (2006).

<sup>104</sup> Jay, *supra* note 103, at 250. However, race was only required as a question on applications in face-to-face interviews.

<sup>105</sup> Home Mortgage Disclosure, Regulation C, 63 Fed. Reg. 12,329 (March 12, 1998) (codified at 12 C.F.R. Part 203).

<sup>106</sup> Home Mortgage Disclosure, Regulation C, 65 Fed. Reg. 78,656 (Dec. 15, 2000).

<sup>107</sup> 67 Fed. Reg. 7222 (Feb. 15, 2002) (codified at 12 C.F.R. Part 203).

<sup>108</sup> Jay, *supra* note 103, at 251–54.

<sup>109</sup> *Id.* at 253.

<sup>110</sup> *Id.*

<sup>111</sup> Jay, *supra* note 103, at 253.

<sup>112</sup> *Id.*

Prior to the amendments, the regulations only required lenders to ask for the race of an applicant in a face-to-face interview.<sup>113</sup> Now lenders must inquire about the race of an applicant whether the application occurs by phone, mail, or electronically, thus providing a more complete picture on racial disparities in lending.<sup>114</sup> Perhaps most importantly, lenders must now release HMDA data in electronic form.<sup>115</sup> For the first time, researchers can effectively and efficiently use HMDA data to determine differences in loan pricing between various groups of people based on race and geography.<sup>116</sup>

Various organizations, including the National Community Reinvestment Coalition (NCRC),<sup>117</sup> the Association of Community Organizations for Reform Now (ACORN),<sup>118</sup> and the Center for Responsible Lending (CRL)<sup>119</sup> have studied this newly released data.<sup>120</sup>

#### E. *Disproportionate Impact on African American and Latino Borrowers*

While the subprime crisis affects individuals of all races, it has been a catastrophe for African Americans and Latinos.<sup>121</sup> The CRL conducted one of the most comprehensive studies on the subject by using HMDA data combined with a “large, proprietary subprime loan dataset.”<sup>122</sup> The study found that, de-

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<sup>113</sup> *Id.* at 254.

<sup>114</sup> *Id.*

<sup>115</sup> *Id.* 247.

<sup>116</sup> DEBBIE GRUENSTEIN BOCIAN, KEITH S. ERNST AND WEI LI, CENTER FOR RESPONSIBLE LENDING, UNFAIR LENDING: THE EFFECT OF RACE AND ETHNICITY ON THE PRICE OF SUBPRIME MORTGAGES 3 (May 31, 2006), [http://www.responsiblelending.org/pdfs/tr011-Unfair\\_Lending-0506.pdf](http://www.responsiblelending.org/pdfs/tr011-Unfair_Lending-0506.pdf) (however, HMDA does not allow studies to identify the race of individual borrowers on individual loans).

<sup>117</sup> NATIONAL COMMUNITY REINVESTMENT COALITION, INCOME IS NO SHIELD 11 (2008), [http://www.ncrc.org/index.php?option=com\\_content&task=view&id=319&Itemid=1](http://www.ncrc.org/index.php?option=com_content&task=view&id=319&Itemid=1).

<sup>118</sup> Ass’n of Cmty. Orgs. for Reform Now, *supra* note 26.

<sup>119</sup> Bocian et al., *supra*, note 116.

<sup>120</sup> *Id.* at 3.

<sup>121</sup> Ass’n of Cmty. Orgs. for Reform Now, *supra* note 26, at 3. The impact of foreclosures extends well beyond the individuals who lose their homes to the communities where the foreclosures occur. See THE PEW CHARITABLE TRUSTS, DEFAULTING ON THE DREAM: STATES RESPOND TO AMERICA’S FORECLOSURE CRISIS 12, (April 2008) [http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Subprime\\_mortgages/defaulting\\_on\\_the\\_dream.pdf](http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Subprime_mortgages/defaulting_on_the_dream.pdf) (explaining that based on loans issued in 2005 and 2006, “communities will likely experience a \$356 billion cumulative decrease in their house values and tax base from nearby foreclosures . . . .” (citations omitted). Further, “[o]ne study, focused on the City of Chicago, estimates that an abandoned, foreclosed property on average costs a municipality approximately \$7,000, although it can rack up more than \$30,000 in police, fire and code enforcement costs.”).

<sup>122</sup> Bocian et al., *supra* note 116, at 3. Each set of data by itself lacks key lending information to allow analysts to track subprime lending by race. However, by combining the two, the CRL created a dataset of over 177,000 subprime loans containing both background infor-

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pending on the type of loan, African American and Latino borrowers were anywhere from 6% to 142% more likely to receive a higher-rate loan than white borrowers with similar qualifications.<sup>123</sup>

According to the CRL study, the racial disparity in subprime lending has not been strictly based on borrowers' income-levels or risk-related credit factors.<sup>124</sup> The study breaks down its data by LTV, FICO credit score range, and race.<sup>125</sup> In the highest-risk borrower category—featuring an LTV of above 90% and FICO score below 620—African Americans were only 6% more likely than white borrowers to receive a subprime loan for a home purchase and 5% more likely to receive a subprime loan for refinancing.<sup>126</sup> For borrowers with the best credit histories and thus the lowest risk categories—LTV below 80% and FICO score of above 680—African Americans were 65% more likely to receive subprime loans than their similarly situated white counterparts for a home purchase and 124% more likely when refinancing.<sup>127</sup> Beyond the clear racial disparities in lending, the increased disparity in refinancing is particularly unsettling as minorities who refinance with subprime loans are at risk of losing the equity that they have invested in their homes, often comprising their life savings.<sup>128</sup>

The Federal Reserve Board's report on the HMDA data found similarly concerning statistics.<sup>129</sup> On average, 53.7% of African Americans received high cost home purchase loans compared to 17.7% of whites, and only one-sixth of the 36% difference appeared to be based on legitimate "borrower-related factors."<sup>130</sup> Similarly, when refinancing, high cost loans were issued to 52.8% of African Americans as compared to 25.7% of whites, with only one-ninth of the 27% difference based on legitimate "borrower-related factors."<sup>131</sup> A significant portion of this disparity is thus found in factors unrelated to the borrower's risk of default, which is theoretically the only factor that should matter.<sup>132</sup> Interestingly enough, controlling for the lender<sup>133</sup> accounted for a much more signifi-

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mation on the borrower—age, race, sex, etc.—along with important lending characteristics such as loan-to-value ratio, debt-to-income ratio, FICO credit scores, etc.

<sup>123</sup> Bocian et al., *supra* note 116, at 3–4.

<sup>124</sup> *Id.* at 10.

<sup>125</sup> *Id.* at 9.

<sup>126</sup> *Id.* at 11–12 tbls. 2, 3. Interestingly, African American borrowers taking out loans with LTV ratios of 90 percent or higher who had higher credit scores of 680 or above were even more likely to receive high cost loans than their white counterparts - 37% more often with origination loans and 21 percent more often with refinancing.

<sup>127</sup> *Id.* at 11–12 tbls. 2, 3.

<sup>128</sup> *E.g.*, KOCHHAR, *supra* note 84.

<sup>129</sup> Avery et al., *supra* note 83, at A95.

<sup>130</sup> *Id.* at A95 (borrower-related factors accounted for 5.9%).

<sup>131</sup> *Id.* at A96 tbl. 11 (here borrower-related factors only accounted for 2.8%).

<sup>132</sup> *Id.* at A95–A96.

<sup>133</sup> *Id.* at A95 (while the study does not exactly explain how it controls for the lender, we

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cant part of the difference in both cases.<sup>134</sup> In other words, the disparity is much more closely related to factors relating to a bank's lending practices than to factors associated with the borrower.<sup>135</sup>

An ACORN study analyzing the 2006 HMDA data found that African Americans and Latinos are more likely to receive high-cost loans for home purchase and refinance, and that the disparity actually rises with income level.<sup>136</sup> For example, the ratio between African Americans and whites receiving high cost home purchase loans is 2.0 for low-income individuals, 2.3 for moderate income, 2.6 for middle income, and an astounding 3.3 for upper income (54.4% vs. 16.4%).<sup>137</sup> The ACORN study even shows that upper income African Americans and Latinos receive high cost loans at *higher rates than lower income whites*.<sup>138</sup>

#### F. *Litigation Ensues Based on Disparate Impact Theory*

The banking industry correctly predicted that the new HMDA disclosure regulations would cause a groundswell of race discrimination class action lawsuits against lenders.<sup>139</sup> As expected, in the wake of the subprime crisis's initial impact and the subsequent release of more detailed HMDA data, plaintiffs have filed many lawsuits against lenders alleging discrimination in the terms of mortgages issued to minority borrowers.<sup>140</sup>

Because proving discriminatory intent is difficult, these cases rely largely on evidence showing that lenders pursued a policy that resulted in issuing loans to minority borrowers on terms considerably less favorable than those offered to similarly situated white borrowers.<sup>141</sup> This type of statistical analysis is known as "disparate impact theory," which allows plaintiffs to prove discrimination by demonstrating that the lenders' policies, though facially neutral, had an unjustifiably disparate impact on minority borrowers that resulted in unlawful discrimination under federal law.<sup>142</sup> Plaintiffs are not required to prove that lenders

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can assume that in some way they adjusted the statistics to mitigate the differences among various lenders.).

<sup>134</sup> *Id.* at A96 tbl. 11. Controlling for the lender accounted for 17.3% for home purchase loans (nearly half of the difference) and 19.8% for refinancing loans (more than two-thirds of the difference). This obviously provokes some interesting questions about the higher rates for minorities.

<sup>135</sup> *Id.* at A95.

<sup>136</sup> ASS'N OF CMTY. ORGS. FOR REFORM NOW, *supra* note 26, at 1.

<sup>137</sup> *Id.* at 2.

<sup>138</sup> *Id.*

<sup>139</sup> Lynyak, *Regulation C and Fair Lending*, *supra* note 102, at 3 ("Because of the Modifications to Regulation C, Subprime Lenders May Soon be Exposed to Fair Lending Lawsuits—Alleging Reverse Discrimination and Targeting Protected Minorities. . .").

<sup>140</sup> *Id.* at 19–20.

<sup>141</sup> *Id.* at 24.

<sup>142</sup> *Id.*

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had discriminatory intent.

The banking industry has responded to these lawsuits by alleging that disparate impact claims are not cognizable under either the FHA or ECOA.<sup>143</sup> The banking industry acknowledges that the courts that have addressed the issue have unanimously allowed such claims, but they argue that recent Supreme Court decisions require that courts no longer allow disparate impact claims under either statute.<sup>144</sup> Successful elimination of disparate impact claims under these statutes would devastate civil rights efforts aimed at curbing housing and credit discrimination, both in terms of the mortgage discrimination cases<sup>145</sup> and in a wide array of other housing and credit related actions.<sup>146</sup>

## II. DISPARATE IMPACT THEORY

### A. *A Brief History of Disparate Impact Theory*

Disparate impact theory has proven to be a very important tool in protecting civil rights over the past forty-plus years, because it allows plaintiffs to challenge a party's discriminatory practices that have an unjustifiably disproportionate impact on a protected group without requiring the plaintiff to prove that the party discriminated intentionally.<sup>147</sup> The Supreme Court described disparate impact theory as covering "practices that are facially neutral in their treatment of different groups but that in fact fall more harshly on one group than another and cannot be justified by business necessity. Proof of discriminatory motive . . . is not required under a disparate-impact theory."<sup>148</sup>

In the United States, "facially neutral" practices have often had discriminatory effects on protected groups.<sup>149</sup> The landmark case that acknowledged the availability of disparate impact claims under Title VII, *Griggs v. Duke Energy*,<sup>150</sup> "was the result of a legal campaign that 'was almost on par with the campaign that won *Brown [v. Board of Education]*'" and was aimed at address-

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<sup>143</sup> See *infra* section III.

<sup>144</sup> *Id.*

<sup>145</sup> See *infra* sections II & III.

<sup>146</sup> See *infra* section IV.C.

<sup>147</sup> See Civil Rights Acts of 1991, Pub. L. No. 102-166, § 2 (codified at 42 U.S.C. § 1981 (2000)) (in the findings at the beginning of The Civil Rights Act of 1991, Congress noted that a recent Supreme Court decision banning disparate impact had "weakened the scope and effectiveness of Federal civil rights protections; and . . . legislation is necessary to provide additional protections against unlawful discrimination in employment.").

<sup>148</sup> *Int'l Bhd. of Teamsters v. United States*, 431 U.S. 324, 335 n. 15 (1977).

<sup>149</sup> JAVAID REHMAN, *THE WEAKNESSES IN THE INTERNATIONAL PROTECTION OF MINORITY RIGHTS* 122 (Martinus Nijhoff Publishers) (2000) (quoting Theodor Meron, *The Meaning and Reach of the International Convention on the Elimination of all Forms of Racial Discrimination*, 79 AM. J. INT'L L., 283, 283 (1985).

<sup>150</sup> 401 U.S. 424 (1971).

ing facially neutral discriminatory employment practices.<sup>151</sup> In the buildup to *Griggs*, the NAACP Legal Defense and Education Fund brought two cases that challenged facially neutral policies: *Whitfield v. United Steelworkers of America, Local No. 2708*,<sup>152</sup> which introduced the business necessity defense (a crucial feature of disparate impact claims), in which African American employees were divided from whites for seniority purposes in a steel mill,<sup>153</sup> and *Quarles*, which established the present-effects-of-past-discrimination theory,<sup>154</sup> later used in *Griggs*.<sup>155</sup>

Judicial acceptance of disparate impact theory was important for several reasons.<sup>156</sup> Many employers in the 1960s had adopted new unbiased employment policies after Title VII, which still resulted in discriminatory effects due to past intentional racism.<sup>157</sup> Further, intentional discrimination is often nearly impossible to prove and disparate impact theory provided a way to address “facially neutral” yet discriminatory practices.<sup>158</sup> Finally, disparate impact theory embodies the notion that if a practice severely disadvantages a protected group, even when the plaintiff cannot show discriminatory intent, the practice should be prohibited as a matter of public policy absent a legitimate business justification.<sup>159</sup>

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<sup>151</sup> Robert Belton, *Title VII at Forty: A Brief Look at the Birth, Death, and Resurrection of the Disparate Impact Theory of Discrimination*, 22 HOFSTRA LAB. & EMP. L.J. 431, 435 (2005) (quoting JACK GREENBERG, CRUSADERS IN THE COURTS: HOW A DEDICATED BAND OF LAWYERS FOUGHT THE CIVIL RIGHTS REVOLUTION 412 (1994)).

<sup>152</sup> 263 F.2d 546, 550 (5th Cir. 1959).

<sup>153</sup> Belton, *supra* note 151, at 446. The court accepted the new defense, but it was *Quarles v. Philip Morris, Inc.*, that “established the doctrinal foundations” of the defense:

Present discrimination was allowed in *Whitfield* only because it was rooted in the Negro employees’ lack of ability and training to take skilled jobs on the same basis as white employees. The fact that white employees received their skill and training in a discriminatory progression line denied to the Negroes did not outweigh the fact that the Negroes were unskilled and untrained. Business necessity, not racial discrimination, dictated the limited transfer privileges under the contract. 279 F. Supp. 505, 518 (E.D. Va. 1968).

<sup>154</sup> *Quarles*, 279 F. Supp. at 515–16. See Belton, *supra* note 151, at 443 (The NAACP Legal Defense and Education Fund, Inc., which litigated *Griggs* and *Brown*, brought *Quarles* as one of the first cases under Title VII and argued for the present-effects theory as “an alternative to a pure intent standard . . . [that] embraced both an ‘intent’ and an ‘effect’ standard.”).

<sup>155</sup> *Griggs v. Duke Power Co.*, 292 F. Supp. 243, 249 (M.D.N.C. 1968).

<sup>156</sup> Belton, *supra* note 151, at 445.

<sup>157</sup> See *id.*

<sup>158</sup> *Id.*

<sup>159</sup> *Id.* at 446 (“In a line of reasoning that is remarkably similar to the one adopted by the Court in *Griggs* in recognizing the disparate impact theory, the court in *Quarles* reasoned that ‘[p]resent discrimination may be found in contractual provisions that appear fair upon their face, but which operate unfairly because of the historical discrimination that undergirds them.’”).

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### 1. *Griggs v. Duke Power*

The Supreme Court first addressed the validity of disparate impact claims in 1971 in *Griggs v. Duke Power Company*.<sup>160</sup> African American plaintiffs sued defendant Duke Power Company under Title VII of the Civil Rights Act of 1964<sup>161</sup> for discriminating on the basis of race in the hiring and assigning employees.<sup>162</sup> The Court explained that prior to 1965, Duke Power “openly discriminated on the basis of race in the hiring and assigning of employees” by confining African Americans to the Labor Department, where even the best “jobs paid less than . . . the worst jobs available in the other four departments where ‘only whites were employed.’”<sup>163</sup> However, after the enactment of Title VII in 1965,<sup>164</sup> Duke Power abandoned its blatantly discriminatory practices, while continuing to enforce more subtle practices that excluded African Americans from securing jobs or transfers to the better paying departments within Duke Power.<sup>165</sup>

Duke Power enforced two facially neutral policies that were at issue in the case.<sup>166</sup> The first, instituted in 1955, required that an individual must have a high school diploma in order to secure a job in any department other than the Labor Department.<sup>167</sup> Additionally, Duke Power adopted another policy in 1965, on the same day that Title VII took effect, requiring employees or applicants seeking admission to a department other than Labor to pass two company-administered aptitude tests.<sup>168</sup> The District Court found that while the Company had overtly discriminated against African Americans in the past, “such conduct had ceased.”<sup>169</sup> The Court of Appeals held that because “there was no showing of a racial purpose or invidious intent in the adoption of the high school diploma requirement or general intelligence test and that these standards had been applied fairly to whites and Negroes alike,” Duke Power had not violated Title VII.<sup>170</sup>

The Supreme Court disagreed.<sup>171</sup> Writing for the majority, Chief Justice

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<sup>160</sup> *Griggs*, 401 U.S. 424 .

<sup>161</sup> Pub. L. No. 88-352, § 701, 78 Stat. 253 (1964) (codified at 42 U.S.C. § 2000e (2000)).

<sup>162</sup> *Griggs*, 401 U.S. at 426–27.

<sup>163</sup> *Id.*

<sup>164</sup> Pub. L. No. 88-352, § 701, 78 Stat. at 255 (codified at 42 U.S.C. § 2000e-2). Notably, Duke Power overtly discriminated against employees until Title VII’s effective date of July 2, 1965, and enacted their new facially neutral procedure that same day. *Griggs*, 401 U.S. at 427–28.

<sup>165</sup> *Griggs*, 401 U.S. at 427–28.

<sup>166</sup> *Id.*

<sup>167</sup> *Id.* at 427.

<sup>168</sup> *Id.* at 427–28.

<sup>169</sup> *Id.* at 428.

<sup>170</sup> *Id.* at 429.

<sup>171</sup> *Id.* at 430.



Burger explained that “practices, procedures, or tests neutral on their face, and even neutral in terms of intent, cannot be maintained if they operate to ‘freeze’ the status quo of prior discriminatory employment practices.”<sup>172</sup> Chief Justice Burger noted that while Title VII “does not command that any person be hired simply because he was formerly the subject of discrimination, or because he is a member of a minority group,” it does require “the removal of artificial, arbitrary, and unnecessary barriers to employment when the barriers operate invidiously to discriminate on the basis of racial or other impermissible classification.”<sup>173</sup> In determining whether a facially neutral policy is discriminatory, the Court said, “[t]he touchstone is business necessity. If an employment practice which operates to exclude Negroes cannot be shown to be related to job performance, the practice is prohibited.”<sup>174</sup>

The Court found that “neither the high school completion requirement nor the general intelligence test . . . bear[s] a demonstrable relationship to successful performance of the jobs for which it was used.”<sup>175</sup> The Court cited the guidelines of the Equal Employment Opportunity Commission (“EEOC”), the federal enforcement agency responsible for enforcing Title VII, which only permitted using “job-related test[ing]” as screening mechanisms for job placement.<sup>176</sup> In deciding the legitimacy of the EEOC’s job-testing guidelines, the Court emphasized that “[t]he administrative interpretation of the Act by the enforcing agency is entitled to great deference,”<sup>177</sup> and concluded, “[f]rom the sum of the legislative history relevant in this case, the conclusion is inescapable that the EEOC’s construction of § 703(h) to require that employment tests be job related comports with congressional intent.”<sup>178</sup>

Thus, finding no correlation between Duke Power’s listed job qualifications and its actual job duties, the Court held that Duke Power had discriminated against its African American employees by enacting policies that effectively excluded African Americans, even though Duke Power did not demonstrate discriminatory intent.<sup>179</sup>

Notably, the *Griggs* Court principally relied on congressional purpose and the EEOC’s interpretation of Title VII in finding that a disparate impact may constitute a violation of the statute.<sup>180</sup> In fact, the entire opinion focuses on “[t]he objective of Congress in the enactment of Title VII”<sup>181</sup> and “[t]he admin-

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<sup>172</sup> *Id.*

<sup>173</sup> *Id.* at 430–31.

<sup>174</sup> *Id.* at 431.

<sup>175</sup> *Id.* (“Both [policies] were adopted . . . without meaningful study of their relationship to job-performance ability.”).

<sup>176</sup> *Id.* at 433.

<sup>177</sup> *Id.* at 433–34.

<sup>178</sup> *Id.* at 432, 436.

<sup>179</sup> *Id.* at 431–32.

<sup>180</sup> *Id.* at 429–30.

<sup>181</sup> *Id.* at 429

istrative interpretation of the Act by the enforcing agency.”<sup>182</sup> Not only did the *Griggs* Court base its opinion on the purposes of the Act, but the Court in *Smith v. City of Jackson*, upon which defendant lenders heavily rely, reinforced this foundation: “[O]ur opinion in *Griggs* relied *primarily* on the purposes of the Act, buttressed by the fact that the EEOC had endorsed the same view.”<sup>183</sup> Only after mentioning this primary reliance did the *City of Jackson* Court mention that the language also supported this interpretation.<sup>184</sup> Disparate impact theory was therefore born out of congressional purpose and agency interpretation.<sup>185</sup>

## 2. Disparate Impact Theory Post-*Griggs*

Shortly after *Griggs*, the courts refined disparate impact jurisprudence. Judge Gordon, the same trial judge who heard *Griggs* at the district court level, decided *Robinson v. Lorillard Corp.*, one of the first key disparate impact cases after *Griggs*.<sup>186</sup> In *Robinson*, plaintiffs challenged discrimination in promotions and seniority policies.<sup>187</sup> Judge Gordon refined the business necessity test by adopting a balancing test.<sup>188</sup> The Fourth Circuit affirmed the decision and heightened the burden on employers for proving business necessity:

The test is whether there exists an *overriding* legitimate business purpose such that the practice is necessary to the safe and efficient operation of the business. Thus, the business purpose must be sufficiently compelling to override any racial impact; the challenged practice must effectively carry out the business purpose it is alleged to serve; and there must be available *no acceptable alternative* policies or practices which would better accomplish the business purpose advanced, or accomplish it equally well with a lesser differential racial impact.<sup>189</sup>

Other courts around the country soon began to adopt this balancing test,<sup>190</sup> although in later years the test lost some of its initial effect.<sup>191</sup>

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<sup>182</sup> *Id.* at 433–34.

<sup>183</sup> 544 U.S. 228, 235 (2005).

<sup>184</sup> *Id.* at 235–236.

<sup>185</sup> *Id.*

<sup>186</sup> *Id.*

<sup>187</sup> *See id.* at 841.

<sup>188</sup> *Id.* (“[B]usiness necessity’ is an element to be balanced against the anti-value of discrimination or its continuing effects. If the *business necessity* is somehow vital to the operation of a particular industry, and if, *in the Court’s opinion*, it outweighs whatever vestiges of discrimination are thereby maintained, it may be considered *bona fide*”).

<sup>189</sup> *Robinson v. Lorillard*, 444 F.2d 791, 798 (4th Cir. 1971) (emphasis added).

<sup>190</sup> *See, e.g.* *Head v. Timken Roller Bearing Co.*, 486 F.2d 870, 879 (6th Cir. 1973) (finding that the trial court correctly applied the business necessity test as developed in *Robinson*, but that it failed to determine whether an alternative plan with “a lesser racial impact” would have been appropriate).

<sup>191</sup> *See, e.g.*, *Contreras v. City of Los Angeles*, 656 F.2d 1267, 1276 (9th Cir. 1981)

Another important development in disparate impact cases pertained to the availability of statistical evidence in proving a claim. Proving that a certain policy has broad discriminatory effects without statistics is obviously quite difficult. In three cases decided by the Supreme Court in 1977, known as the “Teamsters Trilogy,” the Court validated the use of statistics in proving discrimination claims.<sup>192</sup> The defendant employers in these cases argued that § 703(j) of Title VII disallowed use of statistics in proving employment discrimination,<sup>193</sup> but the Court allowed the plaintiffs’ use of statistics.<sup>194</sup> Statistical evidence became an indispensable instrument for proving discrimination claims.<sup>195</sup>

The Supreme Court further expanded Title VII’s reach in *Albemarle Paper Co. v. Moody*<sup>196</sup> by awarding back pay to plaintiffs to encourage employers to voluntarily end discriminatory practices.<sup>197</sup> The Court also found “that all forms of relief under Title VII . . . should be deemed equitable, so that the defendants were not entitled to a jury trial.”<sup>198</sup> This helped clear the potential landmine of litigating racial discrimination cases in front of “potentially hostile white jurors.”<sup>199</sup>

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(holding that the employer did not have to prove the policy was absolutely necessary for business purposes).

<sup>192</sup> *Dothard v. Rawlinson*, 433 U.S. 321, 330–31 (1977) (holding that statistical height and weight of applicants demonstrated discriminatory impact on women); *Hazelwood Sch. Dist. v. United States*, 433 U.S. 299, 307–08 (1977) (finding that significant statistical disparities can constitute prima facie proof of a pattern of discrimination); *Teamsters*, 431 U.S. at 337–340 (1977) (approving the use of statistical analysis to support a finding of racial discrimination).

<sup>193</sup> *See, e.g.*, *Teamsters*, 431 U.S. at 339 n.20.

<sup>194</sup> *See, e.g.*, *Dothard*, 433 U.S. at 338 (Rehnquist, J., concurring) (“The fact that these statistics are national figures of height and weight, as opposed to statewide or pool-of-labor-force statistics, does not seem to me to require us to hold that the District Court erred . . . .”); *Hazelwood Sch. Dist.*, 433 U.S. at 313 (Brennan, J., concurring) (“It should be plain . . . that the liberal substantive standards for establishing a Title VII violation, including the usefulness of statistical proof, are reconfirmed.”).

<sup>195</sup> *Teamsters*, 431 U.S. at 339 (“[S]tatistical analyses have served and will continue to serve an important role” in discrimination cases. (quoting *Mayor of Philadelphia v. Educ. Equal. League*, 415 U.S. 605, 620 (1974))).

<sup>196</sup> 422 U.S. 405 (1975).

<sup>197</sup> *Id.* (“If employers faced only the prospect of an injunctive order, they would have little incentive to shun practices of dubious legality. It is the reasonably certain prospect of a back pay award that ‘provide[s] the spur or catalyst which causes employers and unions to self-examine and to self-evaluate their employment practices and to endeavor to eliminate, so far as possible, the last vestiges of an unfortunate and ignominious page in this country’s history.’” (citing *United States v. N.L. Indus., Inc.*, 479 F.2d 354, 379 (8th Cir. 1973))).

<sup>198</sup> *Belton*, *supra* note 151, at 460.

<sup>199</sup> *Id.*

### 3. Disparate Impact's Demise and Resurrection

As the political winds of the Supreme Court changed, so too did the Court's view of disparate impact claims. In 1976, the Court held that the Equal Protection Clause did not encompass disparate impact claims, thus limiting the future availability of such claims.<sup>200</sup> Throughout the next dozen years, the Court continued to limit the reach of disparate impact litigation by narrowly interpreting a number of key issues.<sup>201</sup> In 1988 the Court came within one vote of eliminating the disparate impact theory altogether.<sup>202</sup> The addition of Justice Kennedy to the Bench in 1989 allowed the Court to virtually bar disparate impact claims in *Wards Cove Packing Co. v. Atonio*<sup>203</sup> by adopting several rigorous standards for plaintiffs in terms of using statistical analysis.<sup>204</sup> The Court also eased employers' burden by lessening the difficulty of proving business necessity.<sup>205</sup>

Alarmed by the Court's decision in *Wards Cove*, Congress quickly took action to codify disparate impact theory and protect it from the Court's political

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<sup>200</sup> *Washington v. Davis*, 426 U.S. 229, 239–40 (1976) (distinguishing Title VII from the 5th and 14th amendment and concluding that “[t]he central purpose of the Equal Protection Clause of the Fourteenth Amendment is the prevention of official conduct discriminating on the basis of race . . . . But our cases have not embraced the proposition that a law or other official act, without regard to whether it reflects a racially discriminatory purpose, is unconstitutional *solely* because it has a racially disproportionate impact . . . . The school desegregation cases have also adhered to the basic equal protection principle that the invidious quality of a law claimed to be racially discriminatory must ultimately be traced to a racially discriminatory purpose.”) (citations omitted).

<sup>201</sup> *Belton*, *supra* note 151, at 464 (listing cases and issues).

<sup>202</sup> *Watson v. Fort Worth Bank and Trust*, 487 U.S. 977 (1988). The Court in *Watson* did little to hide its contempt for disparate impact theory. This contempt stemmed in part from the Court's belief that the use of statistical evidence along with the strict business necessity defense forced defendants to adopt quotas or face liability under the theory:

Preferential treatment and the use of quotas by public employers subject to Title VII can violate the Constitution, and it has long been recognized that legal rules leaving any class of employers with “little choice” but to adopt such measures would be “far from the intent of Title VII.” Respondent and the United States are thus correct when they argue that extending disparate impact analysis to subjective employment practices has the potential to create a Hobson's choice for employers and thus to lead in practice to perverse results. If quotas and preferential treatment become the only cost-effective means of avoiding expensive litigation and potentially catastrophic liability, such measures will be widely adopted. The prudent employer will be careful to ensure that its programs are discussed in euphemistic terms, but will be equally careful to ensure that the quotas are met. Allowing the evolution of disparate impact analysis to lead to this result would be contrary to Congress' [sic] clearly expressed intent, and it should not be the effect of our decision today. *Id.* at 993 (citations omitted).

<sup>203</sup> 490 U.S. 642 (1989) (J. Kennedy joined in the majority opinion).

<sup>204</sup> See Robert Belton, *The Dismantling of the Griggs Disparate Impact Theory and the Future of Title VII: The Need for a Third Reconstruction*, 8 YALE L. & POL'Y REV. 223, 237–39, 240 n.94 (1990).

<sup>205</sup> *Id.* at 239.

whims.<sup>206</sup> Congress passed the Civil Rights Act of 1990, which included provisions that explicitly allowed disparate impact claims under Title VII in the same manner as had been allowed before *Wards Cove*.<sup>207</sup> President George H. W. Bush initially vetoed the Act,<sup>208</sup> but Congress persisted and one year later the President signed the Civil Rights Act of 1991 into law.<sup>209</sup> The Act expressly preserved disparate impact claims under Title VII, explaining that one of its purposes was to “codify the concepts of ‘business necessity’ and ‘job related’ enunciated by the Supreme Court in *Griggs v. Duke Power Co.* . . . and in other Supreme Court decisions prior to *Wards Cove Packing Co. v. Atonio*”<sup>210</sup>

#### 4. Proving Disparate Impact

While much debate surrounds legitimacy of disparate impact theory,<sup>211</sup> Title VII provides a relatively clear framework for proving a disparate impact claim.<sup>212</sup> A plaintiff must first present prima facie evidence of discrimination by showing—often through statistical data<sup>213</sup>—that a challenged practice or policy has a disproportionately adverse impact on a protected group.<sup>214</sup> The defendant employer may rebut the prima facie case by proving that the challenged “employment practice d[id] not cause the disparate impact,”<sup>215</sup> or by presenting evidence that the challenged practice or policy is “job related for the position in question and consistent with business necessity.”<sup>216</sup> Even if the employer proves that business necessity justifies the policy, the plaintiff employee may still successfully prove that the employer could have achieved its legitimate business interests by other reasonable means that would have a lesser disparate impact on the protected class.<sup>217</sup>

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<sup>206</sup> Act of Nov. 21, 1991, Pub. L. No. 102-166, § 2(2), 105 Stat. 1071 (codified at 42 U.S.C. § 1981) (“[T]he decision of the Supreme Court in *Wards Cove Packing Co. v. Atonio*, 490 U.S. 642 (1989) has weakened the scope and effectiveness of Federal civil rights protections . . .”).

<sup>207</sup> Helen Dewar, *Senate Upholds Civil Rights Bill Veto, Dooming Measure for 1990*, WASH. POST, Oct. 25, 1990, at A15.

<sup>208</sup> 136 CONG. REC. 31,828 (Oct. 22, 1990) (reprinting President Bush’s veto message, which reflected a concern that disparate impact theory would lead to quotas).

<sup>209</sup> See Ann Devroy, *Bush Saw Gains in Deal, Officials Say; President Sought to Secure Domestic Victory, Avoid Veto Showdown*, WASH. POST, Oct. 26, 1991, at A1.

<sup>210</sup> Civil Rights Act of 1991, Pub. L. No. 102-166, § 3(2), 105 Stat. 1071, 1071 (1991) (codified at 42 U.S.C. § 1981 (note)).

<sup>211</sup> See Linda Lye, *Title VII’s Tangled Tale: The Erosion and Confusion of Disparate Impact and the Business Necessity Defense*, 19 BERKELEY J. EMP. & LAB. L. 315 (1998).

<sup>212</sup> 42 U.S.C. § 2000e-2(k) (2000) (explaining the burdens of proof for each party).

<sup>213</sup> See *supra* note 192.

<sup>214</sup> 42 U.S.C. § 2000e-2(k)(1)(A)(i).

<sup>215</sup> *Id.* at § 2000e-2(k)(1)(B)(ii).

<sup>216</sup> *Id.* at § 2000e-2(k)(1)(A)(i).

<sup>217</sup> *Id.* at § 2000e-2(k)(1)(A)(ii).

B. *Disparate Impact Theory in FHA and ECOA Cases*

In lending discrimination cases under the FHA and ECOA, plaintiffs often bring claims under the disparate impact theory instead of disparate treatment<sup>218</sup> because disparate impact allows borrowers to prove, through statistical evidence, that lenders discriminated against them, without having to prove that the lenders *intended* to discriminate against them.<sup>219</sup> Because intent is so difficult to prove in institutional discrimination suits, if courts barred disparate impact claims under the FHA and ECOA as the banking industry urges, consumers would lose both the principal means available to challenge discriminatory practices in the mortgage industry, and the ability to challenge discrimination that results from facially neutral policies in a wide array of other settings in the housing and credit industry.<sup>220</sup>

The FHA and ECOA were enacted over thirty years ago,<sup>221</sup> at approximately the same time that *Griggs* acknowledged disparate impact claims under Title VII.<sup>222</sup> Courts began allowing disparate impact claims under the FHA as early as 1972, shortly after *Griggs* and just four years after Congress enacted the FHA. For example, in *United Farmworkers of Florida Housing Project, Inc. v. City of Delray Beach, Florida*,<sup>223</sup> plaintiffs alleged that a city discriminated on the basis of race by refusing to permit a housing development to utilize existing water and sewer systems. The Fifth Circuit reversed the district court, holding that “the district court’s threshold determination of ‘no satisfactory evidence of discrimination’ [was] clearly erroneous. For the evidence presented . . . clearly demonstrates that the *effect* of the City’s action was racially discriminatory . . . .”<sup>224</sup> The court explained, “To prove a prima facie case of racial discrimination, no more is required.”<sup>225</sup> Similarly, in 1974, the Eighth Circuit explained, “The discretion of local zoning officials . . . must be curbed where ‘the clear result of such discretion is the segregation of low-income Blacks from all White neighborhoods.’”<sup>226</sup> The court continued, “To establish a prima facie case of racial discrimination, the plaintiff need prove no more than that the

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<sup>218</sup> See *Lye*, *supra* note 211, and *Belton*, *supra* note 151.

<sup>219</sup> See *supra* section II.A.4.

<sup>220</sup> See *Lye*, *supra* note 211, and *Belton*, *supra* note 151.

<sup>221</sup> Fair Housing Act, 42 U.S.C. §§ 3601–3619 (2001) (effective Apr. 11, 1968); Equal Credit Opportunity Act, 15 U.S.C. §§ 1691–91(f) (2001) (effective date Mar. 23, 1976).

<sup>222</sup> *Griggs*, 401 U.S. at 424 (1971).

<sup>223</sup> 493 F.2d 799 (5th Cir. 1974).

<sup>224</sup> *Id.* at 808 (emphasis added).

<sup>225</sup> *Id.* at 810. The court explained this principle: “The ultimate effect of the City’s past and present conduct is three-fold: first, the confinement of low income housing construction to the segregated area of the City; second, a further reinforcement of segregation in the City because minority citizens in disproportionate numbers live in low income housing; and third, a frustration of efforts to construct housing which farmworkers can afford.”)

<sup>226</sup> *United States v. City of Black Jack, Missouri*, 508 F.2d 1179, 1184 (8th Cir. 1974) (citations omitted).

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conduct of the defendant actually or predictably results in racial discrimination; in other words, that it has a discriminatory effect.”<sup>227</sup> Since then, all eleven circuits to directly address the issue have allowed disparate impact claims under the FHA.<sup>228</sup>

Perhaps due to the unanimity among the circuit courts, the Supreme Court has yet to pass on whether the FHA permits disparate impact claims. However, in *Village of Arlington Heights v. Metropolitan Housing Development Corp.*,<sup>229</sup> despite holding that the plaintiff could not prove that the defendant engaged in disparate treatment since the evidence did not support a finding of discriminatory intent,<sup>230</sup> the Court nonetheless remanded the case to consider FHA claims that had not been decided, thus implying that the plaintiff might have been able to prove discrimination through the use of disparate impact theory.<sup>231</sup>

While fewer courts have addressed whether the ECOA allows disparate impact claims, every court that has ruled on the issue has allowed such claims.<sup>232</sup>

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<sup>227</sup> *Id.* at 1185. The court underscored that “[e]ffect, and not motivation, is the touchstone, in part because clever men may easily conceal their motivations, but more importantly, because ‘whatever our law was once, we now firmly recognize that the arbitrary quality of thoughtlessness can be as disastrous and unfair to private rights and the public interest as the perversity of a willful scheme’” (quoting *Hobson v. Hansen*, 269 F. Supp. 401, 497 (D.D.C. 1967)).

<sup>228</sup> The lone holdout, the D.C. Circuit, has noted the other courts’ general consensus and has implied its agreement. *See, e.g.*, *Miller v. Poretsky*, 595 F.2d 780, 790 n.10 (D.C. Cir. 1978); *Dana L. Kaersvang, The Fair Housing Act and Disparate Impact in Homeowners Insurance*, 104 MICH L. REV. 1993, 2007 (2006). Additionally, district judges within the D.C. Circuit have allowed these claims. *See, e.g.*, *Nat’l Fair Hous. Alliance, Inc. v. Prudential Ins. Co. of Am.*, 208 F. Supp. 2d 46, 58–59 (D.D.C. 2002). *Simms v. First Gibraltar Bank*, 83 F.3d 1546, 1555 (5th Cir. 1996); *Mountain Side Mobile Estates P’ship v. Sec’y of Hous. and Urban Dev.*, 56 F.3d 1243, 1250–51 (10th Cir. 1995); *Jackson v. Okaloosa County, Fla.*, 21 F.3d 1531, 1543 (11th Cir. 1994); *Casa Marie, Inc. v. Super. Ct. of P.R. for the Dist. of Arecibo*, 988 F.2d 252, 269 n.20 (1st Cir. 1993); *Keith v. Volpe*, 858 F.2d 467, 482–84 (9th Cir. 1988); *United States v. Starrett City Assocs.*, 840 F.2d 1096, 1100 (2d Cir. 1988); *Arthur v. City of Toledo, Ohio*, 782 F.2d 565, 575 (6th Cir. 1986); *Smith v. Town of Clarkton, N.C.*, 682 F.2d 1055, 1065 (4th Cir. 1982); *Resident Advisory Bd. v. Rizzo*, 564 F.2d 126, 147–48 (3d Cir. 1977); *Metro. Hous. Dev. Corp. v. Vill. of Arlington Heights*, 558 F.2d 1283, 1290 (7th Cir. 1977); *United States v. City of Black Jack, Mo.*, 508 F.2d 1179, 1184 (8th Cir. 1974).

<sup>229</sup> 429 U.S. 252 (1977).

<sup>230</sup> *Id.* at 265.

<sup>231</sup> *Id.* at 271.

<sup>232</sup> *See, e.g.*, *Haynes v. Bank of Wedowee*, 634 F.2d 266, 269 n.5 (5th Cir. 1981) (“ECOA regulations endorse use of the disparate impact test to establish discrimination . . .”); *A.B. & S. Auto Serv., Inc. v. South Shore Bank of Chicago*, 962 F. Supp. 1056 (N.D. Ill. 1997); *Latimore v. Citibank, F.S.B.*, 979 F. Supp. 662, 664 n.7 (N.D. Ill. 1997) (“ECOA encompass[es] ‘disparate impact’/‘discriminatory effect’ claims . . .”); *Gross v. United States Small Bus. Admin.*, 669 F. Supp. 50 (N.D.N.Y. 1987); *Sayers v. General*

Furthermore, as discussed in Section IV, the legislative history underlying the ECOA and the Federal Reserve Board's regulations implementing the ECOA clearly endorse disparate impact claims.<sup>233</sup>

### C. Ongoing Disparate Impact Cases Against Lenders

As the subprime crisis has grown over the past few years, so has the litigation challenging subprime lending. In dozens of lawsuits filed across the country, minority borrowers have alleged that lenders discriminated against them on the basis of race in the terms, conditions, and servicing of their mortgages.<sup>234</sup> To our knowledge, none of these cases have proceeded to trial. Many of the cases have gone or are going through rigorous battles over motions to dismiss. The banking industry has challenged plaintiffs' claims on a number of bases, including whether the FHA and ECOA allow disparate impact claims.<sup>235</sup>

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Motors Acceptance Corp., 522 F. Supp. 835 (W.D. Mo. 1981); *Cherry v. Amoco Oil Co.*, 490 F. Supp. 1026 (N.D. Ga. 1980).

<sup>233</sup> 12 C.F.R. § 202.6 n.2 (2008) ("The legislative history of the Act indicates that the Congress intended an 'effects test' concept, as outlined in the employment field by the Supreme Court in the cases of *Griggs v. Duke Power Co.*, 401 U.S. 424 (1971), and *Albemarle Paper Co. v. Moody*, 422 U.S. 405 (1975), to be applicable to a creditor's determination of creditworthiness.").

<sup>234</sup> While there are a number of lawsuits being brought by individuals, *see, e.g.*, *Charity v. GMAC Mortgage Inv., Inc.*, No. 08-cv-00743 (N.D. Tex. Mar. 28, 2008), and local governments, *see, e.g.*, *Mayor and City Council of Baltimore v. Wells Fargo Bank, N.A.*, No. 08-cv-00062 (D. Md. Jan. 8, 2008), this article will focus primarily on class action suits since this is the area where disparate impact is most relevant. *See Barrett v. H&R Block, Inc.*, No. 08-cv-10157 (D. Mass. June 2, 2008); *Sierra v. First Franklin Fin. Corp.*, No. 08-cv-02735 (N.D. Cal. May 30, 2008); *Mables v. IndyMac Bank, F.S.B.*, No. 08-cv-02216 (N.D. Ill. Apr. 17, 2008); *Murray v. H&R Block, Inc.*, No. 08-cv-02206 (N.D. Ill. Apr. 17, 2008); *Rivas v. Lehman Bros. Bank, FSB*, No. 08-cv-03685 (S.D.N.Y. Apr. 17, 2008); *Steele v. GE Money Bank*, No. 08-cv-01880 (N.D. Ill. Apr. 1, 2008); *Gonzalez v. JP Morgan Chase & Co.*, No. 08-cv-02140 (C.D. Cal. Mar. 31, 2008); *Doiron v. HSBC N. Am. Holdings*, No. 08-cv-00605 (E.D. Cal. Mar. 14, 2008); *Jones v. Prime Inv. Mortgage Corp.*, No. 08-cv-01521 (N.D. Ill. Mar. 13, 2008); *NAACP v. Ameriquest Mortgage*, No. 07-cv-00794 (C.D. Cal. Mar. 7, 2008); *Lopez v. Long Beach Mortgage Co.*, No. 08-cv-10279 (D. Mass. Feb. 15, 2008); *Brown v. Wells Fargo Bank, N.A.*, No. 08-cv-00492 (N.D. Cal. Jan. 23, 2008); *Ramirez v. GreenPoint Mortgage Funding, Inc.*, No. 08-cv-00369 (N.D. Cal. Jan. 18, 2008); *Rodriguez v. Bear Stearns Co., Inc.*, No. 07-cv-01816 (D. Conn. Dec. 10, 2007); *Garcia v. Countrywide Fin. Corp.*, No. 07-cv-01161 (C.D. Cal. Sept. 12, 2007); *Chavers v. Option One Mortgage Corp.*, No. 07-cv-04916 (N.D. Ill. Aug. 30, 2007); *Ventura v. Wells Fargo Bank*, No. 07-cv-04309 (N.D. Cal. Aug. 21, 2007); *Newman v. APEX Fin. Group, Inc.*, No. 07-cv-04475 (N.D. Ill. Aug. 8, 2007); *Zamudio v. HSBC N. Am. Holdings, Inc.*, No. 07-cv-04315 (N.D. Ill. Aug. 2, 2007); *Miller v. Countrywide Bank*, No. 07-cv-11275 (D. Mass. July 12, 2007); *Tribett v. BNC Mortgage, Inc.*, No. 07-cv-02809 (N.D. Ill. May 18, 2007); *Jackson v. Novastar Mortgage, Inc.*, No. 06-cv-02249 (W.D. Tenn. Apr. 28, 2006).

<sup>235</sup> *See infra* section III.B.



Before discussing the banking industry's challenges to disparate impact theory, we will discuss the nature of the discrimination claims brought against the lenders.

### 1. Discretionary Pricing Policy

The most common allegation in these cases focuses on the discretionary pricing policy of the defendant lenders.<sup>236</sup> Generally speaking, discretionary pricing refers to lenders' policies that allow "loan officers, brokers and correspondent lenders to impose subjective, discretionary charges and interest mark-ups"<sup>237</sup> that are "unrelated to a borrower's objective credit characteristics such as credit history, credit score, debt-to-income ratio and loan-to-value ratios and result[ ] in purely subjective charges that affect the rate otherwise available to borrowers."<sup>238</sup> Judging by the various complaints, the use of discretionary pricing policies appears to be widespread.<sup>239</sup>

Discretionary pricing begins when an applicant provides necessary credit information to a loan officer or broker, including such objective measures as credit history, debt ratio, credit score, loan-to-value ratios, and other risk-related attributes.<sup>240</sup> Lenders use this information to determine a "mortgage score" which in turn determines a risk-based financing rate, otherwise known as the "par rate."<sup>241</sup> Loan officers and brokers<sup>242</sup> add subjective discretionary rates

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<sup>236</sup> Class Action Complaint at 4, *Miller v. Countrywide Bank*, No. 07-11275 (D. Mass. July 12, 2007).

<sup>237</sup> *Id.*

<sup>238</sup> First Amended Class Action Complaint at 15, *Barrett v. H&R Block, Inc.*, No. 08-10157, (D. Mass. February 12, 2008).

<sup>239</sup> Complaint at 9–11, *Miller v. Countrywide Bank*, No. 07-11275 (D. Mass. July 12, 2007).

<sup>240</sup> *See id.* at 8.

<sup>241</sup> *Id.* at 9.

<sup>242</sup> Brokers carry significant blame for the subprime crisis. In large part this is a result of the immense increase in the number of brokers during the housing bubble and the lower requirements for brokers' sales officers: "the bubble swelled the ranks of mortgage salesmen by 100,000 in nearly a decade, to 334,000, according to Wholesale Access . . . . What's more, while a broker must be licensed, most states set no minimum qualifications for the salespeople he employs." Amanda Gengler, *Mortgage Brokers: The salesman factor*, CNN MONEY MAGAZINE, July 26, 2007, available at [http://money.cnn.com/2007/07/24/real\\_estate/salesman\\_factor.moneymag/index.htm](http://money.cnn.com/2007/07/24/real_estate/salesman_factor.moneymag/index.htm). The means by which brokers are compensated is also suspect. Brokers tend to receive their full commission upon closing a deal and are unaffected by the success of the borrower in staying current with the mortgage. *See* Steven D. Levitt, *Freakonomics Blog*, N.Y. TIMES, July 29, 2008 available at <http://freakonomics.blogs.nytimes.com/2008/07/29/why-do-mortgage-brokers-get-paid-everything-up-front/> (suggesting as a solution that "instead of paying mortgage brokers a lump sum when the deal closes, have them pay a small amount out of every mortgage payment. That way, the mortgage brokers will have a disincentive to initiate high-risk mortgages that are likely to default.").

that increase broker and lender profits, as well as the borrowers' mortgage costs.<sup>243</sup>

This discretionary approach to pricing by lenders and brokers poses two critical problems. First, the borrower is almost certainly unaware that the lender may have imposed a subjective, non-risk-related markup.<sup>244</sup> In other words, borrowers believe that they receive rates based solely on the most favorable and objective risk-based credit factors available.<sup>245</sup> Loan officers are generally under no obligation to inform applicants of alternative, more affordable lending options.<sup>246</sup> Second, lenders incentivize these discretionary practices by paying loan officers and brokers larger commissions when they inflate the rates above the original "par rate."<sup>247</sup> This type of scheme pushes brokers to offer loans at higher rates and on less favorable terms than necessary, without requiring either the broker or the lender to inform the borrowers that they had qualified for a lower-rate loan.<sup>248</sup> This discretionary pricing policy appears to have affected minorities at much higher rates than non-minorities. As one suit alleges:

[M]inorities paid disparately more discretionary charges (both in frequency and amount) than similarly situated whites. Statistical analysis of discretionary charges imposed on minority and white customers of [mortgages companies using this system] has revealed that minorities, after controlling for credit risk, are substantially more likely than similarly situ-

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<sup>243</sup> See Gengler, *supra* note 242.

<sup>244</sup> See Brooks & Simon, *supra* note 23.

<sup>245</sup> *Id.*

<sup>246</sup> According to Paul Leonard of the Center for Responsible Lending, brokers are more likely to market subprime loans to borrowers, "partially because there is no state law requiring the broker to disclose that the borrower is eligible for a lower rate." William Finn Bennett, *Mortgage brokers get fatter payoff for selling riskier loans*, NORTH COUNTY TIMES (May 5, 2007) available at [http://www.nctimes.com/articles/2007/05/06/news/top\\_stories/1\\_33\\_265\\_5\\_07.txt](http://www.nctimes.com/articles/2007/05/06/news/top_stories/1_33_265_5_07.txt) (stating that in California, brokers "are licensed by the state Department of Real Estate, [and] are legally obligated to act in the best interest of the borrower . . . . 'However, there is no enforcement mechanism in place to ensure that they [do so]'").

<sup>247</sup> *Subprime Lending: Defining the Market and Its Customers: Hearing Before the Subcomm. on Housing, and Community Opportunity and the Subcomm. on Financial Institutions and Consumer Credit of the H. Comm. on Financial Services*, 108th Cong. 190, 200 (2004) available at <http://www.responsiblelending.org/pdfs/SteinStatement033004.pdf> ("[S]uch payments create an incentive to steer certain consumers—those viewed as unsophisticated—into particularly costly loans.").

<sup>248</sup> This is especially true for brokers as their compensation is hardly tied to loan performance. See MORTGAGE BANKERS ASSOCIATION, MORTGAGE BANKERS AND MORTGAGE BROKERS: DISTINCT BUSINESSES WARRANTING DISTINCT REGULATION 19 (2008) <http://www.nga.org/Files/pdf/0805FORECLOSUREBANKER.PDF> ("[M]ortgage brokers do not receive compensation based on loan performance . . . . As a result, a broker has a strong incentive to close loans and maximize their direct and indirect upfront fees.").

ated whites to pay such charges.<sup>249</sup>

## 2. Excessive Fees

The next most common allegation against lenders involves excessive fees and, more specifically, yield spread premiums (“YSPs”).<sup>250</sup> A YSP is a bonus paid to a loan officer or broker when he or she provides a loan that carries a higher interest rate than the minimum rate that a lender would have accepted.<sup>251</sup> The YSP increases with the interest rate,<sup>252</sup> creating an incentive for brokers<sup>253</sup> to negotiate higher interest rates.<sup>254</sup> While not all YSPs are abusive, the worst brokers will abuse YSPs because they are easy to hide<sup>255</sup> and provide tremendous profits.<sup>256</sup> Nearly 90% of all subprime loans carry YSPs, which costs borrowers anywhere from \$800 to \$3,000 per loan.<sup>257</sup> For example, if a \$200,000 loan has an interest rate one percent above the “par rate”—the objective, risk-based rate—the broker would receive an additional bonus of \$2,000. A more specific example from an ongoing case involves a thirty-year adjustable rate mortgage loan in the amount of \$231,000.<sup>258</sup> The borrower paid \$8,335 in “settlement charges” including a \$4,500 broker fee.<sup>259</sup> The broker also received \$4,620 in YSP from the lender, more than doubling the normal broker

<sup>249</sup> First Amended Class Action Complaint at 17, *Barrett v. H&R Block, Inc.*, No. 08-10157 (D. Mass. Feb. 12, 2008).

<sup>250</sup> *See, e.g.*, *Ware v. Indymac Bank, FSB*, 534 F. Supp. 2d. 835, 839 (N.D. Ill. 2008); Complaint, *Rodriguez v. Bear Stearns Cos., Inc.* No. 07-01816 (D. Conn. Dec. 10, 2007); Complaint, *Tribett v. BNC Mortgage, Inc.*, No. 07-02809 (N.D. Ill. May 18, 2007); Complaint, *Jackson v. Novastar Mortgage*, No. 06-02249 (W.D. Tenn. Apr. 28, 2006).

<sup>251</sup> *Mortgage Bankers Ass’n*, *supra* note 248, at 16.

<sup>252</sup> *Id.* at 16 (“The greater the spread between the rate on the specific loan and the par rate, the greater the YSP”).

<sup>253</sup> *Id.* at 19 (“Since YSPs are not well understood and loan performance does not affect compensation, a broker has a strong incentive to seek the most lucrative indirect fees.”).

<sup>254</sup> *See Id.* 248, at 5 (“When a consumer does not understand the YSP, which is often the case, the risk is greater that the YSP will simply augment the broker’s direct fees and saddle the borrower with a higher rate and monthly payment.”). *See also* Center for Responsible Lending, *Yield Spread Premiums*, *supra* note 37; Howell E. Jackson and Jeremy Berry, *Kickbacks or Compensation: The Case of Yield Spread Premiums*, 12 *STAN. J. L. BUS. & FIN.* 289 (2006–2007).

<sup>255</sup> In fact, brokers are not required to fully disclose all fees until closing, at which point borrowers are unlikely to back out. *See* Les Christie, *New Fed Rules Miss One Key Lending Abuse*, CNN MONEY, July 23, 2008, [http://money.cnn.com/2008/07/21/real\\_estate/mo\\_ban\\_on\\_lending\\_abuse/?postversion=2008072316](http://money.cnn.com/2008/07/21/real_estate/mo_ban_on_lending_abuse/?postversion=2008072316).

<sup>256</sup> *See id.*

<sup>257</sup> Center for Responsible Lending, *Yield Spread Premiums*, *supra* note <CITE>\_Ref214174928“>.

<sup>258</sup> Class Action Complaint at 18, *Miller v. Countrywide Bank, N.A.*, No. 07-cv-11275 (D. Mass. July 12, 2007).

<sup>259</sup> *Id.*

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fee for a total of \$9,120.<sup>260</sup> While the lender technically paid the YSP, note that the settlement charges are nearly the same amount as the broker fee plus the YSP, i.e. the borrower ultimately paid it herself.<sup>261</sup> Therefore, more than half of the total earned by the broker resulted from the broker's ability to charge an additional rate above what the lender would have accepted regularly from a borrower with these specific, objective, risk-based credit characteristics.<sup>262</sup>

The Federal Reserve Board recently instituted new lending regulations; although the original proposal included a rule limiting YSPs, the final regulations did nothing to curb YSP abuse.<sup>263</sup> A dozen or so states, however, have created YSP-related laws limiting lenders' use of subprime loans.<sup>264</sup> YSP regulation is of considerable consequence in mortgage discrimination litigation because YSPs have been shown to affect minority borrowers at much higher rates than similarly situated non-minority borrowers.<sup>265</sup>

The Commonwealth of Massachusetts brought an action against H&R Block, alleging that H&R Block discriminated on the basis of race by charging African American and Latino borrowers excessive points and fees.<sup>266</sup> The Commonwealth included very revealing statistics pertaining to defendants' lending practices, which demonstrated the stark difference in loan costs for African American and Latino borrowers, compared to white borrowers.<sup>267</sup> For example, in the complaint, the Commonwealth shows that while defendants charged a white borrower with an income of \$200,000 and a FICO score of 520 a total of \$2,275 in points and fees, defendants charged an African American borrower, with an income of \$167,000 and a FICO score of 523 a total of \$10,635.<sup>268</sup> Similarly, where defendants charged a white borrower with an income of \$186,000 and a FICO score of 571 a total of \$4,769 in points and fees, defendants charged a Latino borrower with an income of \$182,000 and a FICO score

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<sup>260</sup> *Id.*

<sup>261</sup> *See id.*

<sup>262</sup> *See id.*

<sup>263</sup> Christie, *supra* note 255.

<sup>264</sup> *Id.*

<sup>265</sup> *See Predatory Mortgage Lending Practices: Abusive Uses of Yield Spread Premiums: Hearing Before the S. Comm. on Banking, Hous., and Urban Affairs*, 107th Cong. 57 (2002) (statement of Professor Howell E. Jackson), available at [http://banking.senate.gov/02\\_01\\_hrg/010802/jackson.htm](http://banking.senate.gov/02_01_hrg/010802/jackson.htm) ("The results indicated that mortgage brokers charged two racial groups—African-Americans and Hispanics—substantially more for settlement services than they did other borrowers.").

<sup>266</sup> Complaint at 37–42, *Commonwealth of Mass. v. H&R Block*, No. 08-cv-2474, (Mass. Super. Ct. June 3, 2008).

<sup>267</sup> *See id.*

<sup>268</sup> *Id.* at 39. (The loan to value ratio for the loan issued to the white borrower was six points higher and the APR was one third of a point lower than the loan issued to the African American borrower.)

of 605 a total of \$8,597.40.<sup>269</sup>

Massachusetts Attorney General Martha Coakley obtained this data from defendants before initiating litigation using the Commonwealth's investigatory powers. While these statistics likely reflect the impact caused by the practices of many lenders, without the powers of an attorney general, plaintiffs will only be able to uncover such statistics if litigation reaches the discovery stage. Of course, the motions to dismiss at issue here aim to prevent plaintiffs from reaching discovery.

### 3. Other Challenged Practices

While the majority of lawsuits are focused on discretionary pricing policies and YSPs, plaintiffs challenge other lending practices as well. Plaintiffs allege that defendant lenders failed to properly disclose information regarding their loans.<sup>270</sup> Specifically, plaintiffs allege that lenders failed to properly disclose details regarding final rates and fees, whether the determination of rates was based on risk-related factors, the actual cost of future payments, and whether the borrower qualified for a lower-priced loan.<sup>271</sup>

Plaintiffs have also alleged that the defendant lenders targeted marketing efforts for their subprime loans specifically to minority communities, regardless of income.<sup>272</sup> In one case, evidence of discriminatory marketing of subprime loans even included radio advertisements run only on gospel stations.<sup>273</sup> Plain-

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<sup>269</sup> *Id.* at 40. The white borrower also had greater debt to income and loan to value ratios than the Latino borrower.

<sup>270</sup> *See, e.g.*, Class Action Complaint, *Leaks v. Ill. Mortgage Funding Corp.*, No. 08-cv-01395 (N.D. Ill. Mar. 7, 2008); Complaint, *Cazares v. Pacific Shore Funding*, No. 2:04-cv-06887 (C.D. Cal. Aug. 17, 2004).

<sup>271</sup> *See* Class Action Complaint, *Leaks*, No. 08-cv-01395; Complaint, *Cazares*, No. 2:04-cv-06887.

<sup>272</sup> *See, e.g.*, Complaint, *Jackson v. NovaStar Mortgage*, No. 06-cv-02249 (W.D. Tenn. Apr. 28, 2006); Complaint, *NAACP v. Ameriquest Mortgage*, No. 07-cv-00794 (C.D. Cal. Mar. 7, 2008).

<sup>273</sup> Complaint, *Jackson v. NovaStar Mortgage*, No. 06-cv-02249; *NAACP*, No. 07-cv-00794. *See, e.g.*, Molly Rath, *Swimming with Sharks: Subprime Lenders Put the Bite on Baltimore's Poorest Homeowners*, *BALT. CITY PAPER*, Mar. 29, 2000, available at <http://www.citypaper.com/news/story.asp?id=3611>.

Deborah Claude receives such solicitations almost daily. Buckling under home-repair costs, and in default on the mortgage on her Patterson Park house, Claude received a letter from Cleveland-based Champion Mortgage Co. March 14 letting her know that a "fresh, new start is just a phone call away." The next day, listening to local gospel station Heaven 600 AM, she heard a pitch for Promised Land Financial, a "Christian-based" refinancing company." If it's money you need, Promised Land Financial has it," the radio announcer urged.

*See also* Testimony of Secretary Thomas E. Perez Maryland Department of Labor, Licensing and Regulation Before the United States S. Spec. Comm. on Aging Hearing On Foreclosure Aftermath: Preying on Senior Homeowners, 110th Cong. 12–13 (2008), available at <http://>

tiffs also allege that the defendant lenders purposefully steered minority borrowers towards poor products, regardless of their qualifications.<sup>274</sup>

One last challenged practice, which is now illegal,<sup>275</sup> is brokers' and lenders' failure to verify borrowers' credit information.<sup>276</sup> Many lenders provided applications without attempting to verify the incomes or assets of the borrowers.<sup>277</sup> Even more troubling is the significant evidence that brokers completed loan applications without documentation of the borrowers' income, which allowed them to inflate borrowers' income levels, thus allowing borrowers to secure loans for which they were otherwise unqualified.<sup>278</sup>

### III. THE BANKING INDUSTRY FIGHTS BACK

The defendant lenders named in these lawsuits have opposed the litigation through Rule 12(b)(6) motions to dismiss.<sup>279</sup> Defendant lenders have common-

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aging.senate.gov/events/hr187tp.pdf (reporting that Metropolitan Money Store Corp. solicited homeowners in Maryland on gospel radios stations, marketing refinancing packages that allegedly "enlisted investors or straw buyers with good credit to buy the houses and borrow as much as possible against the home value, siphoning the equity").

<sup>274</sup> See, e.g., Complaint, NAACP, No. 07-cv-00794. This is especially troubling when you consider that traditionally, most people probably assume they can trust banks and lenders to help them make the best decision in choosing the right loan for them.

<sup>275</sup> Tami Luhby, *Fed's War Against Shady Home Loans*, CNN MONEY, July 14, 2008, <http://money.cnn.com/2008/07/14/news/economy/fedrules/index.htm?cnn=yes> (The new rules "[r]equire creditors to verify income and assets they rely upon to determine repayment ability.").

<sup>276</sup> See Complaint, NAACP, No. 07-cv-00794.

<sup>277</sup> *Id.* "[I]t became common to reduce or eliminate income verification requirements—so-called 'low- and no-doc' loans." John Kiff & Paul Mills, *Lessons from Subprime Turbulence*, IMF SURVEY MAGAZINE: IMF RESEARCH, Aug. 23, 2007, available at <http://www.imf.org/external/pubs/ft/survey/so/2007/RES0823A.HTM>. "In recent years, Mr. Malburg said, lenders were willing to make 'no documentation' loans—loans that do not require verification of income or assets—for people with credit scores as low as 620. 'Now lenders are starting to tighten up their underwriting criteria,' he said. 'For a lot of lenders, the benchmark now for a no-doc loan is a credit score of 680, and some want a score of 720 or higher.'" Jay Romano, *The Subprime Crisis: Will It Affect Borrowers?*, N.Y. TIMES, Aug. 21, 2007, available at <http://homefinance.nytimes.com/nyt/article/qa/2007.08.21.qa1/?scp=1&sq=no-doc%20loan&st=cse>.

<sup>278</sup> See Chris Isidore, *'Liar loans': Mortgage woes beyond subprime*, CNN MONEY, Mar. 19, 2007, [http://money.cnn.com/2007/03/19/news/economy/next\\_subprime/index.htm?postversion=2007031916](http://money.cnn.com/2007/03/19/news/economy/next_subprime/index.htm?postversion=2007031916) (referring to "Alt. A" loans where lenders borrow to "people with better credit scores (A-rated) who borrow with little or no verification of income, or so-called alternative documentation. But some people in the industry call them 'stated income' loans, or worse, 'liar loans.'").

<sup>279</sup> See, e.g., Notice of Motion and Motion to Dismiss Plaintiffs' First Amended Complaint; Memorandum of Points and Authorities in Support Thereof, *Ramirez v. Greenpoint Mortgage Funding, Inc.*, No. 08-cv-00369 (N.D. Cal. May 19, 2008).

ly argued that plaintiffs failed to state actionable claims of discrimination because disparate impact claims are not cognizable under the FHA and ECOA.<sup>280</sup> This section explores and debunks that claim.<sup>281</sup>

#### A. *The Banking Industry Braces for Litigation*

For years, the banking industry has anticipated that minority borrowers would bring class action suits alleging discrimination in lending based on race.<sup>282</sup> Many representatives within the industry explained that the release of information under the Home Mortgage Disclosure Act's ("HMDA") new requirements would result in discrimination litigation, especially the disclosure of the APRs of high-cost loans.<sup>283</sup> In a PowerPoint presentation at a mortgage banker's conference on May 5, 2008, an industry attorney noted how the banking industry had "warned" the Federal Reserve Board that the new HMDA requirements would lead to "a flood of baseless discrimination lawsuits."<sup>284</sup> Unsurprisingly, fear of disparate impact claims has concerned the banking industry for some time: "[L]enders have complained about the concept of disparate impact . . . . Lenders also say enforcement on disparate impact grounds may be capricious. Because disparate impact does not allege that minorities were subject to different treatment or intentional discrimination, it has been controversial within the lending industry."<sup>285</sup>

Most telling is the tone set in a number of presentations available on the

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<sup>280</sup> *Ramirez v. Greenpoint Mortgage Funding, Inc.*, No. C08-cv-00369 TEH, slip op. at 3–5 (N.D. Cal. May 13, 2008).

<sup>281</sup> Many of the legal arguments that defendant lenders have put forward have little to no basis in law. Some of their arguments, particularly those relating to *Alexander v. Sandoval* and *Jackson v. Birmingham*, misrepresent the holdings of Supreme Court cases so severely that they may constitute Rule 11(b) violations. See Fed. R. Civ. P. 11(b) (requiring that "legal contentions are warranted by existing law or by a nonfrivolous argument for extending, modifying, or reversing existing law or for establishing new law"); see also *Jackson v. Birmingham Bd. of Educ.*, 544 U.S. 167 (2005); *Alexander v. Sandoval* 532 U.S. 275 (2001).

<sup>282</sup> *CBA Conference Examines New HMDA Reporting and Mortgage Reform*, CBA REPORTS (Oct. 1, 2002) available at <http://www.allbusiness.com/government/1096476-1.html> ("Annett Castro-Kirkpatrick, Chairman of the CBA Fair Lending Committee, in opening remarks. . . . 'But the more interesting questions, to my mind, are how customers will respond to the new questions about race and ethnicity; how the telephone applicants will deal with the new impositions; and—most importantly—how the public will respond to data about the price of loans by race and geography' . . . .").

<sup>283</sup> See Lynyak, *Regulation C and Fair Lending*, *supra* note 102 ("Because of the modifications to regulation C, subprime lenders may soon be exposed to fair lending lawsuits—Alleging reverse discrimination and targeting protected minorities").

<sup>284</sup> Naimon, *supra* note 2.

<sup>285</sup> 'Regulatory Relief' May Hit Fair Lending, NATIONAL MORTGAGE NEWS, Apr. 3, 1995.

Mortgage Banker's Association of America ("MBA") website,<sup>286</sup> in which leading attorneys in the field caution industry leaders about the harmful effects of the new HMDA data, disparate impact, and the impending litigation threats to the banking industry.<sup>287</sup> One such presentation notes that the "paramount concern" posed by the litigation is a risk to the industry's reputation,<sup>288</sup> and another presentation (by the same lawyer) disparages disparate impact theory in general, calling it "an obligation to prove a negative."<sup>289</sup> The presentations also include suggestions to help lenders avoid litigation, such as "limit[ing] and document[ing] discretion"<sup>290</sup> and having a system in place to "[q]uickly find similar applicants who were treated differently."<sup>291</sup> Clearly, the industry was on notice that the potential for discrimination litigation was ripe.

More importantly, these presentations mark the beginnings of the banking industry's concerted effort to marshal the Supreme Court's holding in *Smith v. City of Jackson* to attack the availability of disparate impact claims under the FHA and ECOA,<sup>292</sup> an approach that now dominates the motions to dismiss the mortgage discrimination claims that have been filed against lenders across the country.<sup>293</sup> For example, in Jeffrey Naimon's presentation, after introducing the subject of disparate impact theory and the likely litigation that would follow changes in HMDA reporting, he referred to *City of Jackson* by explaining, albeit in an inaccurate manner, that the "Supreme Court clarified . . . disparate impact theory," and emphasizing that "[n]either the FHA nor ECOA contains

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<sup>286</sup> See, e.g., Naimon, *supra* note 2, and Lynyak, *Regulation C and Fair Lending*, *supra* note 102. Those and other presentations are available at the MBA's website. See <http://www.mortgagebankers.org/ProfessionalDevelopment/UpcomingConferencesandEvents/PresentationsfromPastConferencesandEvents.htm> (note the links to past "Event Presentations" ranging from 2000-2008).

<sup>287</sup> See, e.g., Naimon, *supra* note 2.

<sup>288</sup> Lynyak, *Regulation C and Fair Lending*, *supra* note 102, at 13.

<sup>289</sup> Joseph T. Lynyak III, *Mortgage Bankers Association Legal Issues in Mortgage Technology—Fair Lending and Fraud Considerations* (Nov. 30, 2007), available at <http://www.mortgagebankers.org/files/Conferences/2007/2007LIMT/2007LIMTProtectingJosephLynyak.pdf>.

<sup>290</sup> See Joseph L. Barloon, *Current Issues in Fair Lending*, MBA's Legal Issues and Regulatory Compliance Conference (Apr. 29–30, 2008) available at <http://mortgagebankers.org/files/Conferences/2008/2008LIRC/LIRC08JosephBarloonGenLegandReg.pdf> (also suggesting that those in the industry should "[a]pply and follow rate sheet or pricing matrix; [r]equire deviations from rate sheet to be documented; [t]rack and limit pricing exceptions").

<sup>291</sup> David Dietrich & Lynette I. Hotchkiss, *Using Technology to Facilitate Regulatory Compliance*, MBA's Legal Issues and Regulatory Compliance Conference (Apr. 29–30, 2008) (also suggesting that the industry should "[d]etermine in *real-time* if an applicant was denied who should have been approved; [p]revent an applicant from being overcharged").

<sup>292</sup> Paul F. Hancock, *HMDA, Fair Lending, and ECOA Developments* (Sept. 25, 2007) ("*Smith v. City of Jackson* offers some suggestion that disparate impact may not apply to the language of § 805, which is similar to the language of § 4(a)(1) of the ADEA").

<sup>293</sup> See *infra* section III.B.

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the ‘effects’ language the Supreme Court identified as creating the disparate impact cause of action.”<sup>294</sup> This “effects” language argument<sup>295</sup> is found in most, if not all of the motions to dismiss,<sup>296</sup> and, as explained below, is without merit.

B. *Stretching the Holdings in Smith v. City of Jackson and Other Recent Supreme Court Decisions*

As mentioned above, in their various motions to dismiss, defendant lenders have latched onto select language from *City of Jackson*<sup>297</sup> to argue that disparate impact claims are simply not available under the FHA and ECOA, and therefore the plaintiffs have failed to state a claim.<sup>298</sup> Contrary to defendants’ convoluted interpretations, *City of Jackson* did not establish a requirement that civil rights statutes contain “effects” language to allow disparate impact claims.<sup>299</sup> In *City of Jackson*, the Supreme Court actually *upheld* the availability of disparate impact claims under the Age Discrimination in Employment Act of 1967 (“ADEA”).<sup>300</sup> Nonetheless, defendant lenders point to dicta found within *City of Jackson* to support their dubious claim that the Supreme Court has established a rule that a statute must contain specific “effects” language to allow disparate impact claims.<sup>301</sup> Virtually every defendant lender has put forward nearly identical language reciting this same argument.<sup>302</sup> The reliance on

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<sup>294</sup> Naimon, *supra* note 2, at 11–12.

<sup>295</sup> *Id.* at 12, *see infra* section III.B for a further discussion.

<sup>296</sup> *See, e.g.*, Notice of Motion and Motion to Dismiss Plaintiffs’ First Amended Complaint; Memorandum of Points and Authorities in Support Thereof at 4, Ramirez v. Greenpoint Mortgage Funding, Inc., No. 08-cv-00369 (N.D. Cal. May 19, 2008) (“In contrast, the Court noted, subsection [sic] (a)(1) of both statutes—which do not contain the ‘effects’ language—do *not* allow for disparate impact claims . . .”).

<sup>297</sup> Smith v. City of Jackson, 544 U.S. 228 (2005).

<sup>298</sup> *See, e.g.*, Memorandum of Law in Support of Defendants’ Motion to Dismiss, Puello v. CitiFinancial Serv., Inc., No. 08-cv-10417, 2008 WL 2149264 (D. Mass. May 9, 2008); Defendants’ Memorandum in Support of Motion to Dismiss the First Amended Complaint at 10, Lopez v. Long Beach Mortgage Co., No. 08-cv-10279 (D. Mass. July 3, 2008); Memorandum of Law in Support of Motion to Dismiss Plaintiffs’ First Amended Class Action Complaint at 5–6, Barrett v. H&R Block, Inc., No. 08-10157 (D. Mass. Mar. 27, 2008).

<sup>299</sup> Smith v. City of Jackson, 544 U.S. 228, 232 (2005).

<sup>300</sup> 29 U.S.C. § 623 (2000); *City of Jackson*, 544 U.S. at 232.

<sup>301</sup> *See, e.g.*, Memorandum of Law in Support of Motion to Dismiss Plaintiffs’ First Amended Class Action Complaint at 6–7, Barrett v. H&R Block, Inc., No. 08-10157 (D. Mass. Mar. 27, 2008); Memorandum of Law in Support of Defendants’ Motion to Dismiss, Puello v. CitiFinancial Serv., Inc., No. 08-cv-10417, 2008 WL 2149264 (D. Mass. May 9, 2008).

<sup>302</sup> *Compare* Brief in Support of Defendants’ Motion to Dismiss at 2, Guerra v. GMAC LLC, No. 08-cv-01297 (E.D. Pa. June 9, 2008) (“The Supreme Court’s recent decision in *Smith v. City of Jackson* demonstrates that neither statute provides for liability under a disparate impact theory” (citation omitted)), *with* Defendants’ Memorandum of Points and Au-

the Court's dicta in *City of Jackson* is misplaced,<sup>303</sup> and this section seeks to debunk the industry's interpretation of the case.

### 1. Defendant Lenders' Reasoning

Defendant lenders' argument that *City of Jackson* requires specific "effects" language within civil rights statutes in order to bring disparate impact claims<sup>304</sup> is predicated on the false assertion that the Court allowed disparate impact under the ADEA solely because the ADEA "include[s] language regarding the 'effect' on protected classes equivalent to that found in § 703(a)(2) of Title VII."<sup>305</sup> Defendant lenders argue that "neither the FHA nor the ECOA contain the crucial 'effects' language discussed in *Smith*,"<sup>306</sup> and therefore the statutes must not allow disparate impact claims.<sup>307</sup>

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thorities in Support of Motion to Dismiss at 11, *Payares v. JP Morgan Chase & Co.*, No. 07-cv-05540 (C.D. Cal. May 5, 2008) ("[T]he Supreme Court's decisions in *Alexander v. Sandoval* and *Smith v. City of Jackson* make it clear that disparate impact theories are not available under ECOA or the FHA either." (citations omitted)).

<sup>303</sup> *Myers v. United States*, 272 U.S. 52, 142 (1926) (quoting *Cohens v. Virginia*, 6 Wheat. 264, 399) ("It is a maxim, not to be disregarded, that general expressions, in every opinion, are to be taken in connection with the case in which those expressions are used. If they go beyond the case, they may be respected, but ought not to control the judgment in a subsequent suit when the very point is presented for decision. The reason of this maxim is obvious. The question actually before the court is investigated with care and considered in its full extent. Other principles which may serve to illustrate it, [sic] are considered in their relation to the case decided, but their possible bearing on all other cases is seldom completely investigated.").

<sup>304</sup> *See, e.g.*, Defendants' Memorandum in Support of Their Motion to Dismiss Plaintiff's First Amended Complaint at 8, *Zamudio v. HSBC N. Am. Holdings, Inc.*, No. 07-C-4315 (E.D. Ill. Nov. 9, 2007): "In 2005, the Supreme Court concluded that whether a federal anti-discrimination statute provides for a disparate impact claim must be determined by the language of the statute, and specifically by whether the statute includes the language found in § 703(a)(2) of Title VII, 42 U.S.C. § 2000e-2(a)(2)." *See, also* Defendants' Memorandum in Support of Motion to Dismiss the First Amended Complaint at 13, *Lopez v. Long Beach Mortgage Co.*, No. 08-cv-10279 (D. Mass. July 3, 2008) ("When the statutory text creates a cause of action based on the 'effects' or 'results' of actions, the Court has held that the statute permits disparate impact claims.").

<sup>305</sup> Notice of Motion and Motion to Dismiss Plaintiffs' First Amended Complaint; Memorandum of Points and Authorities in Support Thereof at 4, *Ramirez v. Greenpoint Mortgage Funding, Inc.*, No. 08-cv-00369 (N.D. Cal. May 19, 2008).

<sup>306</sup> *Id.*

<sup>307</sup> *Id.* at 5; *see also* Brief in Support of Defendants' Motion to Dismiss, *Guerra v. GMAC LLC*, No. 08-cv-01297 (E.D. Pa. June 9, 2008); Motion to Dismiss at 1, *Mayor & City Council of Baltimore v. Wells Fargo Bank, N.A., et al*, 1-08-cv-00062-BEL (D.MD Jan. 8, 2008); Defendants' Memorandum of Points and Authorities in Support of Motion to Dismiss, *Payares v. JP Morgan Chase & Co.*, No. 07-cv-05540 (C.D. Cal. Mar. 11, 2008); Memorandum of Law in Support of Motion to Dismiss at 12, *Rivas v. Lehman Bros*, No. 08-cv-3685 (S.D.N.Y. April 17, 2008).

Defendants' argument rests entirely on the fact that the subsections of the ADEA, 29 U.S.C. § 623 (a)(2), and of Title VII, 42 U.S.C.A. § 2000e-2(a)(2), which have been interpreted to allow disparate impact claims, include the phrase "otherwise adversely affect."<sup>308</sup> Conversely, the defendant lenders stress that the corresponding sections of the ADEA, 29 U.S.C. § 623 (a)(1), and of Title VII, 42 U.S.C.A. § 2000e-2(a)(1), which do not contain the "otherwise adversely affect" language, have been found not to allow disparate impact claims.<sup>309</sup> In their motions to dismiss, defendants often employ a chart<sup>310</sup> comparing the language of each statute:

Title VII (42 U.S.C.A. § 2000e-2)	ADEA (29 U.S.C.A. § 623)	ECOA (15 U.S.C.A. § 1691)	FHA (42 U.S.C.A. § 3605)
(a) It shall be an unlawful employment practice for an employer—(1) to fail or refuse to hire or to discharge any individual, or otherwise to <i>discriminate against any individual</i> with respect to his compensation, terms, conditions, or privileges of employment, <i>because of such individual's</i> race, color, religion, sex, or national origin;	(a) It shall be unlawful for an employer—(1) to fail or refuse to hire or to discharge any individual or otherwise <i>discriminate against any individual</i> with respect to his compensation, terms, conditions, or privileges of employment, <i>because of such individual's</i> age;	(a) It shall be unlawful for any creditor to <i>discriminate against any applicant</i> , with respect to any aspect of a credit transaction—(1) <i>on the basis of</i> race, color, religion, national origin, sex or marital status, or age (provided the applicant has the capacity to contract);	(a) It shall be unlawful for any person or other entity whose business includes engaging in residential real estate related transactions to <i>discriminate against any person</i> in making available such a transaction, or in the terms or conditions of such a transaction, <i>because of</i> race, color, religion, sex, handicap, familial status, or national origin.
(a) It shall be an unlawful employment practice for an employer—(2) to limit, segregate, or classify his employees or applicants for employment in any way which would deprive or tend to deprive any individual of employment opportunities or <i>otherwise adversely affect</i> his status as an employee, because of such individual's race, color, religion, sex, or national origin.	(a) It shall be unlawful for an employer—(2) to limit, segregate, or classify his employees in any way which would deprive or tend to deprive any individual of employment opportunities or <i>otherwise adversely affect</i> his status as an employee, because of such individual's age . . . .	<b>None.</b>	<b>None.</b>

<sup>308</sup> See chart *infra* at 311.

<sup>309</sup> *Id.*

<sup>310</sup> See, e.g., Notice of Joint Motion and Joint Motion of Defendants to Dismiss Plaintiff's Second Amended Complaint; Memorandum of Point and Authorities in Support Thereof at 27, NAACP v. Ameriquest Mortgage, No. 07-cv-00794 (C.D. Cal. Apr. 4, 2008); See also Defendants' Memorandum of Points and Authorities in Support of Motion to Dismiss at 15, Payares v. JP Morgan Chase & Co., No. 07-cv-05540 (C.D. Cal. Mar. 11, 2008).

Thus, defendant lenders argue that because the FHA and ECOA, like § 623(a)(1) of the ADEA and § 2000e-2(a)(1) of Title VII, lack the phrase “otherwise adversely affect,” disparate impact claims are not available under those statutes.<sup>311</sup>

2. *City of Jackson* Did Not Establish a Rule Requiring the Inclusion of “Effects” Language to Allow Disparate Impact Claims

Defendant lenders overstate the Supreme Court’s reliance on the text of the ADEA in *City of Jackson*. As a preliminary matter, the language from *City of Jackson*, upon which defendant lenders depend, is purely dicta.<sup>312</sup> Section 623(a)(1) of the ADEA, which lenders liken to the relevant language of the FHA and ECOA, was not at issue in *City of Jackson*, and any discussion of that subsection, or of Title VII, was limited to dicta.<sup>313</sup> The Court limited its ruling to the issue of whether disparate impact claims were available under § 623(a)(2).<sup>314</sup> Thus, the Court’s discussion of the availability of disparate impact claims under § 623(a)(1) of the ADEA, upon which defendant lenders rely, is of very limited relevance to the availability of such claims under either the FHA or the ECOA.

In *City of Jackson*, while the Court clearly considered the text of the ADEA, the Court also examined other relevant factors, including:

1. the legislative history of the ADEA,<sup>315</sup>
2. the purpose of the ADEA, especially in comparison to that of Title VII, 42 U.S.C. § 2000e,<sup>316</sup>
3. deference to regulating authorities’ reasonable interpretation and enforcement of the statute,<sup>317</sup>
4. the Reasonable Factors Other Than Age (RFOA) provision, particularly as interpreted by the EEOC,<sup>318</sup>
5. the nature of the discrimination the ADEA regulates (age-based) as compared to the discrimination regulated by Title VII (race, national

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<sup>311</sup> See Defendants’ Reply to Memorandum of Law in Support of Defendants’ Motion to Dismiss the First Amended Complaint at 12, *Puello v. CitiFinancial Serv., Inc.*, No. 08-cv-10417 (“Like the comparable language in Title VII and the ADEA, both the FHA and ECOA make it unlawful to “discriminate” against members of protected classes.”).

<sup>312</sup> See *Smith v. City of Jackson*, 544 U.S. 228 (2005).

<sup>313</sup> See *id.*

<sup>314</sup> See *id.*

<sup>315</sup> See *id.* at 232–33 (majority opinion); *id.* at 238 (plurality plus); *id.* at 248, 253–56 (O’Connor, J., concurring).

<sup>316</sup> See *id.* at 234, 235 n.5 (plurality plus); *id.* at 248, 256–58, 262 (O’Connor, J., concurring).

<sup>317</sup> See *id.* at 239–40 (plurality plus); *id.* at 243–47 (Scalia, J., concurring); *id.* at 263–66 (O’Connor, J., concurring).

<sup>318</sup> See *id.* at 240–41 (majority opinion); *id.* at 238–40 (plurality plus); *id.* at 245–46 (Scalia, J., concurring); *id.* at 251–53, 263–67 (O’Connor, J., concurring).

origin, etc.),<sup>319</sup>

6. unanimous Circuit Court treatment of the ADEA, supporting disparate impact claims.<sup>320</sup>

Rather than relying exclusively on the text of the ADEA, the Court's decision to uphold the availability of disparate impact claims depended on an analysis of the ADEA's text, as well as the legislative history, administrative enforcement, and case law interpretation of the statute.<sup>321</sup>

3. Even Considering Statutory Text Alone, the Language of the FHA and ECOA Is Not Identical to that of the ADEA

Defendant lenders have improperly relied on dicta found in *City of Jackson* to argue that the Court established an "effects" language rule requiring the inclusion of specific language as a prerequisite to allowing disparate impact claims under a statute.<sup>322</sup> However, even if we look exclusively at the text of the FHA and ECOA, we believe that the text can be read to allow disparate impact claims and that defendant lenders ignored key textual differences with the relevant language of the ADEA and of Title VII.

First, while the plain language of neither statute explicitly allows disparate impact claims, neither does the language in either clearly bar such claims.<sup>323</sup> The FHA reads, in part: "It shall be unlawful for any person or other entity whose business includes engaging in residential real estate-related transactions to discriminate against any person in making available such a transaction, or in the terms or conditions of such a transaction, because of race . . . or national origin."<sup>324</sup> The ECOA reads, in part: "It shall be unlawful for any creditor to discriminate against any applicant, with respect to any aspect of a credit transaction . . . on the basis of race . . . [or] national origin"<sup>325</sup> In essence, each statute bars private actors from discriminating against consumers on the basis of race. Nothing in this language inherently implies that the actors must have intentionally discriminated against consumers. Admittedly, it is not unreasona-

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<sup>319</sup> See *id.* at 240–41 (majority opinion); *id.* at 236 n.7 (plurality plus); *id.* at 254–55, 258–59, 261 (O'Connor, J, concurring).

<sup>320</sup> See *id.* at 236–238 (plurality plus).

<sup>321</sup> Also worth noting is the extreme deference shown to the administrative construction of the ADEA. *Id.* at 239. While this was only one of several factors in Justice Stevens' opinion, Justice Scalia believed that the Court's decision should be guided *solely* by deference to the EEOC under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984): "This is an absolutely classic case for deference to agency interpretation. The [ADEA] confers upon the EEOC authority to issue 'such rules and regulations as it may consider necessary or appropriate for carrying out' the [Act]." *City of Jackson*, 544 U.S. at 243 (Scalia, J., concurring) (citation omitted).

<sup>322</sup> See *supra*, section III.B.1–2.

<sup>323</sup> See 42 U.S.C. § 3605(a) (2000); 15 U.S.C. § 1691(a)(1) (2000).

<sup>324</sup> 42 U.S.C. § 3605(a) (2000).

<sup>325</sup> 15 U.S.C. § 1691(a) (2000).

ble to read this language to imply that the discrimination must have been intentional. However, the language may also be read to bar facially neutral policies that, regardless of intent, have the effect of discriminating against borrowers. The latter interpretation is precisely what every jurisdiction and federal agency to consider the issue has adopted.

Further, unlike the “key textual differences”<sup>326</sup> found in the ADEA and Title VII, which the Supreme Court emphasized in *City of Jackson* when interpreting the two subsections in each statute, the banking industry cannot point to such internal textual differences within the FHA or the ECOA. In *City of Jackson*, the Supreme Court focused on the juxtaposition of two sections within Title VII: § 4(a)(2), which allows disparate impact claims, and § 4(a)(1), which does not.<sup>327</sup> The Supreme Court emphasized, and the industry acknowledges, that internal textual differences between the two sections support the theory that Congress intended that each subsection carry different meaning.<sup>328</sup> Unlike the ADEA and Title VII, which each have two provisions barring discrimination in two distinct manners, the relevant sections banning discriminatory practices in both the FHA and ECOA stand on their own and are not coupled with another provision.<sup>329</sup>

Finally, the FHA and ECOA’s language is not identical to that of the ADEA’s § 623(a)(1) and Title VII’s § 4(a)(1). Defendants overlook key differences between the language of the ADEA<sup>330</sup> and the FHA.<sup>331</sup> Subsection 623(a)(1) of the ADEA “makes it unlawful for an employer ‘to fail or refuse to hire . . . any individual . . . because of such individual’s age.’”<sup>332</sup> The term “individual” appears to refer only to a *single* individual, particularly considering its placement next to the subsequent paragraph that addresses “employees” in the aggregate.<sup>333</sup> In contrast, § 3605(a) of the FHA makes it “unlawful . . . to discriminate against any person.”<sup>334</sup> According to the definitions of the FHA, “[p]erson” includes one *or more* individuals,” not only a single individual.<sup>335</sup> This raises the possibility that Congress intended the term “person,” as used in the FHA’s prohibition against discrimination,<sup>336</sup> to refer to discrimination in an

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<sup>326</sup> *City of Jackson*, 544 U.S. at 236 n.6.

<sup>327</sup> *Id.*

<sup>328</sup> *Id.*

<sup>329</sup> See 42 U.S.C. § 3605(a) (2000); 15 U.S.C. § 1691(a)(1) (2000).

<sup>330</sup> 29 U.S.C. § 623(a)(1) (2000).

<sup>331</sup> 42 U.S.C. § 3605(a).

<sup>332</sup> *City of Jackson*, 544 U.S. at 236 n.6 (quoting § 623(a)(1) (emphasis added)).

<sup>333</sup> 29 U.S.C. § 623(a)(2).

<sup>334</sup> 42 U.S.C. § 3605(a) (emphasis added).

<sup>335</sup> 42 U.S.C. § 3602(d) (2000) (emphasis added); see also 29 U.S.C. § 630 (2000) (applying the same definition to the ADEA); 42 U.S.C. § 2000e(a) (2000) (applying the same definition to Title VII).

<sup>336</sup> 42 U.S.C. § 3605(a) (2000) (“It shall be unlawful . . . to discriminate against any person . . .”).

aggregate sense, protecting many individuals.

The Defendant Lenders also overlook key textual and structural differences between the ADEA and ECOA. The ECOA includes a section listing activities *not* constituting discrimination, which, notably, does not include disparate impact claims.<sup>337</sup> The fact that Congress lists activities not falling within the scope of the Act, but omits disparate impact claims from the compendium, is instructive<sup>338</sup> when considering the long-followed maxim of statutory construction: *expressio unius est exclusio alterius*—the express mention of one thing excludes all others.<sup>339</sup> As the Court has explained, “Congress’[sic] enactment of a provision defining the pre-emptive reach of a statute implies that matters beyond that reach are not pre-empted.”<sup>340</sup> Therefore, because Congress created a list of activities that do not violate the ECOA, and did not include disparate impact within that list, courts should presume that Congress did not intend disparate impact to constitute a violation of the ECOA.<sup>341</sup>

These textual nuances in the FHA and ECOA support the growing list of courts that have upheld the availability of disparate impact claims under these statutes.<sup>342</sup> While the text does not conclusively make clear that Congress intended to allow disparate impact claims under the FHA and ECOA, it certainly does not demonstrate that Congress intended to allow consumers to only pursue intentional discrimination claims.<sup>343</sup>

#### 4. When a Statute Is Not Clear, Courts Should Look Beyond the Text of the Statute to Determine Its Meaning

Because the FHA and ECOA are not clear as to whether disparate impact claims should be allowed, courts look beyond the text (as the Supreme Court did in *City of Jackson*) to establish the meaning of the statutes.<sup>344</sup> Defendant

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<sup>337</sup> 15 U.S.C. § 1691(b) (2000).

<sup>338</sup> See *City of Jackson*, 544 U.S. at 239 n.11 (“[I]f Congress intended to prohibit all disparate-impact claims, it certainly could have done so.”).

<sup>339</sup> *Botany Mills v. United States*, 278 U.S. 282, 289 (1929) (“When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode.”). *Nat’l R.R. Passenger Corp. v. Nat’l Ass’n of R.R. Passengers*, 414 U.S. 453, 458 (1974) (“This principle of statutory construction reflects an ancient maxim—*expressio unius est exclusio alterius*.”).

<sup>340</sup> *Cipollone v. Liggett Group*, 505 U.S. 504, 517 (1992) (interpreting the Federal Cigarette Labeling and Advertising Act, 15 U.S.C. § 1331).

<sup>341</sup> Congress enacted the ECOA after *Griggs*, 401 U.S. 424, so it must have known of the disparate impact theory of discrimination.

<sup>342</sup> See *infra* section IV.C.

<sup>343</sup> See 42 U.S.C. § 3601; 15 U.S.C.S. § 1601.

<sup>344</sup> In *Puello*, Defendant Lenders assert that “Where the language actually used by Congress in a statute is clear—as it is in § 701 of ECOA and § 805 of FHA—legislative history and administrative agency pronouncements cannot augment or change the meaning of statutory text.” Defs.’ Reply Mem. of Law in Supp. of Defs.’ Mot. to Dismiss the First Am.

lenders incorrectly argue that because § 623(a)(1) of the ADEA is similar to the language found in the relevant sections of the FHA and ECOA, and because § 623(a) does not permit disparate impact claims, courts *must* determine that the FHA and ECOA also do not permit disparate impact claims.<sup>345</sup> Defendants quoted *City of Jackson* for the proposition that when Congress uses the same language in two statutes with similar purposes, “it is appropriate to presume that Congress intended that text to have the same meaning in both statutes.”<sup>346</sup> As is evident from this quote, the Supreme Court did not insist that courts “must” interpret similar statutes similarly.<sup>347</sup> Instead the Supreme Court merely said that it is “appropriate” to “presume” that statutes with the same language and similar purposes have the same meaning.<sup>348</sup>

Courts consider the particular facts and circumstances surrounding the statute’s enactment and enforcement when interpreting a statute.<sup>349</sup> If a statute is sufficiently clear, then a court need not look beyond the text of the statute to determine its meaning. However, if a statute is ambiguous on a particular point, then courts routinely look beyond the text for the statute’s meaning.<sup>350</sup> Just as the Supreme Court considered factors beyond the text of Title VII and the ADEA when determining the availability of disparate impact claims under

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Compl. at 14–15, *Puello v. Citifinancial Services, Inc.*, No. 08-10417 (D. Mass. Aug. 26, 2008) (citing *Exxon Mobil Corp. v. Allapattah Servs., Inc.*, 545 U.S. 546, 568 (2005) (“Extrinsic materials have a role in statutory interpretation only to the extent they shed a reliable light on the enacting Legislature’s understanding of otherwise ambiguous terms.”) and *Garcia v. United States*, 469 U.S. 70, 76 n.3 (1984) (“Resort to legislative history is only justified where the face of the Act is inescapably ambiguous . . . .”)).

<sup>345</sup> Amicus Brief at 10, *Lopez v. Long Beach Mortgage Co.*, No. 08-cv-10279, (D. Mass. Aug. 5, 2008) (quoting *City of Jackson*, 544 U.S. at 232–33).

<sup>346</sup> Defs.’ Reply of Law in Supp. of Mot. To Dismiss the First Am. Complaint at 8, *Lopez v. Long Beach Mortgage Co.*, No. 08-cv-10279 (D. Mass. Aug. 29, 2008) (quoting *City of Jackson*, 544 U.S. at 233).

<sup>347</sup> *Id.*

<sup>348</sup> *Id.*

<sup>349</sup> See, e.g., Order Denying Mot. to Dismiss at 4, *Zamudio v. HSBC N. Am. Holdings, Inc.*, No. 07 C 4315, (N.D. Ill. Feb.20, 2008) (Although the identical language found in the ADEA and Title VII was a basis for comparison in *Smith*, the *Smith* decision does not reach so far as to prohibit disparate-impact claims under other statutes that do not contain this same language; nor does it set forth a new test for determining whether a statute supports disparate-impact claims.).

<sup>350</sup> For example, 42 U.S.C. § 1983 (2000) and Title VI of the Civil Rights Act of 1964, 42 U.S.C. § 2000d (2000), do not contain a statute of limitations. Looking strictly at the text, a plaintiff might argue that Congress intended no statute of limitations to exist, thereby allowing plaintiffs to bring claims under the statute indefinitely. This of course would make no sense, and the courts have ruled accordingly, applying the relevant state statute of limitations for personal injury actions to each statute. See *Taylor v. Regents of Univ. of Cal.*, 993 F.2d 710, 712 (9th Cir. 1993); *LeGoff v. Trs. of Boston Univ.*, 23 F. Supp. 2d 120, 127 (D. Mass. 1998); *Nelson v. Univ. of Me. Sys.*, 914 F. Supp. 643, 649 (D. Me.1996).



those statutes, courts should do the same when analyzing the FHA and ECOA.<sup>351</sup> As discussed in Section IV, courts that have looked beyond the text of the FHA and ECOA unanimously held that disparate impact claims are available under each statute.<sup>352</sup>

### C. Defendant Lenders Mischaracterize Additional Supreme Court Cases

In addition to relying on *City of Jackson*, many of these motions to dismiss also refer to and mischaracterize a laundry list of other cases in an attempt to bolster their “effects” language argument.<sup>353</sup> The two cases cited most often are *Alexander v. Sandoval*<sup>354</sup> and *Jackson v. Birmingham Board of Education*.<sup>355</sup>

#### 1. In *Alexander v. Sandoval*, the Availability of Disparate Impact Claims under Title VI Was Not before the Court

Surprisingly, many motions to dismiss rely on *Sandoval*<sup>356</sup> for the notion that courts must strictly limit their interpretation of the FHA and ECOA to an analysis of the statutory text—precluding consideration of other factors, including

<sup>351</sup> See e.g., *City of Jackson*, 544 U.S. at 232–33, 238, 248, 253–56.

<sup>352</sup> See *infra* section IV.

<sup>353</sup> Reply in Supp. of Mot. to Dismiss Pl.’s First Am. Class Action Compl. at 2, *Barrett v. H&R Block, Inc.*, No. 08-10157, (D. Mass. June 2, 2008) (“The plain fact is that the Supreme Court has held that civil rights statutes lacking ‘effects’ language permit claims of intentional discrimination but do not permit disparate impact claims.”).

<sup>354</sup> *Alexander v. Sandoval*, 532 U.S. 275 (2001). For example, in *Tribett*, the defendants claim that “statutes without the Disparate Impact Clause do not support disparate impact claims,” noting that “Title VI lacks the Disparate Impact Clause.” Defs.’ Mot. to Dismiss Am. Compl. at 5, *Tribett*, No. 07-cv-02809 (N.D. Ill. May 18, 2007) (citing *Sandoval*, 533 U.S. at 280-81). Interestingly, the term “Disparate Impact Clause” has never appeared in any Supreme Court decision, and, for that matter, as far as we know it has never appeared in any federal or state decision.

<sup>355</sup> *Jackson v. Birmingham Bd. of Educ.*, 544 U.S. 167 (2005). See, e.g., Mem. of Law in Supp. of Mot. to Dismiss Pl.’s First Am. Class Action Compl. at 7, *Barrett v. H&R Block, Inc.*, No. 08-10157 (D. Mass. June 2, 2008) (citing *Jackson* for the proposition that the Supreme Court has barred disparate impact claims under “Title IX of the Civil Rights Act, and claim that the Court based its decision on a lack of” effects language).

<sup>356</sup> See, e.g., Mot. to Dismiss, *Puello v. Citifinancial Services, Inc.*, No. 08-cv-10417, 2008 WL 2149264, at \*16 (D. Mass. May 9, 2008) (“the Court rejected disparate impact liability under Title VI in *Alexander v. Sandoval* . . . .”; Defs.’ Mem. in Supp. of Mot. to Dismiss the First Am. Compl. at 12, *Lopez v. Long Beach Mortgage Co.*, No. 08-cv-10279 (D. Mass. Feb. 15, 2008) (“The Court’s reasoning in *Sandoval* . . . demonstrates that neither the FHA nor ECOA can be interpreted to permit disparate impact claims.”); Reply in Supp. of Mot. to Dismiss Pls.’ First Am. Class Action Compl. at 7, *Barrett v. H&R Block, Inc.*, C.A. No. 08-10157 (D. Mass. June 2, 2008) (claiming that under *Sandoval*, “plaintiffs’ disparate impact claims must be dismissed”).

legislative history, administrative enforcement, and prior case law.<sup>357</sup> Defendant lenders have wildly misinterpreted *Sandoval*.

The issue presented to the Court in *Sandoval* was not whether disparate impact claims were available under Title VI, but whether a private right of action existed to enforce regulations under Title VI.<sup>358</sup> Contrary to Defendants' implications,<sup>359</sup> the Court's holding in *Sandoval* was limited to deciding that a private cause of action does not exist under regulations promulgated pursuant to § 602 of Title VI, and, therefore, that private individuals may not bring any claims, disparate impact or otherwise, under that section.<sup>360</sup> In fact, the Court specifically assumed, for the sake of narrowing its discussion to the issue of whether a private right of action existed, that under § 602 federal agencies may

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<sup>357</sup> Reply in Supp. of Mot. to Dismiss Pls.' First Am. Class Action Compl. at 2, 6–7, *Barrett v. H&R Block, Inc.*, C.A. No. 08-10157 (D. Mass. June 2, 2008).

<sup>358</sup> *Alexander*, 532 U.S. at 278.

<sup>359</sup> Defendants mischaracterize *Sandoval*'s treatment of these two very distinct issues by conflating their discussion of the issues into a single narrative. First, Defendants misleadingly emphasize that “[i]n analyzing Title VI, the Court focused on its *text*.” Def. Mem. in Supprt of Mot. to Dismiss First Amended Complaint at 10, *Lopez v. Long Beach Mortgage Co.*, No. 08-cv-10279 (D. Mass. Feb. 15, 2008). While it is true that the Court focused on the text of Title VI, it did so only with regard to § 602 of Title VI in deciding whether a private right of action existed under that section. *Sandoval*, 532 U.S. at 288–89. Second, Defendants state, “[t]he Court first considered § 601 of Title VI . . . and concluded that ‘it [was] beyond dispute . . . that § 601 prohibits only intentional discrimination,’” Def. Mem. in Supprt of Mot. to Dismiss First Amended Complaint at 10, *Lopez v. Long Beach Mortgage Co.*, No. 08-cv-10279 (D. Mass. Feb. 15, 2008), (falsely implying that the Court “focused on” the text of Title VI relating to whether disparate impact claims were available). The text that the Court focused on instead concerned whether a private right of action existed. The Court’s discussion of § 601 was purely dicta and relied not on the text of that section but on prior case law interpretation of § 601. *Sandoval*, 532 U.S. at 279–82. Third, Defendants, referring to the language of § 601 that barred “only intentional discrimination,” which was not at issue in *Sandoval*, emphasized that “*This language is essentially the same as that at issue here.*” Def. Mem. in Supp. of Mot. to Dismiss First Am. Compl. at 10, *Lopez v. Long Beach Mortgage Co.*, No. 08-cv-10279 (D. Mass. Feb. 15, 2008). Thus, Defendants falsely suggest that *Sandoval* focused on the text of § 601, which they contend is very similar to that of the FHA and the ECOA. The problem, of course, is that the language that the Court analyzed in *Sandoval* was that of § 602, concerning a private right of action, not of § 601, which bars intentional discrimination. *SANDOVAL*, 532 U.S. at 288–89.

<sup>360</sup> *Sandoval*, 532 U.S. at 293; *see also* Mins. of In Chambers Order Re: Mot. to Dismiss Case at 3, *Payares v. JP Morgan Chase & Co.*, No. 07-cv-05540 (C.D. Cal. May 15, 2008) (“*Sandoval* itself held only that no private right of action was available to enforce regulations enacted by federal agencies to prohibit disparate impact discrimination under a statute previously held to prohibit only intentional discrimination.”); *Osborne v. Bank of Am., Nat. Ass’n.*, 234 F. Supp. 2d 804, 811 (M.D. Tenn. 2002) (“Properly construed then, *Sandoval* holds only that regulations may not create private rights of action where no such right was intended by Congress.”); *Smith v. Chrysler Fin. Co., L.L.C.*, 2003 WL 328719, at \*6 (D.N.J. Jan. 15, 2003) (agreeing with the distinction made in *Osborne*).

proscribe activities that had a disparate impact on protected classes.<sup>361</sup>

The Supreme Court based its *Sandoval* opinion on the text of Title VI, without considering other factors, because it found the language of § 602 sufficiently clear to disallow a private right of action.<sup>362</sup> The *Sandoval* Court explained that “the text of § 602 provides that ‘[e]ach Federal department and agency . . . is authorized and directed to effectuate the provisions of [§ 601].’”<sup>363</sup> In interpreting this portion of § 602, the Court found that the statute authorized federal departments and agencies, not private individuals, to enforce statutory provisions.<sup>364</sup> At no point did the Court suggest that future courts would solely consider statutory text when interpreting civil rights statutes.<sup>365</sup> Unlike the text of § 602, the language of the FHA and ECOA does not clarify whether disparate impact claims are necessarily available.<sup>366</sup> Because the text of these statutes is not sufficiently clear, courts have looked to the legislative history, administrative enforcement, and judicial treatment of the acts in order to resolve whether disparate impact claims are available.<sup>367</sup>

We find it particularly noteworthy and troublesome that, in their motions to dismiss, defendant lenders misrepresent the holding in *Sandoval* by conflating the Supreme Court’s treatment of two separate topics:<sup>368</sup> (1) its non-binding discussion of precedent that bars disparate impact claims under § 601 of Title VI,<sup>369</sup> which was not at issue in *Sandoval*, and (2) whether a private right of action is available under § 602 of Title VI, the issue that was before the *Sandoval* Court.<sup>370</sup> By conflating these issues, defendants wrongly create the impression that the *Sandoval* Court ruled on the availability of disparate impact claims—which it did not—and that its treatment of the availability of disparate impact claims was based strictly on Title VI’s text.<sup>371</sup> *Sandoval* did not hold

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<sup>361</sup> *Sandoval*, 532 U.S. at 282.

<sup>362</sup> *Id.* at 288.

<sup>363</sup> *Id.* at 288–89 (quoting 42 U.S.C. § 2000d-1).

<sup>364</sup> *Id.*

<sup>365</sup> *See id.* at 275.

<sup>366</sup> *See* 42 U.S.C. § 3605(a) (making it unlawful to discriminate against “any person” on the basis of race in residential real estate transactions); 15 U.S.C. § 1691(a)(1) (making it unlawful to discriminate against “any applicant” on the basis of race in credit transactions).

<sup>367</sup> *See infra* section IV.

<sup>368</sup> *E.g.*, HSBC’s Mem. In Supp. of its Mot. to Dismiss at 8–9, *Zamudio v. HSBC N. Am. Holdings, Inc.*, No. 07-C-4315 (E.D. Ill. Nov. 9, 2007).

<sup>369</sup> *Sandoval*, 532 U.S. at 279–81.

<sup>370</sup> *Id.* at 288–89.

<sup>371</sup> Even when acknowledging in part that *Sandoval* specifically addressed the availability of a “private right of action,” one defendant continued to obscure the Court’s holding by falsely stating, “the *Sandoval* Court rejected the notion that disparate impact theories should . . . be available if they would promote the purposes of Title VI . . . .” Def. Mem. in Supp. of Mot. to Dismiss First Am. Compl. at 8, *Lopez v. Long Beach Mortgage Co.* No. 08-cv-10279 (D. Mass. July 3, 2008) The *Sandoval* Court did no such thing. Instead, it barred the availability of a private right of action, preserving the right for administrative agencies to

that disparate impact claims were unavailable under Title VI, and it did not limit statutory interpretation strictly to textual analysis.<sup>372</sup>

The *Sandoval* Court discussed the availability of disparate impact claims under § 601,<sup>373</sup> but did not hold that such claims were unavailable under § 601 of Title VI, as defendants suggest. Rather, the Court merely recalled, for the sake of providing background, that prior cases had disallowed disparate impact claims under § 601.<sup>374</sup> The Court's discussion of disparate impact claims was purely dicta.<sup>375</sup>

Rather than citing *Sandoval*<sup>376</sup> for its discussion of disparate impact claims, defendant lenders should have cited to *Alexander v. Choate*,<sup>377</sup> *Guardians Assn. v. Civil Service Commission of New York City*,<sup>378</sup> and *Regents of University of California v. Bakke*,<sup>379</sup> (all of which were cited in *Sandoval*)<sup>380</sup> because in each of those cases the Court actually passed on the issue of whether disparate impact claims were available under Title VI.<sup>381</sup> However, those cases do not support defendants' statutory interpretation theory either, which is likely the reason that defendants chose, instead, to torture the holding and language of *Sandoval*.<sup>382</sup>

In fact, *Sandoval*'s limited discussion of disparate impact claims under § 601

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bring disparate impact claims under § 602. *Sandoval*, 532 U.S. at 288–90. Defendants' assertion quoted above is very misleading. Defendants should omit the term “disparate impact theories” and instead include the phrase “private rights of action.” The banking industry's Motions to Dismiss clearly contain legal assertions relating to *Sandoval* that are wholly inaccurate.

<sup>372</sup> *Sandoval*, 532 U.S. at 288–90.

<sup>373</sup> *Id.* at 288–89.

<sup>374</sup> *Id.* at 280–81 (citing *Alexander v. Choate*, 469 U.S. 287, 293 (1985); *Guardians Assn. v. Civil Serv. Comm'n of New York City*, 463 U.S. 582 (1983); *Regents of University of California v. Bakke*, 438 U.S. 265 (1978)).

<sup>375</sup> *See Sandoval*, 532 U.S. at 280–81.

<sup>376</sup> 532 U.S. 275.

<sup>377</sup> 469 U.S. 287.

<sup>378</sup> 463 U.S. 582.

<sup>379</sup> 438 U.S. 265.

<sup>380</sup> 532 U.S. at 280–81.

<sup>381</sup> *Choate*, 469 U.S. 287; *Guardians Assn.*, 463 U.S. 582; *Bakke*, 438 U.S. 265.

<sup>382</sup> *See Choate*, 469 U.S. at 293–94 (“Title VI . . . delegated to the agencies in the first instance the complex determination of what sorts of disparate impacts upon minorities constituted sufficiently significant social problems . . . to warrant altering the practices of the federal grantees that had produced those impacts.”); *Guardians Assn.*, 463 U.S. at 584 (explaining that disparate impact claims *are* available under Title VI, but only for the purpose of securing declaratory or injunctive relief); *Bakke*, 438 U.S. at 284 (examining “voluminous legislative history of Title VI” because “[t]he concept of ‘discrimination’ . . . is susceptible of varying interpretations,” and concluding that Congress intended to “halt federal funding of entities that violate a prohibition of racial discrimination similar to that of the Constitution”).

of Title VI undercuts defendants' argument that courts should focus exclusively on the statutory text of the FHA and ECOA in determining the availability of disparate impact claims.<sup>383</sup> *Sandoval*'s recognition that § 601 only prohibits intentional discrimination—and therefore not disparate impact claims—was based entirely on precedent, not on textual analysis.<sup>384</sup> More importantly, the precedent cited in *Sandoval* addressing the availability of disparate impact claims developed out of extensive examination of evidence beyond the statutory text, including legislative history, congressional intent, and agency interpretation.<sup>385</sup> Therefore, the uncontested underlying premise in *Sandoval*—that § 601 prohibits only intentional discrimination—in no way hinged on the presence or absence of any specific statutory language.<sup>386</sup>

## 2. *Jackson v. Birmingham Board of Education* Did Not Pass on the Availability of Disparate Impact Claims

Defendant lenders' reliance on *Jackson v. Birmingham Board of Education*<sup>387</sup> makes even less sense. As in *Sandoval*, the issue before the Court in *Birmingham Board of Education* had nothing to do with disparate impact claims.<sup>388</sup> Rather, the Court addressed “whether the private right of action implied by Title IX encompasses claims of retaliation.”<sup>389</sup> The Court did not address whether disparate impact claims were available under Title IX, and it certainly did not hold that such claims were barred.<sup>390</sup> In fact, the phrase “disparate impact” (or variations thereof) appears in the *Birmingham Board of Education* opinion a total of four times, all in the same paragraph, and all in describing *Sandoval*, which did not address the availability of disparate impact

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<sup>383</sup> See 538 U.S. at 280–81.

<sup>384</sup> See *id.* at 280 (citing Choate, 469 U.S. 287; Guardians Assn., 463 U.S. 582; Bakke, 438 U.S. 265). See also Civil Minutes at 3, Payares v. JP Morgan Chase & Co., No. 07-5540 (C.D. Cal. May 15, 2008) (“*Sandoval* merely acknowledged that disparate impact claims under Section 601 had been foreclosed in 1978, by the Court’s decision in [*Bakke*].”).

<sup>385</sup> See Bakke, 438 U.S. at 284–85 (“We must, therefore, seek whatever aid is available in determining the precise meaning of the statute before us” by examining the “voluminous legislative history,” “congressional intent,” “the background of both the problem that Congress was addressing and the broader view of the statute that emerges from a full examination of the legislative debates.”); Guardians, 463 U.S. at 592, 599–601 (Powell, J., concurring in the judgment) (discussing the interpretation of “the federal agency given enforcement authority,” the legislative history, the structure of Title VI, and Congressional intent. See also Choate, 469 U.S. at 292–97, 299.

<sup>386</sup> See Bakke, 438 U.S. at 280–81.

<sup>387</sup> *Jackson v. Birmingham Bd. of Educ.*, 544 U.S. 167 (2005).

<sup>388</sup> *Id.*

<sup>389</sup> *Id.* at 171 (holding that a “private right of action” is available under Title IX “where the funding recipient retaliates against an individual because he has complained about sex discrimination”).

<sup>390</sup> See *id.* at 167.

claims either.<sup>391</sup> Yet in numerous motions to dismiss, defendants claim that, in *Birmingham Board of Education*, “the Court recognized that Title IX of the Civil Rights Act authorizes only intentional discrimination claims, not claims of disparate impact.”<sup>392</sup> *Birmingham Board of Education* does no such thing. In fact, it actually hurts defendant lenders’ statutory construction argument because the Court upheld the right to bring retaliation claims despite the absence of a clear statutory hook,<sup>393</sup> thus supporting existing case law that the FHA and ECOA, despite clear statutory authority, allow disparate impact claims.

### 3. Recent Supreme Court Decisions Affirm the Importance of Stare Decisis When Interpreting Civil Rights Statutes

Two recent Supreme Court decisions involving statutory interpretation of civil rights statutes reaffirm that statutory text is not the only consideration when determining the availability of causes of action.<sup>394</sup> In *CBOCS* and *Gomez-Perez*, the Supreme Court held that retaliation claims were available under the relevant statutes *despite the absence of express statutory language* allowing such claims.<sup>395</sup>

In *CBOCS*, the Supreme Court held that retaliation claims are available under 42 U.S.C. § 1981, based on the weight of precedent supporting retaliation claims under the statute and despite the absence of express statutory text allowing such claims.<sup>396</sup> The Court placed a special emphasis on the importance of *stare decisis*, stating that “considerations of *stare decisis* strongly support our adherence to that view. And those considerations impose a considera-

<sup>391</sup> *Id.* at 177–78.

<sup>392</sup> For example, defendants boldly asserted, “In *Jackson v. Birmingham Bd. of Educ.*, 544 U.S. 167 (2005), the justices held *unanimously* that this language cannot support disparate impact claims and requires that discriminatory intent be shown.” Reply to Opp’n to Mot. to Dismiss at 12–13, *Puello v. Citifinancial Services, Inc.*, 08-cv-10417 (D. Mass. May 11, 2008). In support of this wild assertion, defendants cited *Birmingham Bd. of Educ.*, “‘Discrimination’ is a term that covers a wide range of *intentional* unequal treatment.” *Id.* (emphasis added) (quoting *Birmingham*, 544 U.S. at 175.). However, this entirely misrepresents the Court’s holding in *Birmingham Bd. of Educ.* The full quote reads: “‘Discrimination’ is a term that covers a wide range of intentional unequal treatment; by using such a broad term, Congress gave the statute a broad reach.” *Birmingham Bd. of Educ.*, 544 U.S. at 175. The Court extended that broad reach to include retaliation claims. *Id.* at 171. The court did not state that discriminatory intent must be shown.

<sup>393</sup> See *Birmingham Bd. of Educ.*, 544 U.S. at 182.

<sup>394</sup> See *CBOCS West, Inc. v. Humphries*, 128 S. Ct. 1951 (2008); *Gomez-Perez v. Potter*, 128 S. Ct. 1931 (2008).

<sup>395</sup> *CBOCS West*, 128 S. Ct. at 1958 (“We agree with *CBOCS* that the statute’s language does not expressly refer to the claim of an individual (black or white) who suffers retaliation because he has tried to help a different individual, suffering direct racial discrimination, secure his § 1981 rights. But that fact alone is not sufficient to carry the day.”); *Gomez-Perez*, 128 S. Ct. at 1936–37.

<sup>396</sup> *CBOCS West*, 128 S. Ct. at 1954–55.

ble burden upon those who would seek a different interpretation that would necessarily unsettle many Court precedents.<sup>397</sup> More importantly, the Court said that even a change in judicial approaches to statutory interpretation, such as the approach that Defendants argue flows from *City of Jackson*, is not enough to overturn “well-established prior law. Principles of *stare decisis*, after all, demand respect for precedent whether judicial methods of interpretation change or stay the same.”<sup>398</sup>

Similarly, in *Gomez-Perez*, the Supreme Court held that retaliation claims are available under the ADEA,<sup>399</sup> the same statute analyzed in *City of Jackson*,<sup>400</sup> despite the absence of statutory language expressly allowing such actions.<sup>401</sup> In *Gomez-Perez*, the defendant’s argument centered on the textual contrast of two provisions, one dealing with the private sector and the other with federal employees.<sup>402</sup> The provision concerning the private sector explicitly authorizes retaliation claims while the provision regarding federal employees is silent on the issue.<sup>403</sup> This led the defendant to argue that the plaintiff’s retaliation claims under the provision concerning federal sector employees must fail as Congress would have included a retaliation clause as it had done in the other section if it intended retaliation claims to be available.<sup>404</sup> However, Justice Alito rejected this argument, holding that retaliation claims may be brought against federal employees under the ADEA even though the key provision lacked specific language allowing it.<sup>405</sup>

The Court’s opinions in *CBOCS* and *Gomez-Perez* clearly demonstrate that *stare decisis* is highly relevant when interpreting civil rights statutes.<sup>406</sup> In lending discrimination cases brought under the FHA and ECOA, precedent heavily supports the availability of disparate impact claims.

#### IV. DISPARATE IMPACT CLAIMS ARE COGNIZABLE UNDER THE FHA AND ECOA

As explained in Section III, the Supreme Court has repeatedly stressed that while statutory text is important to statutory construction, courts must also consider the legislative history, agency interpretation, and previous courts’ inter-

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<sup>397</sup> *Id.* at 1958.

<sup>398</sup> *Id.* at 1961.

<sup>399</sup> *Gomez-Perez*, 128 S. Ct. at 1936.

<sup>400</sup> *City of Jackson*, 544 U.S. at 230.

<sup>401</sup> *Gomez-Perez*, 128 S. Ct. at 1939–41.

<sup>402</sup> *Id.*

<sup>403</sup> *Id.* at 1940.

<sup>404</sup> *Id.* at 1939–40.

<sup>405</sup> *Id.* at 1936, 1943 (“The key question in this case is whether the statutory phrase ‘discrimination based on age’ includes retaliation based on the filing of an age discrimination complaint. We hold that it does.”).

<sup>406</sup> *Id.* at 1939–41; *CBOCS West*, 128 S. Ct. at 1958.

pretation of the statute.<sup>407</sup> Having already discussed the text of the FHA and ECOA, we analyze each of the remaining factors to demonstrate that disparate impact claims are, and should remain, cognizable under the FHA and ECOA.

### A. *Legislative History*

Since the early 1970s, the Supreme Court has placed a strong emphasis on the legislative history and purposes underlying civil rights statutes when determining the availability of disparate impact claims.<sup>408</sup>

#### 1. The Fair Housing Act

In 1967, Lyndon B. Johnson created the National Advisory Commission on Civil Disorders to identify the causes of recent race riots.<sup>409</sup> The Commission's Kerner Report warned that the "[N]ation is moving toward two societies, one black, one white—separate and unequal."<sup>410</sup> The report pointed to residential segregation and racism as primary causes of the riots and recommended, among other things, comprehensive legislative reform to eradicate housing discrimination.<sup>411</sup> Within two months, Congress enacted the Fair Housing Act.<sup>412</sup>

Upon enacting the FHA, the primary sponsor of the Act, Senator Walter Mondale, noted in the Congressional Record that the Act was necessary "to correct the enduring *effects*" of discriminatory governmental action.<sup>413</sup> He also stated that although the Supreme Court had outlawed explicit racial zoning laws, "ordinances *with the same effect*, although operating more deviously in an attempt to avoid the Court's prohibition, were still being enacted."<sup>414</sup> Another key sponsor of the Act, Senator Edward Brooke, stated that African Americans were "surrounded by a pattern of discrimination based on individual prejudice, often institutionalized by business and industry, and Government practice."<sup>415</sup> The purpose of the Act must have included remedying the effects of discrimination, as well as prohibiting continued intentional discrimination.

Throughout the lengthy floor debate concerning the Fair Housing Act (Title

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<sup>407</sup> See *supra* section III.B.4.

<sup>408</sup> See *General Bldg. Contractors Ass'n, Inc. v. Pennsylvania*, 458 U.S. 375, 386–391 (1982) (analyzing 42 U.S.C. § 1981 (2000)); *Griggs v. Duke Energy*, 401 U.S. 424, 429–30 (1971) (analyzing Title VII). Not only does *City of Jackson* not abolish this analytical framework, it actually reaffirms the relevance of legislative history and Congressional purpose. *Smith v. City of Jackson*, 544 U.S. 228, 235 (2005)

<sup>409</sup> Joyce Ladner, Op-Ed., *40 Years Later, Revisiting the Kerner Commission; Where Do the Candidates Stand?*, WASHINGTON TIMES, Feb. 29, 2008, at A17,

<sup>410</sup> REPORT OF THE NAT'L ADVISORY COMM'N ON CIVIL DISORDERS I (1968).

<sup>411</sup> See *id.* at 13.

<sup>412</sup> Fair Housing Act, 42 U.S.C. § 3601 (1968).

<sup>413</sup> 114 CONG. REC. 2699 (1968) (emphasis added).

<sup>414</sup> *Id.* (emphasis added).

<sup>415</sup> *Id.* at 2526.



VIII) in the Senate,<sup>416</sup> a number of Senators spoke to the significance of the Act in eliminating the negative effects of discrimination in housing.<sup>417</sup> At one point, Senator Howard Baker introduced an amendment that would have required evidence of discriminatory intent in order to prove a violation of Title VIII.<sup>418</sup> Adopting this amendment would have demonstrated conclusively that Congress intended to limit the Act to claims of disparate treatment and not of disparate impact. The Senate rejected the amendment,<sup>419</sup> with Senator Charles Percy emphasizing that if “racial preference” were required to violate the FHA, “proof would be impossible to produce.”<sup>420</sup> Several other senators also argued against the amendment due to the difficulty of proving intent.<sup>421</sup>

Congress has since ratified the use of disparate impact analysis under the FHA through its amendments to the Act. In 1988, Congress passed the Fair Housing Amendments Act (“FHAA”) in order to include new prohibitions against discrimination based on familial status or handicap.<sup>422</sup> In doing so, Congress used the exact same language that the FHA already employed with regard to race.<sup>423</sup> By that time, all eight Circuit Courts that had confronted the issue had allowed disparate impact claims under the FHA.<sup>424</sup> Because courts

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<sup>416</sup> The legislative history is somewhat incomplete because Title VIII was adopted from Senator Mondale’s floor amendment to the 1968 Civil Rights Act. *Resident Advisory Bd. v. Rizzo*, 564 F.2d 126, 147 (3d Cir. 1977).

<sup>417</sup> *See, e.g.*, 114 CONG. REC. 2279–81, 3421 (1968) (remarks of Senator Brooke and Senator Mondale).

<sup>418</sup> *See id.* at 5214.

<sup>419</sup> *Id.* at 5221–22.

<sup>420</sup> *Id.* at 5216 (quoted in *Resident Advisory Bd. v. Rizzo*, 425 F. Supp. 987, 1022 (D.C. Pa. 1976)).

<sup>421</sup> *See id.* at 5220 (Senator Peter Dominick arguing that the amendment “increases the opportunity for discrimination”); *see also id.* at 5218, 5220–21 (Senators Mondale and Philip Hart on the difficulty of showing discriminatory intent).

<sup>422</sup> Fair Housing Amendments Act of 1988, Pub. L. No. 100-430, 102 Stat. 1619 (1988), codified at 42 U.S.C. § 3601.

<sup>423</sup> *Compare* 42 U.S.C. § 3604(f)(1), (2) (2000) *with* 42 U.S.C. § 3604(a)(b) (2000).

<sup>424</sup> *Betsey v. Turtle Creek Associates*, 736 F.2d 983, 986 (4th Cir. 1984); *United States v. Marengo County Comm’n*, 731 F.2d 1546, 1559 n.20 (11th Cir. 1984); *Phillips v. Hunter Trails Cmty. Ass’n*, 685 F.2d 184, 189–90 (7th Cir. 1982); *Halet v. Wend Inv. Co.*, 672 F.2d 1305, 1311 (9th Cir. 1982) (“Significant discriminatory effects flowing from rental decisions may be sufficient to demonstrate a violation of the Fair Housing Act.”); *Robinson v. 12 Lofts Realty, Inc.*, 610 F.2d 1032, 1036 (2d Cir. 1979) (“[I]n order to prove a *prima facie* case of race discrimination plaintiffs needed to show only that the action complained of had a racially discriminatory effect; they were not required to show that the defendants acted with racially discriminatory motivation.” (citations omitted)); *United States v. Mitchell*, 580 F.2d 789, 791 (5th Cir. 1978) (“The Fair Housing Act prohibits not only direct discrimination but practices with racially discouraging effects . . . .”); *Resident Advisory Bd. v. Rizzo*, 564 F.2d 126, 146 (3d Cir. 1977) (“What we do decide is that plaintiffs have established a *prima facie* Title VIII case under § 3604(a) against PHA and RDA by proving that the

generally presume that Congress “adopt[s] prior judicial] interpretation when it re-enacts a statute without change,”<sup>425</sup> the FHAA’s passage supports the notion that Congress intended to allow the continued availability of disparate impact claims under the FHA.

The legislative history of the FHAA reinforces congressional intent to allow disparate impact claims. According to a House Report, “[t]he Committee understands that housing discrimination against handicapped persons *is not limited to blatant, intentional acts* of discrimination. Acts that have the *effect* of causing discrimination can be just as devastating as intentional discrimination.”<sup>426</sup> The House Report cited a pair of FHA cases in the Fourth and Ninth Circuits that involved disparate impact: “[b]ecause minority households tend to be larger and exclusion of children often has a racially *discriminatory effect*, two federal courts of appeal have held that adults-only housing may state a claim of racial discrimination under Title VIII.”<sup>427</sup>

Much like the original FHA, the House also rejected an FHAA amendment that would have limited disparate impact claims.<sup>428</sup> The amendment would have included the provision: “a zoning decision is not a violation of the Fair Housing Act unless the decision was made with the *intent* to discriminate on the basis of race or other prohibited criteria under the Act.”<sup>429</sup> Once again, the House rejected an amendment that had the express purpose of excluding disparate impact claims.<sup>430</sup>

Perhaps the clearest evidence of congressional recognition that the FHA includes disparate impact claims comes from the principal sponsor of the FHAA, Senator Edward Kennedy.<sup>431</sup> The day after Congress signed the Act into law, Senator Kennedy said that “Congress accepted th[e] consistent judicial interpretation” of the courts of appeals, explaining that the FHA “prohibit[s] acts that have discriminatory effects, and that there is no need to prove discriminatory intent.”<sup>432</sup>

## 2. Equal Credit Opportunity Act

The legislative history and congressional purpose for the ECOA also confirms the availability of disparate impact claims. The Senate Report that ad-

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agencies’ acts had a discriminatory effect and that the agencies have failed to justify the discriminatory results of their actions.”); *United States v. City of Black Jack*, 508 F.2d 1179, 1184–85 (8th Cir. 1974).

<sup>425</sup> *Lorillard v. Pons*, 434 U.S. 575, 580 (1978).

<sup>426</sup> H.R. REP. NO. 100-711, at 25 (1988) (emphasis added).

<sup>427</sup> *Id.* at 21 (emphasis added).

<sup>428</sup> *Id.* at 89.

<sup>429</sup> *Id.* (emphasis added).

<sup>430</sup> *Id.*

<sup>431</sup> 134 CONG. REC. 23711–12 (1988).

<sup>432</sup> *Id.*

ressed the ECOA amendments of 1976, which incorporated race as a protected group, specifically endorsed disparate impact claims:

In determining the existence of discrimination . . . courts or agencies are free to look at *the effects of a creditor's practices* as well as the creditor's motives or conduct in individual transactions. Thus judicial constructions of anti-discrimination legislation in the employment field, in cases such as *Griggs v. Duke Power Company* and *Albemarle Paper Company v. Moody*, are intended to serve as guides in the application of this Act, especially with respect to the allocations of burdens of proof.<sup>433</sup>

This Senate Report did not accompany the original enactment of the ECOA, but instead accompanied amendments that expanded the breadth of the statute to include racial discrimination, further underscoring congressional intent to make disparate impact claims available under the ECOA in race discrimination lawsuits.<sup>434</sup>

Similar to the history of the FHA, Congress's subsequent amendments to the ECOA confirmed the continued availability of disparate impact claims under the Act. Congress amended the Act in 1996 as part of the Omnibus Consolidated Appropriations Act of 1997.<sup>435</sup> By the time Congress passed the amendment, at least three courts had already analyzed the ECOA and found that it included disparate impact claims.<sup>436</sup> Silence from Congress implied approval of that widely held interpretation.<sup>437</sup>

#### B. Federal Regulation and Enforcement

Administrative treatment of the FHA and ECOA further supports the availability of disparate impact claims under each statute. As *City of Jackson* explained,<sup>438</sup> and as Justice Scalia's concurring opinion wholly relied upon,<sup>439</sup> an administrative agency's interpretation and enforcement of a statute warrants

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<sup>433</sup> S. REP. NO. 94-589, at 4–5 (1976) (citations omitted) (emphasis added).

<sup>434</sup> See Consumer Credit Protection Act, Pub. L. No. 94-239, 90 Stat. 255 (1976).

<sup>435</sup> Omnibus Consolidated Appropriations Act of 1997, Pub. L. No. 104-208, 110 Stat. 3009 (1996).

<sup>436</sup> See *Haynes v. Bank of Wedowee*, 634 F.2d 266, 269 n.5 (5th Cir. 1981); *Thomas v. First Fed. Sav. Bank*, 653 F. Supp. 1330, 1341 (N.D. Ind. 1987); *Guisewhite v. Muncy Bank & Trust Co.*, 1996 WL 511525 at \*4 (M.D. Pa. 1996); *Sayers v. Gen. Motors Acceptance Corp.*, 522 F. Supp. 835, 839–40 (W.D. Mo. 1981) (“[T]he proper test for determining whether a creditor has engaged in the prohibited discrimination is the ‘effects test’ or disparate impact theory as outlined by the Supreme Court in the employment cases of *Griggs* . . . .” (citations omitted)); *Cherry v. Amoco Oil Co.*, 490 F. Supp. 1026, 1029–30 (N.D. Ga. 1980).

<sup>437</sup> See *Lorillard v. Pons*, 434 U.S. 575, 580 (1978).

<sup>438</sup> *City of Jackson*, 544 U.S. 228, 239 (2005).

<sup>439</sup> *Id.* at 243 (Scalia, J., concurring).

deferential treatment and is certainly at least relevant in interpreting a statute.<sup>440</sup>

### 1. Fair Housing Act

Every agency in charge of implementing, enforcing, and administering the FHA has unmistakably shown support for allowing disparate impact claims. The Department of Housing and Urban Development (“HUD”), which has the authority to issue federal regulations<sup>441</sup> and bring claims under the FHA,<sup>442</sup> endorses the availability of disparate impact claims. Much like the EEOC’s position regarding the ADEA, and as Justice Scalia forcefully argued in *City of Jackson*,<sup>443</sup> HUD’s position regarding the FHA should be treated with significant deference.<sup>444</sup>

HUD describes its position on the issue through enforcement handbooks, related regulations, and reports to Congress. The FHA enforcement handbook states that “even in cases where there is absolutely no evidence of discriminatory intent, a discriminatory impact claim may result in a finding of liability.”<sup>445</sup> Another HUD handbook informs all HUD auditors that the FHA “prohibitions extend to actions, which have disparate impact because of any of the prohibited bases.”<sup>446</sup>

The Code of Federal Regulations, addressing guidelines under the FHA, states that recipients of Community Development Block Grants are presumed to be “affirmatively furthering fair housing unless . . . [t]here is evidence that a policy, practice, standard or method of administration, although neutral on its face, operates to deny or affect adversely in a significantly disparate way . . . fair housing to [minorities].”<sup>447</sup>

In 1993, the Secretary of HUD, who has “[t]he authority and responsibility for administering th[e] Act,”<sup>448</sup> successfully argued in *Mountain Side Mobile Estates Partnership* that a disparate impact analysis is applicable to the FHA.<sup>449</sup>

<sup>440</sup> See *United States v. Mead Corp.*, 533 U.S. 218, 234 (2001) (“[A]n agency’s interpretation may merit some deference whatever its form, given the ‘specialized experience and broader investigations and information’ available to the agency and given the value of uniformity in its administrative and judicial understandings of what a national law requires.” (quoting *Skidmore v. Swift*, 323 U.S. 134, 139 (1944)).

<sup>441</sup> 42 U.S.C. § 3608(a) (2000).

<sup>442</sup> 42 U.S.C. § 3610 (A)(1)(A)(III) (2000).

<sup>443</sup> 544 U.S. at 243.

<sup>444</sup> See *id.* at 244–45.

<sup>445</sup> THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, TITLE VIII COMPLAINT INTAKE, INVESTIGATION AND CONCILIATION HANDBOOK 2-28 (2d rev. 1998).

<sup>446</sup> THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, CONSOLIDATED AUDIT GUIDE FOR AUDITS OF HUD PROGRAMS 1–8 (2d rev. 2001).

<sup>447</sup> 24 C.F.R. § 570.904(a)(1)(ii) (2008).

<sup>448</sup> 42 U.S.C. § 3608(a).

<sup>449</sup> See *Mountain Side Mobile Estates P’ship*, Case No. 08-92-0010-1, 1993 WL 307069 (H.U.D. July 19, 1993).

Under both the familiar *Chevron* doctrine<sup>450</sup> and the newer *Mead* analysis,<sup>451</sup> the Secretary's interpretation of FHA is entitled to deference. Through litigation, HUD repeatedly has expressed the view that the FHA allows a disparate impact cause of action.<sup>452</sup>

Finally, the Assistant Secretary of HUD for Fair Housing and Equal Opportunity told Congress at a Senate hearing that the "standards to determine discrimination [in home insurance under the FHA] will be based on the principles of overt discrimination, disparate treatment and disparate impact."<sup>453</sup>

HUD is not the only regulatory agency to interpret the FHA to allow disparate impact claims. In 1994, ten separate agencies that regulate financial institutions—the Office of Federal Housing Enterprise Oversight, the Department of Justice, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Federal Housing Finance Board, the Federal Trade Commission, and the National Credit Union Administration, along with HUD—issued a joint "Policy Statement on Discrimination in Lending."<sup>454</sup> In the Policy Statement, the agencies specifically confirmed that disparate impact claims were cognizable under both the FHA and ECOA and that "[e]vidence of discriminatory intent is not necessary."<sup>455</sup> The Department of Justice ("DOJ") also has enforcement responsibilities under the FHA<sup>456</sup> and has successfully argued that courts must allow disparate impact claims.<sup>457</sup>

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<sup>450</sup> See *Chevron*, 467 U.S. 837, 843–44.

<sup>451</sup> See *United States v. Mead Corp.*, 533 U.S. 218, 230–31, n.12 (2001).

<sup>452</sup> See, e.g., *Pfaff v. U.S. Dep't of Hous. and Urban Dev.*, 88 F.3d 739, 745 (9th Cir. 1996).

<sup>453</sup> See *Homeowners Insurance Discrimination: Hearing Before the Sen. Comm. on Banking, Housing, and Urban Affairs*, 103d Cong. 20 (1994) (statement of Roberta Achtenberg, Assistant Secretary for Fair Housing and Equal Opportunity, U.S. Department of Housing and Urban Development).

<sup>454</sup> 59 Fed. Reg. 18266 (Apr. 15, 1994).

<sup>455</sup> *Id.* at 18269.

<sup>456</sup> See, e.g., 42 U.S.C. §§ 3610(g)(2)(C), 3614(a), (b) (2000).

<sup>457</sup> See *Pfaff*, 88 F.3d at 745–46 ("[W]e find no support for the proposition that a finding of intent is required to establish a prima facie case of disparate impact under the FHA."); *Mountain Side Mobile Estate P'ship*, 56 F.3d 1243, 1250 (10th Cir. 1995) ("HUD argues that the disparate impact theory applies to FHA claims . . . . The FHA prohibits discrimination in housing on the basis of familial status. Discrimination may occur either by disparate treatment or disparate impact." (citation omitted)); *Pfaff*, 88 F.3d at 745–46 ("[W]e find no support for the proposition that a finding of intent is required to establish a prima facie case of disparate impact under the FHA"); *United States v. City of Black Jack*, 508 F.2d 1179, 1184–85 (8th Cir. 1974) ("Effect, and not motivation, is the touchstone, in part because clever men may easily conceal their motivations, but more importantly, because . . . 'we now firmly recognize that the arbitrary quality of thoughtlessness can be as disastrous and unfair to private rights and the public interest as the perversity of a willful scheme.'" (quoting *Hobson v. Hansen*, 269 F. Supp. 401, 497 (D.D.C. 1967))).

## 2. Equal Credit Opportunity Act

Administrative interpretation of the ECOA also confirms the availability of disparate impact claims. Congress delegated the duty of implementing the ECOA to the Federal Reserve Board (“the Board”),<sup>458</sup> which has issued a group of regulations commonly known as Regulation B.<sup>459</sup> These regulations and their commentaries overtly allow disparate impact claims:

The legislative history of the Act indicates that the Congress intended an “effects test” concept, as outlined in the employment field by the Supreme Court in the cases of *Griggs v. Duke Power Co.*,<sup>460</sup> and *Albemarle Paper Co. v. Moody*,<sup>461</sup> to be applicable to a creditor’s determination of creditworthiness.<sup>462</sup>

Thus, not only do federal regulations allow disparate impact claims under the ECOA, but the agency in charge of implementing the Act strongly favors allowing such claims. Additionally, as mentioned in the previous section, the Joint Statement released by ten federal agencies in 1994 explicitly endorsed the availability of disparate impact claims under the ECOA.<sup>463</sup>

### C. Case Law

When interpreting civil rights statutes, courts must afford considerable deference to prior case law.<sup>464</sup> As mentioned in Part III.C.3, the Supreme Court decided two cases in 2008 involving statutory construction of civil rights statutes, and in both cases allowed retaliation claims under the statutes despite the absence of express statutory text, relying heavily on principles of stare decisis.<sup>465</sup>

The Circuit Courts that have considered the issue are unanimous in allowing disparate impact claims under both the FHA<sup>466</sup> and the ECOA.<sup>467</sup> The banking

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<sup>458</sup> 15 U.S.C.S. § 1691b(a)(1) (LexisNexis 2005).

<sup>459</sup> See 12 C.F.R. §§ 202.1–16 (2008).

<sup>460</sup> 401 U.S. 424 (1971).

<sup>461</sup> 422 U.S. 405 (1975).

<sup>462</sup> 12 C.F.R. § 202.6(a) n.2 (2008) (emphasis added).

<sup>463</sup> See *supra* section IV.B.1.

<sup>464</sup> See *Smith v. City of Jackson*, 544 U.S. 279, 236–38; *CBOCS West, Inc. v. Humphries*, 128 S.Ct. 1951, 1961 (2008); *Gomez-Perez v. Potter*, 128 S.Ct. 1931, 1936 (2008).

<sup>465</sup> See *CBOCS*, 128 S.Ct. at 1961 (2008); *Gomez-Perez*, 128 S.Ct. at 1936 (2008).

<sup>466</sup> See, e.g., *Casa Marie, Inc. v. Superior Court of Puerto Rico*, 988 F.2d 252, 269 n.20 (1st Cir. 1993); *United States v. Starrett City Assocs.*, 840 F.2d 1096, 1100 (2d Cir. 1988); *Resident Advisory Bd. v. Rizzo*, 564 F.2d 126, 148 (3d Cir. 1977); *Smith v. Town of Clarkton*, 682 F.2d 1055, 1065 (4th Cir. 1982); *Simms v. First Gibraltar Bank*, 83 F.3d 1546, 1555 (5th Cir. 1996); *Arthur v. City of Toledo*, 782 F.2d 565, 575 (6th Cir. 1986); *Metro. Hous. Dev. Corp. v. Vill. of Arlington Heights*, 558 F.2d 1283, 1290 (7th Cir. 1977); *United States v. City of Black Jack*, 508 F.2d 1179, 1184 (8th Cir. 1974); *Keith v. Volpe*, 858 F.2d 467, 482 – 84 (9th Cir. 1988); *Mountain Side Mobile Estate P’ship v. Sec’y of Hous. and*

industry's assertions that these cases are not dispositive because they were decided before *City of Jackson* is wrong because *City of Jackson* did not suggest or otherwise hold that statutory text was the sole basis for deciding whether disparate impact claims are available under a statute.<sup>468</sup> The banking industry also wrongly dismisses cases decided subsequent to *City of Jackson* which acknowledge the continued viability of disparate impact claims under these statutes by weakly claiming "they were wrongly decided."<sup>469</sup>

As these discrimination claims against lenders progress before the courts, several judges have indeed directly addressed the impact of *City of Jackson* and the "effects language" argument.<sup>470</sup> So far, every judge to do so has confirmed that disparate impact claims remain available under both the FHA and ECOA.<sup>471</sup>

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Urban Dev., 56 F.3d 1243, 1250 – 51 (10th Cir. 1995); *Jackson v. Okaloosa County*, 21 F.3d 1531, 1543 (11th Cir. 1994); *Miller v. Poretsky*, 595 F.2d 780, 790 n.10 (D.C. Cir. 1978) (declining to reach the issue but noting general consensus that such claims are cognizable).

<sup>467</sup> *Golden v. City of Columbus*, 404 F.3d 950, 963 n.11 (6th Cir. 2005); *Latimore v. Citibank, F.S.B.*, 979 F. Supp. 662, 664 n.7 (N.D. Ill. 1997) ("ECOA encompass[es] 'disparate impact'/'discriminatory effect' claims . . ."); *Dismuke v. Connor*, 2007 U.S. Dist. LEXIS 91912, at \*10 (W.D. Ark. 2007); *Haynes v. Bank of Wedowee*, 634 F.2d 266, 269 n.5 (5th Cir. 1981) ("ECOA regulations endorse [the] use of the disparate impact test to establish discrimination." (citations omitted)); *Powell v. Am. Gen. Fin., Inc.*, 310 F. Supp. 2d 481, 487 (N.D.N.Y. 2004) ("The ECOA provides for a private cause of action based on disparate impact or disparate treatment." (citations omitted)); *Smith v. Chrysler Fin. Co.*, 2003 U.S. Dist. LEXIS 1798, at \*5 (D.N.J. 2003); *Wise v. Union Acceptance Corp.*, 2002 U.S. Dist. LEXIS 23335, at \*10 (S.D. Ind. 2002) ("Disparate impact analysis clearly is available to demonstrate discrimination under the ECOA." (citations omitted)); *Osborne v. Bank of Am., Nat'l Ass'n.*, 234 F. Supp. 2d 804, 811 – 12 (M.D. Tenn. 2002); *Faulkner v. Glickman*, 172 F. Supp. 2d 732, 737 (D. Md. 2001); *Church of Zion Christian Ctr. v. Southtrust Bank*, 1997 U.S. Dist. LEXIS 12425, at \*21 – 22 (D. Ala. 1997); *A.B. & S. Auto Serv., Inc. v. South Shore Bank of Chi.*, 962 F. Supp. 1056, 1060 (N.D. Ill. 1997).

<sup>468</sup> See *supra* section III.B.1.

<sup>469</sup> Reply in Support of Motion to Dismiss Plaintiffs' First Amended Class Action Complaint at 6, *Barrett v. H&R Block, Inc.*, C.A. No. 08-10157 (D. Mass. June 2, 2008).

<sup>470</sup> See *Zamudio v. HSBC N. Am. Holdings, Inc.*, 2008 WL 517138, at \*2 (N.D. Ill. 2008); *Beaulialice v. Fed. Home Loan Mortg. Corp.*, 2007 WL 744646, at \*4 (M.D. Fla. 2007); Amended Order Granting in Part and Denying in Part Defendants' Motion to Dismiss at 7–11, *Garcia v. Countrywide Fin. Corp.*, No. CV 07-cv-1161 (C.D. Cal. Jan. 17, 2008); *Ramirez v. Greenpoint Mortgage Funding, Inc.*, 2008 WL 2051018 (N.D. Cal. May 13, 2008); Order Denying Defendants' Motion to Dismiss at 3–4, *Payares v. JP Morgan Chase & Co.*, CV 07-5540 (C.D. Cal. May 15, 2008).

<sup>471</sup> *Zamudio v. HSBC N. Am. Holdings, Inc.*, 2008 WL 517138, at \*4; Amended Order Granting in Part and Denying in Part Defendants' Motion to Dismiss at 7–11, *Garcia v. Countrywide*, No. CV 07-cv-1161 at 7-11; *Ramirez v. Greenpoint Mortgage Funding, Inc.*, 2008 WL 2051018, at \*5–6; Order Denying Defendants' Motion to Dismiss, *Payares v. JP Morgan Chase & Co.*, CV 07-5540 at 3–4, *Beaulialice v. Fed. Home Loan Mortg. Corp.*, 2007 WL 744646, at \*4.

For example, in *Payares v. JP Morgan Chase*, Judge Collins explained that “in no way can *Smith* [*v. City of Jackson*] be read as holding that an anti-discrimination statute must contain ‘effects’ language like that in the ADEA in order to allow disparate treatment claims. Nor is this the first Court to read *Smith* [*v. City of Jackson*] in such a way.”<sup>472</sup> Further, Judge Collins noted that “*Sandoval* itself held only that no private right of action was available to enforce regulations enacted by federal agencies to prohibit disparate impact discrimination under a statute previously held to prohibit only intentional discrimination.”<sup>473</sup> Judge Bucklew in *Beaulialice v. Federal Home Loan Mortgage Corp.* stated that “neither *Smith* [*v. City of Jackson*] nor *Sandoval* prohibit disparate impact claims under either statute [the FHA or ECOA].”<sup>474</sup> In the Northern District of Illinois, Judge Darrah’s *Zamudio v. HSBC* order ruled similarly:

The effect of *Smith* [*v. City of Jackson*] is to narrow the scope of a disparate-impact claim under the ADEA compared to the scope of such claims under Title VII. Although the identical language found in the ADEA and Title VII was a basis for comparison in *Smith* [*v. City of Jackson*], the *Smith* [*v. City of Jackson*] decision does not reach so far as to prohibit disparate-impact claims under other statutes that do not contain this same language; nor does it set forth a new test for determining whether a statute supports disparate-impact claims.<sup>475</sup>

In *Garcia v. Countrywide*, Judge Phillips noted that the *City of Jackson* decision rested on much more than text:

*Smith* [*v. City of Jackson*], however, did not hold that a statute *must* contain this “effects” language in order to authorize disparate impact claims. Indeed, the Court did not rely only on this textual analysis of the statutes, but also held that the purpose and legislative history of the ADEA, as well as unanimous circuit court treatment of the Act, supported disparate treatment claims.<sup>476</sup>

Similarly, in *Ramirez v. GreenPoint*, Judge Henderson ruled both on the merits and noted the growing consensus with his decision:

GreenPoint reads *Smith* [*v. City of Jackson*] too broadly, and no court has applied *Smith* to find that disparate impact claims are not cognizable under

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<sup>472</sup> Order Denying Defendants’ Motion to Dismiss at 4, *Payares v. JP Morgan Chase & Co.*, CV 07-5540.

<sup>473</sup> *Id.* at 3.

<sup>474</sup> *Beaulialice v. Fed. Home Loan Mortg. Corp.*, 2007 WL 744646, at \*4 (citations omitted).

<sup>475</sup> *Zamudio v. HSBC N. Am. Holdings, Inc.*, 2008 WL 517138, at \*5–6.

<sup>476</sup> Amended Order Granting in Part and Denying in Part Defendants’ Motion to Dismiss at 7–11, *Garcia v. Countrywide*, No. CV 07-cv-1161 (citing *Smith v. City of Jackson*, 544 U.S. 228, 239 (2005) (citations omitted)).



the FHA or ECOA. To the contrary, numerous courts post-*Smith* [*v. City of Jackson*] have addressed disparate impact claims under these statutes. . . . [T]his Court agrees that *Smith* [*v. City of Jackson*] “did not hold that a statute must contain . . . ‘effects’ language in order to authorize disparate impact claims.”<sup>477</sup>

More recently, on August 28, 2008, in *National Community Reinvestment Coalition v. Accredited Home Lenders Holding Company*, the United States District Court for the District of Columbia rejected a lender’s challenge to the availability of disparate impact claims under the FHA, holding that “*Smith* [*v. City of Jackson*] does not preclude disparate impact claims pursuant to the FHA.”<sup>478</sup>

## V. CONCLUSION

Disparate Impact claims have long been allowed under the FHA and ECOA and should remain so.<sup>479</sup> While lenders understandably have a legitimate interest in opposing class action litigation brought against them, the effort to summarily undermine disparate impact claims under these statutes does not pass muster.

As has been detailed extensively, minority borrowers have been disproportionately affected by the mortgage foreclosure crisis.<sup>480</sup> This disproportionate impact has not necessarily been the result of lenders and brokers sitting down and conspiring to intentionally craft lending policies that rob minority communities of their homes and savings.<sup>481</sup> However, regardless of the lenders’ intent, that has been precisely the result of the banking industry’s collective approach to subprime lending.

Indeed, lenders, as of yet, have not argued that their policies have had no such disparate impact on minority borrowers. Instead, to date, lenders have merely argued that the law does not bar them from lending in such away that has a disproportionately negative impact on borrowers based on their race or

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<sup>477</sup> *Ramirez v. Greenpoint*, 2008 WL 2051018, at 5–6 (quoting Amended Order Granting in Part and Denying in Part Defendants’ Motion to Dismiss, *Garcia v. Countrywide*, No. CV 07-cv-1161) (citations omitted).

<sup>478</sup> *Nat’l Comty. Reinvestment Coal. v. Accredited Home Lenders Holding Co.*, No. 07-cv-1357, 2008 WL 3974310, at \*8 (D.D.C. Aug. 28, 2008).

<sup>479</sup> *See supra* section IV.

<sup>480</sup> *See supra* section I.

<sup>481</sup> Because we have yet to see litigation develop deeply into discovery, we do not have the privilege of peering through the internal emails and memoranda of the lenders and brokers to determine the degree to which they were aware of the inevitable impact that their policies would have on minority borrowers. Our strong suspicion is that the lenders were well aware of the disparate impact that their policies would have on minority communities and that proceeded with their lending policies despite that awareness based on their own immediate business interests.

national origin. To be clear, the lenders' argument that disparate impact claims are not cognizable under the FHA and ECOA, at its core, is that lenders may lawfully enact and enforce policies that disproportionately devastate minority communities as long as that devastation was not intentional. To us, that just seems wrong.

We believe that disparate impact claims should be allowed under the FHA and ECOA precisely as Justice Burger explained in the context of employment discrimination claims: that while the FHA and ECOA do "not command that any person be [issued a loan] simply because [the borrower] was formerly the subject of discrimination, or . . . is a member of a minority group," it does require "the removal of artificial, arbitrary, and unnecessary barriers to [lending opportunities] when the barriers operate invidiously to discriminate on the basis of racial or other impermissible classification."<sup>482</sup>

Ultimately, it will be for the courts to determine whether disparate impact claims should remain available under the FHA and ECOA, and, if so, whether arbitrary lending practices have caused invidious discrimination. Fortunately, the legislators who enacted and amended the FHA and ECOA, the administrative agencies that have enforced these statutes, and the courts that have interpreted them all appear to agree that such claims are cognizable under both statutes.<sup>483</sup>

Because of the seeming unanimity among administrative agencies and courts, coupled with the fact that the lenders' legal theory is hinged entirely on skewed interpretations of recent Supreme Court case law,<sup>484</sup> the lenders face what is hopefully an insurmountable battle. Thus, for defenders of civil rights, there is some cause for optimism that disparate impact claims will remain available under the FHA and ECOA. Indeed, in two recent Supreme Court decisions, the Court upheld causes of action under civil rights statutes in spite of congressional failure to explicitly articulate the availability of such causes of action.<sup>485</sup>

Still, we cannot predict how the appellate courts or the United States Supreme Court will ultimately handle the issue. We may again see a battle between the Congress and the Court where the Supreme Court, by what would likely be a slim majority, limits the availability of disparate impact claims, and where a Democratically-controlled Congress reverses the Court by amending the statutes to include explicit statutory language allowing such claims.<sup>486</sup> Let us hope that the claims of minority borrowers who have lost their homes do not depend on such a showdown.

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<sup>482</sup> *Griggs v. Duke Energy*, 401 U.S. 424, 430 (1971), *see also supra* section II.A.1.

<sup>483</sup> *See supra* section IV.

<sup>484</sup> *See supra* section III.B.

<sup>485</sup> *See supra* section III.B.3.

<sup>486</sup> *See supra* section II.A.3.