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Recent Supreme Court Actions Likely to Affect Fair Lending 'Disparate Impact' Litigation and Enforcement

Judges, practitioners and academics have debated for a number of years whether the legal theory of "disparate impact" discrimination, which the Supreme Court first articulated in the employment discrimination context, can be applied in a case alleging discrimination in lending. While it always has been clear that intentional discrimination in lending is prohibited by the Equal Credit Opportunity Act (ECOA) and (if the credit is secured by a residence) the Fair Housing Act (FHA), it has been less clear whether those statutes also prohibit a lender from applying a neutral policy that has a disparate impact on a protected group if the lender cannot demonstrate that the policy is justified by objective, nondiscriminatory business reasons.

Against this backdrop of uncertainty, the Department of Justice, for many years, proceeded with fair lending cases only if it could allege disparate treatment or intentional discrimination. However, in a break from prior policy, the Obama Administration last year announced that it would prosecute both disparate treatment and disparate impact fair lending cases and launched an aggressive campaign to investigate and pursue disparate impact cases based on statistical analyses of loan data. This enforcement posture mirrored actions taken by class action lawyers, who had filed numerous lawsuits against lenders based on the theory of disparate impact.

Recent action by the Supreme Court in two separate matters, however, could cut back significantly, or eliminate altogether, the viability of such class actions and the applicability of the disparate impact theory to fair lending cases.

First, in *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011), the Supreme Court held that evidence that a "discretionary" employment practice has produced sex-based pay or promotion disparities is not sufficient to satisfy the commonality element of the federal class action certification standard. Although this decision arose in the employment context, several federal courts already have applied *Wal-Mart* to fair lending class actions brought under the ECOA and the FHA. In a departure from precedent, these decisions hold that claims that a lender's policy of allowing different prices to be charged to similarly situated borrowers resulted in higher-than-average pricing for minority borrowers can no longer proceed as class actions.

Second, on November 7, 2011, the Supreme Court granted certiorari in the case of *Magner v. Gallagher* to determine whether disparate impact is a valid theory of liability under the FHA and, if so, what standard should be applied to the theory. The outcome of this case, which likely will be argued before the Court next spring, could have even greater ramifications for fair lending enforcement and litigation.

The *Wal-Mart* Case

The *Wal-Mart* decision arose out of a lawsuit filed against the company by current and former female employees, who alleged that Wal-Mart's facially neutral, discretionary hiring, promotion and pay policies caused a disparate impact affecting female employees in violation of Title VII of the 1964 Civil Rights Act. The claim was based in large part on statistical analyses comparing Wal-Mart's pay and promotion data for men and women.

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The Supreme Court held that the plaintiffs had not established commonality under Rule 23(a) of the Federal Rules of Civil Procedure and, consequently, that the case could not proceed as a class action. In particular, the Court stated that Wal-Mart's "policy" of allowing discretion by supervisors was "just the opposite of a uniform employment practice that would provide the commonality needed for a class action." 131 S. Ct. at 2554.

The Court also rejected the plaintiffs' effort to establish commonality through the use of statistics relating to disparities at the national and regional level. The Court stated that such disparities "do[] not establish the existence of disparities at individual stores, let alone raise the inference that a company-wide policy of discrimination is implemented by discretionary decisions at the store and district level." *Id*. at 2255. The Court noted that a regional disparity, for example, "may be attributable to only a small set of Wal-Mart stores, and cannot by itself establish the uniform, store-by-store disparity upon which the plaintiffs' theory of commonality depends." *Id.*

Finally, although the Court observed that, under some circumstances, a disparate-impact claim conceivably could be based on a policy of "subjective decision making," it reiterated its prior holding that "merely proving that the discretionary system has produced a racial or sexual disparity is not enough" to support Title VII liability under a disparate impact theory. *Id.* at 2555-56 (citing *Watson v. Fort Worth Bank & Trust*, 487 U.S. 977, 994 (1988)).

Applying *Wal-Mart* to Fair Lending Class Action Lawsuits

At the time that the *Wal-Mart* decision was issued, several putative class action lawsuits alleging that lenders charged higher loan prices to minority borrowers as compared to nonminority borrowers were pending in courts across the country. These cases typically alleged that the lender had implemented a "discretionary pricing policy" that allowed loan officers and mortgage brokers to charge overages above the objectively determined par rate. The lawsuits also have alleged, based primarily upon statistical pricing data, that the exercise of this discretion resulted in an impermissible disparate impact against minorities in violation of the federal fair lending laws. Prior to the Supreme Court's decision in *Wal-Mart*, courts had allowed such cases to proceed as class actions, holding that the "policy" of discretion was sufficient to establish commonality. *See Ramirez v. Greenpoint Mortgage Funding, Inc.*, 268 F.R.D. 627 (N.D. Cal. 2010); *Barrett v. H & R Block*, No. 08-10157-RWZ, 2011 WL 1100105 (D. Mass. Mar. 21, 2011).

Since *Wal-Mart*, however, every court to consider the issue has ruled that fair lending mortgage pricing cases cannot proceed as class actions.

- In *In re Wells Fargo Residential Mortgage Lending Discrimination Litigation*, No. 08–MD–01930 MMC, 2011 WL 3903117 (N.D. Cal., Sept. 6, 2011), the court held that the plaintiffs had not identified a "common mode" of exercising discretion, and rejected the plaintiffs' argument that available data was "more comprehensive and specific to the actual decision-making process at issue" than the data analyzed in *Wal-Mart*. *Id*. at *4. The court concluded that the evidence showed that different loan brokers exercised their pricing discretion differently, and that "where persons who are afforded discretion exercise that discretion differently, commonality is not established." *Id.* Accordingly, the court denied the plaintiffs' motion for class certification.
- Two days after the *Wells Fargo* decision, a Pennsylvania court denied class certification in a similar case, *Rodriguez v. National City Bank*, No. 08–2059, 2011 WL 4018028 (E.D. Pa. Sept. 8, 2011). In *Rodriguez*, the court had preliminarily approved a classwide settlement, but a motion for final approval was pending when the Supreme

Court issued the *Wal-Mart* decision. After receiving briefing on the impact of *Wal-Mart*, the court denied final approval of the settlement on the grounds that the parties had not established commonality.

- Most recently, the court in a multidistrict fair lending mortgage pricing case denied class certification based on *Wal-Mart*, for reasons similar to those expressed by the courts in the *Wells Fargo* and *Rodriguez* cases. *See In re Countrywide Financial Mortgage Lending Practices Litigation*, No. 08–MD–1974, 2011 WL 4862174 (W.D. Ky. Oct. 13, 2011).

Finally, at least one court has applied *Wal-Mart* to preclude class certification in a subprime "steering" case. *See In re Countrywide Financial Corp. Mortgage Marketing and Sales Practices Litigation*, No. 3:08-MD-01988 (WMC) (S.D. Cal. Oct. 11, 2011). While plaintiffs are seeking to appeal these decisions, the Ninth Circuit already has declined to grant interlocutory appeal on the *Wells Fargo* case.

Thus, a consensus appears to have emerged among the district courts that the *Wal-Mart* holding applies to lending discrimination class actions, not just employment discrimination class actions. None of these cases, however, has had occasion to address the merits of the disparate impact allegations, leaving unclear whether the reasoning of *Wal-Mart* prohibits application of disparate impact theories to all fair lending cases, including government enforcement actions. Now, however, the Supreme Court appears poised to take on that issue as well.

Magner v. Gallagher

In *Magner*, owners of residential rental properties sued the housing authorities in St. Paul, Minn., alleging that the city's policy of aggressively enforcing the local housing code specifically against rental (as opposed to owner-occupied) residential properties was exacerbating the housing shortage for low-income residents. The landlords alleged, among other things, that this policy had a disparate impact against minorities, particularly African-Americans, in violation of the FHA.

The trial court ruled for the city and against the landlords, but the Eighth Circuit reversed and ruled that the disparate impact claim could go forward. *See Gallagher v. Magner*, 619 F.3d 823 (8th Cir. 2010). The appeals court held that the landlords had shown that the stepped-up enforcement policy had a disproportionate adverse effect on racial minorities and that the city had shown that the policy had a manifest relationship to legitimate, nondiscriminatory objectives (*e.g.*, keeping the city clean and housing habitable), but that there was a fact question as to whether there was a viable alternative to the enforcement policy that would have less impact on minorities. *Id.* at 833-838.

The city housing authorities petitioned the Supreme Court to review the Eighth Circuit's decision, asking the Court to decide whether "disparate impact claims [are] cognizable under the Fair Housing Act" and, if so, what standard should be applied to such claims. The Court's decision to grant certiorari and agree to hear the case surprised many observers and may indicate that some members of the Court are concerned about application of the disparate impact theory. The factual circumstances of *Magner* are quite different from those presented in a lending discrimination case, but courts hearing fair lending cases have often looked to nonlending cases for precedent and guidance, and the legal issue of the applicability of the disparate impact theory is as important in the lending context as it is in the housing enforcement context. It is expected that a decision in the case will be issued in May or June of 2012.

Implications of the Supreme Court's Actions on Government Fair Lending Enforcement Actions

The *Wal-Mart* decision effectively eliminated plaintiff fair lending class action cases based solely on statistical analyses purporting to show disparities in how pricing discretion was exercised. Whether the Court's reasoning in that case has a broader effect on fair lending litigation and enforcement likely depends upon the Court's disposition of *Magner*. Although the Court could seek to sidestep the issue or narrow its decision to the unusual facts presented by the case at hand, if the Court does rule that disparate impact claims cannot be pursued under the FHA, the Obama Administration's attempt to resuscitate the disparate impact theory in fair lending cases likely would be dealt a fatal blow. The government could still seek to pursue disparate impact cases under the ECOA, but a decision that the theory cannot be applied to the FHA would provide ammunition for ruling that it cannot be applied under the ECOA either, given the similarity of the language in the two statutes. Finally, even if the Court rules that disparate impact claims can proceed under the FHA, its decision could provide much-needed guidance on what a lender would need to show in order to justify a neutral policy that has a disparate impact on minority borrowers.

Predicting how the Supreme Court will rule in any given case is always a risky business, and the ultimate impact of *Wal-Mart* and *Magner* on fair lending litigation and enforcement actions will not be clear for some time. What is clear is that these decisions and the interpretation of these decisions by lower courts all bear close watching.