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Commentary

NOT-SO-SUDDEN IMPACT: INSURERS FACE NEW BREED OF FAIR HOUSING ACT CLAIM

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Robert D. Helfand of Carlton Fields Jorden Burt discusses whether plaintiffs may bring "disparate impact" claims under the Fair Housing Act against insurance companies.

Property insurers have rarely had to defend against fair housing suits based on "disparate impact," but that might soon change. In 2014, industry groups successfully challenged a "discriminatory effects rule" issued by the U.S. Department of Housing and Urban Development. But much of that success was negated when the U.S. Supreme Court endorsed parts of the rule last year.

While these contests were being fought, housing groups quietly established a new beachhead. Two separate courts ruled that insurers may be liable under federal law for decisions that "predictably will cause" *someone else* to place a disproportionate burden on the housing rights of protected classes. This liability can attach even if *both* the decisions of the insurer *and* the future actions they allegedly will cause are nondiscriminatory on their face.

Disparate-impact litigation

The Fair Housing Act, 42 U.S.C.A. § 3601, prohibits several forms of discrimination based on "race, color, religion, sex, familial status ... national origin" or disability in connection with the sale or rental of a "dwelling." Individuals claiming past or future injuries may seek damages or injunctive relief, either in court or before the Department of Housing and Urban Development.

Intentionally discriminatory acts --"disparate *treatment*" -- are expressly prohibited. Most federal courts have also entertained claims based on "disparate *impact*." These claims are based on the consequences of acts that make no prohibited distinctions -- and which may have an innocent motive -- but which nonetheless produce a "disproportionately adverse effect" on the housing rights of protected classes.

In 2013, HUD issued a rule "to prohibit housing practices with a discriminatory effect." 24 C.F.R. § 100.500. Last June, the Supreme Court cited parts of the rule with approval in *Texas Department of Housing and Community Affairs v. Inclusive Communities Project*, 135 S. Ct. 2507 (2015). *Inclusive Communities* definitively established the validity of disparate-impact theories under the FHA.

HUD's rule forbids certain conduct that "predictably will cause a discriminatory effect." In essence, it imposes a duty not only to avoid intentional discrimination but also to calculate the likely consequences that *nondiscriminatory* practices will have on housing rights.

In litigation, a showing of discriminatory effect places the burden on the defendant to demonstrate that its conduct is "necessary to achieve ... substantial, legitimate, nondiscriminatory interests." But plaintiffs can still succeed if they can show that the defendant's interests could "be served by another practice ... [with] less discriminatory effect."

***2** In short, defendants need evidence both that their actions had a valid, nondiscriminatory business objective and that they chose the most efficacious means to pursue that objective.

Disparate-impact claims against insurers

Most FHA claims against insurers have alleged disparate treatment -- intentional discrimination -- such as "redlining," as in *NAACP v. American Family Mutual Insurance Co.*, 978 F.2d 287 (7th Cir. 1992). When HUD first proposed a discriminatory effects rule that would apply to insurers, the industry strongly opposed it, arguing that disparate-impact analysis is inappropriate for "risk-based business practices."

When the proposed rule was adopted, industry groups challenged different aspects of it in two cases: *Property Casualty Insurers Association of America v. Donovan*, 66 F. Supp. 3d 1018 (N.D. Ill. 2014), and *American Insurance Association v. U.S. Department of Housing and Urban Development*, 74 F. Supp. 3d 30 (D.D.C. 2014).

In the *PCIA* case, the court held that HUD had failed to give adequate consideration to the following arguments: the rule, as applied to insurers, violates the McCarran-Ferguson Act, 15 U.S.C.A. § 1012; it violates the "filed rate" doctrine; and it is inconsistent with the "fundamental nature of insurance." The case was remanded to HUD for consideration of those issues.

The decision means the regulation will not receive deference on those questions, but this will not prevent other courts from reaching the same conclusions as HUD.

In *AIA*, the court predicted that the Supreme Court would disapprove disparate-impact claims under the FHA -- which turned out to be incorrect. Thus, even after two successful challenges, disparate-impact claims against property insurers remain viable.

A new breed of housing claim

The plaintiffs in *Viens v. American Empire Surplus Lines Insurance Co.*, No. 14-cv-952, 2015 WL 3875013 (D. Conn. June 23, 2015), included two Connecticut landlords who rented apartments to participants in HUD's Section 8 housing choice voucher program. (The other plaintiff was a civil rights organization.)

The rent paid by Section 8 tenants is capped at a portion of their incomes, and the program uses federal funds to pay the balance directly to landlords.

Both landlords were insured by American Empire. One policy was canceled and the other was not renewed, allegedly because the insurer's underwriting guidelines excluded properties for which tenants receive housing assistance.

The Connecticut Fair Housing Act, Conn. Gen. Stat. Ann. § 46a-63, prohibits discrimination on the basis of "lawful source of income," and the FHA does not. Thus, while the plaintiffs asserted a disparate *treatment* claim under the CFHA, they could not do so under the FHA.

Instead, they alleged the underwriting guidelines "predictably will cause" landlords to make fewer units available to Section 8 participants. They cited evidence that black and Hispanic households in Connecticut are more likely than white, non-Hispanic households to participate in that program. Consequently, the argument concluded, reducing the availability of Section 8 housing disproportionately burdens racial minorities.

***3** *Viens* was not the first case involving a disparate-impact claim against an insurer under the FHA. Others include *Dehoyos v. Allstate Corp.*, 345 F.3d 290 (5th Cir. 2003) (credit scoring had allegedly disparate impact on minority customers for

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homeowners insurance), and *National Fair Housing Alliance v. Prudential Insurance Co*., 208 F. Supp. 2d 46 (D.D.C. 2002) (homeowners underwriting criteria had allegedly disparate impact).

But earlier cases asserted that the "impact" of the insurer's decisions fell on the *insurers' own customers*; they did *not* hold the insurer responsible for consequences of *the customers' intervening acts*.

There have been other FHA cases based on insurers' alleged influence over the acts of others. But earlier examples -- *Nevels v. Western World Insurance Co., Inc.*, 359 F. Supp. 2d 1110 (W.D. Wash. 2004), and *Wai v. Allstate Insurance Co.*, 75 F. Supp. 2d 1 (D.D.C. 1999) -- alleged disparate *treatment*; that is, the insurers declined to insure properties with disabled residents, and persons with disabilities are protected by the FHA.

The novelty of *Viens* is its combination of these elements. The plaintiffs asserted that insurers have a duty to consider both how their underwriting decisions will affect how their customers treat other parties -- who are strangers to the insurance contract -- and whether those third-party interactions will disproportionately burden the housing rights of protected classes.

In June, the District Court ruled that the plaintiffs had stated a claim under the FHA. The case settled a few months later.

The plaintiffs in another case, *Jones v. Travelers Casualty Insurance Co.*, No. 13-cv-02390, 2015 WL 5091908 (N.D. Cal. May 7, 2015), advanced similar allegations and theories. The landlord plaintiffs (who sued with a fair-housing group) owned a California building insured by Travelers. Their policy was not renewed, allegedly because it had Section 8 tenants. The plaintiffs showed that Section 8 households are more likely than others to be headed by members of several protected classes.

The plaintiffs asserted a claim for disparate *treatment*, and they attributed the insurer's acts to racial and other "stereotypes" about tenants who receive government assistance. But the plaintiffs also pursued their claims on disparate-impact grounds -- for the same reasons that were offered in *Viens*.

Jones, however, highlighted an anomaly of the underlying theory. Because Section 8 is a voluntary program, California landlords who *refuse* Section 8 participants are *not* liable under state or federal law -- even under a disparate-impact theory. [1] Thus, the plaintiffs asserted that an insurer can be guilty of "discrimination" for *causing* certain third-party actions that *do not* constitute "discrimination" under either the FHA or applicable California law.

Last May the court denied the insurer's motion for summary judgment, holding that plaintiffs' "circumstantial evidence of ... discriminatory intent" raised a triable issue concerning disparate treatment. As to disparate impact, it also found sufficient evidence that the insurer's underwriting "predictably falls more heavily on protected classes and results in discrimination."

***4** The court acknowledged the voluntary nature of the Section 8 program, but it reasoned that there are "no cases where a court has held that landlords and insurers are similarly situated under Section 8." The case settled a month later.

Insurer responsibility for others 'acts

Viens and Jones present several novel issues.

Causation

As a general rule, "FHA plaintiffs' injuries must be proximately caused by the defendant's discriminatory acts." [2] Proximate cause is usually *absent* if "an intervening act of a third party ... actively operates to produce harm after the first person's wrongful act has been committed." [3]

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The exception is the rare case where the intervening act was a "foreseeable" consequence of the first one. [4]

In *Inclusive Communities*, the Supreme Court majority observed that, in disparate-impact cases, "it may ... be difficult to establish causation [,] because of the multiple factors that go into decisions [affecting the housing market]." This remark could reasonably be applied to a landlord's decision about whether to participate in the Section 8 program. That being the case, it might be hard to support a claim that the landlord's decision is a "foreseeable" result of decisions about pricing property insurance.

Viens illustrates this problem. The court found the insurer's underwriting practices imposed a "financial penalty [on policyholders] for renting to Section 8 tenants," which would make them "less likely to participate in the program." This, the court concluded, "would result in less housing being available to Section 8 participants."

But the court also acknowledged (in a footnote) that Connecticut law, unlike the FHA, *prohibits* landlords from discriminating against Section 8 tenants. [5] Without further explanation, it found that the insurer had "create[d] an incentive for [policyholders] *to not comply with this requirement*" (emphasis added).

Was this "incentive" actually great enough to "result in less housing" for subsidized tenants? One plaintiff alleged his replacement policy cost $162 more per year than the policy that was canceled. The court did not discuss whether it was "plausible" that this amount would cause other landlords to violate a Connecticut statute and thereby risk exposure to both compensatory and punitive damages. [6]

Future cases might examine this question more closely. A week after *Viens* was decided, *Inclusive Communities* admonished that the FHA includes a "robust causality requirement," which "ensures that '[r]acial imbalance ... does not, without more, establish a prima facie case' ... and thus protects defendants from being held liable for racial disparities they did not create."

On the other hand, future plaintiffs might also note that the industry invests substantial resources in systems that purport to predict how pricing structures will affect the decision-making of insureds -- systems often lumped together under the term "price optimization." These systems generally focus on policyholders' buying decisions, not on their future interactions with others. But insurers have arguably endorsed the notion that underwriting practices can influence policyholder behavior in predictable ways. These tools might also generate records that will be used as evidence in support of arguments over causation.

Prohibited conduct

***5** The goals of the FHA are not clearly served by imposing liability for *every* act that can be connected to a "disparate impact." *Inclusive Communities* stated that the FHA forbids housing "barriers" that are not only "unnecessary" but also "artificial" and "arbitrary." It warned, "Courts should avoid interpreting disparate-impact liability to be so expansive as to inject racial considerations into every housing decision."

In *Jones* the court held that insurers are liable for causing acts that would not otherwise give rise to a fair-housing claim. In *Viens*, the insurer was liable for future acts of others for which Connecticut law already provides a remedy. In neither case does there appear to be a compelling need to "inject racial considerations" into the *underwriting* decision.

Furthermore, as the plaintiffs argued in the *AIA* case (one of the challenges to HUD's discriminatory-effects rule), the only way for insurers to avoid "disparate impact" might be to collect and analyze data about protected classes and to take account of it in underwriting. Several states *prohibit* using race in at least some ratemaking decisions. [7] In some states, insurers may not even collect the relevant data in connection with applications for insurance. [8]

On the other hand, insurers are voluntarily introducing many new types of data into their decision-making processes. Acxiom, one of the country's largest data brokers, reported in 2013 that its customers included "nine of the top 10 property and casualty

insurers."[9] As underwriting achieves new levels of granularity, calls to subject the process to anti-discrimination safeguards might gather strength.

Standing

To establish standing under the FHA, a plaintiff must show she "ha[s] suffered or [is] imminently threatened with a concrete and particularized 'injury in fact' that is fairly traceable to the challenged action."[10] The "fairly traceable" standard is less stringent than "proximate cause," which is an element of the substantive claim.[11]

In *Viens* and *Jones*, the courts applied these rules to plaintiff landlords rather than to the tenants who would allegedly suffer the "disparate impact." The landlords relied on two propositions. First, a plaintiff need not be a member of a protected class to be an "aggrieved person" within the meaning of the FHA.[12] Second, "paying a higher price for insurance" has been found to be "an injury" that confers standing,[13] and the landlords had to replace the defendants' policies with more expensive ones.

The landlords in *Viens* also argued that their "injury" would give them standing, even if they could not establish harm to any member of a protected class. The court rejected that argument: Without any injury to tenants, it held, there would be no "disparate impact" and the plaintiffs would have failed to state an actionable claim. Thus, while standing can usually be established under a "fairly traceable" standard, the circumstances in *Viens* appear to require an additional showing of proximate cause -- one that is not only "plausible" but also "robust."

***6** The standing issue in *Jones* was even more confusing. As noted, California *landlords* may lawfully discriminate against subsidized tenants. Thus, even under *Jones*, the tenant does not suffer a legally cognizable "injury" from such discrimination -- *unless* the injury was "caused" by the landlord's insurer. That is not how standing usually works.[14]

Regulating underwriting

Viens and *Jones* also raised questions about how to apply federal law to underwriting decisions.

'Risk discrimination is not race discrimination'

Insurance laws typically prohibit "unfairly discriminatory" rates. But the actuarial concept of "unfair discrimination" focuses on costs: "A rate is ... not ... unfairly discriminatory if it is an actuarially sound estimate of the expected value of all future costs associated with an individual risk transfer."[15]

Some state laws also forbid consideration of factors associated with racial discrimination, such as the fact that property is in a disfavored neighborhood. But even those laws make allowances for determinations that result from "actuarial principles related to ... loss experience."[16]

Consequently, underwriting decisions that disfavor minorities are not necessarily "unfair discrimination" in the actuarial sense. In *AIA,* the judge cited one actuary who argued that there is an "inevitable and irreconcilable conflict between the two standards." He explained:

> It is reasonable to assume ... that no protected minority class ... will be uniformly distributed throughout any given insurance risk classification plan. This assumption implies that all risk factors used to measure and assess risk are potentially in violation of a disparate impact rate standard, even though each risk factor accurately reflects expected losses and expenses.[17]

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In *NAACP*, U.S. Circuit Judge Frank H. Easterbrook expressed this point more succinctly: “Risk discrimination is not race discrimination.”

The case for disparate impact

Housing advocates do not generally challenge these arguments. They point out, instead, that underwriting practices incorporate many decisions that are not based on the “expected value of all future costs.”

Filed rates, after all, may deviate from strict actuarial models because of business goals or judgments, such as a desire to penetrate a new market or change a mix of business, predicted legal or regulatory developments, or judgments about the credibility of individual risk experiences.

Furthermore, individual underwriters sometimes exercise broad discretion in applying the rate structure. In *PCIA*, amici curiae cited an author who contended that “half or more of the underwriting decisions may be ultimately made ,,, by human underwriters,” rather than in strict accordance with filed rates. [18]

***7** There is also a distinction between filed rates and underwriting guidelines, which are the standards used by agents and brokers to make an initial decision (usually subject to underwriters' review) about coverage. In most states, guidelines are not publicly filed, and some include rules that are not part of the filed rate.

For example, according to a 2007 survey by the Texas Office of Public Insurance Counsel, 70 percent of homeowners insurers made adverse underwriting decisions “based on whether the property shows ‘pride of ownership,”’ as demonstrated by “vegetation that is well manicured, watered and cared for, ... premises free of any debris, clutter, disabled or unusable vehicles, disabled or unusable appliances, discarded lumber or scattered trash.”

Critics say such criteria make it possible for agents' biases to enter into the sale of insurance in ways that hurt protected classes, without actuarial justification.

Jones *as test case*

Jones shows a reality that exists between these poles: Many *non*-actuarial pricing, marketing and sales decisions are both objectively reasonable and integrally connected to the risk-based calculations of the insurance business.

The policy in *Jones* was a product called “Apartment Pac,” a “high-volume, low-risk, simplified insurance product” that is sold “with minimal involvement of Travelers' underwriters.” The relatively low price reflects its “highly automated, ... ‘low touch’ nature”--so low that agents can bind policies without consulting underwriters or physically inspecting the premises.

The guidelines exclude risks that are “not within Travelers' core knowledge and experience.” “Subsidized, public or government-funded [apartment] complexes” are excluded, along with correctional facilities and halfway houses. (The plaintiffs' policy in *Jones* was issued in error.) But excluded risks also include properties that are *not* associated with protected classes, such as waterfront complexes with marinas, resort communities and certain buildings over six stories tall.

Although these exclusions are not based on actuarial assessments, Travelers produced evidence that insurance for subsidized housing and other specialized risks is generally provided by surplus lines insurers, which emphasize their special expertise. Travelers showed, in other words, an objective, reasonable basis to believe that Apartment Pac's guidelines allow it to avoid unique underwriting complexities, analysis of which would raise the overall cost.

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Jones therefore raises difficult questions about how deeply federal anti-discrimination law should extend into the underwriting process. If, like Travelers, an insurer designs a product for non-specialty risks, does the FHA require it to review demographic information about excluded specialty markets, so as to learn whether the exclusion "predictably will cause" a disparate impact? If so, how can the insurer show that the exclusion is "necessary" to achieve a legitimate business goal? If an actuarial analysis of the excluded markets is required, then it might be impossible to create a "low touch" product in the first place.

***8** On the other hand, what if the insurer conducts such an analysis and finds that it might safely enter the market after all? Under the FHA, does the company have an obligation to do so?

What about McCarran-Ferguson?

Under McCarran-Ferguson, state laws that "regulat[e] the business of insurance" will "reverse preempt" any federal statute that conflicts with them. The case for preemption is strongest where the federal law requires courts to make judgments that are usually made by state insurance regulators.

In *NAACP,* the 7th U.S. Circuit Court of Appeals rejected a reverse preemption argument in an FHA case. But several years later, in *Doe v. Mutual of Omaha Insurance Co.*, 179 F.3d 557 (7th Cir. 1999), the same court held that the plaintiffs could not assert a claim against their insurer under the Americans with Disabilities Act.

"[McCarran-Ferguson does not permit] federal courts to determine whether limitations on coverage are actuarially sound and consistent with state law," the *Doe* court said. "Even if the formal criteria are the same under federal and state law, displacing their administration into federal court -- requiring a federal court to decide whether an insurance policy is consistent with state law -- obviously would interfere with the administration of state law."

Federal laws penalizing practices that state insurance law clearly permits are also preempted. [19] But courts reject McCarran-Ferguson arguments in cases, such as *Jones* and *Nevels*, where they conclude that state law "complements" the FHA.

In *AIA* the court said this reasoning applies to disparate-impact claims: "[E]xpansion of the FHA to include disparate-impact liability [against insurers] would ... have a wide-ranging disruptive effect on the pricing and provision of homeowners insurance ... [and] raises serious concerns regarding widespread federal encroachment upon state insurance regulation."

Essentially the same argument was *rejected* in *Viens* -- but the court's discussion of the issue focused on whether state law preempts civil rights statutes in general rather than on the plaintiffs' particular claim. And in *PCIA*, the court held that the McCarran-Ferguson arguments were not yet ripe for adjudication and should be resolved on a case-by-case basis.

Get busy!

Insurers should review their underwriting guidelines now. The point is not necessarily to conduct a race- or gender-based analysis (which might be unlawful in many cases), but to ensure that the policies and choices that complement purely actuarial analyses reflect business judgments that are clear, rational and defensible.

Vague terms connoting value judgments -- such as "pride of ownership" or "clutter" -- should be eliminated, because plaintiffs can attack those terms as coded invitations to unlawful discrimination. For the same reason, agents' discretion to interpret the operative language should be limited, and insurers should consider offering literature or training about how to apply guidelines in a nondiscriminatory way.

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***9** Insurers should also apply an understanding of anti-discrimination laws to the way they use consumer data -- and especially data from outside sources -- in marketing and pricing decisions.

The FHA prohibits discrimination on the basis of race, color, religion, sex, familial status, national origin or disability. State laws further bar distinctions based on such characteristics as source of income (Connecticut) and sexual orientation, gender expression and genetic information (California). If insurance decisions are based on data points that can be characterized as surrogates for any of these prohibited categories, those decisions might expose the company to complex civil rights claims.

By building a record that shows a sound "business justification" for their policies, insurers can prepare to defend against future cases on the facts. That record will also improve the chances that some of the legal arguments discussed in this commentary will succeed.

Footnotes

1 *Doe v. WCP I LLC*, No. A121112, 2009 WL 1564909 (Cal. Ct. App., 1st Dist. June 4, 2009) (California landlords who discriminate against subsidized tenants may be liable under state law.)

2 *Pac. Shores Props. v. City of Newport Beach*, 730 F.3d 1142 (9th Cir. 2013).

3 *Egervary v. Young*, 366 F.3d 238 (3d Cir. 2004).

4 *SEC v. Apuzzo*, 689 F.3d 204 (2d Cir. 2012).

5 Conn. Gen. Stat. Ann. § 46a-64c.

6 *See Bell Atl. Corp. v. Twombly*, 548 U.S. 903 (2007).

7 *See*, *e.g.*, 215 Ill. Comp. Stat. 5/424(3).

8 *See*, *e.g.*, Md. Code Ann., Ins. § 27-501(c)(1).

9 Office of Oversight and Investigations Majority Staff, Comm. on Commerce, Sci. & Transp., A Review of the Data Broker Industry: Collection, Use and Sale of Consumer Data for Marketing Purposes (2013).

10 *Lexmark Int'l v. Static Control Components*, 134 S. Ct. 1377 (2014).

11 *Id.*

12 *Trafficante v. Metro. Life Ins. Co.*, 409 U.S. 205 (1972).

13 *NAACP*, 978 F.3d at 293

14 *Pagan v. Calderon*, 448 F.3d 16 (1st Cir. 2006) ("the standing inquiry turns on the plaintiff's injury, not the defendant's motive").

15 Casualty Actuarial Society, Principles Regarding Property and Casualty Insurance Ratemaking.

16 *See*, *e.g.*, Colo. Rev. Stat. Ann. § 10-3-1104(f)(XIV).

17 Michael J. Miller, Disparate Impact and Unfairly Discriminatory Rates, Casualty Actuarial Society E-Forum 276, 277 (2009).

18 Donald Light, *Transforming Underwriting: From Risk Selection to Portfolio Management*, at 7 (Celent Mar. 2004).

19 *Ojo v. Farmers Grp.*, 356 S.W.3d 421 (Tex. 2012).

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