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Fairness in Disparity: Challenging the Application of Disparate Impact Theory in Fair Housing Claims Against Insurers

Matthew Jordan Cochran

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FAIRNESS IN DISPARITY: CHALLENGING THE APPLICATION OF DISPARATE IMPACT THEORY IN FAIR HOUSING CLAIMS AGAINST INSURERS

Matthew Jordan Cochran*

INTRODUCTION

"Risk discrimination is not race discrimination . . . , but is a higher [premium] for fire insurance in an inner city neighborhood attributable to risks of arson or to racial animus?"1 Similarly, given the marked disparity between the credit scores of minorities and whites,2 does a facially race-neutral practice like credit-based insurance scoring constitute unlawful race discrimination?3 This article is concerned with determining how courts ought to go about answering such questions. Specifically, what analytical standard should a court apply—or not apply—when addressing disparate insurance impacts?

* J.D., Campbell University School of Law (magna cum laude); B.A., University of North Carolina at Chapel Hill.


2 E.g., TEXAS DEP’T OF INSURANCE, REPORT TO THE 79TH LEGISLATURE: USE OF CREDIT INFORMATION BY INSURERS IN TEXAS 13 (2004) (reporting that the average credit score of blacks was roughly 10%–35% lower than that of whites, and that Hispanics’ average score was about 5%–25% lower than whites); see also CHI CHI WU, CREDIT SCORING AND INSURANCE: COSTING CONSUMERS BILLIONS AND PERPETUATING THE ECONOMIC RACIAL DIVIDE 1 (2007), http://www.consumerlaw.org/reports/content/insurancescoring.pdf (stating that “at least 5 studies of traditional credit scores . . . have shown that African Americans and Latinos have lower scores as a group”).

3 See generally Latonia Williams, African American Homeownership and the Dream Deferred: A Disparate Impact Argument Against the Use of Credit Scores in Homeowners’ Insurance Underwriting, 15 CONN. INS. L.J. 295 (2008) (attempting to answer this question in the affirmative). But see Property Casualty Insurers Association of America, Banning Credit-Based Insurance Scores Would Hurt Main Street USA 1, 2 (Apr. 1, 2009), available at http://www.pciaa.net/web/sitehome.nsf/lcpublic/402/$file/creditscoringmainst.pdf [hereinafter PCI Report] (describing credit scores as “one of the most accurate and equitable factors used in pricing and underwriting . . . insurance” and as “provid[ing] information about a risk that no other factor provides,” and arguing that “attempts to ban the use of [credit-based] insurance scores may be seen by some as helping middle-class America, [but] are actually misguided and will only end up hurting them financially instead”).

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Although homeowners’ insurance underwriters who overtly do business according to racial prejudice are broadly condemned by national policies against segregated housing, it is unclear whether the same can be said for insurers whose race-neutral practices incidentally affect a disproportionate number of members of protected classes. Thus, litigants and commentators have insisted that the burden-shifting disparate impact analysis developed in Title VII employment discrimination cases should be applied in claims against insurance companies brought under the Fair Housing Act (FHA). But such an argument, however convenient, is subject to a number of serious challenges. While courts should recognize a course of action for disparate insurance impacts, the Title VII standard should not control such claims.

The discussion begins in Part I with an overview of the FHA and its gradual application to homeowners’ insurance. Next, Part II describes the development of the disparate impact theory under Title VII; describes the ratemaking practices used by insurers to mitigate risk of loss, potential payment problems, and nonretention; relates arguments for applying the Title VII standard in FHA claims challenging such practices; and provides a recent case as an illustration. Part III then argues that central aspects of the Title VII standard for disparate impacts are legally infirm, and Part IV argues that these aspects are conceptually and practically unsuitable for FHA claims against insurers. Finally, Part V asks whether alternative analytical standards for disparate insurance impact cases might be fashioned from the criticisms provided in this article.

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4 The term “homeowners’ insurance” used throughout this article is intended to include the property or hazard insurance required by mortgage lenders prior to financing a home purchase. Technically speaking, the range of losses covered by a homeowners policy is quite broad, and typically exceeds the scope of property or hazard insurance. See, e.g., United Farm Bureau Mut. Ins. Co. v. Metro. Human Relations Comm’n, 24 F.3d 1008, 1014 n.8 (7th Cir. 1994) (rejecting insurance company’s argument that because only “hazard” insurance is required for a mortgage, alleged discrimination in “homeowners” insurance should not be actionable under the Fair Housing Act because a denial of homeowners coverage does not make housing “unavailable”).

5 See infra text accompanying note 40.

6 See infra discussion accompanying notes 10–36.

7 See infra discussion accompanying notes 37–137.

8 See infra discussion accompanying notes 138–245.

9 See infra discussion accompanying notes 246–57.
I. THE FAIR HOUSING ACT AND HOMEOWNERS’ INSURANCE

Seven days after the assassination of Dr. Martin Luther King, Jr., Congress enacted the FHA as Title VIII of the Civil Rights Act of 1968, the stated purpose of which was “to provide, within constitutional limits, for fair housing throughout the United States.”10 This new statute made it unlawful “to discriminate against any person in the terms, conditions, or privileges of sale or rental of a dwelling, or in the provision of services or facilities in connection therewith, because of race, color, religion, or national origin.”11 Sex and familial status have since been added to the list of protected classes.12 The FHA also makes it illegal 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 the person’s membership in a protected class.13

According to Senator Walter Mondale, who introduced the original bill, the legislation was necessary to combat the discriminatory conduct of property owners, real estate brokers, builders, and lenders.14 Senator Mondale also indicated more broadly that he intended the FHA “to replace the ghettos by ‘truly integrated and balanced living patterns.’”15 Liberally interpreted, it appears “the FHA’s goal was not only to increase housing opportunities for racial minorities, but also to promote integration for the benefit of all Americans.”16

11 Civil Rights Act of 1968, Pub. L. 90-284, § 804(b), 82 Stat. at 83. Note that the quoted text is the provision courts have applied to discriminatory conduct by homeowners insurance underwriters.
13 42 U.S.C § 3605(a). “Residential real estate-related transaction” is defined as “[t]he making or purchasing of loans or providing other financial assistance,” or “selling, brokering, or appraising . . . residential real property.” Id. § 3605(b).
But as the Fourth Circuit observed in *Mackey v. Nationwide Insurance Cos.*, although the FHA specifically addresses home lending practices, neither its language nor its legislative history indicates that it was intended to apply to the business of homeowners’ insurance.  

The plaintiff in that case (a black Nationwide agent who had just been fired) brought an FHA claim against his former employer based on the company’s “arbitrary refusal to underwrite the risks of persons residing in predominantly black neighborhoods.”  

In so doing, he argued that because lenders will not loan money for the purchase of an uninsured home, discriminatory denials of homeowners’ insurance served to “make [housing] unavailable” to minorities under § 3604 of the FHA. He also contended that insurance is a “service in connection with a dwelling” under § 3604(b). But the court rejected these arguments, explaining that the term “service” merely “encompasses such things as garbage collection and other services of the kind usually provided by municipalities,” and that homeowners’ underwriting could not “reasonably be described as the provision of a service in connection with dwellings.” Moreover, the court reasoned that if § 3604 “was designed to reach every discriminatory act that might conceivably affect the availability of housing, § [36]05’s specific prohibition of discrimination in the provision of financing would have been superfluous.” Accordingly, the court held that the FHA did not apply to the provision of insurance.

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17 *Mackey*, 724 F.2d at 423.

18 *Id.* at 420. Even though the plaintiff used the term “redlining,” *cf. infra* note 27, there is no indication that this was a “disparate impact” claim, as the alleged conduct at issue was characterized as the defendant’s “racially discriminatory refusal to insure houses in predominantly black neighborhoods.” *Mackey*, 724 F.2d at 421 (emphasis added).

19 *Mackey*, 724 F.2d at 423.

20 *Id.* at 424.

21 *Id.*

22 *Id.* at 423.

23 *Id.* at 425; *see also* Stanton, *supra* note 16, at 150 (“The Fourth Circuit concluded that the FHA does not reach insurance essentially because (1) Congress explicitly prohibited discrimination by financial institutions, but failed to mention insurance companies in the FHA, and (2) [subsequent] legislative efforts to get insurance explicitly mentioned in the FHA . . . failed.” (citing *Mackey*, 724 F.2d at 423–25)).
In what appears to have been a response to the *Mackey* decision, the Department of Housing and Urban Development (HUD) promulgated regulations interpreting the FHA to forbid the practice of “[r]efusing to provide . . . property or hazard insurance . . . for dwellings or providing such services or insurance differently because of [a person’s protected status].” Not long thereafter, the Seventh Circuit deferred to HUD’s interpretation in its disapproval of *Mackey*.

Like the claim in *Mackey*, the plaintiff’s FHA claim in *NAACP v. American Family Mutual Insurance Co.* centered on allegations of “redlining” by the insurance company. Although it acknowledged the case’s potential for disparate impact analysis, the Seventh Circuit purposefully limited its review to the question of the FHA’s applicability, stating unequivocally that it was not deciding “whether to sub-

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25 24 C.F.R. § 100.70(d)(4) (2010).

26 *NAACP v. Am. Family Mut. Ins. Co.*, 978 F.2d 287, 300 (7th Cir. 1992) (explaining that “Congress gave the Executive Branch [rulemaking power to enforce the FHA] with knowledge that since 1978 a succession of Secretaries have believed that insurance redlining, by denying or impeding coverage, makes mortgage money unavailable, rendering dwellings ‘unavailable’ as effectively as the denial of financial assistance on other grounds” and concluding that § 3604 was “sufficiently pliable that its text can bear the Secretary’s construction.” (alterations omitted) (internal quotation marks omitted)).

27 See id. at 290. The Seventh Circuit defined redlining as “charging higher rates or declining to write insurance for people who live in particular areas (figuratively, sometimes literally, enclosed with red lines on a map).” *Id.* The court reasoned that “[i]f insurers redline areas with large or growing numbers of minority residents, that practice raises the cost of housing for black persons and also frustrates their ability to live in integrated neighborhoods.” *Id.* But see infra explanation accompanying notes 83–84.

28 See *American Family*, 978 F.2d at 290 The Seventh Circuit assumed that “[b]ecause the district judge dismissed [the plaintiff’s FHA claim] in advance of discovery,” the plaintiffs could “establish disparate treatment and not just a disparate impact of decisions made on actuarial grounds.” *Id.* The court considered this an important distinction “not only because the Supreme Court ha[d] yet to decide whether practices with disparate impact violate Title VIII, but also because of the nature of insurance.” *Id.* (citation omitted). With regard to the “nature of insurance,” the court proceeded to explain:

Insurance works best when the risks in the pool have similar characteristics. For example, term life insurance costs substantially more per dollar of death benefit for someone 65 years old than for one 25 years old, although the expected return per dollar of premium is the same to both groups because the older person, who pays more, also has a higher probability of dying during the term. Auto insurance is more expensive in a city than in the countryside, because congestion in cities means more collisions. Putting young and old, or city and country, into the same pool would lead to adverse selection: people knowing that the risks they face are less than the average of the pool would drop out. A single price for term life insurance would dissuade younger persons from insuring, because the
ject redlining by insurers to evaluation under the disparate impact paradigm.”29 Instead, its emphasis was that interpreting the FHA to apply to such insurance practices was imminently reasonable: “No insurance, no loan; no loan, no house; lack of insurance thus makes housing unavailable.”30 After criticizing the Mackey opinion on numerous points, the Seventh Circuit held that the FHA “applies to discriminatory denials of insurance, and discriminatory pricing, that effectively preclude ownership of housing because of the race of the applicant.”31

Since the American Family decision, “every court to consider the issue has held that the FHA applies to insurance.”32 There is also agreement that the FHA prohibits “disparate impact” discrimination.33 But as the Seventh Circuit has pointed out, “disparate impact analysis is not appropriate in certain contexts.”34 “Some practices lend themselves to disparate impact method, others do not.”35 Not surprisingly, the federal circuit courts have not uniformly approved application of the Title VII standard to disparate effects on minorities resulting from the business of insurance.36

The next part of this dis-

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29 American Family, 978 F.2d at 298; see also id. at 291 (“All we decide is whether the complaint states claims on which the plaintiffs may prevail if they establish that the insurer has drawn lines according to race rather than actuarial calculations.”).

30 Id. at 297.

31 Id. at 301.

32 See Stanton, supra note 16, at 152.

33 See id. at 174 n.180, 179 (citing a host of cases and concluding that “every federal jurisdiction has approved a disparate impact theory of liability in FHA suits brought in contexts other than insurance”).

34 Knapp v. Eagle Prop. Mgmt. Corp., 54 F.3d 1272, 1280 (7th Cir. 1995) (citing American Family, 978 F.2d at 290; Vill. of Bellwood v. Dwivedi, 895 F.2d 1521, 1533 (7th Cir. 1990)).

35 Id. (quoting Dwivedi, 895 F.2d at 1533) (internal quotation marks omitted).

36 See, e.g., Saunders v. Farmers Ins. Exch., 537 F.3d 961, 964 (8th Cir. 2008) (assuming, without deciding, that “private insurers may be liable under the [FHA] on a disparate impact theory,” but emphasizing that “with respect to insurers, the question [of disparate impact liability] is not free from doubt”); 2922 Sherman Ave. Tenants’ Ass’n v. District of Columbia, 444 F.3d 673, 679–80 (D.C. Cir. 2006) (showing disagreement among the circuits as to the test to apply for disparate impacts in FHA cases); Nationwide Mut. Ins. Co. v. Cisneros, 52 F.3d 1351, 1362 (6th
cussion traces the legal development of this standard and explains the arguments being made in support of applying it in disparate insurance impacts cases.

II. HOLDING INSURERS TO THE TITLE VII STANDARD

Discrimination claims under the disparate impact theory generally involve the following. First, the plaintiff’s prima facie burden requires showing (1) the occurrence of outwardly neutral practices by the defendant; (2) a significantly adverse or disproportionate impact on members of a protected class; and (3) that the neutral practice caused the disparate impact. The burden then shifts to the defendant to show that the practice is justified by business necessity. Even if the defendant makes this showing, the plaintiff can still prevail if it demonstrates that an alternative policy would create a less disparate impact. This configuration of burdens is referred to herein as the “Title VII standard” and is what commentators and litigants have

37 See Kaersvang, supra note 36, at 2007 (synthesizing relevant case law).
38 Id. (citing 42 U.S.C. § 2000e(k)(1)(A) (2006)). What the courts actually mean by “business necessity” is not easy to pin down. The conceptual problems presented by this notion are taken up at length in Part II, Sections A and B, infra.
39 Kaersvang, supra note 36, at 2008. In employment discrimination cases—the breeding ground of the Title VII standard—the plaintiff has the burden of proof on this issue. See Stanton, supra note 16, at 184. Some courts dealing with FHA claims have assigned the burden to defendants, requiring them to demonstrate (in addition to business necessity) the lack of a less-disparately-impacting alternative. E.g., Resident Advisory Bd. v. Rizzo, 564 F.2d 126, 148–49 (3d Cir. 1977). Nevertheless, at least one FHA plaintiff has conceded that proving the availability of such an alternative is the plaintiff’s burden. See Appellant’s Opening Brief at 34–35, Ojo., 565 F.3d 1175 (No. 06-55522) [hereinafter Patrick Ojo] (acknowledging that once the defendant carried its business necessity burden, “[i]t would then be plaintiff’s burden to show alternative[s] . . . that are [just] as effective . . . but produce a less discriminatory impact”).
attempted to impose on insurers for disparate impact claims. To understand why this standard is not appropriate for application to the challenged practices of insurers in FHA claims, it is necessary first to understand the standard’s origins.

A. The Disparate Impact Theory: Lurching from Employment Law to Fair Housing

Several years before the FHA became law, Congress passed the Civil Rights Act of 1964. Title VII of that Act bars discrimination against protected classes in employment. At first, claims under Title VII were limited to cases involving evidence of intentional discrimination; but in 1970, the Supreme Court changed this. In its landmark decision in *Griggs v. Duke Power Co.*, the Court interpreted Title VII to proscribe “not only overt discrimination but also practices that are fair in form, but discriminatory in operation.”

Duke Power had a history of engaging in overtly discriminatory employment practices prior to passage of Title VII; particularly, it excluded blacks from non-Labor Department jobs, or “inside” jobs. It had since discontinued these open practices, but had begun limiting new inside jobs to persons who had high school diplomas and who

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40 See, e.g., Kaersvang, supra note 36, at 2007–08, 2008 n.126 (arguing that the “test derived from Title VII jurisprudence is appropriate in the FHA context” and listing cases from “[s]everal circuits [which] have used this precise test”); Stanton, supra note 16, at 184–85 (stating that, for FHA claims, “courts have borrowed the disparate impact test developed in employment litigation” and that insurers “must demonstrate that there are no alternatives available to lessen the discriminatory effect of [their] policies in FHA cases”); Williams, supra note 3, at 315 (arguing, in essence, that the Title VII standard should be applied in cases of disparate insurance impacts).


42 See id. § 703, 78 Stat. at 253 (codified as amended at 42 U.S.C. § 2000e-2 (2006) (“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 discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual’s race, color, religion, sex, or national origin; or . . . (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 otherwise adversely affect his status as an employee, because of such individual’s race, color, religion, sex, or national origin.”)).

43 *Griggs v. Duke Power Co.*, 401 U.S. 424, 428 (1970) (noting that the question of application of Title VII to disparate impacts in the absence of intentional discrimination was one of first impression).

44 Id. at 431.

45 Id. at 426–27.

46 Id. at 427.
passed two professionally-prepared aptitude tests. Incumbent employees who lacked a high school education could transfer to an inside job only by passing two tests, “[n]either [of which] was directed or intended to measure the ability to learn to perform a particular job or category of jobs.” Notably, those who already had inside jobs (whites) were not subject to these requirements. In short, the requirements operated to disqualify blacks from inside jobs at a substantially higher rate than white applicants.

Observing that Congress had intended Title VII to provide “that tests or criteria for employment or promotion may not provide equal- ing of opportunity merely in the sense of the fabled offer of milk to the stork and the fox,” the Court set out a seemingly simple test for determining whether facially race-neutral practices were unlawful: “The touchstone is business necessity. If an employment practice which operates to exclude [minorities] cannot be shown to be related to job performance, the practice is prohibited.” A lack of evidence of discriminatory intent—and even evidence of anti-discriminatory intent—was of no consequence, because “Congress directed the thrust of [Title VII] to the consequences of employment practices, not simply the motivation.”

Importantly, the Court’s analysis did not turn on whether the challenged employment practice bore indicia of “subjectivity.” Indeed, the problem existed not in the subjective judgments about each applicant, but in a failure to consider each applicant individually: “What Congress has commanded is that any tests used must measure

47 Id. at 427–28

48 Id. at 428. Because “[t]he requisite scores used for both initial hiring and transfer approximated the national median for high school graduates,” the Court concluded that these tests were “more stringent than the high school requirement, since they would screen out approximately half of all high school graduates.” Id. at 428 & n.3.

49 See id. at 431–32.

50 See id. at 426–27, 432.

51 Id. at 431. In the fable referenced by the Court, the fox gives soup to the stork, but serves it in a shallow dish into which the stork can only place the tip of her long beak; so to return the prank, the stork serves soup to the fox in a long-necked jar. See Aesop’s Fables: The Stork and the Fox, in 17 Harvard Classics 17–18 (Charles W. Eliot ed., P.F. Collier & Son 1914) (as retold by Joseph Jacobs).

52 Griggs, 401 U.S. at 431 (emphasis added).

53 Id. at 432 (emphasis added).

54 See id. at 429–36. The terms “subjective” and “objective,” and their derivatives (in the adjectival sense) do not appear in the Griggs opinion.
the person for the job and not the person in the abstract.” To that end, the Court observed, “Congress had placed on the employer the burden of showing that any given requirement must have a manifest relationship to the employment in question.” Duke Power’s testing and diploma requirements “were adopted . . . without meaningful study of their relationship to job-performance ability.” Moreover, incumbent inside-job employees continued to work satisfactorily and receive promotions despite the fact that they would not have been able to satisfy the new requirements. Each requirement therefore failed “to bear a demonstrable relationship to successful performance of the jobs for which it was used.” Because the consequence of the diploma and testing requirements was continued exclusion of blacks from inside jobs, the Court held that Duke Power had violated Title VII.

For almost all of the next two decades, the Title VII standard continued to govern disparate impact cases. Courts following Griggs began requiring defendant-employers to show their challenged practice was a business necessity and that no acceptable alternative policies or practices existed “which would better accomplish the business purpose advanced, or accomplish it equally well with a lesser differential racial impact.”

But in 1989, the Supreme Court modified the Title VII standard in Wards Cove Packing Co. v. Antonio. As the Third Circuit explained, Wards Cove held that

a challenged discriminatory employment practice need not be necessary in the sense of “essential” or “indispensable” to pass muster under Title VII; rather, the practice must merely “serve, in a signifi-

55 Id. at 436 (emphasis added).
56 Id.
57 Id. at 431.
58 See id. at 431–32.
59 Id. at 431. Duke Power had also failed to make any showing that its requirements—even if characterized as long-range requirements taking into account “capability for the next succeeding position or related future promotion”—would fulfill a genuine business need. Id. at 432.
60 Id. at 431, 436.
62 Robinson v. Lorillard Corp., 444 F.2d 791, 798–800 (4th Cir. 1971) (holding that the employer’s seniority system violated Title VII).
cant way, the legitimate employment goals of the employee.” Even more significant was that [Wards Cove] shifted the burden of proof from the employer to the employee.64

The decision is also read as having replaced the business necessity burden with a far less burdensome “business justification” test.65

Congress reacted negatively to this stark departure from Griggs, and quickly passed legislation66 intended to abrogate Wards Cove and codify the Griggs definition of business necessity “as clarified and developed in the Supreme Court’s pre-Wards Cove jurisprudence.”67 Specifically, the relevant provisions of the Civil Rights Act of 1991 revived both the employer’s business necessity burden and the plaintiff’s ability to win by showing the availability of a less-disparately-impacting alternative practice.68 It is important to recognize, however, that the new statute addressed only “unlawful employment practice[s] based on disparate impact.”69 Congress took no similar action regarding housing practices.

Indeed, the Title VII standard introduced by Griggs and codified by Congress has not been uniformly applied by the few circuits that have addressed the question of disparate impact claims against insurers under the FHA.70 Instead, it appears that “the relevant standards for a disparate impact claim under the [FHA] are . . . rather fluid.”71 And while unofficial statements by HUD and the United States Attorney General have “reaffirmed the federal government’s commitment to use the disparate impact test,”72 HUD has not promulgated any regulations specifically clarifying the FHA’s application to insurance.

Instead of the Title VII standard, some circuits have employed a multi-factor balancing test for disparate impact claims brought under

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65 See, e.g., Stanton, supra note 16, at 186.
67 El, 479 F.3d at 241.
69 Id. § 2000e-2(k)(1)(A) (emphasis added).
70 See, e.g., cases cited supra note 36.
72 Stanton, supra note 16, at 181–82.
the FHA.73 In *Metropolitan Housing Development Corp. v. Village of Arlington Heights*, the Seventh Circuit recognized that “[c]onduct that has the necessary and foreseeable consequence of perpetuating segregation can be as deleterious as purposefully discriminatory conduct.”74 The court therefore approved the disparate impact theory’s application to FHA claims.75 But instead of trumpeting the Title VII burden-shifting and business necessity lingo, the court analyzed four factors to determine whether “conduct that produces a discriminatory impact but which was taken without discriminatory intent will violate [the FHA].”76 These factors are:

(1) how strong is the plaintiff’s showing of discriminatory effect; (2) is there some evidence of discriminatory intent . . . ; (3) what is the defendant’s interest in taking the action complained of; and (4) does the plaintiff seek to compel the defendant to affirmatively provide housing for members of minority groups or merely to restrain the defendant from interfering with individual property owners who wish to provide such housing.77

While disparate impact claims doubtless are attractive to plaintiffs because they allow a discrimination case to proceed even without direct evidence of intent,78 such plaintiffs need not rely on the disparate impact theory. Even without explicit direct proof, plaintiffs can establish the defendant’s intentional discrimination through the use of a burden-shifting test articulated by the Supreme Court in *McDonnell–Douglas Corp. v. Green*.79 One scholar has summarized this test as follows:

73 See id. at 185 (citing Keith v. Volpe, 858 F.2d 467, 483 (9th Cir. 1988); Arthur v. City of Toledo, 782 F.2d 565, 575 (6th Cir. 1986); Smith v. Town of Clarkton, 682 F.2d 1055, 1065 (4th Cir. 1982); Metro. Hous. Dev. Corp. v. Vill. of Arlington Heights, 558 F.2d 1283, 1290 (7th Cir. 1977)); cf. Williams, supra note 3, at 314 (asserting that this multi-factor test “has been most commonly used in municipal zoning cases”).
74 558 F.2d at 1289.
75 Id.
76 Id. at 1290.
77 Id.
78 See, e.g., United States v. Real Estate Dev. Corp., 347 F. Supp. 776, 783 (N.D. Miss. 1972) (recognizing that defendants are unlikely to have left a trail of evidence that would reveal their conduct to have been motivated by racial prejudice).
A prima facie housing discrimination case is shown when the plaintiff proves: (1) that he or she is a member of a racial minority, (2) that he or she applied for and was qualified to . . . purchase certain property or housing, (3) that he or she was rejected and/or treated differently, and (4) that the housing or . . . property remained available thereafter. . . .

The defendant, in turn, must show some legitimate, nondiscriminatory reason for the disparate treatment. In response, the plaintiff must show that the proffered reason is a pretext that masks discrimination. Whether the purported nondiscriminatory reason for the disparate treatment is a pretext is a factual issue for the court.\textsuperscript{80}

The salient conclusion at this point is that even if disparate impact theory is applicable to insurance practices in FHA cases, there is no meaningful consensus on how it is to be applied. As the following section explains, however, some argue that the Title VII standard is the obvious choice for adjudicating disparate insurance impacts.

B. \textit{Redlining and Credit-Based Insurance Scoring: Innocent, Incidental Impacts, or Invidious Discrimination?}

Fair housing advocates take issue with a number of insurance underwriting and rating techniques that, despite being race-neutral on their face, tend to affect minorities more so than whites.\textsuperscript{81} This section first identifies these challenged techniques and then describes the arguments for applying the Title VII standard to disparate impact claims arising from the results of these techniques.

Insurance “redlining” is the most consistently challenged practice. In its more virulent form, redlining consisted of insurance com-

\textsuperscript{80} Stanton, \textit{supra} note 16, at 172 (footnotes omitted).

\textsuperscript{81} Some have defined “underwriting” as “the process by which companies determine whether to accept or to reject an application for insurance coverage.” John Hugh Gilmore, Note, \textit{Insurance Redlining & The Fair Housing Act: The Lost Opportunity of Mackey v. Nationwide Insurance Companies}, 34 CATH. U. L. REV. 563, 576 (1985). In this article, the term “underwriting” will sometimes be used more generally to mean both the decision to approve or deny coverage and the decision to charge a particular rate for coverage if it is offered—the latter of which is sometimes called “rating.” \textit{See}, e.g., Michael J. Miller, \textit{Disparate Impact and Unfairly Discriminatory Insurance Rates}, \textit{Casualty Actuarial Soc. E-Forum}, Winter 2009, at 276, 279, http://www.casact.org/pubs/forum/09wforum/miller.pdf; Robert Detlefsen, “\textit{Disparate Impact” Theory Provides No Support for Banning Credit Scoring in Insurance}, \textit{Legal Backgroinder}, Apr. 8, 2005, at 1, \textit{available at http://www.namic.org/pdf/050408wlfcreditscoring dispimpact.pdf}. 

panies literally drawing lines around black neighborhoods on a map and instructing agents not to sell insurance inside the lines. But when today’s commentators speak of redlining, they generally use the term to describe a race-neutral analysis by insurers that results in riskier properties (such as older homes, structures with low market values, and properties in dangerous or deteriorating locations) being either excluded from eligibility for hazard or homeowners’ coverage or more costly to insure. The reasons for this practice are clear: older homes are often more susceptible to fire and more vulnerable to wind and water damage, and their replacement cost is frequently greater than their market value. Homes in high-crime neighborhoods are more likely to be burglarized, vandalized, or otherwise damaged. But because minority homeowners are more likely to live in older, cheaper homes in high-crime locations, redlining affects minorities more pervasively than whites. Insurance redlining of this sort is race-neutral on its face, yet it results in minorities paying higher premiums than whites for homeowners’ coverage or being denied coverage altogether. This result is a textbook example of the type of disparate impact to which fair housing advocates believe Title VII standard should apply.

More recently, the use of credit scores by insurers in underwriting and pricing insurance has come under attack. As one opponent of credit-based insurance scoring has acknowledged, “the difficult issue with credit scoring is that while it has a disparate impact, it is predic-

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83 E.g., Williams, supra note 3, at 310 (“[R]edlining is . . . when insurance companies price homeowner’s insurance premiums based on crime rates, vacant buildings and the percentage of owner-occupied dwellings in a neighborhood.”); Wu, supra note 2, at 2.
84 See supra note 27 and accompanying discussion; Kaersvang, supra note 36, at 1995–97; Murray, supra note 24, at 743; Williams, supra note 3, at 310.
88 E.g., Ojo v. Farmers Grp., Inc., 565 F.3d 1175, 1178 (9th Cir. 2009) (describing allegation that “Farmers used ‘a number of undisclosed factors’ to compute credit scores and price homeowners’ insurance policies,” resulting in higher premiums for minorities), rehearing granted en banc, 586 F.3d 1108 (9th Cir. 2009), further proceedings stayed by 600 F.3d 1205 (9th Cir. 2010) (en banc); DeHoyos v. Allstate Corp., 345 F.3d 290, 293 (5th Cir. 2003) (“Appellees allege that Allstate uses a ‘credit-scoring system’ to target non-Caucasian customers for the sale of more expensive insurance policies than those directed at Caucasian customers.”); see also Williams, supra note 3, at 311–12; Wu, supra note 2, at 12.
There is a strong correlation between a person’s credit score and the risk that he will file a claim. In addition, lower credit scores correlate strongly with future account delinquencies, while higher scores are associated with healthy payment performance. Not surprisingly, insurers are sensitive to the predictive power of credit scores. The lower a person’s credit score is, the more claims he is likely to file, and the greater the amount of each loss is likely to be. Insurance companies therefore consider the individual’s personal credit score as part of generating what is often referred to as a “credit-based insurance score,” or CBIS. As a result, these insurers’ rates

89 Wu, supra note 2, at 17.
90 See Detlefsen, supra note 81, at 1 (“Insurers are interested in credit information for one specific reason: An individual’s experience managing credit is an accurate predictor of whether he will file a claim . . . and the potential size of losses.”); Miller, supra note 81, at 285 (describing credit score as a risk factor); PCI Report, supra note 3, at 1 (stating that there is a “strong correlation between one’s credit and the risk of insured loss”); Colorado Division of Insurance, Credit Scoring and Insurance Premiums—Frequently Asked Questions (Feb. 15, 2009), http://www.dora.state.co.us/insurance/consumer/2009%20docs/conscreditscoringfaq021509.pdf (“[H]ow a person manages personal finances, which is what an insurance score indicates, is a good predictor of insurance claims.”).
92 See Detlefsen, supra note 81, at 1 (“During the 1990s, a growing number of . . . insurance companies began using consumer credit information to help them decide whether to issue or renew a policy, and to establish its price.”).
94 For example, one insurance company explains that
[y]our CBIS is not the same as your personal credit score, nor is it a measure of your credit worthiness. The CBIS is a number that measures your likelihood of having an insurance claim. Studies have shown that consumers with higher CBIS have fewer and less severe losses. For this reason the CBIS is useful as a rating factor, but it is only one of many that are used.
generally indicate an inverse correlation between premiums and credit score: persons with higher scores pay lower premiums, and persons with lower scores pay higher premiums.95 This relationship reflects insurance companies’ conviction that

when an insurer acquires information that allows it to improve the accuracy of its ability to assess risk, it can more closely align the price it charges for coverage with the cost of providing that coverage. Insurers that predict claim costs better than their competitors prosper, while the least prescient end up losing money.96

To that end, insurers compete for low-risk customers by offering them lower rates.97 Insurance companies, in short, have a “market-driven incentive to accurately assess risk” that “ensures that the price of insurance will be commensurate with the level of risk that a particular policyholder presents.”98

Assessing “risk,” however, is about more than just predicting the likelihood of claims. An equally important feature of credit scores to insurance companies is that they are predictive of customers’ payment performance and their retainability.99 Policyholders’ responsibility in making full and timely payments becomes absolutely critical when evaluated in the aggregate, as the late payment or non-payment of premiums across the board would have a negative effect on the insurer’s cash flow and thus on its ability to adjust claims.100 Moreo-
ver, because credit scores are impacted by the duration or longevity of the person’s accounts, a low score warns the insurer that it may be prudent to front-load that customer’s premiums, as he or she is more likely to be “flighty,” generating less income for the insurer than would a loyal customer. Allstate Corporation’s former CEO emphasized that “the economics of insurance are driven largely by [customer] retention levels. . . . [S]ome will shop every six months in order to save a buck on a six-month . . . policy. That’s not exactly the kind of customer that we want.”

The alleged problem with credit-based insurance scoring methodology is that it disproportionately impacts racial minorities—a constitutionally and congressionally protected group that, because of its lower credit scores, finds itself paying more for insurance coverage than is paid by whites as a group. Of course, the mere fact that minorities have relatively poorer credit scores does not mean insurers

“insurance premiums are a recurring revenue stream for insurance companies, and [low credit-based insurance] scores help justify higher premiums”); Diane Levick, Hard Times Renew Focus on Using Credit Scores to Set Premiums, HARTFORD COURANT, Jan. 25, 2009, available at http://www.iericson.com/hartfordcourant.pdf (“Worsening credit for customers won’t mean a windfall for insurers, as some consumer advocates allege . . . [: instead,] [i]nsurers figure what revenue they need to cover claims and make a profit, and using credit information just affects what proportion of the revenue will come from people with good credit, as opposed to bad credit.”).

Letter from Thomas Quinn, Vice President, Fair Isaac Corporation, to Jennifer J. Johnson, Sec’y, Bd. of Governors of the Fed. Res. Sys. 1 (Aug. 11, 2009), available at http://www.federalreserve.gov/sercs/2009/september/20090918/r-1300/r-1300_083109_22123_551515637587_1.pdf (explaining that “the age of the oldest account on file, the age of the most recently opened account, an average age of all of the accounts on file, how long it has been since a new account was opened, [and] how many new accounts have been recently opened” are all factors making up the “Length of Credit History” portion of the FICO credit score).

See, e.g., Judi Russell, Bad Credit Boosts Insurance Costs, NEW ORLEANS CITY BUSINESS, June 5, 2000, available at 2000 WLNR 4503171 (describing credit scores as useful, in the car insurance context, for “showing which applicants will probably retain their insurance over the years”); Lee Bowron, Staying in the Race: Policy Retention Affects Insurers’ Product Development, Operations, Pricing and Profitability, BEST’S REV., Dec. 1, 2001, at 73, available at 2001 WLNR 12637920 (explaining the insurer’s interest in charging higher premiums to demonstrably transient customers and the corresponding interest in attracting loyal customers with preferred rates, and observing that “[e]ven small improvements in retention can make large improvements to profitability levels”); Wu, supra note 2, at 10 (reflecting insurers’ concerns about customer retention).

Wu, supra note 2, at 10 (quoting Edward M. Liddy, Remarks at the Twenty-First Annual Strategic Decisions Conference of the Allstate Corporation (June 2, 2005)).

See sources cited supra note 88; Wu, supra note 2, at 15 (reporting that a “Missouri study found a stunning correlation between insurance scores and race”).
use those scores as a way to act out racial prejudices.\textsuperscript{105} Indeed, on the whole, credit-based scoring allows insurers to provide better coverage to more people for less money.\textsuperscript{106} More importantly, credit scores of the sort contemplated by insurance companies are themselves race-neutral. According to the Federal Reserve Board, “[c]redit-scoring systems \textit{explicitly avoid} making use of impermissible data, a fact that can be readily verified. . . . [T]he records maintained by credit-reporting agencies on the credit experiences of individuals do \textit{not} include information on personal characteristics such as race, ethnicity, sex, and marital status.”\textsuperscript{107} Furthermore, the Board reports that credit characteristics do not serve as a “proxy” for race.\textsuperscript{108}

Nevertheless, invoking the Title VII standard of analysis for disparate impact claims, opponents of credit-based insurance scoring practices raise a series of troubled contentions. First, they argue that the Title VII standard is appropriate because insurers should find it easy to prove the correlation between their risk factors and actual risk.\textsuperscript{109} Second, they believe the notion that any practices resulting in more expensive insurance for minorities—whether justified by the fact that their homes are in gangland or that their credit scores and other financial history are poor—are not a “business necessity” unless the insurer can show a very narrow premiums-to-losses ratio.\textsuperscript{110} In other words, the theory is that if the risks warned of by the insurer’s meth-

\begin{itemize}
\item \textsuperscript{105} \textit{Cf.} Wu, supra note 2, at 2 n.3 (“[U]nscrupulous sellers [often] target minority consumers for higher priced credit, not because of overt bias, but stemming from a perception that these consumers are more vulnerable to ‘sucker pricing.’”).
\item \textsuperscript{106} \textit{E.g.}, Allstate Insurance Company, \textit{Why Does Allstate Use Credit Information to Evaluate Insurance Policies?} 2 (2001), available at http://www.michigan.gov/documents/cis_ofis_allstate_31814_7.pdf (“At Allstate, we’re finding that our use of credit information enables us not only to offer lower premiums to many customers who otherwise would pay more for their insurance, [but] also . . . to provide insurance coverage to more . . . homeowners than we previously could.”).
\item \textsuperscript{107} Federal Reserve, supra note 91, at 37 (emphasis added).
\item \textsuperscript{108} See \textit{id.} at 101 (“For race and ethnicity, almost all of the credit characteristics . . . are more correlated with performance than with demographic characteristic . . . regardless of the specific group considered.”).
\item \textsuperscript{109} See, e.g., Kaersvang, supra note 36, at 2013 (arguing that “[i]f accurate classification of risk is as important to the insurance business as insurers claim, it seems unlikely that insurers would rely on risk assessment factors without knowing how these factors actually correlate to risk,” and that “[a]lthough the data may not be easy for insurers to gather, they have much more ready access to this information than do their customers”).
\item \textsuperscript{110} \textit{E.g.}, Patrick Ojo, supra note 39, at 34 (announcing that in order “[t]o prove business necessity, Farmers must prove that its credit factors correlate to risk of loss”); Wu, supra note 2, at 9.
\end{itemize}
ods never materialize into losses, a premium hike disproportionately affecting minorities that is predicated on risk avoidance is not the product of business necessity.\textsuperscript{111} Similarly, some have opined that “unfair discrimination within the context of the FHA [should] be understood today to mean any differentials in insurance classifications based upon membership in a protected class that have no grounding in sound actuarial data.”\textsuperscript{112} Accompanying these arguments is the suggestion that because insurance companies make “excessive” profits on the whole, cost-saving and moneymaking practices like credit or property location-based ratemaking cannot possibly serve legitimate business interests.\textsuperscript{113}

At the core of all these arguments is the belief that an “innocent” insurer will charge no more than is necessary to break even on its losses and that it should easily be able to satisfy the business necessity prong of the Title VII standard. That belief, unfortunately, does not properly recognize how conceptually inapt the business necessity requirement is. Moreover, these advocates have made no effort to articulate how an insurance company might ever survive the requirement that there be no less-disparately-impacting alternative.\textsuperscript{114}

C. Case Illustration: Ojo v. Farmers Group, Inc.

The Ninth Circuit recently dealt with a disparate impact challenge to credit-based pricing of homeowners’ premiums brought under the FHA.\textsuperscript{115} Patrick Ojo, an African-American attorney who had never made a claim on his homeowners’ policy, found that Farmers had raised his premium by nine percent.\textsuperscript{116} Upon inquiring as to why his rate had increased, Ojo was told by Farmers that “the increase was

\textsuperscript{111} See Detlefsen, \textit{supra} note 85, at 40 (pointing out that “aggressive regulators and private litigants will demand, and courts may agree, that business justification must be established by statistical studies that demonstrate unequivocally the relationship between the criteria in question and risk”) (citing Richard M. Esenberg, \textit{Courts Should Strike Down HUD’s Attempts to Regulate Property Insurance}, \textsc{Legal Backgrounder}, Dec. 15, 1995).

\textsuperscript{112} Stanton, \textit{supra} note 16, at 143–44 (internal quotation marks omitted). \textit{But see} Patrick Ojo, \textit{supra} note 39, at 35 (anticipating that “the parties’ main focus [at trial] would be on the discriminatory effect of credit factors \textit{regardless of actuarial soundness}” (emphasis added)).

\textsuperscript{113} \textit{E.g.}, Wu, \textit{supra} note 2, at 1 (reporting, with alarm, that “[c]redit scoring may have benefited insurers . . . [by] somewhere in the neighborhood of $67 billion from 2003 to 2006”).

\textsuperscript{114} The likely reasons for this are addressed at length \textit{infra} Part IV.B.

\textsuperscript{115} Ojo v. Farmers Grp., Inc., 565 F.3d 1175 (9th Cir. 2009), \textit{rehearing granted en banc}, 586 F.3d 1108 (9th Cir. 2009), \textit{further proceedings stayed by} 600 F.3d 1205 (9th Cir. 2010) (en banc).

\textsuperscript{116} \textit{Id.} at 1179.
due to ‘unfavorable credit information’ obtained through the company’s automated credit scoring system.”117 In response, he filed a race discrimination suit “on behalf of himself and all others similarly situated.”118

The gravamen of Ojo’s complaint was this:

Over the years, Farmers has employed geographical distinctions and various other artifices to identify and target minorities for the purpose of charging minorities higher premiums than the premiums charged to similarly situated Caucasians. Specifically, . . . the credit scoring system is a formula that uses a number of undisclosed factors to produce a credit score for each applicant for homeowners’ property and casualty coverage. . . . [F]urther, . . . minorities as a group have lower credit scores than whites, and . . . the effect of Farmers’ credit scoring system is that minorities are charged disparately higher prices in violation of the federal FHA.

. . . Farmers has vigorously defended its use of this credit scoring system as actuarially sound, whilst keeping secret the formula, the actuarial basis for the formula, and the specific credit factors which impact a policyholder’s score. The result is that the price an individual pays for a policy is largely dependent on a secret credit score allegedly justified by secret actuarial information. As a result of Farmers’ unlawful practices, Ojo and those similarly situated have lost and face losing millions of dollars in premiums paid as a result of overcharges due to racial discrimination.119

His claim thus featured a unique twist. Instead of attacking Farmers’ credit scoring per se, Ojo challenged only its use of the “undisclosed factors” that produced the score.120 The Title VII standard would have required only that he allege a facially neutral practice exerting a disparate impact on members of a protected class. So why did Ojo elect to grapple with only one alleged component of the credit scoring process? To avoid potential reverse-preemption of his claim by the McCarran–Ferguson Act.121

117 Id.
118 Id. at 1177.
119 Id. at 1179 (alterations omitted) (emphasis added) (footnotes omitted) (internal quotation marks omitted).
120 See id. at 1183.
121 See id. at 1992 (Bea, J., dissenting) (“To avoid the application of the McCarran–Ferguson Act, Ojo needed to have alleged a practice that violated not only federal law, but
Under that Act, when a state has decided to permit a particular insurance practice, federal laws like the FHA cannot be used to invalidate or impair that state’s law (making the legal insurance practice illegal) unless the federal statute explicitly relates to the business of insurance. In this case, Texas insurance regulations arguably permitted disparate impacts on minorities resulting from credit-based scoring or similar uses of other facially nondiscriminatory factors. Because Ojo knew that if he were to challenge Farmers’ credit scoring practices per se he would risk having his claim reverse-preempted by the McCarran–Ferguson Act, he attempted to distinguish the use of “secret” factors in credit scoring from credit scoring itself.

This distinction had not persuaded the district court. It interpreted Texas law as allowing something the FHA (according to Ojo) forbid, so the McCarran–Ferguson Act precluded Ojo’s FHA claim. But the Ninth Circuit reversed the district court’s dismissal, confident that “the Texas legislature intended to prohibit insurers from engaging in ‘unfair discrimination.’” The court also announced that disparate impact claims were cognizable under the FHA even if those impacts resulted from the facially nondiscriminatory policies of homeowners’ insurance providers. It concluded that because Texas law did not permit Farmers’ alleged practices, allowing a claim to proceed under the FHA against those practices would not impair state law, but rather, complement it. The Ninth Circuit thus

also Texas law.”); cf. Saunders v. Farmers Ins. Exch., 537 F.3d 961, 969 (8th Cir. 2008) (holding that under the McCarran–Ferguson Act, Missouri insurance regulations preempted claims brought under the FHA against the defendant insurance company).

122 See 15 U.S.C. § 1012(b) (2006) (“No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance . . . .”).

123 See Ojo, 565 F.3d at 1191 (Bea, J., dissenting) (“In effect, Texas law has already decided that the use of credit scores to price homeowners insurance constitutes a valid business necessity; a defendant does not have to prove such business necessity in each case.”).

124 Patrick Ojo, supra note 39, at 4 (arguing to the Ninth Circuit that his complaint “did not challenge credit scoring per se, but rather the underlying factors that produce such [disparate] impacts”).


126 Ojo, 565 F.3d at 1189 (majority opinion) (relying on Tex. Ins. Code § 559.051 (Vernon 2005)).

127 See id. at 1180–81.

128 Id. at 1187 (“Because Texas law is . . . bereft of evidence that Texas ‘encourage[s] or condone[s] racial distinctions in the provision of . . . insurance,’ . . . we hold that the federal FHA
reversed and remanded the case without occasion to discuss what standard it might use in applying the disparate impact theory against Farmers. Instead, the ruling turned on reverse-preemption—which Ojo had succeeded in avoiding.

Notice what he did in the process. In evading McCarran–Ferguson reverse-preemption, Ojo had very nearly styled his claim as a disparate treatment claim, albeit one that lacked an essential allegation: that he and other class members were treated differently because of race. The substance of Ojo’s claim was that Farmers had done something “unknown” that had harmed him. Very shrewdly, he did not articulate why Farmers was doing this unknown thing (e.g., he might have said that it was because he was black). And he did not specify why Farmers was keeping its credit-scoring algorithms secret—because if he had, his FHA claim might easily have been interpreted by the Ninth Circuit as one for disparate treatment, not disparate impact. If Ojo’s problem with the “unknown,” “secret” nature of the algorithm was that it allowed Farmers to perpetrate intentional discrimination undetected, then his complaint was really about blacks being treated differently because of race. Discriminatory treatment like this is not the sort of “facially neutral practice[ ]” that Ojo knew he was required to allege in a disparate impact claim.

So would Ojo have prevailed at trial under a disparate treatment analysis? Not unless he produced evidence (or persuaded a jury) that

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129 See id. at 1192 (Bea, J., dissenting).
130 Id. (characterizing the majority as holding that “when a plaintiff pleads the defendant is doing something unknown to harm the plaintiff, the court can fill in the missing facts and presume the plaintiff has pleaded the facts necessary to state a claim for relief,” and arguing that “[t]his holding could have far reaching implications because now the great unknown would conceivably save every complaint from a motion to dismiss”).
131 Patrick Ojo, supra note 39, at 11–12 (citing Connecticut v. Teal, 457 U.S. 440, 446 (1982), for the proposition that Ojo was required to “allege that one or more of defendant’s facially neutral practices causes a significantly adverse and disproportionate impact on a protected class”). As Justice O’Connor stated, the plaintiff’s burden in establishing a prima facie [disparate impact] case goes beyond the need to show that there are statistical disparities . . . . The plaintiff must begin by identifying the specific . . . practice that is challenged. . . . Especially in cases where [the defendant has] combine[d] subjective criteria with the use of more rigid standardized rules or tests, the plaintiff is in our view responsible for isolating and identifying the specific . . . practices that are allegedly responsible for any observed statistical disparities.

Watson v. Fort Worth Bank & Trust, 487 U.S. 977, 994 (1988) (plurality opinion) (emphasis added); cf. id. at 1000 (Blackmun, J., concurring in part and concurring in the judgment).
Farmers actually used race as a factor in its credit-based scoring system, or something else as a pretext for race. In contrast, if Ojo’s disparate impact claim ever proceeds to trial, Farmers will be put in the distasteful position of having to prove a negative, and it will likely have to compromise its proprietary risk assessment formula in the process. This formula likely cost Farmers millions of dollars to develop, and it surely has an interest in keeping its trade secrets out of the courthouse. Thus, even if the insurer would ultimately win the lawsuit, its incentive to settle a case like this is quite strong for practical reasons. Perhaps this incentive is why another large insurance company settled with the class action plaintiffs in *DeHoyos v. Allstate Corp.* Those plaintiffs brought a more straightforward disparate impact claim than did Patrick Ojo, alleging that Allstate’s credit-based insurance scoring system “placed non-Caucasian applicants into more expensive policies than those polices into which Caucasian applicants are placed.”

While neither *Ojo* nor *DeHoyos* reached the point where a court actually applied the Title VII standard in addressing the plaintiffs’ disparate impact claims, it is clear that the courts assumed it would apply when the cases finally proceeded on their merits. But the applicability of the Title VII standard to disparate insurance impacts should cease to be assumed. Unless that standard is modified to remedy its legal, conceptual, and practical flaws with regard to insurance, it should be rejected.

132 See *infra* text accompanying notes 78–80.

133 An en banc rehearing is pending in the Ninth Circuit Court of Appeals.

134 See *Restatement of Torts* § 757 cmt. b (1939) (defining trade secret as “[a]ny formula, pattern, device or compilation of information which is used in one’s business and which gives him an opportunity to obtain an advantage over competitors who do not know or use it”); *eti g. baranoff, risk management and insurance* 53–62, 79 (2004).

135 345 F.3d 290 (5th Cir. 2003); see also Becky Yerak, *Allstate Settles Suit on Credit Score Use*, *Chicago Tribune*, June 3, 2006, *available at* 2006 WLNR 9524804 (reporting that Allstate “agreed to change the way it uses credit information to price insurance” as part of the class action settlement, yet also that Allstate “does not know how many customers might be eligible for the settlement because [it] doesn’t know how many of its customers are black or Hispanic” (emphasis added)).

136 *DeHoyos*, 345 F.3d at 293 (internal quotation marks omitted).

137 See *Ojo v. Farmers Grp., Inc.*, 565 F.3d 1175, 1191 (9th Cir. 2009) (Bea, J., dissenting), *rehearing granted en banc*, 586 F.3d 1108 (9th Cir. 2009), *further proceedings stayed by* 600 F.3d 1205 (9th Cir. 2010) (en banc); *DeHoyos*, 345 F.3d at 297 n.5.
III. Legal Objections to Applying the Title VII Standard in Disparate Insurance Impacts Cases

Courts, commentators, and litigants seeking to impose FHA liability on insurance companies for disparate impacts have adopted an oversimplified set of assumptions regarding the scope of the FHA and the applicability of Title VII disparate impact principles. A closer look at the development, purposes, and components of the disparate impact theory and the FHA suggests that these assumptions are erroneous to the extent they (1) disregard the \textit{Wards Cove} standard for evaluating disparate impacts; (2) permit even the flimsiest of statistical claims—or claims without any statistics at all—to satisfy the disparate impact pleading and proof requirements; (3) interpret certain regulatory proclamations as specifically approving use of the disparate impact theory to insurers in FHA cases; or (4) ignore the Title VII standard’s potential for causing insurance companies to adopt quota-like practices. The fact that some of the following contentions would apply equally on behalf of a non-insurer FHA defendant is no discredit to them.

A. The Skeleton in the Closet: Wards Cove

In \textit{Wards Cove Packing Co. v. Antonio}, the Supreme Court modified its disparate impact theory by (1) requiring that the plaintiff—not the defendant—bear the burden of persuasion on the issue of whether a specific practice was the cause of a disparate impact and (2) relaxing the business necessity requirement such that the challenged practice need not be “essential” or “indispensable” to the defendant’s business to meet the requirement.\footnote{See 490 U.S. 642, 659–60 (1989).} But the Court’s opinion provides an additional rule, one not generally included in commentators’ summaries of the case: it gives the proper method for identifying actionable disparate impacts.\footnote{See id.} Moreover, contrary to the apparent assumptions of commentators and courts,\footnote{E.g., El v. Se. Pa. Transp. Auth., 479 F.3d 232, 241–42 (3d Cir. 2007); Stanton, \textit{supra} note 16, at 186.} the case was never congressionally superseded with respect to FHA claims and is still applicable law for disparate impacts outside the employment discrimination context.
Former employees of a salmon cannery in Alaska brought the Wards Cove suit under Title VII. The relevant allegation was that the percentage of labor-intensive positions (cannery jobs) occupied by minority employees was greater than the percentage of “skilled” positions (noncannery jobs) held by the same group. The Ninth Circuit had held that this statistic “made out a prima facie case of disparate impact.”

The Supreme Court disagreed. It held that the circuit court’s “comparison between the racial composition of the cannery work force and that of the noncannery work force, as probative of a prima facie case of disparate impact in the selection of the latter group of workers,” had “fundamentally misconceived the role of statistics in employment discrimination cases.” The Supreme Court explained:

The Court of Appeals’ theory, at the very least, would mean that any employer who had a segment of his work force that was—for some reason—racially imbalanced, could be haled into court and forced to engage in the expensive and time-consuming task of defending the “business necessity” of the methods used to select the other members of his work force. The only practicable option for many employers would be to adopt racial quotas, insuring that no portion of their work forces deviated in racial composition from the other portions thereof.

Instead, the proper basis for the initial disparate impact inquiry was a comparison of “the racial composition of the at-issue jobs and the

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141 See Wards Cove, 490 U.S. at 650.
142 See id. (“[T]he Court of Appeals relied solely on [the plaintiffs’] statistics showing a high percentage of nonwhite workers in the cannery jobs and a low percentage of such workers in the noncannery positions.”).
143 Id. at 651.
144 Id.
145 Id. at 650–51.
146 Id. at 652 (emphasis added); cf. Albemarle Paper Co. v. Moody, 422 U.S. 405, 448 (1975) (Blackmun, J., concurring) (observing that such statistical comparisons would “leave the employer little choice . . . but to engage in a subjective quota system of employment selection . . ., [which would be] far from the intent of Title VII”). In the insurance context, the Court’s apprehension with regard to quotas is confirmed by an analysis of the less-disparately impacting alternative requirement. See infra Part IV.B.
racial composition of the *qualified population* in the relevant labor market."\(^{147}\)

The Court continued, remarking that “[m]easuring alleged discrimination in the selection of [skilled] noncannery positions . . . by comparing the number of nonwhites occupying these jobs to the number of nonwhites filling cannery worker positions [was] nonsensical.”\(^{148}\) This was because “[i]f the absence of minorities holding such skilled positions is *due to a dearth of qualified nonwhite applicants,*” the defendant’s challenged practices are not responsible for any disparate impact experienced by minorities.\(^{149}\) The Court concluded:

As long as there are no barriers or practices deterring qualified nonwhites from applying for noncannery positions, if the percentage of selected applicants who are nonwhite is not significantly less than the percentage of qualified applicants who are nonwhite, the employer’s selection mechanism probably does not operate with a disparate impact on minorities.\(^{150}\)

Having thus “barred the use of internal workforce comparisons,”\(^{151}\) the Court articulated a strong causation requirement for discrimination. No longer would showing a mere “bottom line . . . racial imbalance” be enough to make out a case of disparate impact; rather, the plaintiff would have to demonstrate that the challenged practice itself—as opposed to the plaintiff’s lack of qualification—was, in isolation, the impact’s cause.\(^{152}\) Further, nowhere in its opinion did the Court question the employer’s determination of what rendered a given person “qualified” to hold a noncannery position, or invite lower courts to undertake this inquiry.

For the plaintiffs in *Wards Cove*, the Court’s explanation of the law required showing, at a minimum, that the racial makeup of the

\(^{147}\) *Wards Cove*, 490 U.S. at 650–51 (alterations omitted) (emphasis added) (internal quotation marks omitted).

\(^{148}\) *Id.* at 651 (citation omitted).

\(^{149}\) *Id.* at 651–52 (emphasis added).

\(^{150}\) *Id.* at 653 (citation omitted).

\(^{151}\) *Id.* at 661–62 (Blackmun, J., dissenting) (lamenting, in addition, the Court’s decision to “require[] practice-by-practice statistical proof of causation”); cf. Marcel C. Garaud, Comment, *Legal Standards and Statistical Proof in Title VII Litigation: In Search of a Coherent Disparate Impact Model*, 139 U. PA. L. REV. 455, 456 (1990) (complaining that the *Wards Cove* standard “require[es] that the plaintiff present an air-tight statistical case, thus essentially insulating the defendant employer from disparate impact claims”).

\(^{152}\) See *Wards Cove*, 490 U.S. at 657 (original emphasis omitted)
qualified labor pool was not properly reflected in the makeup of the employer’s “skilled” workforce. Applied to insurance-related FHA claims like that of Patrick Ojo, the *Wards Cove* standard would require plaintiffs to establish a disparity between the “racial composition of [the persons actually] qualified [for lower rates] in the [homeowners’ insurance] market and the persons [paying the lower rates].” The practical implications of applying the *Wards Cove* standard for disparate insurance impacts are considered in Part V.

The question at this juncture is whether the case is still good law with respect to disparate insurance impacts. The answer is yes. Although Congress quickly succeeded in abrogating *Wards Cove*, it did so only with respect to employment discrimination claims under Title VII, not housing (or insurance) discrimination claims under the FHA. The Civil Rights Act of 1991 only amended the statutory text of Title VII, and by its language applies only to “unlawful employment practice[s] based on disparate impact.” If one must assume Title VII jurisprudence governs disparate impact claims under the FHA, then one must also assume that entire body of that jurisprudence applies—including *Wards Cove*—to the extent Congress has failed specifically to nullify it.

The *Wards Cove* standard, with its significant modifications to the *Griggs* doctrine of disparate impacts, is thus the skeleton in the closets of those who would seek to impose the current Title VII standard on homeowners’ insurance companies for creating disparate impacts by classifying and pricing their products based on risk-relevant, customer-specific information such as the proximity of their home to fire stations or their credit history.

B. *Disparate Insurance Impacts Should Be Pledged with Statistics and Proven with Significance*

The goal of the FHA was to increase housing opportunities for minorities. Specifically, the statute was intended to “prevent the
increase of segregation, in ghettos, of racial groups.”158 It thus represented Congress’s “strong national commitment to promoting integrated housing.”159 These objectives are recognized to some degree by the requirement that a plaintiff bringing a disparate impact claim must “allege that one or more of defendant’s facially neutral practices causes a significantly adverse and disproportionate impact on a protected class.”160 But the Title VII standard—at least as it was employed by the Ninth Circuit in *Ojo v. Farmers Group, Inc.*—makes it too easy for litigious persons to embroil insurance companies in expensive lawsuits, the costs of which are ultimately borne by insureds. In so doing, it goes beyond the purposes of the FHA. First, it appears to protect complaints against a Rule 12(b)(6) dismissal without requiring a single allegation from the plaintiff as to the numerical extent of the alleged disparity. Second, it allows claims to survive summary judgment even if the underlying disparity is no more significant than the average minority’s coverage costing nominally more than the average non-minority’s coverage.

The first problem is the flimsy pleading requirements of the Title VII standard. Recall that Patrick Ojo alleged nothing more than that Farmers Group had hiked his premium by nine percent and that minorities generally “received less favorable pricing than Caucasians as a result of [Farmers’] credit evaluative and scoring system.”161 Neither in his complaint nor in his subsequent briefs did Ojo assert any statistical data indicating the extent or severity of the disparity allegedly suffered by “minorities” other than himself.162 Of course, the Title VII standard as interpreted by the Ninth Circuit did not require him to do so, given that Farmers had moved for dismissal on various Rule 12 grounds instead of for summary judgment.163 As Ojo

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162 *See id.; Patrick Ojo, supra* note 39.

163 *See Ojo v. Farmers Grp., Inc.*, 565 F.3d 1175, 1178 (9th Cir. 2009), *rehearing granted en banc*, 586 F.3d 1108 (9th Cir. 2009), *further proceedings stayed by* 600 F.3d 1205 (9th Cir. 2010) (en banc).
rightfully boasted, he was not required to “plead” his prima facie case.\textsuperscript{164}

But as Farmers argued in its briefs to the Ninth Circuit, Ojo \textit{should} have been required to allege more than he did.\textsuperscript{165} Because the Title VII standard will ultimately saddle the defendant insurer with the burden of proof, it is unfair to permit claims involving insignificant, nominal disparities—or worse, claims lacking any assertion of fact by which the disparity might be judged significant—to survive a Rule 12(b)(6) dismissal.\textsuperscript{166} It also bears noting that, questions of fairness aside, “[e]ven when read in the light most favorable to [Ojo], the only \textit{facts} alleged in the complaint merely establish that as a result of Farmers’ use of risk assessment scoring, [his] homeowner’s premiums increased by 9%.”\textsuperscript{167} Such insignificant allegations state no claim for which relief can be granted, as they do not “raise a right to relief above the speculative level.”\textsuperscript{168}

The second problem concerns measuring the meaningfulness of the disparity at issue. The Title VII standard’s requirement that the proven disparity be “\textit{significantly} discriminatory”\textsuperscript{169} appears to lack teeth because even inconsequential disparities may survive summary judgment. Arguably, any disparity-based claim should concern an adverse consequence whose nature \textit{and magnitude} are repugnant to the purposes of the applicable civil rights statute. Perhaps this concept is implicit in the trailblazing \textit{Griggs v. Duke Power Co.} case, where the Supreme Court justified its newly-minted disparate impact

\begin{footnotesize}
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\item[164] Patrick Ojo, \textit{ supra } note 39, at 9 (citing \textit{Teal}, 457 U.S. at 446; Edwards v. Marin Park, Inc., 356 F.3d 1058, 1061 (9th Cir. 2004)).
\item[165] See Answering Brief of Appellees Farmers Grp., Inc. et al. at 51–54, \textit{Ojo}, 565 F.3d 1175 (No. 06-55522).
\item[166] See id. at 70 (citing Zahran \textit{ex rel.} Zahran v. N.Y. Dep’t of Educ., 306 F. Supp. 2d 204, 212 (N.D.N.Y. 2004) (“No allegations whatsoever have been offered, neither in the form of statistical nor anecdotal evidence, as support for the alleged disparate impact. Even at the liberal pleading phase of the litigation, [a] . . . bare, conclusory allegation cannot suffice.”); Kaplan v. Cal. Pub. Employees’ Ret. Sys., No. C 98-1246 CRB, 1998 WL 575095, at *6 (N.D. Cal. Sept. 3, 1998) (dismissing disparate impact claim with prejudice where plaintiff “has relied on wholly conclusory allegations at the pleading stage while hoping to find data to support his claim through discovery”)).
\item[167] Answering Brief, \textit{ supra } note 165, at 53.
\item[169] \textit{Teal}, 457 U.S. at 446 (emphasis added); \textit{see also } id. at 448 (describing “non-job-related barrier[s]” that have a “\textit{significant} adverse effect on minorities” as unlawfully discriminatory (emphasis added)); Patrick Ojo, \textit{ supra } note 39, at 9.
\end{enumerate}
\end{footnotesize}
theory by arguing that Title VII was directed at giving plaintiffs relief from the consequences of discriminatory employment practices, not the motivations of such practices. Not surprisingly, federal guidelines advise employers that disproportionate adverse impacts on protected classes will not be viewed as discriminatory unless they are “significant,” and even provide formulae for measuring significance.

Similarly, the FHA’s purpose is to ensure housing opportunities and to prevent inroads on integrated housing. As the Seventh Circuit recognized in Arlington Heights, the purpose behind applying the disparate impact theory to the FHA is to assail “[c]onduct that has the necessary and foreseeable consequence of perpetuating segregation.” Fifteen years later, the same court iterated that the FHA is concerned with insurance practices “that effectively preclude ownership of housing because of the race of the [person].” Arguably, therefore, a differential in homeowners’ coverage prices that rises only to the level of irritation or inconvenience—as opposed to

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170 See Griggs v. Duke Power Co., 401 U.S. 424, 436 (1970). Recall that in Griggs the consequence suffered by minorities was that they were altogether barred from obtaining or being promoted to “inside” jobs. See id. at 426. Such a complete denial of employment opportunity as this clearly cannot be incrementalized. Yet Title VII disparate-impact plaintiffs must nevertheless offer “statistical evidence of a kind or degree sufficient to show that the practice in question has caused the exclusion of applicants for jobs or promotion because of their membership in a protected group.” Scales v. J.C. Bradford & Co., 925 F.2d 901, 908 (6th Cir. 1991) (internal quotation marks omitted). In Scales, the plaintiff “introduced statistical studies . . . which concluded that it took females longer than males to be promoted at Bradford” and which “consisted of taking the average length of time it took both males and females to be promoted at Bradford to the positions of vice-president and broker representative.” Id. “These averages revealed that it took males an average of 5.83 years to be promoted to vice-president whereas it took females an average of 12.33 years,” and that “[t]o be promoted to the position of broker representative, it took males on average 2.38 years whereas it took females 4.75 years.” Id. Portions of this data persuaded the court to reverse what was effectively the district court’s vitiation of the plaintiff’s disparate impact claim. See id. at 909.

171 See, e.g., Miller, supra note 81, at 281. According to Miller, Equal Employment Opportunity Commission guidelines instruct that [an] adverse impact is considered to be significant only when the “4/5’s Rule” is failed. For example, if 60% of the job applicants in the majority class are hired and only 50% of the job applicants in the minority class are hired, the difference in impact is considered not significant and not discriminatory. This is because the hiring rate of the minority class is more than 80% of that of the majority class.

172 See supra text accompanying notes 10–16 (discussing statute’s aim).


preventing the person from being able to afford the coverage entirely or from buying the home of his choice—is not the sort of consequence the FHA was designed to combat. In short, an alleged disparity in the availability or price of property insurance should not be deemed “significant” enough to survive summary judgment unless it is shown, in measurable terms, to be so severe that it is tantamount to a denial of coverage for the affected group, or actually denies the group the “opportunity” to obtain or keep its preferred housing, or otherwise has the “necessary and foreseeable consequence of perpetuating segregation.”

An argument can be made, however, that because the FHA’s language broadly prohibits discrimination in “the provision of services . . . in connection” with “the terms, conditions, or privileges of sale or rental of a dwelling,” a disparate impact need not resemble a segregation effort to support a claim. This argument finds support in a HUD regulation interpreting the FHA as making it unlawful to “provide . . . insurance differently” because of an insured’s membership in a protected class. However, resorting to HUD’s interpretation requires making questionable assumptions.

Dismissing the suggestion that “only a denial of [lender-required] insurance makes housing ‘unavailable’ under the FHA,” one commentator suggests that the Title VII standard applies to insurers because “[t]here is absolutely nothing in the [FHA’s] statutory language or legislative history . . . that could plausibly support an argument exempting insurers from disparate impact claims.” But perhaps such language is missing because neither the FHA itself nor its legislative history mentions insurance in the first place. Nor do they mention the disparate impact theory. Both the applicability of the FHA to insurers and the disparate impact theory’s application to the FHA are all creations of the judiciary. There appears to be noth-

175 See id.; Patrick Ojo, supra note 39, at 9; Stanton, supra note 16, at 155 (“[I]nsurers must remain mindful in FHA cases that ‘[t]he critical determination is whether defendant’s conduct could hinder the ability of members of a minority group to acquire a dwelling.’”).
177 24 C.F.R. § 100.70(d) (2010).
178 Stanton, supra note 16, at 155 (citing United Farm Bureau Mut. Ins. Co. v. Metro. Human Relations Comm’n, 24 F.3d 1008, 1014 n.8 (7th Cir. 1994)).
179 Id. at 179.
ing to keep the judiciary from applying these inventions differently to different types of defendants.  

C. HUD and an Unprincipled Assumption

Courts that have addressed disparate impact claims under the FHA have pointed to a regulatory interpretation of the statute in holding that it applies to homeowners’ insurance underwriting.  

The problem is that although 24 C.F.R. § 100.70 does explicitly bring housing-related insurance within the ambit of the FHA generally, it does not provide that *disparate impact* analysis applies to insurers for such purposes.  

In reading this regulation, however, litigants and commentators appear to have assumed that because the FHA generally applies to insurance, the disparate impact theory—and specifically the Title VII standard for applying it—applies to insurance as well.

The relevant language of the regulation states simply that “[p]rohibited activities [under the FHA] include . . . [r]efusing to provide municipal services or property or hazard insurance for dwellings or providing such services or insurance differently because of race, color, religion, sex, handicap, familial status, or national origin.” This language cannot be read as “ban[ning] . . . disparate impact discrimination in the sale of property insurance.”  

 Anything done “because of race” is, by definition, a facially discriminatory practice—which is not what the disparate impact theory was designed to address. Indeed, in at least one FHA case against an insurer, HUD

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181 See, e.g., Graoch Assocs. #33 v. Louisville/Jefferson County Metro Human Relations Comm’n, 508 F.3d 366, 389 (6th Cir. 2007) (Moore, J., concurring in part and dissenting in part) (observing that “the lead opinion applies factors from a case concerning a public defendant to cases against private defendants, without explaining why they are transferable”).

182 See, e.g., Ojo v. Farmers Grp., Inc., 565 F.3d 1175, 1185 (9th Cir. 2009); Nationwide Mut. Ins. Co. v. Cisneros, 52 F.3d 1351, 1354 (6th Cir. 1995); NAACP v. Am. Family Mut. Ins. Co., 978 F.2d 287, 300 (7th Cir. 1992); Stanton, supra note 16, at 152, 155 (referring to the regulation in the context of applying the FHA to insurers, interpreting it as overruling *Mackey v. Nationwide Ins. Cos.*, 724 F.2d 419 (4th Cir. 1984)); see also *supra* notes 25–26 and accompanying text.

183 See Saunders v. Farmers Ins. Exch., 537 F.3d 961, 964 n.3 (8th Cir. 2008) (citing Cisneros, 52 F.3d at 1362) (addressing the regulation only for purposes of ripeness analysis).

184 See, e.g., Kaersvang, *supra* note 36, at 1998, 2002–04 (arguing for *Chevron* deference to HUD’s interpretation of the FHA and citing relevant cases); Williams, *supra* note 3, at 311–12 (pointing to the regulation and citing numerous cases in the context of an argument for application of the disparate impact theory to insurance); Patrick Ojo, *supra* note 39, at 11, 18.

185 24 C.F.R. § 100.70(d) (2010).


187 24 C.F.R. § 100.70(d)(4); see also *supra* discussion accompanying notes 43–61.
chose not to argue for the application of disparate impact theory when it had the opportunity to do so.\textsuperscript{188} And even though the government has since stated informally that it intends to apply the disparate impact theory to insurers, HUD has never promulgated even a single regulation explaining how insurers might avoid creating disparate impacts.\textsuperscript{189}

HUD has thus spoken only to the scope of the FHA in terms of defendants, not to alternative theories of discriminatory conduct or to the proper analytical standard used for imposing them on insurers. To the extent § 100.70 informs the arguments of those seeking to apply the Title VII standard to disparate insurance impacts, those arguments should be given less weight.

D. The Problem of Quotas

The Supreme Court generally condemns the practice of engaging in race discrimination even when such measures are intended to remedy past prejudicial treatment\textsuperscript{190} or taken in hopes of warding off potential lawsuits by minorities.\textsuperscript{191} The Title VII standard for disparate impacts, if applied in full to property insurance providers sued under the FHA, could ultimately lead a court to require the insurer to utilize a quota system as part of adopting what this article refers to as a “less-disparately-impacting alternative” to the challenged practice. As the \textit{Wards Cove} Court might have put it, thrusting the Title VII standard on an insurance company “would mean that any [insurer] who had a segment of his [price groupings] that was—for some reason—racially imbalanced” would be left with no alternative but “to adopt racial quotas, insuring that no portion of [its price groups

\textsuperscript{188} See Cisneros, 52 F.3d at 1362.

\textsuperscript{189} See Stanton, \textit{supra} note 16, at 180–81 (admitting that “HUD guidelines delineating exactly how insurers could avoid disparate impact claims might be helpful,” but proceeding to blame “HUD’s failure to promulgate such regulations” on “the insurance industry itself”).

\textsuperscript{190} See Wygant v. Jackson Bd. of Ed., 476 U.S. 267, 277 (1986) (plurality opinion) (invalidating school district’s plan to terminate non-minority teachers while retaining minority teachers with less experience); City of Richmond v. J.A. Croson Co., 488 U.S. 469, 499–500 (1989) (rejecting a set-aside program for minority contractors that operated as “an unyielding racial quota”).

\textsuperscript{191} See generally Ricci v. DeStefano, 129 S. Ct. 2658, 2681 (2009) (stating that fear of litigation alone cannot justify an employer’s reliance on race as a promotion criterion to the detriment of individuals who passed examinations and qualified for promotion).
would] deviate[] in racial composition from the other portions thereof." 192

However, the federal courts are aware that they are “generally less competent than [defendant companies] to restructure business practices.” 193 It is therefore possible that a court would never require an insurer to make race-based adjustments in order to equalize the racial composition of its price groups. But in such a potentiality, the less-disparately-impacting alternative requirement is an illusion as long as property insurers continue to base their rates on factors across which minorities and non-minorities are unevenly spread, such as the customer’s credit history or their home’s proximity to deteriorating or crime-infested neighborhoods. 194 Further, even if a court would never consider a quota-like system to be an “acceptable” alternative to a challenged practice like credit-based insurance scoring, 195 unless and until the courts announce this conclusion for all prospective plaintiffs to hear, the presence of the less-disparately-impacting alternative requirement might cause insurers to engage in this racial balancing proactively, leery of stumbling into expensive FHA lawsuits. 196

In short, application of the Title VII standard to insurers risks creating a de facto quota-like obligation for insurance companies even if it would not lead to the imposition of deliberate alterations to the balance of the races across its price groupings. 197

IV. CONCEPTUAL AND PRACTICAL OBJECTIONS

Given the historic indignity worked upon American citizens by racism and other prejudices in the housing market, the courts’ efforts to use the Title VII standard (the non- Wards Cove version) in distinguishing between innocent and invidious disparate impacts are admirable and understandable. But on a conceptual and practical level, the Title VII business necessity requirement and less-disparately-

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192 Wards Cove Packing Co. v. Antonio, 490 U.S. 642, 652 (1989); cf. supra text accompanying note 146 (using the quoted language in its original context of employment).
194 See supra Part II.B (discussing redlining and credit-based insurance scoring).
195 See Watson v. Fort Worth Bank & Trust, 487 U.S. 977, 988 (1988) (plurality opinion) (stating that the plaintiff’s proposed alternative is required to be “equally as effective as the challenged practice in serving the [defendant’s] legitimate business goals”); cf. supra text accompanying note 62.
196 This issue is discussed more in Part IV, infra.
197 The mechanics of this problem are explained more fully in Part IV.B, infra.
impacting alternative requirement are unsuitable for application in claims brought against insurers under the FHA.

Three points deserve special emphasis right away. First, one must keep the business necessity requirement and the less-disparately-impacting alternative requirements separate while reading the following arguments. The latter is not merely another way to express the requirement of business necessity. One should think of it as the plaintiff’s backup procedure in the event the defendant carries its burden of showing business necessity.

Second, it is a mistake to treat the business necessity and less-disparately-impacting alternative requirements as being interchangeable with notions of “objectivity” or “race-neutrality.” In other words, asking an insurer to show business necessity is not the same thing as asking it to show its practices are objective or race-neutral. The reason for the disparate impact theory, after all, is that some challenged practices are facially race-neutral; there is no evidence of subjective discriminatory treatment.

Lastly, the mere presence of “subjectivity” in a challenged practice does not render it discriminatory—otherwise, objectivity would be the standard, and clearly it is not. Instead, disparate impacts are actionable whether they have been created by subjective or objective systems.

A. The “Business Necessity” Requirement

Where a business and its challenged practice are essentially indistinguishable, the business necessity requirement is conceptually inapposite and practically unworkable. Applied to the insurance industry, its principal conceptual flaw stems from the indivisibility of the insurance business and its challenged techniques. In addition, requiring

198 See Wards Cove Packing Co. v. Antonio, 490 U.S. 642, 658 (1989) (citing Albemarle Paper Co. v. Moody, 422 U.S. 405, 425 (1975)) (stating that “disparate-impact case contains two components: first, a consideration of the justifications an employer offers for his use of these practices; and second, the availability of alternative practices to achieve the same business ends, with less racial impact”).

199 See, e.g., Watson, 487 U.S. at 988–90 (plurality opinion) (indicating most disparate impact theory cases have required the employer to defend “objective tests” or other standardized practices); Griffin v. Carlin, 755 F.2d 1516, 1522–25 (11th Cir. 1985) (holding that disparate impact analysis also applies to employment practices that involve the use of “discretionary” or “subjective” criteria); Segar v. Smith, 738 F.2d 1249, 1266, 1276 (D.C. Cir. 1984) (describing a disparate impact claim as a “pattern or practice” claim and stating that “subjective criteria may well serve as a veil of seeming legitimacy behind which illegal discrimination is operating”).
insurers to produce evidence of narrow risk-to-loss ratios to establish business necessity presumes a prescience that, if it existed, would render the business of insurance impracticable.

Properly understood, the requirement’s justifiability in a given case depends largely on what the defendant’s business actually is, and whether that business can be distinguished from the practice the defendant seeks to justify. An employer’s “business” is not hiring, firing, promoting, demoting, training, or disciplining its employees. Rather, its business is providing services or goods in exchange for value, and it uses employees to conduct that business with greater scale or speed. It therefore makes sense that, in requiring employers to demonstrate that an allegedly discriminatory (yet facially neutral) hiring practice is justified by business necessity, courts look to whether the practice eliminates job applicants on the basis of factors other than whether they have the skills or abilities required for the work. But courts do not pretend to instruct defendant employers as to alternative types of business that might also be profitable. Businesses engage in race-based employment discrimination when they use employment practices that have the effect of disadvantaging members of protected classes. In contrast, choosing to run a business whose operations require skills with which a disproportionately large number of minorities incidentally are not equipped is not an employment decision at all. Instead, it is a quintessential business decision—a decision that defines the business itself.

Accordingly, when the Supreme Court crafted the business necessity requirement in Griggs, it implicitly recognized that an employer’s allegedly discriminatory hiring practice is distinct from its decision to run the type of business purportedly necessitating that practice. In

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200 Cf. Knapp v. Eagle Prop. Mgmt. Corp., 54 F.3d 1272, 1280 (7th Cir. 1995) (“Some practices lend themselves to disparate impact method, others do not.”) (quoting Vill. of Bellwood v. Dwivedi, 895 F.2d 1521, 1533 (7th Cir. 1990)).

201 See Griggs v. Duke Power Co., 401 U.S. 424, 428 (1971). Another case that provides illustration of this point is El v. Southeastern Pennsylvania Transportation Authority, 479 F.3d 232 (3d Cir. 2007). There, the Third Circuit permitted the defendant’s use of criminal records in its employee policies—a practice which exerted a disparate impact on the number of blacks and Hispanics employed—because employing formerly violent criminals and likely recidivists would risk injury to customers. Id. at 243–48. Clearly the safety of customers can be of no relevance to the employer’s business necessity defense if it does not somehow impact the business’s bank account.

202 Griggs, 401 U.S. at 432 (stating that any employment practice “must have a manifest relationship” to the job). It would be illogical to read Griggs as requiring the business of providing utilities to bear a “manifest relationship” to itself. Instead, the Court required that the
stark contrast, an insurance company’s business and its allegedly discriminatory practice in fair housing cases are not distinct, but are one and the same: providing insurance on terms and to persons that make the provision of insurance profitable to the insurance company. Because the insurer risks losing money in the event of a covered casualty, it must use care in selecting the property and persons it will insure. In addition, it must evaluate the risk that its prospective insureds will make payments irregularly, late, or never, or that they will discontinue coverage altogether. If a person’s credit score indicates she is less likely to make full and regular payments, the insurance company may charge a greater premium at the outset in order to mitigate a potential cash flow infirmity with respect to that insured. Similarly, because a policyholder can typically part ways with the insurer simply by discontinuing her payment of premiums, this same front-loading is justifiable where credit scores indicate that the prospective insured has relatively short account histories and no track record of sticking around and making payments over a long period of time.

Thus, commentators who claim that an insurance practice is not a business necessity unless it is justified by “risk of loss” have blinded themselves to a crucial element of the insurer’s business: income. Even if all premiums paid to the insurance company by a given insured ultimately become “profit” with respect to that insured (assuming he creates no losses), the insurer does not necessarily realize a net gain, as losses created by other policyholders must still be taken into account. The insurer therefore has a fundamental interest in guarding against the likelihood that it will be forced to exhaust its income in payment of insurance claims. It achieves this, in part, by the front-loading described above. It defies reason to maintain that an insurer should forego the collection of all or some portion of its premiums from an insured until it is proven that this income is actually needed to cover the person’s losses.

Of course, covering a loss may require the insurer to spend far more money than the particular insured has ever paid in premiums. If employment practice relate to the business of providing utilities. Id. Likewise, the insurer’s business of conducting risk transfers cannot be required to have a manifest relationship to itself.

203 See Baranoff, supra note 134, at 122–37.
204 See supra discussion accompanying notes 99–102.
205 See Baranoff, supra note 134, at 34–39.
206 See supra text accompanying notes 101–03.
this were not the case, homeowners’ insurance would be valueless to the homeowner, who could just as easily put money in a piggy bank as send it to an insurer who would be unable to cover a loss in excess of the premium payments made. But the commodity offered by insurance companies to those who are risk-averse is not valueless. It is a calculable worst-case scenario: the worst thing that can result from the arrangement is that the insured’s premium payments are a waste if no casualty ever transpires. To most people (and virtually all home-mortgage lenders), this cost is preferable to the combination of losing

\[207\] One University of South Carolina economics professor provides the following useful explanation:

Buying insurance is hard to justify using the theory of expected value. That’s because buying insurance is a gamble with a negative expected value, in dollar terms.

Regular indemnity insurance specifies that you get money if certain things happen. If those things don’t happen, you don’t get any money. So far, that’s just like playing roulette.

In return for the chance to get some money, you bet some money by paying the insurance company a “premium.” The insurance company keeps your premium if you don’t have a claim. So far, that’s still just like playing roulette.

Over the large number of people who sign up for insurance, the insurance company pays out less money in claims than it takes in. If it doesn’t, it can’t stay in business. Your expected payoff is therefore less than your premium, unless you can fool (or legally force) the insurance company into selling you a policy with odds are in your favor. Buying insurance has a negative expected value. Still just like playing roulette.

Except that insurance is worse than roulette. Roulette’s expected value is about -5% of the amount bet. The expected value of a health insurance policy is about -10%, relative to the amount bet, the insurance premium paid. This is for the best-regarded health insurance plans, like Blue Cross. It’s what they mean when they say that their “medical loss ratio” is about 90%.

Going without insurance generally does have a higher expected value than going with insurance, but the risk is much greater without insurance. This is the opposite of roulette, in which you assume a risk by playing. In insurance, you pay the company to assume a risk for you.

A risk averse person will pay more than the expected value of a game that lets him or her avoid a risk. Suppose you face a 1/100 chance of losing $10,000. Risk aversion means that you would pay more than $100 (the expected or “actuarially fair” value) for an insurance policy that would reimburse you for that $10,000 loss, if it happens.

Suppose there are many people like you, and you’d each be willing to pay $110 to avoid that risk of losing $10,000. You all could join together to form a mutual insurance company, collect $110 from each member, pay $10,000 to anyone who is unlucky and loses, and come out ahead, probably. The more participants in your mutual insurance company, the more likely it is that you’ll have money left over for administrative costs and profit. That’s how insurance companies with “Mutual” in their name got started.

How can an insurance company assume all these risks? Isn’t it risk averse, too?

The insurance company can do what an individual can’t: Play the game many times and get the benefit of the Law of Large Numbers. The larger an insurance company is, the better it can do this.


\[208\] See id.
one’s property and shouldering its replacement cost. Risk-averse persons prefer this high risk of small loss to the low risk of massive loss, and the insurer’s business is to profit from this preference, making the most money it can from each risk transfer.

Just as it would be absurd to demand that a business provide its services or produce its goods differently just to make it possible for all persons to be its employees, it would be absurd to instruct an insurer to do its business differently for the sole purpose of giving all its customers equal rates. When imposed in an employment discrimination context, the business necessity requirement does not call into scrutiny the business’s entire moneymaking operation, but instead requires the employer to demonstrate that the challenged employment practice is necessary to maintain that operation. But for an insurer embroiled in an FHA claim, the business necessity requirement constitutes a wholesale attack on its profits engine. An insurer cannot argue that its challenged profitability scheme is necessitated by its business because its business is its profitability scheme.

An even simpler objection is that in applying the Title VII business necessity requirement to an insurance company whose rates are challenged, a court must ask how much profit is “necessary.” But generally speaking, profit is not necessary at all. Shareholders might expect a company to be profitable, but as long as the business can generate enough revenue to pay its expenses and liabilities, it need not declare a dividend or carry a surplus to continue as a going concern. When courts permit attacks on an insurer’s system of generating revenue, as opposed to its employment practices, the only inevitable losers are its employees, whose jobs depend on their company sustaining or improving its revenues. This is troubling given that the lawfulness of a challenged employment practice depends on whether that practice has a manifest bearing on “job performance,” which (along

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210 See Casualty Actuarial Society, Statement of Principles Regarding Property and Casualty Insurance Rate Making 6 (1988), available at http://www.casact.org/standards/princip/sppcrate.pdf (advising that “[r]atemaking should provide for the costs of an individual risk transfer so that equity among insureds is maintained,” and that “[w]hen the experience of an individual risk does not provide a credible basis for estimating these costs, it is appropriate to consider the aggregate experience of similar risks.”); Baker, supra note 207.
with employee safety and the like) is itself irrelevant unless it ultimately has bearing on the employer’s ability to make money.\footnote{See Griggs v. Duke Power Co., 401 U.S. 424, 431 (1970).}

Another more practical objection to foisting the business necessity requirement on insurers is that it ignores the problem of temporal limitations. Particularly for those who argue that insurers should only be able to justify their premiums by reference to verifiable risk of loss,\footnote{E.g., Wu, supra note 2, at 9.} the easiest way to understand this point might be through an old adage: “Hindsight is always twenty-twenty.” In hindsight, one might easily conclude, after a decade of paying homeowners’ premiums promptly without making a single claim, that the insurance coverage was not necessary for that period. She might also conclude that the insurance company did not “need” her premium payments to cover the risks of account delinquency or covered loss that she presented, which for that period have proven to be zero. But what she most definitely cannot conclude is that these risks did not exist \textit{at the time the policy was entered into}. As they say in the investment business, past performance is no guarantee of future returns.\footnote{See, e.g., U.S. Sec. & Exch. Comm’n, Mutual Fund Investing: Look at More Than a Fund’s Past Performance, http://www.sec.gov/investor/pubs/mfperform.htm (last visited Jan. 19, 2011).} For an insurance company, past performance (that is, the insured’s timely payments and success in not burning down her house) is no indicator that the premium amount charged was not justified. The possibility that insurance might ultimately have been a “waste of money” is precisely what risk-averse people willingly confront when they obtain a policy. Requiring an insurance company to limit its premiums-to-losses ratio in an effort to achieve the “necessary” amount of premiums income is the wrong way to handle a price-related disparate impact claim. As a concept and practically speaking, the business necessity requirement just does not fit here.\footnote{To a limited extent, the same might be also said in disparate impact cases involving lenders. Because of this parallel, one might suppose that because courts have allowed the disparate impact theory in claims against mortgage lenders, see, e.g., Old W. End Ass’n v. Buckeye Fed. Sav. & Loan, 675 F. Supp. 1100, 1105–06 (N.D. Ohio 1987), there can be no argument to the contrary on behalf of insurers. This reasoning, of course, would be analogous to arguing against suffrage for immigrants on the grounds that it is already denied to felons. But there are even better reasons not to lump insurers together with lenders. A lender in a typical home transaction is essentially an investor: it commits a cash sum to the purchase price of the borrower’s home, expecting the interest paid by the borrower to combine with the repaid principal to result in a net gain. Its investment, moreover, is made secure by its legal title to the property. Upon the...}
B. The “Less-Disparately-Impacting Alternative” Requirement

Assuming a defendant-insurer has managed to establish that its pricing methodology is a business necessity, the plaintiff will then come forward with an alternative to that practice, which she alleges will create a less disparate impact while still producing acceptable results for the insurance company. On a conceptual and practical level, however, it does not make sense to force a defendant-insurer to establish that “no acceptable alternative policies or practices [exist] which would better accomplish the business purpose advanced, or accomplish it equally well with a lesser differential racial impact.”

Under the Title VII standard for disparate impacts, it is possible to show that an employer can conduct its business for a profit without engaging in its challenged employment practice because the thing measured by the practice may be altogether different from the person’s ability to perform the work in a profitable manner. Consider the following example. Although a company specializing in custom home building might show that a high school education requirement bears a “demonstrable relationship” to quality carpentry workman-

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borrower’s default, the lender loses money only to the extent the property cannot be resold for an amount equal to the balance of the loan. Moreover, in a declining market, the sooner the default, the more likely the home can be resold at the same price. Even if default occurs towards the very end of the loan period, the lender has by then realized most of its expected return through payments of interest and principal. By that point, the home does not even need to sell at its market price to satisfy the remaining relatively small deficiency. Even if every single one of the lender’s borrowers defaults at the same time, the lender will find itself with rights to the corresponding foreclosed properties. The insurance company, by contrast, can boast of no such security. The moment the insurance agreement becomes effective, the insurer is on the hook to cover the total loss of the home. Indeed, it is possible that a host of casualties might occur simultaneously, triggering a massive obligation for the insurer. Thus, insureds who fail to pay their premiums work a far greater hardship upon the insurance company than do borrowers upon their lenders when they default on their loans. The lender’s risk of loss in a home loan situation depends more on the housing market than on the borrower’s performance of her obligations. The insurer’s risk of loss depends not only on the risk of casualty, but also on the vagaries of its premiums income. Also telling is that no one has attempted to hold lenders liable under the FHA for refusing to finance uninsured homes, even though this would have the same sort of disparate effect created by insurance redlining.

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215 See supra note 39 and accompanying text.
217 See id. at 798 n.7 (“It should go without saying that a practice is hardly ‘necessary’ if an alternative practice better effectuates the intended purpose or is equally effective but less discriminatory. . . . [A]ny differential rejection rates that may exist, based on a test, must be relevant to performance on the jobs in question.” (emphasis added) (internal quotation marks omitted) (referencing guidelines issued by the Equal Employment Opportunity Commission)).
it will still be liable under Title VII if another, more individualized screening method is more effective for that purpose—such as a visual test specifically designed to measure the prospective carpenter’s eye for detail or knowledge of commonplace building techniques. Similarly, evidence that the builder’s incumbent carpenters perform well on the job despite lacking high school diplomas militates against a finding of business necessity. Questions of cost and efficiency associated with the implementation of such alternatives are relevant but not determinative.

The practical effect of requiring the builder to utilize this less-disparately-impacting alternative is simple: its screening becomes more focused on the individual applicant and therefore more accurate in evaluating the very skills the builder has claimed are necessary to do business profitably. Even if this increases the costs involved with screening carpenters, the builder ought to be able to recoup these costs in the form of materials and other savings produced by more skilled carpenters or (more practically) by raising its prices. This sound business result is practicable precisely because the builder’s income-production model is distinct from the challenged employment practice. But the same cannot be said when the requirement is imposed on insurers.

Unlike in the case of the builder, the effect of requiring the insurer to utilize a less-disparately-impacting alternative would not be that its ratemaking becomes more focused on the individual risk. When the challenged practice is credit-based scoring or location-based pricing, which responds to the individual’s credit score or proximity to bad neighborhoods, the only way to reduce the disparate impact produced by the lower credit scores or urban residential patterns of minorities is to focus less on the individual risk, and to focus instead on achieving equal rates for all races. A less-disparately-impacting alternative in such cases necessarily marginalizes the individual in pursuit of a suitable aggregate. This focus is clearly contrary to what the Griggs Court envisioned in fashioning the Title VII standard when it

219 Robinson, 444 F.2d at 797–98.
220 See Griggs, 401 U.S. at 431–32.
221 See Robinson, 444 F.2d at 799 n.8.
said that proper hiring evaluations “must measure the person for the job and not the person in the abstract.”

The insurance company’s business is conceptually indistinguishable from the practice allegedly causing the disparate impact because insurers only make money by collecting more premiums income than is ultimately necessary to pay their customers’ claims. Thus, when courts impose the less-disparately-impacting alternative requirement on insurers, the result is unintuitive, non-businesslike, and impracticable. Even worse is that it does not solve the disparity problem without some degree of reverse discrimination.

An initial conceptual difficulty with the requirement concerns the problem of relativity, or quantifiability. Put simply, how much “less disparate” must the impact created by the plaintiff’s proposed alternative be? Arguably, even a rate reduction of one dollar in favor of minority insureds would constitute a “less” disparate impact. However, it may be fair to concede that such a reduction would not be legally sufficient, given the plaintiff’s disparate impact claim would have been predicated on a “significantly discriminatory impact,” which would not have been very significant if it could have been avoided by an adjustment of only one dollar.

The most grievous difficulties with respect to this requirement arise in attempting to articulate both the contours of a proposed alternative and how it is to be implemented. What exactly does the less-disparately-impacting alternative requirement demand of the insurance company? Practically speaking, an insurer hoping to avoid lawsuits must monitor the availability of supposed alternative practices that might be paraded before the court by plaintiffs bringing disparate impact claims. But legally speaking, it demands far more. As one circuit judge correctly observed, applying the Title VII standard to disparate insurance impacts “inevitably draws federal courts into the

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222 *Griggs*, 401 U.S. at 436.
223 See supra Part IV.A.
224 For instance, suppose the average Caucasian paid $100.00 per month while the average African-American paid $200.00 per month—all based on factors like credit score, property value, or property location. Suppose the insurance company adopts an alternative practice that reduces the disparateness of this impact by $1.00 per month. This would only be a 0.33% rate reduction overall for blacks, with a yearly savings of only $12.00. But as puny as these numbers are, the insurer’s approach would nevertheless be a less-disparately-impacting alternative under the Title VII standard.
Recall the allegations of Patrick Ojo in his FHA claim against Farmers Group, Inc., his homeowners’ insurance provider. Suppose Farmers decided to settle out of court with Ojo, and as part of the settlement agreed to modify its ratemaking formula so that it would have a less discriminatory effect on minorities—much like Allstate supposedly did in settling the DeHoyos case. How, exactly, would Farmers go about doing this? In his brief, the closest Ojo came to forecasting his proposed alternative was suggesting that the “[r]emoval or alteration of factors that are highly correlated to race could significantly reduce or eliminate the discriminatory impact.” This reformulation is easier said than done.

The figure below illustrates the difficulties encountered when one tries to replace the credit-based insurance scoring method with some other determinative evaluative factor in an effort to fabricate a less-disparately-impacting mechanism for pricing insurance. In this illustration, the insurance prices are divided into a $200 rate and a $100 rate. The company insures a total of 300 people: 200 whites and 100 blacks. The offending pricing factor is a credit score cutoff that causes a disproportionate number of blacks to pay the higher rate. Compared alongside the challenged factor are two “alternative” factors. Note that these alternatives, although supported for purposes of the illustration by genuine data, are intended only as hypotheticals and

226 DeHoyos v. Allstate Corp., 345 F.3d 290, 301 (5th Cir. 2003) (Jones, J., dissenting).
227 See supra notes 118–21. A change in Ojo’s credit information prompted Farmers to raise his rate, causing Ojo to allege that Farmers was using “undisclosed factors” in its credit-scoring formula which had a disproportionate effect on minorities’ rates. Ojo v. Farmers Grp., Inc., 565 F.3d 1175, 1179 (9th Cir. 2009), rehearing granted en banc, 586 F.3d 1108 (9th Cir. 2009), further proceedings stayed by 600 F.3d 1205 (9th Cir. 2010) (en banc). Interestingly, Ojo never alleged that the negative report on his credit was made in error or otherwise unjustified.
228 See Ojo, 565 F.3d at 1175–79; sources cited supra note 135.
229 Patrick Ojo, supra note 39, at 16.
230 See Detlefsen, supra note 85, at 10 (“To keep premiums low and thus prevent adverse selection, insurers have developed the practice of classifying insureds into groups posing similar risks. Why treat individuals as members of groups for risk classification purposes? Because group probabilities provide the credibility necessary to the predictions that are at the heart of the insurance system.” (footnote omitted)). The reason for using different price groups, or risk classifications, is also discussed supra note 97 and accompanying text.
231 The figure presented here is based on an example in Michael J. Miller, Presentation: Adverse Disparate Impact and Insurance, at 14 (2009), http://www registrazione123.com/pci/09jmu/media/mmiller_disparateimpact.pdf. Data for the “Challenged Factor” column of Figure 1 comes from Raphael W. Bostic et al., Hitting the Wall: Credit as an Impediment to Homeownership 6, 18 (Joint Center for Hous. Studies, Working Paper No. BABC 04-5, 2004), available at http://www.jchs.harvard.edu/publications/finance/babc/babc_04-5.pdf (reporting that 660 is generally the credit score above which individuals are considered creditworthy, and showing that in
are not claimed to be demonstrative of actual factors relied upon by insurers.  

<table>
<thead>
<tr>
<th>Challenged Factor</th>
<th>Alternative A</th>
<th>Alternative B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit Score</td>
<td>Admitted to Paying Their Bills Late</td>
<td>More Than One Occupant Per Room</td>
</tr>
<tr>
<td>Below 660</td>
<td>WHITES BLACKS</td>
<td>WHITES BLACKS</td>
</tr>
<tr>
<td>No. Insureds Paying $200</td>
<td>40 40</td>
<td>50 50</td>
</tr>
<tr>
<td>No. Insureds Paying $100</td>
<td>160 60</td>
<td>150 50</td>
</tr>
<tr>
<td>Average Rate Paid</td>
<td>$120 $140</td>
<td>$125 $150</td>
</tr>
<tr>
<td>Average Savings</td>
<td>N/A ($5)</td>
<td>($10) ($78)</td>
</tr>
<tr>
<td>Disparate Impact</td>
<td>+ $20</td>
<td>+ $25</td>
</tr>
</tbody>
</table>

First, as a substitute predictor of payment performance, Alternative A considers whether the insured admitted in his or her application to having made late payments in the past. This consideration does not penalize honesty, but instead presumest honesty, penalizing one’s record of having made payments late. Second, Alternative B assumes that homes with more occupants per room are less likely to burn down or be vandalized. The theory here is that that unoccupied homes have a greater risk of fire and burglary, and that the greater the number of people living in a house, the less likely it is to be left unoc-

2001, less than 19% of Caucasians had a score below 660, while over 41% of African-American scores fell below 660). Data for the “Alternative A” column is drawn from National Foundation for Credit Counseling, 2009 Financial Literacy Survey 2 (April 2009), available at http://www.nfcc.org/newsroom/financialliteracy/files/2009financialliteracysurvey.pdf (reporting that over 50% of African-Americans have admitted to failing to pay their bills on time, while that figure is less than 30% for the nation). Data for “Alternative B” is found at U.S. Census Bureau, American Community Survey, Tables B25014A, B25014B, http://factfinder.census.gov/servlet/DatasetMainPageServlet?_program=ACS (select “2005–2009 American Community Survey 5-Year Estimates;” then follow “List all tables” hyperlink; then select the desired table and click “Next” button; then select “United States” as the geographical region, click “Add” button, and click “Show Result” button) (last visited Jan. 20, 2011) (reporting that roughly 2.01% of whites live in dwellings with more than one occupant per room, whereas this number is roughly 3.58% for blacks).

232 After all, insurance companies keep most details of their ratemaking formulas close to the vest and beyond the access of curious law students and litigious insureds. See, e.g., Patrick Ojo, supra note 39, at 5 (complaining about his insurance company’s guarding access to its “secret” algorithms).
cupied.\textsuperscript{233} It is assumed that this alternative will not give rise to reverse familial status discrimination claims.\textsuperscript{234}

A customer’s credit score is a good predictor of both risk of insured loss and risk of the customer failing to make timely payments or discontinuing the policy altogether.\textsuperscript{235} However, because it has produced a disparate impact of $20.00, the homeowners’ insurance company must turn to another criterion. But a person’s admission of making past late payments (used as Alternative A)—in addition to being a less comprehensive piece of information having no demonstrable relationship to whether the person’s property is more likely to sustain an insured loss—produces an even more disparate impact. A finding that late-payment history correlates with race is not surprising given that payment history is part of what makes up a person’s credit score, which itself correlates with race.\textsuperscript{236}

If focusing on similar sets of data—which are subsets of credit score—yields results similar to Alternative A because blacks are more heavily represented in the relevant criterion, the insurer might ultimately decide to hunt deliberately for a factor across which blacks and whites are equally distributed.\textsuperscript{237} Alternative B is such a factor, and will reduce the disparity between the races to $2.00. While Alternative B has, in theory, some bearing on the likelihood of a loss to the property, it tells the insurance company nothing about the individual’s payment performance history or retainability. It also prevents the insurer from being able to use the lower rate to compete for those who continue to be viewed by other insurers as attractive customers.\textsuperscript{238}

There are additional difficulties in requiring the insurer to implement Alternative B. Most notable in this illustration, perhaps, is that

\textsuperscript{233} See, e.g., \textit{Insurance Companies May Not Cancel Homeowners Policies Mid-Term When Non-Occupancy Is Only Consideration}, U.S. \textsc{State News}, Nov. 19, 2008, \textit{available at} 2008 WLNR 22221000 (reporting a news release by the New York Department of Insurance in which the Department responded with criticism to property insurers that raised rates simply because their insureds’ dwellings were being left unoccupied).

\textsuperscript{234} See 42 U.S.C. § 3604(b) (2006). Clearly a system encouraging greater incidence of occupancy would not discriminate against those with children, but would reward them. The question of whether single persons (for example, seniors who have lost their spouses) might be able to attack such a factor under the Fair Housing Act is far beyond the scope of this discussion.

\textsuperscript{235} See discussion of credit-based insurance scoring \textit{supra} Part II.B.

\textsuperscript{236} See, e.g., Ojo v. Farmers Grp., Inc., 565 F.3d 1175, 1179 (9th Cir. 2009) (describing Ojo’s complaint as admitting the correlation asserted in the text).

\textsuperscript{237} This, of course, is precisely what the author of this essay had to do in creating an illustration of a less-disparately-impacting alternative to credit-based insurance scoring.

\textsuperscript{238} \textit{Cf. supra} note 97 and accompanying text.
the insurer’s revenue in the form of premiums from these 300 insureds has skyrocketed from a total of $38,000 to a total of $59,200—an increase of 55.79%. While this increase renders the insurance company much better equipped to compensate its insureds in the event of losses to their property, it bears indicia of highway robbery. “Adverse selection” will surely follow such a change in pricing.\textsuperscript{239} The less-disparately-impacting alternative in this case has inflated the value of the insurer’s product to the point where the bulk of its customers are less likely to pay for it.

Arguably the most serious problem with such alternatives is that even if they address the disparity suffered by the minority, they nevertheless result in unfair pricing. Note that while Alternative B cures the disparate impact with respect to African-Americans, it \textit{creates} a disparate impact of $2.00 for the average Caucasian insured, who is now free to bring his own discrimination claim.\textsuperscript{240} As one statistician has explained, since every alternative factor has the potential for causing a disparate impact if the distribution of insureds of all races is not constant across that factor, the Title VII disparate impact standard is in conflict with fairness:

This conflict will potentially exist for nearly every risk factor used to develop property/insurance rates because protected classes, most if not all of the time, will not be evenly distributed throughout the various risk classifications. If a court or legislature were to order that all disparate impacts be eliminated from insurance premiums, it is likely that accurate risk assessment would be destroyed, \textit{resulting in unfairly discriminatory rates}. . . . [This would] mean that some people would pay less than the insurance was worth, at the expense of other people who would be required to pay more than the insurance is worth in

\textsuperscript{239} Adverse selection is the term used by insurers to describe the phenomenon of customers abandoning an expensive policy in favor of one that costs less—a reaction more fundamentally caused by more equalized pricing that makes low-risk customers pay premiums that ought instead to be paid by those with high risk. \textit{See Detlefsen, supra} note 85, at 10 n.19 (“Adverse selection occurs when the applicants for insurance represent a sample of the population which is biased toward those with a greater loss exposure rather than representing a true random sample . . . [or] may result when the premium charged is inadequate for the risk involved.” (internal quotation marks omitted)).

order to subsidize the under-payers. *It is possible that the only rate structure which could survive a strict disparate impact standard is “one-rate-for-all.”*241

If such an egalitarian ratemaking system were ever to become reality, “adverse selection would be rampant in the insurance market and coverage availability would suffer.”242

Consider another practical problem brought on by the less-disparately-impacting alternative requirement: price negotiability would virtually disappear or become impracticable. Suppose the insurance company has finally managed to equalize its rates across all races, perhaps by using the “one-rate-for-all” approach. Further, suppose the insurance company is, over a period of subsequent years, willing to negotiate its rates with its customers. But what if only Caucasian and African-American (non-Hispanic) insureds actually called the insurer to negotiate for a reduction in their homeowners’ premiums? If those callers’ rates are in fact reduced, the result could be a disparity in the rates of Hispanics. Thus, the insurance company wishing to avoid a disparate impact claim would need to measure out any negotiated reductions evenly across the race categories, perhaps waiting until it had spoken with an equal percentage of insureds from each race before agreeing to reduce any of their rates. This process would lead to unjustifiable differences in rates between people of the same race. More problematically, it would mean that if the insurer were only willing to negotiate the rates of 5% of its Hispanic insureds, it would only be able to reduce rates for 5% of persons of other ethnicities as well, even if 10% of them would otherwise have obtained a reduction in price.

It is also clear that a completely individualized alternative to a practice like credit-based insurance scoring would never be suitable. If an insurer abandoned its credit-based scoring model and began assessing risk only on the basis of information presented to it by the insured, it would be discarding sophisticated multivariate analyses in favor of the interpretive responses of its agents to insurer representations lacking statistical predictive value. Furthermore, under a subjective system, the only way the insurer would be able to avoid creating

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241  Miller, *supra* note 81, at 284 (emphasis added).
242  *Id.*
the context for a disparate impact claim would be by keeping the rates equal for all races.243

Thus, if one accepts that credit scores are reasonably accurate predictors of payment performance and risk of loss, it becomes clear that refocusing the formula on supposedly more individualized alternative factors like “prior insurance” and “homeownership” history244 would not lessen the disparity for minorities as long as they continued to demonstrate weaker performance on these factors as a group. Any relevant alternatives are merely subsets of the challenged credit scoring data. Simply put, there is no alternative to credit-based insurance scoring that would not (1) have a disproportionate impact on minorities who perform poorly on the substitute factors, (2) involve intentional discrimination or race-based disparities disfavoring non-minorities, or (3) be reduced to completely individualized—but completely subjective—rating determinations made by insurance agents.245 The Title VII standard’s less-disparately-impacting alternative requirement thus renders that standard extremely problematic if not altogether inapplicable in insurance contexts.

One might contend that if no proposed less-disparately-impacting alternative could produce acceptable results for the insurer, the insurer would not be liable under the disparate impact theory. The point of such an argument would be that the Title VII standard is appropriate for disparate insurance impacts, and that an “innocent” insurance company has nothing to fear. But the innocent insurance

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243 See supra note 241 and accompanying text. Note that the Supreme Court has not yet decided “whether a legitimate fear of disparate impact is ever sufficient to justify discriminatory treatment” of this sort. Ricci v. DeStefano, 129 S. Ct. 2658, 2676 (2009).

244 See Dexter Johnson & Ron Latva, Presentation: CASE Meeting, at 17 (Sept. 9, 2006), http://www.casact.org/affiliates/case/0906/handouts/johnson.ppt (mentioning these factors as possible alternatives).

245 As to the third point just listed, one cannot simply respond that proof of “objectivity” will cure the impact, because an objective system—like credit-based insurance scoring, or pricing based on property value and location—is what was challenged to begin with. For instance, if the DeHoyos plaintiffs had instead alleged that the subjective determinations of insurance agents were having a disparate impact on minorities, the presumptive less-disparately-impacting alternative to that practice would have been the very thing they challenged in their actual litigation—an objective formula. Of course, if their response to the hypothetical subjective system had instead been to bring a disparate treatment claim, the disparate impact theory would not have been necessary. The same would have been true if they had alleged that the objective credit-scoring practice was tainted by subjectivity. See Watson v. Fort Worth Bank & Trust, 487 U.S. 977, 989 (1988) (plurality opinion) (“However one might distinguish ‘subjective’ from ‘objective’ criteria, it is apparent that selection systems that combine both types would generally have to be considered subjective in nature.” (emphasis added)).
company does have something to fear: the constant possibility that any disparity in risk indicators across the racial categories of its insureds will give rise to litigation, with all its attending costs and complications. Food fights in the school cafeteria do not become appropriate a priori just because pizza stains come out in the wash. Neither does a Title VII disparate impact lawsuit against an insurance company become appropriate just because the innocent insurer ultimately will prevail in the litigation.

V. THE QUEST FOR AN ALTERNATIVE STANDARD

If the Title VII standard is wrong, what is right? After all, if the theory of disparate impact discrimination is going to survive at all in homeowners’ insurance FHA cases, clearly there needs to be some way to go about identifying those impacts which are actually motivated by illicit prejudice but for which there is no hard evidence of intent. The question is whether any standard of analysis would be capable of distinguishing legitimate practices from invidious ones while avoiding the conceptual and practical pitfalls of the Title VII standard described in this article.

However, such a question deserves an entirely separate analysis of law and public policy rather than cursory and inadequate treatment here. Indeed, the objective of this discussion has been to identify problems with the Title VII standard that no court or commentator has addressed as such, rather than to advance a new judicial standard. Even so, principles and concepts drawn from the foregoing criticisms might provide a starting point for developing alternative analyses. Accordingly, any new judicial approach might reasonably take the following suggestions into account.

First, perhaps the most straightforward way to make disparate impact insurance claims more fair would be to require the plaintiff to allege and to prove that the insurance company’s ratemaking personnel know the race (or membership in another protected class) of each insured, not just that they know minorities are statistically likely to have lower credit scores or live in urban neighborhoods.246 If the insurer at its ratemaking level has no knowledge of the racial composi-

246 Cf. Ojo v. Farmers Grp., Inc., 565 F.3d 1175, 1179 (9th Cir. 2009) (suggesting that Farmers knew about the disproportionately number of blacks with lower credit scores), rehearing granted en banc, 586 F.3d 1108 (9th Cir. 2009), further proceedings stayed by 600 F.3d 1205 (9th Cir. 2010) (en banc).
tion of its insureds, the disparate impact claim should fail. This requirement would bring the calculus closer to the “animus” standard used in some disparate treatment cases brought under the FHA, without necessarily reinstating the formidable burden of proof of intent. It should be fairly easy for plaintiffs to prove, for example, that customers are asked to indicate their race on the defendant’s insurance application forms, or that they are required to meet in person with an agent who is cognizant of their race when he assigns a premium. Of course, if rates are not assigned on the spot, the plaintiff would need to show the agent communicated information about the plaintiff’s race to the personnel responsible for determining the price of the policy.

Second, a court might utilize the reasoning of the Supreme Court’s maligned *Wards Cove* opinion in requiring (1) that the plaintiff’s statistical inquiry concern the racial composition of “qualified” populations on the one hand and the racial composition of the group ultimately selected by the defendant to receive the benefits of such qualification on the other, and (2) that the plaintiff isolate the offending practice with specificity and show a causal connection between that practice and the disparate impact. These rules, if applied in Patrick Ojo’s case, would have required that he attack something more specific than just “unknown factors” and that he show a causal link between the offending practice and the disparate impact. Thus, if Ojo chose to attack credit-based insurance scoring, he would need to allege that the racial makeup of the “bad credit” population and that of the group actually paying higher rates for a Farmers’ homeowners’ policy were disproportionate. He would also bear the burden of proof in showing that credit-based scoring was not justified by some legitimate business purpose. This approach would avoid the Title VII standard’s business necessity and less-disparately-impacting alternative requirements and the conceptual and practical confusion attending them.

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247 *Cf.* Stanton, *supra* note 16, at 166–67 (stating that “[c]ourts deciding FHA claims occasionally equate ‘evil motive’ with ‘animus’” (citing Smith & Lee Assocs. v. City of Taylor, 102 F.3d 781, 794 (6th Cir. 1996); Sofarelli v. Pinellas County, 931 F.2d 718, 723 (11th Cir. 1991))); *id.* at 171–72 (“Under the ‘animus’ standard, there is no FHA violation, because the insurer never took the [plaintiff’s membership in a protected class] into account when denying coverage.”).

248 See *supra* discussion accompanying notes 138–55.

249 Compare *supra* discussion accompanying notes 138–55, *with supra* note 130 and accompanying text.

250 See *supra* text accompanying notes 64 and 138.
Third, an alternative approach could address the flimsiness of the current Title VII pleading standards for disparate impacts, requiring that the plaintiff allege a significant statistical disparity in order to survive a Rule 12(b)(6) dismissal, as well as making more rigorous the prima facie requirement of showing a “significant” adverse impact.251

Fourth, the analysis could mirror the McDonnell–Douglas test by (1) replacing the business necessity and less-disparately-impacting requirements with the simpler burden of showing that the challenged practice is not a “pretext” for discrimination and (2) making the question of pretext one for the court to decide under an abuse of discretion standard.252 This would effectively convert disparate insurance impacts claims into claims of intentional discrimination for which indirect evidence is an appropriate source of proof.253 Such cases would turn not on the “necessity” of the challenged practice, but on whether that practice was so arbitrary or ungrounded in reasonableness that it revealed actual intent to discriminate.254 Proof of the insurer’s knowledge of race would also be relevant. And because a judge would be answering this question instead of a more unpredictable, sentiment-motivated jury, the prospect of the litigation surviving summary judgment might be less likely to force an innocent insurer to settle a meritless case.255

Fifth, a court might utilize components of the balancing test articulated in the Seventh Circuit’s Arlington Heights decision, weighing (1) the strength of the plaintiff’s showing of discriminatory intent and (2) the defendant’s interest in taking the challenged action in determining whether discrimination has occurred. Under this analysis, the more drastic the plaintiff’s proven statistical disparity under the first prong, the more likely the insurer would need to compromise the secrecy of its ratemaking formulae in order to demonstrate its interests under the second prong. For example, suppose Patrick Ojo’s claim had been that only 40% of the general population having credit

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251 This approach is explained in Part IV.B, supra.
254 See id.
255 Insurers would likely have good reason to be apprehensive of jurors in such cases. See supra text accompanying notes 135, 228 (discussing settlements); College of Lake County, Some Background on Lifestyles Health Insurance, ADJUNCT VOICES, Oct. 2006, at 7 (“Pretty much everyone hates insurance companies. ‘I pay in all those premiums and I never have a claim, or my claims are small. They make a lot of money off of me.’”).
scores under 660 were black, but that 80% of Farmers’ customers paying more expensive “sub-660” insurance premiums were black. Farmers could demonstrate either (1) that it did not consider credit scores in its ratemaking, thus defeating the causal link; (2) that Ojo’s percentages were so erroneous as to render the actual racial disparity legally “[in]significant” or (3) that other legitimate factors, in addition to or instead of credit score, were responsible for the disparity—in other words, that the aggrieved group and the segment of the general population to which the plaintiff compared that group were not sufficiently similar. A fourth option would allow the insurer to reveal all details of its risk classification formula to the court, which would then make a determination (reversible only for an abuse of discretion) as to whether that formula was a pretext for unlawful discrimination. The risk of being required to disclose its formula—as a matter of proof, not as part of a “business necessity” requirement—would give the insurance company an incentive to make its rates as fair as possible. Generally speaking, the insurance company should be given more ways to demonstrate the fairness of the challenged disparity than the Title VII standard currently provides.

CONCLUSION

This article described the advent of the FHA and the eventual marriage of that statute to the disparate impact theory of discrimination, which has its roots in (and is most suited for) employment discrimination cases. It also examined the nature of insurance underwriting practices alleged to create disparate impacts, particularly for racial minorities, and illustrated how litigants have attacked these practices in FHA claims. With this backdrop in place, the article presented legal, conceptual, and practical problems connected with application of the Title VII standard to disparate insurance impacts. An understanding of these problems should shape the development of any alternative standards.

In short, the risk of racial and other unlawful forms of discrimination does not evaporate simply because insurers—fearing adverse selection by those whose rates are unfairly high—have no commercial

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256 Connecticut v. Teal, 457 U.S. 440, 446 (1982) (“To establish a prima facie case of discrimination, a plaintiff must show that the facially neutral . . . practice had a significantly discriminatory impact.”); cf. Miller, supra note 81, at 281–82 (discussing different standards for measuring whether or not an alleged disparity is significant enough to sustain the claim).
incentive to discriminate unfairly. Unlike the Title VII standard, however, a proper legal standard will recognize that certain disparities are fair, and that it is not fair to put insurance companies through conceptually inapposite, impractical rigors to prove their fairness.