HUNTON& WILLIAMS

Client Alert

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Foreseeable Harm is Not Enough: Supreme Court Rejects Eleventh Circuit's Relaxed Interpretation of Proximate Cause for Lending Discrimination Claims

The Supreme Court handed a significant victory to lenders last week, vacating lower court opinions allowing the City of Miami to sue two banks under the Fair Housing Act ("FHA"). The Eleventh Circuit let the City's claims survive dismissal because its complaints identified plausible financial harms that foreseeably resulted from the banks' alleged discriminatory lending practices. The Supreme Court rejected the low bar set by the Eleventh Circuit, finding mere "foreseeability" failed to ensure the "close connection" required to show proximate cause under the FHA. Though a majority of the Court declined to dismiss the complaints outright for lack of statutory standing, the Court imposed a directness requirement in the "close connection" test that may prevent many municipalities and similarly situated parties from successfully bring suit under the FHA—even if they qualify as "aggrieved persons."[1]

Background

The City filed separate lawsuits against the banks in 2013 alleging similar patterns and practices of intentional and disparate impact discrimination against Miami's minority residents in connection with allegedly predatory lending. Specifically, the City alleged each of the banks engaged in reverse redlining[2] and redlining[3] from 2004-2012, citing various studies and statistics in support of its claims.[4] The City further alleged it was entitled to bring suit as an aggrieved person because it suffered damages due to the banks' alleged misconduct including: (1) lost tax revenues due to property devaluation following loan foreclosures, and (2) higher costs for increased municipal services to remedy dangerous conditions, crime, and vagrancy in neighborhoods disproportionately affected by foreclosures. From the City's

[1] The FHA provides that "[a]n aggrieved person may commence a civil action in an appropriate United States district court or State court not later than 2 years after the occurrence or the termination of an alleged discriminatory housing practice . . . to obtain appropriate relief with respect to such discriminatory housing practice or breach." 42 U.S.C. § 3613(a)(1)(A).

[2] "Reverse redlining is the practice of extending mortgage credit on exploitative terms to minority borrowers." *City of Miami v. Bank of Am. Corp.*, 800 F.3d 1262, 1267 (11th Cir. 2015), *cert. granted sub nom. Bank of Am. Corp. v. City of Miami, Fla.*, 136 S. Ct. 2544, 195 L. Ed. 2d 867 (2016) and *vacated and remanded sub nom. Bank of Am. Corp. v. City of Miami, Fla.*, 15-1111, 2017 WL 1540509 (U.S. May 1, 2017).

[3] "Redlining is the practice of refusing to extend mortgage credit to minority borrowers on equal terms as to non-minority borrowers." *Id.*

[4] Specific to one bank, the City alleged: African-Americans with FICO scores over 660 were 1.533 times more likely to receive a predatory loans than white borrowers from 2004-2012; Latino borrowers with FICO scores over 660 were 2.137 times more likely to receive a predatory loans than white borrowers from 2004-2012; a predatory loan was 1.721 times more likely to result in foreclosure than is a non-predatory loan from 2004 to 2012; predatory loans to an African-American borrowers were 2.744 times more likely to result in foreclosures than non-predatory loans to similar white borrowers; predatory loans to Latino borrowers were 2.861 times more likely to result in foreclosures than non-predatory loans to similar white borrowers; and loans in majority minority neighborhoods were 5.857 times more likely to result in foreclosure than loans in majority white neighborhoods. *See* Complaint at 37, ¶ 115; 40, ¶ 122; 44, ¶¶ 130-31; *City of Miami,* No. 13-24506-CIV (S.D. Fla. Dec. 13, 2013) (ECF No. 1).

perspective, these damages were foreseeable and traceable to the banks' conduct because the results of allegedly "predatory"[5] loans—like more foreclosures—were or should have been expected.

The banks strongly denied the City's allegations, contested the validity of the studies and statistic on which the claims were based, and moved to dismiss the complaints on several grounds.

a. The District Court's Decision to Dismiss the City's Complaints

The district court dismissed the City's complaints for failure to state a claim.[6] The court held the City lacked statutory standing to sue as an aggrieved person under the FHA because its "merely economic" interests did not fall within the "zone of interests" the statute seeks to protect.[7] Moreover, the City failed to allege facts showing the banks' alleged redlining and reverse redlining proximately caused the City's financial injuries. Applying the "close connection" requirement of *Lexmark International, Inc. v. Static Control Components, Inc*., 134 S. Ct. 1377 (2014), the district court concluded the City could not establish a sufficient causal link between its injuries and the alleged discrimination.[8] The City appealed.

b. The Eleventh Circuit's Decision

The Eleventh Circuit reversed, finding the "district court imposed too stringent a zone of interests test and wrongly applied the proximate cause analysis" and, as a result, the City has standing to assert claims under the FHA.[9] Citing earlier Supreme Court decisions, the Eleventh Circuit held the FHA "sweeps as broadly as allowed under Article III" of the Constitution."[10] The City consequently met the zone-of-interests test by identifying financial harms loosely linked to banks' allegedly wrongful conduct.[11]

The Eleventh Circuit took a similarly broad view of proximate cause under the FHA. Drawing on tort principles, the Eleventh Circuit adopted "foreseeability" as the appropriate test for proximate cause.[12] Even though the City's alleged causal chain contained several links (alleged discriminatory lending→ defaults → foreclosures → vacant homes → vagrancy, crime, and property damage → decreased property values and increased demand for services → additional costs to City), the Eleventh Circuit reasoned none of the links were unforeseeable.[13] In so holding, the Eleventh Circuit expressly rejected the banks' contention that direct harm was required.[14] The Supreme Court granted a writ of certiorari.

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[5] As defined by the City, predatory loans include:

> high-cost loans (i.e., loans with an interest rate that was at least three percentage points above a federally established benchmark), subprime loans, interest-only loans, balloon payment loans, loans with prepayment penalties, negative amortization loans, no documentation loans, and/or ARM loans with teaser rates (i.e., lifetime maximum rate > initial rate + 6%).

Complaint at 34, ¶ 106, *City of Miami*, No. 13-24506-CIV (S.D. Fla. Dec. 13, 2013) (ECF No. 1). The alleged predatory lending practices at issue included steering qualified borrowers into risky subprime loans when they qualified for prime or conventional loans, offering risky adjustable rate mortgages without adequately without adequately explaining the impact of future payment increases following the loans' initial rate periods, and permitting borrowers to refinance existing mortgages with new loans on less affordable terms. *See id.* at 15-17, ¶ 48.

[6] *See generally City of Miami*, 13-24506-CIV, 2014 WL 3362348, at *7 (S.D. Fla. July 9, 2014), *aff'd in part, rev'd in part and remanded*, 800 F.3d 1262 (11th Cir. 2015), *vacated and remanded sub nom.*, 15-1111, 2017 WL 1540509 (U.S. May 1, 2017).

[7] *Id.* at *4.

[8] *Id.* at *5.

[9] *City of Miami*, 800 F.3d at 1266.

[10] *Id.* at 1278.

[11] *Id.*

[12] *Id.* at 1282.

[13] *Id.*

[14] *Id.* at 1280.

c. The Supreme Court's Decision

The Supreme Court, despite finding it was bound to hold the City was an aggrieved person with statutory standing to sue under the alleged facts,[15] unanimously rejected the Eleventh Circuit's conclusion that mere foreseeability of harm could establish proximate cause. All eight justices[16] deciding the case agreed proximate cause under the FHA demands much more:

> The proximate-cause analysis asks whether the harm alleged has a sufficiently close connection to the conduct the statute prohibits. With respect to the FHA, foreseeability alone does not ensure the required close connection. Nothing in the statute suggests that Congress intended to provide a remedy for any foreseeable result of an FHA violation, which may cause ripples of harm to flow far beyond the defendant's misconduct; and doing so would risk massive and complex damages litigation. Rather, proximate cause under the FHA requires some direct relation between the injury asserted and the injurious conduct alleged.[17]

The majority opted not to decide the exact contours of proximate cause under the FHA, including whether the City's indirect financial harms were closely connected to the banks' alleged violation,[18] but Justice Thomas's opinion concurring in part and dissenting in part (joined by Justices Kennedy and Alito) expressed little doubt the City would fail the "rigorous standard" set by the Court.[19] Because the Eleventh Circuit found proximate cause basedon foreseeable harm, the Court vacated the opinion below and remanded the case for further consideration.[20]

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[15] The doctrine of *stare decisis*—at least according to the majority—compelled the conclusion that the City was an aggrieved person because its alleged financial injuries, specifically its lost tax revenues, arguably fell within the FHA's zone of interests, as the Court previously had interpreted what it means to be aggrieved under the FHA very broadly in cases like *Trafficante v. Metropolitan Life Ins. Co*., 409 U.S. 205, 209-12 (1972) (permitting white tenants to sue based on discriminatory leasing practices that prevented minorities from living in an apartment complex), and *Gladstone, Realtors v. Village of Bellwood*, 441 U.S. 91, 110-11 (1979) (endorsing a suit by a village against real estate brokers and sales personnel, in part, based on the tax revenue lost due to discrimination against minority purchasers in the home-buying process). *See City of Miami*, 2017 WL 1540509, at *6. This result was buttressed by the fact that Congress re-enacted the relevant statutory text in 1988 with no material change, thereby ratifying the Court's prior interpretations. *Id.* at *7.

The majority notably did not rely on statements in earlier decisions such as *Gladstone* suggesting the FHA sets a zone of interests as broad as Article III permits. As the banks explained, giving a cause of action under the FHA to every person with constitutional standing would conflict with the Court's more recent holding in *Thompson v. North American Stainless, LP*, 562 U.S. 170 (2011), recognizing that stretching the zone of interests under Title VII of the Civil Rights Act of 1964 to the outer limits of Article III would produce farfetched results. *Id.* The banks argued the reasoning of *Thompson* equally should apply under the FHA because it could not have been Congress's intent when it enacted or amended the FHA to authorize lawsuits by every participant in the local economy who may experience some attenuated harm due to a bank's alleged discriminatory lending practices. *Id.* The majority's decision to side-step *Thompson* leaves open the possibility that indirect injuries suffered by municipalities not covered by *stare decisis* may not fall within the FHA's zone of interests. The same is true for injuries alleged by other market participants whose "interests are so marginally related to or inconsistent with the purposes implicit in the statute that it cannot be assumed that Congress intended to permit the suit." *Thompson*, 562 U.S., at 178.

[16] Justice Gorsuch did not participate in the decision.

[17] *City of Miami*, 2017 WL 1540509, at *2 (internal citations omitted) (internal quotation marks omitted) (emphasis added). Justices Thomas, Kennedy, and Alito joined in the majority's "conclusions about proximate cause, as far as they go." *Id.* at *15 (Thomas, J., concurring in part and dissenting in part).

[18] *Id.* at *4.

[19] *Id.* at *15 (Thomas, J., concurring in part and dissenting in part).

[20] *Id.* at *4.

Takeaways for Lenders

There are several reasons for lenders to appreciate the Court's decision notwithstanding its limitations.

First, the Court squarely rejected the idea that a party suing to recover for indirect harms can state a viable claim under the FHA merely because the alleged harms were foreseeable.

Second, the Court set its directness requirement recognizing courts generally should not go beyond the "first step" in the causal chain.[21] The case cited by the Court in support of this requirement suggests the City's claim may fail on remand.[22] At least three Justices agree the City of Miami cannot show proximate harm.[23] With Justice Gorsuch joining the Court and Chief Justice Roberts uncommitted to a position, there is reason to believe a majority of the Court may support this proximate cause analysis.

Third, several roadblocks to derivative lending discrimination claims still stand.

- **Viable claims/damages will be difficult to allege, much less prove**. The studies and statistics underlying the City of Miami's complaints against the banks (which still have not been shown to be accurate or reliable), may be unavailable or prohibitively expensive.

- **The statute's limitations period is two years**.[24] Crisis-era claims like the City's likely are barred if not yet filed. Indeed, even the City's claims may be barred.[25]

- **Lending standards and practices have tightened since 2004**. Considering the heightened judicial and regulatory scrutiny under which lenders now operate—and have operated for many years—it seems much less likely that sophisticated financial institutions are engaging in the allegedly problematic lending practices the City complained about (but has not proven) in type, degree, or volume.

- **The available damages are not bet-the-company sums**. Even in the case of Miami, one of the cities hit hardest by the recent recession, the damages the City seeks to recover spanning from 2004 to 2012 are in the "millions, not hundreds of millions, not

[21] *City of Miami*, 2017 WL 1540509, at *2 (quoting *Hemi Group, LLC v. City of New York, N.Y.*, 559 U.S. 1, 10 (2010)) (internal quotation marks omitted).

[22] *See generally Hemi Group, LLC*, 559 U.S. 1, 10 (2010) (concluding the City of New York failed to establish proximate cause for a RICO claim when the City's multi-step theory of causation between the defendant's alleged failure to report customer information to the State of New York and the City's inability to determine whether those customers paid cigarette possession taxes required the Court to "move well beyond the first step").

[23] *City of Miami*, 2017 WL 1540509, at *17 (Thomas, J., concurring in part and dissenting in part) ("Under Miami's own theory of causation, its injuries are one step further removed from the allegedly discriminatory lending practices than the injuries suffered by the neighboring homeowners whose houses declined in value. No one suggests that those homeowners could sue under the FHA, and I think it is clear that they cannot.").

[24] *See* 42 U.S.C. § 3613(a)(1)(A).

[25] The City contends the suits are timely because the banks' alleged patterns and practices of unlawful discrimination have been continuous since 2004, therefore, the Act's two-year statute of limitations had not commenced when the complaints were filed. *See, e.g.*, Complaint at 51-52, ¶ 151, *City of Miami*, 13-24506-CIV (S.D. Fla. Dec. 13, 2013) (ECF No. 1). In one of the cases, the district court rejected this argument and dismissed the City's FHA claims as untimely. *City of Miami*, 13-24506-CIV, 2014 WL 3362348, at *6. The Eleventh Circuit reversed, concluding the City alleged sufficient facts at the pleading stage to plausibly invoke the continuing violation doctrine *if* it identified violations within the limitations period on remand. *City of Miami*, 800 F.3d at 1285.

On remand, the district court again found the claims untimely based on the City's amended allegations but granted leave to amend once more. Order Granting Motion to Dismiss Second Amended Complaint, *City of Miami*, 13-24506-CIV (S.D. Fla. Mar. 17, 2016) (ECF No. 98). The City filed a third amended complaint, which the bank again moved to dismiss on limitations grounds. Third Amended Complaint, *id.* (ECF No. 102); Motion to Dismiss Third Amended Complaint, *id.* (ECF No. 103). The case was soon thereafter stayed in view of the Supreme Court proceedings and the motion remains pending. Order, *id.* (ECF No. 128). The claims could be time-barred.

billions" according to the City's counsel.[26] And that figure presumably reflects an optimistic estimate based on an unproven methodology.

- **The risk of a take-nothing judgment for plaintiffs is high**. The Court's silence on the specifics of the FHA's proximate cause requirement could invite claims from municipalities or other parties in the short term. The indirect injuries inherent in these categories of claims, however, necessarily involve causal chains, and that, in many instances, will go beyond the "first step" in the chain. The Supreme Court's opinion invites aggressive motion practice on proximate cause, potentially resulting early dismissals.

Conclusion

The *City of Miami* ruling is a mixed bag for the lending community. The banks lost the initial battle on statutory standing under the FHA but may be set to win the war on proximate cause. Lenders should pay particular attention to the Eleventh Circuit's decision on that issue after remand. Considering the court's rejection of the banks' positions in the first instance, a change of course in view of the Supreme Court's guidance could send a strong message to the bench and bar that new FHA claims based on similarly attenuated causal theories will be dead on arrival.

A copy of the Supreme Court's opinion is available here (no password required).

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[26] Transcript of Oral Argument at 35, *City of Miami*, No. 15-1111 (Nov. 8, 2016) (Robert S. Peck, Esq. arguing for the Respondents) (noting "that before the City of Miami brought its case, the cities of Memphis and Baltimore both brought cases, and they ended up settling cases with identical types of allegations for less than 10 million each. So we are not talking about huge sums of money . . . .").