

Real Estate *Update*

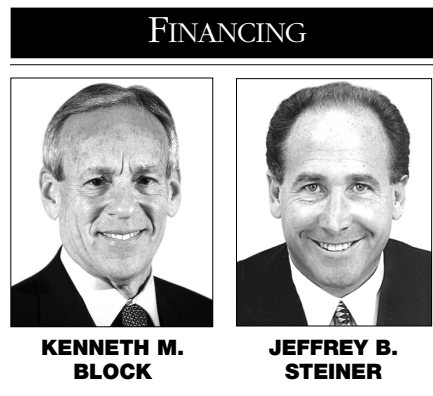
30 Years of 'Equal Credit'

Courts Remain Split on a Standard of Proof

The recent Second Circuit decision in *Kwiatkowski v. JPMorgan Chase & Co., Citibank, N.A.*, 96 Fed. Appx. 789 (2d Cir. 2004), involving the Equal Credit Opportunity Act of 1974, 15 U.S.C. §1691 et seq., affords us an opportunity to reexamine the provisions of this important anti-discrimination statute and review the split in authority among the circuits in applying standards of proof to determine the presence of discriminatory lending practices.

The Equal Credit Opportunity Act prohibits any creditor from discriminating against a credit applicant, "with respect to any credit transaction, on the basis of race, color, religion, national origin, sex or marital status, or age ..."¹ The types of credit transactions that are protected include but are not limited to business loans, consumer leases, consumer loans, auto loans, credit cards, and various loans for residential or commercial real estate.² By enacting the act and thereby prohibiting discrimination in credit transactions, Congress hoped to promote

Kenneth M. Block and **Jeffrey B. Steiner** are members of Brown Raysman Millstein Felder & Steiner in New York. **Natalie Newman**, a summer associate, assisted in the preparation of this article.



economic stabilization and strengthen competition "among the various financial institutions and other firms engaged in the extension of credit."³

The law provides a private right of action in the federal courts but fails to set forth any evidentiary standards a claimant must meet in order to establish a claim of unlawful discrimination in a credit transaction. This statutory void led many courts deciding credit discrimination cases to resort to a methodology utilized by the courts in the employment discrimination context, as enunciated in *McDonnell Douglas Corp. v. Green*, 411 U.S. 792 (1973). However, not all federal courts have adopted this methodology, as the Second Circuit noted in *Kwiatkowski*, where it expressly declined to reach the issue. Thus, the use of the *McDonnell Douglas* methodology remains an open question in this circuit.

The 'McDonnell Douglas' Methodology

In 1973, the United States Supreme Court set forth the elements that a private, non-class action claimant must prove in order to establish a prima facie cause of action under Title VII of the Civil Rights Act of 1964 alleging employment discrimination. The Court also outlined a specific burden-shifting methodology, by which subsequent adjudicating courts are to allocate the burden of proof among the parties.

First, the plaintiff in a Title VII trial has the burden of establishing a prima facie case of racial discrimination. To accomplish this, the plaintiff must show:

- (a) That he belongs to a racial minority.
- (b) That he applied and was qualified for a job which the employer was seeking applicants.
- (c) That, despite his qualifications, he was rejected.
- (d) That, after his rejection, the position remained open and the employer continued to seek applicants from persons of complainant's qualifications. *McDonnell Douglas Corp. v. Green*, 411 U.S. at 802.

Once the plaintiff has proven these four elements, the burden shifts to the defendant employer, who must put forth a

“legitimate, non-discriminatory” reason for denying plaintiff’s application. If the defendant meets this burden, the analysis does not end, but rather another shift must occur, thereby giving the plaintiff “a full and fair opportunity to demonstrate by competent evidence that the presumptively valid reasons for his rejection were in fact a cover-up for a racially discriminatory decision.” *Id.* at 805.

In *McDonnell Douglas*, Green, the employee-claimant, charged that he was denied re-employment with defendant employer because of his involvement in various activities in the Civil Rights movement, and because of his race. *Id.* at 794. The court found that Green met his initial burden, thereby establishing a *prima facie* case. *Id.* at 803. *McDonnell Douglas* then denied any discriminatory reason for rejecting Green’s employment application and cited only to the fact that he was involved in unlawful activity targeted directly at the company itself.

Ultimately, the Supreme Court held that even though Green was as qualified for the position as the other applicants, “nothing in Title VII compels an employer to absolve and rehire one who has engaged in such deliberate, unlawful activity against it.” *Id.*

Notwithstanding the particular facts and holding in *McDonnell Douglas*, the standard set forth by the Supreme Court, articulated above, has since been utilized in numerous later cases and in a variety of legal and factual contexts, including, most relevantly, credit discrimination.

The ‘Kwiatkowski’ Approach

In *Kwiatkowski*, the Second Circuit held that two lenders, JPMorgan Chase & Co. and Citibank, N.A., did not violate the Equal Credit Opportunity Act when they denied claimant’s application for a \$550,000 business loan. The court affirmed the district court’s finding that the plaintiff failed to show that he was

otherwise qualified for the loan, which not only constituted a legitimate explanation for the lenders’ rejection, but which also sufficiently countered any allegation of discrimination. *Kwiatkowski*, 96 Fed. Appx. 789, 790.

In *Kwiatkowski*, plaintiff charged the two lending institutions with intentional discrimination based on national origin, a clear violation of the act’s prohibitions. *Id.* at 789. The district court dismissed the complaint after evaluating it under the Title VII burden-shifting procedure laid out in *McDonnell Douglas*. The district court based its decision on the fact that Kwiatkowski failed to show that he was qualified for the loan in the first place, and he did not meet the requirements set by either the Small Business Administration or the individual defendant-banks’ lending criteria.

Because Kwiatkowski was not qualified for the loan he applied for, his claim could not withstand defendants’ summary judgment motion, since such qualification is “determinative to a claim of intentional discrimination under the ECOA.” *Id.* at 790. The Second Circuit affirmed, explicitly avoiding the issue of whether the lower court’s application of the Title VII burden shifting methodology was proper. Because the plaintiff was not qualified for the loan regardless of his nationality, the court did not have to borrow any specific methodology to reach a decision. It ruled: “this Court has not yet reached the question of whether that methodology applies to credit discrimination cases.” *Id.* In so ruling, the Second Circuit also observed that a rift remains among the circuits regarding the appropriateness of this very methodology to credit discrimination cases.

In *Latimore v. Citibank Fed’l Savings Bank*, 151 F.3d 712, 715 (7th Cir. 1998), the Seventh Circuit expressly rejected the Title VII methodology, specifically stating that “neither *McDonnell Douglas* nor the kind of *McDonnell Douglas* knock off

which we have just sketched is available here.” Rather, “it is always open to a plaintiff in a discrimination case to try to show in a conventional way, without relying on any special doctrines of burden-shifting, that there is enough evidence, direct or circumstantial, of discrimination to create a triable issue.” *Id.* at 715.

Appraisal Issue

In *Latimore*, the plaintiff, a black female loan applicant, brought a suit against Citibank and two of its individual employees, claiming that her loan application was rejected for discriminatory reasons, in violation of ECOA and the Fair Housing Act. *Id.* at 713. Even though *Latimore* met Citibank’s requirements for creditworthiness, she failed to satisfy the bank’s appraisal qualifications, which require that the ratio of the appraised value of the applicant’s security — in this case, plaintiff’s home — to the loan amount does not exceed 75 percent. In fact, *Latimore*’s loan-to-value ratio was 113 percent, which led to the rejection of her application. When *Latimore* provided the bank with an appraised value from another institution, the bank still rejected her loan application, and she filed this suit charging credit discrimination.

The main reason for the court’s rejection of the “wholesale transposition of the *McDonnell Douglas* standard” was the absence of the kind of direct competition that exists amongst applicants in credit or lending situations, but which readily exists in the employment context, where often, multiple applicants are directly competing against one another for a single position of employment. *Id.* at 714. *Latimore* did not allege any competition and could not establish a strong argument that she was in a similar situation as another applicant.

The court pointedly said that the *McDonnell Douglas* standard is an “unsuitable[e] ... framework when there is no basis

for comparing the defendant's treatment of the plaintiff with the defendant's treatment of other, similarly situated persons." *Id.* at 714. The court also felt the need to "remind" readers that the Supreme Court never intended to establish a rigid standard to be applied to every subsequent discrimination case, but rather, intended to limit it to the employment context, or at least, closely analogous situations. *Id.* Thus, under the "conventional standards" of proving a claim of discrimination and "without relying on any special doctrines of burden shifting," the court found that Latimore was unable to create a triable issue for a reasonable jury to decide. *Id.* at 715.

Contrary to the Seventh Circuit, the First Circuit, along with the Fifth and Sixth Circuits, have each affirmatively adopted and applied the *McDonnell Douglas* Title VII burden-shifting methodology into their lending discrimination jurisprudence.

Mercado-Garcia v. Ponce Federal Bank, 979 F.2d 890 (1st Cir. 1992), is the leading First Circuit decision adopting the Title VII burden-shifting methodology in a credit context. The court there pointed out that ECOA itself offers no guidance to the courts that are faced with its enforcement. Specifically, ECOA "does not reveal what it is an ECOA plaintiff like Mercado must establish in order to make out a prima facie case of unlawful discrimination in a credit decision and to withstand a creditor's motion for summary judgment." *Id.* at 892. The court therefore utilized the employment discrimination standard to place the initial burden of pleading a prima facie case of age discrimination on the plaintiff.

The facts of *Mercado* are a bit different from other typical Equal Credit Opportunity Act cases. In *Mercado*, plaintiff was an employee of defendant bank and sued the bank for age discrimination when he was dismissed from his job, which incidentally terminated his

credit card and a loan he had taken out from the bank. *Id.*

Shifting Burdens

The court found that *Mercado* presented sufficient evidence to establish a prima facie case of discrimination, which shifted the burden to the bank to "articulate some legitimate, nondiscriminatory reason" for the various credit and financial terminations. *Id.* at 893. Because the credit card and the loan were both privileges that accompanied — and were contingent on — plaintiff's continued employment with the defendant, plaintiff's termination as an employee with defendant constituted a sufficiently "legitimate and nondiscriminatory" reason for its actions, thereby allowing the court to find that the bank carried its burden. *Id.* When the burden shifted back to Mercado to demonstrate that the bank's reasons were merely a pretext for the discrimination, Mercado was unable to do so. Thus, after applying the *McDonnell Douglas* standard in full, the court ultimately affirmed the lower court's grant of defendant's summary judgment. *Id.* at 896.

Another First Circuit case found the Title VII methodology quite applicable to a claim of credit discrimination based on gender, against a lending institution. In *Rosa v. Park West Bank & Trust Co.*, 214 F.3d 213 (1st Cir. 2000), plaintiff alleged that the defendant bank refused to give him a loan application because he was wearing traditional female clothing, instead of "masculine attire." *Id.* at 214. Plaintiff alleged that an employee of the bank told him that she would not give him a loan application until he "went home and changed." *Id.* The District Court held for the defendant, finding that "the Act does not prohibit discrimination based on the manner in which someone dresses." *Id.* However, on appeal, the First Circuit reversed the District Court, and remanded the case for further proceedings

utilizing the *McDonnell Douglas* standard, which may help to suggest that plaintiff "did not receive the loan application because he was a man, whereas a similarly situated woman would have received the loan application." *Id.* at 215.

Like the First Circuit, the Sixth Circuit⁴ and the Fifth Circuit have both found the Title VII burden-shifting methodology applicable and useful in their own credit discrimination analyses.

Conclusion

The Equal Credit Opportunity Act was intended by Congress to prohibit credit determinations based on characteristics other than those related to creditworthiness. It has been enacted for 30 years, but has continued to burden courts with its enforcement by failing to provide an explicit methodology by which a plaintiff must establish a claim under the act.

While some circuit courts have borrowed standards from the employment discrimination arena and while other courts have refused to adopt such standards, the Second Circuit has failed to take a position altogether, neither adopting nor rejecting the Title VII methodology. Such adoption, if ever, must await further decisions.

1. 15 U.S.C. §1691(a)(1).

2. ECOA Examination Procedures, Part III, Fair Lending (also includes all definitions of terms relating to the ECOA).

3. Section 502 of Title V of the Act of Oct. 28, 1974, showing findings and purpose, available at <http://www.fdic.gov/regulations/laws/rules/6500-1200.html>.

4. See, e.g., *Lewis v. ACB Business Services Inc.*, 135 F.3d 389 (6th Cir. 1998) (adapting the burden allocation framework used in employment discrimination claims to ECOA claims).