

No. 10-0245

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IN THE SUPREME COURT OF TEXAS

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PATRICK O. OJO, On Behalf of Himself and  
All Others Similarly Situated,

Plaintiff-Appellant,

vs.

FARMERS GROUP, INC., FIRE UNDERWRITERS ASSOCIATION, FIRE  
INSURANCE EXCHANGE, FARMERS UNDERWRITERS ASSOCIATION, and  
FARMERS INSURANCE EXCHANGE,

Defendants-Appellees.

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On Certification From  
The United States Court of Appeals  
For The Ninth Circuit  
No. 06-55522

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APPELLANT'S OPENING BRIEF ON THE MERITS

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## I. STATEMENT OF THE CASE

*Nature of the Claim:* Plaintiff Ojo, an African-American resident of Houston, filed a class action suit against Farmers Group, Inc., *et al.*, under the federal Fair Housing Act (“FHA”), 42 U.S.C. §3604. Ojo alleges that Farmers engaged in disparate impact discrimination by using undisclosed and unfairly discriminatory credit factors to increase by at least nine percent his homeowner’s insurance rates, and those of other African-American policyholders.

*Trial Court:* United States District Court for the Central District of California, Hon. Donald Walter, Judge.

*Course of Proceedings:* Farmers moved to dismiss Ojo’s complaint on the ground that the federal FHA claim was reverse-preempted under the McCarran-Ferguson Act (15 U.S.C. §1012). Farmers contended that Texas credit scoring laws (Tex. Ins. Code §§559.051-559.052) permit disparate impact discrimination. The district court granted the motion to dismiss, holding that Texas credit scoring statutes only prohibit the use of credit factors that constitute intentional discrimination, and therefore the federal FHA disparate impact claim was in conflict with and preempted by Texas insurance laws.

*Court of Appeals:* The Ninth Circuit reversed and held that by prohibiting credit factors that “constitute unfair discrimination,” the Texas credit scoring statutes prohibit all forms of discrimination, including disparate impact discrimination. As so construed, the Texas statutes are not in conflict with and do not preempt the FHA claim. *Ojo v. Farmers Group, Inc.*, 565 F.3d 1175 (9th Cir. 2009). The Ninth Circuit granted rehearing *en banc*, and held that the FHA applied to homeowners insurance, *Ojo v. Farmers Group Inc.*, No. 06-55522, 2010 U.S. App. LEXIS 7325 (9th Cir. Apr. 9, 2010), but certified the state law question of the scope of the Texas credit scoring provisions to this Court. *Ojo v. Farmers Group, Inc.*, No. 06-55522, 2010 U.S. App. LEXIS 9052 (9th Cir. Apr. 9, 2010).

## II. JURISDICTION

This Court has jurisdiction to address the question certified pursuant to Texas Rule of Appellate Procedure 58, and also because this matter involves the “construction” of a statute “necessary to the determination of the case.” Tex. Gov’t Code §22.001(a)(3).

## III. STATEMENT OF THE ISSUE

Does Texas law permit an insurance company to price insurance by using a credit-score factor that has racially disparate impacts, or would using such a credit-score factor violate Texas Insurance Code §§544.002(a), 559.051, 559.052, or some other provision of Texas law?

## IV. STATEMENT OF FACTS

The factual background is drawn mainly from the Ninth Circuit’s Order Certifying Question, as supplemented by the record.<sup>1</sup> *See Ojo*, 2010 U.S. App. LEXIS 9052.

Patrick O. Ojo is an African-American resident of Texas and the owner of a homeowner’s property-and-casualty policy issued by Farmers, a Nevada Corporation that maintains its headquarters in Los Angeles, California. In January 2004, Farmers increased Ojo’s homeowner’s insurance premium by nine percent, even though he had made no prior claims on the policy. Farmers told Ojo that the increase was due to unfavorable credit

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<sup>1</sup> All “ER” references are to pages in the Excerpts of Record filed in the Ninth Circuit; “SER” = Supplement Excerpts of Record. All “¶” references are to the Complaint. “DB” = Defendant Farmers Group, Inc.’s (“Farmers”) Brief in the Ninth Circuit.

information obtained through the company's automated credit scoring system. *Ojo*, 2010 U.S. App. LEXIS 9052, at \*2.

Ojo sued Farmers and its affiliates, subsidiaries, and reinsurers (collectively "Farmers") in federal court on behalf of himself and other minorities who were charged higher homeowners' policy premiums due to Farmers' credit scoring system. Ojo claims that defendants, acting in concert, use a number of "undisclosed factors" in their credit scoring system that disparately impact minorities, in violation of the federal FHA, 42 U.S.C. §§3601-3619. Ojo does not claim that defendants intentionally discriminated against any members of the putative plaintiff class. *Ojo*, 2010 U.S. App. LEXIS 9052, at \*3.<sup>2</sup>

It is unlawful under the FHA "[t]o 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." 42 U.S.C. §3604(b). Federal courts have interpreted this provision to prohibit not just intentional discrimination but also actions that have a discriminatory effect based on race (disparate impact discrimination). *See, e.g.,*

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<sup>2</sup> Ojo's disparate racial impact claim, based on increased insurance rates charged to minorities, is not an isolated incident. Similar complaints, based on unfairly discriminatory insurance practices, including credit scoring, redlining, and other such tactics, have been upheld in several circuits. *See, e.g., Dehoyos v. Allstate Corp.*, 345 F.3d 290, 295 (5th Cir. 2003) (disparate impacts/credit scoring); *Moore v. Liberty Nat'l Life Ins. Co.*, 267 F.3d 1209, 1211-13 (11th Cir. 2001) (intentional discrimination/burial insurance); *Nationwide Mut. Ins. Co. v. Cisneros*, 52 F.3d 1351, 1354, 1359-60 (6th Cir. 1995) (disparate impacts/redlining); *NAACP v. Am. Family Mut. Ins. Co.*, 978 F.2d 287, 300-01 (7th Cir. 1992) (disparate impacts/redlining).

*Simms v. First Gibraltar Bank*, 83 F.3d 1546, 1555 (5th Cir. 1996); *Pfaff v. United States HUD*, 88 F.3d 739, 745-46 (9th Cir. 1996).

Nearly all circuits have held that the FHA and its implementing regulation ban both intentional and disparate impact discrimination in the sale of property insurance. *See, e.g., Am. Family*, 978 F.2d at 300-01. The regulation provides that it is unlawful to discriminate by “[r]efusing to provide . . . property or hazard insurance . . . or providing such . . . insurance differently because of race.” 24 C.F.R. §100.70(d)(4).

Texas enacted its own state Fair Housing Act (“Texas FHA”) in 1989, to “provide rights and remedies substantially equivalent to those granted under federal law.” Tex. Prop. Code §§301.001, 301.002(3), 301.021(b). To implement the Texas FHA, Texas adopted a regulation – ***identical to the federal FHA regulation*** – whose language federal courts have construed to ban ***both*** intentional and disparate impact race discrimination by insurers. 40 Tex. Admin. Code §819.124(b)(4); *see Am. Family*, 978 F.2d at 300-01. Like the federal FHA, the Texas FHA also allows an “aggrieved person” to file a civil action for damages. Tex. Prop. Code §§301.151, 301.153; 42 U.S.C. §3613.

To establish his disparate impact claim, Ojo must plead and later prove that one or more of Farmers’ credit factors caused a disparate increase in insurance rates for minority policyholders. If Ojo did so prove, the burden switches to Farmers to prove a legitimate business necessity for such factors. If Farmers proves business necessity, Ojo would bear the burden of proving that alternative factors would be as effective, but produce less disparate impacts. *See Albemarle Paper Co. v. Moody*, 422 U.S. 405, 425 (1975).

Ojo’s complaint alleges that Farmers used “a number of undisclosed [credit] factors” in setting rates for homeowners insurance that disparately impact policyholders on the basis of race. (ER 5¶17, 7¶27) Farmers moved to dismiss contending incorrectly that the complaint challenges credit scoring *per se*. (DB 38-40) The district court did not determine whether Ojo’s complaint sufficiently stated a claim of disparate impact discrimination under Rule 12(b)(6) pleading standards. Instead, despite Ojo’s express disclaimers at the hearing that he only challenged credit factors producing disparate racial impacts (ER 79-80, 83; SER 100), the court erroneously concluded that Ojo challenges “the very practice of credit scoring.” (ER 123:11, 129:9) Based on this incorrect characterization, the court held that the Texas Insurance Code preempted Ojo’s FHA claims under the reverse-preemption standard set forth in the McCarran-Ferguson Act. *Ojo*, 2010 U.S. App. LEXIS 9052, at \*3.<sup>3</sup>

Ojo appealed, and a divided three-judge panel of the Ninth Circuit reversed the district court. *Ojo*, 2010 U.S. App. LEXIS 9052, at \*3. The majority first held that the complaint did not challenge credit scoring *per se*: “Read in the light most favorable to Ojo, the Complaint does not advance an ‘all or nothing’ challenge to the practice of credit scoring.

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<sup>3</sup> The McCarran-Ferguson Act provides: “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 . . . .” 15 U.S.C. §1012(b). Thus, under the McCarran-Ferguson Act, state law preempts a federal statute if (1) the federal law does not specifically relate to insurance; (2) the state law is enacted for the purpose of regulating insurance; and (3) the application of federal law to the case might invalidate, impair, or supersede the state law. *Humana Inc. v. Forsyth*, 525 U.S. 299, 307 (1999).

The Complaint alleges only that certain ‘undisclosed factors’ used by Farmers in its credit scoring system produces a disparate impact on minorities.” *Ojo*, 565 F.3d at 1183.<sup>4</sup>

The majority further held that Texas insurance laws, including those permitting credit scoring, do not condone disparate impact discrimination and therefore do not reverse-preempt *Ojo*’s federal FHA claim. *Ojo*, 565 F.3d at 1183-89. The panel majority found it “most significant” that “Texas’s own Fair Housing Act prohibits disparate impact race discrimination,” and held that “‘unfair discrimination’” in §§559.051 and 559.052, when read in harmony with the related provisions of the Texas FHA, as well as §§544.002, 544.003(b) and art. 1.02 of the Code, encompassed both intentional and disparate impact discrimination. *Ojo*, 565 F.3d at 1184-85.

The Ninth Circuit subsequently ordered that the case be reheard *en banc*. *Ojo v. Farmers Group, Inc.*, 586 F.3d 1108 (9th Cir. 2009). On April 9, 2010, in its *en banc* decision and in its certification order, a unanimous Ninth Circuit put to rest the controversy regarding the scope of the complaint, stating that it alleges defendants “use a number of ‘undisclosed factors’ in their credit scoring system that disparately impacts minorities.” *Ojo*, 2010 U.S. App. LEXIS 7325, at \*3 (*en banc*); *Ojo*, 2010 U.S. App. LEXIS 9052, at \*3.

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<sup>4</sup> The rule is the same in Texas: “the allegations of the pleadings” are “taken as true and construed most favorably in behalf of the pleader.” *Round Rock v. Smith*, 687 S.W.2d 300, 301 (Tex. 1985). Defendants are not free to recharacterize the complaint.

Thus, as the Ninth Circuit explicitly recognized, Ojo’s complaint challenges racially discriminatory credit factors – not credit scoring *per se*.

The unanimous *en banc* decision also held, consistent with nearly all circuits, that the federal FHA applies to homeowners insurance. *Ojo*, 2010 U.S. App. LEXIS 7325, at \*4-\*7. The *en banc* court also held that if state insurance law conflicts with the federal FHA, an FHA claim could be preempted by the McCarran-Ferguson Act. *Id.* at \*7-\*10. The *en banc* court concluded, however, that the degree of protection against racial discrimination afforded by Texas insurance law is an unsettled question of Texas law. The Ninth Circuit therefore certified to this Court the question of whether Texas insurance laws which allow credit scoring but prohibits the use of credit “factors that constitute unfair discrimination” – prohibits only intentional discrimination, or also prohibits disparate impact discrimination based on race. *Ojo*, 2010 U.S. App. LEXIS 9052, at \*7-\*9.

## V. SUMMARY OF THE ARGUMENT

Texas Insurance Code §§559.051 and 559.052 authorize insurance companies to set rates using credit scoring to assess risk. But both provisions explicitly prohibit use of credit “factors that constitute unfair discrimination.” *Id.* Ojo does not challenge credit scoring *per se*, but rather alleges that Farmers used “a number of undisclosed factors” in its credit scoring system which exert a disparate impact on racial minorities. (ER 7¶27, 10¶44)

First, Ojo relies on the plain language of the Texas credit scoring statutes. The words “unfair discrimination” mean something broader than “intentional discrimination.” If the Texas Legislature had intended to prohibit only credit factors that constitute intentional

discrimination it could have easily have said so directly by using the words “intentional discrimination,” but did not. Texas courts adhere strictly to the plain language of the statute to discern legislative intent, and do not insert words that the legislature omitted.

The broad plain meaning of “unfair” is consistent with the view that disparate racial impacts are just as unfair as intentional discrimination. ““The arbitrary quality of *thoughtlessness can be as disastrous and unfair* to private rights and the public interest *as* the perversity of *a willful scheme.*” *Pfaff*, 88 F.3d at 746 n.2. The United States Supreme Court has rejected as unsubstantiated rhetoric contentions like Farmers has made in this case, that allowing suits for disparate racial impacts would disrupt legitimate business activity: “We do not believe that disparate impact theory need have any chilling effect on legitimate business practices.” *Watson v. Ft. Worth Bank*, 487 U.S. 977, 993 (1988).

Second, the Texas FHA was enacted in 1989 with the express intent to provide the same rights and remedies as the federal FHA, which prohibited disparate impact discrimination. Tex. Prop. Code §301.002(3). “When the [Texas] Legislature adopts a federal statute, we presume that it knew of the federal court’s construction . . . when it adopted the statute and intended to adopt that construction.” *City of Garland v. Dallas Morning News*, 22 S.W.3d 351, 360 (Tex. 2000). In fact, the Texas agency that enforces the Texas FHA adopted a regulation containing language identical to the federal FHA regulation that bars disparate impact discrimination with respect to homeowners insurance. 40 Tex. Admin. Code §819.124(b)(4); *see* 24 C.F.R. §100.70(d)(4).

Third, when the Texas Legislature enacted the credit scoring authorization provisions in 2003, and used the phrase “unfair discrimination,” rather than “intentional discrimination,” it did so with full knowledge that the Texas FHA already prohibited disparate impact discrimination in the sale of homeowners insurance. *Acker v. Texas Water Comm’n*, 790 S.W.2d 299, 301 (Tex. 1990). Texas courts will construe Texas statutes implementing federal rights consistent with federal case law, including protection against disparate impact discrimination. *Quantum Chem. Corp. v. Toennies*, 47 S.W.3d 473, 476 (Tex. 2001); *Texas Parks & Wildlife Dep’t. v. Dearing*, 240 S.W.3d 330, 351 (Tex. App. – Austin 2007, pet denied).

Accordingly, reading the Texas credit scoring provisions in harmony with the Texas FHA, as required by Texas rules of statutory interpretation, confirms that the plain meaning of “unfair discrimination” is broader than “intentional discrimination,” and encompasses disparate impact discrimination. Since the Texas Insurance Code provisions barring credit factors that “constitute unfair discrimination” are in harmony with the Texas FHA barring disparate impact discrimination, those insurance provisions are also in harmony with and do not conflict with the federal FHA.

Farmers has previously contended, however, that a Texas regulation, 28 Tex. Admin. Code §5.9941(a), creates a complete “actuarial defense” and permits insurers to use credit factors that produce disparate racial impacts on insurance rates as long as the factors used are actuarially sound. (DB 23-24) Plainly, Farmers hopes to avoid judicial scrutiny of its credit

factors by blocking Ojo’s disparate impact discrimination claim. But such scrutiny is warranted because Texas law prohibits disparate impact discrimination.

In fact, the regulation simply provides that if an insurer charges higher rates due “solely” to credit scoring, the factors used must be actuarially sound. The regulation establishes a *necessary but not sufficient requirement* that increased rates based “solely” on credit scoring be actuarially justified. The regulation does not address, let alone excuse, any form of race discrimination. Indeed, many intentionally discriminatory factors frequently are actuarially sound, which is why insurers often use them. Thus, the regulation does not create an actuarial soundness defense to discrimination based in whole or in part on race, or trump the rest of the Texas Insurance Code.

Moreover, the Texas Insurance Code expressly provides there is no actuarial defense to “unfair discrimination” in rates charged “because of the individual’s race.” Tex. Ins. Code §§544.002(a)(1), 544.003(b). Significantly, the Texas Legislature reaffirmed the preclusion of any actuarial justification for race discrimination in another statute – art. 1.02 – enacted in the same legislation as the credit scoring provisions. Act of June 11, 2003, 78th Leg. ch. 206, 2003 Tex. Sess. Law Serv. 206 (Vernon). That provision, now codified as Texas Insurance Code §560.002(c)(3), provides that a rate is “unfairly discriminatory” if it “(A) is not based on sound actuarial principles; (B) does not bear a reasonable relationship to the expected loss and expense experience among risks; *or* (C) is based *wholly or partly on the race*, creed, color, ethnicity, or national origin *of the* policyholder or an *insured*.” Tex. Ins. Code §560.002(c)(3) (emphasis added). Thus, it is unfair and unlawful in Texas to use credit

factors to set policy rates that discriminate in part based on race, even if the factors used are actuarially sound and related to risk.

For all of these reasons, this Court should construe “unfair discrimination” in §§559.051-559.052 to include all forms of racial discrimination including disparate impact discrimination – and not confine it to intentional discrimination.

## **VI. ARGUMENT**

### **A. By Its Plain Language, the Texas Insurance Code Broadly Prohibits “Unfair Discrimination” and Is Not Narrowly Limited to “Intentional Discrimination”**

The dispositive question in the appeal before the Ninth Circuit is whether application of the federal FHA to Ojo’s case might invalidate, impair, or supersede the Texas Insurance Code provisions that authorize insurance companies to use credit scoring in setting insurance rates. If Texas insurance laws are construed to permit the use of credit factors which produce a racially disparate impact, Farmers contends that the federal FHA conflicts with Texas law, and Ojo’s claim would be reverse-preempted under the McCarran-Ferguson Act.

On the other hand, when the Texas credit scoring statutes prohibiting the use of credit factors that “constitute unfair discrimination” are construed in harmony with §560.002(c)(3) prohibiting rates “based wholly or partly” on race, and with the Texas FHA which prohibits disparate impact discrimination in the sale of property insurance, then the FHA would complement – rather than invalidate or impair – Texas law. As such, Ojo’s FHA disparate impact discrimination suit would not be reverse-preempted by the McCarran-Ferguson Act.

The Ninth Circuit found no Texas decision that has determined whether Texas insurance laws are strictly limited to prohibiting intentional discrimination and thus allow insurers to use credit factors that cause racially disparate impacts. Accordingly, Ojo looks to well-established Texas principles of statutory construction to determine the meaning of the term “factors that constitute unfair discrimination” in §§559.051 and 559.052. As a matter of statutory construction, the issue presented is a legal question subject to *de novo* review. *State v. Shumake*, 199 S.W.3d 279, 284 (Tex. 2006).

**1. Texas Insurance Laws, Including the Credit Scoring Provisions, Contain Language Designed to Prohibit Every Form of Racial Discrimination by Insurers**

Determining legislative intent is the essence of statutory interpretation, but that intent is to be gleaned first and foremost from the statute’s plain language. *Fitzgerald v. Advanced Spine Fixation Sys.*, 996 S.W.2d 864, 865-66 (Tex. 1999). As detailed below, the Texas Insurance Code has long prohibited unfair racial discrimination in the rates charged to policy holders. We begin with the language of the relevant statutory provisions.

The Texas Insurance Code broadly proscribes two kinds of unfair discrimination. Sections 544.002 and 544.003 deal with the kind of discrimination at issue in this case – discrimination based on characteristics that traditionally have placed the individual in a protected class. Section 544.002, titled “Unfair Discrimination,” prohibits an insurer from charging “an individual a rate that is different from the rate charged to other individuals for the same coverage because of that individual’s . . . race, color, religion, or national origin.” That section also prohibits discrimination based on other characteristics, such as age, gender,

marital status or disability. Section 544.003 excuses certain characteristic-based discrimination (*e.g.* age, gender, marital status, disability) if it is “based on sound underwriting or actuarial principles reasonably related to actual or anticipated loss experience.” But there is no actuarial excuse for racial discrimination. Tex. Ins. Code §544.003(b). An insurer may, however, charge a different rate based on race, but only where the “charge is required or authorized by law or a regulatory mandate.” Tex. Ins. Code §544.003(c). The anti-discrimination provisions of §§544.002 and 544.003 are essentially identical to the provisions of art. 21.21-6, which was enacted in 1995. Acts 1995, 74th Leg. Ch. 415. In 2003, §§544.002 and 544.003 replaced portions of art. 21.21-6. Acts 2003, 78th Leg. Ch. 1274, effective April 1, 2005.

In contrast to the protected-class discrimination provisions, §544.052 (also titled “Unfair Discrimination”), prohibits an insurer from differentiating between “individuals of the same class and of essentially the same hazard” in policy premiums, rates, or benefits. Section 544.053 excuses discrimination proscribed by §544.002 if it is “based on sound actuarial principles.”<sup>5</sup>

In 2003, Texas added Chapter 559 to the Insurance Code, which allows insurers to use credit scoring formulas in the pricing of insurance policies. Act of June 11, 2003, 78th Leg.

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<sup>5</sup> The anti-discrimination provisions in §§544.052 and 544.053 are essentially the same as those in art. 21.21-8. In 2003, the Texas Legislature re-codified art. 21.21-8, replacing that article with §§544.052 and 544.053. Acts 2003, 78th Leg. Ch. 1274, effective April 1, 2005.

Ch. 206, 2003 Tex. Sess. Law Serv. 206 (Vernon). But the Code emphasizes that, “[a]n insurer may use credit scoring, except for factors that constitute unfair discrimination, to develop rates.” Tex. Ins. Code §§559.051. Farmers’ entire argument hangs on this provision. But the very next section reiterates as an express prohibition that “[a]n insurer may not . . . use a credit score that is computed using factors that constitute unfair discrimination.” Tex. Ins. Code §559.052 (emphasis added). Thus, the legislature was careful to explain that its long-standing prohibitions against “unfair discrimination” “because of [race]” applied with equal force to insurers’ credit scoring practices. Further, §559.052 means that a credit score that is computed using an unfairly discriminatory factor is *not* “authorized by law” under §544.003(c).

Pursuant to Texas Insurance Code §559.201, the prohibition on credit factors that constitute “unfair discrimination” in §559.052(a)(1) are deemed “an unfair practice in violation of Chapter 541.” Unfair practices are enforceable by private civil suits, including class actions. Tex. Ins. Code §§541.151, 541.251(a); *Farmers Group, Inc. v. Lubin*, 222 S.W.3d 417, 421-22 (Tex. 2007).

In the same 2003 legislation as the credit scoring statutes, the Texas Legislature enacted art 1.02, later codified as §560.002 of the Texas Insurance Code. *See* Act of June 11, 2003, 78th Leg. ch. 206, 2003 Tex. Sess. Law Serv. 206 (Vernon). Section 560.002 dovetails with the anti-discrimination provisions in both §§554.002-544.003 and §§559.051-559.052. Section 560.002(c)(3) provides, in disjunctive terms, that a rate is “unfairly discriminatory” if it “(A) is not based on sound actuarial principles; (B) does not bear a

reasonable relationship to the expected loss and expense experience among risks; *or (C) is based wholly or partly on the race*, creed, color, ethnicity, or national origin of the policyholder or an insured” (emphasis added).

Taking all of these provisions together, under the Texas Insurance Code, Farmers may use credit scores to price homeowner’s insurance, so long as the credit score is not computed using factors that constitute “unfair discrimination,” which means that the rate cannot be based, even in part, on race. Tex. Ins. Code §§559.051, 559.052, 560.002(c)(3). The question presented to this Court thus boils down to whether “unfair discrimination” is narrowly limited to mean only “intentional discrimination” and allows insurers to use credit factors even though they produce racially disparate impacts.

**2. The Plain Language of the Texas Insurance Code Provisions Which Allow Insurers to Use Credit Scoring, Except for Credit “Factors that Constitute Unfair Discrimination,” Encompasses Disparate Racial Impacts**

“[I]t is cardinal law in Texas that a court construes a statute, ‘first, by looking to the plain and common meaning of the statute’s words.’ If the meaning of the statutory language is unambiguous, we adopt, with few exceptions, the interpretation supported by the plain meaning of the provision’s words and terms.” *Fitzgerald*, 996 S.W.2d at 865. The reasons for this rule are durable and familiar. “[I]t is a fair assumption that the Legislature tries to say what it means, and therefore the words it chooses should be the surest guide to legislative intent. Also, ordinary citizens should be able to rely on the plain language of a statute to mean what it says.” *Id.* at 866.

Farmers previously contended that when the Texas Legislature prohibited “factors that constitute unfair discrimination” in Texas Insurance Code §§559.051-559.052, it meant to prohibit only intentional discrimination. (DB 16) But “unfair discrimination” is a broader term than “intentional discrimination.” If the legislature had wanted to prohibit only intentional discrimination, all it had to do was use the narrower phrase “intentional discrimination” instead of the broader phrase, “unfair discrimination.” But since the legislature chose to employ broad language, this Court must read the language broadly. Accordingly, the plain language of Texas Insurance Code §§559.051-559.052 indicates the Legislature’s intent to prohibit all forms of discrimination, including both intentional and disparate impact discrimination.

The term “unfair” means “not just or even handed.” *See American Heritage Dictionary* 1320 (2d ed. 1985). As such, it serves to modify the word “discrimination” broadly by suggesting that any sort of unfair discrimination is covered – including disparate impact discrimination. Texas courts often rely on dictionary sources to determine the plain meaning of undefined statutory terms. *See, e.g., Powell v. Stover*, 165 S.W.3d 322, 326 (Tex. 2005).

The broad plain meaning of “unfair” is consistent with the view that disparate racial impacts are just as unfair as intentional discrimination. As the Eighth Circuit aptly observed: “Title VIII [FHA] is designed to prohibit ‘all forms of discrimination, sophisticated as well as simple-minded.’” *United States v. City of Black Jack*, 508 F.2d 1179, 1184 (8th Cir. 1974). “Effect, and not motivation is the touchstone, in part because clever men may easily

conceal their motivations, but more importantly, because . . . ‘we now firmly recognize that the arbitrary quality of thoughtlessness can be as disastrous and unfair to private rights and the public interest as the perversity of a willful scheme.’” *Id.* at 1185; *accord Pfaff*, 88 F.3d at 746 n.2; *Norwalk CORE v. Norwalk Redevelopment Agency*, 395 F.2d 920, 931 (2d Cir. 1968); *Affordable Hous. Dev. Corp. v. City of Fresno*, 433 F.3d 1182, 1194 (9th Cir. 2006).

The Supreme Court has likewise held that disparate impact discrimination “may in operation be functionally equivalent to intentional discrimination.” *Watson*, 487 U.S. at 987. Further, if one of the undisclosed factors Farmers used to compute Ojo’s credit score and increase his premiums involved, for example, the location of Ojo’s residence, the disparate racial impact of such back-door redlining could also be evidence of intentional discrimination. “Necessarily, an invidious discriminatory purpose may often be inferred from the totality of relevant facts, including the fact, if it is true, that the . . . [conduct alleged] bears more heavily on one race than another.” *Washington v. Davis*, 426 U.S. 229, 242 (1976).

Accordingly, the plain meaning of “unfair discrimination” in the credit scoring provisions of the Texas Insurance Code encompasses credit factors used by insurers that constitute not only disparate treatment (intentional discrimination because of race), but also includes disparate racial impacts.

In contrast, Farmers’ view would require this Court to substitute a narrow interpretation of discrimination by changing the word “unfair” to the word “intentional.” “Courts are not responsible for omissions in legislation, but must take statutes as they find

them.” *City of Garland*, 22 S.W.3d at 358. “[Courts] should search out carefully the intendment of a statute, giving full effect to all of its terms. ***But they must find its intent in its language and not elsewhere.***” *RepublicBank Dallas, N.A. v. Interkal, Inc.*, 691 S.W.2d 605, 607 (Tex. 1985) (emphasis added).

A court’s subjective assessments cannot displace the statutory text. “Where language in a statute is unambiguous, this court must seek the intent of the legislature as found in the plain and common meaning of the words and terms used.” *Moreno v. Sterling Drug, Inc.*, 787 S.W.2d 348, 352 (Tex. 1990). Hewing to the statutory text is faithful to judicial restraint and separation of powers. The judiciary will not “exercise any power properly attached” to the legislature. Tex. Const. art. II §1. As this Court has warned, “when we stray from the plain language of a statute, we risk encroaching on the Legislature’s function to decide what the law should be.” *Fitzgerald*, 996 S.W.2d at 866.

In an attempt to justify its narrow interpretation of broad statutory language, Farmers has previously contended that the legislature’s use of the word “constitute” before “unfair discrimination” rather than “cause,” “produce” or “result in,” should be read to prohibit only those credit factors that intentionally “consider race itself” or are “intended to serve as a proxy for race” – and not to factors that result in disparate racial impacts. (DB 24)

But Farmers misreads the word “constitute.” Contrary to Farmers’ grudging view, the word “constitute” is a very broad term, and means “to be the elements or parts of” or to “compose.” *The American Heritage Dictionary* 314 (2d ed. 1985). As such, the word contains no sense of limitation, but rather suggests multiple components, consistent with the

multiple components of discrimination encompassed by the broad term “unfair,” to which “constitute” is linked textually.

Finally, Farmers contends that Texas credit scoring statutes do not prohibit disparate racial impacts because those statutes do not explicitly refer to disparate impacts. (DB 20) Farmers ignores that these provisions do not explicitly mention “intentional discrimination” either. Thus, Farmers’ contention proves too much. Had the Texas Legislature intended to limit prohibited credit factors to intentional discrimination, it could easily have said so, but did not. Instead, by using the word “unfair,” the Texas Legislature indicated that its ban on race discrimination was not confined to intentional discrimination, but covered all forms of race discrimination, including disparate impacts.

In sum, Farmers’ interpretation limiting “unfair” to “intentional” silently excludes disparate racial impacts. “It is a rule of statutory construction that every word of a statute must be presumed to have been used for a purpose . . . [and] ***we believe every word excluded from a statute*** must also be presumed to have been excluded for a purpose.” *Cameron v. Terrell & Garrett*, 618 S.W.2d 535, 540 (Tex. 1981) (emphasis added); *accord City of Rockwall v. Hughes*, 246 S.W.3d 621, 627-28 (Tex. 2008). ““A court may not write special exceptions into a statute so as to make it inapplicable under circumstances not mentioned in the statute.”” *Jones v. Liberty Mut. Ins. Co.*, 745 S.W.2d 901, 902 (Tex. 1988); *accord Fitzgerald*, 996 S.W.2d at 867 n.24. The statute’s plain language contradicts Farmers’ view. “Unfair” includes all unfair race discrimination, including disparate impact discrimination.

**B. Under the Texas Rule of Construction that Statutes Be Considered in Context and in Harmony, the Enactment of Section 560.002 Confirms that the Credit Scoring Provisions Prohibit Disparate Impact Discrimination**

In addition to adhering strictly to the plain meaning of the statute, Texas courts “look at the entire act, and not a single section in isolation.” *Fitzgerald*, 996 S.W.2d at 866. Texas courts must “consider[] [the Code] in its entirety.” *Fleming Foods, Inc. v. Rylander*, 6 S.W.3d 278, 284 (Tex. 1999).

As explained above, §560.002 of the Texas Insurance Code was enacted in the same 2003 legislation as the Insurance Code credit scoring provisions. Stats. 2003, 78th Leg. Sess., Ch. 206. Accordingly, the credit scoring provisions must be read in conjunction with §560.002, which provides disjunctively that an insurance rate is “unfairly discriminatory” if it “(A) is not based on sound actuarial principles; (B) does not bear a reasonable relationship to the expected loss and expense experience among risks; *or* (C) **is based in whole or in part on the race**, creed, color, ethnicity or national origin of the policyholder or an insured.” Tex. Ins. Code §560.002(c)(3) (emphasis added).

The use of the disjunctive “or” means that a rate is unfairly discriminatory if it violates any one of the three factors – such as race – even if it satisfies the other two factors – actuarially sound and correlated to risk. *Shell Petroleum Corp. v. Royal Petroleum Corp.*, 137 S.W.2d 753, 758 (Tex. 1940); *In re Porter*, 126 S.W.3d 708, 711 (Tex. App. – Dallas 2004, orig. proceeding). Thus, under §560.002, a rate is “unfairly discriminatory” if it is “based” even “in part” on race – even if the rate is actuarially sound.

Farmers has conceded, as it must, that “Plaintiff is correct that [§560.002] prohibits rates that are ‘based on race even though [sic] actuarially sound.’” (DB 28) Farmers nevertheless asserted a tortured distinction between insurance “rates” in §560.002 and “credit scoring” in §559.051. (DB 28-29) Farmers’ attempted distinction ignores that §559.051 authorizes insurers to use credit scoring “*to develop rates.*” Tex. Ins. Code §559.051 (emphasis added). In short, read in harmony with §560.002, credit scoring must be actuarially sound, but if the credit factors used to develop rates “constitute unfair discrimination” based on race, the use of such factors is prohibited by §559.052(a)(1).

**C. Under the Texas Rule of Construction that Statutes Be Harmonized with Related Provisions, the Texas Insurance Code Cannot Be Interpreted to Allow Disparate Impact Discrimination Because the Texas FHA, a Related Statute, Prohibits Disparate Impact Discrimination**

In interpreting “unfair discrimination” in §559.051-559.052, Texas courts must consider all laws bearing on the same subject-matter and strive to give the statute “a meaning that is in harmony with the [other] provisions.” *See, e.g., City of Dallas v. Abbott*, 304 S.W.3d 380, 384 (Tex. 2010). The credit scoring provisions were enacted in 2003. Those provisions must be read in harmony with the Texas FHA enacted in 1989 modeled exactly on the federal FHA which prohibits disparate impact discrimination in the pricing of property insurance.

In fact, the Texas FHA was explicitly designed to “provide rights and remedies substantially equivalent to those granted under federal law.” Tex. Prop. Code §§301.001, 301.002(3), 301.021(b); *see Meadowbriar Home for Children Inc. v. Gunn*, 81 F.3d 521, 531

n.8 (5th Cir. 1996). To implement the Texas FHA, Texas adopted a regulation providing “[i]t is unlawful to discriminate based on race” by “refusing to provide” property insurance or providing such “insurance differently based on race.” 40 Tex. Admin. Code §819.124(b)(4). This language adopts nearly verbatim the federal FHA regulation whose language federal courts have construed to prohibit disparate impact race discrimination as well as intentional discrimination in the sale of property insurance. *Ojo*, 2010 U.S. App. LEXIS 7325, at \*4-\*7 (collecting cases).

Thus, the Texas FHA addresses the same issue as the Texas Insurance Code – prohibiting race discrimination in the sale of homeowners insurance – and bars disparate impact race discrimination in the sale of such insurance. Texas credit scoring laws are “presumed to have been enacted by the legislature with complete knowledge of the existing law and with reference to it,” including its prior enactment of the Texas FHA. *Acker*, 790 S.W.2d at 301; *accord State Farm Lloyds v. Geeslin*, 267 S.W.3d 438, 443 (Tex. App. – Austin 2008, no pet.). Further, “[w]hen the [Texas] Legislature adopts a federal statute, we presume that it knew of the federal court’s construction of the federal statute when it adopted the statute and intended to adopt that construction.” *City of Garland*, 22 S.W.3d at 360.

Directly relevant here, this Court has consistently held that the employment discrimination provisions of Texas law were intended to “provide for the execution of the policies of Title VII” of the federal civil rights act, as to race, sex and age discrimination. *NME Hosps., Inc. v. Rennels*, 994 S.W.2d 142, 144 (Tex. 1999); *Caballero v. Central Power & Light Co.*, 858 S.W.2d 359, 361 (Tex. 1993); *Toennies*, 47 S.W.3d at 476. Therefore,

Texas courts construe Texas employment discrimination laws consistent with federal case law to encompass disparate impact discrimination, as well as intentional discrimination, not only as to race, but also as to age. *See Dearing*, 240 S.W.3d at 351, following U.S. Supreme Court decision in *Smith v. City of Jackson*, 544 U.S. 228, 232 (2005) (holding disparate impact claims actionable under Age Discrimination in Employment Act).

The Texas Legislature linked the Texas FHA to the federal FHA in the same way it linked Texas labor laws to Title VII. As noted above, the Texas FHA states explicitly that its aim is to provide “rights and remedies substantially equivalent to those granted under federal law.” Tex. Prop. Code §301.002(3). And, Texas regulators adopted a regulation identical to the federal FHA regulation that federal courts have construed to bar disparate impact discrimination as well as intentional discrimination. *Am. Family*, 978 F.2d at 300-01, *Ojo*, 2010 U.S. App. LEXIS 7325, at \*7.

Accordingly, in permitting the use of credit scoring to set rates for homeowners insurance, except for credit factors “that constitute unfair discrimination,” the Texas Legislature knew “unfair” would include disparate impact discrimination under the Texas FHA – a statute regulating the same conduct. Construing the Texas Insurance Code’s credit scoring provisions’ prohibition of “unfair discrimination” broadly, rather than narrowly limited to intentional discrimination, harmonizes those provisions with the Texas FHA – both would bar disparate impact discrimination. *Dearing*, 240 S.W.3d at 351.

Because it is devastating to their argument, Farmers has previously attempted to avoid the impact of the Texas FHA’s prohibition on disparate impact discrimination in the sale of

homeowners insurance by contending that the Texas FHA contains a “carve-out” section, §301.044(b), that assertedly provides that to the extent the Texas FHA is “in any way inconsistent” with another state law like the later-enacted credit scoring provisions, the latter trumps. (DB 27-28)

In fact, the provision of the Texas FHA on which Farmers attempts to rely on contains no “inconsistent” language, but simply provides: “This Chapter does not affect a requirement of nondiscrimination in any other state or federal law.” Tex. Prop. Code §301.044(b). There are no cases interpreting this statute, however, the plain dictionary meaning of the word “affect” is “to have an influence on” or “bring about a change in.” *The American Heritage Dictionary* 84 (2d ed. 1985). Thus, this statute means only that the Texas FHA is not intended to influence or change *nondiscrimination* requirements in other statutes. It does not mean that the Texas Insurance Code credit scoring provisions should not be harmonized with the Texas FHA.

Farmers previously relied on a Texas statute governing statutory construction which provides that if statutes “are irreconcilable, the statute latest in date of enactment prevails.” Tex. Gov’t Code §311.025(a). But that provision does not support Farmers either. As discussed earlier, the Texas FHA is in no way irreconcilable with the Texas Insurance Code. Moreover, implicit in §311.025(a) is the rule that courts are to construe statutes “so as to harmonize with other relevant laws.” *La Sara Grain Co v. First Nat’l Bank of Mercedes*, 673 S.W.2d 558, 565 (Tex. 1984); *White v. Sturns*, 651 S.W.2d 372 (Tex. 1983).

Although Farmers cites *White* without any discussion (DB 28), that case supports Ojo's position. *White* found "no conflict" between two state law provisions, and construed them in harmony "to operate in conjunction." *Id.* at 374-76. Applying the Texas rule of construction requiring that statutes be read to harmonize rather than conflict with one another, the Texas Insurance Code must be read to prohibit disparate impact discrimination in the sale of homeowners insurance, just as the Texas FHA does.

**D. Because the Federal FHA and the Texas FHA Are Identical, the Texas Credit Scoring Provisions Are Either in Conflict with Both the Federal and Texas FHA (Violating Texas Rules of Statutory Construction) or in Harmony with Both of Them**

As noted earlier, the dispositive question before the Ninth Circuit is whether the federal FHA, which prohibits disparate impact discrimination, is reverse-preempted under the McCarran-Ferguson Act by the Texas Insurance Code provisions that authorize insurance companies to use credit scoring in setting insurance rates. This question turns on the issue certified to this Court – whether the Texas Insurance Code authorizes the use of credit factors that result in disparate impact discrimination.

To assert that the federal FHA is reverse preempted by the Texas Insurance Code, Farmers is forced to make the illogical assertion that the Texas Insurance Code is in conflict with the federal FHA without being in conflict with the Texas FHA, an identical statute. But, the identical statutory language of the federal and Texas FHA is either in harmony with the Texas Insurance Code or in conflict with it.

Under Texas rules of statutory construction, the Texas insurance statutes allowing insurers to use credit scoring in setting rates prohibit the use of credit factors that “constitute unfair discrimination” that are “based wholly or partly” on race, must be read in harmony with each other and with the Texas FHA to prohibit factors that produce disparate racial impacts. As such, the Texas Insurance Code is also in harmony with the federal FHA because it would complement – rather than invalidate or impair – Texas law, and Ojo’s federal FHA disparate impact claim would not be reverse-preempted under the McCarran-Ferguson Act.

**E. The Texas Insurance Commissioner’s Credit Scoring Regulation, His Letter to the Legislature, and Legislative History Do Not Trump the Statutes’ Plain Language**

Finding no support in the statutory text or the larger scheme of related insurance laws, Farmers has relied on a Texas Insurance Department regulation which states:

An insurer may vary its rates charged to applicants or insureds for personal insurance policies due solely to credit scoring. The differences in rates charged due solely to credit scoring shall be based on sound actuarial principals and supported by data filed with the department.

28 Tex. Admin. Code §5.9941(a). Farmers asserts that this regulation serves to permit higher insurance rates based on credit scoring that is actuarially sound. (DB 23-24)

Farmers misreads the regulation. It simply provides that if an insurer uses credit scoring as the *sole* basis for charging higher rates, the factors used to compute the score better be actuarially sound. The regulation does not address, let alone excuse, any form of

race discrimination. To read it that way improperly inserts words that are not there. *Cameron*, 618 S.W.2d at 540; *City of Rockwall*, 246 S.W.3d at 627-28.

Farmers' reading of the regulation is further contradicted by §560.002(C)(3), which prohibits rates based on race as "unfairly discriminatory" even if they are actuarial sound. Farmers evidently understood that the regulation does not provide a defense to race discrimination, as it never cited the regulation in its moving papers in the district court. (SER 57-63, 125-28) Moreover, in its brief Farmers concedes that under the credit scoring statutes, credit factors that constitute overt intentional race discrimination would be precluded, despite the regulation, but asserts that credit factors producing disparate impacts can be justified if they are actuarially sound. (DB 24, 27, 29)

Farmers' purported "actuarial defense" makes no sense. Intentional racial discrimination in setting insurance rates can be masked by risk factors that appear actuarially sound – which is why insurers use them – but it is nonetheless unlawful under both Texas and federal law. Applying Farmers' logic, the regulation would mean that actuarially sound credit factors based on intentional discrimination could not be challenged. Such faulty logic reveals there is no basis for limiting "unfair discrimination" in the statutes to intentional discrimination or for excluding disparate impact discrimination. Actuarial soundness is a necessary, but not alone sufficient defense to discrimination. Actuarial soundness is required, but it does not excuse an insurer's use of unfair racially discriminatory credit factors. Disparate racial impacts, like intentional race discrimination, is unfairly discriminatory, and thus unlawful, even if actuarial soundness and business necessity are

shown, when the plaintiff can prove there are less discriminatory alternatives available. *Watson*, 487 U.S. at 997-98.

Farmers has also relied on a January 31, 2005 letter to the legislature from the Texas Insurance Commissioner in which he expressed the belief that he had legal authority to prohibit a credit practice that is “either unfair or intentionally discriminatory” but not one “that has a disproportionate impact if it produces an actuarially supported result.” (DB 26)

Because it was not a regulation or formal policy, and was issued one year after plaintiff’s injury, the district court refused to consider the letter: “[t]he Court declines to consider the documents as evidence.” (ER 116:23) The Ninth Circuit panel majority also refused to consider it. *Ojo*, 565 F.3d at 1185 n.13.

In any event, the Commissioner’s letter contains obvious errors in reading the statutes precluding deference to the Commissioner’s interpretation under Texas law. *Southwestern Bell Tel. Co. v. PUC of Texas*, 31 S.W.3d 631, 639 (Tex. App. 2000) (no deference where commission interpretation “is not reasonable”); *see Dodd v. Meno*, 870 S.W.2d 4, 7 (Tex. 1994). Agency construction of a statute will be upheld only “so long as the construction is reasonable and does not contradict the plain language of the statute.” *Mid-Century Ins. Co. v. Ademaj*, 243 S.W.3d 618, 623 (Tex. 2007). Here, the agency’s view is at odds with the statute’s plain meaning.

The Commissioner’s letter states: “The Texas Insurance Code defines unfair discrimination to be the unequal treatment of individuals in the same class or hazard. Underwriting or rating classifications are not unfair, though, if they are actuarially

supported.” (SER 152) The Commissioner erred by citing the provisions of the code which provide a defense “based upon sound actuarial principles,” but only when *race* is conspicuously absent. Tex. Ins. Code §§544.052-544.053. The Commissioner overlooked that “unfair discrimination” based on race is defined elsewhere and provides no actuarial defense. Tex. Ins. Code §§544.002, 544.003(b), 560.002(c)(3).

“The meaning of a term in different sections of a statute must be considered in the different contexts in which the word is found in the separate sections.” *Cortez v. Progressive Mut. Ins. Co.*, 61 S.W.3d 68, 72-73 (Tex. App. – Austin 2001, vacated pursuant to settlement) (distinguishing the predecessor provisions of §§544.002 and 544.052). In *Cortez*, the court relied on the Insurance Commissioner’s amicus submission that “discrimination between insureds of the same risk class” in art. 21.21-8 (now §544.052) is distinct from and does “restrict” it to require proof that the discrimination was based on a specific protected class such as race, which is separately addressed in article 21.21-6 (now §544.002). *Cortez*, 61 S.W.3d at 74.

Farmers has also contended that the legislative history shows that the Texas Legislature intended to allow disparate impacts. First, the legislative history cited by Farmers does not support Farmers’ assertion that the new provisions permitting credit scoring were enacted over opposition of legislators who argued it “would have a discriminatory impact.” (DB 25) Neither the words “discriminatory impact” nor that concept appear in the legislative history cited in Farmers’ brief. (ER 127:6) Rather, the cited material reveals that the opponents were concerned that “[c]redit scoring is

discriminatory” (ER 127:9-10) – a broad objection encompassing both intentional and disparate impact discrimination. Second, there is no need to resort to the opponents’ view of legislation when the intended scope can be gleaned from the plain meaning of the statutory language itself. *Fleming Foods*, 6 S.W.3d at 285.

The legislative history cited by Farmers states that the Legislature intended that insurers would be required to base credit scoring **both** “on reasonably sound and verifiable actuarial principles” **and** factors that were **not** “unfairly discriminatory as to race.” (ER 126:17-25) Such history does not exclude disparate impacts. As discussed above, by prohibiting “unfair discrimination” related to race, §559.052 includes a ban on all forms of “unfair” racial discrimination including disparate impact discrimination.

In light of this broad intent expressed in both the statute’s words and history, it is indeed a major and quite startling leap for Farmers to assert that Texas condones and completely immunizes insurers from liability for even the most egregious disparate impacts on racial minorities despite the fact that the credit scoring statutes do not mention, let alone provide, an actuarial soundness defense. Farmers’ interpretation ignores that “consequences” are a relevant consideration under Texas law. Tex. Gov’t Code §311.023(5); *State v. Hodges*, 92 S.W.3d 489, 494-95 (Tex. 2002). Courts may not “amend a statute and add words” that are not contained in its language. *Jones*, 745 S.W.2d at 902. Here, in the same bill as the credit scoring laws, the Legislature enacted a statute that prohibits unfair discrimination based on race in insurance rates even if the rates are actuarially sound. Tex. Ins. Code §560.002. That provision precludes Farmers’ assertion.

## VII. CONCLUSION

For the foregoing reasons, this Court should hold that the term “unfair discrimination” in Texas Insurance Code §§559.051 and 559.052 is not limited to intentional discrimination – or the Legislature would have said so – and encompasses all forms of racial discrimination, including disparate impact discrimination.

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Respectfully submitted,

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DECLARATION OF SERVICE BY MAIL

I, the undersigned, declare:

1. That declarant is and was, at all times herein mentioned, a citizen of the United States and employed in the City and County of San Francisco, over the age of 18 years, and not a party to or interested party in the within action; that declarant's business address is 100 Pine Street, Suite 2600, San Francisco, California 94111.

2. That on May 14, 2010, declarant served the **APPELLANT'S OPENING BRIEF ON THE MERITS** by depositing a true copy thereof in a United States mailbox at San Francisco, California in a sealed envelope with postage thereon fully prepaid and addressed to the parties listed on the attached Service List.

3. That there is a regular communication by mail between the place of mailing and the places so addressed.

I declare under penalty of perjury that the foregoing is true and correct. Executed on May 14, 2010, at San Francisco, California.

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TAMARA J. LOVE