

PUBLICATION

CFPB's Structure Declared Unconstitutional – What You Need to Know

October 12, 2016

The CFPB suffered a blow yesterday in the most significant attack against its authority to date. In PHH Mortgage's appeal from a \$109,000,000 disgorgement order issued by the CFPB in June of 2015, the U.S. Court of Appeals for the D.C. Circuit held that "the CFPB is unconstitutionally structured" and violates Article II of the Constitution. The court also found that the CFPB violated PHH's due process rights and rejected the Bureau's determination that its enforcement actions brought as administrative proceedings are not bound by any statutes of limitations.

Article II

The architects of the CFPB provided in the Dodd-Frank Act that the Bureau is to be led by a director appointed by the President and confirmed by the Senate. The director has a five-year term, and prior to the expiration of that term, the President may only remove the director for cause – "for inefficiency, neglect of duty, or malfeasance in office." In its appeal, PHH argued that the CFPB's status as an independent agency headed by a single director violates Article II of the Constitution. PHH urged the court to strike down the CFPB and prevent its continued operation, if not strike down the entire Dodd-Frank Act.

The court, while pointing out that most other independent agencies are headed by a commission, observed that "the Director of the CFPB possesses more unilateral authority – that is, authority to take action on one's own, subject to no check – than any single commissioner or board member in any other independent agency in the U.S. Government" and that "the Director enjoys more unilateral authority than any other officer in any of the three branches of the U.S. Government, other than the President."

The court held that the structure of the CFPB was unconstitutional, as Congress made its director removable only for cause, as noted above. To remedy the Article II issue, the court struck the "for cause" provision from Dodd-Frank. The court left Dodd-Frank otherwise intact, with the CFPB continuing to function with a director removable at the President's discretion. As the court noted, "the CFPB's operation as an executive agency will not in any way prevent the overall Dodd-Frank Act from remaining operative as a law." This narrower ruling no doubt was intended to avoid the ramifications that would come with the far-sweeping remedy PHH was requesting.

Due Process

Before the creation of the CFPB, the Department of Housing and Urban Development (HUD) was responsible for the administration and enforcement of the Real Estate Settlement and Procedures Act (RESPA). Section 8(a) of RESPA prohibits the giving and accepting of "any fee, kickback or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person." At the same time, Section 8(c)(2) of RESPA goes on to state that "nothing in this section shall be construed as prohibiting...the payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed."

HUD had issued various guidance and policy statements on the interpretation of Section 8(c)(2), in which the department arguably sanctioned arrangements similar to those used by PHH and under attack by the CFPB. Industry participants had relied on HUD's pronouncements, with the understanding that if fair market value was received for the goods or services being rendered, there was no RESPA violation. PHH argued that due process requires "fair notice of conduct that is forbidden." PHH took the position that Director Cordray's actions were unconstitutional because he ignored decades of HUD's regulatory guidance and effectively rewrote RESPA to exclude Section 8(c)(2), which amounted to depriving PHH of due process.

The D.C. Circuit agreed that the CFPB violated PHH's due process rights when it "discarded HUD's longstanding interpretation of Section 8 and, for the first time, pronounced its new interpretation.

Statute of Limitations and CFPB Enforcement Actions

The CFPB advanced two arguments as to why no statute of limitations applied to its case against PHH. Both revolved around the CFPB's choice to bring an enforcement action as an administrative proceeding or as a judicial proceeding (this action against PHH was an administrative proceeding). First, the CFPB argued that the Dodd-Frank Act contains no statute of limitations in CFPB enforcement actions brought as administrative proceedings and that the lack of any limitations period should trump any statute of limitations in any underlying law enforced by the CFPB. Second, the CFPB argued that if Dodd-Frank's lack of a statute of limitations in administrative proceedings did not override the limitations periods in the underlying statutes enforced by the CFPB, the statute at issue (RESPA) imposes a three-year limitations period only on enforcement "actions" that the CFPB files in a court.

The court rejected both of these arguments. The court first found that the CFPB misread the enforcement section of Dodd-Frank as the act states that the CFPB may enforce federal laws "unless such Federal law specifically limits the Bureau from conducting a hearing or adjudication proceeding." As the court explained, "obviously, one such 'limit' is a statute of limitations." In rejecting the CFPB's second argument, the court stated that RESPA limits "actions" to enforce Section 8 "brought by the Bureau, the Secretary, the Attorney General of any State, or the insurance commissioner of any State to three years." The court concluded that RESPA "does not specify a jurisdiction or forum for said actions" and that "the term 'actions' is not limited to actions brought in court," as the CFPB had suggested, but also encompasses administrative proceedings.

Here the court had harsh words for the CFPB, stating, "The absurdity of the CFPB's position is illustrated by its response to a hypothetical question about the CFPB's bringing an administrative enforcement action 100 years after the allegedly unlawful conduct. Presented with that question, the CFPB referenced its prosecutorial discretion." The court then held that a "much more logical, predictable interpretation of the agency's authority is that the three-year limitations period applies equally to CFPB court actions and CFPB administrative actions."

Future Impact

The ramifications of this case go far beyond restricting the CFPB's reach, clarifying the interpretation of RESPA, and resolving the question of how statutes of limitation apply to the CFPB's enforcement actions. This case makes clear that the CFPB has exceeded its bounds and that the CFPB's approach to regulation through enforcement actions must be reined in. If this decision stands, the Director of CFPB will be less likely to push the boundaries and limits of the Bureau's authority as he has done for the first five years of the CFPB's operations.

As noted above, the court included language to protect the operations of the Bureau on a going-forward basis, but the decision opens up prior actions taken by CFPB to various challenges, including potential challenges to the validity of past guidance, consent orders, fines and rules. The possibilities of such challenges should be

enough to force the CFPB to seek a rehearing en banc (a petition for en banc review would be due within 45 days from the date of the order) or to seek a writ of certiorari from the U.S. Supreme Court. Compounding the likelihood of an appeal is the dissent of Judge Henderson, who agreed with the majority opinion except as to the need to address the constitutionality of the CFPB's structure.

The D.C. Circuit's ruling should also embolden ongoing legislative efforts to restructure the CFPB. Since its creation, critics of the Bureau have engaged in an aggressive campaign to reform or abolish it. Those critics will now point to the court's pronouncement that the "CFPB's concentration of enormous executive power in a single, unaccountable, unchecked Director not only departs from settled historical practice, but also poses a far greater risk of arbitrary decision making and abuse of power, and a far greater threat to individual liberty, than does a multi-member independent agency." The court addressed the question of why it did not attempt to restructure the CFPB as a multi-member independent agency, noting that "doing so would require us to create a variety of new offices, designate one of the offices as Chair, and specify various administrative details of the reconstituted agency. All of that "editorial freedom" would take us far beyond our judicial capacity."

Within hours of the court's announcement of its decision, the House Financial Services Committee seized upon the ruling to bolster support for the "Financial CHOICE Act," which was approved by the committee last month and seeks to reform the CFPB by (1) tasking the Bureau with the dual mission of consumer protection and competitive markets, with a cost-benefit analysis of its rules performed by an Office of Economic Analysis, (2) replacing the current single director with a bipartisan, five-member commission subject to congressional oversight and appropriations, (3) establishing an independent, Senate-confirmed Inspector General, (4) requiring the five-member commission to obtain permission before collecting personally identifiable information on consumers, (5) repealing the authority to ban bank products or services it deems "abusive" and to prohibit arbitration, and (6) repealing the Bureau's indirect auto lending guidance. The upcoming elections will likely dictate whether the proposed legislation gains any traction in Congress. This bill is one of many proposals to reform the CFPB, and to date, there has not been sufficient support to bring about real change.

If you have any questions regarding the issues raised in the PHH matter, concerns with an upcoming CFPB exam or investigation, or CFPB compliance questions, please contact a member of Baker Donelson's Financial Services Litigation Group or our CFPB Task Force at any time.