Banking and Finance Law Daily Wrap Up, TOP STORY—D.C. Cir.: CFPB single-director structure is not unconstitutional, (Jan. 31, 2018)

Banking and Finance Law Daily Wrap Up

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By Richard A. Roth, J.D.

The Consumer Financial Protection Bureau's structure, which features a single director who can be removed by the President only for cause, does not violate the Constitution, according to the U.S. Court of Appeals for the District of Columbia Circuit. A majority of the full court rejected the concerns of an earlier three-judge panel that the Bureau's organization infringed on the President's power to ensure that federal law is faithfully executed and violated separation of powers principles. However, the underlying CFPB administrative enforcement proceeding is being remanded to the Bureau for reconsideration (*PHH Corporation v. CFPB*, Jan. 31, 2018, Pillard, C.).

The decision came in the context of the CFPB's effort to enforce the Real Estate Settlement Procedures Act's anti-kickback provisions against PHH Corporation and its affiliates. According to PHH, the CFPB changed a long-standing Department of Housing and Urban Development RESPA interpretation that allowed captive reinsurance arrangements as long as the reinsurance was purchased at market prices. The CFPB then applied its reinterpretation of RESPA to past PHH conduct, determined that there was no time limit on its enforcement authority, and imposed a $109 million disgorgement order.

PHH appealed the result, asserting both that the CFPB was unconstitutional and that the retroactive application of RESPA had denied the company due process.

Original panel decision. A three-judge panel of the appellate court rendered somewhat of a split decision. According to the panel, it was not constitutionally permissible to treat the Bureau as an independent agency. However, rather than invalidate the Bureau as a whole, the panel relied on a severability clause in the Dodd-Frank Act to decide that the Bureau should be treated as an executive agency and that its director could be removed by the president at will (see *Banking and Finance Law Daily*, Oct. 11, 2016).

That decision was vacated when the appellate court granted *en banc* review.

Bureau independence. According to the opinion of the court, Congress responded to consumer abuses that led up to the 2008 financial crisis by creating the CFPB to be "a regulator attentive to individuals and families." This was necessary because the existing regulatory agencies were too concerned about the industry they were supposed to supervise. The CFPB needed a degree of independence to do its job, and the Bureau's organization was intended to confer that independence.

The opinion of the court said that analyzing the constitutionality of that organization required answering two questions:

1. Is the "means of independence"—a single director with discharge-for-cause protection—constitutionally permissible?
2. Does the nature of the job that Congress gave the Bureau require that means of independence?

Answering both questions in the affirmative, the court decided that the Bureau's structure was constitutional. The Supreme Court has never invalidated a law that confers a single level of discharge-for-cause protection, the opinion noted, especially when a degree of independence is necessary to an agency's ability to function properly.

The court rejected each of PHH's challenges. The opinion said repeatedly that the CFPB's organization was not meaningfully different from the structure of other federal agencies and that nothing about that organization conflicted with the Constitution in any way.

Past practices. To begin with, precedent and history both make the Bureau's constitutionality clear, the court said. For-cause restrictions have repeatedly been upheld. Only when Congress tried to claim a voice in an executive officer's removal or made that removal "abnormally difficult" did the Supreme Court reject the law.

Analyzing the Supreme Court's decisions in *Myers v. U.S.*, 272 U.S. 52 (1928), *Morrison v. Olson*, 487 U.S. 654 (1988), *Wiener v. U.S.*, 357 U.S. 349 (1958), *Free Enterprise Fund v. PCAOB*, 561 U.S. 477 (2010),and most importantly *Humphrey's Executor v. U.S.*, 295 U.S. 602 (1935), the appellate court said that the Constitution permits a level of for-cause protection when independence is needed. *Humphrey's Executor* allowed such protection in the case of the Federal Trade Commission, which is in every meaningful respect similar to the CFPB, according to the court.

Financial services regulation is a clear example of a situation in which independence is needed, the court then said. The Federal Reserve Board, Comptroller of the Currency, Federal Deposit Insurance Corporation chair, head of the National Credit Union Administration, and members of the Securities and Exchange Commission all have such protection.

CFPB director. "The for-cause protection shielding the CFPB's sole Director is fully compatible with the President's constitutional authority," the opinion said. Independence is necessary to the Bureau's task, and the language of the Dodd-Frank Act is identical to the Federal Trade Commission Act language approved in *Humphrey's Executor*. PHH's challenge inescapably challenged the organization of many independent federal agencies, the court added.

The Bureau's budgetary independence was said to be comparable to that enjoyed by the other financial supervisory agencies, even when combined with for-cause protection.

For-cause protection. The Dodd-Frank Act does not infringe on the President's power any more than the FTC Act does, the court said, and the FTC Act was upheld. The nature of the tasks of the CFPB and the FTC are very similar, as are their powers.

Budget powers. Freeing the CFPB from the appropriations process was another step Congress took to secure its independence, the court went on. There was no reason why Congress could not create agencies that funded themselves through fees and assessments, and the Fed, OCC, and FDIC all worked in precisely that way.

There was no reason the CFPB could not be funded in the same manner, and the independent funding had no meaningful effect on presidential powers, the court asserted.

Combining budgetary independence and for-cause removal protection was not novel, the court observed. Other agencies worked the same way. There would be no concern unless both raised the same constitutional concern and together had a relevant effect. That was not the case.

Director v. board. One director as opposed to a multi-member commission made no difference either, the court said. First, *Morrison* upheld for-cause protection for a single independent counsel who had been appointed to investigate possible executive branch misdeeds. The Comptroller of the Currency also was just one individual.

The court believed that a single director actually could be more accountable to the President than members of a commission. The President could more easily change the course of an agency by changing one director than by changing a majority of a board. Also, by giving the responsibility for consumer financial protection to a single director, Congress left no doubt about who was responsible.

Other theories. Passing on to what it termed PHH's "broader theories of unconstitutionality," the court remained unsympathetic.

The CFPB could not be said to be too powerful to be permissible under the Constitution. The extent of the Bureau's power was not out of the ordinary. Even if the Bureau's organization was novel—a claim the court rejected—novelty is not a constitutional defect. The Constitution does not ban Congress from innovating.

The court's opinion reserved its most scathing criticism for what it referred to as PHH's "unmoored liberty analysis." In the opinion's understanding, PHH argued that a multi-member commission was required because it would be less able to act. As the court characterized the position, "Because multiple heads might make the

CFPB less likely to act against the financial services industry it regulates, group leadership is, according to PHH, constitutionally compelled."

"It remains unexplained why we would assess the challenged removal restriction with reference to the liberty of financial services providers, and not more broadly to the liberty of the individuals and families who are their customers," the court replied. "Congress understood that markets' contribution to human liberty derives from freedom of contract, and that such freedom depends on market participants' access to accurate information, and on clear and reliably enforced rules against fraud and coercion. Congress designed the CFPB with those realities in mind."

Dealing a final blow to PHH's case, the court rejected the "slippery slope" argument that allowing for-cause protection to the CFPB director could, down the road, allow Congress to grant the same protection to other government officials, even cabinet members. The focus on the nature of the official's tasks would prevent that, the court said.

In fact, "the slipperiest slope lies on the other side of the mountain," the court observed. In the court's understanding, PHH essentially was arguing that only independent agencies that precisely copy the FTC, which was approved in *Humphrey's Executor*, could be permitted. That would threaten many, perhaps even all, modern agencies.

"If PHH's version of liberty were the test—elevating regulated entities' liberty over those of the rest of the public, and requiring that such liberty be served by agencies designed for maximum deliberation, gradualism, or inaction—it is unclear how such a test could apply to invalidate only the CFPB. That test would seem equally to disapprove other features of many independent agencies" the opinion said.

Concurring opinions. Three members of the *en banc* court, including the judge who wrote the court's opinion, used a concurring opinion to address the RESPA issues that the court had avoided. They would have allowed the CFPB to reinterpret the RESPA anti-kickback section and to enjoin future conduct by PHH that was contrary to the reinterpretation. They would not, however, have permitted the Bureau to impose disgorgement based on earlier activity.

A concurring opinion by two other judges advanced a different basis for upholding the constitutionality of the CFPB's organization. According to this opinion, the fact that PHH was appealing from a final decision in a CFPB adjudication made clear that the director had significant quasi-judicial duties. As a result, the for-cause protection was permissible.

Yet another concurring judge would have said simply that the for-cause protection was constitutional because it provided only "a minimal restriction on the President's removal power, even permitting him to remove the Director for ineffective policy choices."

Dissents. The three judges who comprised the original panel all wrote separate opinions to dissent from the full court's decision:

- Judge Henderson placed great emphasis on the assertion that the CFPB's structure was novel and therefore was to be considered with great skepticism. In reaching that conclusion, she attempted to distinguish the CFPB from the independent agencies that had been approved in the Supreme Court precedents and argued that the combination of the various differences made the Bureau unconstitutional.
- Judge Kavanaugh, joined by Senior Judge Randolph, disagreed with the court's opinion on the bases of "history, liberty, and Presidential authority." As did Judge Henderson, he disputed the import of the Supreme Court precedents and the Bureau's similarity to other independent agencies. He also repeated the liberty-based concerns on which he relied heavily in the opinion he wrote on behalf of the three-judge panel.
- Judge Randolph, in addition to agreeing with Judge Kavanaugh, believed that the ALJ who presided over the hearing was an inferior officer under the Constitution who had not been properly appointed. In his opinion, that made any proceedings against PHH unconstitutional.

What does it mean? Because the original three-judge panel decision on the RESPA issues was reinstated by the court opinion, the administrative proceeding has been remanded to the CFPB "for further proceedings." In those proceedings, the CFPB can attempt to show that the reinsurance practices of PHH and its affiliates amounted to an illegal kickback under the prior interpretation of the law. The prior interpretation is what matters because the panel decided both that the reinterpretation was wrong and that, if it were right, it could not be applied retroactively.

If the Bureau can prove that there was a violation, and that the violation occurred within three years of the start of the proceeding, it can impose an appropriate remedy.

However, whether the CFPB under Acting Director Mick Mulvaney will have an appetite to continue an administrative enforcement proceeding against a company that arguably was acting in compliance with existing guidance is very much an open question.

Should PHH choose to ask the Supreme Court to review the decision, an additional complication arises. Under the Dodd-Frank Act, the CFPB can represent itself in the Supreme Court only if the Justice Department agrees. Given that the Justice Department has taken the position that the panel decision was correct and the CFPB should be treated as an executive agency, would a Trump Administration Justice Department consent to allowing the CFPB to argue a contrary position?

And, of course, having won a substantial victory on the RESPA enforcement issues, would PHH want to ask for a Supreme Court appeal rather than working for a dismissal at the administrative level?

The case is No. 15-1177.

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Companies: PHH Corporation

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