



## DC Circuit Rules CFPB's Structure Unconstitutional—Overturns \$106mm Fine

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### Case Summary

On October 11, 2016, the United States Court of Appeals for the District of Columbia, widely regarded as the nation's second most powerful court, ruled that the structure of the Consumer Financial Protection Bureau ("CFPB") is unconstitutional. In *PHH Corporation v. CFPB*, the court found that structure violated Article 2 of the Constitution by permitting the CFPB to usurp the executive power of the President. As headline-grabbing as this ruling is, other aspects of the case are of more importance to many companies.

In a 2-1 decision, a panel of the court found that two aspects of the structure of the CFPB, which alone are permissible, when combined usurp too much power of the President—(1) the CFPB is headed by a single person, rather than a board and (2) that person may only be removed by the President for cause. This ruling will have little immediate effect on companies regulated by the CFPB, because the court simply deleted the "for cause" provision from the statute, effectively changing the Director of the CFPB ("Director") from an official who can be removed only for cause to one who serves at the will of the President. Thus, the current Director, Richard Cordray, who was appointed by President Obama, will likely continue to serve for some time unless Donald Trump is elected president.

The immediate impact on the financial industry is minimal, because the decision explicitly declines to overturn prior orders, regulations or decisions of the CFPB, which will continue to have legal authority to carry out its statutory responsibilities. Citing to cases successfully challenging the constitutionality of other agencies, the court opines "[t]hat without major tumult, the agencies and courts have subsequently worked through the resulting issues regarding the legality of past rules and of past or current enforcement actions." Notably, the judge who dissented on the Article 2 issue argues that, because the court found unanimously that the decision below should be vacated and remanded to the agency, there was no reason for the court to reach the constitutional question.

PHH was a direct appeal to the U.S. Court of Appeals for the District of Columbia Circuit from a decision of Director Cordray in an administrative proceeding alleging violations of prohibitions on kickbacks under the Real Estate Settlements Protection Act ("RESPA"). The case challenged common tying arrangements by mortgage lenders who would refer mortgage insurance business only to insurance companies that agreed to purchase reinsurance from the lender's captive reinsurance company. The Director found that these tying arrangements were illegal kickbacks. The agency proceeding achieved some notoriety, because on appeal to the Director from an administrative law judge's order requiring that PHH pay \$6.4 million in disgorgement, the Director exploded the award to over \$109 million.

RESPA includes a safe harbor from kickback liability for "bona fide" agreements to provide services, which PHH argued permitted the tying arrangements so long as actual reinsurance was provided. PHH also argued that several Department of Housing and Urban Development ("HUD") opinion letters, subsequently adopted by the CFPB, had tacitly approved the arrangements and that the lack of "fair notice" of the Director's new interpretation violated the Due Process Clause of the Constitution. The CFPB argued that the Director correctly ruled that tying arrangements were

disguised kickbacks and not “bona fide,” that the prior HUD letters had not directly addressed tying arrangements and that PHH could not rely on the letters anyway because they had not been published in the Federal Register.

The court unanimously agreed with PHH, finding that the tying arrangements are permitted if the services are priced at “market value,” and remanding the case to the CFPB to determine whether and by how much the price of the reinsurance exceeded market value. The court also unanimously reversed the Director’s determination that no statute of limitations applies to law violations the CFPB challenges in administrative proceedings, which had been part of his rationale for the large award. The court held that the three-year limitations period in RESPA applied regardless of whether the CFPB challenged conduct in court or in an administrative proceeding.

## Important Implications of the Decision for Our Clients

The court rejected the notion that no statute of limitations applies if the CFPB is challenging law violations in an administrative proceedings. We expect this aspect of the decision to hold up. This is good news, because it creates some limits to the CFPB’s ability to reach back and challenge transactions and impose monetary sanctions for transactions that are far in the past.

Note, however, that the PHH court did not take issue with a finding by the Director that under RESPA each payment of a premium constituted a new violation. If a company is under investigation by the CFPB, it is important to compare the applicable statutes or regulations to RESPA’s kickback provisions to see if the agency can make an argument that each payment for a service is a violation rather than the initial agreement or transaction.

The court also included a great deal of language indicating that the Director violated constitutional principles of due process by levying a large monetary award based upon a new interpretation of the applicable law. This principle of “fair notice” may serve to cool the CFPB’s ardor as it seeks to impose draconian monetary awards on businesses that have been engaged in practices that have not been challenged previously by the government.

Fair notice may, in particular, be an important argument where the agency is pursuing novel claims of unfair, deceptive and abusive acts or practices, especially abusive acts and practices in light of the lack of precedent and guidance as to the meaning of “abusive” under the Dodd-Frank Act.

The holding regarding the constitutionality of the Director’s position has no prospective impact on proceedings, because the court has effectively amended the statute to make the position constitutional.

Whether past actions (regulations, cease and desist orders, etc.) of the CFPB can be challenged because, at the time he ruled, the Director mistakenly believed he could only be removed for cause is an issue that will be addressed in future cases.

## What’s Next?

The finality of the panel’s decision will be uncertain for some time. The CFPB could request an “*en banc*” rehearing, which means all the judges on the D.C. Circuit would consider the case. The government has 45 days (and PHH has 30 days) under the court’s rules to petition for rehearing *en banc*. Either party could also petition the U.S. Supreme Court to review the case. If the government chooses to do this, it has 90 days, and extensions are rarely granted. If the government seeks review, the parties will have 90 days to petition the Supreme Court after any decision regarding the *en banc* petition. In both cases review is discretionary—neither of these courts is required to review the panel’s decision.

It is not clear, which, if any, of the issues will be appealed by the CFPB. Although the CFPB has independent litigating authority, the Justice Department will be heavily involved in the decision-making at this point and the Solicitor General will make the determination whether the agency may petition the Supreme Court and on what issues.

This case forces the Administration to decide whether it wants to argue that Congress has the power to create an

executive agency that is headed by a single person who is largely beyond the power of the President to control through exercising his authority to remove executive branch officials at will. Ordinarily, the President would want to maximize his authority to remove such officials to protect his ability to execute the laws under Article 2 of the Constitution. Because of broader implications of making such an argument, we do not believe the Justice Department and the Solicitor General will support an appeal by the CFPB of the substance of the ruling. A compromise approach might be to argue instead that the dissent was correct—that there was no reason for the court to reach the Article 2 issue. The government may also question the standing of PHH to raise that argument, because it was not harmed in any tangible or meaningful way by the constitutional defect in the CFPB’s structure.

Other issues in the case probably do not arise to the level that normally would be worthy of review by the Supreme Court unless and until another circuit issues a conflicting opinion.

The CFPB is likely to request *en banc* review of interpretation of “bona fide,” which may attract the attention of enough judges on the full circuit to obtain such review. The panel’s substitution of its “market value” test is arguably no better supported than the Director’s prohibition of tying arrangements and the government would argue that the panel did not give the deference to the Director’s interpretation that Supreme Court precedents require. If *en banc* review is granted, there will be an additional round of briefs and oral argument, with a final decision six months to a year from now.

We think it unlikely that the CFPB will appeal the court’s holding regarding the applicable statute of limitations. The courts generally disfavor no-limitations arguments and the agency will probably decide that it can do its job using the same limitations periods that are specified in the statutes it administers for judicial proceedings.

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