What's Next for PHH v. CFPB?

October 15, 2016

Introduction

Not surprisingly, the many media and political reactions to the *PHH Corp. v. CFPB* decision have reflected the competing stakeholder interests around every aspect of the CFPB.[1] In this memorandum, we step back a bit and make some observations about the strategic choices facing the CFPB, the Obama Administration, the next President, and the next Congress in light of the decision. We begin with a short review of the tension between the two contradictory Supreme Court cases upon which the federal administrative state is built and explain how they informed the D.C. Circuit's invalidation of the CFPB's independent structure. We then discuss the D.C. Circuit's statutory interpretation, which we believe will have wide implications across a range of regulatory enforcement actions, both in the financial sector and beyond. We also discuss the extent to which the D.C. Circuit's ruling may raise questions as to the validity of past or pending CFPB rulemaking and enforcement actions. Finally, we end with an exploration of the considerations behind the possible next steps by the CFPB and other stakeholders.

Background

The case stems from a 2014 administrative proceeding in which the CFPB and PHH Corporation ("PHH") appealed to Director Richard Cordray an Administrative Law Judge's ("ALJ") recommended finding that PHH violated the Real Estate Settlement Procedures Act ("RESPA"). The ALJ had recommended disgorgement of $6.44 million based, in part, on a ruling that alleged violations before July 21, 2008 were not actionable because they fell outside the applicable 3-year statute of limitations.

Upholding the decision in part and reversing in part, Director Cordray expressly rejected the then-existing written guidance on RESPA's application to captive reinsurance on which PHH had relied. That guidance had been issued by the Department of Housing and Urban Development ("HUD"), which was the agency responsible for interpreting RESPA before the creation of the CFPB. Director Cordray determined that PHH violated RESPA with each payment by mortgage insurers rather than, as the ALJ recommended, when each reinsured loan closed. Finally, Director Cordray determined that RESPA's 3-year statute of limitations applies only to court actions and not to administrative proceedings. On these bases, he increased the disgorgement penalty from $6.44 million to $109 million.

PHH appealed the decision to the United States Court of Appeals for the District of Columbia Circuit. PHH argued that Director Cordray's interpretation of RESPA was inconsistent with its plain language and longstanding precedent and therefore not entitled to *Chevron* deference and that the Director's retroactive reinterpretation of the statute violated the Due Process Clause of the Fifth Amendment.[2] PHH also argued that Director Cordray incorrectly determined that statutes of limitations were inapplicable to an administrative proceeding. Finally, it argued that the agency's decision was invalid for the independent reason that the CFPB's structure violates the Constitution. Before oral argument, the D.C. Circuit asked the parties to address the historical precedents for independent agencies led by a single director and any proposed remedies for structures that did not pass constitutional muster.

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[1] No. 15-1177 (D.C. Cir. Oct. 11, 2016). The full opinion is available **here**.

[2] *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

The PHH Corp. v. CFPB Decision

The Constitutional Ruling

The D.C. Circuit held, in a majority decision written by Judge Kavanaugh, that in light of the Supreme Court's separation of powers precedents, the CFPB is unconstitutionally structured because it is headed by a single director who can be removed by the President only for cause rather than at will. The court then severed the unconstitutional for-cause removal provision from the rest of the Dodd-Frank Act, making it clear that henceforth the Director is removable by the President at will. If the court's ruling stands, the CFPB will continue to operate but will now do so as an agency within the executive branch, rather than as an independent agency.[3]

The constitutional tension is created by two contradictory Supreme Court cases. The first, *Myers v. United States*, was decided in 1926 and held that executive power is typically exercised by the President or by removable-at-will subordinate officers subject to the supervision and command of the President.[4] The second case, *Humphrey's Executor v. United States*, decided in 1935, over the objections of President Franklin D. Roosevelt, held that Congress could create an independent agency subject to less control by the President.[5] In *PHH Corp. v. CFPB*, the D.C. Circuit expressed the view that the Supreme Court had permitted the creation of independent agencies because, among other things, the agency at issue in *Humphrey's Executor* was designed to be non-partisan, to act with impartiality, and most importantly, to be led by a "body of experts" rather than a single director.[6] As noted by the panel, independent agencies now "possess authority over vast swaths of American economic and social life."[7] The tension between *Myers* and *Humphrey's Executor* has been apparent in virtually every separation of powers case involving agencies.[8]

Following *Humphrey's Executor*, the vast majority of independent agencies have been led by multi-member boards.[9] The CFPB is an exception. Established under the Dodd-Frank Act, the CFPB is headed by a single director who is authorized to enforce 19 distinct consumer protection laws and removable only for cause, i.e., for "inefficiency, neglect of duty, or malfeasance in office."[10] The D.C. Circuit opined that the Director "is the single most powerful official" in the government, other than the President, at least within the Director's narrower sphere of authority. This concentration of power, in the view of the panel, is a departure from historical practice, is exceptional in our constitutional structure, and makes the CFPB a "historical anomaly."[11] This, the panel said, "strongly counsels caution with respect to single-Director independent agencies" like the CFPB.[12]

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[3] *PHH Corp.*, No. 15-1177 at *28 n.4.

[4] 272 U.S. 52 (1926).

[5] 295 U.S. 602 (1935).

[6] *PHH Corp.*, No. 15-1177 at *21.

[7] *Id.* at *22.

[8] The existence of independent agencies contradicts the theory of a "unitary" executive, or one where executive power resides solely in the President.

[9] The court lists over 20 examples.

[10] *PHH Corp.*, No. 15-1177, at * 23 (citing 12 U.S.C. § 5491(c)(3) and *Humphrey's Executor*, 295 U.S. at 620).

[11] *Id.* at *27.

[12] *Id.* at *33.

In explaining why the CFPB's "departure from historical practice matters," the D.C. Circuit reasoned that, where the constitutional text does not resolve the separation of powers issue, longstanding practices should inform a court's decision as to what the law is. For example, the Supreme Court in a very recent 9-0 opinion written by Justice Breyer, *NLRB v. Noel Canning*, interpreted a 200-year old practice regarding Senate recess appointments as a constitutional standard.[13] In *Free Enterprise Fund v. Public Company Accounting Oversight Board*, a divided 5-4 Supreme Court drew a line between one level and two levels of for-cause removal in part because historical practice had settled on one level of for-cause removal.[14]

The Constitution, as interpreted by the *Humphrey's Executor* Court, does not answer *how* independent agencies should be structured, just that they can be constitutional. In an in-depth analysis, the panel examined the historical purpose behind the multi-member boards that govern agencies such as the SEC or NLRB—a concern for safeguarding individual liberty. The panel focused on the CFPB's lack of the sort of "critical check" on abuse applicable to traditional independent agencies: majority, deliberative, and diverse decision-making.[15] According to the panel, a single director is more prone to extreme, idiosyncratic, and influenced decision-making and is thus more likely to infringe on individual liberties. The single director structure was particularly concerning to the panel in light of the CFPB's quasi-judicial and quasi-investigative authority.[16]

Furthermore, the *PHH* court held that the CFPB's structure—having a single director with for-cause removal only—contradicts the Constitution's bedrock principle of dividing power among and within multiple entities (e.g., two houses in the legislative branch, equal votes among the Chief and Associate Justices of the Supreme Court, etc.). The panel emphasized that, apart from the executive branch, which has power concentrated in one person but subject to national election and accountability, the Constitution reflects the notion that multi-member bodies are less likely to engage in arbitrary decision-making and abuses of power. In fact, the panel asserted that the multi-member agency form has "become synonymous with independence."[17] Since the CFPB represents a "sharp break" from that historical practice, lacks the internal checks of other agencies, and poses a great threat to individual liberty, the panel held that its structure raises grave constitutional doubt.[18] According to the panel, "*Humphrey's Executor* does not mean that anything goes."[19]

The *PHH* panel's 52-page analysis of the history and structure of independent agencies, with its copious citations to public statements and recent Supreme Court opinions written by Justices both liberal and conservative, was clearly intended to signal the depth and seriousness of the panel's analysis. Judge Kavanaugh is well acquainted with cases regarding the President's executive power. In 2008, Judge Kavanaugh dissented from the D.C. Circuit's opinion in *Free Enterprise Fund* upholding the structure of the Public Company Accounting Oversight Board ("PCAOB"); the D.C. Circuit's opinion was later invalidated by the Supreme Court.[20] Here, Judge Kavanaugh hinted in a footnote that *Humphrey's*

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[13] 134 S. Ct. 2550, 2657 (2014).

[14] 561 U.S. 477, 484, 505 (2010).

[15] *PHH Corp.*, No. 15-1177, at *44-45.

[16] *Id.* at *48-49.

[17] *Id.* at *52 (internal quotation marks and citations omitted).

[18] *Id.* at *53.

[19] *Id.* at *58.

[20] *Free Enterprise Fund v. Public Co. Accounting Oversight Bd.,* 537 F.3d 667, 685-715 (D.C. Cir. 2008) (Kavanaugh, J., dissenting).

Executor and the reasoning of *Free Enterprise Fund* are in tension with one another but noted that it was not the D.C. Circuit's place to overrule *Humphrey's Executor*.[21] It is noteworthy that Judge Henderson did not join this portion of the opinion but also did not address or criticize it substantively.

While carefully not calling *Morrison v. Olson* itself into question, the majority opinion copiously cites Justice Scalia's dissent from that case, notes that the dissent has been complimented by Justice Kagan and also points to a number of other separation of powers statements, in opinions or otherwise, by Justice Breyer.[22] The D.C. Circuit noted the "nearly universal consensus" that the independent counsel law upheld in *Morrison v. Olson* was a mistake.[23] In our view (shared by the three authors of this memorandum who are former Supreme Court law clerks), the press and instant pundits have been mistaken to the extent they have characterized the potential views of the Supreme Court on this separation of powers issue as clearly falling along classic conservative/liberal lines. While it seems likely that Justices Roberts, Alito, and Thomas would uphold the ruling, given the 9-0 decision in *Noel Canning* and other statements by Justices Breyer and Kagan, it is far from clear the other Justices would vote to reverse the D.C. Circuit.

The Court's Remedy: Severing the For-Cause Removal Provision

PHH argued that if the for-cause removal provision was unconstitutional, the panel must strike down the CFPB and prevent its continued operation. The D.C. Circuit declined to go that far. Instead, the panel noted that partial invalidation is the favored course, so long as (1) Congress would have preferred a law with the offending provision severed over no law at all, and (2) the law with the offending provision severed would otherwise remain fully operative.[24]

The court concluded that there was no evidence that Congress would have preferred no CFPB at all to a CFPB whose director is removable by the President at will. As the court pointed out, the Dodd-Frank Act itself states that if any provision is found to be unconstitutional, the remainder "shall not be affected thereby."[25] The court stressed that the restructured CFPB would still be able to "regulate the offering and provision of consumer financial productions or services under the federal consumer laws," as Congress had intended.[26]

The approach by the *PHH* court followed the one taken by the Supreme Court in *Free Enterprise Fund*. In *Free Enterprise Fund*, the petitioners claimed that the Sarbanes-Oxley Act violated the separation of powers by creating a five-member PCAOB board not subject to Presidential removal. There, the Supreme Court agreed, but it did not strike down the entire law. Instead, the Supreme Court followed the "normal rule" and invalidated only the offending provision.[27] We believe that the D.C. Circuit is on solid ground in *PHH* in deciding to sever the for-cause removal provision it found to be unconstitutional. If the constitutional ruling stands, the portion of the court's ruling on severability is unlikely to be overturned.

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[21] *PHH Corp.*, No 15-1177 at *59 n.15.

[22] *Id.* at *3-4, 8-9, 29, 30-31, 33-34, 36-37, 40, 43, 52, 54, 59; *see also Morrison v. Olson*, 487 U.S. 654 (1988).

[23] *Id.* at *33. A three judge panel of the D.C. Circuit originally invalidated the independent counsel statute. That panel was composed of Judge Silberman, Judge Williams and then Judge Ruth Bader Ginsburg. Judge Ginsburg dissented. *In re Sealed Case*, 838 F.2d 476 (D.C. Cir. 1988). In *Morrison v. Olson*, 487 U.S. 654 (1988), the Supreme Court reversed 7-1 with Justice Scalia dissenting. Judge Randolph, who joined Judge Kavanaugh in the constitutional ruling in *PHH*, was on the D.C. Circuit at the time that it decided *In re Sealed Case*.

[24] *PHH Corp.*, No. 15-1177 at *66 (citing *Free Enterprise Fund*, 561 U.S. at 508-09).

[25] 12 U.S.C. § 5302.

[26] *PHH Corp.*, No. 15-1177 at *67-68 (quoting 12 U.S.C. § 5491(a)).

[27] *PHH Corp.* No 15-1177 at *66 (quoting *Free Enterprise Fund*, 561 U.S. at 508).

The Statutory Rulings

The D.C. Circuit also reached PHH's statutory interpretation challenges: that the CFPB misinterpreted RESPA, that it violated the Due Process Clause by applying its interpretations retroactively, and that it failed to observe a statute of limitations in penalizing PHH's conduct. The three-judge panel unanimously ruled in PHH's favor on each of these points.

The entire panel held that the CFPB's interpretation of RESPA "flout[ed] not only the text of the statute but also decades of carefully and repeatedly considered official government interpretations."[28] The court rejected the CFPB's calls for *Chevron* deference, concluding that there was no statutory ambiguity. The D.C. Circuit also held that CFPB's retroactive application of its new interpretation of RESPA to PHH's conduct contravened the foundational due process principle of fair notice. The court stated that the CFPB violated "Rule of Law 101" and characterized its retroactive imposition of penalties as "gamesmanship."[29] The court remanded to permit the CFPB to determine whether the reinsurance payments exceeded reasonable market value under RESPA.

By rejecting the CFPB's interpretation of RESPA, the D.C. Circuit aligned with the "longstanding interpretation" of the statute by HUD. The D.C. Circuit's ruling that an agency cannot change the course of a long-standing interpretation in the midst of an enforcement action reaffirms an important principle of administrative law which applies across a range of agencies.

The panel also rejected the CFPB's arguments that Dodd-Frank imposes no statute of limitations on agency administrative enforcement actions. It held that the statutes of limitations for all 19 federal consumer protection laws enforced by the CFPB apply to administrative actions. As the CFPB has often taken the position that statutes of limitations do not apply to investigations or administrative proceedings, we view this interpretation as highly significant, and it will be a welcome relief to many.

Impact of the Decision on Other Agencies

In an attempt to defend its structure, the CFPB had pointed to four other agencies: the Social Security Administration ("SSA"), the Office of Special Counsel ("OSC"), the Office of the Comptroller of the Currency ("OCC"), and the Federal Housing Finance Agency ("FHFA"). The CFPB argued that because these other agencies, like the CFPB, each have a single director, there was no constitutional issue. The D.C. Circuit did not find the comparisons persuasive.

With respect to the SSA and OSC, the panel noted that these agencies, unlike the CFPB, do not unilaterally bring law enforcement actions or impose fines and penalties against private citizens for violations of statutes or agency rules. With respect to the OCC, its head, unlike the Director, is removable at will by the President. This analysis suggests that these agencies are on solid ground.

In contrast, the panel did not contest the CFPB's comparison to the FHFA, which, like the CFPB, has a single director that can be removed only for cause. Rather, the panel noted that the two agencies are contemporaries and said that the FHFA's structure "raises the same [constitutional] question" as the structure of the CFPB.[30] If the court's decision stands, it seems likely the FHFA will face challenges. The statute creating the FHFA does not have a severability clause.

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[28] *Id.* at *76.

[29] *Id.* at *86, 88.

[30] *Id.* at *33.

Impact of the Decision on Past or Pending CFPB Actions

The D.C. Circuit's ruling raises questions as to the validity of past or pending CFPB rulemaking and enforcement actions. The panel expressly declined to consider the ramifications of the constitutional portion of its decision on this issue.[31] The panel noted that the constitutional defects of the NLRB and the PCAOB were remedied without "major tumult." If the cases that restructured those decision-making bodies serve as a guide, the effects of the *PHH* decision on past or pending actions may be limited. Following *Noel Canning*, the NLRB, then properly constituted, essentially readopted its earlier order, and the D.C. Circuit held this action was a proper approach. After *Free Enterprise Fund*, the SEC took the position that *Free Enterprise Fund* did not invalidate pending PCAOB actions, which the SEC observed could be ratified by a properly constituted PCAOB.[32]

The CFPB has grappled with this issue before. The Supreme Court's ruling in *Noel Canning* was widely understood to also invalidate the President's 2012 recess appointment of Director Cordray. After Director Cordray was re-nominated and confirmed by the Senate, he issued a "Notice of Ratification" that "affirm[ed] and ratif[ied] any and all actions" taken while serving as a recess appointee. The Ninth Circuit thereafter held that so long as Congress had properly granted the CFPB the authority to bring the enforcement action in question, the Notice of Ratification was sufficient to validate an ongoing enforcement action.[33] Similarly, in the context of rulemaking, the U.S. District Court for the District of Columbia held that Director Cordray's Notice of Ratification was sufficient to ratify prior rulemakings.[34]

In light of these precedents, challenges to the CFPB's rulemakings and enforcement actions based on the separation of powers issue found by the D.C. Circuit are likely to face significant hurdles. In contrast, the issues the D.C. Circuit found with the CFPB's abuse of power may make the CFPB vulnerable in challenges to some enforcement actions if the challengers are able to show similar types of Due Process or statutory interpretation issues. As noted above, the D.C. Circuit was sharply critical of the CFPB's interpretation of the statute and found that the CFPB's order had violated "bedrock principles of due process."[35] This strong language suggests that a limited set of challengers to CFPB enforcement actions may find success at the D.C. Circuit.

What's Next?

There are multiple possibilities for next steps with an added degree of uncertainty in light of the election. Without making any predictions in a volatile and changing environment, here are some considerations that we expect are in the minds of politicians and policymakers.

- The deadline for seeking *en banc* review is 45 days after a final order. For a *cert* petition, the parties will have 90 days, with a 60-day possible extension. Both dates fall after the election on November 8th.
- Using an *en banc* petition to play out the time may appeal to the Administration, in that it gives the next President a chance to take a view.

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[31] *Id*. at *69 ("We need not here consider the legal ramifications of our decision for past CFPB rules or for past agency actions.").

[32] SEC Release No. 34-78764, In the Matter of Laccetti.

[33] *CFPB v. Gordon*, 819 F.3d 1179 (9th Cir. 2016). Gordon's petition for rehearing *en banc* before the Ninth Circuit was denied. Justice Kennedy has extended the deadline to file a *cert* petition with the Supreme Court to November 17, 2016.

[34] *State Nat'l Bank of Big Spring v. Lew*, Civil Action No. 12-1032 (ESH), 2016 WL 3812637 (D.D.C. July 12, 2016). The *Big Spring* court declined to rule on Big Spring's separation of powers argument, noting that *PHH* was currently before the D.C. Circuit.

[35] *PHH Corp.*, No. 15-1177 at *12.

- After losing 3-0 on the statutory points, the CFPB may see limited downside to seeking an *en banc* ruling. At the least, the CFPB might get a forceful and substantive dissent, something that is lacking in the current opinion.
- The cloud placed over the FHFA would likely also be considered in deciding whether to grant *en banc* rehearing.
- It seems highly unlikely that the current Congress will enact new legislation to create a multi-person commission for either the CFPB or FHFA. What the next Congress might do is unknowable before the election.
- PHH, whose business purpose aligned with advocates for the unitary executive theory, has now won and thus has no incentive to seek *en banc* or Supreme Court review.
- The decision increases Presidential power and a new Administration may not object to that result.
- An 8-person Supreme Court may or may not want to grant *cert* in *PHH* in light of the limited nature of the impact on other agencies. The Supreme Court will most certainly receive any *Gordon* petition first, but it does not follow that the decision to grant or deny a *cert* petition in *Gordon* will impact that same decision in *PHH.*
- Were the Supreme Court to grant *cert*, it is not at all clear that its decision would break down on conventional conservative/liberal lines.
- The Supreme Court need not resolve the longstanding *Myers*/*Humphrey's Executor* tension should it take this case. It could, like the D.C. Circuit panel, decide it on the narrower ground that "*Humphrey's Executor* does not mean that anything goes."

These considerations and variables make it impossible to determine whether the courts, the executive branch, or the legislature will be the ultimate decision maker. Of course, some might say that is entirely fitting for a separation of powers topic.

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