

D.C. Circuit Clips CFPB's Wings

October 11, 2016

Financial Services

The U.S. Court of Appeals for the D.C. Circuit today released its long-awaited decision in *PHH Corp., et al. v. Consumer Financial Protection Bureau*, No. 15-1177 (D.C. Cir., Oct. 11, 2016). The 110-page decision, which includes a concurrence and a concurrence in part and dissent in part, represents a significant blow to the CFPB. The full opinion is available [here](#).

PHH represented the first serious challenge to the constitutionality of the Bureau's structure and the first-ever challenge to the CFPB's exercise of its administrative enforcement powers. In a dramatic setback for the CFPB, *PHH* prevailed on both the constitutional and administrative law grounds. In light of the significance of the issues involved, the CFPB is likely to seek rehearing by the Court of Appeals *en banc* or Supreme Court review.

The Court, in an opinion written by Judge Kavanaugh, found:

- The Bureau's single-Director structure is unconstitutional under Article II of the U.S. Constitution. To remedy the constitutional flaw, the Court severed the Dodd-Frank Act's removal "for-cause" provision, giving the President the power "to remove the Director at will, and to supervise and direct the Director."¹
- The CFPB incorrectly interpreted Section 8 of the Real Estate Settlement Procedures Act (RESPA). Contrary to the Bureau's position, RESPA permits captive reinsurance arrangements "so long as the amount paid by the mortgage insurer for the reinsurance does not exceed the reasonable market value of reinsurance."²
- The Bureau "violated bedrock principles of due process" when it departed from prior RESPA guidance issued by the U.S. Department of Housing and Urban Development (HUD) and retroactively applied its new interpretation of RESPA against *PHH*.³
- The CFPB misread the law relating to statutes of limitations. Contrary to the Bureau's position, CFPB administrative proceedings are subject to the statutes of limitations in the underlying statutes enforced by the CFPB, including RESPA's three-year statute of limitations.⁴

¹ *PHH Corp., et al. v. Consumer Financial Protection Bureau*, slip op. at 9-10.

² *Id.* at 12.

³ *Id.* at 12.

⁴ *Id.* at 12-13.

Judge Randolph concurred with a brief, one-page concurring opinion. Judge Henderson concurred with the RESPA, due process, and statute of limitations portions of the opinion, but dissented on grounds that it was unnecessary to reach the constitutional challenge to the CFPB's structure.

The Court's decision deals a major blow to the CFPB. Although the Court's constitutional holding may dominate the headlines, the most significant aspects of the Court's decision for the industry may be the way it prevents the CFPB from retroactively applying new interpretations of laws and bringing cases that involve alleged violations outside the relevant statutes of limitations. The first should ensure that industry has fair notice about new or revised CFPB interpretations of law before the Bureau takes enforcement actions. The second should substantially limit industry's exposure to penalties and restitution for violations that occurred many years ago.

I. Background

A. Administrative Enforcement

This case arose in January 2014 when the CFPB [initiated](#) an administrative enforcement action against PHH for alleged violations of RESPA's Section 8 kickback rules. PHH contested the CFPB's allegations, maintaining that Section 8(c)(2) of RESPA exempts certain payments and citing previous interpretations of that section, including a 1997 interpretive letter issued by HUD. PHH also maintained that RESPA's three-year statute of limitations applied to administrative enforcement actions.

An administrative law judge (ALJ) [ruled](#) against PHH, held that RESPA's statute of limitations did not apply to administrative enforcement actions, and recommended the disgorgement of \$6.5 million in fees. PHH and CFPB Enforcement each appealed the ALJ's decision to CFPB Director Cordray.

In June 2015, Director Cordray issued a [decision](#) holding that: Section 8(c)(2) of RESPA is not an exemption; the HUD letter is nonbinding and inconsistent with the statute; and statutes of limitations do not apply in an administrative forum. Director Cordray's [decision](#) also expanded the ALJ's findings, and directed the company to disgorge \$109 million, instead of the \$6.5 million initially ordered by the ALJ.

B. Petition for Review

PHH filed a petition for review of Director Cordray's decision in the D.C. Circuit and also obtained a stay of Director Cordray's decision in August 2015. Following briefing, the D.C. Circuit held [oral argument](#) on April 12, 2016, with Judges Kavanaugh and Randolph present and Judge Henderson not present but listening to a recording of the argument.

In the order scheduling the oral argument, the court asked the parties to address the following two questions, which turned out to foreshadow the Court's opinion:

1. What independent agencies now or historically have been headed by a single person? For this purpose, consider an independent agency as an agency whose head is not removable at will but is removable only for cause; and
2. If an independent agency headed by a single person violates Article II as interpreted in *Free Enterprise Fund v. PCAOB*, 561 U.S. 477 (2010), what would the appropriate

remedy be? Would the appropriate remedy be to sever the tenure and for-cause provisions of this statute, see 12 U.S.C. § 5491(c)? *Cf. Free Enterprise Fund*, 561 U.S. at 508-10. Or is there a more appropriate remedy? And how would the remedy affect the legality of the Director's action in this case?

In the *Free Enterprise Fund* case, the Supreme Court ruled that limits on the ability to remove members of the Public Company Accounting Oversight Board violated the separation of powers under the Constitution. The *Free Enterprise Fund* Court did not strike down the PCAOB, but merely severed the “for cause” removal provisions from the relevant law.

On appeal, PHH argued that: the CFPB’s single-Director structure was unconstitutional; the CFPB misinterpreted RESPA; the CFPB improperly applied its new interpretation of RESPA retroactively; and the administrative proceedings are subject to the relevant statute of limitations.

II. The Court’s Decision

A. The Constitutionality of the CFPB’s Structure

The Court, with Judge Henderson dissenting, found that the CFPB’s structure as an independent agency violated the separation of powers provision of Article II of the U.S. Constitution. Recognizing that *Humphrey’s Executor v. United States*, 295 U.S. 604, 624, 631-32 (1935), held that Congress may create independent agencies whose heads were not removable at will by the President, the Court focused on the fact that the CFPB is a “single-Director independent agency exercising substantial executive authority” compared to other independent agencies which have all been multi-member commissions or boards.⁵

The Court found the single-Director independent agency structure unconstitutional because it “departs from settled historical practice” and “threatens individual liberty far more than a multi-member independent agency does.”⁶ To remedy the separation of powers violation, the Court severed the for-cause removal provision of the Dodd-Frank Act, followed *Free Enterprise Fund v. PCAOB*, 561 U.S. 477 (2010).⁷ As a result, the Court’s decision gives the President the power to remove the CFPB Director at will, and to supervise and direct the CFPB Director.⁸ Depending upon the results of the Presidential election, this decision could have enormous or no consequences for the workings of the Bureau in the near future.

B. The CFPB’s New RESPA Interpretation and Retroactive Application

In the administrative enforcement action against PHH, the CFPB interpreted Section 8 of RESPA to prohibit captive reinsurance agreements even if the mortgage insurers pay no more than reasonable market value to the reinsurers.⁹ In doing so, the CFPB disregarded an existing

⁵ *Id.* at 21, 27.

⁶ *Id.* at 59, 64.

⁷ *Id.* at 69.

⁸ *Id.*

⁹ *Id.* at 72.

rule adopted by HUD under RESPA, Regulation X, that permitted captive reinsurance arrangements so long as the insurer paid reasonable market value for the reinsurance.¹⁰ PHH argued that the CFPB not only changed course, but then retroactively applied its new interpretation against PHH based on conduct that PHH engaged in before the CFPB issued its new interpretation.¹¹

The Court agreed, finding that the CFPB's interpretation misinterpreted Section 8(c) of RESPA, and "flout[ed] not only the text of the statute but also decades of carefully and repeatedly considered official government interpretations." Because the Court concluded that the statutory text was unambiguous, it found that the Bureau's contrary interpretation was not entitled to the deference often afforded agencies under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843 n. 9 (1984).¹² Even if the CFPB's new interpretation had been consistent with the statute, the Court also concluded that the CFPB "violated due process by *retroactively* applying the new interpretation to PHH's conduct that occurred before the date of the CFPB's new interpretation."¹³ The Court also found the CFPB's argument that PHH could not rely upon prior HUD guidance "deeply unsettling in a Nation built on the Rule of Law."¹⁴ The Court remanded to allow the CFPB to determine whether the mortgage insurers paid more than reasonable market value to the reinsurer.¹⁵

C. Statute of Limitations

The Court also rejected the Bureau's claim that the Dodd-Frank Act imposes no statute of limitations to CFPB enforcement actions brought in administrative proceedings or, alternatively, that the statutes of limitations in underlying statutes only apply to enforcement actions the CFPB brings in court.¹⁶ The Court noted that the CFPB's Dodd-Frank argument would make the statutes of limitations in all 19 consumer financial protection statutes enforced by the CFPB inapplicable in administrative proceedings.¹⁷ Instead of allowing such a loophole, the Court found that the CFPB's enforcement authority under the Dodd-Frank Act was limited by the terms of those 19 statutes, including the statutes of limitations in each of those laws.¹⁸ The Court similarly rejected the CFPB's attempt to claim that "actions" refers only to court actions, not to administrative proceedings,¹⁹ citing the Dodd-Frank Act's repeated use of "actions" to refer both

¹⁰ *Id.* at 76.

¹¹ *Id.* at 72.

¹² *Id.* at 76-78.

¹³ *Id.* at 79.

¹⁴ *Id.* at 87.

¹⁵ *Id.* at 89.

¹⁶ *Id.* at 91-92.

¹⁷ *Id.* at 93.

¹⁸ *Id.*

¹⁹ *Id.* at 95.

to court and administrative proceedings and the broad purpose and history of the Act.²⁰ In addition, the Court noted that it would “expect Congress to actually say that there is no statute of limitations for CFPB administrative actions” before adopting a standard that would allow the CFPB to bring an administrative enforcement action “100 years after the allegedly unlawful conduct.”²¹

D. Looking Ahead

In addition to its substantive findings, the Court’s tone and overall approach may have long term effects. Although the opinion doesn’t draw the link directly, it appears that the Court concluded that its theoretical concerns about the potential for unfairness in the Bureau’s structure were borne out by the Bureau’s handling of the PHH matter itself. Accordingly, the Court is unsparing in its language regarding the Bureau’s approach:

- “[T]he basic statutory question in this case is not a close call.” Instead, the Bureau’s approach “makes little sense.”²²
- The application of the Bureau’s reading of RESPA to PHH retroactively is “facially nonsensical,” and “gamesmanship” that amounts to “a serious due process violation.”²³
- The Bureau’s position on statute of limitations “is flatly wrong” as a reading of the statute, and imputes a “nonsensical” intention to Congress.²⁴
- In sum, “‘trust us’ is ordinarily not good enough.”²⁵

The tone of this rebuke may embolden litigants and courts alike to redouble their scrutiny of the Bureau’s interpretations of law. For its part, the Bureau may wish to use the Court’s decision as an opportunity to re-examine the ways it makes decisions to better replicate the pressure-testing that occurs in agencies that include commissioners with different viewpoints.

²⁰ *Id.* at 95-98.

²¹ *Id.* at 98, 100.

²² *Id.* at 73, 74.

²³ *Id.* at 82, 88, 87.

²⁴ *Id.* at 95, 99.

²⁵ *Id.* at 100.

III. Conclusion

Today's PHH decision, unless overturned by the Court of Appeals *en banc* or Supreme Court, will be a critical landmark in the Bureau's development as an enforcement agency. Most significantly, the Court's decision restricts the Bureau's ability to reinterpret settled law in enforcement actions and to apply such new interpretations against parties on a retroactive basis. The decision also eliminates a distinct home-field advantage the CFPB had claimed for administrative proceedings—specifically, the ability of the CFPB to disregard the statutes of limitations in underlying statutes when pursuing enforcement actions through administrative proceedings. The result should be a fairer enforcement process and less severe penalty and restitution amounts in enforcement actions.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Financial Services practice:

<u>Eric Mogilnicki</u>	+1 202 662 5584	<u>emogilnicki@cov.com</u>
<u>Andrew Smith</u>	+1 202 662 5049	<u>andrewsmith@cov.com</u>
<u>D. Jean Veta</u>	+1 202 662 5294	<u>jveta@cov.com</u>
<u>David Stein</u>	+1 202 662 5074	<u>dstein@cov.com</u>

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