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COMMENTARY

PHH v. Consumer Financial Protection Bureau: What it Means for Current and Future CFPB Enforcement

On October 11, 2016, the United States Court of Appeals for the District of Columbia issued its long-awaited decision in *PHH Corporation, et al. v. Consumer Financial Protection Bureau* (“*PHH Corp.*”).[1] In a lengthy opinion, the court vacated the Consumer Financial Protection Bureau’s (“CFPB” or “Bureau”) first contested administrative action and held that mortgage company PHH Corporation (“PHH”) did not violate Section 8(a) of the Real Estate Settlement Procedures Act (“RESPA”) by engaging in captive reinsurance arrangements, in part because the Bureau in its ruling retroactively applied a new interpretation of law.

The court did not stop with addressing the Bureau’s reading of RESPA, however. The court also ruled on PHH’s arguments concerning the constitutionality of the CFPB’s structure and the applicability of limitations periods to CFPB administrative enforcement actions. Again, the court ruled against the Bureau, finding the structure of the Bureau unconstitutional and holding that the agency must adhere to the limitations periods that apply to the statutes it is charged with enforcing.

While the court’s remedy for the Bureau’s structural problems—making the Director removable without cause—is unlikely to impact the CFPB’s enforcement operations in the short-term, the court’s retroactivity and statute of limitations rulings are more immediately significant. Both substantially curtail aggressive statutory interpretations made by the Bureau, and the statute of limitations analysis in particular means that the CFPB is now bound by the same limitations periods whether it chooses to bring enforcement actions through administrative proceedings or in federal court.

The CFPB may seek *en banc* review of the decision, and if review is denied or the result after review is unchanged, then the Bureau will likely appeal to the Supreme Court. Consequently, the long-term impact of the D.C. Circuit’s decision is unknowable. This analysis focuses instead on the practical effect of the court’s opinion on businesses and individuals that already are or will be before the Bureau’s Office of Enforcement in the near-term.

Case Background

The case arose after the CFPB’s Office of Enforcement brought an administrative action against mortgage lender PHH, alleging that PHH violated RESPA by referring business to mortgage insurers with whom PHH had captive reinsurance agreements. The CFPB called the payments between mortgage insurers and PHH's reinsurance subsidiary unlawful "kickbacks" that violated RESPA. At the time the administrative action was brought against PHH, all but two of the CFPB's administrative actions had been filed as consent orders. The PHH action became the first adjudication of an administrative action and the first test of the CFPB's administrative hearing and appeals procedures.

The administrative law judge ("ALJ") hearing the action gave the Bureau a narrow victory, recommending to CFPB Director Richard Cordray that PHH disgorge $6.5 million. Both PHH and the CFPB appealed aspects of the ALJ's recommendation to Director Cordray. Rather than affirming the ALJ's decision, Director Cordray disagreed with certain findings of the ALJ and increased the disgorgement amount to $109 million. The disgorgement calculation rested on two legal conclusions reached by Director Cordray: first, that PHH had violated RESPA each time a payment at issue in the case was made; and second, that the Bureau is not bound by any statute of limitations period when it brings an enforcement action administratively rather than in federal court.

Immediately following Director Cordray's decision, PHH asked the D.C. District Court to stay the ruling, which it did. The Court of Appeals heard arguments in this case on April 12, 2016, and then issued its ruling on October 11, 2016.

Practical Implications of *PHH Corp.*

Applicable Statute of Limitations Periods Apply to All CFPB Enforcement Actions. For regulated entities, among the most significant aspect of the court's decision relates to the statute of limitations period applicable to Bureau enforcement actions. The Bureau has argued repeatedly that it has no limitations period for enforcement actions brought in an administrative forum.[2] The court in *PHH Corp.* ruled to the contrary, however, holding that the limitations period for the underlying statute applies regardless of forum. While only RESPA was directly implicated in the court's decision, the court discussed the issue more expansively, focusing on the CFPB's enforcement of the 19 enumerated consumer laws under its jurisdiction.

Curiously, the court did not also cite the Bureau's enforcement of Dodd-Frank's Unfair, Deceptive, or Abusive Acts and Practices ("UDAAP") provisions. However, the logic of the holding and the court's dismissive attitude toward the Bureau's position strongly suggest that the holding would apply equally to UDAAP claims, and that Dodd-Frank's discovery-based three-year limitations period applies regardless of forum.[3] Even if the Bureau will not formally acknowledge that the ruling applies to UDAAP, it is well aware that under *PHH Corp.*, it would face an uphill battle in a future challenge on the issue.

Thus, the practical effect of this ruling is to immediately change the presumptive limitations period for entities investigated by the CFPB from limitless to ranging from one[4] to five[5] years, depending on the relevant statute.

Impact of Shorter Limitations Periods. There are several significant potential benefits for regulated entities resulting from this decision, but each comes with a potential downside. First, a shorter limitations period may have a dramatic effect on reducing entities' monetary exposure for consumer redress. However, if the Bureau believes it cannot obtain full redress in a particular matter due to applicable limitations periods and it perceives that an alleged wrongdoer will unjustly profit due to this limitation, the Bureau may try to remedy this perceived problem through a larger civil penalty. Such a shift from redress toward penalties would be unwelcome and potentially more costly: statutory maximums for penalties are quite onerous,[6] and the Bureau has substantial discretion regarding the size of the penalty it seeks. In addition, larger penalties carry greater reputational risk, and, based on the terms included in past CFPB settlements, institutions cannot seek indemnification or contribution for penalties or seek favorable tax treatment.[7]

A second benefit for regulated entities is that fewer investigations will drag on for indefinite periods of time, resulting in potentially lower investigative discovery burdens and shorter periods of lingering uncertainty for entities under investigation. On the other hand, Bureau investigators may feel the need to make decisions about whether to prosecute alleged violations based on a less complete record. In addition, if the Bureau exhausts most of the limitations period conducting its investigation, it may not leave reasonable time for an entity to effectively use the NORA[8] process to avoid meritless prosecutions or properly shape settlements. Consequently, entities under investigation in this new environment should consider whether to proactively provide the Bureau with exculpatory evidence or other sympathetic information even before the NORA process begins. Finally, the Bureau may also begin seeking tolling agreements more frequently and aggressively, forcing companies under investigation to consider agreeing to toll the limitations period or face precipitous litigation.

A third potential benefit from the court's decision is that because the limitations period is now the same regardless of whether actions are filed administratively or in federal court, one of the largest incentives for the Bureau to pursue enforcement actions administratively has been removed. The administrative forum, with its limited discovery provisions and rocket docket procedures, has been the subject of much criticism for giving the CFPB a substantial home court advantage. Many defendants would prefer the more robust and deliberative process of federal court, where Bureau interpretations may not receive as much deference. With the infinite limitations period incentive removed, and with matters by necessity moving through the investigative process more quickly, Bureau staff may also begin to prefer federal court, where they can obtain significant additional discovery to build out their record after filing a complaint. Of course, this comes with the same risk noted above that matters will be filed prematurely, since the Bureau staff knows it can continue to investigate after the matter is filed. That said, regulated entities should welcome even a portion of an investigation being limited by the rules of civil discovery and the chance to vindicate their rights in federal court, rather than being subject to the Bureau's in-house investigative and administrative processes.

Impact on UDAAP Claims. Section 5564(g)(1) of Dodd-Frank, which sets forth the limitations period for UDAAP claims, states: "Except as otherwise permitted by law or equity, no action may be brought under this title more than 3 years after the date of discovery of the violation to which the action relates." While the limitations period appears to be three years, because Dodd-Frank has a discovery-based limitations period, the reality is a bit less clear.

The specific meaning of "date of discovery" has yet to be litigated in the context of Bureau enforcement actions, and it will likely be subject to fact-specific inquiry in each matter as to when the Bureau knew or should have known about a violation of law. Thus, even with a three-year limitations period, UDAAP claims brought under Dodd-Frank may provide the Bureau with more flexibility than consumer statutes without discovery-based limitations periods. Using UDAAP, the Bureau may try to reach back farther than three years if there is a bona fide question regarding when the limitations clock should have started ticking.[9] Accordingly, regulated entities may see a shift to UDAAP claims, rather than claims under enumerated statutes, as the Bureau seeks to take advantage of this extended discovery period.[10]

However, the discovery-based limitations period for UDAAP also creates potential opportunities for regulated entities. The Bureau prides itself on the seamlessness of its many parts working together, including the offices of Consumer Response, Enforcement, and Supervision. Parties under investigation may be able to effectively claim that the appropriate date of discovery should be when Consumer Response first receives a complaint and investigates it, or when an issue is first identified by a supervisory examiner. These events may occur many months or even years before the Office of Enforcement commences a formal investigation, and parties under investigation should strongly consider demanding the information gathered and reviewed by all offices of the CFPB related to the alleged violation. As the United States Supreme Court said in *Gabelli v. Securities & Exchange Commission* regarding a similar discovery-based limitations issue, it is difficult to pinpoint when an agency knew or should have known of a violation[11]:

> Agencies often have hundreds of employees, dozens of offices, and several levels of leadership. In such a case, when does "the Government" know of a violation? Who is the relevant actor? Different agencies often have overlapping responsibilities; is the knowledge of one attributed to all?[12]

Moreover, judicial inquiries relating to the date of discovery could result in burdensome discovery obligations for the Bureau and expose internal operational processes and strategic decisions that the Bureau might otherwise prefer to keep confidential. This may give the Bureau pause when contemplating using the "date of discovery" provision to extend the three-year limitations period, especially where the defendants signal a willingness to litigate the issue.

Finally, there remains an open question as to the impact of a CFPB investigation on the limitations periods for other agencies. Given the Bureau's overlapping jurisdiction with so many federal agencies, it is easy to anticipate a situation where the Bureau is unable to complete its investigation in time and turns the matter over to the Federal Trade Commission, the Office of the Comptroller of the Currency, or another regulatory agency, hoping to extend or restart the clock. Whether such a gambit would be successful is an open question and would likely involve a fact-specific inquiry as to what the other agencies knew and when. A similar issue is currently being litigated in *CFPB v. Intercept Corp. et al.*[13] Regulated entities should keep an eye on the decision in that matter and on similar arguments in future cases, which will either help open this door for the Bureau or slam it shut.

Limits on Retroactive Application on CFPB Statutory Interpretation. In *PHH Corp.*, the court held that the Bureau violated PHH's due process rights when it strayed from a long-standing HUD interpretation of RESPA and retroactively applied its new standard to impose sanctions. Going forward, this decision has implications for actions where the Bureau appears to be departing from past federal practice or where the Bureau is using creative UDAAP theories to identify legal violations.

There are countless examples of federal guidance relating to statutes and rules now enforced by the Bureau—after all, each of the 19 enumerated laws in the Bureau's domain was previously regulated by other government agencies. These include explicit instructions and informal guidance (including comments made in the context of supervisory exams) reflecting conscious and long-standing determinations by regulators to not identify a questionable practice as a legal violation. Participants in the market seeking to comply with the law have rightly relied on these interpretations in shaping their practices.

After this ruling, it will be much more difficult for the Bureau to bring an enforcement action seeking to directly reinterpret and overrule prior guidance (as it did in *PHH Corp.*), which Bureau critics cite as a particularly virulent strain of "regulation by enforcement." Moreover, if the Bureau seeks to maneuver around prior guidance regarding a particular statute by arguing that a previously permitted act or practice is now illegal as a UDAAP under Dodd-Frank, it may face similar challenges as courts look askance at attempts to reshape what has been accepted practice into a violation of law without prior notice. Ultimately, these due process concerns may encourage the Bureau to take steps that critics have long advocated—issuing more formal guidance and rulemaking to provide clarity to the market as to which practices, especially long-standing ones, the Bureau now deems to be noncompliant, and only then bring enforcement actions for conduct that continues after the date of such guidance. Such a step would provide substantially more certainty to regulated entities attempting to comport their activities with Bureau expectations, while also enhancing the Bureau's reputation as a fair enforcer of the law. In the alternative, the Bureau may seek to establish its interpretations through ad hoc public statements and consent orders, going after relatively easy or compliant targets while avoiding litigation until it can point to a substantial record to establish its interpretations and expectations.[14] This path, however, lacks both the due process benefits and market clarity that would flow from more formal guidance.

Conclusion

While it is unlikely that the three-judge D.C. Circuit panel will have the final say on the matters discussed in the *PHH Corp.* opinion, until the D.C. Circuit sitting *en banc* or the Supreme Court rules on the case, institutions and individuals should frame their arguments and interactions with the Bureau with the points discussed in this *Commentary* in mind. The post-*PHH Corp.* Bureau will have to tread somewhat more softly, and those caught up in investigations or enforcement actions in the near-term would do well to politely, but firmly, remind the Bureau of its new constraints.

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Mr. Wiggins and Mr. Levisohn held positions in the Office of Enforcement for several years, going back to the Bureau's inception. Prior to his departure, Mr. Wiggins was the Principal Deputy Enforcement Director, the number-two position in the Office of Enforcement. Mr. Levisohn served as an Enforcement Attorney. Mary M. Shepro, an associate in the Chicago Office, assisted in the preparation of this Commentary.

Endnotes

1 No. 15-1177 (Oct. 11, 2016 D.C. Cir.).

2 *See, e.g.*, *Integrity Advance, LLC and James R. Carnes*, 2015-CFPB-0029, Bureau's Opposition to Respondents' Motion to Dismiss at 7 (Jan. 15, 2016) ("The statutes of limitations relied upon by Respondents expressly apply only to 'actions' that are brought in courts, not administrative proceedings like this one"); *PHH Corp., et al.*, 2014-CFPB-0002, Decision of the Director at 10 (June 4, 2015) (relying on *BP America Production Co. v. Burton*, 549 U.S. 84, 91 (2006) and stating that 12 U.S.C. § 5564(g)(1) does not apply to Bureau administrative proceedings).

3 *See* 12 U.S.C. § 5564(g)(1).

4 *See, e.g.*, 15 U.S.C. § 1667d(c) (actions brought under the Consumer Leasing Act of 1976 must be brought within one year); 15 U.S.C.§ 1693m(g) (actions brought under the Electronic Fund Transfer Act must be brought within one year); 15 U.S.C. § 1692k(d) (actions brought under the Fair Debt Collection Practices Act must be brought within one year).

5 *See, e.g.*, 15 U.S.C. § 1691e(f) (actions brought by government agencies under the Equal Credit Opportunity Act must be brought no later than five years after the date of the occurrence of the violation); 15 U.S.C. § 1681p (actions brought under the Fair Credit Reporting Act must be brought no later than the earlier of: (i) two years after the date of discovery by the plaintiff of the violation that is the basis for such liability, or (ii) five years after the date on which the violation that is the basis for such liability occurs); 10 U.S.C. § 987 (actions brought under the Military Lending Act must be brought within two years after the date of discovery or within five years after the date on which the violation that is the basis for such liability occurs).

6 As of July 14, 2016, the maximum penalty amounts are $5,437 for any "Tier 1" violation; $27,186 for any "Tier 2" violation, which requires recklessness; and $1,087,450 for any "Tier 3" violation, which requires knowledge. These amounts are calculated on a per-day basis "for each day during which such violation continues." *See* 12 C.F.R. part 1083 at 38570-71.

7 *See, e.g.*, *In the Matter of Pressler & Pressler, LLP, Sheldon H. Pressler, and Gerard J. Felt*, No. 2016-CFPB- 0009 at ¶ 50 (Apr. 25, 2016). Paragraph 50 of the consent order states:

Respondents must treat the civil money penalty paid under this Consent Order as a penalty paid to the government for all purposes. Regardless of how the Bureau ultimately uses those funds, Respondents may not: a. Claim, assert, or apply for a tax deduction, tax credit, or any other tax benefit for any civil money penalty paid under this Consent Order; or b. Seek or accept, directly or indirectly, reimbursement or indemnification from any source, including but not limited to payment made under any insurance policy, with regard to any civil money penalty paid under this Consent Order.

Id.

8 NORA refers to the Bureau's "Notice and Opportunity to Respond and Advise" process. Before the Office of Enforcement recommends that the Bureau commence enforcement proceedings, the Office of Enforcement may give the subject of such recommendation notice of the nature of the subject's potential violations and may offer the subject the opportunity to submit a written statement in response. *See* CFPB Bulletin 2011-04 (Enforcement), Nov. 7, 2011. Companies frequently follow up written submissions with in-person meetings and additional discussions, even before settlement negotiations begin.

9 The CFPB may seek penalties for conduct going back as far as five years from when an alleged claim accrues. *See* 28 U.S.C. § 2462 (any ''action'' or ''proceeding'' for civil penalties is subject to a five-year limitations period running from ''accrual'' of the claim).

10 In addition to using UDAAP to reach back farther than would be possible under the consumer statutes, the Bureau may try, through settlements or future contested proceedings, to develop the line of argument that some common types of UDAAP violations are part of a scheme that is or was continuing in nature. This would afford the Bureau more time to bring an enforcement action because where there is a scheme or illegal act that is continuing in nature, the limitations period does not start running until the final act in the scheme. *See, e.g.*, *Toussie v. United States*, 397 U.S. 112, 115 (1970); *United States v. Edelkind*, 525 F.3d 388, 393–98 (5th Cir. 2008).

However, the statutory language defining a UDAAP violation may make it difficult for the Bureau to meet the "continuing in nature" standard. This is because a UDAAP violation is defined as an "act" committed in connection with a "transaction" for or the "offering of" a consumer financial product or service. In other words, UDAAP's language speaks in terms of individual transactions and offers rather than continuing schemes. Furthermore, if the CFPB does try to rely on UDAAP's prohibition on unfair, deceptive, or abusive ''practice[s]'' to support a continuing violation argument, the Bureau may find itself spending substantial time and resources during a now shortened investigative window trying to establish that the alleged conduct was an ongoing practice as opposed to a violation or series of violations. As a practical matter, the incremental extension of time afforded by trying to claim a violation constituted an "ongoing practice" may not be worth the Bureau's energy or manpower.

11 *Gabelli et al. v. Sec. and Exch. Comm'n*, 568 U.S. ____, slip op. at 4 (2013).

12 *Id.*

13 No. 16-144, 3:16-cv-00144 (D. N.D.) (defendant alleges that the FTC's investigation started the Bureau's limitations clock because the knowledge of one government agency should be imputed on another government agency, especially where the two agencies have overlapping jurisdiction, coordinated enforcement efforts, and agreements to meet and share information).

14 *See, e.g.*, *FTC v. Wyndham World Cup et al.*, where the Third Circuit cited public statements and consent orders entered into by the Federal Trade Commission as support for the conclusion that the defendant had fair notice of what the FTC considered to be a violation of law. 799 F.3d 236, 255–59 (3d Cir. 2015).