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WHITE PAPER

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In the Eye of the Storm: The Constitutional, Regulatory, and Political Implications of *PHH v. CFPB*

A magnet for controversy since its inception, the CFPB remains in the eye of the storm in the wake of the 2016 elections. Since the CFPB was created, numerous stakeholders have challenged the constitutionality of its structure and have raised concerns about its approach to regulation and enforcement. In *PHH Corp. v. CFPB*, the U.S. Court of Appeals for the District of Columbia Circuit ruled that the CFPB is unconstitutionally structured, rejected the CFPB's contention that its administrative enforcement actions are not subject to any statute of limitations and applied due process protections against the retroactive application of new regulatory interpretations. This White Paper discusses the court's ruling and offers some thoughts on the implications of the decision, if left intact, and on the possibility of consideration of legislation that could have avoided the constitutional separation of powers question altogether.

TABLE OF CONTENTS

Administrative History 2

The Court's Separation of Powers Ruling 2

The Court's Statutory and Due Process Rulings 4

Implications of the Court's Ruling 6

Lawyer Contacts 9

Endnotes 10

Creation of the Consumer Financial Protection Bureau ("CFPB") was one of the most controversial elements of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"),[1] and the intensity of the debate since then has not dissipated. A key question at the center of the controversy around the CFPB is the constitutional separation of powers question: Does an independent federal government agency headed by a single Director, who can be removed by the United States President only for cause, survive constitutional scrutiny?

Some constitutional scholars have expressed reservations based upon the inability of the President to remove the CFPB Director at will, while others believe the United States Supreme Court settled the issue long ago in *Humphrey's Executor v. United States*[2] by upholding the constitutionality of independent government agencies. Throughout the existence of the CFPB, various stakeholders have brought actions challenging the agency's structure as violating the separation of powers doctrine of Article II of the United States Constitution.[3] The issue came to a head in the recent decision by a panel of judges of the United States Court of Appeals for the District of Columbia Circuit in *PHH Corp. v. CFPB*[4] ("PHH Decision"). The PHH Decision, along with the subsequent election of a Republican President and a Republican majority in Congress, portends that the CFPB may soon be restructured, either judicially or legislatively, from a single-director to a multimember commission or board.

The majority decision, written by Circuit Judge Brett Kavanaugh, draws pivotal constitutional conclusions with potentially far-reaching consequences. Most of the D.C. Circuit's lengthy ruling is devoted to review of the Supreme Court's separation of powers precedents in support of the conclusion that the CFPB is unconstitutionally structured. The court also discusses and applies important due process protections against the retroactive application of new agency interpretations of existing rules. Finally, the court rejects as "absurd" and "alarming" the CFPB's assertion that its administrative enforcement actions are not subject to any statute of limitations whatsoever.

First, the court applied the Supreme Court's separation of powers precedents to hold that the CFPB is unconstitutionally structured because it is headed by a single Director who can be removed by the President only for cause.[5] The remedy the court fashioned for this constitutional infirmity was to sever the for-cause removal provision from the rest of the statute. The court chose this remedy to ensure that the CFPB can continue to operate but as an executive agency led by a single Director who is subject to the supervision, direction, and removal power of the President.

Second, the court held that the CFPB's interpretation of the Real Estate Settlement Procedures Act ("RESPA") to prohibit so-called captive reinsurance arrangements violated both the statute and due process protections. The court found that the CFPB's interpretation of RESPA was inconsistent with the statutory text and longstanding government precedent, and it therefore determined that the CFPB's interpretation was not entitled to deference under the Supreme Court's ruling in *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*[6] The court also held, in the alternative, that the CFPB's attempt to apply its new RESPA interpretation retroactively to conduct that occurred long before the adoption of the new interpretation amounted to a serious violation of due process. These alternative holdings are both binding precedent of the court if left intact on appeal.

Third, the court rejected the CFPB's contention that, under the Dodd-Frank Act, there is no statute of limitations applicable to any CFPB administrative enforcement action to enforce any of the federal consumer financial laws, holding instead that the three-year limitations period in RESPA applies not only to CFPB court actions but to CFPB administrative actions as well.[7]

On November 17, 2016, the CFPB filed a petition for rehearing by the full D.C. Circuit Court. Whether or not the PHH Decision stands, legislation to change the structure of the CFPB from a single Director to a commission or board may be on the horizon in the near-term.

This *White Paper* begins with an overview of the administrative enforcement action that preceded consideration by the court and then discusses the court's ruling and interpretations, focusing, as the court did, on the history of the key Supreme Court cases that informed the court's constitutional holdings.[8] We offer our thoughts on some of the potential impacts of the court's constitutional holdings for the CFPB and other similarly situated agencies and conclude with some observations of the potential enduring regulatory and political impacts if the PHH Decision stands or if the 115th Congress takes up legislation that replaces the CFPB Director with a five-member commission or board.

ADMINISTRATIVE HISTORY

The PHH Decision emanated from a 2014 administrative enforcement action initiated by the CFPB against PHH for alleged violations of RESPA's ban on certain unearned referral fees.[9] Specifically, the notice of enforcement action alleged that PHH had violated Section 8(a) of RESPA:

> …when it referred business to mortgage insurers that had entered into captive reinsurance agreements; that the reinsurance payments received by PHH from mortgage insurers were a "thing of value," consideration for PHH's referrals, accepted by PHH, and either not for services actually performed or grossly exceeded the value of the reinsurance services [PHH's subsidiary] provided; and that PHH violated section 8(b) of RESPA because the amounts that were ceded to [PHH's subsidiary] constituted a split of mortgage insurance premiums paid by the borrowers.[10]

PHH contested these allegations on the grounds that its actions were permitted by Section 8(c)(2) of RESPA, which provides an exemption from the prohibitions of Section 8(a) of RESPA, and by supportive interpretative letters issued by the Department of Housing and Urban Development ("HUD"),[11] the agency that had been responsible for interpreting and enforcing RESPA before the Dodd-Frank Act redelegated that responsibility to the CFPB.[12] PHH also maintained that the three-year statute of limitations in RESPA applied to administrative enforcement actions initiated by the CFPB.

After a lengthy proceeding, an administrative law judge ("ALJ") determined that PHH had violated Section 8(a) of RESPA and should pay a disgorgement penalty of $6.44 million based upon each reinsured mortgage loan closed within a three-year statute of limitations period. Both PHH and the CFPB appealed this decision to the CFPB Director.

On June 4, 2015, the CFPB Director upheld the ALJ's ruling that PHH had violated Section 8(a) of RESPA, finding that neither Section 8(c) of RESPA nor HUD's prior rule and interpretations provided an exemption for PHH's actions. The CFPB Director expressly rejected HUD's longstanding position as set forth both in HUD's rule implementing RESPA and in written interpretations regarding the application of RESPA to captive reinsurance arrangements. The CFPB Director determined that no statute of limitations applies to CFPB challenges of potential violations of RESPA in an administrative proceeding and that each acceptance of payment from a mortgage insurer was a separate violation of RESPA. On these bases, the Director increased the amount of the disgorgement penalty greater than 15-fold, from $6.44 million to $109 million.

THE COURT'S SEPARATION OF POWERS RULING

PHH's Article II Challenge. On appeal to the D.C. Circuit Court, PHH raised the fundamental constitutional objection that the structure of the CFPB violates Article II of the U.S. Constitution[13] because the CFPB operates as an independent agency headed by a single Director who can be removed by the President only for cause. The President may remove the CFPB Director only for "inefficiency, neglect of duty, or malfeasance in office."[14]

PHH asserted that the placement of legislative, executive, and judicial power in the hands of a single Director who is not accountable to the President or to the Congress violates constitutional separation of powers principles. PHH argued that, "to comply with Article II, either (i) the agency's Director must be removable at will by the President, meaning that the CFPB would operate as a traditional executive agency; or (ii) if structured as an independent agency, the agency must be structured as a multi-member commission."[15]

The D.C. Circuit Court's Analysis and Holding. The majority opinion begins, "This is a case about executive power and individual liberty," and the balance of the constitutional part of the opinion carefully describes the application of the Supreme Court's separation of powers precedent to the PHH case. Article II of the U.S. Constitution assigns executive power to the President in order to preserve individual liberty and ensure accountability. The President carries out executive power through subordinate executive officers who are appointed by the President by and with the advice and consent of the Senate. A landmark 1926 Supreme Court decision, *Myers v. United States*, recognized the authority of the President under Article II to remove executive officers, "[W]hen the grant of the executive power is enforced by the express mandate to take care that the laws be faithfully executed, it emphasizes the necessity for including within the executive power as conferred the exclusive power of removal."[16] Against that backdrop, the court observes that traditionally, only

executive agencies have been led by a single official, as the CFPB is, and that official is subject to supervision, direction, and removal by the President, who controls executive power.

The court described the evolution of independent agencies and their relationship to the executive power the U.S. Constitution vests in the President. In its 1935 *Humphrey's Executor* decision, the Supreme Court upheld the constitutionality of independent agencies when President Roosevelt asserted his authority under Article II to remove Commissioner Humphrey from the Federal Trade Commission ("FTC") because he had refused to follow the policies of the New Deal adopted by the Roosevelt administration.[17] The D.C. Circuit Court explained, "[a]t its core, the case raised the question whether Article II permitted Congress to create independent agencies whose heads were not removable at will and would operate free of the President's supervision and direction."[18] The D.C. Circuit Court highlighted several characteristics of the design of the FTC raised by the *Humprey's Executor* Court that, in the court's view, distinguished the structure of the FTC from that of the CFPB. The court pointed out that the FTC was designed "to be non-partisan," to "act with entire impartiality," and "to exercise the trained judgment of a body of experts appointed by law and informed by experience."[19]

Today there are numerous independent agencies that "possess authority over vast swaths of American economic and social life,"[20] and "[u]ntil this point in U.S. history, independent agencies exercising substantial executive authority have all been multi-member boards or commissions."[21] The Supreme Court's decision in *Humphrey's Executor* settled the question of the constitutionality of independent agencies, but according to the majority opinion, "*Humphrey's Executor* does not mean that anything goes."[22]

The question before the D.C. Circuit Court in the PHH case, according to the majority opinion, was whether *Humphrey's Executor* extended to the structure of the CFPB, an independent agency led by a single Director rather than by a Commission. In answering this question, the court reviewed the expansive responsibilities of the CFPB Director and observed that "when measured in terms of unilateral power, the Director of the CFPB is the single most powerful official in the entire U.S. Government, other than the President."[23] According to the majority opinion, the CFPB lacks critical checks and balances and structural constitutional protections but has substantial power over the U.S. economy, so, "this wolf comes as a wolf."[24]

As an independent agency with a single Director who can be removed by the President only for cause, the court saw the CFPB as the "first of its kind and a historical anomaly."[25] This characterization of the CFPB as an anomaly is significant because it enables the court to rely upon two additional Supreme Court cases construing separation of powers issues. In the more recent case, *NLRB v. Noel Canning*,[26] the Supreme Court held that recess appointments in Senate recesses of fewer than 10 days were presumptively unconstitutional under Article II, in part because "[l]ong settled and established practice is a consideration of great weight in a proper interpretation of constitutional provisions regulating the relationship between Congress and the President."[27] Turning to historical practice, the *Noel Canning* Court found "few historical examples" of recess appointments made during a recess period shorter than 10 days."[28]

Several years earlier, in *Free Enterprise Fund v. Public Company Accounting Oversight Board*,[29] the Supreme Court held that the provisions of the Sarbanes-Oxley Act that made members of the Public Corporation Accounting Oversight Board ("PCAOB") removable by the Securities and Exchange Commission ("SEC") only for good cause were inconsistent with the Constitution's separation of powers. In ruling that the structure of the PCAOB violated Article II of the Constitution, the Supreme Court indicated that the lack of historical precedent for the new structure was "the most telling indication of the severe constitutional problem" with the PCAOB, which had two levels of for-cause protection from removal by the President.[30]

Based upon *Noel Canning* and *Free Enterprise Fund*, the D.C. Circuit Court reasoned that, therefore, "historical practice matters a great deal" in determining the constitutional limits of the executive and legislative branches in separation of powers cases like this that are not resolved by the constitutional text alone.[31] The court opined that "[t]he CFPB's concentration of enormous executive power in a single, unaccountable, unchecked Director not only departs from settled historical practice, but also poses a far greater risk of arbitrary decision-making and abuse of power, and a far greater threat to individual liberty, than does a multi-member independent agency."[32] According to the court, when evaluated against the historical

practice of independent agencies, the CFPB structure is a constitutional problem even if it "does not occasion additional diminishment of Presidential power beyond the significant diminishment already caused by *Humphrey's Executor* itself."[33]

The court recognized the prevalence of independent agencies that are headed by a board of directors or commission, listing more than 20 such agencies. As further support for its conclusion that the CFPB is an anomaly, the court addressed three examples of independent agencies led by a single official whom the President can remove only for cause—the Social Security Administration, the Office of Special Counsel, and the Federal Housing Finance Agency—stating, "[t]hose examples do not count for much when weighed against the deeply rooted historical practice demonstrating that independent agencies are multi-member agencies."[34] The court regarded two of these agencies as different in kind from the CFPB and other independent agencies because they do not exercise the core executive power of bringing enforcement actions for violations of statutes or agency rules and because they lack deep historical roots. The court noted that President Clinton had issued a signing statement contesting the constitutionality of changing the Social Security Administration to a single-Director independent agency[35] and that President Reagan had vetoed a bill regarding the Office of Special Counsel due to constitutional concerns about the status of that Office as an independent agency.[36] The court viewed the Federal Housing Finance Agency as a contemporary of the CFPB that raises the same question of constitutionality addressed by the court in the PHH Decision.[37]

Ultimately, the court concluded that *Humphrey's Executor* does not cover the CFPB's novel agency structure. Because there is no settled historical practice of independent agencies led by single Directors who have the substantial executive power the CFPB Director enjoys, the CFPB is "exceptional in our constitutional structure and unprecedented in our constitutional history."[38] According to the majority opinion, the single-Director structure of the CFPB departs so markedly from the settled historical practice of independent agencies governed by multi-member bodies—a departure that makes a "significant difference for the individual liberty protected by the Constitution's separation of powers"—that applying the Supreme Court's precedents, the CFPB is unconstitutionally structured.[39]

To remedy this constitutional infirmity, the D.C. Circuit Court declined PHH's invitation to strike down the CFPB or the entire Dodd-Frank Act.[40] Instead, the court looked to *Free Enterprise Fund* for guidance on the appropriate remedy: "… when confronting a constitutional flaw in a statute, we try to limit the solution to the problem, severing any problematic portions while leaving the remainder intact."[41] In this regard, the Dodd-Frank Act provides that, "[i]f any provision" is held to be unconstitutional, the remainder of the Act "shall not be affected thereby."[42]

After determining that Congress would prefer the Dodd-Frank Act with the unconstitutional provision severed and that the Act would remain fully operative without the unconstitutional provision, the court severed the unconstitutional for-cause removal provision from the Act, giving the President the power to remove the CFPB Director at will and to supervise and direct the Director. The court explained:

> The CFPB therefore will continue to operate and to perform its many duties, but will do so as an executive agency akin to other executive agencies headed by a single person, such as the Department of Justice and the Department of the Treasury. Those executive agencies have traditionally been headed by a single person precisely because the agency head operates within the Executive Branch chain of command under the supervision and direction of the President. The President is a check on and accountable for the actions of those executive agencies, and the President now will be a check on and accountable for the actions of the CFPB as well.[43]

THE COURT'S STATUTORY AND DUE PROCESS RULINGS

The court considered PHH's statutory objections to the CFPB's enforcement action because the court's constitutional ruling would not impact the CFPB's ability to uphold the disgorgement penalty imposed against PHH on the ground that PHH had violated RESPA and its implementing regulations.

The CFPB alleged that PHH violated RESPA by participating in captive reinsurance agreements. The CFPB asserted that Section 8(a) of RESPA prohibited payment by a mortgage insurer to a lender for the lender's referral of a customer to the mortgage insurer. Prior to initiation of the CFPB enforcement action, PHH would refer borrowers to mortgage insurers, who, in turn, would purchase mortgage reinsurance from a wholly owned subsidiary of PHH.[44] These agreements had

been permitted by HUD since 1997 as long as the insurer paid no more than the reasonable market value for reinsurance. The CFPB, however, interpreted RESPA as forbidding any captive reinsurance agreements and sought to apply this interpretation against PHH for conduct that occurred prior to issuance of the CFPB's new interpretation.

PHH challenged the CFPB's statutory decision on two alternative and independent grounds. First, PHH argued that the CFPB's reading of RESPA to prohibit captive reinsurance arrangements was not entitled to deference under *Chevron* because the interpretation was contrary to the plain language of the statute and to longstanding, consistent government interpretations. PHH also contended that, regardless, the CFPB's application of its new interpretation to conduct that occurred before announcement of the new interpretation violated fundamental tenets of due process.

The D.C. Circuit Court agreed with PHH on both points. The court held that Sections 8(a) and 8(c) of RESPA permit captive reinsurance arrangements as long as the mortgage insurance companies do not pay more than reasonable market value to the reinsurers for the services that are actually provided. The court also held that the CFPB's interpretation of RESPA could not constitutionally be applied retroactively to PHH's conduct that occurred prior to the new interpretation. The court's alternative holdings are both binding precedent of the court if left to stand following appeal by the CFPB.

The court opined that the "basic statutory question in this case is not a close call."[45] Section 8(a) of RESPA provides, "No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person."[46] This provision of law precludes payments for referrals in the residential real estate settlement process.

Section 8(c) of RESPA creates a safe harbor that allows captive reinsurance arrangements: "Nothing [in Section 8] shall be construed as prohibiting" the "payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed." Based upon this statutory text, the court found that Congress made clear that the transactions at issue were lawful as long as reasonable market value was paid and the services were actually performed. Consistent with this view, the court rejected the CFPB's position that a mortgage insurer's payment for reinsurance is not "bona fide" if it was part of a tying arrangement, finding instead that a payment for a service pursuant to a tying arrangement does not make the payment any less bona fide, provided the payment reflects reasonable market value.[47]

The CFPB argued that its statutory interpretation of RESPA was entitled to *Chevron* deference. The court demurred, explaining that the first step of *Chevron* requires application of tools of statutory interpretation and that the court would defer to the CFPB's interpretation only if there the statute was ambiguous and only if the CFPB's interpretation were at least reasonable. The court then determined that the CFPB's interpretation of RESPA failed at the first step of *Chevron* because the statute is clear and that even if the court were to reach the second step of *Chevron*, the court would conclude that the CFPB's interpretation was not reasonable based upon the text, history, context, and purposes of RESPA.

In short, the court ruled that "Section 8(c) bars the aggressive interpretation of Section 8(a) advanced by the CFPB…."[48] Indeed, in the court's view, the CFPB's interpretation disregarded not only the text and purposes of the statute but also "decades of carefully and repeatedly considered official government interpretations."[49]

The court next determined that the CFPB's retroactive application of its new interpretation of RESPA violated the Due Process Clause, reasoning that "Retroactivity—in particular, a new agency interpretation that is retroactively applied to proscribe past conduct—contravenes the bedrock due process principle that the people should have fair notice of what conduct is prohibited." The CFPB had applied its new interpretation to PHH's conduct from 2008 to the date of the administrative enforcement action.

The court noted that an agency's change to a statutory interpretation is not in and of itself a problem as long as the change is explained and is consistent with the statute. Here, however, in addition to determining that the CFPB's interpretation was inconsistent with the statute, the court determined that the CFPB's "complete about-face" from HUD's longstanding interpretation of RESPA,[50] combined with its retroactive application to PHH's conduct that occurred before the new interpretation

was issued, was a violation of due process. The court highlighted and relied upon several Supreme Court precedents such as that in *Christopher v. SmithKline Beecham Corp.*, where the Supreme Court said: An "agency should not change an interpretation in an adjudicative proceeding where doing so would impose new liability on individuals for past actions which were taken in good-faith reliance on agency pronouncements."[51] In the court's view, all of the fundamental anti-retroactivity principles articulated by the Supreme Court are "Rule of Law 101"[52] and fit the instant case exactly, to the end that the Due Process Clause does not allow retroactive application of a change to the government's longstanding interpretation of a statute.

Finally, the court addressed the CFPB's position that no statute of limitations whatsoever applied to its case against PHH. The CFPB based its position on the absence of an explicit limitations period in the Dodd-Frank Act for administrative proceedings as opposed to court actions, and it argued that even if the Dodd-Frank Act did not override the limitations periods set forth in all of the consumer financial protection statutes the CFPB is authorized to enforce, RESPA imposes a three-year statute of limitations only on enforcement actions that the CFPB brings in court.

The court disagreed with the CFPB on both points. The court found that the Dodd-Frank Act ties the CFPB's administrative adjudications to the statutes of limitations of each of the various statutes the CFPB is responsible for enforcing[53] and that the three-year statute of limitations in Section 8 of RESPA applies both to court actions and to administrative proceedings.[54]

IMPLICATIONS OF THE COURT'S RULING

Implications for Other Independent Agencies with a Single Head. The court distinguished from the CFPB all but one of the few other independent federal agencies that are led by a single person. According to the court, one of the key differences between the Social Security Administration[55] and the Office of Special Counsel[56] on the one hand, and the CFPB on the other, is that the former agencies do not have unilateral authority to initiate enforcement actions and impose penalties, as the CFPB does. The majority opinion viewed this difference as meaningful because unlike the CFPB, neither of these agencies possesses a core executive power that raises the primary threat to individual liberty posed by executive power.[57] This difference in law enforcement powers may lend greater constitutional credence to the structure of these agencies because they do not possess the same executive powers accorded to the CFPB.

The majority opinion also distinguished the President's removal power over the Comptroller of the Currency from his removal power over the Director of the CFPB. The Comptroller of the Currency may be removed by the President "upon reasons to be communicated by him to the Senate,"[58] whereas the CFPB Director can be removed only for "inefficiency, neglect of duty, or malfeasance in office," meaning for cause.[59] Thus, the Comptroller may be removed by the President on broader grounds than the CFPB Director may be removed, provided the President communicates those grounds to the Senate.

By contrast, the Director of the Federal Housing Finance Agency has a single Director who can be removed by the President only for cause.[60] The court noted that the agency is a contemporary of the CFPB and "merely raises the same question we confront here"[61] regarding the constitutionality of the structure of the CFPB. If the court's ruling is not overturned on appeal, the structure of the Federal Housing Finance Agency appears vulnerable to the same separation of powers constitutional challenge. A potential complexity associated with any future remedy to this constitutional infirmity is that the Housing and Economic Recovery Act,[62] the law that established the Federal Housing Finance Agency, does not have a severability clause, as exists in the Dodd-Frank Act, which established the CFPB.

Implications for Past and Pending CFPB Actions. The court expressly declined to "consider the legal ramifications of [its] decision for past CFPB rules or for past agency enforcement actions," leaving these issues to be resolved going forward. In a footnote, the court indicated that other agencies that have "been on the receiving end of successful constitutional and statutory challenges to their structure and legality" have worked through these issues, stating, "[w]ithout 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."[63]

A look at the aftermath of the Supreme Court's rulings in *Noel Canning* and *Free Enterprise Fund* sheds some light on the

impact that successful constitutional challenges have had on pending court cases, administrative actions, and rulemakings for the National Labor Relations Board ("NLRB") and the PCAOB.

Following the Supreme Court's affirmation of the D.C. Circuit Court of Appeal's decision invalidating President Obama's recess appointments of three members of the NLRB, the NLRB set aside certain board decisions that were on appeal to the federal circuit courts and filed motions asking those courts to vacate and remand other cases to the board for further proceedings, consistent with the decision. The NLRB also reconsidered prior ALJ decisions that had been considered while the recess appointees were in place. Some of the NLRB's administrative orders had already been implemented by the date of the *Noel Canning* decision and presented complex questions about how to properly unwind those actions, if at all. Nonetheless, the NLRB appears to have handled the consequences of the Supreme Court's *Noel Canning* ruling without major disruption.

Separate from the impacts on the NLRB's actions, *Noel Canning* had potential impacts on the CFPB Director's actions too. When the Supreme Court decided *Noel Canning*, the CFPB Director was also a recess appointee whose appointment was considered to have been impacted by the decision.[64] Accordingly, after the CFPB Director was nominated again by the President and subsequently confirmed by the Senate, he ratified all actions he had taken during his tenure as a recess appointee. The Notice of Ratification stated:

The President appointed me as Director of the [CFPB] on January 4, 2012, pursuant to his authority under the Recess Appointments Clause, U.S. Const. art. II, §2, cl. 3. The President subsequently appointed me as Director on July 17, 2013, following confirmation by the Senate, pursuant to the Appointments Clause, U.S. Const. art. II, §2, cl. 2. I believe that the actions I took during the period I was serving as a recess appointee were legally authorized and entirely proper. To avoid any possible uncertainty, however, I hereby affirm and ratify any and all actions I took during that period.[65]

Thereafter, the Ninth Circuit Court of Appeals considered the effect of this ratification on a pending CFPB enforcement action, ruling that because the CFPB had authority to bring the enforcement action when initiated, the subsequent ratification of actions by the Director cured any Article II deficiency that may have existed at that time.[66] Similarly, this past summer, the United States District Court for the District of Columbia upheld the validity of the CFPB Director's ratification with respect to rulemakings.[67]

The Supreme Court's decision in *Free Enterprise Fund* did not address the extent to which past actions of the PCAOB were subject to reconsideration,[68] although the SEC later determined that pending PCAOB actions could be ratified. Immediately following issuance of the *Free Enterprise Fund* decision, the PCAOB published a press release explaining that:

> … Because the [Supreme] Court severed [the unconstitutional] provisions from the Act, however, no legislation is necessary to bring the Board's structure within constitutional requirements. The consequence of the Court's decision is that PCAOB Board members will be removable by the SEC at will, rather than only for good cause. All other aspects of the SEC's oversight, the structure of the PCAOB and its programs are otherwise unaffected by the Court's decision. Accordingly, all PCAOB programs will continue to operate as usual, including registration, inspection, enforcement, and standard-setting activities.[69]

The Supreme Court's remedy in *Free Enterprise Fund* for the PCAOB's constitutional defect appears to have had negligible follow-on impacts on the operations of the PCAOB, though outcomes may be dependent on particular facts and circumstances.[70]

Implications for the CFPB's Rulemaking Procedures. The majority opinion states that by severing the for-cause provision from the Dodd-Frank Act, "the President will now have the power to remove the [CFPB] Director at will, and to supervise and direct the Director … and the President now will be a check on and accountable for the actions of the CFPB as well."[71] Accordingly, the CFPB will operate as an executive agency and not as an independent agency.

This new structure raises important questions about the rulemaking procedures that the CFPB must follow if the majority opinion remains intact after appeal by the CFPB and, in particular, about how much direction and control the President must or should exercise.

Executive agencies are required by Executive Order 12866 to submit their proposed and final rules for advance review to the Office of Management and Budget ("OMB"), Office of Information and Regulatory Affairs ("OIRA") in the Executive Office of the President before issuing them.[72] Executive Order 12866 sets forth the responsibilities of each executive agency for adhering to the President's planning and review processes, principles of regulation, and centralized review of regulations. In accordance with Executive Order 12866, each agency has appointed a Regulatory Policy Officer who reports to the agency head and who is involved at each phase of the regulatory process to promote development of regulations that further the principles of the Executive Order.[73]

The Administrator of OIRA is responsible for providing meaningful guidance to ensure that each executive agency's regulatory actions are aligned with the President's priorities, the principles of Executive Order 12866, and the regulatory analysis guidance issued by OMB on the development of good regulatory analysis, which includes benefit-cost analysis of regulatory options.[74] Executive agencies must provide an assessment of the benefits and the costs of significant regulatory actions as well as an assessment of potentially effective and reasonably feasible alternatives to planned rules.[75] Each executive agency is responsible for complying with applicable administrative laws, such as the Administrative Procedure Act, the Regulatory Flexibility Act, and the Paperwork Reduction Act ("PRA").[76]

Independent agencies, by contrast, are subject to a circumscribed subset of the full requirements of Executive Order 12866. For example, independent agencies must prepare an annual unified regulatory agenda and a regulatory plan of the most important significant regulatory actions the agency expects to issue in proposed or final form, but these agencies are not subject to the provisions of Executive Order 12866 governing centralized review of regulations by OIRA. Accordingly, independent agencies are not required to submit their proposed and final rules for review by OIRA and are not required to comply with the benefit-cost requirements of Executive Order 12866 and its implementing guidance.

The terms of Executive Order 12866 define independent regulatory agencies by reference to the definition in the PRA, which was amended by the Dodd-Frank Act to include the CFPB.[77] Given the court's holding in the PHH Decision that the CFPB will now operate as an executive agency, this statutory amendment may itself be invalid. Regardless, if the D.C. Circuit's constitutional ruling in the PHH Decision is not overturned on appeal, then either Congress, by amending the PRA, or the President, by revising Executive Order 12866, may decide to subject CFPB rulemaking to the same OIRA review that governs other executive agencies. Additionally, there are several other Executive Orders and OMB guidances that apply to all executive agencies that would need to be examined for possible application to the CFPB if the D.C. Circuit Court's constitutional ruling stands.[78]

Finally, the court's ruling that the CFPB violated due process by retroactively applying a new interpretation of RESPA to conduct that occurred prior to the date of the new interpretation could cause the CFPB to reconsider its methods for applying new interpretations of rules to ensure fair notice to stakeholders. In particular, the court's ruling could diminish the CFPB's willingness to announce new requirements through backward-looking enforcement measures rather than through prospective rulemakings.

The election of Donald Trump as President and the Republican's maintaining a majority in the House of Representatives and the Senate for the 115th Congress may have significant implications for the PHH Decision and the structure and operations of the CFPB.

President-elect Trump has advocated for repeal of some or all of the Dodd-Frank Act that created the CFPB, and several influential Republican members of Congress support a rollback of the Act on grounds that it is stifling economic growth and limiting consumer choice. The structure, mission, budget and regulatory requirements of the CFPB are likely to be a focus of achieving Dodd-Frank Act reforms in the 115th Congress.

Although President-elect Trump has neither called for elimination of the CFPB nor specified the particular CFPB reforms his Administration would support, the CFPB reforms in previous Republican-sponsored legislation would be a likely starting point for consideration. Many strategists and industry associations expect that the Financial CHOICE Act, H.R. 5983, passed by a majority-Republican vote of the House Financial Services Committee in June 2016, would be taken up in whole or in part early in the next congressional session.[79] The Financial CHOICE

Act includes provisions that would replace the CFPB Director with a five-member commission, among other CFPB reforms.[80]

Senate Republicans are not a supermajority and would likely need to garner the votes of some Senate Democrats to secure passage of legislation. A key to enactment of all or part of the Financial CHOICE Act, or other Dodd-Frank reform legislation, will be the extent to which it can garner bipartisan support. Several influential Democratic Senators who will remain following the 2016 elections are among those who, in the past, have supported a five-member commission in lieu of a single Director to oversee the CFPB. Major financial services industry associations have also supported such a change in CFPB structure while major consumer groups have not, and this difference in viewpoints is unlikely to be affected by the elections.

The PHH Decision invalidates the part of the Dodd-Frank Act that makes the CFPB Director independent and thereby, if left undisturbed, would provide President-elect Trump with the power to remove the CFPB Director at will rather than for cause. Appointing a new CFPB Director would enable the new President to better align the agency's direction with his policy objectives. The Trump Administration would likely want the PHH Decision to stand unaltered.

If the PHH Decision is overruled, the grounds available to the President for removing the CFPB Director before July 2018 when his 5-year term of office ends are for "inefficiency, neglect of duty, or malfeasance in office."[81] After nomination by the President, a new CFPB Director must be confirmed by the Senate. In the interim, prior to Senate confirmation, the CFPB's Deputy Director would serve as Director. While Senate Republicans do not constitute a supermajority, since 2013, Senate rules permit a simple majority vote on executive branch nominations, disallowing filibuster and facilitating confirmation.

After all is said and done, the 2016 elections may enable Congress to move legislation forward that could have avoided altogether the constitutional separation of powers question decided by the court in PHH v. CFPB.

LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com/contactus/.

Lisa M. Ledbetter
Washington
+1.202.879.3933
lledbetter@jonesday.com

Christian G. Vergonis
Washington
+1.202.879.3914
cvergonis@jonesday.com

Noel J. Francisco
Washington
+1.202.879.5485
njfrancisco@jonesday.com

ENDNOTES

1 Pub. L. No. 111-203 (July 21, 2010).

2 *Humphrey's Executor v. United States*, 295 U.S. 602 (1935).

3 *See Morgan Drexen, Inc. v. Consumer Fin. Prot. Bureau*, 785 F.3d 684 (D.C. Cir. 2015) (affirming the district court conclusion that an attorney not subject to a CFPB enforcement action lacked standing to challenge the constitutionality of the CFPB); *National Bank of Big Spring, Texas, et al. v. Lew, et al.*, No. 13-5247, 2015 WL 4489885 (D.C. Cir. July 24, 2015) (holding that the bank has standing to challenge the constitutionality of the CFPB and remanding for further proceedings); *Consumer Fin. Prot. Bureau v. CashCall, Inc.*, No. CV157522JFWRAOX, 2016 WL 4820635 (C.D. Cal. Aug. 31, 2016) (denying motion for summary judgment filed by defendant that argued that the CFPB is not constitutionally structured); *Consumer Fin. Prot. Bureau v. ITT Educational Services, Inc.,* No. 1:14-CV-00292-SEB. 2015 WL 1013508 (S.D. Ind. Mar. 6, 2015) (denying motion to dismiss by defendant that argued that the CFPB is structured unconstitutionally). Additionally, the subject of a CFPB Enforcement Action in North Dakota has recently challenged the structure of the CFPB as unconstitutional in a motion to dismiss. *See generally Consumer Fin. Prot. Bureau v. Intercept Corporation, et al.,* 3:16-cv-00144-RRE-ARS (D.N.D. June 6, 2016). The district court has not yet ruled on the motion.

4 *PHH Corporation, et al., v. Consumer Financial Protection Bureau*, No. 15-1117 (D.C. Cir. Oct. 11, 2016). (hereinafter, "*PHH Corp.*").

5 Circuit Judge Karen Henderson did not join the majority opinion in this constitutional holding on the ground that reaching the constitutional challenge proffered by PHH was unnecessary because PHH's statutory arguments were sufficient to grant relief from the CFPB's administrative order. In a footnote, she indicated that her dissent was not intended to suggest that the CFPB was immune from constitutional challenge, and that in all likelihood, that challenge would be before the court relatively quickly, *see, e.g., State Nat'l Bank Big Spring v. Lew*, No. CV 12-1032 (ESH), 2016 WL 3812637 at *1 (D.D.C. July 12, 2016).

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

7 *PHH Corp.*, at 12.

8 A prior Jones Day *Commentary*, "*PHH v. Consumer Financial Protection Bureau*: What it Means for Current and Future CFPB Enforcement," addressed the implications of the Court's ruling for current and future CFPB enforcement actions.

9 "CFPB Takes Action Against PHH Corporation for Mortgage Insurance Kickbacks," Jan. 29, 2014.

10 *In the Matter of PHH Corp.*, File No. 2014-CFPB-0002.

11 *See* Letter from Nicolas P. Retsinas, Assistant Secretary for Housing, Department of Housing and Urban Development, to Countrywide Funding Corporation 3 (Aug. 6, 1997) and Letter from John P. Kennedy, Associate General Counsel for Finance and Regulatory Compliance, Department of Housing and Urban Development, to American Land Title Association 1 (Aug. 12, 2004).

12 Pursuant to the Dodd-Frank Act, HUD's rule implementing RESPA, Regulation X, was transferred to and codified by the CFPB at 12 C.F.R. § 1024 (2012). 24 C.F.R. §§ 3500.01-3500.14.

13 Article II, § 1 of the U.S. Constitution states, in relevant part, "The executive Power shall be vested in a President of the United States of America."

14 12 U.S.C. § 5491(c)(3).

15 *PHH Corp.*, at 17.

16 *Myers v. United States*, 272 U.S. 52, 122 (1926).

17 *Humphrey's Executor v. United States*, 295 U.S. 602 (1935).

18 *PHH Corp.*, at 21.

19 *Id*. at 21 (quoting *Humphrey's Executor*, 295 U.S. at 624 (internal quotation marks omitted)).

20 *Id*. at 22.

21 *Id*. at 27.

22 *Id*. at 58. The court notes the tension between *Humphrey's Executor* and *Free Enterprise Fund*, stating that "the reasoning of *Humphrey's Executor* is in tension with some of the reasoning of the Supreme Court's recent decision in *Free Enterprise Fund*…. Of course, overruling *Humphrey's Executor* would not mean the end of the agencies that are now independent…. So the question is not the existence of the agencies; the question is the President's control over the agencies and the resulting accountability of those agencies to the people." *Id*. at ftn. 15, 59-60.

23 *Id*. at 27.

24 *Id*. at 9 (quoting *Morrison v. Olson*, 487 U.S. 654, 699 (1988) (Scalia, J., dissenting).

25 *Id*. at 27.

26 *NLRB v. Noel Canning*, 134 S. Ct. 2550 (2014). *See* Jones Day, "Noel Canning victorious as U.S. Supreme Court unanimously rules to invalidate President Obama's 2012 recess appointments to NLRB," June 2014.

27 *Id*. at 2567.

28 *Id*. at 2567.

29 *Free Enterprise Fund v. Public Company Accounting Oversight Board*, 561 U.S. 477 (2010). *See* Jones Day, "Free Enterprise Institute wins challenge of constitutionality of Public Company Accounting Oversight Board," June 2010.

30 *Id*. at 505.

31 *PHH Corp.*, at 38.

32 *Id*. at 9.

33 *Id*. at 59.

34 *Id*. at 29.

35 *Id*. at 30.

36 *Id*. at 31.

37 *Id*. at 33.

38 *Id*. at 34.

39 *Id*. at 64.

40 *Id*. at 65.

41 *Id*. at 66 (quoting *Free Enterprise Fund* at § 561 U.S. at 508).

42 12 U.S.C. § 5302 (quoted in the majority opinion at 67).

43 *PHH Corp.,* at 10.

44 *Id.* at 71.

45 *Id*. at 73.

46 12 U.S.C. § 2607(a).

47 PHH Corp., at 74-75.

48 *Id*. at 73 and 75.

49 *Id*. at 76.

50 The court also pointed out that other courts had acknowledged and approved of HUD's interpretation. *Id*. at 82.

51 *Christopher v. SmithKline Beecham Corp*., 132 S. Ct. 2156, 2167 (2012).

52 *PHH Corp*., at 86.

53 *Id*. at 93.

54 During oral argument, in reply to the question of whether the CFPB could bring an administrative enforcement action 100 years after allegedly unlawful conduct had occurred, CFPB counsel referred to the agency's prosecutorial discretion and the equitable defense of *laches* for the proposition that a court would look askance at such a proceeding. In response to this answer, the court stated, "This Court looks askance now at the idea that the CFPB is free to pursue an administrative enforcement action for an indefinite period of time after the relevant conduct took place. A much more logical, predictable interpretation … is that the three-year limitations period [in RESPA] applies equally to CFPB court actions and CFPB administrative actions. And most importantly for our purposes, that is what the relevant statutes say." *PHH Corp*., at 100.

55 42 U.S.C. § 902(a)(3) (The head of the Social Security Administration may be removed "only pursuant to a finding by the President of neglect of duty or malfeasance in office").

56 5 U.S.C. § 1211(b) (The Special Counsel may be removed by the President "only for inefficiency, neglect of duty, or malfeasance in office").

57 *PHH Corp.,* at 30-31.

58 12 U.S.C. § 2 ("The Comptroller of the Currency shall be appointed by the President, by and with the advice and consent of the Senate, and shall hold his office for a term of five years unless sooner removed by the President, upon reasons to be communicated by him to the Senate.") Additionally, the Comptroller performs duties under the general direction of the Secretary of the Treasury, and the Secretary cannot delay or prevent rulemakings or intervene in enforcement proceedings, unless specifically provided by law. 12 USC § 1.

59 12 U.S.C. § 5491(c)(3).

60 12 U.S.C. § 4512(b)(2). ("The Director shall be appointed for a term of 5 years, unless removed before the end of such term for cause by the President.")

61 *PHH Corp*., at 33.

62 Pub. L. No. 110-289 (July 30, 2008).

63 *PHH Corp.,* at 69-70, n. 19.

64 President Obama renominated the CFPB Director on January 24, 2013. *See* White House Office of the Press Secretary, *Remarks by the President at a Personnel Announcement* (Jan. 24, 2013). The Senate confirmed the CFPB Director on July 16, 2013.

65 Notice of Ratification, 78 Fed. Reg. 53734 (August 30, 2013).

66 *CFPB v. Gordon*, 819 F.3d 1179, 1191 (9th Cir. 2016).

67 *State Nat'l Bank of Big Spring*, *infra* n. 5.

68 The court has allowed past actions of an agency to have "de facto validity" where the court later finds a constitutional defect in the agency's establishing statute. *Buckley* v. *Valeo*, 424 U.S. 1, 142 (1976).

69 PCAOB News Release, June 28, 2010.

70 The D.C. Circuit severed the for-cause provision that rendered the Copyright Royalty Board unconstitutional, and this step similarly had a negligible impact on the operations of the Copyright Royalty Board. *PHH Corp*., at 69.

71 *PHH Corp*., at 10.

72 Executive Order 12866, Regulatory Planning and Review, 58 Fed. Reg. No. 190 (October 4, 1993).

73 *See id*. at Section 6(a).

74 *See* Office of Management and Budget, Regulatory Analysis, Circular A-4 (September 17, 2003).

75 "Significant regulatory actions" are those that are likely to result in a rule that may: (i) have an annual effect on the economy of $100 million or more or adversely affect the economy in a material way, or a section of the economy, productivity, or competition, among other impacted factors; (ii) create a serious inconsistency with actions of another agency; (iii) materially alter the budgetary impacts of entitlements, loan programs, grants or user fees or the rights of recipients; or (iv) raise novel legal or policy issues emanating from legal requirements, the President's priorities or the principles of regulation set forth in Executive Order 12866. *See* Executive Order 12866 at Section 2(f).

76 *See id*., at Section 6(a)(3).

77 44 U.S.C. § 3502(5).

78 *See, e.g.,* Executive Order 13563, Improving Regulation and Regulatory Review, 76 Fed. Reg. No. 14 (January 21, 2011), Executive Order 13610, Identifying and Reducing Regulatory Burdens, 77 Fed. Reg. No. 93 (May 14, 2012); and Final Bulletin for Agency Good Guidance Practices, 72 Fed. Reg. 3432 (January 25, 2007).

79 *See* American Bankers Association Banking Journal, Nov. 9, 2016 available at http://bankingjournal.aba.com/2016/11/how-the-2016-elections-will-impact-banking.

80 In fact, not only would H.R. 5983 replace the CFPB Director, it would also replace the Comptroller of the Currency and the Director of the Federal Housing Finance Agency with five-member bipartisan commissions.

81 12 U.S.C. § 5491(c)(3).

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