

ALERTS

Federal Appeals Court Rules CFPB Structure Unconstitutional

October 12, 2016

The D.C. Circuit held yesterday in *PHH Corporation (“PHH”) v. Consumer Financial Protection Bureau (“CFPB”)* that the structure of the CFPB was unconstitutional because, as an independent agency, it should have been constituted with a board or commission instead of having all power vested in a single person.[1] However, the court chose not to shut down the CFPB or invalidate its prior actions. Instead, the court decided on a more narrow remedy — it struck down the provision of the Dodd-Frank Act that only permitted the president to remove the CFPB director “for cause.”[2] The court’s ruling essentially makes the CFPB an executive agency, subject to the supervision and direction of the president. The CFPB has not yet indicated how it will react to the court’s ruling on its structure, however it has suggested it is considering options for seeking further review of the court’s decision. The CFPB can either file a petition to the D.C. Circuit for rehearing en banc or file a petition to the Supreme Court for certiorari.

PHH, a mortgage lender, had petitioned the court to review the constitutionality of the CFPB’s agency structure, as part of its appeal of a \$109-million order the CFPB had levied against it (the “PHH Order”) for what the CFPB had deemed a violation of the Real Estate Settlement Procedures Act (“RESPA”). While the court’s ruling on the constitutionality of the CFPB structure did not affect the PHH Order, separately the court vacated the PHH Order and remanded for further proceedings.

Independent vs. Executive Agencies

Under Article II of the U.S. Constitution, the president alone is vested with all executive power (i.e., the power to enforce the law). However, in 1935, the Supreme Court ruled that, notwithstanding Article II, Congress had the power to create independent agencies that exercise executive power. [3] Because independent agency heads are removable by the president only for cause, they are not accountable to or checked by the president. While there is judicial review to ensure the legality of the agency's decisions, the courts do not have the authority to review discretionary decisions that are within the legal boundaries of the agency's authority.

Historically, independent agencies exercising substantial executive power have been headed by a multiple-member board or commission.[4] Thus, each individual board member or commissioner is accountable to and checked by their fellow board members or commissioners. In contrast, the CFPB is headed by a single director, who has unilateral authority to enforce the 19 federal consumer protection statutes under its purview. The court found this provided the CFPB director "more unilateral authority than any other officer in any of the three branches of the U.S. Government, other than the President." [5]

The court maintained that: "The 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." [6] Accordingly, the court held that the CFPB structure exceeds the boundaries of traditional independent agencies and violates Article II of the Constitution.

To remedy this unconstitutional structure, the court found a narrow remedy appropriate, and relying on Supreme Court precedent, severed the unconstitutional for-cause provision from the rest of the statute, removing the CFPB's status as an independent agency. The president now has the power to both remove the CFPB director at will, and to supervise and direct the director's actions. While this ruling affects the oversight of the CFPB director, the CFPB will continue to operate as an administrative agency with the power to enforce federal consumer protection statutes. The court declined to consider the potential effect this decision may have on CFPB's prior actions or decisions.[7] In the particular CFPB action at issue, rather than vacate the PHH Order simply

because it had been issued while the agency was unconstitutionally structured, the court proceeded to judge it on the merits.[8]

The PHH Order

Finding that the CFPB can remain an agency under this new constitutional structure, the court looked to PHH's substantive challenges to the \$109-million order issued against it. The court found for PHH, ruling that: (1) the CFPB incorrectly interpreted Section 8 of RESPA, which does not bar captive reinsurance arrangements; (2) the CFPB retroactively applied a new interpretation of RESPA against PHH, violating its due process rights; and (3) the three-year statute of limitations under RESPA does apply to all CFPB actions to enforce Section 8 of this act. Thus, the court vacated the PHH Order and remanded for further proceedings.

Authored by Joseph P. Vitale and Hannah Thibideau.

If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

[1] *PHH Corp. v. Consumer Fin. Prot. Bureau*, No. 15-1177 (D.C. Cir. Oct. 11, 2016). This opinion was written by Judge Kavanaugh of the D.C. Circuit. While the ruling on the PHH Order was unanimous, Judge Henderson dissented from the court's ruling on the constitutionality question, arguing that the court did not need to address the constitutional issue in its decision. Judge Henderson's dissent does not address the merits of the constitutionality question.

[2] 12 U.S.C. § 5491(c)(3).

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

[4] E.g., the Securities and Exchange Commission or the National Labor Relations Board. The one potential exception recognized by the court is the Federal Housing Finance Agency, which the court indicated "raises the same question we confront here." *PHH Corp. v. Consumer Fin. Prot. Bureau*, No. 15-1177, at 33 (D.C. Cir. Oct. 11, 2016).

[5] *Id.* at 6.

[6] *Id.* at 9.

[7] *Id.* at 69 n.19.

[8] The D.C. Circuit has previously upheld other organizations' past rules and determinations subsequent to a successful challenge to an organizational structure on constitutional grounds. See, e.g., *Intercollegiate Broadcasting System, Inc. v. Copyright Royalty Board*, 796 F.3d 111, 114 (D.C. Cir. 2015) (holding that "ratification [of previous decisions] by a properly constituted board would be appropriate"); see also *Federal Election Com'n v. Legi-Tech Inc.*, 75 F.3d 704, 709 (D.C. Cir. 1996) (finding that the organization's "post-reconstruction ratification of its prior decisions" should be taken at "face value" and treated as "an adequate remedy for the [] constitutional violation"). Pursuant to these precedents it would seem that the CFPB director can insulate prior actions from challenge by revisiting and ratifying them. Nonetheless, it is likely that there will still be legal challenges to overturn previous actions taken by the CFPB.

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