Richard Horn Legal PLLC

CLIENT UPDATE

October 17, 2016

The U.S. Court of Appeals for the D.C. Circuit issued its decision in PHH Corp. v. CFPB on October 11, 2016. The court, in a strongly worded opinion, held that the CFPB was wrong in its interpretation of RESPA, due process, and the applicable statute of limitations, calling the CFPB's various arguments "absurd," "nonsensical," "strained," "deeply unsettling," and "alarming." The court also called the CFPB's lack of due process a violation of "Rule of Law 101." Significantly, the court also held that the CFPB's structure was unconstitutional, because it was an independent agency with a single director who could only be removed by the President for cause. The court allowed the CFPB to continue to operate as an "executive agency," but held that going forward the President is able to remove the Director at will.

The court described the CFPB's structure as a threat to individual liberties and likened the CFPB to a "wolf." After the court's strong words for the CFPB's interpretations, the wolf should be limping away with its tail between its legs. But the CFPB will likely request an *en banc* review by the court, and the case most likely will be appealed to the Supreme Court by one of the parties. This is just the beginning, and whether this opinion will stand remains to be seen. It may not be time to start revising your marketing services agreements just yet.

It is worth noting one significant effect of this decision for current subjects of CFPB administrative enforcement actions or civil investigative demands. For those institutions, the court's rejection of the CFPB's argument that its administrative enforcement actions are not subject to any statute of limitations should warrant attention, as it could be raised to limit the actionable violations in such proceedings.

Another question is whether the CFPB will be more careful about the limits of its authority after this opinion. Remember that recently, in April 2016, the CFPB also had one of its civil investigative demands issued to a college accreditation company rejected by the U.S. District Court for the District of Columbia, because it was outside the CFPB's statutory authority. In that decision, the court stated that, "[a]lthough it is understandable that new agencies like the CFPB will struggle to establish the exact parameters of their authority, they must be especially prudent

Richard Horn Legal, PLLC is the law office of Richard Horn, the former CFPB Senior Counsel and Special Advisor who led the rule the TRID rule (also known as the TILA-RESPA integrated disclosure rule). Richard Horn has extensive experience and expertise in consumer financial services and bank regulation from many years as a Senior Counsel and Special Advisor at the CFPB and Senior Attorney at the FDIC. The office specializes in consumer financial services regulation, with a focus on residential mortgage compliance.

Contact Richard Horn at **rich@richhornlegal.com** | **202-686-2629** | **www.richhornlegal.com**

This Client Update is provided for informational purposes only. It does not constitute a legal opinion or create an attorney-client relationship.

before choosing to plow head long into fields not clearly ceded to them by Congress." Will the CFPB take this advice?

I have summarized the court's opinion below, and provided some of my thoughts on the current and future effects of the decision. Please let me know if you have any questions, or if I can provide any assistance in understanding the repercussions of this opinion.

I. The Court's Findings and Orders

The court held, in a very strongly worded opinion, that the CFPB's structure was unconstitutional, because it had substantial power as an independent agency, but had a single director who was removable by the President only for cause. The court also agreed with each of PHH's arguments, holding that: (1) RESPA section 8(c)(2) provides an exemption for payments that are a reasonable market value for the goods or services, including captive reinsurance arrangements; (2) the CFPB violated due process by retroactively changing the applicable interpretation of RESPA section 8; and (3) the CFPB's administrative actions are subject to a statute of limitations, in this case, RESPA's three-year statute of limitations.

The court allowed the CFPB to continue to operate as an executive agency, severing the "for cause" clause of the removal provision of the Dodd-Frank Act, which change allows the President to remove the Director of the CFPB at will. The court also sent the RESPA enforcement action back to the CFPB because, as a factual matter, the CFPB could find that the prices paid by the mortgage insurance companies for mortgage reinsurance were more than the reasonable market value for the reinsurance, which the CFPB could find represented referral payments in violation of section 8.

II. Constitutionality of the CFPB

A. The Structure of the CFPB is Unconstitutional

The court, in a 2-1 decision, agreed with PHH's argument that the CFPB's structure was unconstitutional, because the CFPB has substantial authority, but was structured as an independent agency with a single director who was removable by the President only for cause. The dissenting judge based her dissent not on the majority's analysis of the issue, but on her opinion that it was unnecessary for the court to address the constitutional issue, because PHH would obtain relief based on the court's opinion on the RESPA issues.

Specifically, section 1011 of the Dodd-Frank Act, 12 U.S.C. § 5491(c)(3), provides that, "[t]he President may remove the Director for inefficiency, neglect of duty, or malfeasance in office." The court held that because of the "for cause" clause in this removal provision, the CFPB's structure violated the separation of powers doctrine in Article II of the Constitution. Article II requires the executive powers be vested in the President and that the President is solely responsible for ensuring that the laws are faithfully executed. In order to do so, the Constitution authorizes the President to appoint executive subordinate officers and supervise and direct those officers.

The court noted two relevant Supreme Court cases: (1) *Myers v. United States*, in which the Supreme Court acknowledged the President's supervisory power to remove officers at will; and (2) *Humphrey's Executor v. United States*, in which the Supreme Court acknowledged that Congress can create independent agencies where the agency heads are removable by the President only for cause. The court noted that *Humphrey's Executor* emphasized that independent agencies were intended to be non-partisan, impartial, and headed by a body of experts. The court found the reference to "body of experts" in *Humprey's Executor* to be an important point, and noted that independent agencies have historically operated as "multi-member bodies of experts," such as multiple commissioners, directors, or board members.

The court drew a sharp contrast between historical precedent and the CFPB's single-director structure, stating that, "no independent agency exercising substantial executive authority has ever been headed by a single person. Until now." The court noted that the CFPB has "broad authority to enforce U.S. consumer protection laws," with the power that was previously exercised by seven different regulatory agencies. The court also noted that this power includes the power to enforce consumer protection laws administratively or judicially, seeking restitution and civil money penalties, and to issue subpoenas requesting documents or testimony. The court took issue with this "massive power" being "lodged in one person," stating that the CFPB's Director, "enjoys more unilateral authority than any other officer in any of the three branches of the U.S. Government, other than the President." The court highlighted the risks this poses, stating that this structure, "poses a far greater risk of arbitrary decisionmaking and abuse of power, and a far greater threat to individual liberty, than does a multi-member independent agency."

The court discussed how multi-member independent agencies better prevent this risk, noting that in such agencies, no single person has authority to take an action to "infringe on your liberty in some way." The court also noted that the deliberative

process and multiple viewpoints in a multi-member agency, "can help ensure that an agency does not wrongly bring an enforcement action or adopt rules that unduly infringe individual liberty."

The court also found that the potential checks on the CFPB's powers of judicial review and the veto-power over its rules by the Financial Stability Oversight Council ("FSOC") were insufficient. Regarding judicial review, the court stated that much of the CFPB's actions occur in "the twilight of judicially unreviewable discretion," such as determining its rulemaking agenda or whom to bring enforcement actions against. Regarding FSOC's veto power, the court noted that it only applies to rules, and only when two-thirds of FSOC's members determine a rule risks the safety and soundness or stability of the financial system. The court stated that this, "limited veto provision falls far short of making the CFPB the equivalent of a multi-member independent agency.

The court concluded that, because of the departure from historical practice for independent agencies with the CFPB's powers, and the threats to individual liberty, the authority under *Humphrey's Executor* for independent agencies, "cannot be stretched to cover this novel structure." The court definitively stated, "[we] therefore hold that the CFPB is unconstitutionally structured."

B. Appropriate Remedy

The court stated that it had to decide what the appropriate remedy was for the CFPB's unconstitutional structure. The court noted that PHH wanted the court to strike down the CFPB. But the court held that the appropriate remedy was to sever the "for cause" clause in the removal provision. The court allowed the CFPB to continue to operate without the "for cause" clause, "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." Without the "for cause" clause, the President is able to remove the Director at will, as with other executive agencies.

The court noted that one of its possible remedies could have been to require the installment of a multi-member commission or board to lead the agency. But the court stated that doing so would require the court to create new offices, designate one of them the Chair, and specify administrative details, and determined that these measures were "beyond our judicial capacity." But the court did leave it up to Congress to restructure the agency, stating that, "if Congress prefers to restructure the CFPB as a multi-member independent agency rather than as a single-Director executive agency, Congress may enact new legislation that creates a Bureau headed by multiple members instead of a single Director."

C. What Does This Mean Now for the CFPB and its Past Rules and Enforcement Actions?

For the CFPB right now, it probably does not mean much. The court did not expressly invalidate any past or pending CFPB rulemakings or actions. The court only subjected the Director to removal by the President at will. And because the current administration is very supportive of the CFPB, it is unlikely to use its newfound influence over the Director to change the agency's direction.

But the court opinion does potentially open up the CFPB's past rulemakings or enforcement actions to challenge, based on the argument that they are invalid because they were issued by an unconstitutionally structured agency. Notably, the court did not provide any express guidance regarding whether the CFPB's past actions are or could be invalidated. Instead, the court stated that it was not addressing the issue of the validity of the CFPB's past rules or actions. Specifically, the court stated that, "[w]e need not here consider the legal ramifications of our decision for past CFPB rules or for past agency enforcement actions." The court noted recent cases in which the National Labor Relations Board, the Public Company Accounting Oversight Board, and the Copyright Royalty Board were found to be unconstitutional or invalidated, and stated that, "the agencies and courts have subsequently worked through the resulting issues regarding the legality of past rules and of past or current enforcement actions."

Based on the relevant cases cited by the court on this issue, it appears that the Director potentially could simply ratify past rules under the agency's new constitutional structure to validate them. In addition, if a court found the CFPB's past or pending enforcement actions invalid, the Director potentially could ratify or reopen them to validate them. But as the court noted, these issues may have to work their way through the courts. It will be interesting to see if this issue is raised in legal challenges to some of the CFPB's more controversial rulemakings, such as its Arbitration or Payday Loan proposed rules. In addition, it will be very interesting to see if the CFPB's past RESPA section 8 enforcement actions are challenged based on both the constitutional and substantive issues in this opinion.

D. What Does this Mean Going Forward?

Will the CFPB's new status as an "executive agency" change the CFPB's processes? One question that comes to mind is whether, because this opinion states that the CFPB is now an "executive agency" rather than an "independent regulatory agency," the opinion effectively requires the CFPB's rulemakings to be subject to review by

the White House's Office of Management and Budget ("OMB") under Executive Order 12866 ("EO 12866"). Under EO 12866, executive agencies are required to submit their proposed and final rules to OMB for review, in part, "to ensure that new or revised regulations promote the President's priorities." This certainly sounds like the level of control that the court was envisioning the President wielding over the agency with a Director removable at will.

But EO 12866 exempts "independent regulatory agencies," cross-referencing the definition of this term in the Paperwork Reduction Act under 44 U.S.C. § 3502, which the Dodd-Frank Act amended to expressly include the CFPB. Because the order relies on a statutory definition that expressly includes the CFPB, it appears that the court's decision will not subject the CFPB to OMB review. The court did not expressly provide a revision of this statutory term in its remedy. Although the court called the CFPB an "executive agency" going forward, it appears to have been referring exclusively to the "for cause" clause. And the statutory definition of "independent regulatory agency" is not conditioned on such general concepts of independence, such as the agency having a "for cause" removal provision. For this reason, the CFPB will likely continue to be considered exempt from OMB review, unless the President or legislation changes its status (note that there have been bills introduced in Congress with the objective of subjecting independent regulatory agencies to such OMB review).

III. Statutory Interpretation of RESPA Section 8(c)(2)

A. Section 8(c)(2) Provides an Exemption for Payments of Reasonable Market Value for Goods and Services

The court strongly disagreed with the CFPB's interpretation, and held that section 8(c)(2) of RESPA provides an exemption from section 8(a)'s prohibition against payments in exchange for referrals of settlement service business. The court described the issue as "not a close call," and described the CFPB's interpretation as "strained."

Specifically, the court held that section 8(c)(2) is an exemption from section 8(a)'s prohibition, rather than an aid in interpretation as the CFPB argued, and that section 8(c)(2) permits the captive reinsurance arrangements that were the subject of the CFPB's enforcement action, to the extent the reasonable market value was for the reinsurance. The court stated, "[w]e agree with PHH that Section 8 of the Act allows captive reinsurance arrangements so long as the amount paid by the mortgage insurer for the reinsurance does not exceed the reasonable market value of the reinsurance."

To recap the relevant statutory provisions, section 8(a) of RESPA prohibits payments for referrals, stating that, "[n]o person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any 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." And section 8(c)(2) of RESPA provides that, "[n]othing in this section 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." 12 U.S.C. § 2607.

In PHH's appeal of the ALJ's decision in the CFPB's administrative action against PHH, Director Cordray's June 2015 opinion analyzed section 8(c)(2) and stated that the provision is not "a substantive exemption to liability," but only clarifies the application of section 8(a). The Director based his opinion, in part, on the fact that section 8(c) begins with, "nothing in this section shall be construed," which he said did not use words that clearly provided an exemption, like "notwithstanding" or "exempt." And he said the use of the word "construed" also indicates that this provision merely is an aid to interpretation of section 8(a). He also opined that reading section 8(c)(2) as an exemption would allow payments for services that are a pretext to compensate for referrals, such as the mortgage insurance arrangement, which payments would distort the market in ways that RESPA meant to prevent. He determined that this is the meaning of the term "bona fide" in section 8(c)(2), *i.e.*, that the payments are not a pretext for a referral. Based on this reasoning, Director Cordray opined that section 8(c)(2) is not an exemption to the prohibition of section 8(a).

However, the D.C. Circuit Court of Appeals disagreed with Director Cordray, stating the question of whether section 8(c) is an exemption "is not a close call." The court noted that section 8(c) begins with the word "nothing," and found that the use of this word operates as an exemption, because, "[n]othing means nothing."

Disagreeing with Director's Cordray's interpretation of the term "bona fide" under section 8(c)(2), the court found that the "bona fide" condition in this provision does not depend on whether there was pretext for the payment, but instead only means that the payments were for the reasonable market value of the goods or services purchased. The court stated that, "the text and context of this statute, a bona fide payment means a payment of reasonable market value." The court continued, stating that REPSA only prohibits payments for referrals and "does not proscribe a tying arrangement, so long as the only payments exchanged are bona fide payments for services and not payments for referrals." The court stated that, "a

payment pursuant to a tying arrangement does not make the payment any less bona fide, so long as the payment for the service reflects reasonable market value."

The court also looked to the legislative history of RESPA with respect to the term "bona fide," and noted that Senate committee reports described the exemption as applying to reasonable payments. Specifically, the court noted that one of the Senate committee reports describes section 8(c)(2) stated, "[r]easonable payments in return for services actually performed or goods actually furnished are not intended to be prohibited." S. Rep. No. 93-866, at 6 (1974). The court noted that the Senate committee report used the word "reasonable" instead of "bona fide," and stated that this indicated that the Senate committee "following the commonsense meaning, expressly equated the two terms." The court called Director Cordray's interpretation of "bona fide" a "strained interpretation."

The court also said that the CFPB is not entitled to deference to its interpretation under *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, because there is no ambiguity to RESPA section 8(c). The court stated that, even if it had to look to the CFPB's interpretation due to an ambiguity in the statute, the "CFPB's interpretation is not a reasonable interpretation of the statute in light of the statute's text, history, context, and purposes."

B. What Does this Mean Going Forward?

This opinion is definitely a strong rebuke of the CFPB's interpretation of RESPA, and very helpful to the industry. But it may be too early to begin revising your marketing services agreements to strip away any "protections" built in after *Lighthouse Title* and other CFPB enforcement actions. The CFPB is likely to ask for a review of this decision by the full D.C. Circuit court. And whether or not the review is granted, the case will likely end up being appealed to the Supreme Court by one of the parties. In spite of the court's strongly worded and unequivocal disagreement with the CFPB's interpretation of RESPA, and the due process issues described below, it is possible that the CFPB's interpretations could be upheld in these subsequent decisions.

It will be interesting to see if the CFPB revises its guidance from last October regarding marketing services agreements (Compliance Bulletin 2015-05) prior to a successful appeal by the CFPB. Much of the substance of that bulletin conflicts with the court's opinion.

IV. Due Process

A. The CFPB's Retroactive Application of its Change in Interpretation Violated Due Process

The court concluded that the CFPB violated PHH's due process rights when it chose to do a "complete about-face from the Federal Government's longstanding prior interpretation of Section 8," and apply this new interpretation retroactively against PHH. The court described these "fundamental anti-retroactivity principles" as "Rule of Law 101," and stated that the CFPB violated them. The court stated that the CFPB's interpretation was "deeply unsettling" and that "[t]he Due Process Clause does not countenance the CFPB's gamesmanship."

The court noted that HUD had issued a "widely disseminated" guidance letter in 1997 that was "relied on in the industry," in which HUD stated that captive reinsurance arrangements are permissible as long as they are for reasonable market value. The court also noted that HUD reiterated its opinion in a 2004 letter to ALTA. Director Cordray in his opinion in the PHH case stated that HUD's 1997 letter was "not in such a form as to be binding on any adjudicator," because it was not published in the *Federal Register*, and concluded that, "the letter provides no protection to PHH in this proceeding." But the court strongly disagreed. In response to the CFPB's argument regarding the HUD guidance, the court stated that it found the CFPB's argument "deeply unsettling in a Nation built on the Rule of Law." The court stated that the CFPB is "confusing" administrative law about *Chevron* deference and due process. The court stated that an agency pronouncement about the legality of conduct does not need to be subject to notice and comment rulemaking, or the like, to trigger due process protection.

In addition, the court stated that CFPB's Regulation X permits payments for goods or services actually furnished or performed that bear a reasonable relationship to the market value. In response to the CFPB's argument that Regulation X does not necessarily permit payments that bear a reasonable relationship to the market value, the court stated that argument was a "facially nonsensical reading of Regulation X."

The court found that the CFPB created a new interpretation of RESPA section 8, and retroactively applied it against PHH. The court held that, "[t]he retroactive application of the CFPB's new interpretation violated the Due Process Clause."

B. What Does this Mean Going Forward?

Due process issues could be raised in CFPB enforcement actions based on other consumer finance laws where the CFPB may be perceived to have changed long-standing interpretations. In addition, if there are any past or pending CFPB enforcement actions based on RESPA section 8, this should be reviewed as a potential challenge.

Regarding the court's statements about HUD's 1997 letter, this is very encouraging for those relying on the CFPB's own informal letters and guidance that it has not published in the *Federal Register.* Remember that Cordray in his opinion stated that HUD's letter was not in a form that could be relied on by any adjudicator, but the CFPB itself has issued a great deal of informal guidance on its rulemakings that are not published in the *Federal Register* but are widely disseminated, including small entity compliance guides, webinars, and letters, including the CFPB's letter regarding liability under TRID. It will be interesting to analyze whether this opinion gives the industry a stronger basis on which to rely on the CFPB's informal guidance.

V. Statute of Limitations

A. The CFPB's Administrative Enforcement Actions are Subject to a Statute of Limitations

The court also disagreed with the CFPB's argument that no statute of limitations applies to the CFPB's administrative enforcement actions, including its administrative actions under RESPA. The court said it "would be absurd" that the Dodd-Frank Act would allow the CFPB to enforce RESPA administratively without a statute of limitations, and that the CFPB's interpretation is "especially alarming."

The CFPB made two arguments to support its interpretation. First, the CFPB argued that, because its authority to engage in administrative and civil actions are under separate statutory sections, 12 U.S.C. §§ 5563 and 5564, respectively, and only § 5564 contains a statute of limitations, no statute of limitations applies to its administrative enforcement actions. Second, the CFPB argued that the three-year statute of limitations under RESPA did not apply to the Bureau's administrative enforcement action, because RESPA's statute of limitation provision only refers to "actions," which the CFPB argued means civil actions and not administrative actions. The CFPB argued that Congress uses the word "proceeding" to describe administrative actions.

Regarding the CFPB's first argument, the court stated that the CFPB, "misreads the enforcement provisions of the Dodd-Frank Act." The court noted that § 5563(a)(2) states that the CFPB can conduct administrative actions under federal consumer finance laws, "unless such Federal law specifically limits the Bureau from conducting a hearing or adjudication proceeding and only to the extent of such limitation." The court determined that this provision incorporates the "limits" under specific consumer laws like RESPA into the CFPB's authority to conduct administrative actions, including statutes of limitations. The court held that, based on this provision, the CFPB's administrative actions are subject to the statutes of limitations of the statutes it is enforcing.

Regarding the CFPB's second argument, the court disagreed with the CFPB's interpretation of RESPA. The court noted that the provision of RESPA that applies a three-year statute of limitations to "actions" by the CFPB, state attorneys general, and state insurance commissioners does not limit the "jurisdiction or forum for actions," which it contrasted with the provision that applies a general one-year statute of limitations for actions brought in court. For this reason, the court found that RESPA "on its face…is therefore straightforward," and that the three-year statute of limitations under RESPA applies to actions, whether they are administrative or in court.

In response to the CFPB's argument that the use of the word "action" in RESPA means only court actions, because Congress uses the word "proceeding" to refer to administrative actions, the court stated that the CFPB's argument was "flatly wrong." The court noted that the Dodd-Frank Act itself uses the word "action" to refer to both administrative and court actions, including in 12 U.S.C. §§ 5537(b)(1), 5538(b)(6), 5565(c), and 5497(d)(1).

The court called the CFPB's argument that Congress would allow this result "absurd," and stated that such a dichotomy between the CFPB's civil and administrative actions would be "nonsensical." The court stated that, "the CFPB's interpretation is especially alarming because the agency can seek civil penalties in these administrative actions."

In addition, the court stated that the "absurdity" of the CFPB's interpretation is illustrated by the fact that the CFPB stated it could look back as much as 100 years in its administrative actions, because it has no statute of limitations, but that it would be limited by "prosecutorial discretion" or the defense of laches. The court stated that it "looks askance" at the CFPB's interpretation that it can pursue an enforcement action for an "indefinite period of time after the relevant conduct took place."

B. What Does this Mean Going Forward?

One issue that is significant for pending enforcement actions is the court's opinion regarding the CFPB's statute of limitations. In its pending administrative enforcement actions, the CFPB has been operating under its interpretation that it is not subject to a statute of limitations for these actions. Under this interpretation, the CFPB may have been looking back for actionable violations further than the applicable statute of limitations pursuant to this opinion. Institutions that are currently the subject of administrative enforcement actions or civil investigative demands could raise this as an issue.