

Client Update

DC Circuit Strips CFPB of Its Independence, Vacates Enforcement Order Against PHH

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On October 11, 2016, the United States Court of Appeals for the District of Columbia Circuit released its long-anticipated decision in *PHH Corp., et al. v. Consumer Financial Protection Bureau*, No. 15-1177 (D.C. Cir., Oct. 11, 2016), handing the Consumer Financial Protection Bureau (the “CFPB” or the “Bureau”) a major setback in the first-ever appellate review of a CFPB administrative enforcement order. In the 110-page landmark decision by Judge Kavanaugh, the Court found that the Bureau’s single-Director structure violated constitutional separation-of-powers principles.

In addition, the Court resoundingly rejected the CFPB’s interpretations of the Real Estate Settlement Procedures Act (“RESPA”) and its own administrative enforcement authority. The Court, contrary to the Bureau’s position, held that RESPA permits captive reinsurance arrangements “so long as the amount paid by the mortgage insurer for the reinsurance does not exceed the reasonable market value of reinsurance.”¹ The ruling also established that CFPB administrative proceedings are subject to the statutes of limitations in the underlying statutes enforced by the CFPB, including RESPA’s three-year statute of limitations. Perhaps even more significantly, the Court sharply rebuked the Bureau for “violat[ing] bedrock principles of due process”² in departing from prior RESPA guidance issued by the U.S. Department of Housing and Urban Development (“HUD”) and retroactively applying its new interpretation of RESPA against PHH Corporation and its subsidiaries (hereinafter, “PHH”). The decision provides considerable ammunition for industry participants concerned about the CFPB’s propensity to “regulate through enforcement.”

¹ *PHH Corp. v. Cons. Fin. Protection Bureau*, No. 15-cv-01177, 2016 WL 5898801, *5 (D.C. Cir. Oct. 11, 2016).

² *Id.*

BACKGROUND

On January 29, 2014, the CFPB initiated an administrative enforcement action against PHH for alleged violations of RESPA. Specifically, the CFPB alleged that mortgage lender PHH referred borrowers to mortgage insurers and that in exchange for this referral, those insurers purchased reinsurance from PHH affiliates in violation of Section 8 of RESPA, which prohibits the receipt of kickbacks in exchange for referrals. PHH contested the CFPB's allegations, contending that Section 8(c)(2) of RESPA establishes a safe harbor for bona fide payments for services actually performed, relying in part on past HUD interpretations.

In November 2014, administrative law judge Cameron Elliot of the U.S. Securities and Exchange Commission (the "ALJ"), working through an interagency agreement, issued a recommended decision finding that the reinsurance payments violated Section 8 of RESPA because PHH failed to establish that the compensation did not exceed the value of the reinsurance services provided. The ALJ further held that RESPA's statute of limitations did not apply to the CFPB's administrative enforcement actions, and recommended the disgorgement of \$6,442,399 in payments. (Enforcement staff had sought more than \$400 million in disgorgement and civil penalties.) Pursuant to CFPB rules, PHH and CFPB Enforcement each appealed the ALJ's recommended decision to CFPB Director Richard Cordray, who heard argument in early 2015.

In his June 4, 2015 decision, the Director affirmed the ALJ's findings that the reinsurance payments violated RESPA, but went further, finding that captive reinsurance arrangements violate RESPA regardless of whether the price that is paid is inflated or is set at the fair market value of the reinsurance received. In so doing, the Director rejected previous guidance from HUD long relied upon by the industry, which stated that captive reinsurance arrangements are permissible under RESPA so long as the Section 8(c)(2) exception for payments in return for goods or facilities actually furnished or for services actually performed is satisfied. The Director increased the disgorgement amount to \$109 million and ordered additional injunctive relief, including enjoining PHH from referring borrowers to any provider of settlement services if that provider has agreed to purchase any service from PHH, or make any payment to PHH, if the purchase or payment is triggered by the referral.

PHH petitioned the D.C. Circuit for review, challenging the CFPB's constitutionality and arguing, among other things, that the CFPB erred in its interpretation of RESPA, retroactively applied an interpretation of RESPA in

violation of due process, and erred in finding that its administration actions are not subject to any statute of limitations.

THE DC CIRCUIT'S OPINION

Noting that the structure of the CFPB departs from historical practice regarding the structure of independent agencies, the Court, with Judge Henderson dissenting on the basis that the matter could be resolved without reaching the constitutional issue, found that the CFPB's structure violated the separation of powers principles embodied in Article II of the U.S. Constitution. The Court focused on the fact that unlike members of other independent agencies that can be removed only "for cause," the Director enjoyed significantly more *unilateral* power, making him "the single most powerful official in the entire United States Government," other than perhaps the President.³ The Court further observed that this structure of concentrating power in a single Director did not appear to be "an especially considered legislative decision," given that there are no committee reports, nor other significant legislative history suggesting that Congress found particular benefit in single-Director independent agencies versus multi-member independent agencies.⁴

Despite its agreement with PHH that the CFPB's structure is unconstitutional, the D.C. Circuit declined to follow PHH's argument that the CFPB must be shut down pending a legislative solution. Instead, following the Supreme Court's path in *Free Enterprise Fund v. Public Company Accountability Oversight Board*, 561 U.S. 477 (2010), the Court concluded the remedy for the constitutional violation was to strike the for-cause restrictions on the removal of the Director, making the Director removable at the will of the President and making the Bureau an executive branch agency under the direct supervision of the President, akin to the Department of Justice and the Department of the Treasury.⁵ The D.C. Circuit observed that this remedy would not "affect the ongoing operations of the CFPB,"⁶ and would not "halt the CFPB's ongoing operations or the CFPB's ability to uphold the \$109 million order against PHH."⁷ Consequently, the Court also addressed PHH's statutory arguments.

³ *Id.* at *11.

⁴ *Id.* at *25.

⁵ *Id.* at *4.

⁶ *Id.*

⁷ *Id.* at *29.

With respect to the disgorgement order, there was unanimity among the panel that the CFPB misinterpreted section 8 of RESPA. Reviewing the plain language of the statute, the Court found that Section 8(c) permits captive reinsurance arrangements where mortgage insurers pay no more than reasonable market value for the reinsurance. The Court further found that even assuming that the Bureau's interpretation was correct, by "discard[ing] HUD's longstanding interpretation" and retroactively applying its own "newly minted interpretation," the CFPB violated PHH's due process rights.⁸

Finally, the Court rejected the CFPB's contention that no statute of limitations applied to its administrative enforcement actions. The Court found that the Dodd-Frank Wall Street Reform and Consumer Protection Act incorporates the limitations periods in the underlying statutes, and under RESPA, "a three-year statute of limitations applies to all CFPB enforcement actions to enforce Section 8, whether brought in court or administratively."⁹ The D.C. Circuit remanded the case for further proceedings, including determining whether, within the applicable three-year statute of limitations, the relevant mortgage insurers paid more than reasonable market value to the PHH-affiliated reinsurer.¹⁰

IMPLICATIONS

The decision is unlikely to be the final word on the constitutionality of the Bureau. En banc review is possible and even if the DC Circuit were to decline to rehear the matter or adopt the opinion of the panel, it is likely that the CFPB will petition for a writ of certiorari to the Supreme Court.

Given the potential for further review, the decision is unlikely to affect day-to-day operations at the Bureau. However, the decision stands as a stunning rebuke of the agency for its positions relative to principles of statutory interpretation and past agency guidance. The decision has already raised questions about whether banks and other firms cited by the agency can contest previous enforcement actions by the CFPB.¹¹ Although it seems unlikely that in the case of a negotiated resolution such challenge would be successful, as a court would likely find a respondent to have waived such challenge, the decision could

⁸ *Id.* at *7.

⁹ *Id.* at *5.

¹⁰ *Id.* at *32.

¹¹ Katy Berry, *Will CFPB Ruling Spur Banks to Reopen Old Enforcement Actions?*, AMERICAN BANKER (Oct. 12, 2016).

embolden financial firms to challenge CFPB enforcement actions going forward. Particularly where firms can point to previous agency guidance to support their positions or suggest that the CFPB is applying novel interpretations of regulations against parties on a retroactive basis, the opinion paves the way for increased judicial scrutiny of CFPB enforcement activity.

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Please do not hesitate to contact us with any questions.