

Alert | Financial Regulatory & Compliance/Financial Services Litigation



February 2018

D.C. Circuit Court of Appeals Rules that CFPB Structure is Constitutional, but Rejects the CFPB's Interpretations of RESPA

On Jan. 31, 2018, the U.S. Court of Appeals for the District of Columbia Circuit issued its long-awaited ruling in the *PHH v. Consumer Financial Protection Bureau* case, finding that the structure of the Consumer Financial Protection Bureau (CFPB) is constitutional, but reinstating the previous panel decision rejecting the CFPB's interpretations of the Real Estate Settlement Procedures Act (RESPA) and the relevant statute of limitations. While PHH may appeal the constitutional ruling to the Supreme Court, and other cases involving the CFPB continue to raise the separation of powers and other structural constitutional issues, this decision is significant in that (a) a three-judge panel of the same circuit court had previously ruled that the CFPB's structure was constitutionally infirm, and (b) the court has now reinstated the prior ruling rejecting the CFPB's interpretation of RESPA Section 8(c)(2) and the applicable statute of limitation.

Background

As we have [written about previously](#), this case stems from a 2014 administrative proceeding before the CFPB, in which the bureau alleged that PHH, a mortgage originator, created a kick-back scheme which violated RESPA. The questioned business arrangement related to the alleged practice by PHH of referring mortgage insurance business to mortgage insurers in exchange for such insurers entering into reinsurance contracts with PHH's wholly-owned reinsurance subsidiary.

The initial proceedings were held in 2014 before an Administrative Law Judge (ALJ) on loan from the SEC. In that proceeding, PHH argued that the reinsurance premiums it received were lawful under RESPA Section 8(c)(2), which provides that RESPA should not be interpreted to forbid compensation for “services actually performed.”¹ PHH further argued that this position had been long accepted by the Department of Housing and Urban Development (HUD) which had responsibility for the interpretation of RESPA prior to the creation of the CFPB. The ALJ rejected this defense, and ruled that the premiums PHH received were in excess of the fair market value of the services provided, and as such were not “services actually performed” under 8(c)(2). The ALJ imposed a \$6.4 million penalty on PHH.

PHH appealed this ruling to the director of the CFPB, at that time Richard Cordray. The director, however, not only rejected PHH’s arguments, he imposed a significantly more limited interpretation of Section 8(c)(2), ruling that any payment tied in any way to the referral of business could not be “bona fide” and therefore severely limited the application of the safe harbor afforded by that section. The director’s ruling held that all of PHH’s reinsurance payments were tied to referrals, and therefore violated RESPA. Importantly, he also rejected the ALJ’s ruling on the applicable statute of limitations,² holding that PHH has violated RESPA every time it collected a premium since July 2008 – this resulted in the CFPB ordering a disgorgement of \$109 million in past payments.

PHH petitioned for appellate review and on Oct. 11, 2016, a three-judge panel of the United States Circuit Court of Appeals for the District of Columbia Circuit declared the CFPB’s single-director structure was unconstitutional and vacated the \$109 disgorgement order.³ In doing so, the panel found that the CFPB’s structure allowed the director to wield too much power, unchecked by any other part of the government, and in violation of the separation of powers. The panel further rejected the director’s ruling on substantive RESPA grounds, finding that (a) CFPB’s interpretation of RESPA violated PHH’s due process rights by reversing long-standing guidance from HUD regarding captive reinsurance arrangements, (b) the CFPB’s interpretation of Section 8(c)(2) was overly narrow, and (c) the director’s interpretation of the Statute of Limitations was incorrect, and should be confined to the three-year period that had traditionally been applied to RESPA.

The CFPB sought *en banc* review of this order, and on Feb. 16, 2017, the Court of Appeals granted that request and vacated the panel decision.⁴ Oral argument was held on May 24, 2017, and the financial services industry has been anxiously awaiting a ruling.

The D.C. Circuit’s Jan. 31, 2018, Ruling

A) Constitutional Analysis

Circuit Judge Cornelia Pillard authored the 68-page opinion of the Court.⁵ The Court’s ruling ultimately rejected the constitutional concerns raised by PHH, and held that “Congress’ decision to establish an

¹ 12. U.S.C. § 2607 (c)(2)

² The ALJ had previously limited the CFPB’s jurisdiction to loans that had closed within a three-year period after the CFPB was created.

³ *PHH Corp. v. Consumer Fin. Prot. Bureau*, 839 F.3d 1, 55 (D.C. Cir. 2016), *reh’g en banc granted, order vacated* (Feb. 16, 2017), *on reh’g en banc*, No. 15-1177, 2018 WL 627055 (D.C. Cir. Jan. 31, 2018) (“PHH 1”), available at: [https://www.cadc.uscourts.gov/internet/opinions.nsf/AAC6BFFC4C42614C852580490053C38B/\\$file/15-1177-1640101.pdf](https://www.cadc.uscourts.gov/internet/opinions.nsf/AAC6BFFC4C42614C852580490053C38B/$file/15-1177-1640101.pdf)

⁴ <https://www.gtlaw-financialservicesobserver.com/2017/02/u-s-court-of-appeals-for-d-c-circuit-vacates-panel-decision-in-phh-v-cfpb-grants-rehearing-en-banc/>

⁵ *PHH Corp. v. Consumer Fin. Prot. Bureau*, ___ F.3d ___, 2018 WL 627055 (D.C. Cir. Jan. 31, 2018) (“PHH 2”), available at: [https://www.cadc.uscourts.gov/internet/opinions.nsf/B7623651686D60D585258226005405AC/\\$file/15-1177.pdf](https://www.cadc.uscourts.gov/internet/opinions.nsf/B7623651686D60D585258226005405AC/$file/15-1177.pdf)

agency led by a Director removable only for cause is a valid exercise of its Article I legislative power.” The Court’s analysis largely focused on whether the additional characteristics of the CFPB (a single director with a five-year term, exemption from the congressional appropriations process, and broad scope of authority) added up to congressional impingement on the president’s authority to “take Care that the Laws be faithfully executed” under Article II of the U.S. Constitution.⁶ Ultimately, it concluded that the CFPB’s structure may be different than other federal agencies, but that those differences did not rise to a level that created a separation of powers issue.

The Court’s ruling relied heavily on the ruling of *Humphrey’s Executor*,⁷ and *Free Enterprise Fund*,⁸ both of which upheld for-cause removal clauses for FTC and SEC Commissioners, respectively, and *Morrison*,⁹ which upheld such a clause in connection with the Office of Independent Counsel. It further distinguished the part of *Free Enterprise Fund* that struck down the “dual layer” protections for officers of the PCAOB, on the basis that this was a much more onerous removal provision than that applicable to the CFPB Director, and which interfered with the ability for the president to remove the relevant officers even in cases of neglect of his or her duties. The ability to remove the director “for cause” was held to still grant the president sufficient authority to exercise his or her Article II powers sufficient to overcome the constitutional challenge.

Moreover, the Court found that the CFPB’s budgetary independence did not mandate a different result, citing to other examples in the federal administrative state such as the Federal Reserve, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency, which have similar exemptions from the congressional appropriations process. In doing so, it rejected the argument that the *combination* of for-cause removal and budgetary independence was fatal to the constitutionality of the CFPB, indicating that it found neither issue troubling from a constitutional perspective. Similarly, the Court found the single-director structure did not meaningfully affect the analysis, highlighting that other agencies have a single director and that such an issue has never been addressed as part of the cases on the removal power. “Congress’s choice,” the court held, “– whether an agency should be led by an individual or a group – is not constitutionally scripted.”

Notably, the Court appears to have focused on the ways in which the president *can* control the CFPB. First, it highlighted that for-cause removal does not stop the President from removing the Director for “inefficiency, neglect of duty, or malfeasance in office,” and that Congress has no role in approving or denying any such removal.¹⁰ The Court highlighted that this authority is “very broad.”¹¹ Moreover, the Court highlighted that the Financial Stability Oversight Council, a super-majority of whose members are directly appointed by the president, by a two-thirds vote of its members, can stay or veto any CFPB regulation that threatens the safety and soundness of the national economy.

⁶ U.S. Const. art. II, § 3.

⁷ *Humphrey’s Executor v. United States*, 296 U.S. 602 (1935).

⁸ *Free Enterprise Fund v. Public Company Accounting Oversight Board*, 561 U.S. 477 (2010).

⁹ *Morrison v. Olson*, 487 U.S. 654 (1988).

¹⁰ PHH 2 at *9 (recognizing that Congress may not “disturb the constitutional balance by arrogating to itself a role in removing the relevant executive officials.”)

¹¹ PHH 2 at *19. Indeed, Judge Wilkins’s concurring opinion spent an unusual amount of time mapping out what might constitute “cause” for removal, including “failure to abide by the stringent statutory requirements of consultation or coordination,” “promulgation of a rule contrary to consensus expert advice without sufficient ground or explanation,” along with “incompetence or deficient performance.” PHH 2 at *36 (Wilkins, J., concurring). Judge Griffith’s concurring opinion went a step further, and held that “inefficiency” includes “ineffective policy choices.” PHH 2 at *39 (Griffith, J., concurring)

The Court further rejected all other theories as to the CFPB's unconstitutionality, holding that its powers, while broad, "are not out of the ordinary for a financial regulator." Essentially the Court ruled that the CFPB's powers are very much analogous to those of the FTC, and since the single-director structure was not viewed as being of constitutional import ("there is no appreciable difference between the historical pedigree of single-member and multi-member independent agencies"), there was no issue raised by the scope of the director's power.

B) The CFPB's Interpretation of RESPA

Although it did not give much discussion to this point in the opinion, the *en banc* decision reinstated the previous unanimous decision by the three-judge panel of the Court that the CFPB's interpretation of RESPA and the applicable statute of limitation was incorrect. "The panel opinion, insofar as it related to the interpretation of RESPA and its application to PHH and Atrium in this case, is accordingly reinstated as the decision of the three-judge panel on those questions."

As we discussed in a [prior alert](#), the panel decision focused on statutory interpretation and due process considerations, and rejected the CFPB's interpretation of the law, holding that RESPA Section 8(c)(2) specifically carves out reasonable compensation for services actually performed. The result is that the matter is now remanded to the CFPB's administrative process to determine whether the relevant mortgage insurers paid more than reasonable market value to the captive reinsurer.¹² Moreover, the CFPB will be bound by a three-year statute of limitations, rather than the limitless time period that the Bureau sought against PHH.¹³

What Happens Next?

Given the changes in CFPB leadership, PHH may elect not to appeal this decision and instead proceed through the administrative process. The original recommended decision by the ALJ had placed the burden of proof on PHH.¹⁴ The panel's ruling made clear that the burden of proof would be on the CFPB to show that PHH violated RESPA by charging more for reinsurance premiums than was reasonable at the time.¹⁵ With the Court agreeing with the panel, PHH may be more optimistic of their chances of success at the administrative level. The CFPB could also abandon the enforcement proceeding as inconsistent with their current interpretation of RESPA, or settle with PHH on more favorable terms. An appeal to the Supreme Court is not a certainty.

However, other cases involving CFPB enforcement proceedings have raised similar constitutional arguments relating to separation of powers, the removal power of the President, and encroachment on the President's ability to "take care" that the laws be faithfully executed. This issue may yet reach the Supreme Court for a final determination.

Key Takeaways

The decision of the D.C. Circuit is not binding on other federal district courts other than the United States District Court for the District of Columbia, so defendants are free to continue to pursue claims regarding the unconstitutionality of the CFPB in other district and circuit courts. Ultimately, it is unclear if the

¹² PHH 1 at 44

¹³ PHH 1 at 55.

¹⁴ PHH 2 at 5

¹⁵ PHH 1 at n. 27 ("It is the CFPB's burden to prove that the payments for reinsurance were more than reasonable market value and were disguised payments for referrals.")

Supreme Court will rule on this issue in the near term, changes in both CFPB leadership and potential legislative changes may diminish the appetite for parties to press this issue.

The interpretation of RESPA is extremely important for the real estate finance industry, however. The PHH decision reinstates the long-held interpretation of RESPA that section 8(c)(2) protects reasonable payments for goods and services actually provided, even in the context of a referral. This interpretation may be consistent with the CFPB's views under new leadership, but any new interpretation by a future administration would likely have to take the form of new rule-making or official guidance before any enforcement action would be accepted by the courts.

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