GT GreenbergTraurig

Financial Services Litigation | Client Advisory

April 2016

CFPB Scrutinized During Oral Argument Before the D.C. Circuit in *PHH Corp. v. Consumer Financial Protection Bureau*

In a closely watched case testing the limits of the Dodd-Frank Act's creation of the Consumer Financial Protection Bureau (CFPB), the U. S. Court of Appeals for the District of Columbia Circuit heard oral arguments in *PHH Corp. v. Consumer Financial Protection Bureau* on April 12, 2016. The case involves PHH Corp.'s appeal of the CFPB's imposition of a $109 million penalty for RESPA violations. Among other arguments, PHH challenged the constitutionality of the CFPB, particularly the amount of authority vested in a single director. Echoing many of PHH's concerns, members of the Panel openly expressed doubts about the constitutionality of the CFPB's structure, which, as one judge observed, concentrates "huge power" in its top official, which he characterized as "very problematic." The Panel appears poised to vacate the PHH Order and potentially require structural changes to the CFPB.

The case stems from a 2014 administrative proceeding in which the CFPB alleged that PHH created an illegal kickback scheme by referring mortgage insurance business to mortgage insurers in exchange for their entering into reinsurance contracts with PHH's wholly-owned subsidiary, Atrium Insurance Corporation. This arrangement was alleged to generate substantial premium revenue for PHH in violation of Section 8(a) and 8(b) of the Real Estate Procedures Act (RESPA). PHH countered that the premiums were lawful because Atrium, the reinsurer, provided actual services in exchange for the reinsurance payments, thereby qualifying for the exemption under RESPA Section 8(c)(2).

PHH argued that these type of "affiliated" or "captive" reinsurance arrangements, whereby mortgage reinsurers only provided reinsurance for loans originated by their related lender, had existed since 1993 and had become an "integral component of the mortgage insurance industry" by 2007. PHH maintained that its practices conformed to a 1997 interpretative letter issued by the U.S. Department of Housing and Urban Development (HUD), which enforced RESPA prior to the CFPB. The HUD letter ruling stated that captive reinsurance payments were acceptable and met the requirements for exemption under Section 8(c)(2) so long as the payments to the reinsurer were (1) for reinsurance services “actually furnished or for services performed” and (2) *bona fide* compensation that does not exceed the value of such services.

Following a trial, an administrative law judge (ALJ) found that the captive reinsurance arrangement exhibited the hallmarks of a classic kickback scheme, observing that when a mortgage insurer entered into a reinsurance contract with Atrium, it generally began to receive substantial mortgage insurance business from PHH, but on the occasions when those reinsurance contracts were terminated, referrals from PHH dropped off quickly. The ALJ agreed with PHH, however, that Section 8(a) would provide a defense if the reinsurance involved a true transfer of risk and the premiums were commensurate with the value of the reinsurance provided. Ultimately, the ALJ concluded that there was limited actual risk transfer and the premiums PHH received exceeded the fair market value of the reinsurance services performed.

In order to calculate a penalty amount, the ALJ considered the applicable statute of limitations. RESPA carries a three-year statute of limitations. Dodd-Frank also establishes a three-year statute of limitations for the CFPB, but within the section addressing the CFPB’s litigation authority, which states that the Bureau may “commence a civil action … no [] more than three years after the date of discovery of the violation to which an action relates.” 12 U.S.C. § 5564(g)(1). PHH argued that most of the loans and payments at issue fell outside a three-year limitations period because it had closed its mortgage reinsurance business in 2009. The ALJ disagreed that a three-year limitations period applied to the proceeding. Both the RESPA and Dodd-Frank limitations provisions relate to “actions,” which the ALJ interpreted to mean a judicial action. The CFPB had brought an administrative proceeding against PHH—not an “action.” Neither RESPA nor Dodd-Frank identified a specific statute of limitations for administrative proceedings. The ALJ reasoned, however, that the transfer of RESPA enforcement authority from HUD to the CFPB on July 21, 2011, should not have the effect of reviving time-barred claims. Accordingly, the ALJ concluded that the CFPB could challenge only violations that accrued within the three-year period before the CFPB was created. Relying on a Fifth Circuit decision, he defined the accrual date for RESPA claims as the date on which a loan allegedly tainted by an unlawful kickback closes. Applying these parameters, the ALJ ordered PHH to disgorge $6.44 million in unlawful premiums. Both the CFPB and PHH appealed to the Director of the CFPB, Richard Cordray.

In a 38-page decision and final order, Cordray upheld PHH’s liability, but reversed the ALJ on a number of issues. First, he adopted a new interpretation of Section 8(c). To be lawful, he explained, payments for services must not only correspond to fair market value, but they must be “bona fide,” which he defined as not being tied in any way to a referral of business. Applying this standard, Cordray concluded that all of PHH’s reinsurance payments had been tied to business referrals and therefore violated RESPA. Next, Cordray agreed with the ALJ’s determination that the Bureau could not revive time-barred claims that HUD itself could not have brought before the CFPB took over enforcement of RESPA. However, he rejected the ALJ’s finding that RESPA violations accrue at the time of closing. Cordray held that PHH committed a separate violation of RESPA each time it accepted a reinsurance payment on or after July 21, 2008, even if the mortgage at issue closed before July 21, 2008. The result of Cordray’s analysis was to increase PHH’s penalty from $6.44 million to $109 million.

PHH petitioned for review before the Court of Appeals for the D.C. Circuit. PHH argued that: (1) the CFPB erred in rejecting HUD’s long-standing interpretation of RESPA; (2) the CFPB erred in concluding that RESPA’s statute of limitations does not apply in administrative adjudications; and (3) the structure of the CFPB is unconstitutional. During the week prior to oral argument, the D.C. Circuit directed the parties to be prepared to address the constitutional questions of whether authority exists for an independent agency to be headed by a single individual, and whether Title D-F of the Consumer Financial Protection Act, which creates the CFPB and permits removal of its head for cause only, interferes with the president’s Article II powers to ensure that the “laws be faithfully executed,” thereby setting up a separation of powers showdown. The Court heard oral arguments April 12. These are highlights from the argument.

<u>The CFPB’s Interpretation of RESPA</u>

PHH argued that it had been deprived of due process by the CFPB’s decision to jettison decades of HUD guidance permitting the very practice the CFPB challenged and replace it –in an enforcement proceeding--with a retroactive application of a new legal standard. PHH argued that it was entitled to know in advance what conduct is permitted or prohibited by law and that the CFPB violated basic principles of due process through its “180 [degree]” reversal on the meaning of Section 8(c)(2).

The Panel appeared to share PHH's concerns. Judge Kavanagh questioned the fairness of the CFPB's decision to disregard HUD's Interpretive Letter and other prior administrative and judicial interpretations in an enforcement proceeding, noting that the entire industry had relied upon HUD's interpretation. The CFPB conceded that PHH's reinsurance structure was a "widespread practice," and acknowledged that it could not point to any prior official interpretation stating PHH's practice was unlawful. Nevertheless, the CFPB argued that the HUD letter was "not an authoritative interpretation that justified broad reliance." Kavanaugh disagreed, noting that even informal government action can raise due process problems under governing case law. He commented that the CFPB's decision to "pull the plug" was "very problematic."

Statute of Limitations

The Panel was troubled by the CFPB's position that it was not bound to any particular limitations period for administrative proceedings, observing that under this theory, the CFPB could impose liability for decades-old conduct. The CFPB defended its approach based on the lack of any specific limitations period in Dodd-Frank as to administrative proceedings and expressed concern that a defined period could hamstring its ability redress unlawful consumer practices. Judge Randolph asked why the standard reasons for subjecting claims to limitations periods -- *e.g.,* difficulty of obtaining evidence, loss of memory, etc. – did not apply here. The CFPB conceded that those reasons applied equally in this case and it knew of no legislative history justifying the omission of a statute of limitations for administrative proceedings.

Constitutionality of the CFPB

PHH argued that the award should be vacated because it was issued by an unconstitutional agency headed by a Director who is neither part of, nor subject to review by, any branch of government. PHH explained that unlike most executive agencies, it is run by a single director rather than as a multimember commission, such as the Securities and Exchange Commission and Federal Trade Commission. The CFPB director is appointed for a term of years and can be removed only by the president and only for cause. Because the CFPB's funding comes from the Federal Reserve, the agency escapes budgetary oversight through the Congressional appropriations process. Further, the CFPB is exempt from the ordinary administrative agency rulemaking process and is free to promulgate its own rules without congressional or public involvement. These characteristics, PHH maintained, make the CFPB an unconstitutional agency.

Echoing these concerns, Judge Kavanaugh asked pointed questions about the constitutionality of the CFPB's structure, particularly its single-director. He observed that it was "very problematic" that such a powerful official was able to make a decision that aimed to overturn a practice long seen by companies as acceptable." The CFPB, has a "very unusual structure" that has "few precedents." "You are concentrating huge power in a single person and the president has no power over it," Judge Kavanaugh said. That is "very problematic."

* * * * *

The Court appears poised to vacate the CFPB's determinations concerning the statute of limitations and its interpretation of RESPA. The Court may also address the constitutionality of the CFPB, either in whole or in part. For example, the Court could rule that the "for cause" limitation on the Director's removal is unconstitutional, particularly given the breadth of his authority and discretion. The Court could excise that language from Dodd-Frank. The Court potentially could hold that the CFPB itself is unconstitutional and invalidate all actions taken by the CFPB to date. To the extent the Court orders broad structural relief, it is almost certain that the CFPB would seek *en banc* review and potentially Supreme Court review.

An audio recording of the oral argument in *PHH Corp. v. Consumer Financial Protection Bureau* is available here.

This *GT Client Advisory* was prepared by **Jennifer L. Gray**, **Murray B. Silverstein**, and **Gil Rudolph.** Questions about this information can be directed to:

> Jennifer L. Gray | +1 310.586.7730 | grayjen@gtlaw.com | Los Angeles
> Murray B. Silverstein | +1 813.318.5741 | silversteinmb@gtlaw.com | Tampa
> Gil Rudolph | +1 202.530.8575 | rudolphg@gtlaw.com | Washington, D.C. and Phoenix
> Any attorney in Greenberg Traurig's Financial Services Litigation Group

Albany
+1 518.689.1400

Amsterdam
+ 31 20 301 7300

Atlanta
+1 678.553.2100

Austin
+1 512.320.7200

Berlin¬
+49 (0) 30 700 171 100

Berlin-GT Restructuring¯
+49 (0) 30 700 171 100

Boca Raton
+1 561.955.7600

Boston
+1 617.310.6000

Chicago
+1 312.456.8400

Dallas
+1 214.665.3600

Delaware
+1 302.661.7000

Denver
+1 303.572.6500

Fort Lauderdale
+1 954.765.0500

Houston
+1 713.374.3500

Las Vegas
+1 702.792.3773

London*
+44 (0)203 349 8700

Los Angeles
+1 310.586.7700

Mexico City+
+52 55 5029.0000

Miami
+1 305.579.0500

New Jersey
+1 973.360.7900

New York
+1 212.801.9200

Northern Virginia
+1 703.749.1300

Orange County
+1 949.732.6500

Orlando
+1 407.420.1000

Philadelphia
+1 215.988.7800

Phoenix
+1 602.445.8000

Sacramento
+1 916.442.1111

San Francisco
+1 415.655.1300

Seoul∞
+1 82-2-369-1000

Shanghai
+86 21 6391 6633

Silicon Valley
+1 650.328.8500

Tallahassee
+1 850.222.6891

Tampa
+1 813.318.5700

Tel Aviv^
+03.636.6000

Tokyo¤
+81 (0)3 4510 2200

Warsaw~
+48 22 690 6100

Washington, D.C.
+1 202.331.3100

Westchester County
+1 914.286.2900

West Palm Beach
+1 561.650.7900