

PHH v. CFPB, Part I: President of Consumer Finance No More

CFPB's Single-Director Structure Found to Be Unconstitutional

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In response to a challenge from mortgage servicer PHH Corp. regarding the constitutionality of the single director structure of the Consumer Financial Protection Bureau (the CFPB or Bureau), the United States Court of Appeals, District of Columbia Circuit (the DC Circuit) found that independent agencies, such as the CFPB, must be led by multi-member commissions in order to be constitutional.¹ To cure this unconstitutional structure, the DC Circuit used the Dodd-Frank Act's severability clause and effectively deleted the provision that the President may remove the CFPB director only for "inefficiency, neglect of duty or malfeasance of office." The practical effect of removing this "removal for cause" clause is that the CFPB is now an executive agency which may have a single director (akin to the Department of Commerce or Environmental Protection Agency), and Director Cordray must follow the direction of the President of the United States.

This alert, the first of a two part series, explains the DC Circuit's constitutional analysis and the implications for the CFPB going forward, particularly with respect to a new incoming President of the United States.

Our second installment, *PHH v. CFPB, Part II: CFPB RESPA Duplicate Fail* will discuss the DC Circuit's finding that the CFPB not only misinterpreted the Real Estate Settlement Procedures Act, but also violated "bedrock due process principles" in applying that misinterpretation retroactively. Part II will address the state of RESPA interpretation today, and it will also suggest how this example of the CFPB's due process violation may help companies navigate CFPB enforcement actions in the future.

¹ See *PHH Corporation, et al., vs. Consumer Financial Protection Bureau*, No. 15-1177 (DC Cir. Oct 11, 2016)

The Trouble with *Humphrey*

To appreciate the full reach of the DC Circuit's recent decision, a little history about the CFPB and the legality of independent regulatory agencies is helpful.

The CFPB, born out of the recent Great Recession, was created to assume primary authority for administering an alphabet soup of federal consumer financial protection laws that had previously been administered by an alphabet soup group of federal agencies. The Dodd-Frank Act, the CFPB's originating statute, gives the CFPB novel powers, such as the authority to regulate "abusive" conduct (a term essentially left open for the CFPB to define through enforcement actions).

Even with the Bureau's extensive authority, the authors of Dodd-Frank were concerned that the nascent federal consumer watchdog could be subject to the political whims of Congress or an unfriendly administration. As such, Congress decided to shield the CFPB from the annual Congressional appropriations process (instead, the Bureau's budget is disbursed by the Federal Reserve). Congress also shielded the CFPB by making it into an independent agency (like the Federal Trade Commission), rather than an executive agency (like the Department of Commerce). The heads of independent agencies can be removed only for cause, rather than serving at the pleasure of the President.

Independent agencies are not a new concept – indeed, they trace their roots back to the turn of the last century. As the United States economy matured beyond its agrarian roots, Congress created "quasi-legislative" and "quasi-judicial" agencies to bring market oversight to an increasingly complex economy. At times, this development created consternation in the Executive Branch, as demonstrated by the famous Supreme Court case, *Humphrey's Executor v. United States*.²

At the heart of the case was a dispute between President Franklin D. Roosevelt, and the pro-business Federal Trade Commission (FTC) Commissioner, William Humphrey, who rejected FDR's progressive New Deal policies. (Humphrey had been appointed by FDR's Republican predecessor, Herbert Hoover). Although FDR requested that Humphrey resign, and ultimately tried to fire him, Humphrey continued coming into work, and the high-stakes employment dispute ultimately made its way to the Supreme Court.

The Court observed that the Federal Trade Commission Act permitted the President to dismiss an FTC commissioner only for "inefficiency, neglect of duty, or malfeasance in office." The Court held that FDR's dismissal of Humphrey was based upon political differences, rather than the for-cause justification that the FTC's authorizing statute demanded.

Humphrey's Executor has since become the seminal Supreme Court case establishing the constitutionality of independent regulatory agencies. The Court drew a line between executive officers, on the one hand, and quasi-legislative or quasi-judicial officers, on the other. The former, such as the Secretary of State, serves at the pleasure of the president. The latter, such as an FTC Commissioner, can only be removed for cause. The Court reasoned that the Constitution does not give "illimitable power of removal" to the President in the context of quasi-legislative or quasi-judicial contexts because Congress, in creating such agencies, requires them to act independently of executive control.

More recent Supreme Court decisions have been in tension with *Humphrey's Executor*, such as *Free Enterprise Fund v. Public Company Accounting Oversight Board*,³ holding that the President's inability to remove members of the Public Company Accounting Oversight Board (PCAOB) was *unconstitutional*,

² 295 U.S. 602 (1935)

³ 561 U.S. 477 (2010)

even though the Securities Exchange Commission, which supervises the PCAOB, could remove PCAOB board members for cause. Even with these tensions, the legality of independent regulatory agencies is generally well established and well beyond the reach of the DC Circuit's consideration.

The Trouble with the CFPB

The "typical" independent agency, such as the FTC, has a bipartisan, multi-commissioner structure. Although the commissioners are only subject to for-cause removal by the President, the presence of multiple decision makers from both major political parties is thought to serve as an inherent check on an independent agency's authority.

The CFPB, however, is unlike any other independent agency. The Bureau has a single director with no direct checks, either from opposing commissioners or the President. Simply put, there is no convincing historical precedent or practice for an independent agency to have a single director.

As the DC Circuit observes,

The CFPB has the power to impose a wide range of legal and equitable relief, including restitution, disgorgement, money damages, injunctions, and civil monetary penalties... And all of this massive power is lodged in one person—the Director—who is not supervised, directed or checked by the President or by other directors.

Although many of the Bureau's critics have also argued for a change in the Bureau's funding (recall that the Bureau's funding is directly disbursed by the Federal Reserve, rather than through Congressional appropriations), the DC Circuit did not find that aspect unconstitutional, in and of itself. Instead, the court considered this fact mere "extra icing on an unconstitutional cake already frosted," noting that Congress could still change the CFPB's funding structure in the future.

Trouble-Free Resolution

PHH advocated shutting down the CFPB, or perhaps even repealing the Dodd-Frank Act, if the Bureau's structure were found unconstitutional. The DC Circuit, however, decided to take a different approach.

Citing historical constitutional precedent, the DC Circuit simply severed the unconstitutional provision (specifically, the provision delineating the Director's for-cause employment) from the remainder of the Bureau's authorizing statute. The DC Circuit also looked at Congressional intent regarding the selection of a single director structure, observing that "nothing in the statute's text or historical context makes it evident that Congress, faced with the limitations imposed by the Constitution, would have preferred no CFPB at all (or no Dodd-Frank Act at all) to a CFPB whose Director is removable at will."

The net result: the CFPB continues its activities, although converted to an executive agency with a director working under the direct supervision of the President. As discussed in the next installment of this article, however, the DC Circuit's constitutional due process concerns about the Bureau's retroactive method of levying penalties upon PHH *will* likely have a meaningful impact on the Bureau's enforcement activity.

The DC Circuit's decision is not necessarily the final word on this matter. The decision is certain to be appealed, and may be considered by either a full panel of the DC Circuit (*en banc*) or by the United States Supreme Court.

Post-Election Outlook after PHH

Regardless of how the PHH dispute turns out in the courts, the upcoming Presidential and Congressional elections could have a significant impact on the future of the CFPB either way.

If elected, former Secretary of State Hillary Clinton has pledged to support and strengthen the CFPB, the brainchild of her close ally, Democratic Senator Elizabeth Warren (D-Mass.). Although Secretary Clinton is known to have close ties to the financial services industry that she previously represented as a Senator from New York, Sen. Warren and the populist top Democrat on the Senate Banking, Housing and Urban Affairs Committee, Sen. Sherrod Brown (D-Ohio), have been among Secretary Clinton's most prominent surrogates and are likely to be influential in a Clinton Administration.

The CFPB would have a less certain future under a Trump Presidency. The Republican Party platform calls for the abolition of the CFPB and Trump himself has called for "dismantling" the Dodd-Frank Act, which authorized the creation of the Bureau. If Republicans maintain control of both the House and Senate, this vision could be realized. At the very least, his appointed director would be very different from Mr. Cordray.

No matter who wins the White House, the CFPB is expected to continue to face oversight and reform efforts in Congress. House Financial Services Committee Chairman Jeb Hensarling (R-Texas) and Senate Banking, Housing, and Urban Affairs Committee Chairman Richard Shelby (R-Ala.) are leading the effort in Congress to oppose the current structure of the CFPB. Although numerous CFPB reform bills have been released since the Bureau was established, the reform efforts have gained momentum in recent months with the House Financial Services Committee's consideration of Chairman Hensarling's Financial CHOICE Act. This comprehensive financial regulatory reform bill includes significant proposed changes to the CFPB, replacing the CFPB director with a bipartisan, five-member commission that would be subject to the Congressional appropriations process. The bill would also reconstitute the CFPB as the Consumer Financial Opportunity Commission (CFOC) and reconfigure its mission to ensure both consumer protection and competitive financial markets. The new commission's rules would be subject to a cost-benefit analysis.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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