

PUBLICATION

PHH Mortgage Attacks the CFPB: Will the Bureau Become a Commission?

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On April 12, the U.S. Court of Appeals for the D.C. Circuit heard arguments in PHH Mortgage's appeal of a [\\$109,000,000 disgorgement order by the CFPB](#). The CFPB found PHH had illegally referred consumers to mortgage insurers in exchange for those insurers reinsuring with PHH. On appeal, PHH is challenging how the CFPB reinterpreted Section 8 of the Real Estate Settlement Procedures Act (RESPA). That issue alone would make this a substantial case to the mortgage industry. PHH is additionally calling into question the authority and structure of the CFPB, which means that every entity subject to the CFPB's jurisdiction should be watching. Not surprisingly, it was standing room only in the courtroom.

Last week, ahead of the hearing, the D.C. Circuit court took the rare step of issuing an order asking the parties to be prepared to address the following questions at oral argument:

- 1) What independent agencies now or historically have been headed by a single person? For this purpose, consider an independent agency as an agency whose head is not removable at will but is removable only for cause; and
- 2) If an independent agency headed by a single person violates Article II, what would the appropriate remedy be? Would the appropriate remedy be to sever the tenure and for-cause provisions of this statute? Or is there a more appropriate remedy? And how would the remedy affect the legality of the Director's action in this case?

The D.C. Circuit's questions placed the consumer lending industry on high alert, as the court signaled that it was taking very seriously the argument that the CFPB's very structure is unconstitutional. To fully understand the arguments before the court, it is helpful to understand the structure of the CFPB, as well as the previous treatment and enforcement of RESPA.

Dodd-Frank states that the CFPB is to be led by a director appointed by the President and confirmed by the Senate. The director has a five-year term, and prior to expiration of that term, the President may only remove the director for inefficiency, neglect of duty, or malfeasance in office. Additionally, the bureau's budget is derived from a fixed percentage of the Federal Reserve's operating expenses. These funds only have to be requested by the CFPB's director. Dodd-Frank also places the power of investigation, enforcement, rule promulgation, and staffing with the director with no oversight or accountability.

Before the creation of the CFPB, the administration and enforcement of RESPA was carried out through the Department of Housing and Urban Development (HUD). Section 8(a) of RESPA prohibits the giving and accepting of "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." However, Section 8(c)(2) of RESPA goes on to state that "nothing 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."

HUD had issued various guidance and policy statements on the interpretation of Section 8(c)(2) in which the department arguably sanctioned arrangements similar to those used by PHH. Industry participants had relied

on HUD's pronouncements, with an understanding that if fair market value was received for the goods or services being rendered, there was no RESPA violation.

It is important to note that the fees that PHH was collecting from mortgage insurers were considered to be within the "fair market value" for the service. In effect, the CFPB's issuance of the \$109 million penalty rejects the previous guidance issued by HUD and overlooks Section 8(c)(2) of RESPA completely.

Ted Olson of Gibson Dunn argued on behalf of PHH, noting that due process requires "fair notice of conduct that is forbidden." He argued that Director Cordray's actions were unconstitutional because he ignored decades of regulatory guidance by HUD and effectively rewrote RESPA to exclude Section 8(c)(2), which amounted to depriving PHH of due process.

When asked by the panel to explain the difference between a single-headed independent agency and multi-member commission, Olsen noted separation of powers, concerns and the lack of checks and balances in the CFPB's current structure, including that the President does not have the power to remove the director without cause. When asked whether granting the President the power to remove the director without cause would correct the constitutional questions, Olsen said no. He listed other flaws in the CFPB structure, including its funding and its ability to write its own rules and regulations and hire and fire personnel, all without oversight. Olsen pointed out that the combined impact is a governmental entity with enormous power to impose penalties like the one assessed against PHH with the only check on that authority being review by the courts.

The panel asked Olsen what remedy PHH sought. He replied, "The only remedy is that this agency is unconstitutional and the decisions of this Director in this case have to be overturned and the decision has to be vacated." Olsen further stated, "If I was in your shoes I would be very tempted to write an opinion that Congress cannot create an agency like this that ignores all the rules of separation of powers. The separation of powers is what protects our liberties as individuals in this country...The very definition of tyranny is to concentrate all powers; legislative, judicial, and executive in a single agency. This agency has more power, I submit, than any other agency ever created by Congress."

Lawrence DeMille-Wagman, arguing on behalf of the CFPB, argued that other agencies are structured such that their leadership can only be removed for cause, citing the Federal Trade Commission (FTC) as an example. He was quickly cut off by Judge Kavanaugh, who pointed out that the FTC is structured as a commission. Judge Kavanaugh stated, "Historically independent agencies have been multi-member on the theory that they are non-partisan or bipartisan. This [the structure of the CFPB] is a novel structure with very few precedents." The judge noted that, "you are concentrating in a huge amount of power in a single person that the President has no authority over." In one of the most telling questions, Judge Kavanaugh asked, "I presume your preferred remedy would be to sever the tenure and for-cause provisions of this statute?" DeMille-Wagman agreed and went further by saying the CFPB would then hope the court would remand the case back to the CFPB for reconsideration under a commission that would be removable for cause.

To rebut Olsen's due process argument, DeMille-Wagman argued that PHH had no right to fair notice as the CFPB is entitled to interpret ambiguous statutory provisions in adjudicative proceedings and may apply those interpretations retrospectively. The panel then referenced HUD's guidance and statements and asked how they were ambiguous. The CFPB argued that HUD never explicitly sanctioned the type of agreement entered into by PHH. The judges did not seem to agree, going as far to compare the CFPB's argument to a police officer saying you can cross the street and then giving you a thousand dollar ticket when you get to the other side. After some back and forth, the panel went further, asking, "Why would HUD issue the letter and then say, just kidding?" Given the tone and the line of questioning, the outlook does not look good for the CFPB.

Olsen closed with the following statement: "This is a very broad grant of authority over many different statutes to one individual who doesn't have to pay any attention to the President or the Congress and can do anything he wants, and what we see here is a violation, systematically, of statute after statute after statute to impose a \$109 million dollar penalty out of the blue on this industry and this company that was following the law, that is unconstitutional and it's an unconstitutional agency...He [Director Cordray] cannot hold that office, someone else will have to be appointed to an agency that Congress should come back and create in a constitutional way."

The case could have a dramatic impact on the financial services industry. If the CFPB structure is held to be unconstitutional, what happens with all the rules the bureau promulgated? Untold sums have been spent on industry compliance with the CFPB's rules. Would those rules still apply? What about the enforcement actions that have already been finalized or the monies paid out under various consent orders? Who would be the primary regulator to those currently subject to CFPB oversight?

Had the architects of the CFPB pursued a commission structure, we would not have had to contemplate these questions. A commission could have provided for a more measured approach and balance of power. If this case does not directly result in the restructuring of the CFPB, it will definitely fuel the push for reform currently underway in Congress with bills like [HR 1266](#), which seeks to replace the CFPB with an agency led by a commission.

The court is expected to issue a decision by the end of the summer, but we are far from over. If the court takes issue with the structure of the CFPB, either by finding it unconstitutional or by striking the tenure and for-cause provisions of Dodd-Frank, the CFPB may request en banc review. If granted, the case would be heard before all the judges on the D.C. Circuit. Not all of the court's members are likely to share the panel's skepticism about the CFPB's structure. Whatever the outcome at the D.C. Circuit, a further appeal to the U.S. Supreme Court seems likely.

If you have any questions regarding the issues raised in the PHH matter, concerns with an upcoming CFPB exam or investigation, or CFPB compliance questions, please contact a member of Baker Donelson's Financial Services Litigation Practice Group or our CFPB Task Force at any time.