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EXPERT ANALYSIS

PHH CORP. FINDS TEMPORARY RESPITE IN DC CIRCUIT'S RESPA RULING

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The D.C. Circuit Court of Appeal recently handed down its much-anticipated decision involving the appeal of a Consumer Financial Protection Board administrative enforcement action that resulted in director Richard Cordray imposing a $109 million fine on PHH Corp. (*PHH Corp. v. Consumer Fin. Prot. Bureau*, No. 15-1177, 2016 WL 5898801 (D.C. Cir. 10/11/16).) The action involved supposed violations of the Real Estate Settlement Procedures Act arising out of reinsurance kickbacks from captive reinsurance deals involving private mortgage insurance. Overall, the expansive 110-page majority opinion made six key determinations:

1) The CFPB is unconstitutionally configured with its sole director left unchecked by other directors/commissioners and without the President being able to terminate him as the President can do for other agencies.

2) RESPA is not violated by captive reinsurance arrangements unless it is proven that the amount paid by the mortgage insurer for the reinsurance does not exceed the reasonable market value of reinsurance.

3) RESPA's three-year statute of limitations governs and limits the reach of the bureau even in the context of an administrative enforcement action.

4) The CFPB's advocated interpretations of RESPA are not entitled to *Chevron* deference when the RESPA statute is unambiguous in allowing reinsurance arrangements.

5) The CFPB violated due process when it departed from prior HUD-issued RESPA guidance and retroactively applied its new interpretation to PHH.

6) The bureau can continue to function as is and the courts need not invalidate nor rule on the past actions taken by the bureau.

Despite the majority's criticism of legal positions taken by the CFPB, the after-effects of the decision may be mostly political, given the limited remedy for the constitutional defect in the bureau's structure.

No doubt the decision will be appealed, but the appellate route is unknown for sure at this time. The CFPB has choices to make. The bureau has 45 days from the D.C. Circuit's October 11, 2016 order to file a petition for rehearing, until November 25, 2016, well after the elections. The CFPB has 90 days to seek review by the Supreme Court, at least until January 9th, 2017).

Pundits can argue about what the holding could mean down the road, but uncertainties remain

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unless/until the issues are clarified. The important questions for the industry appear to be:

- What does the DC Circuit's ruling mean for the CFPB and for its RESPA enforcement decisions in the PHH situation and/or for other actions attacking marketing services agreements as kickbacks?
- What are the potential political implications of the ruling?
- Will the bureau be less inclined to utilize aggressive enforcement actions instead of or in advance of detailed rulemaking?
- Will other challenges to the CFPB's constitutionality similarly determine defects in the structure of the bureau?
- Will any previous actions taken by the CFPB be challenged after the consent orders have already been executed?
- Will the bureau be less aggressive in its past practices of sending civil investigation demands (CIDs), which insist on reviewing data outside the applicable statute of limitations?

Only time will tell regarding the issues on appeal, but for now it is business as usual by the CFPB. Many have been saying it all along: the CFPB is unconstitutional. And throughout its five-year existence, the consumer watchdog has endured sustained efforts to muzzle it through lobbying, spending bills, and other legislation.

The most recent attack came in the form of a proposed Republican response to the Dodd-Frank Act, the Financial CHOICE Act of 2016, H.R. 5983. Among other significant rollbacks to Dodd-Frank, the CHOICE Act purports to dismantle the CFPB, which was created by the financial-crisis-era legislation something many hoped would be the result of the D.C. Circuit's *PHH* opinion.

CFPB wields RESPA § 8 as a sword

After waiting a year to initiate its first enforcement action in July 2012, the CFPB hit four mortgage insurance companies — Mortgage Guaranty, Genworth, Radian, and United Guaranty — with enforcement actions between December 2012 and April 2013, alleging that each violated RESPA § 8 by engaging in captive reinsurance arrangements. All four of these PMI insurers did business with PHH.

Specifically, the bureau alleged payments from the insurer to the reinsurer were part of a mortgage kickback scheme, involving kickbacks disguised as payments in exchange for lender referrals. All four companies entered into consent orders with the CPFB on April 4, 2013, paying a combined total of $15 million in civil penalties, and agreeing not to participate in captive arrangements for ten years.

Since July 2012, nearly 35 percent of all reported CFPB mortgage-related enforcement actions have invoked RESPA § 8. Most of these involved the CFPB's interpretation of the statute as prohibiting captive arrangements completely — one of those being the action against PHH. PHH received its notice of charges from the CFPB in January 2014, stemming from its involvement in captive reinsurance arrangements.

The ALJ ruling

The administrative proceedings took up the better part of 2014, and on November 25, Administrative Law Judge Cameron Elliot issued his ruling in the CFPB's favor. However, Judge Elliot determined that the agency's interpretation of § 8 ran counter to HUD's longstanding view that captive arrangements are permissible as long as the insurer pays the reinsurer a reasonable market value for its services and those services are "actually performed."

Specifically, the ALJ cited the 1997 HUD interpretation letter expressly taking this view, which PHH and other industry members relied upon for years. As part of the CFPB's assumption of HUD actions and enforcement, it was expected to "carr[y]

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Even so, ALJ Elliot found that, under his interpretation of § 8, PHH's captive reinsurer affiliate received payments from the insurers that were not for "actual goods or services," because there was no effective transfer of risk between the reinsurer and the insurer. Accordingly, he ordered PHH to disgorge $6.4 million. Both PHH and the CFPB appealed. Thus arose the first appeal of an administrative proceeding in the CFPB's history.

Cordray agreed that PHH violated RESPA, but disagreed with how the ALJ assessed PHH's penalty. Cordray determined that PHH had to disgorge all premiums accepted on or after July 21, 2008, regardless of when the underlying loan closed, given the periodic, as opposed to lump sum, payments of the premiums at issue.

As a result, he upped the disgorgement figure by a multiple of 17 times to a whopping $109 million. Moreover, he concluded that the previous HUD guidance was never captured in a binding rule, and therefore, because the agency was not bound by HUD's interpretation of § 8, it was free to apply its own.

PHH defends itself with due process as a shield

PHH turned to the D.C. Circuit for protection and argued that the CFPB's unchecked powers were unconstitutional and its after-the-fact reinterpretation of RESPA deprived PHH of due process. Siding with PHH, the D.C. Circuit found, in a split decision, that "the CFPB is the first of its kind and a historical anomaly," and concluded that under its present structure, "the director enjoys more unilateral authority than any other officer in any of the three branches of the U.S. Government, other than the President."

Citing examples of other agency structures and distinguishing examples of single-Director heads listed by the CFPB, the court concluded: "The bottom line is that there is no settled historical practice of independent agencies headed by single directors who possess the substantial executive authority that the director of the CFPB enjoys."

Although the CFPB is required to consult with a consumer advisory board, "the advisory board is just that: advisory," the appellate majority said. Moreover, although the Financial Stability Oversight Council — another product of Dodd-Frank — may veto certain CFPB regulations in some circumstances, it has no say over enforcement actions or adjudications.

To resolve the issue, relying on the express severability clause in Dodd-Frank and Supreme Court precedent, the D.C. Circuit majority struck the "for cause" clause in Title X, and in doing so, converted the CFPB into an executive agency.

Congressional intent behind CFPB structure is scant

The appellate panel failed to find any evidence in the judicial record or the congressional history regarding how the CFPB's structure came to fruition to support the CFPB's position.

"It bears mention that Congress's choice of a single-Director CFPB was not an especially considered legislative decision," wrote Judge Brett Kavanaugh for the majority. "There are no committee reports, nor substantial legislative history, delving into the benefits of single-director independent agencies versus multi-member independent agencies. The CFPB has identified no congressional hearings studying the question. Congress apparently stumbled into this single-director structure as a compromise or landing point between the original Warren multi-member independent agency proposal and a traditional executive agency headed by a single person."

Senator Elizabeth Warren has publicly disagreed. Following the decision, she responded to this portion of the court's opinion, saying it "bizarrely relies on a mischaracterization of my original proposal." (Senator Elizabeth Warren, *Statement from Senator Warren About Today's Ruling on CFPB by Federal Appeals Court*, https://www.warren.senate.gov/?p=press_release&id=1271 (Oct. 11, 2016)). According to Warren, a multimember commission structure was considered early on but dismissed in favor of a single-director CFPB funded by Federal Reserve fees, to insulate the agency's critical functions from political pressures and Congress' appropriations power.

Conservative columnist George Will begged to differ in a *Washington Post* article on October 14, 2016. He pointed out that, to the extent Congress "insists on working itself irrelevant" by "voluntary abandonment of its power of the purse" — regarding its attempt to confer unconstitutional and unprecedented independence to the CFPB — it engages in "regulatory insouciance" made possible by "legislative abnegation." That debate will continue.

The CFPB may ultimately convert back to an independent agency, free from the President's dismissal-at-will power, as long as it is run by a multimember commission. The D.C. Circuit elected not to make the conversion, noting the entanglements that would come along with it; but Congress could choose to do so, regardless of how the appeal of the *PHH* decision shakes out.

HUD directives and *Chevron* deference

The CFPB supported its interpretation of RESPA by asserting that prior HUD interpretations regard-

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ing § 8 were never the subject of any rulemaking or formal, binding decision. As such, the CFPB felt free to disregard prior interpretations of § 8, and under *Chevron*, the agency's interpretation is entitled to deference. The D.C. Circuit found HUD's informal interpretations in 1997 and as restated in 2004 were justifiably relied on by PHH and others.

"To trigger the latter due process protection, an agency pronouncement about the legality of proposed private conduct need not have been set forth in a rule preceded by notice and comment rulemaking, or the like," Judge Kavanaugh wrote. "Here, the agency guidance was provided by top HUD officials and was given repeatedly. ... The CFPB is arguing that it has the authority to order PHH to pay $109 million even though PHH acted in reliance upon numerous government pronouncements authorizing [under RESPA] precisely the conduct in which PHH engaged. The due process clause does not countenance the CFPB's gamesmanship."

In other words, the issue is not that the CFPB wants to apply a new interpretation of RESPA, but with *how* it elected to do so, in an attempt to penalize PHH for behavior that it justifiably believed was permissible at the time. The court agreed the agency is free to engage in rulemaking and new agency interpretations, but said that "change becomes a problem — a fatal one — when the government decides to turn around and retroactively apply that new interpretation to proscribe conduct that occurred before the new interpretation was issued.

"Therefore, even if the CFPB's new interpretation were consistent with the statute (which it is not), the CFPB violated due process by retroactively applying that new interpretation to PHH's conduct that occurred *before* the date of the CFPB's new interpretation," the majority concluded.

This could mean that, under due process principles and notwithstanding *Chevron*, the CFPB cannot disregard prior informal interpretations of the seven government agencies that previously enforced the 19 statutes it is now tasked with enforcing. A challenge to marketing services arrangements under RESPA could certainly be a next battleground.

The appellate majority criticized the "absurdity of the CFPB's position" that it is not bound by RESPA's three-year limitations period when it enforces actions administratively as opposed to in the courts. Arguably, the same logic applies to the other 19 statutes the CFPB is responsible for enforcing — the underlying limitations period in the substantive statute is what governs the limitations periods for any claims arising under it.

Business as usual

In sum, the appellate court "underscore[d] the limited real-world implications of [its] decision. As before, the CFPB will continue to operate and perform its many critical responsibilities, albeit under the ultimate supervision and direction of the President." And absent any affirmative action by the President or Congress, the CFPB is not automatically subjected to the reporting requirements, for example, that are imposed on most executive agencies. The court expressly stated it was not striking down the statutory provisions of Dodd-Frank that created the CFPB and define its duties and authority to enforce the Act.

Specifically, it said that "the Dodd-Frank and its CFPB-related provisions will remain 'fully operative as a law' without the for-cause removal restriction." In other words, by converting the CFPB to an executive agency, the *PHH* court means only that the President can now fire the Director at will, and not only in cases of "inefficiency, neglect of duty, or malfeasance in office." The statutory authority and procedures governing the CFPB's examination, regulatory, rulemaking, and enforcement power are still housed in Dodd-Frank's provisions.

Further, "Section 8 will continue to mean what it has traditionally meant: that captive reinsurance agreements are permissible so long as the mortgage insurer pays no more than reasonable market value for reinsurance." And relatedly, "the three-year statute of limitations that has traditionally applied to agency actions to enforce Section 8 will continue to apply."

On balance, even given the court's treatment of many of its positions, the CFPB made it out relatively unscathed, although the court's rebuke of many of the agency's positions may undermine the agency's pending and future enforcement actions.

Nonetheless, PHH is not off the hook. On remand, the CFPB will determine whether the PMIs paid PHH's affiliate more than a reasonable market value within the applicable three-year limitations period to determine whether and how much PHH must disgorge in premium payments.

Other challenges to the CFPB's constitutionality

A similar constitutional challenge to the CFPB, initiated in 2012, is still pending in U.S. District Court, District of the District of Columbia.

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In *State National Bank of Big Spring v. Lew*, the district court originally granted the CFPB's motion to dismiss, finding that the Texas bank and eleven attorneys general (from Oklahoma, South Carolina, Georgia, Michigan, Nebraska, Alabama, Kansas, Montana, Texas, Ohio, and West Virginia) lacked standing and that the claims were not ripe.

On appeal, a D.C. Circuit panel ruling (also authored by *PHH*'s author Judge Kavanaugh) reversed, finding the parties had standing to challenge both the constitutionality of the CFPB and Cordray's recess appointment (*State Nat'l Bank of Big Spring v. Lew*, 795 F.3d 48, 57 (D.C. Cir. 2016)). The case was remanded back to the D.C. District Court to decide both issues on the merits. In July 2016, Judge Ellen Segal Huvelle ruled in favor of the CFPB on the recess appointment issue, but stayed the challenge to the CFPB's constitutionality pending the *PHH* decision. Likely, the anticipated arguments pending in *State National* will be moot.

State National is not the only instance in which the CFPB's structure has been challenged through litigation. In *Morgan Drexen*, a debt relief servicer charged with violating the Consumer Financial Protection Act alleged the CFPB was unconstitutional for many of the reasons asserted by PHH and also argued that its creation and structure violates the nondelegation doctrine. (*Consumer Fin. Prot. Bureau v. Morgan Drexen, Inc.*, 60 F. Supp. 3d 1082, 1090 (C.D. Cal. 2014)).

The nondelegation doctrine is a separation of powers rule that is sometimes invoked but rarely successful. It provides that legislative power is reserved to Congress except where Congress asks another branch to assist and specifies "an intelligible principle" that is "fixed according to common sense and the inherent necessities of the governmental coordination." (*J.W. Hampton, Jr. & Co. v. United States*, 276 U.S. 394, 406 (1928)).

The servicer argued that the Dodd-Frank Act does not contain an "intelligible principle" guiding the CFPB's ability to regulate and enforce "abusive" practices as the term is broadly defined in the Act, and therefore, its power violates the Constitutional prohibition against delegation. The California district court dismissed this argument without much discussion, concluding that the Dodd-Frank Act contains an intelligible principle. Whether others facing enforcement by the CFPB will make the same argument is unlikely, but it may garner more attention in the wake of *PHH*.

It's not over

The CFPB has not yet appealed the panel's decision, although Senator Warren predicted the decision will likely be appealed and overturned. However, *en banc* hearings are rare in the D.C. Circuit — the court averages only one en banc review per 500 three-judge panels.

Under Federal Rule of Appellate Procedure 35(a), *en banc* hearings are "not favored" and "ordinarily will not be ordered unless: (1) *en banc* consideration is necessary to secure or maintain uniformity of the court's decisions; or (2) the proceeding involves a question of exceptional importance."

If *en banc* review is granted, however, the panel decision likely could be reversed. The original panel consisted of three Republican appointees, Judges Kavanaugh, Henderson, and Randolph. The D.C. Circuit sitting *en banc* includes all eleven active judges, plus any senior judges who were members of the original panel and who wish to participate.

Assuming senior Judge Randolph elects to participate, the en banc panel would consist of seven Democratic appointees and five Republican appointees. In the event of a tie, 6-6 vote, the panel decision will be affirmed. But in the more likely scenario, a 7-5 vote in favor of the CFPB means the panel's decision goes away.

The CFPB may also petition the Supreme Court for a writ of *certiorari* pending further D.C. Circuit review. Or, it may wait and file its petition after the D.C. Circuit denies its *en banc* request. Even if the Supreme Court decides to hear the case, it will certainly be months, and may be years, before the case is resolved. Given the effect the upcoming presidential, Senate, and House races will have on the makeup of all three branches, and significantly of the Supreme Court, it is too soon to tell how this will play out.

Fate of arrangements and MSAs

As of now, the *PHH* decision will probably not impact the current state of captive reinsurance arrangements or marketing service agreements in the mortgage industry. Captive arrangements dropped off significantly when the market dipped in the late 2000s and many industry participants have elected to avoid MSAs altogether for fear of noncompliance. While the CFPB has yet to prohibit either arrangement through rulemaking, it has effectively done so via enforcement actions.

The CFPB has imposed over $75 million in fines on industry participants for activities related to MSAs and, in 2015, it issued a stern compliance bulletin, noting its "grave concerns" with the practice and "encourag[ing] all mortgage industry participants to consider carefully RESPA's requirements and restrictions and the adverse consequences that can follow from non-compliance." (*CFPB Compliance Bulletin 2015-05*).

But what noncompliance means is not entirely clear. Many have criticized the CFPB's apparent preference for regulating through enforcement actions instead of by rulemaking. Although Cordray maintains enforcement is a supplement, not a substitute, for rulemaking, the absence of clear guidance has frustrated industry participants, forced to patch together information gleaned from past enforcement actions to theorize what activity is permissible. Unfortunately, this is likely to continue.

Neither issue is on the CFPB's upcoming rulemaking agenda. And after the *PHH* decision, the bureau is likely to continue to prioritize enforcement efforts over rulemaking. Given the D.C. Circuit's treatment of its statute of limitations argument in *PHH*, the CFPB may justifiably fear it is bound by the applicable statute of limitations in all 19 statutes it enforces and race against the clock to initiate enforcement actions before it is too late.

CFPB dismisses the D.C. Circuit's ruling

Just three days after the PHH decision was announced, the CFPB responded to a notice of supplemental authority about the import of the ruling in a case before the U.S. District Court, Eastern District of North Dakota, filed by Intercept Corp., arguing about a pending enforcement action by the CFPB against Intercept.

The CFPB referenced the panel's "split decision (2-1)," and said it "was wrongly decided and, in any event, does not control the outcome of defendants' motion to dismiss in this case." (*CFPB v. Intercept Corp.*, No. 3:16-CV-00144 (E.D.N.D. Oct. 14, 2016).)

In particular, the CFPB challenged the panel's decision to remove the "for cause" clause as lacking any historical or constitutional basis (no aggrandizement/no showing that structure affects POTUS' control over executive branch). The bureau also mentioned the DC Circuit's ruling on the RESPA statute of limitations point, but did not say whether it was abiding by it or not.

The bureau It did say that in the North Dakota dispute it did not matter because a different statute, the Consumer Financial Protection Act, applied and the parties did not dispute the applicable limitations period. It also argued that, regardless, a D.C. Circuit panel ruling does not bind a North Dakota district court.

The response signals that the CFPB will not roll over and abide by new statute of limitations interpretation for any statute in any jurisdiction until it is forced to do so, and overall, the CFPB appears disinclined to change anything about its current operations or legal positions.

Where do we go from here?

Some suggested take-aways:

- Unless the CFPB and PHH agree to settle the case, and to moot the issues on appeal, this dispute could take quite a long time to be resolved.
- Expect political volleyball to persist with the front-line bashers being Warren for the bureau and House Financial Services Committee Chair Jeb Hensarling for the reform/dismantling of the CFPB.
- Don't expect the CFPB to materially change its RESPA and other statutory guidance interpretations unless forced to do so. If the past is prologue, then expect a continued mix of enforcement actions along with rulemaking by the Bureau.
- Don't expect the CFPB to voluntarily circumscribe its regulatory powers to investigate via CIDs or to compel data from companies which may be outside the applicable statute of limitations — although, at least one other court ruled the CFPB must timely bring any claims in a TILA case (*CFPB v. ITT Educ. Servs.*, No. 14-00292 (S.D. Ind. 03/06/15).)
- Do anticipate that other companies may choose to fight with the CFPB over aggressive enforcement actions — particularly if the bureau's position is at odds with pre-CFPB regulation guidance.
- Don't expect past consent orders involving RESPA-related enforcement actions by the CFPB to be relitigated.
- Do watch out for similar-type constitutional structure challenges to other agencies — perhaps to the Federal Housing Finance Agency — which the CFPB argued back in April 2016 was a contemporary agency with similar structural issues.

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