

EXPERT ANALYSIS

The Constitutionality of the CFPB — An Exegesis

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Not since the governmental restructuring occasioned by President Franklin Delano Roosevelt's creation of agencies as part of the New Deal have we been squarely confronted with the question of whether a federal agency has been structured in a manner that violates the fundamental principle of separation of powers as embodied in the U.S. Constitution.

As the complexities of society continue to increase, we have become used to (or desensitized to) the enormous powers frequently wielded by federal departments and agencies, ranging from those involving the restructuring of our energy policies to national security.

In every instance, however, governmental agency power has remained subject to acceptable levels of oversight by the three branches of the federal government — at least until now.

In April the U.S. Court of Appeals for the District of Columbia Circuit heard arguments in *PHH Corp. et al. v. Consumer Financial Protection Bureau*, No. 15-1177, a case that challenges the permissible structure and powers of the CFPB. Based upon the amount of scrutiny the court leveled against the CFPB during the oral arguments, it appears that the appeals court recognized the concern expressed by PHH that the CFPB's statutory authority exceeds constitutional limits.

This analysis examines this issue, with a view toward enabling the reader to analyze the merits of the allegation that constitutional principles were violated when the CFPB was created.

AN OVERVIEW OF THE GOVERNING PRINCIPLE

As most of us are aware, the U.S. Constitution creates three separate constituencies that form the basis for the functioning of our federal government: the executive, legislative and judicial branches. While each branch has primary authority over its designated operational sector, the Founding Fathers included numerous countervailing protections against the exercise of excessive power to the detriment of the people, such as checks and balances and the congressional power of the purse.

While the power of the executive branch has grown dramatically, over the past few decades there has been created a category of agency — commonly termed an “independent agency” — that is not completely under the control of the executive.

As allowed by the courts in a series of cases dating back to the 1930s, independent agencies may perform important governmental functions that are judicial and legislative in nature. In many cases, these agencies have a narrow focus in their assigned mission and are intended to perform their functions in a non-partisan manner.

In those circumstances, the U.S. Supreme Court has held that an independent agency may be slightly separated from the power of the president — namely the power of the president to remove inferior



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executive branch officers based on Article II of the Constitution.¹ Specifically, the Supreme Court has limited the president's power to dismiss the head of an independent agency to removals for "cause."

In addition, the court has determined that to protect against day-to-day administrative abuse by a single agency head or director, a commission form of agency governance is another permissible remedial measure.²

Admittedly, these boundaries are broad and have provided ample flexibility for Congress and the executive branch to address the evolving needs for national governance. In the case of the CFPB, however, even these limitations may have been exceeded.

THE CFPB'S STATUTORY STRUCTURE

The CFPB was created as one of the two primary components of the Dodd-Frank Act (the other being the "too big to fail" initiative). Longtime consumer advocates, including both members of Congress and private parties, saw the opportunity to mold an agency that would protect consumers and be safe from business interests seeking to defeat that mission.

In that regard, consumer advocates pointed to problems with agencies such as the Federal Trade Commission, which allegedly was hamstrung by business opponents who used the commission form of governance to block that agency's consumer protection actions, as well as by congressional oversight that resulted in funding levels that diminished its enforcement capabilities.

To effectuate the goal of maximizing the CFPB's strength and authority, among other provisions of the Dodd-Frank Act, the following authorizations were included for the bureau:

- All authority for the CFPB rests with a sole director, who can be removed only by the president for cause. During his five-year term, the director has regulatory authority over virtually every federal consumer protection statute, affecting over 70 percent of the U.S. gross domestic product.
- The CFPB is not technically a stand-alone federal agency — it is a "bureau" of the Board of Governors of the Federal Reserve System — but the Federal Reserve cannot oversee the CFPB's operations. (While it is a federal instrumentality, the CFPB is one or two steps removed from being an executive branch agency.)
- The CFPB's budget is not subject to congressional review; rather, it is allocated 12 percent of the Federal Reserve's revenues each year. Those funds are not subject to Federal Reserve approval, but can be transferred at the order of the director.
- The CFPB has broad administrative authority to examine and supervise a wide range of consumer financial firms, with administrative hearing authority to enforce orders requiring corrective measures. Favorable hearing determinations by an administrative judge can be summarily reversed by the director.
- Absent its ability to oversee the actions of the CFPB based on the power of the purse, Congress' oversight of the bureau's activities is limited to semi-annual appearances by the director before congressional committees — and those committees are bereft of authority to influence agency behavior due to the lack of budget oversight.
- The CFPB has the authority to address "unfair, deceptive and abusive" acts and practices, which the agency has refused to describe in any bright-line manner. As interpreted by the CFPB, a so-called unfair, deceptive or abusive act or practice (known as a UDAAP act or practice) need not be illegal; instead, it may be merely unfair in the view of the bureau.
- The CFPB may ignore the due process rights of people and entities subject to its jurisdiction by regulating via enforcement orders — a practice that in many cases obviates the responsibility to extend the protections afforded by the Administrative Procedure Act (the

APA affords the opportunity for public comments and dialogue prior to the exercise of an agency rulemaking).

- The CFPB has taken the position that statutes of limitation do not apply to its enforcement activities, with the result being that targeted institutions have been sanctioned for conduct occurring well beyond the five-year federal agency statute of limitations governing agency enforcement actions that seek monetary penalties.

With this background of the grant of enormous regulatory and enforcement authority over a large segment of our economy — and concomitant little oversight — a review of the context of the lawsuit challenging the CFPB's constitutionality is in order.

THE PHH CASE

Approximately 18 years ago, the U.S. Department of Housing and Urban Development issued a safe harbor letter that authorized mortgage lending companies to engage in reinsurance activities through affiliated (i.e., "captive") reinsurance companies and thereby share in the revenue streams for private mortgage insurance tied to the mortgages they generated.

Importantly, in order to engage in this activity while avoiding the prohibitions on referrals of settlement services prohibited by Section 8 of the Real Estate Settlement Procedures Act, among other things, actual credit risk had to be assumed by the mortgage lender's affiliated reinsurance company.³

Many mortgage lenders, including PHH Corp., relied on the above-referenced safe harbor interpretative guidance. All experienced years when earnings were positive or losses were incurred. After inheriting enforcement authority for RESPA, the CFPB indicated that existing HUD interpretative positions would remain in place unless modified by the bureau.

The CFPB then adopted an interpretative position regarding affiliated business arrangements that overturned decades of interpretative guidance. It assessed PHH a civil penalty of approximately \$6 million, which was confirmed by an administrative hearing officer. When PHH appealed the decision, CFPB Director Richard Cordray upheld it and the bureau's legal position — and increased the penalty to \$106 million.⁴

After two years of administrative delay, PHH was finally able to obtain a de novo hearing of the administrative matter in the District of Columbia Circuit. In addition to PHH's allegations of administrative and statutory errors by the bureau, the constitutionality of the CFPB's status was raised.

At the oral argument in the case, the three-judge panel expressed serious doubts regarding the bona fides of the CFPB's constitutionality.

CONSTITUTIONALITY CONSIDERATIONS

Several questions might be asked in regard to the constitutionality of the CFPB:

- Does the scope of authority granted to the CFPB exceed the established constitutional norms used when evaluating federal agencies?
- Assuming that the District of Columbia Circuit makes a determination favorable to PHH, will it or should it address whether the CFPB's structure has constitutional infirmities?
- If the CFPB's structure requires amendment to bring it within constitutional boundaries, what steps are needed to accomplish that action?

As to whether the CFPB's current structure can withstand a constitutional challenge, it is suggested that the correct answer to that question is no. Although the necessities of a federal agency's administrative mission concededly require flexibility, in the CFPB's case the outer parameters of permissible agency boundaries have been far exceeded.

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A review of the somewhat patchwork set of judicial decisions addressing this issue indicates that courts balance several factors against an infringement on the president's right to dismiss agency officials without cause.

The scope of an agency's statutory mission is relevant, as is the need for the agency to exercise legislative functions (such as the authority to adopt legislative rules) and to enforce and regulate through the use of judicial hearing powers.

When the president's authority is reduced or modified, the existence of other protections may be sufficient, such as the use of a commission form of agency governance to oversee a sole agency department head.

As stated recently by the Supreme Court, it is the court's role to revisit these parameters whenever a new approach to an agency's structure is presented.⁵ In the current case, the broad scope of the CFPB's authority well exceeds the Supreme Court standard.

In light of the clear efforts of consumer proponents of the CFPB to statutorily insulate the bureau from any meaningful oversight, it is very probable that the CFPB will be found to be unconstitutionally structured.

Assuming that the CFPB's structure is in constitutional violation of the power of the president to supervise the bureau's director, should courts exercise judicial restraint by finding in favor of PHH without ruling on the constitutionality of the CFPB?

In that regard, it is submitted that the powers of the CFPB are so incongruent to the constitutional standards contained in Supreme Court guidance that this very real issue will be raised on a regular basis by parties subject to the CFPB's jurisdiction until the Supreme Court will have no choice but to address the matter.

Importantly, should the CFPB's structure be struck down, the bureau's prior actions and interpretative pronouncements (now spanning more than five years in length) arguably will become void. Also (and absent judicial mischief that might create a solution to the absence of a reasonable degree of executive oversight), any corrective measures to remedy a constitutional infirmity relating to the CFPB must be considered and adopted by Congress.

Finally, if the CFPB is found to be operating on a constitutionally infirm basis, legislative efforts to defend the bureau will encounter an interesting role reversal.

In the past few years, critics of the CFPB have attempted to amend the bureau's statutory structure. These attempts have been soundly defeated by supporters who have effectively filibustered any such efforts. (The most frequent attempts for statutory changes have involved proposing a commission form of agency governance, as well as imposing congressional oversight through the budget process.)

Even though it might be relatively simple to minimally modify the CFPB's structure in order to pass constitutional muster, opponents of the bureau could filibuster any attempt to cure the statutory difficulties without obtaining the concessions demanded by critics. Although this result seems highly likely if the CFPB is found to be unconstitutional, the belief that the bureau has brought about a paradigm shift in consumer protection may prevent consumer advocates from both anticipating this result and compromising sooner rather than later.

NOTES

- ¹ As recognized by the Supreme Court, the president “must have the power to remove [executive officers] without delay.” *Myers v. United States*, 272 U.S. 52, 134 (1926).
- ² See *Humphrey’s Executor v. United States*, 295 U.S. 602, 624 (1935).
- ³ Letter from Nicolas P. Retsinas, Ass’t Sec’y for Hous.-Fed. Hous. Comm’r, U.S. Dep’t of Hous. & Urban Dev., to Sandor Samuels, Gen. Counsel, Countrywide Funding Corp. (Aug. 6, 1997).
- ⁴ *In re PHH Corp.*, CFPB No. 2015-CFPB-0002 (June 4, 2015).
- ⁵ *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477 (2010).



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