CARTER/LEDYARD

our resources

With its Decision in Seila Law the Supreme Court Brings PHH Corp. v. Consumer Financial Protection Bureau Full Circle

July 15, 2020

Client Advisory

On June 29 the U.S. Supreme Court handed down its decision in *Seila Law LLC v. Consumer Fin. Prot. Bureau*,[1] capping off a saga that began with a pair of D.C. Circuit decisions in *PHH Corporation v. Consumer Financial Protection Bureau* which held, and then reversed the holding, that the powerful (and politically insulated) single-director structure of the CFPB was unconstitutional.[2] The majority in *Seila Law* included Justice Brett Kavanaugh, who as a Circuit judge was the principal author of the panel's decision in *PHH I* and the dissenters' opinion in *PHH II*. As a result, it was not surprising to see the majority's opinion in Selia Law borrow heavily from his reasoning, writing, and ultimately conclusion that the agency, as structured in the Dodd-Frank Act, was unconstitutional but that ultimately it could be saved by severing the "for cause" removal clause from the rest of the statute.

A. The *PHH* Case

As I previously wrote in "Practical Takeaways From the D.C. Circuit's Decision In *PHH Corp. v. Consumer Financial Protection Bureau*,"[3] the case was the first true test of the CFPB's sweeping powers. The Supreme Court later described it as "a mini legislature, prosecutor, and court, responsible for creating substantive rules for a wide swath of industries, prosecuting violations, and levying knee-buckling penalties against private citizens."[4]

The case began under the Obama administration and the CFPB's aggressive first director, Richard Cordray. It stemmed from an enforcement proceeding against PHH, Atrium, and affiliated entities, regarding a captive reinsurance agreement between PHH and Atrium. The proceeding resulted in a disgorgement order in excess of $109 million, and several problematic findings regarding the agency's ability to retroactively change guidance (issued by agencies previously responsible for regulating the sector) and to punish conduct it now found objectionable. To add fuel to the fire, the eye-popping award was the result of Director Cordray (the final arbiter under the agency's structure) overruling the administrative law judge's recommendation of an approximately $6.5 million disgorgement award. The appeal by PHH to the D.C. Circuit drew an all-Republican appointed panel consisting of Judges Kavanaugh, Randolph, and Henderson.

On October 11, 2016 (approximately a month before Donald Trump was elected president), the panel handed down its decision. Writing for the 2-1 majority, Judge Kavanaugh shredded the agency. The *PHH I* decision was noteworthy for Judge Kavanaugh's lengthy Constitutional analysis of the power concentrated in the CFPB Director's hands. Mincing no words, and joined by Judge Randolph, he wrote that:

[T]he Director of the CFPB possesses enormous power over American business, American consumers, and the overall U.S. economy. The Director unilaterally enforces 19 federal consumer protection statutes, covering everything from home finance to student loans to credit cards to banking practices. The Director alone decides what rules to issue; how to enforce, when to enforce, and against whom to enforce the law; and what sanctions and penalties to impose on violators of the law.

* * * * *

Because the Director alone heads the agency without Presidential supervision, and in light of the CFPB's broad authority over the U.S. economy, the Director enjoys significantly more *unilateral* power than any single member of any other independent agency . . . Indeed, other than the President, the Director of the CFPB is the single most powerful official in the entire United States Government, at least when measured in terms of unilateral power. That is not an overstatement.

See PHH I, 839 F.3d at 7-8, 33-34.

The remedy fashioned by the panel was rather limited. The Court relied on the severability clause in the Dodd-Frank Act (the CFPB's enabling statute) to strike the "for cause" provision, thereby making its Director removable at will by the President. This transformed the agency into something more palatable (like most other executive agencies headed by a single director directly answerable to the President). This holding was ultimately reversed by the *en banc* decision in *PHH II*, which roughly broke down along ideological grounds. Judge Kavanaugh filed a dissenting opinion incorporating most of his reasoning from *PHH I*.

The *PHH I* decision went on to address both the substantive legality of the captive reinsurance arrangement, shortcomings of the CFPB's inhouse process (due process violations in retroactively changing rules, and improperly shifting the burden by recasting substantive elements of a violation as affirmative defenses), and CFPB's position that it was not constrained by the statute of limitations in its administrative adjudications. These findings were not disturbed by the *en banc* Court in *PHH II*, which referred the case back to the CFPB for further consideration. Five months later the administrative case was dismissed by the CFPB (which was by then headed by Mick Mulvaney).[5]

As a result, *PHH* could not serve as the vehicle for the Supreme Court to pass on the constitutional structure of the agency. However its reasoning was incorporated in other courts, most notably by federal courts in New York and California, which came down on different sides of the question.[6] The Ninth Circuit's decision in *Seila Law* ultimately served as the vehicle to vet the constitutional question.

B. The *Seila Law* Decision

The facts of *Seila Law* are much less dramatic than *PHH*. The case started in 2017, when the CFPB issued a Civil Investigative Demand (a type of administrative subpoena) to *Seila Law* with respect to its "debt-relief" services and violations of the Telemarketing Sales Rule. The CFPB moved to enforce the subpoena, and Seila Law challenged its authority on constitutional grounds. The District Court's decision, handed down after the *PHH I* decision was vacated but before the PHH II decision was handed down, brushed the challenge aside.[7] The Ninth Circuit affirmed, in essence incorporating the entirety of the *PHH II* decision with respect to the constitutional analysis.[8] As such, the Supreme Court's decision in *Seila Law* is really the final chapter in the *PHH* saga.

The Supreme Court majority, which included now Supreme Court Justice Kavanaugh, found that the CFPB's structure does, in fact, violate the separation of powers doctrine. Much like then Judge Kavanaugh did in 2016, the majority minced no words in framing the issue: the CFPB has "a single Director, who serves for a longer term than the President and cannot be removed by the President except for inefficiency, neglect, or malfeasance" and has "no boss, peers, or voters to report to" while wielding "vast rulemaking, enforcement, and adjudicatory authority over a significant portion of the U.S. economy."[9] The majority found that such an agency "lacks a foundation in historical practice and clashes with constitutional structure by concentrating power in a unilateral actor insulated from Presidential control."

Section III of the majority's decision, dealing with the constitutionality of the structure, reads very much like Justice Kavanaugh's decision in *PHH I* (referring to the CFPB as "a mini legislature, prosecutor, and court, responsible for creating substantive rules for a wide swath of industries, prosecuting violations, and levying knee-buckling penalties against private citizens."). Section IV of the decision, reached by a plurality,[10] arrives at the same solution: to sever the for-cause removal provision.

The plurality declined to scrap the entire agency (as the petitioners asked them to do). The Court noted that the "only constitutional defect [it] identified in the CFPB's structure" is the for cause removal provision, and if it was severed "the constitutional violation would disappear."[11] They signaled that a broader attack on the agency's constitutionality is not going to be successful, noting the practical implications of other agencies attempting to "absorb the CFPB's 1,500-employee, 500-million-dollar operations" or to administer "the Dodd-Frank Act's new prohibition on unfair and deceptive practices in the consumer-finance sector" without the statutory authority given to the CFPB.[12]

The court also proposed an alternate solution, which congress may well enact in the future: converting the CFPB into a multi-member agency with for-cause removal protections (like other independent agencies).

C. Conclusion

The Supreme Court's decision in *Seila Law* appears to be the natural end of the PHH saga, and the broadside attack on the CFPB's constitutionality. It doesn't look like the CFPB is going away. However, this does not mean that challenges to the CFPB's authority are at an end.

The CFPB moved quickly to ratify the majority of its existing regulations to try and address collateral attacks based on the *Selia Law* decision.[13] This includes the large majority of the Bureau's existing regulations, as well as certain other actions, and would relate back to the original date of each action ratified. The CFPB's position is that under established case law, any agency may, through ratification, "purge[] any residual taint or prejudice left over from" a potential defect in a prior governmental action.[14] It remains to be seen if this rationale will be tested with some of the more controversial regulations, to which there is still industry opposition.

* * *

For more information concerning the matters discussed in this publication, please contact the author **Alexander G. Malyshev** (212-238-8618, malyshev@clm.com), or your regular Carter Ledyard attorney.

---

[1] 591 US___, 2020 U.S. LEXIS 3515 (2020) ("Seila Law").

[2] *See* panel decision, *PHH Corp. v. Consumer Financial Protection Bureau*, 839 F.3d 1 (D.C. Cir. 2016) ("*PHH I*"), and *en banc* decision, *PHH Corp. v. Consumer Financial Protection Bureau*, 881 F.3d 75 (D.C. Cir. 2018) ("*PHH II*").

[3] The Journal of Structured Finance, Winter 2017, Vol. 22, No. 4, pp. 47-50.

[4] *See Seila Law*, fn. 8.

[5] *See* June 7, 2018, Order Dismissing The Notice of Charges (https://files.consumerfinance.gov/f/documents/2014-CFPB-0002_Document_236_06072018.pdf).

[6] *See Consumer Fin. Protection Bur. v RD Legal Funding*, LLC, 332 F Supp 3d 729, 784 [SDNY 2018] (incorporating PHH reasoning and finding the structure to be unconstitutional); *Consumer Fin. Protection Bur. v Seila Law, LLC*, 2017 US Dist LEXIS 217692, at *4-5 [CD Cal Aug. 25, 2017, No. 8:17-cv-01081-JLS-JEM] (incorporating PHH reasoning and finding the structure to be constitutional).

[7] *Consumer Fin. Protection Bur. v Seila Law, LLC*, 2017 US Dist LEXIS 217692, at *4-5.

[8] *Consumer Fin. Protection Bur. v Seila Law, LLC*, 923 F3d 680, 682 [9th Cir 2019] ("We see no need to re-plow the same ground here. After providing a summary of the CFPB's structure, we explain in brief why we agree with the conclusion reached by the PHH Corp. majority.").

[9] *Seila Law* at *10.

[10] Justices Thomas and Gorsuch did not join in this portion of the decision, issuing a concurring opinion. But Justices Kagan, Ginsburg, Breyer, and Sotomayor concurred in the judgment with respect to severability, while dissenting on the constitutionality analysis.

[11] *Id*. *53.

[12] *Id*. *56-57.

[13] *See* 12 CFR Chapter X, Ratification of Bureau Actions *available at* https://files.consumerfinance.gov/f/documents/cfpb_ratification_bureau-actions_2020-07.pdf.

[14] *Citing Guedes v. Bureau of Alcohol, Tobacco, Firearms & Explosives, 920 F.3d 1, 13 (D.C. Cir. 2019).*

related professionals

Alexander G. Malyshev / Partner
D 212-238-8618
malyshev@clm.com