



# STROOCK

## SPECIAL BULLETIN

## WHICH CONSTITUTIONAL QUESTION WILL DECIDE PHH v. CFPB?

*May 25, 2017*

The May 24, 2017, oral argument in *PHH Corp. v. Consumer Financial Protection Bureau* (“CFPB” or “Bureau”) before the U.S. Court of Appeals for the D.C. Circuit, sitting *en banc*, sent strong signals that the Court is likely to decide this case on the Constitutionality questions, rather than the statutory ones. Discussion of the statute of limitations and the Real Estate Settlement Procedures Act (“RESPA”) issues in the case, themselves of weighty legal and practical consequence for the mortgage industry, occupied but a few minutes at the end of the oral argument (with a brief PHH plea for reinstatement of the three-judge panel’s RESPA decision in its favor).

While commentators have focused on the Constitutionality of the CFPB’s structure, there is a real question of whether the deciding Constitutionality issue in *PHH* will be:

- (1) whether the CFPB’s single-director structure is consistent with the Constitution; or
- (2) whether the administrative law judge (“ALJ”) who heard the case was an “inferior officer” under the law and thus appointed in violation of the Appointments Clause (the question in *Securities &*

*Exchange Commission (“SEC”) v. Lucia*, argued immediately before *PHH*).

Finally, perhaps the even more important practical question is whether the Court will render its decision in time to have a significant impact on the date when Richard Cordray will leave his post as CFPB Director.

### **Is the CFPB’s Single-Director Structure Constitutional?**

The beginning of the *PHH* oral argument was dominated by Judges Tatel, Griffith, Pillard, Henderson and Srinivasan, questioning how the Court could rule for PHH on the issue of the CFPB’s single-Director structure given the Supreme Court’s holdings in *Humphrey’s Executor v. United States* and *Morrison v. Olson*. *Humphrey’s Executor* held that Title II of the Constitution permits Congress to create independent agencies (in that case, the Federal Trade Commission) to exercise executive power, with agency heads removable by the President only for cause, not at will. *Morrison* similarly held that Congress’ creation of the Office of Independent Counsel, with a single individual exercising that Office’s executive

power and removable by the President only for cause, not at will, did not violate the principle of Separation of Powers. Of note, while under fire, PHH's counsel suggested that the Court could specify that it was ruling in favor of the CFPB only because it was bound by these two decisions, pointing to the Supreme Court to revisit the issue.

As the CFPB took its turn at the podium, however, Judge Kavanaugh voiced the rationale of the 2-1 opinion which he had penned for the three-judge panel ruling against the CFPB. He emphasized the Supreme Court's directive in *Free Enterprise Fund v. Public Company Accounting Oversight Board* to look to history and tradition in Separation of Powers cases. Pointing to references in *Humphrey's Executor* to independent agencies as quasi-legislative and quasi-judicial entities which, he argued, should thus be multi-member, bi-partisan bodies, Judge Kavanaugh described the CFPB's structure as a gross departure from settled historical practice. Occasional interjections from some of the other judges, including Judges Rogers, Wilkins and Brown, also suggested some questioning of the concentration of powers in the CFPB, and more particularly in its single Director removable only for cause. Nevertheless, the tone of the argument overall likely will render the CFPB cautiously optimistic that it may prevail on this issue.

The argument took an interesting detour after Judge Brown questioned whether there has ever been a successful removal of an agency head for cause, and whether the lack of such examples demonstrates that the for-cause requirement results in a significant diminution of Presidential power. There was some speculation around commentators' arguments that the courts have no jurisdiction to enjoin the President from removing an officer for

cause, which could render the for-cause requirement toothless. One might query whether opponents of the CFPB and Director Cordray might seize on this concept to urge the President's removal of the Director for cause. We continue to believe that the likelihood of the President taking such action is low, given the associated political and procedural complications and other matters dominating this Administration's agenda.

### **Is the ALJ an "Inferior Officer" Subject to the Appointments Clause?**

Despite the spotlight on the CFPB's structure, the Court's ruling in *PHH* well might rest on the question of whether the ALJ in the case, borrowed from the SEC, was appointed in violation of the Constitution. The outcome rests on the interpretation of the Supreme Court's holding in *Freytag v. Commissioner of Internal Revenue* that the Tax Court's special trial judges were inferior officers and not employees. The Supreme Court identified three factors in making the relevant determination: (i) whether the position was "established by law;" (ii) whether "the duties, salary, and means of appointment" for that office were specified by statute; and (iii) most important, whether that person exercised significant duties and discretion.

Notably, in December 2016, the U.S. Court of Appeals for the Tenth Circuit held that, under the *Freytag* standard, SEC ALJs were inferior officers and thus had to be appointed by the President, courts or agency heads (which they were not). In so holding, the Tenth Circuit criticized the D.C. Circuit's 2000 ruling in *Landry v. Federal Deposit Insurance Corporation* ("FDIC") that FDIC ALJs were not inferior officers because they did not have final decision-making authority. The Tenth

Circuit's decision was the first major victory for opponents of the SEC's use of its new authority under the Dodd-Frank Act to seek monetary penalties through its administrative adjudication process rather than through the courts.

The *Lucia* argument, which preceded the *PHH* argument, was rigorous, turning largely on the question of whether: (i) the SEC ALJs' ability to "shape the evidence" and the Commission's practice of conducting substantive review of only a small percentage of ALJ decisions made these ALJs inferior officers; or (ii) the SEC Act's reservation of the Commission's authority to review every ALJ decision, and the necessity of a finality order from the Commission to make an ALJ decision enforceable, established that these ALJs were only employees, not inferior officers. The questions from the Court gave no clear indication of its leaning on this analysis, but did highlight the judges' concern regarding the broader impact of a potential holding that the SEC ALJs were inferior officers. The Court will have to wrestle with the question of whether and how such a decision could affect not only matters involving the SEC ALJs, but also the ALJs in dozens of other federal agencies, including, for example, Social Security judges.

### **Will Resolution of *PHH* Come Too Late to Force Director Cordray's Departure?**

The combination of two complex and high profile Constitutional questions in *PHH* raises a substantial likelihood that the Court, sitting *en banc*, will not reach a decision until early 2018. If the Court holds that the CFPB's structure is unconstitutional, the CFPB would be out of options, as it has no independent authority to seek

Supreme Court review, and the Office of Solicitor General ("OSG") under President Trump would reject its request to file a petition for *writ of certiorari*. Conversely, OSG likely would support *PHH* if it was to seek *cert.* from a holding against it, increasing the probability that the Supreme Court would take the case and further delay its final resolution. Finally, a ruling based on the ALJ issue would present a wild card as it is unclear whether OSG under President Trump would opt to defend the ALJ framework or align with industry opponents.

Given the complexity of these issues, there is a significant probability that *PHH* will not reach a final resolution substantially in advance of the natural expiration of Director Cordray's term in July 2018. As previously noted, it appears unlikely that President Trump will forcibly remove Director Cordray in the interim. Of course, if the Court were to hold that the CFPB's structure is unconstitutional, even if that ruling could be stayed pending review, there is a possibility that President Trump might promptly seize the opportunity to place his own pick to head the agency. Weighed against that, however, will be the prospect of giving Director Cordray additional political capital through a forced early departure. As his opponents mull over these options, Director Cordray himself will be pondering whether to depart before the expiration of his term, given the February 2018 filing deadline for the Ohio gubernatorial race. Nevertheless, the cautious optimism no doubt emboldening the CFPB following the *PHH* hearing only adds to the enormous pressure from CFPB proponents, particularly Democratic Party leaders, for Director Cordray to maintain his leadership of the CFPB for as long as possible.

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The attorneys of Stroock's Financial Services/Class Action Group are well-positioned to answer any questions you may have about the Consumer Financial Protection Bureau and other federal and state authorities affecting the financial industry.

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