Implications of Canning Case on CFPB Rules*

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This article reviews the recent court of appeals decision regarding President Obama's appointments to the National Labor Relations Board, its potential impact on the Consumer Financial Protection Bureau (CFPB) Director Richard Cordray and CFPB regulations, and the potential remedies a court may impose if it found Director Cordray's appointment to be unconstitutional.

I. The Canning Decision

In Canning v. National Labor Relations Board,[1] a three judge panel of the U.S. Court of Appeals for the District of Columbia Circuit unanimously held that the recess appointments of three members of the National Labor Relations Board were invalid. The recess appointments were made on January 4, 2012. At this time, the Senate was operating on a *pro forma* basis, in which no Senate business would be conducted.[2]

The court determined that these three recess appointments were invalid under the Recess Appointments clause of the Constitution. This clause permits the President to appoint "Officers of the United States" without the need for Senate confirmation, during "the Recess" of the Senate. The court reviewed the literal language used in the Constitution, the history of the use of the Recess Appointments clause in prior Administrations, and prior judicial precedent, and concluded that the Recess Appointments clause only applies during *intersession* recess of the Senate in other words, the recess that occurs between the 1st and 2nd sessions of the Senate. Since all three

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[1] No. 12-1115, D.C. Cir. (Jan 25, 2012).

[2] Despite the consent agreement (each chamber must approve the recess of the other if it is for more than three days), the Senate did conduct legislative business on two occasions during this period.

appointments occurred *after* the second session of the Senate had begun, the appointments were invalid.

Second, the court noted that the Recess Appointments clause only permits the filling up of "Vacancies that *may happen* during the Recess of the Senate." Two of the three judges[3] on the panel interpreted the phrase "may happen" to mean that the vacancy must occur during an intersession recess. If a position is vacant prior to the end of a session of the Senate, it cannot be filled by the President during the recess because the vacancy did not "happen" during the recess period.[4] In the case of the NLRB appointees, the positions in question did not become vacant during an intersession recess. Judge Griffith agreed with the court that a recess appointment may only be made during an *intersession* recess of the Senate, but argued that the court should not have addressed the question of whether the vacancy also has to occur during the same intersessional recess.

The court held that since the three appointments to the NLRB were invalid, that agency did not have the requisite quorum to do business, and, therefore, that an NLRB order issued against the Canning Company on February 8, 2012 was invalid.

II. Impact on the Appointment of Richard Cordray to the CFPB

Richard Cordray was given a temporary recess appointment to be the Director of the CFPB on the same day that the recess appointments were made to the NLRB.[5] There is no relevant legal distinction between this appointment and the three NLRB appointments ruled invalid by the D.C. Court of Appeals.

As a technical matter, the Canning case does not affect the authority of Mr. Cordray. However, any party that has standing to challenge a CFPB regulation, CFPB order or CFPB enforcement action may go to an appro-

[3]Chief Judge Sentelle and Judge Henderson.

[4]A vacancy that occurs during an intersession recess can be filled through a recess appointment, but that appointment only lasts until the end of next session of the Senate. Thus, under the court's ruling, the maximum length of a recess appointment is effectively capped at one year.

[5]A recess appointment automatically terminates at the end of this session of the Senate.

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priate Federal court in the D.C. Circuit to challenge the authority of the agency.[6] Whether this is done in the District Court or the Court of Appeals would depend upon the specifics of the claim against the CFPB, but the result would be a finding that Mr. Cordray's appointment is invalid, so long as the case was brought in the D.C. Circuit. It is also possible that a party could initiate a suit to enjoin the CFPB from enforcing regulations or taking any other action that would cause harm to the plaintiff, such as increased expenses or changes in business practices.

III. Impact on CFPB Rulemakings

a. Summary of the QM Rule

On January 10, 2013, Richard Cordray, as Director of the CFPB, signed a final rule implementing Sections 1411 and 1412 of the Dodd-Frank Act requiring creditors to make an "ability to repay" determination prior to granting a mortgage loan, and defining the term "qualified mortgage" (QM) that would be presumed to meet the "ability to repay" standard. The effective date for this rule is January 10, 2014. Sections 1411 and 1412 amend the Truth-in-Lending Act (TILA). The Dodd-Frank Act transferred the authority to implement the TILA to the CFPB on the "designated transfer date," which was set by the Secretary of the Treasury as July 21, 2011.

b. Summary of the Remittance Rule

On January 23, 2012, Richard Cordray, as Director of the CFPB, signed a final rule governing remittance transfers to foreign countries under the Electronic Funds Transfer Act (EFTA).[7] Mr. Cordray approved modifications to the rule on August 7, 2012.[8] Technical corrections were made under Mr.

[6] There is at least one case pending in the D.C. District Court which, in part, challenges the appointment of Cordray, State National Bank of Big Springs v. Geithner, No. 12-CV-01032. The plaintiff could ask for partial summary judgment on the issue of the validity of Cordray to act as Director, and if the court finds that State National Bank has standing to bring the suit, the court could issue the partial judgment very quickly.

[7] The rule was published in the Federal Register on February 7, 2012, 77 Fed. Reg. 6194.

[8] Published on August 20, 2012, 77 Fed. Reg. 50244.

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Cordray's authority on June 26, 2012,[9] and the effective date was extended by Mr. Cordray on January 22, 2013.[10] A comment period is currently open on a proposal to further amend the regulation.[11] The new effective date will not be known until the final rule on these latest amendments is issued.

c. Impact of Canning

A review of the statutory provisions establishing the CFPB clearly demonstrates that the power of the agency is given to the Director, and that the Bureau acts through and under the supervision of the Director.[12] And even where the statute grants authority to the "Bureau," the Bureau has to act through the Director, and, therefore, without a Director, the Bureau cannot take any binding actions.[13] In short, without a valid Director, the CFPB cannot issue regulations, take enforcement actions, or take other actions that affect third parties.

Although the CFPB is precluded from *enforcing* existing regulations, the legal status of such regulations is not entirely as clear. This may be especially important to the extent that existing regulations may provide a basis for actions by third parties. TILA provides for private rights of action including class actions.

IV. Possible Court Imposed Remedies

a. The *De Facto* Officer Doctrine

Under the "*de facto* officer doctrine," agency actions performed by an agency official acting under the color of official title will not be overturned if it later turns out that the official was not validly holding office. In Ryder v. U.S.,[14]

[9] Published in the Federal Register on July 10, 2012, 77 Fed. Reg. 502440459.

[10] ***Temporarily delaying the implementation of our international remittance transfer rule***.

[11] 77 Fed. Reg. 77188 (Dec. 31, 2012)

[12] See, e.g., Section 1022(b) of the Dodd-Frank Act granting the Director rule making authority.

[13] A *validly* appointed Director could, of course, delegate his or other legal authority to subordinates.

[14] 515 U.S. 177 (1995).

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the Supreme Court explained that the de facto officer doctrine springs from the fear of the chaos that would result from multiple and repetitious suits challenging every action taken by every official whose claim to office was open to question. The doctrine seeks to protect the public by ensuring the orderly functioning of the Government. Thus, in the Northern Pipeline case,[15] the Supreme Court held that the process for appointing bankruptcy court judges was unconstitutional, but applied its ruling *prospectively and did not upset prior bankruptcy court rulings*. In Buckley v. Valeo,[16] the Supreme Court held that four members of the Federal Election Commission were improperly appointed, but nevertheless concluded that past acts of the Commission would be accorded "de factor validity."[17] In Connor v. Williams,[18] the Supreme Court held that legislative acts performed by legislators that were elected in accordance with an unconstitutional apportionment would not be retroactively voided. In Franklin v. OTS,[19] the district court held that although the Director of the Office of Thrift Supervision had been unconstitutionally appointed it would not retroactively invalidate the Director's actions because "great chaos could result throughout the savings and loan industry."[20] On the other hand, in 2010, the Supreme Court effectively reversed over 600 NLRB decisions when it held that a two person board was not sufficient to form a quorum for Board action.[21]

b. Factors a Court would Consider in Fashioning a Remedy

A court finding an appointment to be unconstitutional would have considerable discretion to fashion a remedy. In regards to the QM and other mortgage rules, one factor that might lead a court to preserving existing rules is that under section 1400 of the Dodd-Frank Act, sections 1411 and 1412 will go into effect automatically on January 21, 2013, unless final regulations delaying the effective date have been promulgated before that date. Thus, if the QM rule is struck down due to the infirmities of Mr. Cordray's appointment, the ability to repay requirements, as set out in the statute, may automatically become effective without the benefit of regulatory guidance

[15] Northern Pipeline Construction Co. v. Marathon Pipeline Co., 458 U.S. 50 (1982).
[16] 421 U.S. 1 (1976).
[17] Id. at 550-551.
[18] 404 U.S. 544 (1972).
[19] 740 F. Supp. 1535 (D. Kansas 1990), rev'd on other grounds, 934 F.2d 1127 (10th Cir. 1991).
[20] 740 F. Supp. at 1542.
[21] New Process Steel, L.P. v. NLRB, 130 S. Ct. 2635(2010).

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and interpretation. We believe that this may influence a court rule that final regulations issued by the CFPB remain in effect pending the appointment of a Director that meets constitutional requirements.

The exact remedy that a court would formulate will depend on numerous considerations and cannot be predicted, but the fact that voiding the final QM regulation may cause significant disruption in the mortgage markets will weigh in favor of maintaining the validity of the final QM rule. The fact that the QM rule is not in effect until January 2014 also favors a court not upsetting the status of the rule at this time.

A challenge to the remittance rule could be more complicated since an effective date is not yet known and proposed changes have not been finalized. If a court maintains the effect of existing regulations, the Appointments Clause violation would make it impossible for Mr. Cordray to set a new effective date for the remittance rule. Thus, the status of the rule (not in effect) would be locked in place from the date a court rules the Cordray appointment invalid until the date a new Director is validly appointed.

V. Treasury Department Authority

The Secretary of the Treasury has asserted the authority, under section 1066 of the Dodd-Frank Act, to administer the statutory consumer provisions transferred to the CFPB from other agencies prior to the appointment of a CFPB director. We believe that section 1066 applies only to administrative duties relating to the transfer of consumer protection functions from the other agencies to the CFPB. The Treasury Department takes the view that section 1066 allows the Secretary to administer the substantive provisions that are transferred to the CFPB, including the authority to administer TILA, pursuant to which the QM rule was issued, and the EFTA under which the remittance transfer rule was promulgated.[22]

If the Treasury's view is accepted, it will still be necessary to re-promulgate a final remittance rule and QM rule. Under section 1063 of the Dodd-Frank Act, proposed regulations issued by the Federal Reserve Board are saved, meaning that they became proposed regulations of the CFPB. The Federal

[22] ***Letter to Chairman Spencer Bachus and Rep. Judy Biggert, House Financial Services Committee from Inspectors General of the Department of Treasury and the Federal Reserve Board*** (Jan 10, 2011).

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Reserve Board proposed both the QM rule and remittance rule. The Treasury may take the position that if Mr. Cordray's appointment is invalid, the Treasury's authority to implement the statutes transferred to the CFPB means that it can proceed to a final remittance rule and QM rule without the need to issue a new proposed regulation. On QM, a court may even be able to fashion a remedy that delays the January 21, 2013 automatic effective date for a period of time sufficient to allow the Treasury to act.

Whether or not the Treasury starts with a new proposed regulation or issues a new final regulation, its actions would be subject to challenge based on the argument that the Secretary's powers under section 1066 do not include substantive rulemaking.

VI. Conclusion

The legal principles decided by the court of appeals in the Canning case are directly applicable to the CFPB, and will likely result in a court determination that Mr. Cordray's temporary appointment is unconstitutional. The Supreme Court may want to review this decision on an expedited basis.

A finding that Mr. Cordray has been invalidly appointed will very likely prevent the CFPB from issuing *new* regulations or taking enforcement actions. The courts have considerable discretion with respect to the continued validity of CFPB regulations and enforcement actions that have already been issued as final.

The Treasury Department may assert that it has substantive authority to implement TILA and EFTA, including the authority to issue the QM and remittance rules. We believe that this authority is based on a questionable reading of the statute. Nevertheless, a court might use its discretionary authority to delay the January 21, 2013 automatic effective date for sections 1411 and 1412 of the Dodd-Frank Act to enable the Secretary to promulgate a new QM rule.

The Treasury Secretary could argue that he is not required to first promulgate proposed rules, arguing that the Federal Reserve Board's proposed rules were specifically "saved" by Dodd-Frank. The Secretary can also claim authority to issue a regulation establishing an effective date for the remittance rule, but this would likely require the use of a full notice and comment

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procedures, since it would not be covered by the Federal Reserve Board's proposed rule. In any event, the legal authority of the Secretary of the Treasury to take such actions is very questionable.

In short, while we believe that it is clear that a court subject to the jurisdiction of the D.C. Court of Appeals would find that the appointment of Mr. Cordray is unconstitutional, the court would have discretion to formulate a remedy that could preserve existing regulations or that would allow the Treasury time to re-promulgate the remittance rule and QM rule.

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