Implications of the PHH Ruling on the Federal Housing Finance Agency*

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On October 11, 2016, the Court of Appeals for the D.C. Circuit decided the case of PHH Corporation v. CFPB. The plaintiff in this case (PHH Corporation) is a non-bank mortgage lender that was subject to a CFPB order to "disgorge" $109 million. The order was on the CFPB's conclusion that PHH violated the Real Estate Settlement Procedures Act (RESPA) when it referred borrowers to a mortgage insurance company that purchased reinsurance protection from an affiliate of PHH. The CFPB's position was that the purchase of the reinsurance from an affiliated company was, in essence, a "kickback" to PHH in violation of the anti-kickback provision in RESPA.

PHH raised several defenses in this appeal. First, it noted that the anti-kickback provision in RESPA does not apply to a payment for goods or services actually performed. Further, the Department of Housing and Urban Development (HUD), which was the agency implementing RESPA prior to the establishment of the CFPB, consistently opined that this type of arrangement did not violate RESPA, so long as the mortgage insurer paid no more than reasonable market value for the reinsurance. HUD codified this interpretation in its Regulation X, which remained in place after jurisdiction was transferred to the CFPB.

PHH also argued that the CFPB cannot take an enforcement action based on transactions that conformed to the law and agency regulations when the action was conducted, and its attempt to do so violated the fundamental principles of fairness and due process.

Finally, PHH argued that the structure of the CFPB, in which the agency was headed by a single director who could not be removed at will by the President, was an unconstitutional delegation of Executive authority.

The Court of Appeals agreed with PHH on all of these points, and determined that it would remedy the structural problem by reading out of the Dodd-Frank statute the limitation on the President's removal authority. The court remanded the case back to the agency (now with a director removable by the President) for purposes of determining if the purchase of the reinsurance was on reasonable market terms.

The key aspect of this decision is the determination that a single-headed administrative agency, in which the agency head is not removable by the President at will, creates an unconstitutional delegation

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of Executive power to a single individual. Executive power is the power to enforce the laws passed by Congress, such as through the issuance of regulations, taking enforcement actions, and by prosecuting violators through civil or criminal actions. Executive power also includes powers directly given to the President by the Constitution, such as being commander-in-chief of the armed forces.

The court explained that the Constitution vested Executive power only in the President, and by necessity the subordinate officers that the President could control through the power of removal. According to the court, it was not until 1935 that the Supreme Court recognized an exception, so that discrete Executive functions could lawfully be delegated to "a body of experts" that was independent of Presidential control. Since that time, the courts have upheld the constitutionality of many independent regulatory agencies, but only if Congress included appropriate limitations on their discretion so that these agencies had set boundaries on their authority. In this decision, the court added another limitation. To establish a lawful delegation of Executive authority to an agency, the agency must be headed by a multi-member board. If not, the single agency head must be removable by the President, at will.

The court found that the broad scope of discretionary authority given to the Director of the CFPB was of great significance, and it is possible that a more limited grant of authority to a single-headed agency may be distinguished. In particular, the court noted that 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 also unilaterally decides what rules to issue; how to enforce them, when to enforce them, and against whom to enforce the law; and what sanctions and penalties to impose on violators of the law. This, the court found, was a concentration of enormous executive power in a single, unaccountable, and unchecked Director.

On the other hand, the court noted that the Office of Special Counsel (OSC), an independent agency headed by a single Special Counsel, has a much narrower scope of authority. This agency mainly enforces certain personnel rules against government employers and employees, such as the prohibition against improper political activity by government employees. Likewise, the Social Security Administration, headed by a single Commissioner, has a narrow focus, and cannot bring any enforcement actions. The court then explained that because these two agencies "do not exercise the core executive power of bringing law enforcement actions and because they have narrow jurisdiction, a holding invalidating the single-Director structure of "the CFPB would not necessarily invalidate the single-Director structure of the Social Security Administration and the Office of Special Counsel."

The court also noted that FHFA is headed by a single Director. However, the court did not distinguish this agency from CFPB, but instead merely noted that it was created in 2008, around the same time (2010) that Congress established the CFPB. The court stated that the FHFA raises the same questions as at issue with the CFPB, and that the existence of FHFA does not lend support for the structure of the CFPB.

Finally, the court noted, in passing, that the Office of the Comptroller of the Currency is a single headed agency, with all authority held by the Comptroller. However, the court determined that the Comptroller is essentially removable by the President, at will.

Implications for FHHA

The FHFA, like the CFPB, is a single-headed agency with regulatory and enforcement authority over much of the U.S. housing finance market. The court of appeals explicitly stated that the FHFA raises the same constitutional questions as the CFPB. Thus, if the court of appeals decision is not reversed, a challenge to the legality of the FHFA structure could be successful, at least in the D.C. Circuit.

Should a court determine that the structure of the FHFA is unconstitutional, the likely remedy could be to judicially strike the provision limiting the removal authority of the President. While this might be the

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least disruptive solution, since no new legislation would be required, it would nevertheless raise a number of significant issues.

Most importantly, a court ruling that the FHFA was unconstitutionally situated would raise into question the legality of all prior regulatory actions. Some actions, such as the determination to place Fannie Mae and Freddie Mac into conservatorship, may be protected by the statute of limitations on challenging conservatorship determinations. The statute of limitations may also protect some other administrative orders. However, any attempt to enforce a regulation would create an opportunity to challenge the legality of the regulation on the grounds that it was promulgated by an unconstitutional authority.

In this regard, it is important to recognize that the courts have considerable flexibility in fashioning a remedy in this situation. For example, in order to avoid market disruption, a court could make any remedy prospective only. This would preserve all agency actions taken prior to the court's decision. Agency actions taken after a court judicially strikes the "for cause" language would automatically avoid this constitutional issue. Therefore, other than making the Director removal at will, the court decision would have no practical impact on existing regulatory decisions or issuances.

Another possibility would be for the agency to attempt to ratify all prior actions after the constitutional infirmity is resolved. This may be harder to accomplish with the current Director, since the case law indicates that ratification cannot be accomplished by the same party that took the initial action.

A court might also determine that the prior actions of the Director are preserved under the de facto officer doctrine." This common law doctrine protects actions taken by a government official acting under color of official title if it later turns out that the appointment was flawed. It is possible that this doctrine would apply in this case.

In short, while it is not possible to determine if the court of appeals case will survive further review, *if* the decision stands, the precedent would likely be applicable to FHFA. A court would likely apply a similar remedy, i.e., judicially striking the "for cause" limitation on removal. The impact on prior FHFA actions would depend on how the court fashions its remedy, but it would be unlikely that a court would not be cognizant of the potential disruption in the housing markets of invalidating prior FHFA actions. Thus, the court could use its discretion to preserve prior FHFA actions, for example, by making its remedy prospective only. It is also possible that the "de facto officer doctrine" could effectively preserve actions taken by the Director.

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