What Happens If High Court Says CFPB Is Unconstitutional

By Keith Bradley (October 21, 2019)

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The Consumer Financial Protection Bureau's day at the U.S. Supreme Court has finally arrived. Seila Law LLC v. CFPB, in which the court just granted certiorari, may be existential for the bureau. But it could have even larger consequences.

Arguments that the bureau's structure is unconstitutional have been percolating since the agency's founding, but until now those questions have not made it to the Supreme Court.

First, industry plaintiffs challenged the purported recess appointment of the first director, Richard Cordray. But in National Labor Relations Board v. Noel Canning, a case involving a similar appointment of the NLRB's general counsel, the court held that the three-day period during which then-President Barack Obama appointed Cordray was not in fact a recess. The president then reappointed him with Senate consent, eliminating that issue.

Next, several constitutional challenges were dismissed for lack of standing. Curiously, there have not been many lawsuits challenging bureau rules, which could have implicated the constitutional issues presented in Seila Law.

Then, in an enforcement appeal — PHH Corp. v. CFPB — then-Judge Brett Kavanaugh held that the bureau's structure was unconstitutional. However, the en banc U.S. Court of Appeals for the D.C. Circuit reversed that decision, and the Supreme Court denied certiorari.

Since then, Judge Kavanaugh has become Justice Kavanaugh. And the bureau has issued wide-ranging rules that completely remodeled the country's mortgage markets. Through supervision and enforcement, the bureau has also induced fundamental changes in how many financial institutions do business. So in a challenge to the bureau's existence, the stakes are much higher today than they were in 2012.

Seila Law is a law firm that the bureau has been investigating with respect to possible violations of laws protecting consumers from debt-relief scams. The firm objected to the bureau's investigative information demands, in part on the ground that the bureau itself is unconstitutional. The U.S. Court of Appeals for the Ninth Circuit rejected that contention, relying largely on the D.C. Circuit's en banc opinion in PHH.

Seila's basic constitutional argument is that the bureau has broad, unchecked power, yet lacks adequate oversight. The bureau has a perennial appropriation of around $550 million annually, and thus, the argument goes, avoids the political oversight involved in the annual appropriations process.

And the agency is headed by a single director who has a five-year term, and under Public Law Section 1011(c)(3) can be removed only "for inefficiency, neglect of duty, or malfeasance in office." This protection, Seila Law (like past challengers) says, prevents the president from supervising the director.

Meanwhile bureau regulations and enforcement reach a wide variety of consumer financial

products and services. Thus, challengers say, the bureau regulates an enormous swath of the economy, yet has no political oversight. This arrangement is, Seila Law contends, a threat to individual liberty.

Judge Kavanaugh's PHH opinion focused on Section 1011(c)(3), which he said was a violation of the president's executive authority under Article II of the Constitution. The resulting remedy was essentially useless to PHH. The court held that this for-cause protection was severable from the rest of the statute, and the bureau's (and the director's) authority remained intact.

If the Supreme Court takes the same path, the president could remove the director at any time — and without cause. But little would change for consumers or companies.

The court has signaled it might go further. The court ordered the parties to discuss whether the for-cause provision is severable from the rest of the Dodd-Frank Act. Not just Title X, the portion of Dodd-Frank that created the bureau — the entire, 1,300-page-long statute.

The Dodd-Frank Act created several new government bodies and abolished others (such as the U.S. Office of Thrift Supervision). It gave agencies a range of authorities to ensure orderly liquidation of troubled banks (remember 2008?). It created a whole new regulatory regime for swaps. It overhauled mortgage markets and securities laws. And, of course, it created the CFPB.

The Supreme Court has asked a question for which, if the answer is "no," an enormous amount of law and regulated economic activity will be thrown into confusion.

The most recent clear model for answering this question was the decision in Free Enterprise Fund v. Public Company Accounting Oversight Board, a 2010 case in which the court struck a for-cause removal protection, but left the rest of the statute intact.

"The normal rule," the court said, is to sever an offending provision "unless it is evident that the Legislature would not have enacted" the rest of the law without that provision. The bureau — much less the Dodd-Frank Act — should fare well under that principle; surely, one might think, Congress would not have wanted to erase the entire Dodd-Frank Act had it known the CFPB director cannot have for-cause protection.

Things may not be so simple. The author of Free Enterprise — Chief Justice John Roberts — is still around, but two members of that majority are not. One has been replaced by Justice Neil Gorsuch, and the other by Justice Kavanaugh, who wrote the panel decision in PHH. That decision severed Section 1011(c)(3) (the director's for-cause protection), but that was Circuit Judge Kavanaugh, bound to follow Free Enterprise. Today's court might not have the same attitude as it did in Free Enterprise.

In addition, there may be a thread to pull on about the bureau. Seila Law contends that the bureau itself is unconstitutional, not just that the for-cause protection is invalid. If that argument prevails, then of course the court will have to decide whether Title X is severable from the Dodd-Frank Act.

And even if the broad argument is unsuccessful and the court concludes that the problem is solely the for-cause protection, it's conceivable that Congress added that protection precisely because of the director's broad enforcement powers. For an official who can order significant penalties (as much as $250,000 for a knowing violation), Congress might have thought some insulation from political influence would be important. Long ago, reasoning

like this was part of the Supreme Court’s justification for accepting the for-cause protection that commissioners of the Federal Trade Commission enjoy. If so, perhaps Congress would not have enacted the same enforcement provisions without the for-cause protection.

If you keep pulling that thread, it’s not easy to predict where it stops. If the court strikes the enforcement authorities, large areas of substantive consumer protection law would be subject to enforcement solely by states, without a unifying federal enforcer. So perhaps those substantive provisions are not severable. If the bureau’s substantive authorities are not severable, then the court might invalidate the existence of the bureau itself.

At this point, the consequences truly begin to mount. If the bureau is eliminated as unconstitutional, presumably all the regulations it adopted would be void. That would include the sweeping overhaul of residential mortgages that the bureau undertook at the beginning of 2013. Difficult though that process was for the mortgage industry, the industry has absorbed those changes. And eliminating the mortgage regulations would not simply restore the pre-2013 status quo.

Title XIV of the Dodd-Frank Act set up many rules for mortgage lending that would be unworkable without implementing regulations. As just one example, a lender must do an extensive analysis of a borrower’s ability to repay a mortgage — unless the loan satisfies criteria that, under Title XIV, must be established by regulation. Lenders currently do the full analysis on about 3.4% of mortgage volume,[1] because the full analysis is expensive. If the bureau is invalidated, then in short order they will have to do that on 100%. The bureau’s regulations are integral to Title XIV, and perhaps Title XIV is not severable from Title X.

The thread doesn’t even stop there. The Dodd-Frank Act abolished the Office of Thrift Supervision, and transferred important functions of that agency to the bureau. Presumably Congress would not have abolished the OTS, in the way that it did, had it known that the bureau would be eliminated as unconstitutional. Undoing that abolishment could — besides being practically impossible — call into question much of the rest of the Dodd-Frank Act. Similarly, the mortgage provisions implicated not only the bureau, but also many other financial regulators.

Like many other statutes, the Dodd-Frank Act is a tangled, integrated creature. Many of the changes it made are now embedded in the fabric of the law and the economy of the country. The court is clearly aware of the difficulties. It asked the parties to brief, not whether the for-cause provision is severable from Title X, but from the Dodd-Frank Act itself.

It should not be taken for granted that the court will hold the for-cause provision is unconstitutional; there are strong arguments to the contrary. And perhaps if it is unconstitutional, the court will simply sever that provision on its own. If the court goes any further, we are in for an interesting ride.

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[1] https://www.corelogic.com/blog/2019/07/expiration-of-the-cfpbs-qualified-mortgage-gse-patch-part-1.aspx.