

Considerations And Consequences From CFPB's 1st Appeal

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The Consumer Financial Protection Bureau issued its first appellate decision on June 4, leaving little by way of protection for targets of its administrative enforcement proceedings. Targets and subjects of a CFPB enforcement investigation or administrative proceeding, and those who represent targets and subjects that are respondents in such a proceeding, should consider implementing more robust procedural best practices.

Background

On June 4, the CFPB issued its first decision on an appeal of an administrative law judge's decision in a CFPB administrative enforcement proceeding.[1] The ALJ decision was appealed both by the respondent, PHH Corp. and its affiliates[2], and by the CFPB's enforcement division. In his decision of the director, CFPB Director Richard Cordray overruled the ALJ on key legal issues and increased the fines and penalties originally imposed by the ALJ from \$6.4 million to \$119 million. The respondent has publicly stated that it will take an appeal to a circuit court to challenge the decision.



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Because this is the first published decision in which the CFPB's director has decided an appeal of an administrative ruling, and because it resulted in a vastly greater penalty than had been imposed by the ALJ initially, this matter is of significant importance for others subject to CFPB jurisdiction. This article discusses the implications of the decision and provides guidance for those subject to, or represent parties in, CFPB administrative proceedings.

Controversy

PHH is a mortgage loan originator and a trader in mortgage loans originated by others. Beginning in the mid-1990s, PHH entered into a series of agreements with various mortgage insurers to provide mortgage insurance on loans to subprime borrowers originated or acquired by PHH. The premiums for this insurance were paid by the borrower, but the beneficiary was the lender. As part of these arrangements, the mortgage insurers were obligated to enter into captive reinsurance agreements with PHH's captive subsidiary, Atrium Insurance Corp., which reinsured the mortgage insurance provided by the mortgage insurers. In turn, the mortgage insurers would share a portion of the mortgage insurance

premiums with Atrium.

The CFPB alleged that PHH created an unlawful kickback scheme by steering borrowers, whom it required to procure mortgage insurance, toward mortgage insurers that were required to do business with Atrium and that Atrium unlawfully received a portion of those mortgage insurance premiums. After an investigation, the CFPB filed a notice of charges that was heard before an ALJ, alleging that PHH had violated the anti-kickback provisions of the Real Estate Settlement Procedures Act, 12 U.S.C. §2607.

After an evidentiary hearing, the ALJ determined that the CFPB's enforcement division had met its burden of showing that RESPA violations had occurred and ordered disgorgement for loans that had closed on or after July 21, 2008. The ALJ declined to order civil monetary penalties, determining that those would apply only to violations that occurred after July 21, 2011 — the effective date of the CFPB's authority. As there were no such loans, the ALJ ordered no monetary penalties.

In his decision, Cordray determined that there was a RESPA violation on each occasion that respondent accepted a payment, which amounted to at least 12 violations a year per covered loan. The director determined that, even to the extent that the respondent had ceased the practice of prohibited referrals, it continued to violate RESPA each time it accepted a payment from a violative loan. On that basis, the director calculated a total disgorgement of \$109,188,618.

Cordray determined that the standard three-year statute of limitations for fraud does not apply to an administrative proceeding such as this, and also found that it would not be necessary to recalculate any amounts since each violation fell within the statute in light of the continuing nature of the allegations. The director concluded the CFPB could seek equitable remedies under RESPA against a respondent for violations that occurred prior to the CFPB's creation, but could not impose RESPA remedies at law, including civil money penalties, for violations occurring before the CFPB was created.

Respondent may elect to appeal the decision to a federal circuit court. At that hearing, Cordray's findings of fact and conclusions of law will be subject to substantial deference under the Chevron^[3] review standard, which effectively requires the reviewing court to uphold the agency's decision unless the court finds that the decision was arbitrary and capricious. As noted above, the respondent has announced its intention to appeal the decision.

Implications

We do not comment on the merits of the CFPB's allegations or whether the proceedings were fairly conducted. Instead, what is of interest in this particular matter is that the respondent was the target of an investigation conducted by the CFPB's enforcement division pursuant to a civil investigative demand and other compulsory process issued under the authority of the director, whose assistant director is appointed by the director himself. Furthermore, the merits hearing was conducted by an ALJ who was also appointed by the director. Finally, the appeal was heard and decided by the director, and the final penalties were imposed by the director.

Accordingly, it is highly likely that the ultimate disposition of this matter (if it is not resolved by settlement) will be achieved without the facts ever having been adjudicated by an independent judicial officer — let alone an Article III judge — and that the decision-maker in this case is, of necessity, required to find facts and make conclusions of law that affect his own (and the CFPB's) authority.

In other words, the decision may raise questions about the ultimate fairness of the administrative

enforcement process itself, similar to fairness questions that are being raised about administrative enforcement remedies used by other federal agencies, such as the U.S. Securities and Exchange Commission.

Putting aside the relative merits of the PHH proceeding and decision, however, this matter serves as a useful reminder of enforcement practice and procedural “best practices” for persons who are the subjects of CFPB administrative proceedings, or who represent parties in such actions. Below are some best practices to consider.

These points focus on the reality that the administrative proceeding will likely be the sole opportunity at which a subject or target may develop a record. This is fraught with risk and must be carefully considered early in the process.

1. Be Aware of Parallel Proceedings Risk

The CFPB works closely with state attorneys general as well as other federal agencies. It has broad-based memoranda of understanding with some states and works with others on a case-by-case basis. While the Privacy Act of 1974 and other federal statutes may provide substantial protection for evidentiary productions to the CFPB, counsel appearing in CFPB proceedings should consider the level of protection afforded to those same materials if they are shared by the CFPB with a state that has an “open” public records statute or a history of contracting enforcement actions to contingent fee counsel. Also, counsel should consider the impact that decisions of the CFPB may have on parallel proceedings before other agencies or in putative class actions. It may become hard in civil discovery to argue against the production of materials that have been previously produced pursuant to a CID and which may not have been properly protected.

2. Make a Record

It is entirely possible that the target of an investigation may never have the opportunity to present a full record before a neutral judicial official. The final arbiters of the dispute — likely a circuit court panel — will only have before them the decision of the CFPB director and whatever record was developed before the ALJ. Accordingly, it is important, at every stage of the proceedings (including at the preliminary investigative stages) to carefully document every action and then put that before the ALJ at the “trial” stage. Counsel can assist with making a record and preserving issues without burdening the process or creating ill will.

3. Build a Case for a Declaratory Judgment Action

We do not counsel frivolous assertions or the abuse of this powerful tool in American jurisprudence. However, where (as here) there may never be an opportunity to litigate facts before a neutral judicial official, it is important to evaluate whether an action is appropriate at each stage. Here, too, counsel can assist to narrow issues and create a record that focuses on only the most significant issue without bringing needless challenges that only serve to obscure the central point.

4. Process Matters

Solid practice counsels adherence to deadlines. Procedural default before the CFPB may result in even less process than is otherwise due. If deadlines are unreasonable and cannot be negotiated, it is critical to document the reasons for unreasonableness with specific facts (e.g., evidentiary quality affidavits

that document the unreasonableness). By way of example, merely objecting to the scope and volume of a civil investigative demand will not aid a target's cause. If there are indeed 5 million responsive documents that may contain privileged information, a custodian of records should produce a careful affidavit to that effect. In short, merely asserting "burden" and the like will not move either the CFPB or, ultimately, a judge.

5. Make a Plan

Short deadlines can make this difficult, but it is essential to develop and then execute a strategy rather than simply treating a civil investigative demand as a document production exercise. The consequences of each action may be felt far beyond the initial dispute.

The team working on an enforcement matter ought to include members with regulatory, state enforcement and class action experience as well.

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[1] See Decision of the Director, In the Matter of PHH Corp., et al. (2014-CFPB-0002, June 4, 2015) (Decision).

[2] For ease of reference, all PHH entities including PHH Corp., PHH Mortgage Corp., and PHH Home Loans LLC, are referred to as "PHH."

[3] *Chevron USA Inc., v. Natural Resources Defense Council Inc.*, 467 U.S. 839 (1984).