# Consumer Financial Protection Bureau

# ALERT

JANUARY 2013

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## D.C. Court Holds President's Recess Appointments "Constitutionally Invalid," Raising Questions About CFPB's Exercise of Authority Over Small Banks and Non-Banks

The U.S. Court of Appeals for the District of Columbia issued an opinion Jan. 25, 2013, that overturns President Barack Obama's recess appointments of three National Labor Relations Board members and opens the door to challenges to the President's simultaneous appointment of Richard Cordray as director of the Consumer Financial Protection Bureau (CFPB). In addition to undermining the validity of the CFPB director's appointment, the ruling in *Noel Canning v. National Labor Relations Board* also brings into question the Bureau's authority to take many of its actions since the January 4, 2012, appointments.

The Dodd-Frank Wall Street Reform and Consumer Financial Protection Act of 2010 (Dodd-Frank), which created the CFPB, provides that although the agency could, without a director, exercise the powers that were transferred to it from other federal agencies as of July 21, 2011, the "new" powers that were granted to the agency, including the authority to supervise smaller depository financial institutions (banks, thrifts, savings associations, and credit unions with $10 billion or less in assets) and covered nondepository financial institutions (including payday lenders, mortgage lenders and servicers, and student lenders) would not become effective until the agency had a director approved by the Senate.

Although President Obama nominated Mr. Cordray to be the agency's first director in July 2011, Congress refused to act on the appointment, due in part to the signed vow of 44 Republican senators that they would not vote to approve the appointment of any director proposed by the President until agency reforms were implemented, including expanding the CFPB's leadership from a single director to a five-person commission (similar to the Federal Trade Commission's structure) and making the agency subject to the congressional appropriations process (Dodd-Frank provided for the perpetual funding of the agency, delegating an annual percentage of Federal Reserve revenues for CFPB operations).

On January 4, 2012, one day after the Senate began its new session, President Obama appointed Mr. Cordray to be director of the CFPB. The Court of Appeals held that "recess appointments" authorized by the Recess Appointments Clause of the U.S. Constitution are limited to "intersession recesses," or "the period between sessions of the Senate when the Senate is by definition not in session and therefore unavailable to receive and act upon nominations from the President." Since the Senate had begun its new session on the previous day, the court found that the appointments were made while the Senate was in session.

Shortly after Mr. Cordray's appointment, the CFPB began implementing its new powers under Dodd-Frank, including conducting examinations of supervised entities and initiating investigations and enforcement actions with respect to the persons and entities that were now presumably subject to the agency's authority.

The new powers also authorized the CFPB to designate and supervise "larger participants" in other consumer

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financial markets as the agency deemed necessary. The CFPB used this power after Mr. Cordray's appointment, issuing rules that designated credit reporting agencies and debt collectors that met specified revenue and assets criteria as "larger participants." As a result, these entities have also been subject to CFPB compliance examinations since their designation.

Finally, the CFPB initiated two federal court enforcement actions against nondepository consumer financial entities, suing a California attorney, his law firm and other entities for engaging in alleged violations of loan modification laws and a payday loan debt-settlement company in Florida for alleged violations of the Telephone Sales Rule. The California defendants have challenged the CFPB's authority to bring the action, citing, among other things, the President's recess appointment of the director, and presumably will move to dismiss the action on the grounds that the agency lacks standing based on the *Canning* decision. The Florida defendant entered into a stipulated judgment with the CFPB in December, agreeing to pay $100,000 and be subject to injunctive relief. Whether the ruling of the D.C. Court of Appeals in *Canning* will provide grounds for challenging the final order in the Florida action is uncertain.

Any fallout from the *Canning* decision likely will be delayed while the issue is appealed, probably directly to the U.S. Supreme Court. Since the ruling effectively overturns standard recess appointment practices administrations have relied upon for nearly a century, and could nullify many of the activities of both the NLRB and the CFPB in the past year, the Obama administration undoubtedly will challenge the decision at the next level if given the opportunity.

In the meantime, companies and banks (with assets less than $10 billion) that are currently engaged in CFPB investigations and examinations may reconsider whether they are obligated to cooperate in these proceedings while these issues are being resolved by the courts. It is also likely that the onslaught of enforcement actions by the CFPB that had been expected by many industry observers and participants may be delayed further as a result of the *Canning* decision. This may be just the respite needed for companies to prepare themselves for the agency's supervision.

For more information about the content of this alert, please contact Michael Mallow, Michael Thurman or Michael Jahnke.

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