

## Lawyer Insights

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### CFPB In-House Judges May Be Next To Come Under Scrutiny

by Gregory Hesse, Jarrett Hale, Tara Elgie, Allison Jacobsen and Abigail Storm

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On June 21, 2018, the U.S. Supreme Court remanded to the U.S. Securities and Exchange Commission an administrative proceeding against Raymond Lucia to be tried by a different administrative law judge because the original ALJ who issued the initial decision against Lucia was improperly appointed.<sup>1</sup> In the wake of constitutional questions involving the Consumer Financial Protection Bureau, the Lucia decision could affect more than just the SEC.

#### Lucia and the Appointments Clause

The key takeaway from the Supreme Court's decision to remand Lucia is the court's ruling that the SEC ALJ is subject to the appointments clause.<sup>2</sup> By way of background, Section 2 of Article II of the Constitution grants the president, a court of law and the head of a department the exclusive power to appoint federal judges and other officials. The president, court of law or department head shall nominate certain "officers" (or "inferior officers") only with the advice and consent of the Senate. "Employees" can be appointed without such advice and consent. The distinction between officers and employees is constitutionally and practically significant because only a select group may appoint an officer, whereas any arm of government may hire employees. For obvious reasons, only a small minority of government officials are appointed by the president. The vast majority are hired as employees. As in the Lucia decision, appointments clause controversies are generally triggered when a government official who was hired as an employee is accused of unconstitutionally wielding the more significant authority of an officer. If the accusation is proved, then the government official was acting *ultra vires* and every decision the official made is presumptively invalid and subject to collateral attack.<sup>3</sup>

The Lucia opinion expressly emphasizes that the appointments clause prescribes the exclusive means of appointing "officers."<sup>4</sup> The constitutionality of any administrative body's ALJ appointment concerns whether that particular ALJ is an "officer of the United States" or simply an employee of the federal

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government.<sup>5</sup> The Supreme Court's analysis in *Lucia* may affect appointments of "inferior officers" in other federal agencies depending on the particular ALJ appointment, hiring process and applicable governing statutes. Herein lies the constitutional and practical significance of the *Lucia* decision, particularly amid the heated debate about the constitutionality of the single-director structure of the CFPB and whether the structure delegates too much authority to the CFPB's unchecked director. Specifically, the court's ruling that an ALJ relied on by the SEC (governed by a panel of directors) is subject to the appointments clause does not bode well for an ALJ ruling relied on by the CFPB (governed by a single director). Additionally, the ruling may impact decisions issued by ALJs who were in the SEC system but deciding cases for the CFPB.<sup>6</sup>

## The *Lucia* "Officer" Test and the CFPB Structure

When determining whether an ALJ is an "officer," the Supreme Court looked at whether the judge holds: (1) a continuing office established by law; (2) significant responsibilities, including taking testimony, conducting trials, ruling on the admissibility of evidence (including having the power to enforce compliance with discovery orders); and (3) significant discretion in ultimate decisions. The ALJ's ability to play a more autonomous role is also a significant factor in determining if an ALJ is an "officer of the United States" and thus subject to the appointments clause.

Currently, CFPB ALJs are appointed for life under the Administrative Procedure Act<sup>7</sup> through a procedure administered by the Office of Personnel Management. ALJs can only be discharged for good cause based upon a complaint filed with the Merit Systems Protection Board and a hearing before an MSPB judge. Moreover, the CFPB's Rules of Practice of Adjudication Proceedings, similar to the SEC's Rules of Practice, give a CFPB ALJ conducting an administrative proceeding authority akin to the authority provided to an SEC ALJ. Similar to SEC ALJs, CFPB ALJs administer formal proceedings and release opinions that go to the CFPB director. Within these formal proceedings, ALJs perform a role comparable to a trial judge. They have the power to issue subpoenas, rule on the admissibility of evidence, consider and rule upon procedural and other motions, and issue sanctions against parties or their counsel as necessary. Finally, CFPB ALJs have complete judicial independence from the CFPB. Like SEC ALJs, CFPB ALJs are not subject to the control or direction of any officer, employee or agent involved in investigating or prosecuting for the CFPB, and other CFPB officials may not interfere with an ALJ's decision-making process. Like the SEC (which is governed by a panel of directors), the single and unchecked director of the CFPB can decline to review an ALJ decision that has not been appealed. Hence, a CFPB ALJ would likely qualify as an "officer" under the *Lucia* analysis.

As courts continue to analyze the constitutionality of the structure of the CFPB and its broad exercise of executive power, the *Lucia* decision may lead to CFPB ALJ scrutiny. Notably, the initial *PHH Corp. v. CFPB* case was decided by an SEC ALJ on loan to the CFPB pursuant to an agreement between the bureau and the commission.<sup>8</sup> Although the recent D.C. Circuit order granting the petition for rehearing en banc ordered the parties to consider the impact of a then-upcoming ruling in *Lucia*, the D.C. Circuit declined to rule on the separate question involving the appointments clause in its en banc decision.

## The Political Landscape

Acting CFPB Director Mick Mulvaney is aware of the significance of the *Lucia* decision.<sup>9</sup> On March 14, 2018, he issued an order to pause the administrative proceeding of the Integrity Advance case until after the Supreme Court's decision in *Lucia*.<sup>10</sup> Similar to *PHH*, the deciding ALJ in Integrity Advance was borrowed by the CFPB from the Coast Guard. Nevertheless, throughout the twists and turns of the lower-

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court litigation in *Lucia*, neither the CFPB nor the SEC decided to take the less confrontational path taken by at least one other agency — the Federal Trade Commission, whose commissioners ratified the agency's earlier selection of judges in case courts eventually concluded that ALJs are "officers."<sup>11</sup> The SEC continued to argue that the ALJs were "mere employees" and the CFPB stood on the sidelines waiting for the court's decision in *Lucia*.

After the *Lucia* decision, President Donald Trump was quick to implement a "fix." On July 10, 2018, he issued an executive order eliminating the competitive examination and selection procedures for appointing ALJs. The result is that ALJs are being pulled out of the competitive service where they are vetted by the Office of Personnel Management and into a more traditional appointment process — which takes into account whether they are a licensed attorney, their past experience as a judge and similar qualifications. James Sherk, special assistant to the president for domestic policy, said the executive order ensures the ALJs have the requisite authority to do their jobs without fear of appeal of their decisions based on how they were hired. "This ruling potentially implicates the authority of ALJs across government, who have very similar degrees of authority at other agencies," Sherk said. "[There] is now uncertainty over whether binding rulings [from ALJs] can continue enforcement of the many different laws enforced by many different agencies across government. The executive order issued today addresses that uncertainty, and ensures that they are hired in a manner consistent with the Appointments Clause." Sherk said that since the Supreme Court elected to hear *Lucia*, "hundreds" of people appealed cases adjudicated by ALJs, arguing that they were improperly appointed.<sup>12</sup>

## Lucia's Potential Effect on CFPB Precedent

Despite this recent executive order, there are still complicated questions about what will happen to all of the pending cases that have been heard by potentially unconstitutionally appointed actors. The ongoing changes in the CFPB have been under intense scrutiny for well over a year. The July 10 Supreme Court nomination of D.C. Circuit Judge Brett Kavanaugh could significantly impact the future of the CFPB as currently structured, as he authored the original opinion in *PHH*, ruling that the structure of the CFPB was unconstitutional. Given the Supreme Court's analysis in *Lucia* and the constitutional question already presented to Mulvaney in *Integrity Advance* (and presented in other cases pending in the Second and Fifth Circuits),<sup>13</sup> CFPB ALJ appointments and decisions may be next to go under the constitutional microscope. Based on the current landscape, the review may have significant ramifications over past CFPB precedent.

*Gregory Hesse, Jarrett Hale and Tara Elgie are partners at Hunton Andrews Kurth LLP in the Dallas office. Gregory's practice focuses on consumer protection law compliance and litigation. He may be reached at (214) 468-3335 or [ghesse@HuntonAK.com](mailto:ghesse@HuntonAK.com). Jarrett helps financial institutions manage all aspects of complying with consumer protection law and preparing for litigation. He may be reached at (214) 979-2919 or [jhale@HuntonAK.com](mailto:jhale@HuntonAK.com). Tara's practice focuses on compliance and litigation for financial institutions related to consumer protection laws and Bankruptcy Code. She may be reached at (214) 979-8212 or [telgie@HuntonAK.com](mailto:telgie@HuntonAK.com). Allison Jacobsen and Abigail Storm are associates at the firm's Dallas office. Allison is a trial attorney who represents and counsels clients in complex commercial disputes involving financial services litigation and compliance. She may be reached at (214) 979-2930 or [ajacobsen@HuntonAK.com](mailto:ajacobsen@HuntonAK.com). Abigail assists clients with compliance and litigation matters including federal state consumer protection and consumer finance litigation in bankruptcy and federal courts. She may be reached at (214) 468-3357 or [astorm@HuntonAK.com](mailto:astorm@HuntonAK.com)*

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<sup>1</sup> *Lucia v. SEC*, No. 17-130, 2018 WL 3057893 (U.S. June 21, 2018).

<sup>2</sup> Art. II, §2, cl. 2.

<sup>3</sup> In *Lucia*, the SEC charged Raymond Lucia, a financial adviser, for using misleading slideshow presentations to deceive potential clients, a violation of the Investment Advisers Act. The SEC instituted an administrative proceeding and assigned the matter to an ALJ. The ALJ found Lucia guilty of violating the act and imposed a \$300,000 fine, along with a lifetime ban from the investment industry. On appeal to the SEC's commissioners, Lucia argued that the administrative proceeding was unconstitutional because the ALJ was an "officer" who must be appointed under the appointment clause. In support of his argument, Lucia stated that because the ALJ was appointed by SEC staff members, he lacked constitutional authority to impose the sentence. SEC commissioners rejected Lucia's argument, holding that ALJs are "mere employees" and thus, do not need to follow appointments clause procedures. Lucia appealed to the D.C. Circuit, which affirmed. After rehearing en banc, the D.C. Circuit split 5-5, resulting in a per curiam order denying Lucia's claim and creating a circuit split.

<sup>4</sup> *Lucia*, No. 17-130, 2018 WL 3057893 at \*3.

<sup>5</sup> See *Id.* at \*5.

<sup>6</sup> Significantly, the CFPB has a common practice of "borrowing" ALJs appointed by other governmental entities for its purposes. For example, the CFPB borrowed an ALJ from the Coast Guard to preside over an administrative proceeding against Integrity Advance. See *In re Integrity Advance LLC et al.*, CFPB No. 2015-CFPB-0029 (Sept. 27, 2016)(recommended decision). Recognizing the import of the court's impending decision in *Lucia*, the CFPB acting director, Mick Mulvaney, stayed the Integrity Advance case while the *Lucia* decision was pending. Due to this widespread practice of sharing ALJs among governmental entities, the *Lucia* decision has a much wider impact than one might initially expect.

<sup>7</sup> 5 U.S.C. § 500 et seq.

<sup>8</sup> The ALJ decision was appealed to the then-acting single CFPB director Richard Cordray. Cordray's decision was appealed to the D.C. Circuit. *PHH Corp. v. CFPB*, 839 F.3d 1 (D.C. Cir. 2016) (holding CFPB single-director structure unconstitutional abuse of power) (Hon. Judge Kavanaugh), rehearing en banc granted, order vacated (D.C. Cir. 2017), reversed en banc, 881 F.3d 75 (Jan. 31, 2018). On June 7, 2018, then-acting CFPB Director Mick Mulvaney moved to dismiss the action.

<sup>9</sup> Interestingly, on July 6, 2018, Leandra English dropped her legal fight to temporarily lead the CFPB after former CFPB Director Richard Cordray stepped down (arguing that as deputy director and as chosen by Cordray, she should lead the CFPB). Trump appointed Mulvaney — who also serves as the director of the Office of Management and Budget. Thus, questions remain about the prior appointment of the director who would be constitutionally obliged to approve CFPB ALJ appointments under the *Lucia* standard. On July 9, 2018, Mulvaney appointed Brian Johnson to CFPB deputy director to replace English. Johnson previously served as senior counsel to Rep. Jeb Hensarling, R-Texas, of the House Financial Services Committee.

<sup>10</sup> Order Directing The Office of Administrative Adjudication To Maintain The Current Status of This Matter And Cautioning That the Prohibition On Ex Parte Communications Remains in effect, CFPB No. 2015-CFPB-0029, Mar. 14, 2018.

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<sup>11</sup> Article II permits inferior officers to be appointed by the president with Senate advice and consent, the president alone, “heads of departments,” or “courts of law.” Arguably, because the SEC constitutes a department head and the commissioners have statutory authority to appoint their ALJs, the commissioners simply need to utilize their pre-existing statutory authority and approve the prior-delegated selection of their ALJs to avoid an appointments clause debate.

<sup>12</sup> <https://www.govexec.com/management/2018/07/trump-moves-administrative-law-judge-appointments-out-of-competitive-service/149602/> (July 10, 2018).

<sup>13</sup> <https://www.law360.com/banking/articles/1059773/cfpb-structure-is-unconstitutional-5th-circ-hears> (July 3, 2018).