

Another Aggressive CFPB Position Leads to Rebuke by Court of Appeals

Dealing the Consumer Financial Protection Bureau (“CFPB” or “Bureau”) another setback, on April 21, 2017, the DC Circuit Court of Appeals (“DC Circuit” or “Court of Appeals”) refused to enforce a Civil Investigative Demand (CID) issued by the CFPB to an accrediting agency for for-profit schools.¹ Although the court cast its decision as based on a “narrower basis” than the district court’s holding that the CFPB lacked the authority to investigate the process for accrediting for-profit schools,² the Court of Appeals’ decision is likely to have broad implications for how the CFPB identifies the nature and scope of its investigations in its CIDs, which to date have provided investigation subjects with little information about the nature of the CFPB’s concerns. This, in turn, could provide significant benefits to CID recipients, as well as establish a basis to challenge the requests set forth in CIDs.

Background

When the CFPB issues a CID, it is required by statute to identify “the nature of the conduct constituting the alleged violation that is under investigation and the provisions of law applicable to such violation.”³ As a matter of practice, and as discussed further below, the CFPB has typically provided this information in extremely broad terms that provided investigation subjects with little insight into what conduct the CFPB believes may have violated the law. The CID issued to the

Accrediting Council for Independent Colleges and Schools (ACICS)—a non-profit organization that accredits for-profit colleges, thus rendering them eligible to participate in the federal student loan program—was no different.

On August 25, 2015, the CFPB issued a CID to ACICS containing the following statement of purpose:

The purpose of this investigation is to determine whether any entity or person has engaged or is engaging in unlawful acts and practices in connection with accrediting for-profit colleges, in violation of sections 1031 and 1036 of the Consumer Financial Protection Act of 2010, 12 U.S.C. §§ 5531, 5536, or any other Federal consumer financial protection law. The purpose of this investigation is also to determine whether Bureau action to obtain legal or equitable relief would be in the public interest.⁴

ACICS petitioned the CFPB to set aside or modify the CID on the grounds that “ACICS is not within the jurisdiction of the CFPB” and that the CID failed to identify the nature of the conduct under investigation.⁵ That petition—like every other petition the CFPB has considered—was denied by the CFPB Director Richard Cordray, who noted that “the Bureau has previously found that notifications functionally equivalent to the one in this CID satisfied the requirements of the statute and regulations.”⁶

When ACICS refused to comply with the CID, the CFPB filed a petition for enforcement in the District Court for the District of Columbia (the “District Court”). ACICS opposed the petition on a number of grounds, including that the CID concerned an investigation that was outside the scope of the agency’s authority. Focusing on the substance of the CFPB’s investigation as it could be discerned from both the Notification of Purpose and the requests in the CID, the District Court, agreeing with ACICS, “concluded that the CFPB lacks authority to investigate the process for accrediting for-profit schools” and denied the petition to enforce.⁷ The CFPB appealed that decision to the Court of Appeals.

The Court of Appeals Decision

The Court of Appeals did not reach the question of the CFPB’s investigative authority. Instead, in a unanimous opinion written by Senior Circuit Judge David B. Sentelle and joined by Circuit Judges Karen L. Henderson and Robert L. Wilkins,⁸ it held that the CID at issue was invalid on its face because it failed to meet the statutory requirement that the CID state the nature of the conduct under investigation and the applicable provisions of law. That is, the CID failed to provide its recipient the required notice of what it was that the CFPB thought the entity might have done wrong.

After setting out the generally deferential standard applicable to judicial review of CIDs and administrative subpoenas, the court noted that “there are real limits on any agency’s subpoena power.”⁹ Among those are the realities that “[a]n administrative agency’s authority to issue subpoenas ‘is created solely by statute’” and that any subpoenas or CIDs it issues must comply with statutory requirements.¹⁰ The court viewed this question as preliminary to the usual substantive assessment of whether an administrative subpoena or CID (1) is within the authority of the agency, (2) is not too indefinite in its demands and (3) seeks information reasonably relevant to the investigation.¹¹

In this case, the court held that the CID failed to comply with the statutory requirement that the CID identify “the nature of the conduct constituting the alleged violation which is under investigation.” The court noted that the statutory requirement “ensures that the recipient of a CID is provided with fair notice as to the nature of the Bureau’s investigation.”¹² Moreover, “[b]ecause the [substantive] validity of a CID is measured by the purposes stated in the notification of purpose, the adequacy of the notification of purpose is an important statutory requirement.”¹³ That is, the court recognized that the statutory requirement at issue here is not merely a technical matter of form but one that serves several important purposes: the provision of “fair notice” to investigation subjects and a basis for courts to assess the substantive validity of demands included in a CID.

The latter point is critical. Because one of the tests applied in CID challenges is whether the information sought in the CID is relevant to the investigation and because the purpose of the investigation is defined in the Notification of Purpose, the more broadly worded that statement of purpose is, the more latitude an agency will have to seek a wide range of information. Conversely, if the Notification of Purpose is more narrowly drawn, any information requests in the CID would have to be relevant to the more narrowly-defined purpose of the investigation. In this way, the Notification of Purpose plays an important role in cabining an agency’s actions.

The Court of Appeals determined that the Notification of Purpose in the CID issued to ACICS—which referenced “unlawful acts and practices in connection with accrediting for-profit colleges”—fell short because it “never explain[ed] what the broad and non-specific term ‘unlawful acts and practices’ means” and thus did “not inform ACICS of the investigation’s purpose.”¹⁴ The court also noted that the vague and broad language impeded effective judicial

review of the CID. Returning to the underlying purpose served by the Notification of Purpose, the court noted that “broad language used to describe th[e] purpose makes it impossible to apply the other prongs of the *Morton Salt* test” for administrative subpoena enforcement: “We cannot determine, for example, whether the information sought in the CID is reasonably relevant to the CFPB’s investigation without knowing what ‘unlawful acts and practices’ are under investigation.”¹⁵

Not content to stop there, the court also criticized the CID’s statutorily-required description of “the provision of law applicable to such violation,” finding it “similarly inadequate.”¹⁶ The CID identified the applicable provisions of law as the Consumer Financial Protection Act’s (CFPA) general prohibition of unfair, deceptive, or abusive acts or practices (UDAAP) as well as “any other Federal consumer financial protection law.”¹⁷ In this regard, the court noted that the CFPA contains detailed definitions of federal consumer financial law and consumer financial products or services (which limit the scope of the CFPB’s UDAAP authority) and that the CID “contains no mention of these definitions or how they relate to [the CFPB’s] investigation.”¹⁸ The court noted that “these provisions ‘stand[] broadly alone’ in the Bureau’s Notification of Purpose, especially considering the Bureau’s failure to adequately state ‘the specific conduct under investigation,’ and thus tell ACICS nothing about the statutory basis for the Bureau’s investigation.”¹⁹ As with the CID’s description of the conduct under investigation, the court concluded that “Congress limited the Bureau’s CID authority with [the statute’s] notice requirements, and framing the applicable law in such a broad manner does not satisfy Congress’s clear directive.”²⁰

In conclusion, the court stated: “Indeed, were we to hold that the unspecific language of this CID is sufficient to comply with the statute, we would

effectively write out of the statute all of the notice requirements that Congress put in.”²¹

Implications

CFPB PRACTICE

The court’s holding in *ACICS* may have broad implications for how the CFPB frames the scope of its investigations. This is because the “the broad and non-specific term ‘unlawful acts and practices’” is a boilerplate term that the CFPB generally uses in the Notification of Purpose of its CIDs. Indeed, the CFPB’s Enforcement Manual (the “Manual”) contains model language to be used in the Notification of Purpose of a CID. According to the Manual, “the general approach of the model language is to describe the nature of the conduct and the potentially applicable law in very broad terms to preserve the Bureau’s ability to request a broad spectrum of information in any CIDs issued in the investigation, particularly since the direction and scope of the investigation might change.”²² Thus, the Manual makes clear that the CFPB intentionally frames its Notifications of Purpose broadly in order to enable the agency to demand broad categories of information and to change the focus of the agency’s investigation based on what it learns from the materials it obtains.

The Manual breaks out specific examples of CID Notifications of Purpose based on the subject matter of potential investigations.²³ In most cases, the template language uses the “unlawful acts or practices” formulation in describing the purpose of the investigation. Thus, for example, the template language for a mortgage servicing investigation reads as follows:

The purpose of this investigation is to determine whether mortgage servicers or other unnamed persons have been or are engaging in *unlawful acts or practices* relating to the servicing of mortgage loans, in violation of the Section 1036 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 12 U.S.C. § 5536, the Real

Estate Settlement Procedures Act, 12 U.S.C. § 2601 et seq., the Truth in Lending Act, 15 U.S.C. § 1601 et seq., Regulation Z, 12 C.F.R. Part 226, the Fair Debt Collection Practices Act, 15 U.S.C. §§ 1692-1692p, or the Fair Credit Reporting Act, 15 U.S.C. § 1681 et seq., and whether Bureau action to obtain legal or equitable relief would be in the public interest.²⁴

Similarly, the “provision of law applicable to such violation” is also drawn in broad terms, typically referencing the same UDAAP provision at issue in *ACICS* and any other potentially applicable statutes without citation to the specific statutory provisions at issue. Although the Manual template language does not reflect it, it is also the CFPB’s practice to regularly reference “any other Federal consumer financial protection law,” a phrase that the court in *ACICS* noted “does nothing to cure the CID’s defects.”²⁵

The court’s holding, therefore, goes to the heart of how the CFPB defines the purpose of its investigations in the CIDs it issues. Director Cordray is reported to have responded to the court’s decision by stating that: “We will make careful efforts to conform to the ruling in our further investigations, whether in this case or any other case.”²⁶ This suggests a potential wholesale change in the way the CFPB structures its Notifications of Purpose.

That would be a welcome development for recipients of CIDs for both of the reasons identified by the Court of Appeals: it would provide investigation subjects with notice of what conduct is being investigated, and it might help cabin the broad scope of CFPB investigations. As the court noted, the broadly-worded Notifications of Purpose often used by the CFPB to date do not provide an adequate basis upon which to assess the validity of the requests for documents, written reports and information set forth in the CIDs. A change in the CFPB’s practices in this regard would potentially provide greater grounds for CID

recipients to challenge CIDs as seeking material not relevant to an investigation.

PETITIONS TO QUASH

Generalized statements of purpose like that contained in the CID issued to *ACICS* and the template language set forth in the Manual have drawn the ire of entities under investigation by the CFPB. In fact, as of April 22, 2017, roughly 75 percent of the administrative challenges to the CFPB’s CIDs involved assertions that the notice of purpose was too broad, was not within the CFPB’s authority or did not provide specific notice to the entity being investigated.²⁷

In the very first decision on a petition to modify and set aside a CID, the CFPB determined that broad Notifications of Purpose were permissible.²⁸ Specifically, the CFPB upheld a CID that stated its purpose as “to determine whether mortgage lenders and private mortgage insurance providers or other unnamed persons have engaged in, or are engaging in, unlawful acts or practices in connection with residential mortgage loans.”²⁹ This early decision, among others, has been used by the CFPB to administratively uphold more recent challenges to the adequacy of Notifications of Purpose in CIDs. Based on the Court of Appeals’ decision, however, it appears that the CFPB’s reasoning will need to change and that challenges to similar, broadly-worded Notifications of Purpose may fare better.

LEGAL CLAIMS

As discussed above, the court in *ACICS* also took issue with the CFPB’s description of the legal basis for the potential violations it was investigating. The *ACICS* CID referenced sections 5531 and 5536 of the CFPA “as well as any other Federal consumer financial protection law.” The court’s holding that “framing the applicable law in such a broad manner does not satisfy Congress’s clear directive” presents a real challenge for the CFPB. It often refers merely to the CFPA’s UDAAP provisions, or to those provisions and other potentially applicable

statutes, in its Notification of Purpose. The implications of the court's decision are that the CFPB needs to be more specific—identifying, for example, whether it believes the conduct it is investigating is unfair, deceptive or abusive and, if the latter, which of the four different kinds of abusiveness it believes are at issue. To date, the CFPB has been loath to do so. Similarly, the CFPB's practice of referencing entire statutes and regulations, without identifying the specific statutory or regulatory provisions it believes may have been violated, no longer appears sufficient.

Providing greater specificity in this aspect of Notifications of Purpose is also likely to be beneficial to investigation targets. First, it will provide greater insight into the CFPB's thinking and give entities more time to prepare legal defenses. It will also allow them, along with their counsel, to better assess the likelihood that a CFPB enforcement action will be successful. Finally, it may provide additional bases on which to challenge CFPB information demands as not relevant to the purpose of an investigation.

LEGAL HOLD IMPLICATIONS

The standard CFPB CID form contains an instruction that the recipient “must retain, and suspend any procedures that may result in the destruction of, documents, information, or tangible things that are in any way relevant to the investigation, *as defined in the CID's Notification of Purpose*” (emphasis added). This “legal hold” prohibition can be burdensome and expensive for companies to implement. As noted, the scope of the legal hold prohibition is tied directly to the description of the investigation in the Notification of Purpose. When that Notification of Purpose is broadly worded—referring to unspecified acts and practices in connection with, for example, mortgage servicing or debt collection—the concomitant obligation to retain information is extremely broad. A change in the CFPB's practice to more narrowly and precisely define the purpose of its investigations will thus have

the additional benefit of narrowing CID recipients' obligations to preserve information.

IMPLICATIONS FOR THE FEDERAL TRADE COMMISSION (FTC)

The CFPA provisions requiring CIDs to state “the nature of the conduct constituting the alleged violation that is under investigation and the provisions of law applicable to such violation” derive from the FTC Act, which contains identical language.³⁰ The court's holding in *ACICS*, therefore, would appear to be equally applicable to CIDs issued by the FTC. Indeed, much of the case law cited by the court in *ACICS* concerned CIDs issued by the FTC. Some of those cases upheld FTC CIDs describing the conduct being investigated with more precision than what the CFPB often includes. Thus, for example, in *FTC v. Invention Submission*, the court upheld a CID whose stated purpose was “to determine whether Invention Submission Corporation ... may be engaged in unfair or deceptive acts or practices ... including but not limited to false or misleading representations made in connection with the advertising, offering for sale and sale of its services relating to the promotion of inventions or ideas.”³¹ To the extent the FTC consistently identifies the specific activities it is investigating with greater specificity, the court's decision may not have much impact. But the court's conclusion that the *ACICS* CID's reference to Sections 5531 and 5536 was insufficient to identify the applicable provisions of law may prove problematic for the FTC, which often refers to Section 5 of the FTC Act, which prohibits unfair and deceptive acts or practices (UDAP). To the extent that *ACICS* stands for the proposition that reference to UDAP or UDAAP alone is not sufficient, it will require greater specificity of the FTC's legal basis for its concerns.

Conclusion

The *ACICS* decision represents the second time that the DC Circuit has ruled against the CFPB.

The first, of course, was in the *PHH* case, where a panel of the court ruled that the agency's structure was unconstitutional. That decision will be considered by the *en banc* DC Circuit in May. In both *PHH* and *ACICS*, the court's decision came against the backdrop of alleged CFPB overreach. In *PHH*, the agency had rejected years of legal interpretation of the Real Estate Settlement Procedures Act to adopt a novel interpretation that it applied retroactively to impose a \$109 million disgorgement order. That sort of overreach likely fed the panel's assessment of the risks of the single-director structure that was the subject of *PHH*'s constitutional challenge. Similarly, in *ACICS*, the court was faced with a CFPB investigation that the District Court had found to be beyond the agency's jurisdiction, which is limited to enforcing federal consumer financial law, not policing the accreditation of for-profit colleges. It is possible that the agency's aggressive posture colored the court's analysis of the legal question before it.

It appears that aggressive positions lead to collateral damage. The FTC learned this decades ago when its attempts to regulate the advertising of children's cereals led to congressionally-imposed limits on its authority. The CFPB appears to have taken the approach that it should push as far and wide as it can on the theory that doing otherwise would be a form of self-censorship. In that view, a legal loss is not a big deal as it leaves the agency no worse off than had it not sought to act in the first place. But that perspective fails to account for the collateral consequences of judicial decisions. The tightrope of judicial deference gets thinner and more difficult to walk as the CFPB ventures into areas beyond its authority over consumer financial services. And now, rather than simply being told that it cannot investigate the accreditation of for-profit schools, the CFPB faces a change to how it conducts all of its enforcement investigations.

For more information about this topic, please contact any of the following lawyers.

Ori Lev

+1 202 263 3270

olev@mayerbrown.com

James K. Williams

+1 202 263 3891

jwilliams@mayerbrown.com

Endnotes

- ¹ *Consumer Financial Protection Bureau v. Accrediting Council for Independent Colleges and Schools* ("ACICS"), No. 15-1838 (D.C. Cir. April 21, 2017).
- ² *ACICS*, slip. op. at 10.
- ³ 12 U.S.C. § 5562(c)(2); 12 C.F.R. § 1080.5.
- ⁴ *ACICS*, slip op. at 5.
- ⁵ Accrediting Council for Independent Colleges and Schools' Petition to Set Aside or Modify the Civil Investigative Demand, available at http://files.consumerfinance.gov/f/201510_cfpb_decision-on-petition-by-selling-ACICS-to-set-aside-civil-investigative-demand.pdf
- ⁶ Decision and Order on Petition by Accrediting Council for Independent Colleges and Schools to Set Aside or Modify the Civil Investigative Demand, available at http://files.consumerfinance.gov/f/201510_cfpb_decision-on-petition-by-selling-ACICS-to-set-aside-civil-investigative.pdf.
- ⁷ *CFPB v. ACICS*, 183 F. Supp. 3d 79, 84 (D.D.C. 2016).
- ⁸ Judge Sentelle was appointed by President Ronald Reagan, Judge Henderson was appointed by President George H.W. Bush and Judge Wilkins was appointed by President Barack Obama.
- ⁹ *ACICS*, slip op. at 9.
- ¹⁰ *Id.* at 11 (quoting *Peters v. United States*, 853 F.2d 692, 696 (9th Cir. 1988)).
- ¹¹ *Id.* at 11; see also *id.* at 8 (discussing substantive standard for enforcing administrative subpoena).
- ¹² *Id.* at 11.
- ¹³ *Id.* at 11 (internal citation omitted).
- ¹⁴ *Id.* at 12.
- ¹⁵ *Id.* at 13 (internal quotations and citations omitted).
- ¹⁶ *Id.* at 14.
- ¹⁷ *Id.*

- ¹⁸ *Id.*
- ¹⁹ *Id.*
- ²⁰ *Id.*
- ²¹ *Id.*
- ²² CFPB Enforcement Manual, “Complying with Rule of Investigation 1080.5 [Notification of Purpose], at 1 (last revision 04/28/2015) (obtained via FOIA request).
- ²³ *Id.* at 1-3.
- ²⁴ *Id.* at 3 (emphasis added).
- ²⁵ *ACICS*, slip op. at 14.
- ²⁶ Kate Berry, *CFPB loses appeal in case involving for-profit colleges*, *American Banker* (April 21, 2017).
- ²⁷ See <https://www.consumerfinance.gov/policy-compliance/enforcement/petitions/?page=3#0-filterable-list-controls-0>.
- ²⁸ Decision and Order on PHH Corporation’s Petition to Modify or Set Aside Civil Investigative Demand, available at http://files.consumerfinance.gov/f/201209_cfpb_setaside_phhcorp_0001.pdf.
- ²⁹ *Id.* at 6. It should be noted that initial communications from the CFPB to the entity being investigated explained that the CFPB was seeking “to determine whether premium ceding practices by an entity involving captive reinsurers and private mortgage insurance carriers comply with Section 8 of the Real Estate Settlement Procedures Act.” *Id.* at 5. The CFPB noted that CIDs with “terse” statements of conduct have been upheld where previous communications from an administrative agency ensured that “there c[ould] be no doubt that the [subject] understood what conduct was under investigation in light of communications between counsel relating to the same subject matter.” *Id.* at 6 (quoting *Material Handling Institute Inc. v. McLaren*, 426 F.2d 90, 92 (3d Cir. 1970)). Subsequent decisions denying petitions to quash based on the alleged inadequacy of the Notification of Purpose did not contain such further explanatory communications.
- ³⁰ See 15 U.S.C. § 57b-1(c)(2).
- ³¹ 965 F.2d 1086, 1088 (D.C. Cir. 1992).

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