UNITED STATES OF AMERICA
Before the
BUREAU OF CONSUMER FINANCIAL PROTECTION

ADMINISTRATIVE PROCEEDING
File No. 2015-CFPB-0029

In the Matter of:	
INTEGRITY ADVANCE, LLC and JAMES R. CARNES,	**ENFORCEMENT COUNSEL'S BRIEF RESPONDING TO ACTING DIRECTOR'S ORDER**
Respondents.	

ENFORCEMENT COUNSEL'S BRIEF RESPONDING TO ACTING DIRECTOR'S ORDER

Enforcement Counsel filed a notice of charges against Respondents Integrity Advance and James Carnes on November 18, 2015. Dkt. 1. The Administrative Law Judge (ALJ) assigned to the matter ultimately issued a recommended decision, which each party appealed to the Bureau Director. Dkts. 176-178. In their appeal, Respondents argued (for the first time) that the ALJ who presided over the proceedings and issued the recommended decision had not been appointed in conformity with the Appointments Clause of the Constitution. Dkt. 184 at 2. The Acting Director ultimately stayed this matter pending the Supreme Court's decision in *Lucia v. SEC*, which concerned whether the Appointments Clause applied to the appointment of Securities and Exchange Commission (SEC) ALJs. Dkt. 210. The Court ruled in June 2018 that

SEC ALJs "are 'Officers of the United States,' subject to the Appointments Clause." *Lucia v. SEC*, 138 S. Ct. 2044, 2055 (2018).

Following that ruling, and in response to an order by the Acting Director, the parties submitted a Joint Statement regarding further proceedings in this case. Dkt. 212. In that Joint Statement, the parties stated that they agreed that the Supreme Court's decision in *Lucia* applies to this case, and that they were aware of no evidence that the ALJ who presided over the proceedings in this case had been appointed in conformity with the Appointments Clause. Dkt. 212 at 3-4.

In response, the Acting Director issued an order calling for additional briefing on two questions:

> (1) If a new hearing is to be held in this matter before an administrative law judge, must the Bureau also file a new Notice of Charges?
>
> (2) Does the Bureau's current administrative law judge satisfy the requirement … that an administrative law judge be appointed by the President, a court of law, or the head of a department?

Dkt. 213.

On the first question, no new notice of charges is required. The Supreme Court has repeatedly held that, where an adjudication is tainted with an appointments violation, a party is entitled to a "new hearing" before a properly appointed official. It has *never* required a new notice of charges (or an analogous case-initiating document)—and Respondents cite no authority suggesting otherwise. Nor do they identify any legitimate purpose that would be served by imposing such a requirement, which is out of step with the ordinary procedures governing both administrative adjudications and federal-court litigation.

On the second question, the Bureau's current ALJ was appointed in conformity with the Appointments Clause. Former Director Cordray appointed her to the ALJ position, and the Bureau's Director is the "head of a department." The Supreme Court has made clear that executive agencies that are not "subordinate to" or "contained within" other agencies qualify as "Departments" for purposes of the Appointments Clause. *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 511 (2010). Respondents contend that the Bureau fails this test because it is "established within the Federal Reserve System." 12 U.S.C. § 5491(a). But the Federal Reserve *System* is not an agency at all, but rather a collection of distinct entities, including multiple government agencies as well as private banks. While the *Board of Governors* of the Federal Reserve System is an agency, the Bureau is not contained within that agency, nor is the Bureau subordinate to it, as Respondents concede.

ARGUMENT

I. The Bureau need not file a new notice of charges.

The Bureau is not required to file a new notice of charges in this case.[1] The Supreme Court has repeatedly held that "the 'appropriate' remedy for an adjudication tainted with an appointments violation is a new 'hearing before a properly appointed' official." *Lucia*, 138 S. Ct. at 2055 (quoting *Ryder v. United States*, 515 U.S. 177, 183 (2018)). Respondents point to no authority so much as suggesting that this "new hearing" must include the issuance of a new notice of charges by the agency, nor do they provide any reasoned basis for imposing such a

[1] Respondents argue that any new notice of charges would be time-barred. Enforcement Counsel disagrees but does not address that argument here, as it is outside of the scope of the Acting Director's order calling for additional briefing.

requirement. The notice of charges is not issued by the ALJ, so there is no basis to find that the constitutional defect extends to it. Respondents are entitled to an "appropriate" remedy for the constitutional violation that affected them—the previous ALJ's improper appointment. A new hearing before a new ALJ gives them just that. Respondents cannot explain why, in addition to a new hearing, they are also entitled to a new notice of charges from the agency, especially since there was no defect in the original notice of charges. Instead, Respondents seek to capitalize on the Appointments Clause problem with the prior ALJ to escape liability altogether (because, in their view, any new notice of charges would be time-barred). Respondents are not entitled to such a windfall—and they cite no authority suggesting that they are.[2]

Indeed, *Lucia* itself shows that an ALJ's improper appointment does not mean that an agency has to begin its case entirely anew. When the Court concluded in that case that the SEC's ALJs were unconstitutionally appointed, it remedied the problem by requiring that "another ALJ (or the Commission itself) hold [a] new hearing." *Id.* The Court did not require the SEC to file new charges. *See id.* Consistent with the Supreme Court's decision, the SEC reassigned the case to a new ALJ, without requiring a new notice of charges. *Pending Admin. Proc.*, Admin. Proc. Rulings No. 5955, 2018 SEC LEXIS 2264 (C.A.L.J. Sept. 12, 2018); *see also Order*, *In re. Raymond J. Lucia Companies, Inc.*, No. 3-15006, 2018 SEC LEXIS 2719 (Oct. 2, 2018) (new ALJ's order requiring parties to submit joint proposal for how the

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[2] Respondents' attempt to obtain dismissal of the current notice of charges is particularly unwarranted given that they did not raise any objection to the ALJ's appointment in the ten months that the case was pending before the ALJ. Had they raised a timely objection, the agency could have properly appointed an ALJ at the time, thereby avoiding the need for duplicative proceedings now. *Cf. Andrade v. Lauer*, 729 F.2d 1475, 1484 (D.C. Cir. 1984) (describing the general requirement that parties must raise claims before an agency in order to give agency the chance to "correct its own errors").

adjudication should proceed). Likewise, in other cases that were initially heard by improperly appointed ALJs, newly assigned SEC ALJs have already begun conducting new hearings without requiring new orders instituting proceedings (the SEC's equivalent of a notice of charges). *See, e.g.*, *In the Matter of Dearborn Bancorp, Inc.*, No. 3-18223 (SEC Sept. 20, 2018), https://www.sec.gov/alj/aljorders/2018/ap-6041.pdf (providing new opportunity for defaulting respondent to file answer, but not requiring new order instituting proceedings); *In the Matter of Brian Michael Berger*, No. 3-18129 (SEC Oct. 11, 2018), https://www.sec.gov/alj/aljorders/2018/ap-6167.pdf (ordering SEC Division of Enforcement to show that it served order instituting proceedings either initially or after remand).

The remedy in *Lucia* is consistent with other decisions in which the Supreme Court has found Appointments Clause or similar problems with adjudicative bodies. In those cases, too, the Court has granted a party a new hearing before properly appointed officials without also requiring new case-initiating documents. In *Nguyen v. United States*, for example, the Court found that the panel of the court of appeals below had been improperly constituted. 539 U.S. 69 (2003). It therefore remanded the case for "fresh consideration … by a properly constituted panel." *Id.* at 83. On remand, the court of appeals did not require a new notice of appeal—let alone a new complaint—but rather merely invited supplemental briefs on any new decisions "that may impact the arguments already raised in [the parties'] original briefs" and calendared the cases before the next available panel. *United States v. Nguyen*, No. 00-10406, Order (9th Cir. Aug. 20, 2003). Likewise, in *Ryder v. United States*, the Supreme Court held that, where a panel that initially heard a defendant's appeal included two improperly appointed judges, the defendant was entitled to "a hearing before a properly appointed panel of that court." 515 U.S. 177, 188

(1995). The Court did not require the government to refile charges or the defendant to refile his appeal. *See id.*

Indeed, the D.C. Circuit has explicitly held that where the Appointments Clause requires a new hearing before a properly appointed adjudicative body, that new hearing need not be a complete do-over. *Intercollegiate Broadcasting Sys., Inc. v. Copyright Royalty Bd.*, 796 F.3d 111, 117 (D.C. Cir. 2015). Rather, it is enough that the properly appointed officials "conduct an independent evaluation of the merits"—even if they do so on the basis of the "existing record" compiled in the proceedings conducted by the improperly appointed body. *Id.* at 117. If new proceedings to compile a new record are not required, a new notice of charges plainly is not required either.

Unable to cite any authority for their contention that the Appointments Clause violation requires a new notice of charges, Respondents contend that the Bureau's Rules of Practice for Adjudication Proceedings somehow impose a requirement for a new notice of charges where none would otherwise exist. *See* Resp. Br. at 5-7. But they do not point to any provision imposing such a requirement, and indeed there is none. Respondents' argument instead appears to be that Enforcement Counsel's original notice of charges was a legal nullity, and thus must be refiled, because the Rules of Practice require a hearing officer to oversee administrative adjudications, and the previous hearing officer was not properly appointed under the Appointments Clause. Nothing in the Rules of Practice requires that a hearing officer be assigned to a case before Enforcement Counsel may file a valid notice of charges. On the contrary, it is the filing of a notice of charges that initiates a case, and only later is a hearing officer assigned. *See* 12 C.F.R. § 1081.200(a) ("A proceeding … is commenced by filing of a

notice of charges by the Bureau"); *id.* § 1081.105(a) (providing for the assignment of hearing officers "for the conduct of proceedings").

None of the provisions that Respondents cite—which simply provide that the hearing officer will perform certain functions—support its view that, in the absence of a hearing officer, a notice of charges is somehow legally void. *See, e.g.*, *id.* § 1081.203(d) (hearing officer shall issue scheduling order) (cited in Resp. Br. at 6). And one provision that Respondents do not cite specifically contemplates that hearing officers may become unavailable during the course of a proceeding. *Id.* § 1081.105(d). There is nothing in the Rules of Practice, or in reason, that would suggest that such unavailability would render the proceeding itself (or the notice of charges) fatally defective.

In short, Respondents do not explain why anything in the Bureau's Rules of Practice would require that, where the hearing officer was improperly appointed, the agency must start proceedings over from scratch by filing a new notice of charges rather than simply by conducting a "new hearing before a properly appointed official," *Lucia*, 138 S. Ct. at 2055. No new notice of charges is required.

II. The Bureau's current ALJ was appointed in conformity with the Appointments Clause.

The Appointments Clause provides that "only the President, 'Courts of Law,' or 'Heads of Departments' can appoint 'Officers.'" *Lucia*, 138 S. Ct. at 2050 (quoting Art. II, § 2, cl. 2). *Lucia* held that SEC ALJs are "Officers" subject to this restriction, 138 S. Ct. at 2055, and the parties agree that this holding applies to the Bureau's ALJ as well. The Bureau's current ALJ, Christine Kirby, was appointed in accordance with the Appointments Clause. Enforcement Counsel understands that former Director Cordray appointed Hearing Officer Kirby to her ALJ

position.[3] Because the Bureau Director is the "Head[] of [a] Department[]," this appointment satisfied the Appointments Clause.

The Supreme Court has held that a "Department" within the meaning of the Appointments Clause is "a freestanding component of the Executive Branch, not subordinate to or contained within any other such component." *Free Enter. Fund*, 561 U.S. at 511. Respondents object that the Bureau is not such a "freestanding component" because the CFPA provides that the Bureau "is established in the Federal Reserve System," 12 U.S.C. § 5491(a). Resp. Br. at 10. But that does not mean that the Bureau is "subordinate to or contained within" another component of the Executive Branch. The Federal Reserve *System* is not itself an agency. Rather, it is a collection of distinct entities, including the Board of Governors of the Federal Reserve System, the Federal Reserve banks, and every national bank, among other entities. *See* 12 U.S.C. §§ 222, 241; *see also, e.g.*, *id.* §§ 263, 321.

The *Board of Governors* of the Federal Reserve System is of course an agency, but the Bureau is not "established in" or "contained within" the Board of Governors (any more than the private banks which are also part of the Federal Reserve System are "contained within" the Board of Governors). *See id.* §§ 241, 5491(a). The Bureau, moreover, is not "subordinate to"

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[3] Respondents suggest that "[a]vailable records" indicate that the Bureau's Director did not appoint ALJ Kirby, but rather that she was hired "through the traditional OPM process." Resp. Br. at 9. It is Enforcement Counsel's understanding that Bureau records reflect that, although Hearing Officer Kirby was hired through the OPM process, Director Cordray did, in fact, appoint her at the conclusion of that process. Enforcement Counsel assumes that the Acting Director has access to all pertinent records. In addition, if Director Cordray did not appoint Hearing Officer Kirby, the Acting Director could appoint her now, before remanding this matter for new proceedings before her, and thereby satisfy the Appointments Clause's requirements.

the Board of Governors, as Respondents themselves concede.[4] *See* Resp. Br. at 10. The CFPA specifically provides that the Board of Governors may not "intervene in any matter or proceeding before the [Bureau] Director"; "appoint, direct, or remove any officer or employee of the Bureau"; or "merge or consolidate the Bureau," or any Bureau functions or responsibilities, with any part of the Board of Governors or the Federal reserve banks. 12 U.S.C. § 5492(c)(2). Nor is any Bureau order or rule "subject to approval or review by the Board of Governors." *Id.* § 5492(c)(3). The Bureau therefore is not "contained within" or "subordinate to" any other executive branch agency, so it qualifies as a "Department" under *Free Enterprise Fund*, 561 U.S. at 511.

Understanding the Bureau to be a "Department" under the Appointments Clause, moreover, is wholly consistent with the Clause's purpose. As the Supreme Court has explained, the Framers were concerned that "widely distributed appointment power subverts democratic government." *Freytag v. C.I.R.*, 501 U.S. 868, 885 (1991). Thus, "[t]he Appointments Clause prevents Congress from distributing power too widely by limiting the actors in whom Congress may vest the power to appoint." *Id.* This purpose is served where "Departments" are limited to those "agencies immediately below the President in the organizational structure of the Executive Branch." *Freytag*, 501 U.S. at 918 (Scalia, J., concurring in part and concurring in judgment).[5] Such an understanding "constrains the distribution of the appointment power" and limits that power to agencies whose "heads are subject to the exercise of political oversight and share the

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[4] The Bureau likewise is not "subordinate to" the Federal Reserve System. The System itself—which, again, includes every national bank, among various other entities—has no authorities, let alone authority it can exercise over the Bureau.

[5] Although Justice Scalia wrote for only four justices in *Freytag*, the Supreme Court ultimately adopted his reasoning in *Free Enterprise Fund*, 561 U.S. at 511.

President's accountability to the people." *Freytag*, 501 U.S. at 886 (majority op.). The Bureau is just such an agency. The President appoints the Bureau Director with the advice and consent of the Senate, and the President may remove the Director for cause. 12 U.S.C. § 5491(b)(2), (c)(3). This puts the Bureau "immediately below the President" and ensures that the Bureau Director is "subject to the exercise of political oversight"—just as is true of agencies like the SEC. *See Free Enterprise Fund*, 561 U.S. at 511 (holding that SEC "constitutes a 'Departmen[t]' for the purposes of the Appointments Clause").

Understanding the Bureau to be a "Department" also ensures that the Bureau's inferior officers—which likely include not just the ALJ but also other senior officials such as the Deputy Director—"can be made appointable by their ultimate (sub-Presidential) superiors." *Freytag*, 501 U.S. at 919 (Scalia, J., concurring in part and concurring in the judgment). If the Bureau were not a "Department," then those officials could *not* be appointed by their ultimate superior, the Director. Rather, if Congress wanted to vest the authority to appoint the Bureau's inferior officers in someone other than the President or the courts, it could only give that authority to "the 'Secretary of Something Else'"—just the sort of result that Justice Scalia said in *Freytag* would "make[] no sense." *Id.* Indeed, Respondents offer no plausible reason why it would make any constitutional sense for the Federal Reserve Board of Governors, for example, to appoint the Bureau's inferior officers when those officials have no say over how those Bureau officials carry out their duties.

The Bureau is a "Department" under the Appointments Clause, and its head (the Director) may appoint the agency's inferior officers, including the ALJ. The Bureau Director's appointment of Hearing Officer Kirby therefore satisfied the Appointments Clause.

CONCLUSION

The Acting Director should remand this case for a new hearing before the Bureau's ALJ. No new notice of charges is required, and the Bureau's current ALJ was appointed in accordance with the Appointments Clause.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on the 24th day of October 2018, I caused a copy of the foregoing Enforcement Counsel's Brief Responding to Acting Director's Order to be filed by electronic transmission (e-mail) with the Office of Administrative Adjudication (CFPB_electronic_filings@cfpb.gov), and served by email on the Respondents' counsel at the following addresses:

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