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	**RESPONDENTS' OPENING BRIEF RESPONDING TO ACTING DIRECTOR'S ORDER**

RESPONDENTS' OPENING BRIEF RESPONDING TO ACTING DIRECTOR'S ORDER

On July 10, 2018, Bureau of Consumer Financial Protection ("BCFP" or "Bureau") Acting Director Mulvaney ordered Bureau Enforcement Counsel and Respondents Integrity Advance, LLC and James R. Carnes (together, "Respondents") to file a joint statement regarding further proceedings in the above-captioned matter, specifically addressing the applicability of *PHH Corp. v. CFPB*, 881 F.3d 75 (D.C. Cir. 2018), and *Lucia v. SEC*, 138 S. Ct. 2044 (2018).

The parties filed the joint statement on August 13, 2018. In the joint statement, Respondents asserted that the Supreme Court's decision in *Lucia* applies to administrative adjudications before the Bureau, but the Acting Director need not address the question and remedy for that constitutional violation since Respondents have raised several dispositive, threshold arguments. Should the Acting Director reach the constitutional question, however, the remedy required by the Supreme Court's decision in *Lucia* must consist of a new proceeding before a lawfully-appointed hearing officer. The new proceeding must include a new Notice of Charges because the constitutional defect in the Bureau's administrative adjudication invalidated the entire prior proceeding. Furthermore, the Bureau's current administrative law Judge ("ALJ") was not appointed in accordance with the Appointments Clause and the *Lucia* decision.

On September 12, 2018, the Director issued an Order Directing Parties to Provide Additional Briefing (the "Order"). The Order directed 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 in *Lucia v. SEC*, 138 S. Ct. 2004 (2018), that an administrative law judge be appointed by the President, a court of law, or the head of a department?

Pursuant to the Order, Respondents submit this opening brief regarding these two questions. This matter should be disposed of on other threshold issues addressed at length in Respondents' prior filings. However, should the Acting Director reach the Appointments Clause

issue, the entire proceeding must be invalidated. The Bureau would have to file a new Notice of Charges – subject to applicable statutes of limitations—upon the availability of a lawfully-appointed ALJ.

INTRODUCTION

In their appeal from the hearing officer's Recommended Decision in this matter, Respondents have raised threshold legal challenges to the Bureau's authority over Respondents and also as asserted that the claims as to Mr. Carnes were time-barred. Dkt. 184. Respondents also previously asserted that the Bureau's administrative adjudicatory is unconstitutional, among other arguments. *Id.* at 2.

Courts have consistently held that threshold dispositive issues such as authorities and statute of limitations issues should be disposed of – when possible – before addressing other issues. For instance, the D.C. Circuit noted that "[w]e first consider whether [the] claims were brought within the statute of limitations, and we then review the grant of summary judgment in the defendants' favor." *Seed Company Limited v. Westerman*, 832 F.3d 325, 331 (D.C. Cir. 2016); *see also U.S. ex rel. Miller v. Bill Harbert Int'l Const., Inc.*, 608 F.3d 871, 877 (D.C. Cir. 2010) (noting that threshold issues should be addressed first).

Contrary to Enforcement Counsel's assertions,[1] the Director need not address the appointment of the hearing officer should other arguments prove dispositive. Specifically, principles of constitutional avoidance and judicial economy militate in favor of dismissing this matter as outside the scope of the Bureau's jurisdiction and time-barred. Respondents have set forth their positions on these threshold issues more fully in Respondents' portion of the August

[1] *See* Dkt. 212 at 12.

13, 2018 Joint Statement, as well as other filings throughout the course of the administrative adjudication; we incorporate those arguments by reference. *See, e.g.*, Dkt. 212, 184, 28.

Alternatively, as addressed more fully below, if the Acting Director does not dismiss this matter on other grounds, the Bureau's violation of the Appointments Clause must be remedied. Such a remedy requires initiating a new proceeding and filing a new Notice of Charges. Any potential claim against either Respondent would necessarily be time-barred, given the substantial passage of time here.

ARGUMENT

I. THE BUREAU'S CONSTITUTIONAL VIOLATION REQUIRES A NEW PROCEEDING

A. Without A Lawfully-Appointed Hearing Officer, The Bureau Cannot Pursue Administrative Adjudication

It is axiomatic that a new proceeding is required to remedy the Bureau's Appointment Clause violation. Indeed, this constitutional violation undermines "the validity of . . . the proceeding" itself. *See Freytag v. Comm'r*, 501 U.S. 868, 879 (1991); *see also Nguyen v. United States*, 539 U.S. 69, 83 (2003) (requiring "fresh consideration of petitioners' appeals" by a properly-constituted appellate panel); *United States v. L. A. Tucker Truck Lines, Inc.*, 344 U.S. 33, 38 (1952) (stating that the failure to appoint an ALJ in compliance with the Administrative Procedure Act "was an irregularity which would invalidate a resulting order").

The weight of authority, including the Supreme Court's most recent decision in *Lucia*, mandates that the only remedy to cure the constitutional defect in this matter is a new proceeding by a constitutionally-appointed administrative officer. The defect here, an improperly appointed hearing officer, involves what the Supreme Court has described as "basic constitutional protections designed in part for the benefit of litigants." *Ryder v. United States*, 515 U.S. 177, 182 (1995). In *Ryder*, the Supreme Court explained that "[o]ne who makes a timely challenge to

the constitutional validity of the appointment of an officer who adjudicates his case is entitled to . . . whatever relief may be appropriate if a violation indeed occurred." *Id.* at 182-83. Indeed, the Court noted that "[a]ny other rule would create a disincentive to raise Appointments Clause challenges with respect to questionable judicial appointments." *Id.* Public accountability requires that Respondents receive meaningful relief to ensure that Appointment Clause violations are addressed. Indeed, "the Appointments Clause was designed to ensure public accountability for both the making of a bad appointment and the rejection of a good one." *Edmond v. United States*, 520 U.S. 651, 660 (1997).

Similarly, in *Lucia*, a decision that Enforcement Counsel agrees applies here, the Supreme Court determined that the appropriate remedy for an Appointments Clause violation "is a new 'hearing before a properly appointed' official." *Lucia*, 138 S. Ct. at 2055. Although the Court did not define the term "hearing," both logic and the Bureau's own rules dictate that it must extend to the entirety of the proceeding, given the integral nature of the hearing officer to the adjudicatory process. In fact, the Bureau defines the term "hearing officer" as "an administrative law judge or any other person duly authorized to preside at a hearing." 12 C.F.R. § 1081.103. If the "hearing officer" is unavailable, the chief hearing officer or the Director shall designate another hearing officer to serve. *Id.* § 1081.105(d). Under the reasoning of the Supreme Court's decision in *Lucia*, an ALJ or presiding person would be an "inferior officer" and, thus, need to be properly appointed.

Oversight of proceedings by a lawfully-appointed hearing officer is an integral part of the legal authority for any proceeding. The Consumer Financial Protection Act ("CFPA") authorizes the Bureau to conduct administrative adjudications pursuant to the Administrative Procedures Act ("APA"), through a process implemented through the Bureau's rules. 12 U.S.C. § 5563(a),

(e). The Bureau's Rules of Practice for Adjudication Proceedings set forth an adjudicatory process that *requires* a hearing officer,[2] and – importantly – does not create a method whereby the Bureau may proceed without a hearing officer. *See id.* § 1081.105(d) (requiring that a new hearing officer be designated should the hearing officer become unavailable). The availability of a lawfully-appointed hearing officer is a pre-requisite for filing the Notice of Charges and setting the time and place of the hearing. *See* 12 C.F.R. § 1081.203(d); Notice of Charges, Dkt. 1 at 15. The Notice of Charges must set out the legal authority for the proceeding. 12 C.F.R. § 1081.200(b); 5 U.S.C. § 554(b). A hearing officer is also required in order to issue a recommended decision in compliance with the Bureau's Rules. 12 C.F.R. §§ 1081.104(b)(11); 1081.400(d). For example, the preamble to the Rules states that "[t]he Rules implement a procedure . . . whereby a hearing officer will issue a recommended decision in each administrative adjudication." *Rules of Practice for Adjudication Proceedings*, 76 Fed. Reg. 45338, 45339 (Jul. 28, 2011); 12 C.F.R. § 1081.400(d) ("The recommended decision shall be made and filed by the hearing officer who presided over the hearings, except when he or she shall have become unavailable to the Bureau."). The recommended decision from the hearing officer is due "[i]n no event later than 300 days after filing of the notice of charges." *Id.* § 1081.400(a).[3]

[2] *See* 12 C.F.R. §§ 1081.101 (requiring that "[i]n the conduct of such proceedings, the hearing officer and counsel for all parties shall make every effort at each stage of a proceeding to avoid delay), 1081.104 (providing the hearing officer "powers necessary to conduct a proceeding"), 1081.111 (requiring the hearing officer to "file all written orders, rulings, notices, or requests"), 1081.400 (requiring a recommended decision filed by the hearing officer).

[3] In turn, a recommended decision from the hearing officer is also essential to the Director's review and final decision, since the Director must "affirm, adopt, reverse, modify, set aside, or remand . . . the recommended decision . . . ." *Id.* § 1081.405(c).

Moreover, a proceeding without a hearing officer also would violate the Bureau's rule regarding expedition and fairness in the proceeding, *see id.* § 1081.101, as it would require waiting until the constitutional appointment of a hearing officer. Here, this proceeding should not have advanced – certainly not in 300 days, indeed, at all – when Enforcement Counsel filed the Notice of Charges because no properly-appointed hearing officer was available to administer the proceeding. *See Papasan v. Allain*, 478 U.S. 265, 276 (1986) (explaining that government action taken pursuant to unconstitutional authority is without legal effect, because the authorization for such action is a nullity) (internal quotation and citation omitted).

Accordingly, Enforcement Counsel never properly brought an action because the Bureau lacked the legal authority to pursue an adjudication, since it could not bring the proceeding before a properly appointed hearing officer. Unless the Acting Director dismisses this proceeding on other grounds, Enforcement Counsel must re-file a Notice of Charges upon the availability of a properly appointed ALJ, in order to provide the new hearing required by the Supreme Court's decision in *Lucia*.

B. Any Newly-Filed Claims Against Respondents Would All Be Time-barred

Under the CFPA, "no action may be brought under this title more than three years after the date of discovery of the violation to which an action relates." 12 U.S.C. § 5564. The claims in this matter concern alleged business activities that the Bureau knew or should have known of in March 2012. Respondents entirely ceased the offering or provision of any consumer financial product or service in July 2013. Any new notice of charges would involve only time-barred claims. The tolling agreements entered into between the Bureau and Integrity Advance had an effective date that ran between June 2, 2014 and December 31, 2015. *See* Dkt. 200, 201. The invalidity of the Bureau's November 2015 Notice of Charges means that the three-year statute of limitations has run. For example, even assuming a construction of a statute of limitations

computation that is most favorable to the Bureau would mean that the Bureau would have not known about or had reason to know about any of Respondents' alleged conduct before March 2, 2014 – or three months before the beginning of the June 2, 2014 (three months remain between October 2018 and December 2018, three years from December 31, 2015). Evidence in the record establishes that Enforcement Counsel started its investigation well before March 2014 and that Enforcement Counsel knew or had reason to know about Respondents' alleged conduct well before this date. Moreover, Respondents shut down all business operations in July 2013.

A constitutionally defective Notice of Charges does not toll the running of the statute of limitations. Indeed, this principle can be seen in analogous situations, such as invalid indictments in the criminal law context, which similarly fail to toll limiting provisions. *See United States v. Crawford*, 60 F. App'x 520, 531 (6th Cir. 2003) (when an original indictment is constitutionally defective, the government cannot file a new indictment outside the limitations period absent statutory permission); *United States v. Gillespie*, 666 F. Supp. 1137, 1140 (N.D. Ill. 1987) (noting that an "invalid indictment" does not "toll the limitations period for the same charges included in that earlier indictment").[4]

II. THE BUREAU'S CURRENT ADMINISTRATIVE LAW JUDGE DOES NOT SATISFY THE REQUIREMENTS IN *LUCIA*

A. The Bureau's ALJ Was Not Properly Appointed

The Bureau's website indicates that it currently employs one ALJ, Christine L. Kirby. However, Respondents have identified no records that indicate that either former Bureau Director Richard Cordray or Acting Director Mick Mulvaney appointed Judge Kirby in

[4] Even if the Acting Director were to find that the November 2015 Notice of Charges is not invalid as a result of *Lucia*, the Acting Director should still decline to order another hearing. First, the claims against Mr. Carnes were time-barred on the day that the Notice of Charges was filed in November 2015, as there were no tolling agreements in place as to him. Second, Integrity Advance stopped operating more than five years ago.

accordance with the Appointments Clause.[5] Indeed, the Bureau's website states that "[a]dministrative law judges are appointed for life under the Administrative Procedure Act, 5 U.S.C. § 500 et seq., through a procedure administered by the Office of Personnel Management."[6]

This "appointment" procedure, of course, is the same procedure used by the SEC and found to be unconstitutional by the Supreme Court in *Lucia*. *Lucia v. SEC*, 138 S. Ct. 2044, 2049 (2018) (citing Pet. For Cert., *Lucia v. SEC*, No. 17-130, 2017 WL 3189046 at 4 (filed Jul. 21, 2017) ("SEC ALJs are not appointed by the Commission as a whole, but rather selected by SEC staff from a pool of candidates identified by the Office of Personnel Management."). Available records therefor indicate that the Bureau hired Judge Kirby through the traditional OPM process and that she was not appointed in accordance with the Constitution.

B. The Bureau Director May Not Appoint Inferior Officers

Even if a Bureau Director had purported to appoint Judge Kirby, however, such appointment would be defective. Under the Appointments Clause, Congress may vest appointment powers "[i]n the President alone, in the Courts of Law, or in the Heads of Departments." Const. Art. II, § 2, Cl. 2. Since neither the President, nor a Court of Law has appointed Judge Kirby, her appointment must have been performed by a "Head of Department."

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[5] For example, the SEC published an order ratifying the appointment of its ALJs. *In re: Pending Administrative Proceedings*, Order, Securities Act Release No. 10440, Securities Exchange Act Release No. 82178, Investment Advisers Act Release No. 4816, Investment Company Act Release No. 32929, 80 Fed. Reg. 45008 (Jul. 28, 2017). The FTC similarly ratified the appointment of its ALJ. *P130500 Federal Trade Commission Minute* (Sept. 11, 2015), *cited in In the Matter of LabMD, Inc.*, No. 9357 (F.T.C. Sept. 14, 2015).

[6] BCFP, Administrative Adjudication Proceedings, https://www.consumerfinance.gov/administrative-adjudication-proceedings/ (last accessed Oct. 3, 2018).

Due to the structure and placement of the Bureau within the Federal Reserve System, the agency is not a "Department," and its director is not the "Head of Department."

The Supreme Court, interpreting the scope of the term "Department" within the Appointments Clause, has stated that "Departments" are "freestanding component[s] of the Executive Branch, not subordinate to or contained within any other such component . . . ." *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 511 (2010). And the Supreme Court has noted that organizational structures can be an important factor in determining whether an agency is a "Department." *See Freytag*, 501 U.S. at 918 (Scalia, J., concurring) ("A number of factors support the proposition that "Heads of Departments" includes the heads of all agencies *immediately below the President* in the organizational structure of the Executive Branch.") (emphasis added).

The Bureau, of course, is by statute "contained within" the Federal Reserve System. 12 U.S.C. § 5491 ("There is established *in the Federal Reserve System*, an independent bureau to be known as the 'Bureau of Consumer Financial Protection' . . . .) (emphasis added). While the Bureau may not be "subordinate to" the Board of Governors of the Federal Reserve, *see id.* § 5492, it is certainly within the Federal Reserve in terms of the Bureau's statutory organizational structure. The decision by Congress to place the Bureau within the Federal Reserve System for purposes of organization must be read to have meaning and effect, and, here, results in restricting the Bureau from constituting a "Department" under the Appointments Clause.

Because the Bureau is, by statute, contained within the Federal Reserve System, it is not a "Department" as defined by the Supreme Court, and the Bureau Director is not a "Head of

Department." An ALJ purported to be appointed by a Bureau Director is thus not lawfully appointed under the Constitution.

CONCLUSION

For the foregoing reasons, Respondents respectfully request that the Acting Director dismiss this action.

Respectfully submitted,

Dated: October 3, 2018

By: /s/ Allyson B. Baker

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CERTIFICATION OF SERVICE

I hereby certify that on the 3rd day of October, 2018, I caused a copy of the foregoing Respondents' Opening 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 electronic mail on the following parties who have consented to electronic service:

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