UNITED STATES OF AMERICA
Before the
CONSUMER FINANCIAL PROTECTION BUREAU

ADMINISTRATIVE PROCEEDING
File No. 2015-CFPB-0029

In the Matter of:	)	**RESPONDENTS' CONSOLIDATED REPLY BRIEF IN SUPPORT OF THEIR MOTION TO DISMISS ON GROUNDS LIMITED TO FEBRUARY 7, 2020 ORDER AND THEIR MOTION TO STAY PROCEEDINGS**
INTEGRITY ADVANCE, INC. and JAMES R. CARNES,	)	
Respondents.	)	

RESPONDENTS' CONSOLIDATED REPLY BRIEF IN SUPPORT OF THEIR MOTION TO DISMISS ON GROUNDS LIMITED TO FEBRUARY 7, 2020 ORDER AND THEIR MOTION TO STAY PROCEEDINGS

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Enforcement Counsel concedes in its Opposition ("Opp'n"), as it must, that the current structure of the Consumer Financial Protection Bureau ("CFPB") is unconstitutional. Despite that concession, Enforcement Counsel argues that Respondents Integrity Advance, LLC and James R. Carnes ("Respondents") cannot now raise this constitutional separation of powers issue because they failed to raise this issue in their Answer. Enforcement Counsel also argues that the Administrative Law Judge ("ALJ") is powerless to stop an unconstitutional proceeding so Respondents must wait until after the conclusion of the proceedings to vindicate their rights. That analysis is incorrect. The CFPB is unconstitutionally structured, the offending provision cannot simply be severed, and the ALJ can, and should, dismiss this action with prejudice or defer ruling and stay proceedings until the Supreme Court renders its decision in *Seila Law*.

I. Respondents have not waived the constitutional separation of powers issue.

In its Opposition, Enforcement Counsel asserts that Respondents failed to raise a separation of powers argument in their Answer and are thus seeking "to inject an entirely new affirmative defense into this proceeding . . . ." Opp'n at 3. That is not the case. Respondents clearly raised the separation of powers issue, and others, in their Answer:

> Respondents further state that the Bureau ***does not have jurisdiction to proceed with this action*** as to Integrity Advance or Carnes and that their Answer to the Notice of Charges ***does not waive any right to contest the jurisdiction of the Bureau***. Rather, Respondents . . . preserve any and all rights.

Dkt. 21 (emphasis added).

Respondents were not required to use any "magic words" in their Answer, nor list every potential way in which "the Bureau does not have jurisdiction to proceed with this action," Dkt. 21, to put Enforcement Counsel on notice of the separation of powers argument. *See, e.g.*, *Smith v. Travelers Cas. Ins. Co. of Am.*, 932 F.3d 302, 309 (5th Cir. 2019) (finding that "[e]ven though the exact term 'limitations' d[id] not appear" in defendant's answer "the plain language

of [its answer] g[ave] 'fair notice' of [defendant's] intent to assert a contractual limitations defense") (citation omitted); *Starcraft Co., Div. of Bangor Punta Operations, Inc. v. C.J. Heck Co.*, 748 F.2d 982, 990 n.11 (5th Cir. 1984) (a defendant is "not required to state certain magic words in order to assert a successful defense"); *TNT Crane & Rigging, Inc. v. Atkinson*, No. 2:14-CV-265, 2015 U.S. Dist. LEXIS 5355, at *7 (S.D. Tex. Jan. 16, 2015) ("[T]here is no requirement that an affirmative defense be set forth in a particular way or contain 'magic words' in order to be cognizable.").

The ALJ should find that Respondents' statement in their Answer was sufficient to put Enforcement Counsel on notice that Respondents would be challenging the constitutionality of the CFPB's structure and thus its "jurisdiction to proceed with this action...." Dkt. 21; *see, e.g.*, *CFPB v. RD Legal Funding, LLC*, 332 F. Supp. 3d 729, 784 (S.D.N.Y. 2018) (dismissing CFPB from action, finding that it "lack[ed] authority" to bring the action "because its composition violates the Constitution's separation of powers") (citing *Fed. Election Comm'n v. NRA Political Victory Fund*, 6 F.3d 821, 822 (D.C. Cir. 1993)); *FTC v. Compagnie de Saint-Gobain-Pont-A-Mousson*, 636 F.2d 1300, 1315 (D.C. Cir. 1980) ("The exercise of jurisdiction by any governmental body in the United States is subject to . . . the strictures of the particular statute governing that body's conduct.").

In any event, as Enforcement Counsel itself acknowledges, "waiver is not automatic in all cases." Opp'n at 4; *see also Fed. Election Comm'n v. Legi-Tech*, 75 F.3d 704, 706-07 (D.C. Cir. 1996) (affirming District Court's decision to consider otherwise waived constitutional objection). The ALJ should not find any waiver here. If there was any doubt whether Respondents preserved the right to raise the separation of powers argument, that doubt is put to rest by Respondents' Ninth Affirmative Defense, which states that: "Respondents

hereby give notice that they will rely upon such other and further defenses as may become apparent during the course of the action." Dkt. 21 at 15. As Enforcement Counsel itself noted, at the time Respondents filed their Answer in December 2015, courts that had analyzed the CFPB's structure had upheld the structure as constitutional. *See* Opp'n at 4-5 (citing cases).[1] Thus, the weight of authority at the time suggested that the CFPB's structure was constitutional. The tide, however, has since changed. A District Court has recently ruled that the CFPB's structure is unconstitutional, *see RD Legal Funding, LLC*, 332 F. Supp. 3d at 785, and, now, the CFPB's own Director agrees. *See* Opp'n at 5 n.2. The Supreme Court will be resolving this issue in just a few short months.

Though it may not have been so at the time that Respondents filed their Answer, there is now ample authority and CFPB's own concession to support the argument that the CFPB's current structure violates the separation of powers. Thus, even if the ALJ finds that Respondents did not sufficiently raise the separation of powers issue in its Answer, the subsequent change in law and change in the Director's position—especially in light of Respondents' reservation of rights in the Answer—justifies Respondents raising that issue now. *See Legi-Tech*, 75 F.3d at 706-07 (affirming District Court's decision to consider otherwise waived constitutional objection and acknowledging that failure to plead a defense may be excused where a "new rule of law" is announced) (citing *Curtis Publishing Co. v. Butts*, 388 U.S. 130, 142-43 (1967)); *cf. United States v. Washington*, 12 F.3d 1128, 1139 (D.C. Cir. 1994) (noting that "it would be unfair, and even contrary to the efficient administration of justice, to

[1] The D.C. Circuit first found the CFPB's structure to be unconstitutional on October 11, 2016, after the prior ALJ already had issued his Recommended Decision, and then an *en banc* panel of the D.C. Circuit overturned the original panel, rejecting the separation of powers challenge. *See* Opp'n at 5 (citing *PHH Corp. v. CFPB*, 839 F.3d 1 (D.C. Cir. 2016), *rev'd en banc*, 881 F.3d 75 (D.C. Cir. 2018)). Respondents could not have relied on the (later-overturned) *PHH* decision when they filed their Answer almost one year before that decision was rendered.

expect a defendant to object at trial where existing law appears so clear as to foreclose any possibility of success"); *Holland v. Big River Minerals Corp.*, 181 F.3d 597, 605-606 (4th Cir. 1999) (discussing exception to general rule of waiver "when 'there was strong precedent' prior to the change, such that the failure to raise the issue was not unreasonable and the opposing party was not prejudiced by the failure to raise the issue sooner").

Nor can Enforcement Counsel demonstrate any prejudice, much less the level of prejudice that might justify foreclosing Respondents from raising this important (and partially uncontested) constitutional issue. Enforcement Counsel's only claim of prejudice is that considering the separation of powers argument would "run[] counter to the letter and the spirit of the rules governing adjudications" and would "further delay the resolution of this case . . . ." Opp'n at 5, 6. However, while it is true that the CFPB's rules seek to "avoid delay," those rules also seek to avoid unfairness. 12 C.F.R. § 108.101. The Federal Register quote relied upon by Enforcement Counsel makes that point clear. *See* 77 Fed. Reg. 39058, 39059 (June 29, 2012) ("In drafting the Final Rule, the Bureau endeavored to create an adjudicatory process that provides for the expeditious resolution of claims ***while ensuring that parties who appear before the Bureau receive a fair hearing***.") (emphasis added) (partially cited in Opp'n at 5). Precluding Respondents from raising the important constitutional issue of separation of powers would not strike the balance of fairness and expeditiousness envisioned by the CFPB's rules, particularly where, as discussed above, Enforcement Counsel was on notice that Respondents would be challenging the CFPB's authority to act and was aware that Respondents had reserved the right to raise any additional issues that later became apparent.[2] The ALJ should find that

[2] Precluding Respondents from raising the separation of powers issue also would be unfair in light of the ALJ's decision to revive Count IV of the Notice of Charges. *See* Dkt. 249. Just as Enforcement Counsel contends that it made the decision to withdraw Count IV in reliance on a decision from the prior improperly-appointed ALJ,

Respondents did raise the separation of powers issue in their Answer and that, even if they did not, the issue is not waived.

II. The ALJ has the authority to rule on Respondents' constitutional challenge.

Contrary to Enforcement Counsel's argument, administrative agencies and ALJs are often called upon to rule on constitutional claims, even those that would declare the proceedings or the ALJ's authority invalid. *See, e.g.*, *Landry v. FDIC*, 204 F.3d 1125, 1130 (D.C. Cir. 2000) (Appointments Clause challenge initially addressed by the Federal Deposit Insurance Corporation); *Sturm, Ruger & Co. v. Chao*, 300 F.3d 867, 873-875 (D.C. Cir. 2002) (Occupational Safety and Health Administration ALJ could hear Fourth Amendment constitutional challenge to the Occupation Safety and Health Act and Administrative Procedures Act); *Altman v. U.S. SEC*, 768 F. Supp. 2d 554, 560 (S.D.N.Y. Mar. 6, 2011), *aff'd*, 687 F.3d 44 (2d Cir. 2012) ("[Petitioner] does not dispute, nor can he, that the SEC has the authority and expertise to hear constitutional challenges to its rules or rule-making provisions."); *Nat'l Taxpayers Union*. *Nat'l Taxpayers Union v. U.S. Social Security Admin.*, 376 F.3d 239, 243-244 (4th Cir. 2004) (Social Security Administration can hear constitutional challenges to Social Security Act). Thus, contrary to Enforcement Counsel's claim in its Opposition, the ALJ would not be "the first" to rule on a dispositive constitutional issue. *See* Opp'n at 8.

While it is true that the "adjudication of the constitutionality of congressional enactments has generally been thought beyond the jurisdiction of administrative agencies, . . . [t]his rule is not mandatory, however[.]" *Thunder Basin Coal Co. v. Reich*, 510 U.S. 200, 215 (1994). In *Thunder Basin*, the Supreme Court pointed out that the administrative body in that

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see Opp'n at 4 n.1, Respondents similarly relied on the state of the law at the time it filed its Answer in deciding which issues to prioritize. Now that circumstances have changed, and especially because this is a "new hearing," Dkt. 216 at 2, allowing Respondents to raise the separation of powers issue also comports with basic principles of fairness.

case, the Federal Mine Safety and Health Review Commission, had in fact ruled on constitutional claims in multiple prior enforcement proceedings. *Id.* at 215 n.19. Similar to the governing statute in *Thunder Basin*, the Consumer Financial Protection Act ("CFPA") provides for administrative enforcement proceedings overseen by an ALJ with the right to seek judicial review in the Court of Appeals. *See* 12 U.S.C. § 5563(b)(4). Enforcement Counsel argues that Respondents cannot assert their constitutional claim in this administrative forum as the ALJ lacks authority to rule on it, so Respondents must presumably wait to bring the claim on appeal of a final order in the Court of Appeals. Opp'n at 6-10. However, despite arguing that the issue is not yet ripe for consideration, Enforcement Counsel also argues that Respondents have somehow already waived it and, therefore, infers that Respondents would not even be permitted to raise it in the Court of Appeals. Opp'n at 2-6, 8. This self-conflicting interpretation would deny Respondents ***any*** judicial review of the constitutional claim, which itself raises a "serious constitutional question." *See Thunder Basin*, 510 U.S. at 215 n.20 (distinguishing the case from "the 'serious constitutional question' that would arise if an agency statute were construed to preclude all judicial review of a constitutional claim"). Instead, as demonstrated above, courts have recognized that Respondents may raise their constitutional claims with the ALJ and later seek review with a Court of Appeals.[3]

Therefore, the ALJ should consider and grant Respondents' Motion to Dismiss.

[3] Additionally, where, as here, the constitutional claim relates to a structural issue such as separation of powers, it may be first raised on appeal. *See Freytag v. C.I.R.*, 501 U.S. 868, 879 (1991)) (holding that an Appointments Clause challenge raised first in the court of appeals was not waived due to "the interest of the federal judiciary in maintaining the constitutional plan of separation of powers"); *see also Tilton v SEC*, 2015 U.S. Dist. LEXIS 85015, at *14 (S.D.N.Y. June 30, 2015), *aff'd*, 824 F.3d 276 (2d Cir. 2016) (recognizing that "Appointments Clause challenges similar to Plaintiffs' were raised either for the first time before the court of appeals after an administrative proceeding or litigated before the agency and raised again on appeal—as Plaintiffs are authorized by statute to do here").

III. The unconstitutional removal provision is not severable.

As argued in Respondents' Opening Brief, *see* Dkt. 253 at 13-16, the unconstitutional for-cause removal provision cannot "simply [be] sever[ed]" from Title X of the Dodd-Frank Act. Opp'n at 12. To do so would contravene Congressional intent and constitute an improper attempt to rewrite the statute. *See* Dkt. 253 at 16 (citing *PHH Corp. v. CFPB*, 881 F.3d 75, 164 (D.C. Cir. 2018) (Henderson, J., dissenting) ("A severability clause 'does not give the court power to amend' a statute[,]" nor "is it a license to cut out the 'heart' of a statute") (citations omitted)). Notably, Enforcement Counsel does not respond to Respondents' central argument that Congress would have preferred no CFPB to a CFPB subject to Presidential control. And for good reason—because independence was viewed as an indispensable element of Title X. *See* Dkt. 253 at 14; *see also* Transcript of Oral Argument at 13-14, *Seila Law v. CFPB*, No. 19-7 (Mar. 3, 2020) (noting that Elizabeth Warren, "who was really the progenitor of the CFPB, said at the time, if Congress did not create an agency with functional independence, 'my second choice is no agency at all and plenty of blood and teeth left on the floor'").[4] The ALJ should find that the for-cause removal provision is unconstitutional and not severable from the Dodd-Frank Act. *See RD Legal Funding, LLC*, 332 F. Supp. 3d at 784 (holding that the CFPB is unconstitutionally structured and that the for-cause removal provision cannot be severed).

The ALJ also should reject Enforcement Counsel's assertion that the CFPB's unconstitutional action can simply be ratified later "by a Director who is removable at will." Opp'n at 13. That argument, which is made only in passing, fails to recognize that an unconstitutionally structured agency has no legal authority to act and thus any exercise of

[4] Available at: https://www.supremecourt.gov/oral_arguments/argument_transcripts/2019/19-7_3e04.pdf

executive power by that agency is void. *See* Dkt. 253 at 16-17 (citing cases). Enforcement Counsel's argument also misconstrues the ratification doctrine, which arises out of principles of agency law. *See NRA Political Victory Fund*, 513 U.S. at 98. The ratification doctrine is inapplicable here because it does not apply where the principal itself does not have any power to act; rather, it concerns a situation where the principal's ***agent*** acted without appropriate authorization from the principal. *See, e.g.*, *Wilkes-Barre Hosp. Co. v. NLRB*, 857 F.3d 364, 371 (D.C. Cir. 2017) ("[R]atification occurs when a principal sanctions the prior actions of its purported agent.") (citation omitted). Therefore, the ALJ should find that the unconstitutional provision is not severable or, alternatively, cannot be remedied through ratification.

IV. If the ALJ does not grant Respondents' Motion to Dismiss, the ALJ should stay proceedings pending the Supreme Court's decision in *Seila Law*.

Alternatively, the prudent course is to wait for the Supreme Court's ruling on the separation of powers issue in *Seila Law*.[5] As explained in Respondents' Brief in Support of Motion to Stay Proceedings, the ALJ has both the statutory and inherent authority to grant a stay. *See* Dkt. 252 at 2-3. Further, a stay would be appropriate here, as the requested stay is of short duration and serves the interests of judicial economy and consistency in the law on an important constitutional question currently being decided by the Supreme Court. *Id.* at 3-8; *see also CFPB v. Access Funding, LLC*, 2019 U.S. Dist. LEXIS 222465, at *18-19 (D. Md. Dec. 23, 2019) ("[A] stay based on *Seila Law* is warranted. This is because one of the Supreme Court's paths in *Seila*

[5] Enforcement Counsel argues that the ALJ should reject Respondents' Motion to Stay Proceedings for failure to include a signed statement regarding Respondents' good faith effort to resolve the issue with Enforcement Counsel. *See* Opp'n at 10 n.6. The purpose of that requirement is to ensure that the parties attempt to resolve issues amongst themselves before application to the ALJ. However, in this case, the parties already submitted a Joint Statement in which they jointly stated they had conferred about the proposed schedule, which includes Respondents' Motion to Stay Proceedings, but were unable to agree. *See* Dkt. 250 at 1. Subsequently, the ALJ issued an order directing Respondents to file their motion. *See* Dkt. 251. Under these circumstances, a signed statement would be superfluous, and the absence of such a statement should not bar a stay in this case.

Law may render the CFPB unable to prosecute this action; the stay would not be lengthy; and the interests of judicial efficiency and potential harm to the movants justify the stay.").

Despite this, Enforcement Counsel implies that Respondents are requesting a stay to cause improper delay. *See* Opp'n at 10 ("Although Respondents have moved to dismiss this matter, they candidly acknowledge that what they really want is a few months' more delay."). That is unfounded. Respondents have raised valid defenses and legal issues in accordance with the CFPB's rules, followed the Orders of the ALJ, and proposed timely schedules for resolving this matter. *See, e.g.*, Dkt. 250 (Joint Proposed Schedule); Dkt. 228 (Joint Proposed Pre-Hearing Schedule). Instead, the delay in this case has been the result of a prolonged investigation by the CFPB followed by a court decision invalidating the method used to appoint the first ALJ. Importantly, the conduct charged in this matter ceased over seven years ago. Under these circumstances, neither the CFPB nor the public would be harmed by awaiting the result of the Supreme Court's upcoming decision in *Seila Law* in a matter of months. While Enforcement Counsel attempts to distinguish the cases in which the CFPB either requested or acquiesced to stays because those cases were on appellate review, *see* Opp'n at 14-15, such a distinction is without a difference because those cases, like this one, remain unresolved, and any restitution for consumers remains unpaid, pending the conclusion of the appeals and the determination of these important constitutional issues.

Enforcement Counsel further argues that a stay is not appropriate because the unconstitutional provision can be severed from the CFPA. *See id.* at 11-13. As argued above, that is incorrect. However, importantly, that also is one of the questions the Supreme Court is currently considering. *Seila Law LLC v. CFPB*, 140 S. Ct. 427 (Oct. 18, 2019) (granting *certiorari* and directing the parties to provide briefing on the question of severability). In

deciding the Motion to Stay Proceedings, the ALJ should reject the invitation to presume how the Supreme Court will rule. *See Access Funding, LLC*, 2019 U.S. Dist. LEXIS 222465, at *18 ("I cannot speculate on the likelihood of the outcome of *Seila Law*, as the Bureau seems to urge. But, if the removal provision is unconstitutional and cannot be severed from the Act, then the Bureau's entire organic statute will be struck down."). The ALJ also should reject Enforcement Counsel's argument that a stay is not warranted because the Supreme Court's decision in *Seila Law* "is highly unlikely to dispose of the claims here." Opp'n at 11. Even if the Supreme Court's decision in *Seila Law* does not dispose of all claims, a stay is nonetheless appropriate where the ruling will clarify the issues currently before the ALJ. *See Washington v. Trump*, 2017 U.S. Dist. LEXIS 75426, at *11 (W.D. Wash. May 17, 2017) ("It is sufficient that the [resolution of the other matter] will likely 'settle many' issues and 'simplify' others, such that a stay will facilitate the orderly course of justice and conserve resources for both the court and the parties.") (internal citations omitted); *see also* Ex. B to Opp'n at 2 (citing *Leyva v. Certified Grocers of Cal., Ltd.*, 593 F.2d 857, 863 (9th Cir. 1979)) (recognizing that the power to stay proceedings "includes the discretion to stay a case 'pending resolution of independent proceedings which bear upon the case"). If the ALJ does not dismiss this action, she should stay the proceedings pending the Supreme Court's ruling in *Seila Law*.

* * *

For the foregoing reasons, and for the reasons stated in Respondents' Opening Briefs (Dkt. 252; Dkt. 253), the ALJ should dismiss this action with prejudice or, in the alternative, stay further proceedings pending the ruling of the Supreme Court in *Seila Law*.

Respectfully submitted,

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Dated: March 10, 2020

CERTIFICATE OF SERVICE

I hereby certify that on the 10th day of March 2020, I caused a copy of the foregoing Respondents' Consolidated Reply Brief in Support of their Motion to Dismiss on Grounds Limited to February 7, 2020 Order and their Motion to Stay Proceedings to be filed by electronic transmission (email) with the Office of Administrative Adjudication (CFPB_electronic_filings@cfpb.gov), and served by email on opposing counsel at the following addresses:

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