

## SECOND CIRCUIT REVIEW

## Circuit Split on the Consumer Financial Protection Bureau's Funding Structure

By Martin Flumenbaum and Brad S. Karp

June 28, 2023

In *Consumer Financial Protection Bureau v. Law Offices of Crystal Moroney*, 63 F.4th 174 (2d Cir. 2023), the U.S. Court of Appeals for the Second Circuit considered whether the Consumer Financial Protection Bureau (CFPB)'s funding structure was proper under both the appropriations clause and the nondelegation doctrine. In an unanimous opinion authored by Circuit Judge Richard Sullivan and joined by Circuit Judges Amalya Kearse and John Walker, the court determined the CFPB's funding structure was not constitutionally deficient under either doctrine. In reaching this holding, the Second Circuit expressly declined to follow the Fifth Circuit's recent opinion in *Community Financial Services Association of America v. Consumer Financial Protection Bureau*, which held that the CFPB's funding apparatus could not be reconciled with the appropriations clause. The Second Circuit's decision thus creates a circuit split as to the constitutionality of the CFPB's funding structure.



Martin Flumenbaum



Brad S. Karp

**The Consumer Financial Protection Bureau**

In the wake of the 2008 global financial crisis, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd Frank), which made a number of reforms to regulation of the financial services industry. Title X of Dodd Frank created the CFPB in order to empower a single agency to regulate consumer financial products and services. Rather than by being funded through annual Congressional appropriations, the CFPB is funded through its enabling statute. See 12 U.S.C. Section 5497(a). Through this statute, the CFPB is authorized to draw funds from the combined earning of the Federal Reserve System up to a percentage cap of the Federal Reserve's operating expenses. The CFPB can also seek further funding through the annual appropriations process.

---

MARTIN FLUMENBAUM and BRAD S. KARP are litigation partners at Paul, Weiss, Rifkind, Wharton & Garrison, specializing in complex commercial and white-collar defense litigation. Karp is the chairman of the firm. CONNOR J. RITSCHARD, a litigation associate at the firm, assisted in the preparation of this column.

## The Fifth Circuit's Decision In 'Community Financial Services Association of America v. Consumer Financial Protection Bureau'

In *Community Financial Services Association of America v. Consumer Financial Protection Bureau*, 51 F.4th 616 (5th Cir. 2022), the Fifth Circuit held that the CFPB's "funding apparatus cannot be reconciled with the appropriations clause and the clause's underpinning, the constitutional separation of powers." It concluded that Congress "ceded direct control over the CFPB's budget by insulating it from annual or other time limited appropriations" and "ceded indirect control by providing that [the CFPB's self-determined funding be drawn from a source that is itself outside the appropriation process," namely, the Federal Reserve System. The Fifth Circuit opined that this funding structured was a "double insulation from Congress's purse strings" and was therefore unconstitutional. On Feb. 27, the Supreme Court granted the CFPB's petition for a writ of certiorari, requesting that the court review whether the Fifth Circuit erred in holding that the statute providing funding to the CFPB violates the appropriations clause.

### The Second Circuit's Decision

Approximately a month after the Supreme Court's grant of certiorari in *Consumer Financial Protection Bureau v. Community Financial Services Association of America*, the Second Circuit issued its decision in *Consumer Financial Protection Bureau v. Law Offices of Crystal Moroney*. The Second Circuit considered an appeal of a district court order—issued prior to the Fifth Circuit's decision in *Community Financial Services Association of America*—enforcing a civil investigative demand issued by the CFPB. On appeal, Moroney raised four arguments. First, the civil investigative demand was void ab initio under the Supreme Court's decision in *Seila Law v. CFPB*,

which held that certain restrictions on the removal of the CFPB director were unconstitutional, because the CFPB was shielded from presidential oversight at the time the civil investigative demand was issued. Second, the funding structure of the CFPB violates the appropriations clause of the Constitution. Third, Congress violated the nondelegation doctrine when it created the CFPB's funding structure in Dodd Frank. And fourth, that the civil investigative demand was unduly burdensome.

The Second Circuit first determined the civil investigative demand was not void ab initio. The court noted Moroney's argument was foreclosed by the recent Supreme Court decision in *Collins v. Yellen*, in which the Supreme Court held "the relevant inquiry" for whether an action was void ab initio is whether an officer was properly appointed and "not whether

---

While the Supreme Court left open the possibility a party could be entitled to relief if they demonstrated the unconstitutional removal provision inflicted comprehensible harm, the Collins majority did not provide a definite holding on the point.

she was properly removable." While the Supreme Court left open the possibility a party could be entitled to relief if they demonstrated the unconstitutional removal provision inflicted comprehensible harm, the Collins majority did not provide a definite holding on the point. In the case at hand, the Second Circuit adopted the but-for causation requirement advocated for in Justice Elena Kagan concurrence and determined Moroney had failed to satisfy the standard.

Next, the court turned to whether the CFPB's funding structure was proper under the appropriations clause. Moroney argued the CFPB's funding violated the appropriation clause as the Executive Branch determines what is "'reasonably necessary' to

carry out the agency's mission" without meaningful guidance from the Legislative Branch. The Second Circuit rejected this argument finding "the CFPB's funding structure was authorized by Congress and bound by specific statutory provisions" including limiting the maximum amount the CFPB could draw from the Federal Reserve System to 12% of the Federal Reserve System's 2009 Operating Expenses with adjustments for increases in the cost of labor.

When reaching this determination, the Second Circuit expressly declined to follow the Fifth Circuit decision in *Community Financial Services Association of America*. The Second Circuit disagreed with the Fifth Circuit's reading of Supreme Court precedent, the Constitution's text and the history of the appropriation clause.

First, in contrast with the Fifth Circuit's reading of Supreme Court precedent, the Second Circuit emphasized they believe the Supreme Court "has constantly interpreted" the appropriation clause to only require that "the payment of money from the Treasury must be authorized by a statute." Likewise, the Second Circuit rejected the Fifth Circuit's reading of the Constitution's text and instead held that "nothing in the Constitution ... requires that agency appropriations be 'time limited' or that appropriated funds be drawn from a particular 'source.'" As there was no explicit reference to any such limitation in the appropriations clause, the Second Circuit declined to endorse the Fifth Circuit's reading of an implicit limitation.

Finally, the Second Circuit also expressly disagreed with the Fifth Circuit's historical reading of the clause. Citing to the works of Alexander Hamilton for the design of the appropriation clause, the Second Circuit found Congress had properly "prescribed the 'purpose' (or 'object'), 'limit,' and 'fund' of its appropriation for the CFPB in the CFPB Act." (citing 7

Alexander Hamilton, *The Works of Alexander Hamilton* 532, 532 (John C. Hamilton ed. 1851)). Accordingly, the court declined to follow the Fifth Circuit and instead created a circuit split concerning the validity of the CFPB's funding apparatus.

The Second Circuit then considered if the CFPB's funding structure is proper under the nondelegation doctrine. The court noted the Consumer Financial Protection Act lists five objectives and six primary functions for the CFPB. Given the lenient standard of an "intelligible principle" under the nondelegation doctrine, the court found "Congress had plainly provided an intelligible principle to guide the CFPB in setting and spending its budget." Finally, the Second Circuit determined the civil investigative demand was an enforceable administrative subpoena rejecting Moroney's arguments that the civil investigative demand was not issued pursuant to a proper purpose, sought information protected by attorney-client privilege and was duplicative of prior demands. Accordingly, the Second Circuit affirmed the enforcement of the civil investigative demand against *Moroney*.

## Conclusion

The Second Circuit's opinion in *Consumer Financial Protection Bureau v. Law Office of Crystal Moroney* creates a circuit split with the Fifth Circuit regarding whether the CFPB's funding structure violates the appropriations clause. In the short term, this may contribute to legal uncertainty concerning the enforceability of CFPB actions. Although the Supreme Court has granted certiorari and will review the question in the near term, it rejected the CFPB's request to expedite the relevant case to the current term, so the uncertainty and lack of legal uniformity concerning the constitutionality of the CFPB's funding structure will continue for a while longer.