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Barnett Sivon & Natter P.C.
ATTORNEYS at LAW
WASHINGTON, DC

Are Agency Policy Statements Irrelevant in the Courts? *

Katie Wechsler

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A recent Sixth Circuit opinion raises questions about the force of policy statements issued by government agencies.

The Policy Statement in Question

Under the Real Estate Settlement Procedures Act (RESPA), referral fees for real estate settlement services, such as title services, are generally prohibited, and violators are subject to both criminal and civil penalties.[1]

In response to uncertainty about referrals between affiliated companies, in 1983, Congress added a safe harbor for "affiliated business arrangements."[2] Affiliates may make referrals to each other without violating RESPA as long as: (1) the person making the referral discloses the affiliate relationship to the client; (2) the client is not required to use the affiliate; and (3) the only thing of value the person making the referral can receive is a return on the ownership interest or franchise relationship.[3]

While HUD's regulations addressed certain business relationships, questions remained as to arrangements in which a so-called service provider provided little actual services. In 1996, to address these "sham" business arrangements, HUD issued a policy statement on the applications of the affiliate business safe harbor (Policy Statement).[4] In the Policy Statement, HUD added a fourth test to the statutory safe harbor — whether the service provider is "bona fide." 'In RESPA enforcement cases involving a controlled business arrangement created by two existing settlement service providers, HUD considers whether the entity receiving referrals of business... is a bona fide provider of settlement services."[5] The statement outlines ten factors HUD balances in making this determination.

*The information contained in this newsletter does not constitute legal advice. This newsletter is intended for educational and informational purposes only.

[1] 12 U.S.C. §§2607(a), (d).

[2] 12 U.S.C. §§2602(7), 2607(c)(4).

[3] 12 U.S.C. §2607(c)(4). Note: There are other exceptions to the prohibition on referral fees that are not applicable here.

[4] Statement of Policy 1996-2 Regarding Sham Controlled Business Arrangements, 61 Fed. Reg. 29, 258 (June 7, 1996) (hereinafter Policy Statement).

[5] 61 Fed. Reg. 29,262.

The Case

Late last year, in *Carter v. Welles-Bowen*,[6] the U.S. Court of Appeals for the Sixth Circuit determined that HUD's Policy Statement is irrelevant in considering whether an affiliate relationship satisfies the statutory safe harbor.

In this case, homebuyers challenged the affiliate relationship of a real estate agency, Welles-Bowen, and two title service companies, WB Title and Chicago Title. As described by the Sixth Circuit, the relationships between the companies are in the form of both ownership and business:

> The people who own Welles-Bowen also owns a holding company that in turn owns about half of WB. Chicago owns the other half of WB. As for business: Welles-Bowen often refers prospective buyers to WB for title services. WB in turn contracts some of the referred work out to Chicago.[7]

Welles-Bowen referred the homebuyers to WB for title services. The homebuyers found that much of the work was done by Chicago, not WB. The homebuyers viewed WB as a "shell corporation that funneled referral fees between Chicago and Welles-Bowen."[8]

In the district court, Welles-Bowen argued that the Policy Statement is irrelevant for two reasons: (1) it does not deserve deference under *Chevron* and (2) it is unconstitutionally vague.[9] The district court did not consider the merits of the *Chevron* claim, since it found that the Policy Statement, and in particular the ten-factor test, was unconstitutionally vague. Due to the fact that RESPA imposes criminal penalties, in addition to civil penalties, the district court applied a strict vagueness standard. After reviewing the ten-factor test, the district court concluded that the Policy Statement "provides insufficient guidance to the regulated public, and it lacks identifiable standards under which authorities (or private parties) can enforce its provisions in a criminal or civil context."[10] Turning to the statutory test, the district court found that the affiliated entities met the three-part test for the safe harbor.

When the homebuyers appealed, the government stepped in to defend the Policy Statement.

The Sixth Circuit agreed with the district court's conclusion. The court focused on the application of *Chevron* deference, rather than the question of unconstitutional vagueness.

The court refused to grant any deference to the Policy Statement. The statement is not a binding interpretation of a statute, which is necessary for an agency opinion to qualify for *Chevron* deference. The statement only informs the public on what HUD will consider. It offers "non-binding advice about the agency's enforcement agenda, not a controlling interpretation of the statute. Agency recommendations of this sort, even when cast as policy considerations or preferences, do not bind courts tasked with interpreting a statute."[11] The court observed that "a statutory safe harbor is not very safe if a federal agency may add a new requirement to it through a policy statement."[12]

It is significant here that RESPA includes criminal penalties, as that factor reinforced the court's conclusions. "A bedrock principle of American law requires the government to give the people fair notice

[6] Carter v. Welles-Bowen, 736 F.3d 722 (6th Circ. 2013).
[7] Carter, 736 F. 3d at 724.
[8] Id.
[9] Carter v. Welles-Bowen, 719 F. Supp. 2d 846 (N.D. Ohio 2010).
[10] Carter, 719 F. Supp. 2d at 854.
[11] Carter, 736 F. 3d at 726.
[12] Id.

of what conduct it has made a crime."[13] While a regulation may provide that fair warning, the court doubted that a "mere policy statement or opinion letter or agency manual" could do the same.[14]

Finding that the Policy Statement holds no weight, the Sixth Circuit concluded that the affiliate business relationship in question satisfies all three prongs of the statutory safe harbor.

What This Case Means for CFPB

CFPB and RESPA

This case is significant, in the very least in terms of CFPB's reliance on this Policy Statement in one pending case.

With the enactment of the Dodd-Frank Act and the creation of the CFPB, regulatory and enforcement authority under RESPA transferred from HUD to CFPB. Thus far, CFPB has relied on HUD's Policy Statement and its ten-factor test in two enforcement proceedings.

In May 2013, CFPB issued an enforcement action against a Texas homebuilder and related companies for violating the referral fees prohibition under RESPA. CFPB specifically relied on HUD's Policy Statement in its action, finding that the affiliate did not constitute a "bona fide" settlement service provider and instead was a "sham controlled business arrangement as described in [HUD's Policy Statement]."[15]

In October 2013, CFPB announced it filed a complaint in the Western District of Kentucky against a law firm and several of its principals, alleging that the defendants' joint ventures with title companies violated RESPA.[16] CFPB is arguing that the joint ventures do not provide any real service, and thus are not "bona fide" service providers. Significantly, since this case is filed in the Sixth Circuit, it will likely be impacted by *Carter*. It is possible the CFPB could argue that the joint ventures fail to meet the statutory safe harbor and not rely on the Policy Statement. The defendants will likely raise *Carter* as part of their defense and argue that the ten-factor test, which CFPB relies on, is irrelevant.

CFPB Bulletins

It is possible that *Carter* will have implications for the CFPB beyond this one policy statement. If other courts adhere to the Sixth Circuit's line of thinking, it is possible that more policy statements and informal guidance will be considered to hold little or no weight.

Consider, for example, CFPB's controversial bulletin on the application of the Equal Credit Opportunity Act (ECOA) to indirect auto lenders.[17] The bulletin provides "guidance," stating that indirect auto lenders are creditors for purposes of ECOA. The bulletin also outlines steps indirect auto lenders should take to ensure they are in compliance with ECOA, including eliminating auto dealer discretion to mark up rates or imposing controls on dealer markup.

Would a court provide any deference to this bulletin? It is not a formal interpretation of a statute that the CFPB administers. It was not issued under the formal rulemaking procedures of the Administrative

[13] Carter, 736 F. 3d at 727.
[14] Id.
[15] ***291305_cfpb_consent-order-0001.pdf***
[16] ***201310_cfpb_complaint_borders.pdf***
[17] ***201303_cfpb_march_-Auto-Finance-Bulletin.pdf***

Procedure Act. However, it is not quite the same as HUD's Policy Statement, which focused on what HUD would consider in an enforcement action. But it does seem to place restrictions that are above and beyond the statute and regulation. ECOA does not carry criminal penalties, unlike RESPA, which may very well be a factor for consideration. It is also possible that a court would consider this bulletin an agency interpretation that demands some level of deference.

There are more questions than answers on the applicability of this Sixth Circuit case. Whether other courts follow suit in regards to this Policy Statement or other government agency statements remains to be seen. At the very least, we could see impact in the CFPB's case filed in a district court in the Sixth Circuit that, in part, relies on HUD's Policy Statement. It will be interesting to see whether *Carter v. Welles-Bowen* influences the CFPB in its use of policy statements or bulletins. We will have to wait and watch what happens next.

Katie Wechsler is an associate with the law firm of Barnett Sivon & Natter, P.C.