

Clients & Friends Memo

CFPB Suit Against Student Loan Trusts Dismissed

April 1, 2021

On March 26, 2021, Judge Maryellen Noreika of the U.S. District Court for the District of Delaware dismissed a lawsuit brought by the Consumer Financial Protection Bureau (“CFPB”) in *Consumer Financial Protection Bureau v. The National Collegiate Master Student Loan Trusts*,¹ finding, *inter alia*, that the CFPB’s suit was constitutionally defective due to the CFPB’s untimely attempt to ratify the prosecution of the litigation in the wake of the Supreme Court’s decision in *Seila Law LLC v. Consumer Financial Protection Bureau*. This case has been closely watched by many participants in the structured finance industry, because the litigants had disputed over the question of whether the trusts at issue in the litigation are “covered persons” liable under the Consumer Financial Protection Act despite their status as passive securitization trust entities—a question that has important and wide-reaching implications for the structured finance markets.

Background

The National Collegiate Student Loan Trusts (the “Trusts”) hold more than 800,000 private student loans through 15 different Delaware statutory trusts created between 2001 and 2007, totaling approximately \$12 billion. The loans originally were made to students by private banks. The Trusts provided financing for the student loans by selling notes to investors in securitization transactions. The Trusts also provided for the servicing of and collection on those student loans by engaging third-party servicers. However, the Trusts themselves are passive special purpose entities lacking employees or internal management; instead, to operate, the Trusts relied on various interlocking trust-related agreements with multiple third-party service providers to—among other things—administer each of the Trusts, determine the relative priority of economic interests in the Trusts, and service the Trusts’ loans.

On September 4, 2014, the CFPB issued a civil investigative demand (“CID”) to each of the Trusts for information concerning thousands of allegedly illegal student loan debt collection lawsuits used to collect on defaulted loans held by the Trusts. On May 9, 2016, the CFPB alerted the Trusts to the fact that the CFPB was considering initiating enforcement proceedings against the Trusts based on the collection lawsuits through a Notice and Opportunity to Respond and Advice

¹ 2021 WL 1169029, at *3 (D. Del. Mar. 26, 2021).

(“NORA”). A few weeks later, the law firm McCarter & English, LLP (“McCarter”), purporting to represent the Trusts, submitted a NORA response to the CFPB. McCarter and the CFPB then proceeded to negotiate a Proposed Consent Judgment to resolve the CFPB’s investigation of the Trusts.

The Litigation

On September 18, 2017, the CFPB filed suit against the Trusts in Delaware federal court (the “Court”), alleging that the Trusts had violated the Consumer Financial Protection Act of 2010 (the “CFPA”) by engaging in unfair and deceptive practices in connection with their servicing and collection of student loans. Although the CFPB acknowledged that the Trusts had no employees and that the alleged misconduct resulted from actions taken by the Trusts’ servicers and sub-servicers in the course of their debt collection activities—rather than any actions taken by the Trusts themselves—the CFPB nonetheless named *only* the Trusts as defendants. On the same day, the CFPB also filed a motion to approve the Proposed Consent Judgment negotiated with McCarter.

However, within days of the CFPB’s initiation of the lawsuit, multiple parties associated with the Trusts intervened in the litigation to argue against the entry of the Proposed Consent Judgment. The intervenors expressed concern that the entry of the Proposed Consent Judgment would impermissibly impair or rewrite their respective contractual obligations as set forth in the agreements underlying the Trusts. After discovery, on May 31, 2020, the Court denied the CFPB’s motion to approve the Proposed Consent Judgment, holding that McCarter lacked authority to execute the Proposed Consent Judgment pursuant to terms of the agreements governing the Trusts and Delaware law.

On June 29, 2020, in another lawsuit involving the CFPB, the United States Supreme Court held in *Seila Law LLC v. Consumer Financial Protection Bureau* that the CFPB’s structure violated the Constitution’s separation of powers.² Specifically, the Supreme Court held that “an independent agency led by a single Director and vested with significant executive power” has “no basis in history and no place in our constitutional structure,”³ and that the statutory restriction on the President’s authority to remove the CFPB’s Director only for “inefficiency, neglect, or malfeasance” violated the separation of powers.⁴ The Supreme Court then concluded that the proper remedy was to sever the removal restriction, and ultimately allowed the CFPB to stand. The Supreme Court also noted that an enforcement action that the CFPB had filed to enforce a CID while its structure was

² 140 S.Ct. 2183, 2197 (June 29, 2020). For a detailed discussion on *Seila Law*, please see our July 2, 2020 Clients & Friends Memo, “*Seila Law LLC v. Consumer Financial Protection Bureau: Has the Supreme Court Tamed or Empowered the CFPB?*”, available at <https://www.cadwalader.com/resources/clients-friends-memos/seila-law-llc-v-consumer-financial-protection-bureau-has-the-supreme-court-tamed-or-empowered-the-cfpb>.

³ *Id.* at 2201.

⁴ *Id.* at 2197.

unconstitutional may nonetheless be enforceable if it was later successfully ratified by an acting director of the CFPB who was removable at will by the President. If not so ratified, however, the enforcement action must be dismissed.

Around the time the Supreme Court issued its decision in *Seila Law*, various intervenors were briefing multiple motions to dismiss the CFPB's complaint against the Trusts. One subset of intervenors—Ambac Assurance Corporation, the Pennsylvania Higher Education Assistance Agency, and the Wilmington Trust Company⁵ (collectively, "Ambac")—argued, *inter alia*, that: (i) the Supreme Court's decision in *Seila Law* required dismissal of the CFPB's complaint because the CFPB's ratification of the litigation against the Trusts was untimely, and (ii) the Court lacked subject matter jurisdiction over its asserted claims because the Trusts are not "covered persons" as required under the CFPB. Another intervenor, Transworld Systems, Inc.⁶ ("TSI") also argued that the CFPB's complaint merited dismissal for lack of subject matter jurisdiction as well.

The Court's Holding

Subject Matter Jurisdiction

The Court held that it possessed the requisite subject matter jurisdiction to decide the CFPB's claims, and rejected the contention that a showing of whether the Trusts are "covered persons" is a jurisdictional requirement under the CFPB. To determine whether a restriction—such as the term "covered persons"—is jurisdictional, the Court looked to "whether Congress has clearly stated that the rule is jurisdictional."⁷ "[A]bsent such a clear statement," courts "should treat the restriction as nonjurisdictional."⁸

The Court then examined the CFPB, observing that there is no clear statement in the CFPB's jurisdictional grant that "covered persons" is required. The Court noted that only one section of the CFPB addresses the issue of subject matter jurisdiction, and that section granted jurisdiction over "an action or adjudication proceeding brought under Federal consumer law" with no mention of "covered persons" whatsoever.⁹

⁵ Ambac Assurance Corporation provided financial guarantee insurance with respect to securities in over half of the Trusts. The Pennsylvania Higher Education Assistance Agency is the Primary Servicer for the Trusts, while the Wilmington Trust Company is the Trusts' Owner Trustee.

⁶ TSI is a sub-servicer responsible for the collection of the Trusts' delinquent loans.

⁷ *Nat'l Collegiate Master Student Loan Tr. at *3* (citing *Sebelius v. Auburn Reg'l Med. Ctr.*, 568 U.S. 145, 153 (2013)).

⁸ *Id.*

⁹ See 12 U.S.C. § 5565(a)(1).

While the Court agreed that the term “covered persons” appeared multiple times throughout the CFPB, it pointed out that none of the sections where “covered persons” appeared mentioned jurisdiction.

Enforcement Authority

In light of the Supreme Court’s holding in *Seila Law*, the Court granted Ambac’s motion to dismiss the CFPB’s complaint due to the CFPB’s lack of enforcement authority as a result of its untimely ratification of the litigation.

As an initial matter, the Court observed that there was no question that the CFPB initiated the enforcement action against the Trusts at a time when its structure violated the constitutional separation of powers. The task facing the Court, then, would be to determine (i) whether that constitutional defect has been cured by ratification, or (ii) whether dismissal of the suit is required. Under the applicable Third Circuit precedent, there are three general requirements for ratification of previously-unauthorized action by an agency: (1) “the ratifier must, at the time of ratification, still have the authority to take the action to be ratified”; (2) “the ratifier must have full knowledge of the decision to be ratified”; and (3) “the ratifier must make a detached and considered affirmation of the earlier decision.”¹⁰ Here, the parties’ dispute centered around the first requirement.

Under the first requirement, the Court noted that “it is essential that the party ratifying should be able not merely to do the act ratified at the time the act was done, *but also at the time the ratification was made.*”¹¹ On July 9, 2020, the CFPB’s then-Director, Kathy Kraninger, had ratified the decision to initiate the CFPB’s litigation against the Trusts a few weeks after the Supreme Court’s decision in *Seila Law*. The Court held that Director Kraninger’s ratification was ineffective, because (i) an enforcement action arising from alleged CFPB violations must be brought no later than three years after the date of discovery of the violation to which the action relates,¹² (ii) ratification is ineffective when it takes place after the relevant statute of limitations has expired, and (iii) the CFPB clearly had discovery of the Trusts’ alleged CFPB violations more than three years before the ratification date, *i.e.*, before July 9, 2017. Thus, Director Kraninger’s ratification of the CFPB’s decision to file suit against the Trusts failed to cure the constitutional defects raised by *Seila Law*, and the CFPB’s complaint—initially filed by a CFPB director unconstitutionally insulated from removal—could not be enforced.

¹⁰ *Nat’l Collegiate Master Student Loan Tr.* at *4 (quoting *Advanced Disposal Serv. E., Inc. v. Nat’l Labor Relations Bd.*, 820 F.3d 592, 602 (3d Cir. 2016)).

¹¹ *Id.* (quoting *Advanced Disposal*, 820 F.3d at 603) (emphasis in original).

¹² 12 U.S.C. § 5564(g)(1).

In so holding, the Court rejected the CFPB's argument that the timeliness requirements for ratification were satisfied because the CFPB had brought the original suit within the applicable limitations period. The Court likewise rejected the CFPB's request to equitably toll the statute of limitations for ratification, because the CFPB "could not identify a single act that it took to preserve its rights in this case in anticipation of the constitutional challenges that could have reasonably ended with an unfavorable ruling from the Supreme Court."¹³

Key Takeaways

The securitization industry has operated for decades on the premise that agreements governing securitization transactions provide that transaction parties are responsible for their own malfeasance and, barring special circumstances, will not be held accountable for the misconduct of other parties to the transaction. A decision holding that passive securitization entities like the Trusts are "covered persons" under the CFPB—and thus potentially responsible for the actions of their third-party service providers—would undermine the certainty of contract terms that undergirds the success of the structured finance industry, with grave implications for the healthy functioning of the industry. While the substantive question of whether passive securitization entities like the Trusts could indeed be "covered persons" and held accountable for the actions of their third-party service providers remains to be answered for another day, the Court did observe that it "harbor[ed] some doubt" that the plain language of the CFPB extended to passive statutory trusts,¹⁴ and expressed skepticism as to whether the CFPB could successfully replead in a manner that would successfully cure the deficiencies in its original complaint.

¹³ *Nat'l Collegiate Master Student Loan Tr.* at 7.

¹⁴ *Id.* at 3.

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