Business Law Section Newsletter

Spring 2013

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Message From The Chair

Fellow Section Members:

I am pleased to report in this newsletter that the Committee is working to make the Business Law Section even more robust and user-friendly for our approximately 4,000 members. The Section has been active in seeking ways to revise its offerings and actually engaging in a strategic planning process. Please be sure to stay tuned for updates.

The Section has recruited some of the most knowledgeable and insightful speakers for our upcoming CLE events. As a benefit of being a member, each of the CLE's has a reduction in price of $25 for some upcoming events:

- **Essentials of Business Law Course:** Video at the Crowne Plaza River Oaks Hotel, Houston, Texas—April 18-19, 2013;
- **Collections and Creditor's Rights Course:** Video at the Crowne Plaza River Oaks Hotel, Houston, Texas—April 18-19, 2013; and
- **Choice and Acquisition of Entities in Texas Course:** at the Hyatt Hill Country Resort and Spa, San Antonio, Texas—May 24, 2013

I hope that you find this newsletter interesting and useful.

Greg Samuel
Chair of the Business Law Section, 2012-13

Legislation Update on Article 4A Amendment

By: Roger Bartlett, Law Office of Roger A. Bartlett

Legislation is moving through the Texas Senate (SB230) and House of Representatives (HB702) that would bring some remittance transfers under chapter 4A of the Texas Business and Commerce Code. A "remittance transfer" is a consumer-initiated international transfer of funds electronically. The federal Dodd-Frank Wall Street Reform and Consumer Protection Act placed this species of wire transfer under the federal Electronic Fund Transfer Act, thus removing them from article 4A of the Uniform Commercial Code, which governs funds transfers. However, an analysis by the Uniform Law Commissioners—the body that produces the UCC and other uniform laws—concluded that there were some fact situations in which a remittance transfer would fall outside both the EFTA and article 4A. Their solution was to amend section 4A-108 to provide that those transfers would be governed by article 4A, thus providing a body of law to allocate rights and responsibilities for what otherwise would be an unregulated transaction. This uniform amendment to the UCC has been adopted in some states and is now being considered by several others, including Texas.

Commercial Financial Services Committee

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J. Scott Sheehan
Greenburg Traurig LLP

Vice-Chair:
Scott Night
Haynes and Boone, LLP

Description:
The Commercial Financial Services Committee of the Business Law Section of the State Bar of Texas monitors developments and issues relating to commercial finance issues for lenders in Texas. Such issues include Texas usury laws, choice of law matters, opinions of counsel, and secured transactions.

Get Involved:

If you would like to join the Commercial Financial Services Committee please contact **Scott Sheehan at sheehans@gtlaw.com.**

Potential Impact of the Canning Decision on CFPB Rules

By: Cheryl Crandall Tangen, Cheryl Crandall Tangen, P.C.

On January 25, 2013, a three judge panel of the U.S. Court of Appeals for the D.C. Circuit unanimously struck down appointments of three National Labor Relations Board (NLRB) members that were made by President Obama on January 4, 2012, as constitutionally invalid. (*Noel Canning v NLRB*, No. 12-1115, D.C. Cir. 2013) The President had invoked the "Recess Appointments" clause of the U.S. Constitution in making such appointments in order to avoid the Constitutional requirement that such appointments be pursuant to the "advice and consent" of the Senate. While the *Canning* decision only affects the appointments of the three NLRB appointees and NLRB action taken after such appointments, the decision has implications for the President's appointment of Richard Cordray as Director of the Consumer Financial Protection Bureau (CFPB) and, consequently, the rule-making and enforcement authority of the CFPB, since Mr. Cordray's appointment was also made as a "Recess Appointment" on the same day. What follows is a brief summary of the *Canning* ruling, the potential impact of any invalidation of Mr. Cordray's appointment, and pure conjecture as to what may happen next.

The U.S. Constitution generally requires that all officers of the United States be nominated by the President and appointed with the "advice and consent" of the Senate (U.S. Const. art II, Section 2, Clause 2). However, the "Recess Appointments" clause provides an exception to this rule by permitting the President to "fill up all Vacancies that may happen during the Recess of the Senate, by granting Commissions which shall expire at the End of their next Session." ***Id***. art.II, Section 2, Clause 3. Generally, a "session" of the Senate is the period between the "reconvening of the Senate after a *sine die* adjournment and the next *sine die* adjournment. (See CRS Report for Congress RS21308, "*Recess Appointments: Frequently Asked Questions*, Henry B. Hogue.) The Twentieth Amendment to the U.S. Constitution provides that Congress will meet annually on January 3, unless it appoints a different day (U.S. Const., 20th Amend., Sec. 2). Accordingly, an appointment on January 4, 2012 occurred after the commencement of a new "session" of the Senate and not between "sessions." On January 4, 2012, however, the Senate was operating pursuant to a consent agreement, under which it met in "pro forma" sessions every third business day from December 20, 2011 through January 23, 2012. No business was conducted during this period except for the extension of the payroll tax cuts on December 23, 2011, and the "pro forma" session involved banging a gavel to call the proceedings to order and, shortly afterwards, banging the gavel to close the proceedings. While there has been a great deal of discussion as to whether this intermittent use of the gavel destroys any characterization of empty chambers as being in "recess," the *Canning* decision was not based upon any determination of the sufficiency of periodic gavel-banging. Rather, the three judge panel held that the Recess Appointments Clause could only be invoked during "intersession" recesses – recesses occurring *between* each session of the Senate – and not during "intrasession" recesses – recesses occurring *during* sessions. Furthermore, two of the three judges on the panel also interpreted the Recess Appointment Clause as limiting such appointments for "Vacancies" that first occurred *during* the recess, not for vacancies that existed prior to the recess. Since the NLRB vacancies were extant prior to January 4, 2012, the panel ruled that the "Recess Appointments" clause could not be constitutionally invoked for these appointments, even if the appointment occurred during an intersession recess.

The ruling of the D.C. Court of Appeals is in direct conflict with a 2004 decision of the U.S. Court of Appeals for the Eleventh Circuit which expressly rejected a challenge to President George W. Bush's appointment of William H. Pryor to that court, premised upon the fact that the appointment was made during an intrasession recess (*Evans v Stephens*, 387 F. 3d 1220). The Court held that "the" Recess, as used in Clause 3 does not require that appointments be made only during an intersession recess, but rather permits appointments made during intrasession recesses as well. The Court noted that "Twelve Presidents have made more than 285 intrasession recess appoint-

Potential Impact of the Canning Decision on CFPB Rules (*Continued from Page 2)*

ments of persons to offices that ordinarily require the consent of the Senate." (***Id***., p. 1226).

The Administration maintains that the NLRB member appointments were constitutional. It has the option of requesting a re-hearing before the same panel or before the entire D.C. Court of Appeals *en banc* or petitioning to the United States Supreme Court for certiorari. As of this writing, none of those actions have yet been taken.

A similar set of circumstances applies with respect to Mr. Cordray's appointment as Director of the CFPB. The "vacancy" was created as early as July 21, 2010, the date of passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203 (the "Dodd-Frank Act"), which created the CFPB and provided for the appointment of a single director to head the agency, or as late as July 21, 2011, the "transfer date," which is the date upon which certain described functions were to transfer to the CFPB.[1] As referenced above, Mr. Cordray's appointment by President Obama occurred on January 4, 2012, the same day, and in the same manner, as the NLRB member appointments that the D.C. Court of Appeals held to be constitutionally invalid.

To date, no appellate level courts have determined that Mr. Cordray's appointment was unconstitutional, although there are several cases pending in various federal district courts seeking that determination. One case pending in the D.C. District Court, in part, challenges the appointment of Mr. Cordray on this basis, *State National Bank of Big Springs v Geithner,* No. 12-CV-01032. The rambling complaint, which reads like a tirade against anything whatsoever connected with the Dodd-Frank Act, asserts, among other purported constitutional flaws associated with the CFPB, that Mr. Cordray's appointment was unconstitutional, since it was made while the Senate was in session. The complaint asserts that the Senate sets its own rules and if it says it's in "session," it's in session, even if on a "pro forma" basis. This case has been getting a fair amount of press given the joinder of several state Attorneys General (including the Texas Attorney General) in that portion of the complaint that challenges the "orderly liquidation" powers given to the Secretary of the Treasury and the FDIC.

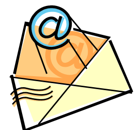
More relevant to the appointment issue and the implications of CFPB's actions if the appointment of its director is deemed to be unconstitutional is a case that is pending in the U.S. District Court for the Central District of California, *Consumer Financial Protection Bureau v Chance Edward Gordon, et al,* No. CV 12-6147- RSWL (MRWx). The *Gordon* case was filed by the CFPB against law firms, individual attorneys, and "credit counseling" agencies that were allegedly engaged in a fraudulent mortgage relief scheme under which the Defendants solicited payments from distressed mortgage borrowers in exchange for negotiating loan modifications on their behalf. The complaint alleged that the Defendants never procured nor accepted any loan modifications. In November, 2012, the District Court issued a preliminary injunction, ordered the winding up of a receivership that was appointed over the Defendants' assets, and further continued a freeze of Defendants' assets. Following the *Canning* decision, the remaining non-settling Defendants in the *Gordon* case objected to the receiver's request for payment citing *Canning* and a July 15, 2011 report of the Offices of the Inspector General (Treasury Department and the Federal Reserve Board) entitled "Review of CFPB Implementation Planning Activities" (the "OIG Report") as support for its assertion that the CFPB has no authority to bring an enforcement action against non-banking persons until a "presidentially appointed, Senate-confirmed director" is leading the agency. Therefore, the Defendants asserted, since the appointment was not Senate-confirmed or at least made in a manner that excuses Senate confirmation as a valid Recess Appointment, the enforcement action may not proceed against Defendants, who are "non-banking" persons.

The OIG Report gives some indication of what activities and rule-making may be constitutionally suspect and perhaps "less salvageable" if the Cordray appointment is ultimately determined to have been unconstitutional. Certain of the CFPB's rule-making powers relative to federal consumer protection issues and supervisory functions are "inherited" from other federal regulatory agencies -- the

Newsletter Submissions

If you would like to submit an article for inclusion in the Business Law Section's Newsletter, please email it to our Newsletter Committee Chair, Shanna Nugent, at snugent@slnlegal.com or Vice Chair, Wendy Curtis, at wcurtis@akingump.com. The Newsletter Committee reserves the right to edit contributions for clarity and content.

Keeping Your Email Address Updated



With the electronic distribution of the newsletter, it will be important for every Section member to keep an updated email address with the State Bar of Texas since that agency will distribute the email on behalf of the Section. You may update your email address at the MyBarPage of the State Bar's website. Please note that the Section will not sell or distribute your email address to anyone, including the State Bar's CLE Division.

Potential Impact of the Canning Decision on CFPB Rules (*Continued from Page 3)*

Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the National Credit Union Administration, the Department of Housing and Urban Development, and the Federal Trade Commission. Certain other powers are characterized by the OIG Report as “newly established federal consumer financial regulatory authorities”, such as prohibiting unfair, deceptive, or abusive acts or practices, prescribing rules and model disclosure forms for features of a consumer financial product, prescribing rules for the filing of reports by non-depository institutions to determine whether they should be subject to CFPB supervisions, and supervising non-depository institutions. The OIG Report concludes that the inherited powers or “transferred” functions may be exercised by the Treasury Department if no Director of the CFPB is appointed. It also points out that the “newly-established powers” may not be exercised by the Treasury Secretary if no Director is appointed (or, as argued by the *Gordon* defendants, “constitutionally appointed”). However, it doesn’t specifically conclude that rules and/or supervisory action may not be taken by the CFPB during a period in which the director has not (validly) been appointed.[2]

Section 1066 of the Dodd-Frank Act (12 USC 5586) provides that “The Secretary [of the Treasury] is authorized to perform the functions of the Bureau [CFPB] under this subtitle until the Director is confirmed by the Senate in accordance with Section 1011.” “This subtitle” refers to Subtitle F of Title X of the Dodd-Frank Act. The functions of the CFPB under Subtitle F are the “consumer financial protection functions” of the agencies listed above. “Consumer financial protection functions” are defined in Section 1061 of Dodd-Frank Act (12 USC 5581) as “all authority to prescribe rules or issue orders or guidelines pursuant to any Federal consumer financial law, including performing appropriate functions to promulgate and review such rules, orders, and guidelines” and the examination authority over “big” insured banks and credit unions and their affiliates (over $10 billion in asset size).

Accordingly, for these “inherited” or “transferred” types of rules and supervisory functions, if the CFPB is deemed to be leader-less and such “leader-less” status is deemed to invalidate rules adopted by a “leader-less” CFPB, the Treasury Secretary could simply ratify the rules and the supervisory action taken. Perhaps the “qualified mortgage/ability to repay” rules implementing the Dodd-Frank Title XIV provisions, including amendments to the Truth in Lending Act and RESPA would be deemed to be valid if ratified by the Treasury Secretary, but only insofar as they apply to banking entities that were formerly regulated by the “transferor agencies” referenced above. The larger issue seems to be with respect to the rules and enforcement actions as they relate to non-banking entities.

The author has been unable to find any in-depth analysis of whether rules adopted by a federal agency, acting during a director vacancy are, as a result of that status, invalid.

Section 1022(b)(1) of the Dodd-Frank Act (12 USC 5512 (b)(1)) provides: “The Director may prescribe rules and issue orders and guidance as may be necessary or appropriate to enable the Bureau to administer and carry out the purposes and objectives of the Federal consumer financial laws and to prevent evasions thereof.” However, in numerous provisions of the Dodd-Frank Act, rule-making authority is not limited to the “Director” but is given to the “Bureau.” Some commentators have simply glossed over this by stating, without any cited authority, that the Bureau cannot take any action without a Director.[3] Some support for that view may be inferred by Section 1066 of the Dodd-Frank Act, referenced above, which specifically allows the Secretary of the Treasury to perform “inherited functions” of the CFPB until a Director is appointed and confirmed. This may suggest that Congress intended that the CFPB not undertake the powers transferred to it until the Director is appointed and confirmed. In the author’s opinion, this is far from a “slam-dunk” invalidation of rules adopted during the tenure of a Director whose appointment is later deemed to be constitutionally invalid.

Some commentators have asserted that the “*de facto* officer rule”[4] will be observed by the courts as a means of upholding the actions taken by the CFPB. That is, agency actions performed under the “color of official title” will not be overturned so as to avoid chaos and confusion that would otherwise ensue. In addition, some of the rules adopted by the CFPB provided further guidance and “safe harbors” to statutory provisions already contained in Title XIV of the Dodd-Frank Act relative to “ability to repay” and “qualified mortgage loans.” Given that the statutory framework is already provided, the courts may determine that the interpretive regulations should be upheld pending the “valid” appointment of the director (again, assuming that the appointment of Mr. Cordray is held to be unconstitutional).

In any event, it is likely that the Administration will seek further review of the *Canning* decision and any lower court determina-

Potential Impact of the Canning Decision on CFPB Rules (*Continued from Page 4*)

tions that may hold the Cordray appointment to be similarly constitutionally flawed. So, in the interim, the Administration's position is that the CFPB has and had full authority to enact the rule-making and undertake the enforcement actions since the recess appointment of Mr. Cordray. Also, President Obama re-nominated Mr. Cordray for appointment as the Director of the CFPB for a full term on January 24, 2013. It is possible (but, given the current lack of bi-partisanship in Washington these days, unlikely) that Mr. Cordray could be confirmed by the Senate, if the Administration and Senate Republicans agree upon some changes to the structure of the CFPB. Republicans have consistently opposed Mr. Cordray's appointment on the basis of its concerns about the bureau, not about Mr. Cordray, who by many accounts is considered to have a "balanced" approach to regulation. Among the structural changes that the Republicans wish to see are the creation of a governing commission for the Bureau, rather than a single Director, making the budget of the CFPB subject to the appropriations process, and giving prudential regulators a "safety and soundness" check or veto authority on CFPB proposed rule-making in order to strike the appropriate balance between consumer protection and the safety and soundness of the entities that they supervise. It is doubtful that these "demands" or compromise changes will be agreed to any time soon.

So until pigs fly (Senators compromise) and pending that further review of the *Canning* decision, the status of rules and actions of the CFPB, especially under its "newly created" powers, or as applied to non-banking entities remains murky.

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[1] Some commentators have asserted that, since the CFPB is a new agency for which no prior Director has been appointed, the appointment of Mr. Cordray was not to fill a "vacancy" of the type that the Recess Appointments Clause was intended to permit. The author could find no support for the assertion that a "vacancy" only occurs when an office was previously held by another who no longer serves in that position.

[2] The OIG Report does state "However, until a Director is in place, as noted in the Background section of this report, CFPB will have limited authority to conduct its nondepository institutions supervisory program as well as some other new responsibilities authorized by the Dodd-Frank Act." Unfortunately, the Background section does not examine what authority the CFPB has to act in the absence of its director.

[3] See "Implications of Canning Case on CFPB Rules" by Raymond Natter, February 2013, "Our Perspectives" publication of Barnett Sivon & Natter PC ("Natter").

[4] *Id*., pp. 4-5 and cases cited therein.

CLE Credit:

Don't miss the Business Law Section sponsored CLE's listed on the back cover!

Legal Opinions Committee Update: Dodd-Frank and Swap Guarantees by and Joint and Several Liability Provisions for Entities that are not Eligible Contract Participants

By: Stephen C. Tarry, Vinson & Elkins LLP

In a No-Action and Interpretation Letter dated as of October 12, 2012 (the "***No-Action Letter***"),[1] the Commodity Futures Trading Commission (the "***CFTC***") has interpreted the Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. No. 111-203, 124 Stat. 1376 (2010)) (the "***Dodd-Frank Act***")[2] to provide that each guarantor[3] of a swap that is not entered into on an exchange must be an "eligible contract participant" (an "***ECP***"), as such term is defined in the CFTC's rules at 17 C.F.R. §1.3.[4] The definition of ECP is lengthy, but many business organizations will qualify as a result of being a corporation, partnership, limited liability company, proprietorship, organization, trust, or other entity:

(a) (i) that has total assets exceeding $10,000,000; or (ii) the obligations of which under an agreement, contract, or transaction are guaranteed or otherwise supported by a letter of credit or keepwell, support, or other agreement by an entity that has total assets exceeding $10,000,000; or

(b) that (i) has a net worth exceeding $1,000,000; and (ii) enters into a swap in connection with the conduct of the entity's business or to manage the risk associated with an asset or liability owned or incurred or reasonably likely to be owned or incurred by the entity in the conduct of the entity's business.[5]

When a business organization enters into a credit agreement with one or more financial institutions, it is not unusual for the credit agreement to require that the borrower's obligations under swaps between the borrower and a lender or its affiliate, along with all of the other obligations of the borrower under the loan documents, be covered by guarantees from all of the subsidiaries of the borrower—even if the subsidiaries do not meet the asset and net worth tests applicable to ECPs. Under the CFTC's rules, if such a subsidiary of a borrower cannot satisfy the ECP requirements, then the subsidiary's guarantee of the swaps will not be enforceable. In the No-Action Letter, the CFTC also concludes that non-ECPs may not be jointly and severally liable for swap obligations.[6] New swaps under existing ISDA Master Agreements and material modifications to such Master Agreements may also be problematic if non-ECP entities guarantee, or become jointly and severally liable for, any of the swap obligations thereunder.

To avoid the issues raised by the CFTC's interpretation of the ECP requirement, counsel to lenders and borrowers may want to consider including in guarantees and joint and several liability clauses express "savings" provisions stating that guarantees provided by, or joint and several liability with respect to, non-ECP subsidiaries do not cover swap obligations. It may also be possible to address the issue by having the parent or subsidiaries that are ECPs enter into guarantees or keepwell agreements with respect to the obligations of non-ECP subsidiaries. If there is a possibility that non-ECP subsidiaries are guaranteeing, or becoming jointly and severally liable for, swap obligations, counsel to the borrower rending opinions on the loan documents may wish to consider excluding those subsidiary guarantees and joint and several liability provisions from their enforceability opinions and their opinions regarding non-contravention of laws, insofar as the guarantees and joint and several liability provisions cover swap obligations. It appears that some practitioners may be opting both to include such savings provisions and to add such express exclusions to their legal opinions.

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[1] The No-Action Letter, which is CFTC Letter No. 12-17, has been published on the CFTC's website: http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/12-17.pdf

[2] The text of the Dodd-Frank Act can be found on the SEC's website: http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf

Legal Opinions Committee Update: Dodd-Frank and Swap Guarantees by and Joint and Several Liability Provisions for Entities that are not Eligible Contract Participants (Continued from Page 6)

[3] Section 2(e) of the Commodity Exchange Act (as amended by the Dodd-Frank Act) provides that each entity that directly enters into a non-exchange cleared swap must be an ECP. The Commodity Exchange Act is available on the website of the Cornell University Law School: http://www.law.cornell.edu/uscode/text/7/chapter-1

[4] The CFTC's rules have been published on the website of the Cornell University Law School: http://www.law.cornell.edu/cfr/text/17

[5] In the No-Action Letter, the CFTC provides certain relief from the total asset and net worth requirements for guarantors who guarantee swaps that are entered into solely to manage floating interest rate risk, provided that certain other requirements set forth in the No-Action Letter are also satisfied. The No-Action Letter also provides relief from some of the ECP requirements during specified transition time periods.

[6] Footnote 12 to the No-Action Letter provides that the interpretation set forth therein is limited to guarantees of, and joint and several liability with respect to, swaps and does not address any other credit support arrangements. The footnote expressly states that a non-ECP may, for example, provide collateral to support a third party's obligations.

State Bar of Texas Task Force Update

Doors may open to foreign lawyers

In 2009, the Texas Supreme Court established a task force to look into why lawyers from foreign countries prefer to sit for the New York bar (approximately 4000 annually) compared to the Texas bar (approximately 20 annually). In January 2013, the Texas Supreme Court Task Force on International Law Practice submitted their proposed recommendations to the Texas Supreme Court. It is expected that the Texas Supreme Court will seek public comment on the proposed recommendations prior to voting on whether to adopt the recommendations. A copy of the task force report is attached for your review.

Please click on the link to view the final report: finalreport.pdf

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Collections and Creditor's Rights Course:

Video: Crowne Plaza River Oaks Hotel, Houston, Texas—April 18-19, 2013
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Choice and Acquisition of Entities in Texas Course:

Live: Hyatt Hill Country Resort and Spa, San Antonio, Texas—May 24, 2013

Video: Crowne Plaza River Oaks Hotel, Houston, Texas—June 28, 2013 and City-place Events, Dallas, Texas—July 12, 2013

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State Bar of Texas Annual Meeting

Anatole Hotel, Dallas

For more information go to http://www.texasbar.com/annualmeeting

Business Law Section members grabbing grub at Chicken Scratch in Dallas.

From left to right: Wendy Curtis, John Podvin, Scott Night, Daryl Robertson