EXAMINING CONSTITUTIONAL DEFICIENCIES AND LEGAL UNCERTAINTIES IN THE DODD-FRANK ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

OF THE

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EXAMINING CONSTITUTIONAL DEFICIENCIES AND LEGAL UNCERTAINTIES IN THE DODD-FRANK ACT

Tuesday, July 9, 2013

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON OVERSIGHT
AND INVESTIGATIONS,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2 p.m., in room 2128, Rayburn House Office Building, Hon. Patrick T. McHenry [chairman of the subcommittee] presiding.

Members present: Representatives McHenry, Fitzpatrick, Bachmann, Duffy, Grimm, Fincher, Hultgren, Wagner, Barr, Rothfus; Green, Cleaver, Maloney, Beatty, and Heck.

Ex officio present: Representative Hensarling.

Chairman MCHENRY. The Subcommittee on Oversight and Investigations of the Financial Services Committee will come to order. Our hearing today is entitled, "Examining the Constitutional Deficiencies and Legal Uncertainties in the Dodd-Frank Act."

Without objection, members of the full Financial Services Committee who are not members of this subcommittee may sit on the dais and participate in today's hearing.

And, without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

We will now proceed with opening statements. And without objection, we will limit it to 5 minutes per side. I will first recognize myself for 5 minutes.

Following the most significant financial crisis since the Great Depression, Dodd-Frank was signed into law with a promise that never again will the taxpayers be forced to bail out Wall Street. Simply put, what we now know is that Dodd-Frank does not work. Over the past several months, this subcommittee has attempted to dissect section by section the parts of Dodd-Frank that pretend to rein in the large interconnected financial institutions which brought us to the brink 5 years ago. It also pretends to end "too-big-to-fail," which is in fact not the case.

What we have discovered is something to the contrary. In over 840 pages of law, Dodd-Frank granted an incredible amount of power and discretion to the Federal Reserve, the FDIC, and the newly created Financial Stability Oversight Council (FSOC).

Almost 3 years later, as the law slowly works its way through the regulatory process, we discover that Dodd-Frank's designation

and resolution processes protect "too-big-to-fail" banks, quite to the disadvantage of their small bank competition.

This new economic reality is illustrated when two large credit rating agencies continue to single out the eight largest banks for a systemic ratings uplift by virtue of their size, interconnectedness, and difficulty to unwind, and furthermore their ripeness for taxpayer bailouts in times of trouble.

As the markets quantify this newly designated safety net, these banks experience a lower cost of borrowing, which is the lifeblood of financial institutions. Likewise, they do say that cost of borrowing may not exist, and there is debate about that, but the World Bank says clearly that there is a cost-of-borrowing advantage.

Not surprisingly, this impressive and unprecedented power, designed to protect the largest and most interconnected financial institutions, is also being criticized as being unconstitutional. Several States, including Alabama, Georgia, Kansas, Michigan, Montana, Nebraska, Ohio, Oklahoma, South Carolina, Texas, and West Virginia have joined with the National Bank of Big Spring as plaintiffs in its suit against the Department of Treasury, the FSOC, the Federal Reserve, the FDIC, and the Consumer Financial Protection Bureau (CFPB). Their claim is that Dodd-Frank violates the Constitution's separation of powers and its protections afforded through due process. Legal scholars are analyzing similar constitutional claims as well.

Our founders understood that government is imperfect and must be kept in check. As a co-equal branch of government, Congress has an obligation to interpret the Constitution and to act within the bounds of its interpretation when carrying out its oversight and legislative functions.

As James Madison discussed Congress' rights to interpret the Constitution in relation to that of the Judicial Branch, he said, "But the great objection is that the legislature itself has no right to expound the Constitution; that whenever its meaning is doubtful, you must leave it to take its course, until the Judiciary is called upon to declare its meaning." And "The Constitution is the character of the people of the government. It specifies certain great powers as absolutely granted and marks out the departments to exercise them. If the constitutional boundary of either be brought into question, I do not see that any one of these departments has more right than another to declare their sentiments on that point."

Today, we will be declaring our sentiments on that very point: the constitutionality of the Dodd-Frank Act. Accordingly, this hearing will examine why certain provisions in Title I and Title II of Dodd-Frank may be susceptible to constitutional challenge. We will also explore the manner and circumstances in which a party with legal interests affected by the Orderly Liquidation Authority could challenge the commencement of an—let's use it in quote marks, "orderly liquidation"—and thereby delay or prevent the liquidation from functioning as intended in the Dodd-Frank Act.

This panel before us today has an impressive background in constitutional law as well as a depth and understanding of the Dodd-Frank Act. I certainly appreciate the three gentleman here today, their willingness to be here.

We will now recognize the ranking member of the subcommittee, Mr. Green, for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman, and I thank the witnesses for appearing.

And I thank the witnesses for the information that they have already provided us. I had an opportunity to peruse your written statements, and I am eager to ask a few questions about some of the statements that have been made. But I do think that each witness has provided us some thoughtful information.

With reference to Dodd-Frank, Dodd-Frank provides a better way. Prior to Dodd-Frank, we had in essence two means by which we could deal with a systemic crisis, a crisis that involved exigent circumstances. These two ways were: one, bankruptcy, which works, but it did not work for Lehman; and two, bailouts. Bailouts are not the preferred choice because the public somehow thinks and, and I agree, that tax dollars ought not be utilized to bail out these large institutions. So, we have these two options: bailout; or bankruptcy.

Dodd-Frank is a better way. And it is interesting to note that while we may look at some of the challenges to the constitutionality of Dodd-Frank, it is interesting to note that Dodd-Frank has not been declared unconstitutional. It is also interesting to note that you can challenge any legislation on constitutional grounds if you like. The question is, will you prevail with your challenge? Will you prevail with your challenge? Thus far, no court has declared Dodd-Frank to be unconstitutional. I will go on to add that if you are concerned about judicial review as it relates to Dodd-Frank, SIFI designation has the means by which judicial review can be perfected. The Orderly Liquidation Authority has a means by which judicial review can be perfected.

Now, there may be some argument as to whether or not there is enough judicial review or the extent to which judicial review should take place, but Dodd-Frank has codified judicial review in it as it relates to the designation of an entity as an SIFI, as well as when orderly liquidation starts to take place.

I believe that Dodd-Frank can be mended, I think there are means by which we can do so, and I would like to see some legislation that purports to amend it. I may very well support some amendments. But I don't think we should end it, and much of what I hear seems to be designed to end Dodd-Frank rather than amend Dodd-Frank. Technical corrections are always appropriate when we have sweeping legislation. Technical corrections are in order with Dodd-Frank, and I would support some of the technical adjustments that may be made.

One of our witnesses today has gone so far as to say, in terms of the substance, that we may have some debate, but that there is a means by which technical corrections can be made to Dodd-Frank and it would meet what he perceives as the challenge associated with the constitutionality of a given section.

My belief is that we must move forward with Dodd-Frank. We must bring the certainty to the market that it richly deserves, and I think that we can do so by having these hearings. But at some point, we have to move on. If there is no legislation, at some point we have to move on and allow Dodd-Frank to function as it should.

I will now yield the remainder of my time to my colleague, the gentlelady to my right.

Mrs. BEATTY. Thank you so much.

Thank you, Mr. Chairman, and Mr. Ranking Member.

And thank you to our witnesses who are here today.

I am happy to be here to further discuss and evaluate the constitutional basis for the authorities granted to Federal regulators under Titles I and II of Dodd-Frank. These two sections collectively compromise the enhanced supervision and orderly liquidation authorities within the law.

In reviewing the submitted testimony from the witnesses today, the main concerns appear to be with Title I and Title II. There seems to be apprehension that the sections improperly restrict the checks and balances created by the Constitution and that certain due process rights are violated. I believe that these apprehensions are somewhat misguided. With respect to Title I, the designation process for enhanced supervision does not simply allow the Federal Reserve Board or the FDIC or the FSOC to arbitrarily pick and choose which firms to select for greater prudential regulation. Instead, I believe the law creates clearly identifiable processes for designation and also provides an opportunity to challenge such a determination.

Thank you.

Chairman MCHENRY. We will now recognize our distinguished witnesses.

Ambassador Boyden Gray is the founding partner of the law firm of Boyden Gray and Associates. He was previously Ambassador to the European Union and was White House Counsel to President George H.W. Bush. He is a graduate of Harvard and the University of North Carolina.

Professor Thomas Merrill is a law professor at Columbia University Law School. He was previously Deputy Solicitor General and Clerk to Supreme Court Justice Harry Blackmun. He is a Rhodes Scholar, and a graduate of Grinnell College, Oxford University, and the University of Chicago.

Mr. Timothy McTaggart is a partner in the law firm of Pepper Hamilton LLP. He was previously a State banking commissioner and a lawyer for the Federal Reserve. He received his undergraduate and law degrees from Harvard.

I think some of you have gone to universities we have heard of.

We certainly appreciate your willingness to be here. You all are familiar with the lighting system, but green means go; yellow, as in traffic, means hurry up; and red means stop. You will have 5 minutes to summarize your opening statements.

And we will begin by recognizing Ambassador Gray.

STATEMENT OF THE HONORABLE C. BOYDEN GRAY, BOYDEN GRAY AND ASSOCIATES

Mr. GRAY. Thank you very much, Mr. Chairman, for the opportunity to discuss parts of this statute with you. It is true that nothing has yet been declared unconstitutional, but I would say we haven't really had our day in court yet. It may be months before we do, but we will, and then we will see what they say.

If there is any message I want to distill from my written remarks, it is that unconstitutional aggregations of power, which this statute represents, at least parts of it on steroids, unconstitutional aggregations of government power that deny the checks and balances that are built into our Constitution invite and create equally pernicious aggregations of private power. They do this by imposing regulatory burdens on smaller entities that are less able to handle them than their bigger competitors, and the bigger competitors end up not necessarily gobbling them up, but watching the consolidation take place, and the mergers eventually do happen.

The centralized institutions of government tend to encourage this because they want to find willing private parties to implement what they want, and what you end up with is a system of crony capitalism with no rule of law and greatly diminished opportunity for the little guy. And I think if you went back to Adam Smith who was conceded to be sort of the architect of our modern miracle of free markets, this was Adam Smith's ultimate nightmare, that the private sector would grab ahold of government entities for their own purpose.

Now, I believe this problem is best illustrated by, as you suggested in your opening remarks, Mr. Chairman, the relationship of Dodd-Frank to "too-big-to-fail" and to the Orderly Liquidation Authority. Title II, as I understand it from what I have been able to sort of get from the participants, and it certainly is backed up by what it actually does, was modeled after the AIG bailout, the idea being perhaps oversimplified to give the government the discretion in a takeover situation to do virtually anything it wants without any check by Congress, by the Executive Branch, by even the Federal Reserve or the courts, and it is the court cutout that I think maybe bothers me the most, and that is possibly because I am a lawyer.

As the Dallas Fed has pointed out, it entrenches "too-big-to-fail." The whole situation is over before anyone has a chance to react. If there is an effort to leak to the public or to third parties that have an interest in the proceeding so that they might go into court to try to preempt something or get review before it is all over, there is a criminal penalty, maybe jail time for anyone who releases this information.

The result is really a bad disadvantage for community banks that can't take the regulatory and the funding advantages that, Mr. Chairman, you talked about. So we are going to see a lot more community bank consolidation, fewer loans from community banks, and that means ultimately—I come from a small town that produced some pretty good banks, a town called Winston-Salem, and what happened there is you don't have any more character loans, which even the government acknowledges are far more reliable than cookie-cutter loans based on paper checkoffs. This situation can only be fixed by untangling this collapse, this separation of powers, by restoring proper judicial review. I do not want to live in a crony capitalist world.

I will conclude by saying that it isn't just Titles I and II that create this problem. If you look at the CFPB, the power grab, the data power grab that they are now engaged in, which has certain resonance in other areas, look at the grab for power with respect to the

auto dealers, and you will see this isn't just limited to Titles I and II; it pervades the entire Act.

Thank you for the opportunity to appear.

[The prepared statement of Ambassador Gray can be found on page 28 of the appendix.]

Chairman MCHENRY. Thank you, Ambassador Gray.

I would ask the rest of the panel to pull your microphones closer when you speak. They are directionally sensitive. Let's just say that they are not the newest and latest and greatest of technology, but they will do.

Professor Merrill, you are now recognized for 5 minutes.

STATEMENT OF THOMAS W. MERRILL, CHARLES EVANS HUGHES PROFESSOR OF LAW, COLUMBIA LAW SCHOOL

Mr. MERRILL. Thank you very much, Mr. Chairman, and thanks to the other committee members for inviting me today.

The focus of my testimony will be on Title II of Dodd-Frank and the constitutional problems that section of the Act creates. I became interested in this about 18 months ago when I was invited to participate in an academic symposium on the administrative and constitutional problems presented by Dodd-Frank, and since then, I have continued to work on this issue. I have a draft article, which I have written with Margaret Merrill, and I have taken the liberty of attaching that to my statement in its current form.

The central point that I want to make is that it is true that Dodd-Frank has not been declared unconstitutional, but the problem is that it contains very serious constitutional problems. And any individual or entity that is opposed to being subjected to an orderly liquidation would have a strong incentive to raise these constitutional issues as a way of trying to increase their leverage with the government in the event of an orderly liquidation or to perhaps derail it. Those constitutional issues will be very difficult to resolve given the procedures that the Act establishes for very minimal judicial review. So my concern is that the constitutional issues will in fact work against the purposes of Title II, that Title II will in fact be undermined by the raising of these constitutional issues at a time when it is least appropriate that they be brought to the fore.

Most of the constitutional issues relate to the judicial review provisions or the lack of judicial review provisions in Title II. Conventional bank receiverships, which I think was the basic model for Title II, are commenced by an administrative appointment of a receiver, but persons aggrieved by that are then given the right to go to court within a short period of time, typically 30 days, and to seek to have the receivership set aside on any legal or factual basis that they wish to advance. This was in fact the way in which the House bill that preceded the enactment of Dodd-Frank structured the commencement of an orderly liquidation.

The Senate had a different idea. The Senate decided that the judicial review process should be put before the appointment of the receiver rather than after the appointment of the receiver, and you could call this ex ante review as opposed to ex post review. The problem with the Senate's approach is that if in fact we are in the midst of what might be a financial crisis, or if the firm which is to be placed in receivership is systemically different, you can't have

an ordinary judicial trial before you create the receivership. This would create adverse publicity and would give rise perhaps to a run on the bank or to the type of financial panic that Title II is designed to prevent. So the Senate in its desire to have ex ante review had a problem with how to structure this review in a way that wouldn't give rise to these concerns.

So what does the bill, as Congress adopted, the Senate version, not the House version, unfortunately, what does the Senate bill do in order to prevent the type of adverse publicity and the panic that a full scale open judicial proceeding would entail? First, it provides that the judicial hearing will take place in complete secret. Second, it provides that most stakeholders, creditors, shareholders, bondholders, and most employees receive no notice of the pending liquidation. Third, it gives the District Court only 24 hours in which to rule on the petition by the Secretary of the Treasury to create a receivership and automatically deems the receivership approved within 24 hours if the District Court has not ruled by that time. Fourth, it provides that the District Court can only review two out of seven legal determinations that the Secretary of the Treasury has to make in order to conclude that a receivership is warranted. Fifth, it limits the review of these two issues to a highly differential arbitrary and capricious standard. Sixth, it provides for expedited appeal of these two issues only, but says there shall be no stay of the receivership pending appeal.

Now, it is important to acknowledge that the Act does contain provisions for judicial review of creditors who have claims. If they are dissatisfied with the way in which the receiver or the FDIC has resolved the claim they can go to court and seek to have that set aside, but it does not contain any provision for judicial review for other stakeholders.

Consider, for example, a pension fund that has a major investment in a systemically significant firm and is upset because it thinks reorganization would be more appropriate than liquidation. Such an entity gets no hearing and no notice, none administratively, none judicially, none before the receivership is commenced, none after the receivership is commenced. This creates, as I detailed in my article and statement, very serious due process, Article III problems, and First Amendment problems. You can go to jail if you disclose the pendency of one of these secret judicial proceedings.

I think the solution is relatively simple: go back to the House version rather than the Senate version and have the review take place after the receivership commences, not before.

Thank you.

[The prepared statement of Mr. Merrill can be found on page 66 of the appendix.]

Chairman MCHENRY. Thank you, Professor Merrill.

Mr. McTaggart, you are recognized for 5 minutes.

STATEMENT OF TIMOTHY R. McTAGGART, PARTNER, PEPPER HAMILTON LLP

Mr. MCTAGGART. Good afternoon, Mr. Chairman. My name is Timothy McTaggart. I thank you for the invitation to appear before the subcommittee and present testimony on this important topic.

I am a partner in the Washington, D.C., office of the law firm Pepper Hamilton, where I head the firm's bank regulatory consumer finance group. I note that my testimony reflects my views alone and not those of Pepper Hamilton LLP or its clients, and of course, any errors are to be attributable solely to me.

By way of background, I served as a supervisor functioning as the bank commissioner for the State of Delaware from 1994 to 1999. I served under then-Governor Tom Carper, who became the Governor of Delaware after serving in the U.S. House of Representatives, including on what was then called the House Banking Committee. Additionally, I served as counsel to the U.S. Senate Banking Committee prior to my service in Delaware.

Earlier in my career, after graduating from Harvard College and Harvard Law School, I had joined the Legal Division at the Board of Governors of the Federal Reserve System in Washington, D.C. The balance of my career has been in private practice in Washington.

I am going to have to beg the mercy of the chairman. I have attached materials which apparently have not made it into the package. I have a copy. I am happy to submit it as part of the record. So, I have attached materials that I prepared with the assistance of Matthew Silver on many of the topics that were noticed for today. There is a 14-page document which was to be an appendix on the constitutionality analysis of the Dodd-Frank Act. Somehow, that got separated out. So I am happy to offer it and present it and ask that the summary be included in the record as part of my remarks.

Chairman MCHENRY. Without objection, it is so ordered.

Mr. MCTAGGART. At this point, I would offer a few overarching comments pertinent to today's topic concerning the constitutionality of the Dodd-Frank Act provisions relating to the Financial Stability Oversight Council (FSOC) and the Orderly Liquidation Authority (OLA).

My written summary also contains references to similar issues regarding the Consumer Financial Protection Bureau, but I am not going to focus on that in this testimony.

First, the courts have routinely exercised judicial restraint in connection with determining whether congressionally enacted legislation is unconstitutional. In the summary that is provided, the most recent statistics that we are aware of show fewer than 170 actions being held to be unconstitutional from 1789 through 2002. It is possible that total undercounts more recent activity from the end of the Rehnquist court and during the Roberts court, but as a matter of historical record, starting with *Marbury* v. *Madison,* it shows the relatively rare overturning of congressional action through the Nation's history. Moreover, the record shows an absence of economic regulation and statutory frameworks being declared unconstitutional.

The second point, there are undoubtedly major policy choices embedded and omitted in the Dodd-Frank Act. Of course, the difference in policy choices reflected in the enacted legislation does not make the legislation unconstitutional. There may be lingering important questions about the effectiveness of the Dodd-Frank Act, I have many myself, to address major policy challenges such as the

"too-big-to-fail" issue. But the debate, of course, over the effectiveness of the Dodd-Frank Act does not go to the constitutionality of the Act.

Third, the genius in our American system of government is the separation of powers among the three branches and the checks and balances among the branches. While we often focus on the executive's power to veto congressional legislation, for example, or the ability of Congress to check the executive power through appropriate oversight, we less frequently focus on the ability of Congress to check the Judiciary by enacting legislation which, for example, limits the jurisdiction of the courts or sets standards of review to be followed by the courts. Congress has the inherent authority to limit the time period available for judicial review and to set other requirements concerning the standard of review to be applied by the courts in reviewing administrative actions.

So it seems to me the crux of the question being considered by the subcommittee is whether the prior Congress, which enacted Dodd-Frank, overstepped its bounds in order to do so. From my perspective, with respect to the limits on judicial review relating to timing and the scope of review in the OLA, I would conclude that Congress did indeed ensure and sought to ensure due process was afforded to the affected financial institutions. With respect to the structural choices made by Congress to create the FSOC, I would conclude that Congress did not impermissibly delegate away its authority.

Now, there are a great many topics, including whether the Dodd-Frank Act ended "too-big-to-fail" or whether the OLA will be a viable alternative to existing Chapter 11 bankruptcy processes for bank holding companies, which previously were not included in the FDIC's resolution authority. The bank regulatory agencies perhaps would be experts to provide testimony.

But I am prepared to answer questions, and I thank you for the opportunity to testify.

[The prepared statement of Mr. McTaggart can be found on page 47 of the appendix.]

Chairman MCHENRY. We thank the panel, and we will now recognize Members for questions.

I will begin by recognizing myself for 5 minutes, and I will begin with you, Professor Merrill.

What is required to establish a violation of the due process clause contained in the Constitution?

Mr. MERRILL. As the text of the Constitution suggests, there are three basic requirements: you have to show that you have life, liberty or property at stake; you have to show that the government is threatening to deprive you of those interests; and then you have to show that the government is threatening to do so in a way inconsistent with due process of law. Due process of law means all sorts of different things, but in this context, it means a notice that the government is going to act adversely against one of those interests and that you have not been given a fair opportunity to present your side of the story before the government takes final action.

Chairman MCHENRY. So now we are looking at the Orderly Liquidation Authority contained within the Dodd-Frank Act. Do you think that a party who might be threatened with this resolution of

the Orderly Liquidation Authority, a creditor, a shareholder, an officer, a director, do you believe that they would have a property interest?

Mr. MERRILL. Absolutely.

Chairman MCHENRY. Okay, so that would be protected under due process?

Mr. MERRILL. Unsecured creditor claims are property, and the position of being president of the bank is property, so I think that covers the waterfront here.

Chairman MCHENRY. Okay. So, in a resolution under the Orderly Liquidation Authority, would the State then be depriving the party of his or her property interests under this construct?

Mr. MERRILL. Arguably, with respect to a creditor, you might say that we would have to wait to see what happens until the receiver resolves the creditor's claim and the creditor has a right to go to court.

But with respect to a number of stakeholders, let's take shareholders, for example. Suppose you have a mutual fund or suppose you have a State employee pension plan that has invested in one of these systemically significant companies and they strongly believe that liquidation is inappropriate, that the company is experiencing a short-term credit crunch, but they could be successfully reorganized.

A shareholder like that is not given any notice under Dodd-Frank before a liquidation is commenced. They are not given any notice or a hearing after the liquidation is commenced. And the statute says this company has to be liquidated, and the shareholders have to take the first hit. So very likely a very substantial financial interest is going to be wiped out without any notice or any hearing, administratively, judicially or otherwise.

Chairman MCHENRY. So, therefore, the Secretary and the FSOC's decision to send an institution through the Orderly Liquidation Authority denies those individuals of due process because it doesn't give them adequate notice and an opportunity to contest the decision?

Mr. MERRILL. That is my reading, unfortunately, of the way the statute is currently drafted.

Chairman MCHENRY. Okay. Ambassador Gray, obviously, with the work that you are doing, you believe that institutions do have a property right and interest and their due process would be violated through the Orderly Liquidation Authority, is that correct?

Mr. GRAY. That is correct.

Chairman MCHENRY. Okay. So do you believe the State would be depriving those parties of his or her property interests?

Mr. GRAY. I believe that is correct. I also believe that it is a cognizable injury to deprive one of the protections granted by the separation of powers. It is a slightly different argument.

Chairman MCHENRY. Explain that argument.

Mr. GRAY. It is related, but it is not the same. And it is true that there are pieces of separation of powers denial throughout our U.S. Code, and especially in the banking industry, but there is nothing like this aggregation, the collapsing of all of these issues all in one place, due process and separation of powers and non-delegation and et cetera, et cetera. So I believe there is more than one ground for

challenge, and I believe the courts will take notice of this when they have the opportunity.

Chairman MCHENRY. Okay. Professor Merrill, to your point on inadequate notice, why might Dodd-Frank provide inadequate notice?

Mr. MERRILL. The administrative procession that leads up to a decision to commence a liquidation is done in secret, and that is the way bank receiverships are done, and that is the way Dodd-Frank is written for these systemically significant non-bank firms. The problem is that if you had an open administrative process, you would trigger the type of financial panic that people want to prevent, that people don't want to have creditors and counterparties cashing out and triggering a financial contagion. So there is no administrative notice.

With respect to the stakeholders, other than the firm itself, the statute says that the judicial proceeding to appoint a receiver takes place in secret, and it makes it a Federal crime to recklessly disclose the fact that proceeding is taking place. That would include, of course, intentionally disclose.

So there is no way that a shareholder or a creditor or a bondholder or any of these stakeholders will find out about this liquidation until it has been announced that the court has approved the appointment of a receiver, and the liquidation at that point under the statute has to take place.

Chairman MCHENRY. My time has expired. We will now recognize the ranking member, Mr. Green, for 5 minutes.

The ranking member asked me to recognize Ms. Beatty instead. I will recognize Ms. Beatty for 5 minutes.

Mrs. BEATTY. Thank you, Mr. Chairman, and Mr. Ranking Member.

And thank you gentlemen.

Mr. McTaggart, much has been said today, and in your documents, regarding the process by which designation occurs. Specifically, Mr. Gray's testimony states that it is no great surprise that big banks would seek to leverage their size, their interconnectedness, and other qualities to obtain favor from the government. The comments appear to suggest that the designation as an SIFI clearly confers strong benefits upon the largest institutions, and yet if this was the case, we would expect that all large and medium-sized financial institutions would be seeking to be designated as SIFIs. In fact, it appears to be just the opposite, that most of the borderline financial firms are making efforts to be excluded from the SIFI class of firms.

So the question is, do you believe that SIFI designation is a way for big financial institutions to curry favor with the government, and if so, why is it that one of our larger insurance companies is challenging its non-bank SIFI designation?

Mr. MCTAGGART. That is a fine and excellent question. With respect to the challenge, the Prudential Insurance Company is, as I understand it, acting within the requisite appeal period to challenge its SIFI designation. Importantly, it is not to challenge the constitutionality of the functioning of the statute, but the SIFI choice that was made and applied to it. So clearly, to the premise

of your question, in that instance, they do not presumably find it beneficial to be designated as an SIFI.

On the broader question of whether SIFI status conferred the special designation, or does it proliferate the "too-big-to-fail" question, my personal view is that it is a dramatic change with the enactment of the statute. I think it is pretty clear that institutions that previously were of concern 20 to 30 years ago as being systemically important—you think of Continental Bank in Illinois and so forth—are not likely to be the ones that would fall within the SIFI designation today. So, it has shifted.

I think the one unspoken comment, but I think it is a critical one, from a policy standpoint, is that typically it is not just a single institution—and I am speaking as a former supervisor—that gets in trouble at once. It might be two or three because they are sort of in the same bad investments or other choices.

So, that is really the challenge I see prospectively for the Fed and the Treasury in terms of how they manage and supervise the SIFI institutions once the next crisis, whatever it happens to be, occurs. I think that is the difficulty. And it is not clear that those institutions would be viewing the SIFI designation as a benefit.

Mrs. BEATTY. Thank you.

I yield back.

Chairman MCHENRY. The gentlelady yields back.

We will now recognize the vice chairman of the subcommittee, Mr. Fitzpatrick of Pennsylvania.

Mr. FITZPATRICK. I thank the chairman for calling the hearing, and certainly, we all appreciate the testimony of the witnesses here today.

In his opening statement, Mr. Green noted correctly that Dodd-Frank has not been found unconstitutional, but I think two of you in your statements said that is as of yet, and it is still early in the game.

Professor Merrill, you outlined in your testimony the ability of the courts to review the FSOC's decisions to subject a company to Federal Reserve supervision under Title I. Can you just go through again, if you would, the constitutional questions that you have in that regard?

Mr. MERRILL. No, my testimony is only devoted to Title II. I did not speak to Title I and the systemic designation under Title I. So I have no opinion on that.

Mr. FITZPATRICK. With respect to—you talked about notice and the opportunity to be heard.

Mr. MERRILL. That is under Title II, yes.

Mr. FITZPATRICK. Okay, Title II. I'm sorry.

Mr. MERRILL. In my view, the statute makes a fatal mistake in trying to push judicial review into this extremely truncated 24-hour period between the Executive Branch's decision to seek an orderly liquidation and the court's issuance of the order approving the orderly liquidation. So the court does not have enough time to consider this, the firm does not have enough time to prepare dissent, and as I mentioned, all of these other stakeholders are given no notice at all. In fact, it would be a crime to give them due process. So it is sort of like a super due process violation when your rights

are vaporized and you have absolutely no way of getting any notice or an opportunity to have a hearing before that takes place.

One of the issues the district court has to resolve in this 24-hour period is whether or not the company is in default or in danger of default, and the statute defines default or danger of default in probabilistic terms. It says, it is likely that the firm will not be able to meet its obligations; it is likely that its debts will exceed its assets and so forth.

Can you imagine a company that is resisting orderly liquidation being able to mount a defense in 24 hours to show that it is not in danger of default, and the type of accounting and actuarial information they would have to develop? And can you imagine the court being able to digest that information in 24 hours and make a meaningful ruling? I can't. It seems to me what the statute does is it tries to conscript the courts and draw upon their prestige in legitimizing this process, which is essentially a total executive process, without allowing the courts to act in a meaningful way or giving parties due process.

Mr. FITZPATRICK. So, professor, why is it then that Dodd-Frank might provide inadequate opportunity to challenge the Secretary's determination? Is it entirely that it can't be done within 24 hours, or are there additional reasons?

Mr. MERRILL. It is partly that it can't be done in 24 hours. It is partly that significant stakeholders are given no notice so they can't show up and participate in the hearing at all. I think the only way to really cure this, consistent with the need for confidentiality and speed, is to do what is done under bank receivership law, which is to give firms and other stakeholders a right to challenge it after a receiver is appointed. Receivership law allows you to go to court within 30 days. You can raise any issue you want. You can challenge the factual base of the receivership.

Now, it is true that not many firms do take advantage of it. Once its receivership has been declared, it is difficult to persuade a court to undo it. But I think having that power is critically important because otherwise it is entirely left up to the discretion of the executive as to who they push into this liquidation process, and there really isn't a chance for the courts to act as check on that. And just the availability of judicial review, I think, would act as a significant check on potential executive abuse. We can't assume the executive will always be acting in perfectly good faith here.

Mr. FITZPATRICK. And finally, professor, I think you testified that you preferred the Senate version—

Mr. MERRILL. No, the House version.

Mr. FITZPATRICK. The House version. That was review after receivership. Review after receivership?

Mr. MERRILL. Yes.

Mr. FITZPATRICK. So what Mr. Green said in his opening statement is that the bill could be amended, and there might be amendments which he would be consider which are important. So, in the 30 seconds I have left, if you or any of the witnesses could tell us, if you could propose one amendment which would be most effective and most important to Dodd-Frank, what would that amendment be?

Mr. MERRILL. Just go back and look at the House bill that was passed in late 2009 or early 2010 and look at the provisions for appointment of receiver and adopt that and take out the provisions that the Senate added in 2010. The Senate added this ex ante review with all of these constitutional problems. I think the House bill would pass constitutional muster.

Mr. FITZPATRICK. I think my time has expired. Thank you.

Chairman MCHENRY. I will now recognize Mrs. Maloney for 5 minutes.

Mrs. MALONEY. I want to thank you, Mr. Chairman, for calling this hearing, and I also want to thank Ranking Member Green.

In 2008, when a large financial company was on the verge of failure, regulators had two options in front of them. They could either let the company file for bankruptcy, which was what happened with Lehman, or they could bail the company out, which happened with AIG; and neither turned out to be a good alternative.

Dodd-Frank gave regulators a third choice by creating an orderly liquidation process for large financial companies that is similar to the power that the FDIC has with commercial banks. By most accounts, the FDIC performed a vital role in stabilizing our economy during this period. Regulators were screaming for the same type of authority that would have helped them better manage AIG and Lehman Brothers than the two options that we had, which were: let it fail; or bail it out. They are both unacceptable. Neither one is a good alternative.

Now, some of my colleagues say that they would simply let large companies file for bankruptcy. They can do that now. And I would like to point out that we have already tried bankruptcy. We tried that with Lehman, and the result was a massive financial crisis. And I don't consider this an acceptable solution. But a financial institution or their creditors can push them into bankruptcy now if they so choose. But Dodd-Frank tried to give another alternative to help confront a financial crisis. I believe someone called it "executive abuse." It wasn't executive abuse. The financial system was crashing. Secretary Paulson was begging for some authority to help him better handle the crisis.

So I guess my question to you is if this is about the constitutional authority that we have under Dodd-Frank, under Title II, it is really Title II, I would say—and I would like to begin with Mr. McTaggart and others if they would like to comment—Title II is really an extension of the FDIC commercial liquidation authority and powers that they have for commercial banks, and this was already challenged in court and the court upheld the authority under the FDIC to manage in a crisis situation.

I would say in most of the—we were in a crisis situation that cost this country $12 trillion; some economists say it is $16 trillion. We are still suffering from it. I for one don't want to go back to it. But most economists and most books that have been written about the crisis, to tell you the truth I can't stand to read them because living through it once was enough, but if you do read them, most of them really laud the FDIC and the role that they played in trying to stabilize the economy.

So, your comments on the constitutionality of Dodd-Frank, Mr. McTaggart, please?

Mr. MCTAGGART. Sure. Those are wonderful observations.

It is clearly the case that a large part of the Dodd-Frank resolution process is derived from the history and the experience that the FDIC has had. I would point out that the bankruptcy process is still available and the Orderly Liquidation Authority is an alternative that is to be utilized essentially if there are decisions made that the bankruptcy process is not going to be satisfactory by the appropriate regulators.

One point that I would like to just, I guess, correct the record on in terms of the orderly liquidation timing, and I have great respect for the courts, including, of course, the United States District Court for the District of Columbia, they have issued a local civil rule to deal with orderly liquidation, and it is not a 24-hour period.

At least 48 hours prior to the filing of a petition under the Act, the Secretary of the Treasury has to provide notice under seal to the clerk of the court that the petition will likely be filed with the court. Additionally, a petition under the Act by the Secretary of the Treasury must contain all relevant findings and recommendations. The petition is assigned to the chief judge or the acting chief judge, thus the petitions will be directed to someone who has fully reviewed the Act, the related precedent, and has experience on matters under the Act. The financial company named in the petition may file an opposition to the petition under seal, may appear at the hearing to oppose the petition. Each petition in opposition shall be accompanied by a proposed order, thus making a response by the judge in a 24-hour period somewhat easier.

So, again, I am not suggesting that it completely changes the timeframe, but it is more than 24 hours.

Chairman MCHENRY. The gentlelady's time has expired.

We will now recognize the gentlelady from Minnesota, Mrs. Bachmann, for 5 minutes.

Mrs. BACHMANN. Thank you so much, Mr. Chairman, and I want to thank you also for holding this hearing and for inviting these witnesses. This has been an excellent hearing.

I think my first question will be to Mr. Merrill. I have appreciated your testimony. Again, I would like if you could go back—you made comments—to this issue of dealing with how Title II would violate constitutional principles when we are dealing with uniform bankruptcy law and we are dealing with vesting substantial discretion in the executive to invoke the Orderly Liquidation Authority? Could you give us a summation of that again? I think this is a very important point, that we need to understand the constitutional vulnerability.

Mr. MERRILL. All right. I would be happy to respond to that and also respond to a couple of points that were just made by Mr. McTaggart.

It is true that most of Title II was borrowed from FDIC receivership law and that the courts have upheld the FDIC's receivership process, whereby there is an administrative appointment of a receiver and then the process unfolds after that.

The big difference between the FDIC law and Title II is that under FDIC receivership law, an aggrieved party can go to court and ask the court to set aside the receivership and can raise any issue that they want to raise. Under Title II, there is no review

after the receiver is appointed. That is the end of the game as far as stakeholders are concerned, other than ordinary creditors, who may get some relief from the FDIC as receivers.

So the shareholders, the directors, the officers of the company, who all have to be mandatorily fired under Dodd-Frank, have no way to protect their interests because there is no judicial review before or after, under Title II. There is under the FDIC Act. There is not under Title II.

Second, this local D.C. rule that has been mentioned, the D.C. court was clearly uncomfortable when it looked at this statute. It asked the Secretary of the Treasury to please notify it 48 hours in advance so that they could try to get a judge lined up and so forth. But that local rule can't change the basic skeletal provisions of the statute, which make it a crime to inform most stakeholders that there is going to be a liquidation, no notice whatsoever, which gives the judge only 24 hours between the time he sees the government's petition and the time he has to rule and which gives the company whatever is left of the 24 hours to try to respond and address the issues that the government raises in its petition for liquidation.

So I think the local rule helps a little bit at the margins, perhaps, but it does not address the fundamental flaws, due process, Article III and so forth that this statute creates.

Mrs. BACHMANN. And, Mr. Merrill, based upon the latter part of your answer, would you classify that as a potential vulnerability under First Amendment grounds?

Mr. MERRILL. Yes. The statute says, you can go to jail for 5 years for telling the world that the government is trying to liquidate your firm. That is unprecedented. I know of no analogy that would sustain that, and I think the court in a proper case where a firm thinks that it is improper to be putting it through liquidation, that there is some kind of abuse, I am not suggesting there was abuse in the past, but in the future there might be, a firm that thinks the government is trying to put it through liquidation inappropriately, they can't leak this to The New York Times or the Washington Post without having the officers of the firm be trucked off to jail for 5 years. That is an extraordinary incursion on the First Amendment, in my view, and I think the courts would be very uncomfortable with that.

Mrs. BACHMANN. Mr. Merrill, have you ever seen anything like this before in your history, in your academic life and in your practical work that you have done? Have you seen any kind of restrictions and constitutional problems in this vein before?

Mr. MERRILL. No. I think this is completely unprecedented. I think you had some interesting models with which you could work. You had the bankruptcy code. You had the FDIC receivership law, and for whatever reason, at the last minute, the Senate came up with this novel hybrid, which essentially dragoons the court into rubber stamping the executive in this highly expeditious fashion with no notice, no hearing opportunity that is meaningful, and with the stakes being so enormously huge. We are talking about all kinds of people having huge financial interests at stake here. I don't think there is anything remotely like it in U.S. law. In fact, you can't—in looking at the Article III issue, I couldn't really find any precedents where the courts had been told that they had to

rule within 24 hours on highly complicated issues that are very difficult for anybody to figure out in a matter of months.

Mrs. BACHMANN. Then, you really do have a denial of due process?

Mr. MERRILL. Yes. Potentially. Again, when the process is ever used, I think there will be due process violations. And all sorts of stakeholders will have a strategic incentive to raise those constitutional concerns, which will very likely cause the whole process to go off the rails and become chaotic.

Mrs. BACHMANN. I thank you for your observations because I think they are stunning. And I think in fact you have even underscored for this committee how important that is.

I yield back, Mr. Chairman.

Chairman MCHENRY. The gentlelady's time has expired.

We will now recognize Mr. Heck for 5 minutes.

Mr. HECK. Thank you, Mr. Chairman. I pass.

Chairman MCHENRY. Okay. We will now recognize Ms. Wagner for 5 minutes.

Mrs. WAGNER. Thank you, Mr. Chairman.

And I thank the witnesses for being here with us this afternoon. I would like to especially welcome one of my former colleagues from the diplomatic team, Ambassador Boyden Gray.

Welcome. And I will start with you, Ambassador Gray. Once the Treasury Secretary invokes the Orderly Liquidation Authority for a troubled firm under Dodd-Frank, the district court can only review two, I believe, of the seven determinations made by the Secretary. Is that correct?

Mr. GRAY. That is correct. It can only review whether the firm is a financial firm and whether it is in trouble.

Mrs. WAGNER. So the other five factors of determination are in a way exempt from the court review and the company has no right to challenge them? Is that correct, sir?

Mr. GRAY. That is correct. When this issue first surfaced in something I wrote, I don't know how long ago now, the Treasury's letter to the Washington Post said, there is a huge check in all of this, which is that we must find that this entity poses a threat to the stability of the United States. That finding is specifically excluded from court review.

Mrs. WAGNER. So if they are unable to challenge those other five factors, what types of concerns does this give you over due process?

Mr. GRAY. It is a denial of due process not to give someone his or her day in court. And it isn't just that. The Congress is basically cut out. You are basically cut out because what finances this is not required of you. You have no way of monitoring it because the orderly liquidation, or the Treasury has its own internal taxing power effectively to finance all this without any oversight by you. So there are multiple problems here. And I think—and you may have another question, but I want to emphasize that problems are accumulating right now. This isn't just a difficulty that is going to arise when and if this kind of a takeover occurs. We are seeing the results of this now as larger institutions get funding advantages based on the implicit bailout of what this provision authorizes, and smaller banks, community banks that really do service local com-

munities like yours, these local smaller banks are having a hard time competing and dealing with the regulations.

Mrs. WAGNER. And in fact, it codified "too-big-to-fail," is what is happening.

Mr. GRAY. Right. It codifies "too-big-to-fail." And it perpetuates it. So, this is happening today. There is a bigger problem at some point, but right now, we have a problem and it needs to be corrected.

Mrs. WAGNER. Thank you, Ambassador Gray.

If I could move on, Professor Merrill, what standard can the court use to review the Secretary's decision that the company is a financial company and that it is in default or in danger of default?

Mr. MERRILL. The statute is quite explicit in saying that the court can only ask whether or not both of those determinations are arbitrary and capricious.

Mrs. WAGNER. How would an arbitrary and capricious review of the Treasury Secretary's decision differ from a de novo review?

Mr. MERRILL. It is hard to say. The arbitrary and capricious language, I think is borrowed from the Administrative Procedures Act, which refers to arbitrary and capricious or otherwise not in accordance with law. And so ordinarily when that standard is invoked, the courts have authority to decide questions of law. It is not clear that Dodd-Frank authorizes the courts to review questions of law. If that is the case, I think it is quite clearly unconstitutional, for that reason among all the other reasons that we discussed. Under bank receivership law, and under the House bill that was rejected by the conference committee, the court would have de novo review powers, which means the court would make the record, the parties would submit evidence to the court that they think is relevant, and the court would hear witnesses, and the court would decide all the legal questions independently of what the agency decided.

Mrs. WAGNER. And the determination, I assume, is based on the merits of its argument?

Mr. MERRILL. Yes. The huge difference between de novo review and arbitrary and capricious, whatever that means without "not in accordance" with law being added.

Mrs. WAGNER. Very quickly, Professor Merrill, how is the court's ability to review the Treasury Secretary's decision to invoke the OLA different from its ability to review the FDIC's decision to resolve a failed bank under the Federal Deposit Insurance Act, for instance?

Mr. MERRILL. Under the FDIC Act, the court has the power, at the behest of any affected person, to set aside the receivership for any and all reasons, and to develop a record, and to decide questions independently. Under the Dodd-Frank Act, the court is restricted to reviewing these two issues out of seven and only under this arbitrary and capricious standard, which we don't know quite what that means, but it sounds very deferential.

Mrs. WAGNER. Thank you, Professor.

I believe my time has expired. Thank you, Mr. Chairman.

Chairman MCHENRY. We will now recognize the ranking member, Mr. Green, for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman.

Let's start with the first option available, which is bankruptcy. Bankruptcy is not precluded by Dodd-Frank. And I think all of our scholars will agree that bankruptcy is still available. But for fear that I may be mistaken, if you agree that bankruptcy is still available, would you kindly extend a hand into the air?

This is sort of like voir dire.

Okay. Thank you.

Let the record reflect that all of the members of the panel have indicated that bankruptcy is still available.

In fact, there has to be a determination of the entity, the company, the large company I might add, there has to be a determination that it is either in default or in danger of default.

Is that a fair statement, Mr. Merrill?

Mr. MERRILL. That is an accurate statement, yes.

Mr. GREEN. Okay. Default or in danger of default. There also has to be, before we get to that determination, involvement of the FDIC, the Federal Reserve, and then you have to confer with the President of the United States. So we are talking about a time of exigent circumstances when we have perhaps what we had in 2008, when banks would not lend to each other, when you could not have other businesses that could go through the bankruptcy process—go to the bankruptcy process and assist a business that was in fact in bankruptcy. We do have these extreme circumstances where bankruptcy does not prove to be an option. Only after we have justified that there is an extreme circumstance do we then go to OLA. Now Mr. Merrill, do you agree with that, that there is this justification process? I know your point is that it is all a part of the executive. And I will get to that in just a moment. But that is your point, correct?

Mr. MERRILL. That is right. And I don't necessarily disagree with your characterization—

Mr. GREEN. Okay. Let me continue. So once we do get to the district court, we have rule 85 to contend with. Now, for those who are concerned about secrecy, rule 85 indicates that if the petition of the Treasury Secretary is granted, then the Secretary has to show cause why the veil of secrecy should not be lifted. Do you agree that rule 85 does this?

Mr. MCTAGGART. I am familiar with the rule. Perhaps the other panelists are not. But that is correct.

Mr. GREEN. So rule 85, which applies to the district court that the case must be filed in, this is a court of venue and of jurisdiction, so you have to go to this court, this local rule has already been promulgated to address the very question of secrecy that has been raised.

Next point before I get to you, Mr. Gray. We will try to get to you in just a moment, but there is one other thing that I have to do. The ruling of the district court is not the final word. In fact, you can appeal from the district court to the next level, which would be the appeals court, circuit court, and you can appeal from there to the Supreme Court. So the district court ruling is not the final word.

This can go all the way to the Supreme Court of the United States of America. And the Supreme Court has supreme authority. Supreme Courts make rulings that we don't always like, but hope-

fully we will continue to respect them. Now, with reference to the process itself of appeal, and of filing the petition, do you agree that in major questions of any type, you have constitutional scholars on both sides of the issue? It is not unusual to have constitutional scholars on both sides of an issue. We just had several cases before the Supreme Court recently, with constitutional scholars on both sides of the issue. Do you agree, Mr. Merrill, that you have constitutional scholars on both sides of issues?

Mr. MERRILL. On many issues, you do. I am not sure that there are going to be two constitutional scholars on either side of the question of whether there is no hearing or opportunity.

Mr. GREEN. We already have—you do not consider your friend sitting next to you a scholar? Is that what you are saying?

Mr. MERRILL. I haven't heard him speak specifically to the issue.

Mr. GREEN. I will let you decide who is a constitutional scholar or not. Let us just say for our purposes that we have people who hold themselves out as experts who will testify on both sides of this issue. That will happen. It is happening right now. And until a court rules, we don't have an issue that has been declared unconstitutional. We don't have any aspect of this law that has been declared unconstitutional. So I appreciate your taking it to court, those of you who are litigating. I have no quarrel with your taking it to court. I will respect the decision of the courts. But I do think that we can't conclude now that it is unconstitutional. What we have are opinions.

I yield back, Mr. Chairman.

Chairman MCHENRY. Spoken like a well-informed former judge.

We will now recognize Mr. Rothfus of Pennsylvania for 5 minutes.

Mr. ROTHFUS. Thank you, Mr. Chairman.

Ambassador Gray and Professor Merrill, in addition to arguing that certain provisions of Dodd-Frank may be susceptible to constitutional challenge, you both suggested that basically it is bad policy and may fail to achieve the purpose of ending taxpayer-funded bailouts of large complex financial companies. Professor Merrill, why might Title II preserve a version of taxpayer funded socialization of losses?

Mr. MERRILL. I think when you read the fine print of Title II, you will find that there is authority for the Treasury Department to provide funding to facilitate an orderly liquidation. And the statute says that the Treasury has to be reimbursed. The taxpayers are not going to be paying for this up front. But in reimbursing the Secretary of the Treasury, you start with the shareholders and then the unsecured creditors, and then you file lawsuits against the officers and directors, who might have been responsible to claw back their compensation. But if there is still a shortfall, then the statute authorizes special assessments to be imposed on major financial companies to pay back the Treasury for the funding that it advanced to this liquidation. Those special assessments are really a tax by any other name. Those assessments would be passed on to consumers in part, or would be taken from shareholders of bank corporations that have to pay these assessments. And so, that is a kind of socialization of losses of the sort that the bailout regime represented. I think it is a perpetuation of that in a different guise.

Mr. ROTHFUS. Thank you.

And Ambassador Gray, despite the passage of Dodd-Frank, do larger firms, in your opinion, enjoy an unfair funding advantage relative to smaller firms?

Mr. GRAY. There are, I think, nearly a half dozen studies which make that point. There is one from Bloomberg that says the advantage is $80 billion-plus a year in terms of profits. I believe the Dallas Fed has gone into some detail about this, identifying somewhere in the neighborhood of 50 basis points advantage. And so I don't think there is any question that there is an advantage. One very high ranking official at one of the big Wall Street institutions said to me, "We are not interested in an all-out attack on these provisions of Dodd-Frank because if our regulators knew we weren't going to be bailed out, they would raise our capital requirements." So I think there is a general understanding that this is a form of bailout. There are, I think as a result perhaps of the questions that you are raising here in this hearing and the questions that have been raised by the lawsuits, some efforts now to actually raise capital requirements to soften the "too-big-to-fail," to cut into the "too-big-to-fail" problem. But that in itself is a recognition that there is a "too-big-to-fail" entrenchment problem that is perpetuated, if not deepened, by Dodd-Frank.

Mr. ROTHFUS. Professor Merrill, would you consider the truncated notice window at play with Title II to be extraordinary?

Mr. MERRILL. Yes.

Mr. ROTHFUS. Would it be fair to call this maybe even a sudden death determination? Is that what happens in this truncated process?

Mr. MERRILL. I am sorry, could you repeat that?

Mr. ROTHFUS. Can you make an argument that this is almost like a sudden death provision? You have 24 hours, or 48 hours basically to respond to the government that is basically going to order the winding up of a business.

Mr. MERRILL. Yes. If there is any kind of contested issue at all with respect to danger of default or default, I think it is just completely unrealistic to imagine that the firm has any way to muster a defense and present it to the court in an orderly fashion and have a meaningful decision on that. I think this is all a charade.

Mr. ROTHFUS. Mr. McTaggart, can you identify any other law that allows such a truncated notice window before a company is going to be ordered to be wound up?

Mr. MCTAGGART. I am not sure that I can, but I would note that based upon the supervisory process, institutions are not ordinarily deteriorating within a 24-hour period. So typically there is going to be a matter of perhaps weeks, perhaps a month prior to this final decision. I respect your point of view of course with regard to the shortness of it. And to respond specifically to your question, I can't reference another framework.

Mr. ROTHFUS. And Professor Merrill again, if we can take just a reminder of some of the stakeholders here, employees of these companies?

Mr. MERRILL. They get no notice, other than the very top officers.

Mr. ROTHFUS. Pension funds.

Mr. MERRILL. No notice.

Mr. ROTHFUS. And ultimately the taxpayers who may have to be responsible for any kind of pension liability.

Mr. MERRILL. Obviously not.

Mr. ROTHFUS. Thank you.

Chairman MCHENRY. We will now recognize Mr. Barr of Kentucky for 5 minutes.

Mr. BARR. Mr. Gray, Mr. McTaggart testified that there was a local rule that provided for a notice that the OLA process was to be invoked. Do you agree with Mr. McTaggart's testimony, and can a local rule cure an unconstitutional statute?

Mr. GRAY. I don't believe so. I have never heard of that being the case. I think the local rule is useful because it is a blueprint for what is wrong with the statute. But I don't think it overrules the statute or can overrule the statute. There will not be 48 hours or 72 hours notice, or a length of time for a district court to react, let alone 48 hours. There will be 24 hours. That is what the statute says. And any notice that goes out to potentially interested parties would violate the statute and subject anyone at the court who did this to criminal penalty, jail, and financial. So the rule is, as I say, useful for the problems it identifies, but I do not think it can solve them.

Mr. BARR. To Ambassador Gray and to Professor Merrill, could the government in litigation over the constitutionality of the Dodd-Frank law, could the government conceivably defend the constitutionality of the statute on the grounds that—or by invoking either the exceptions clause in article three or by invoking article three, section one language conferring to Congress the power to create inferior courts and, by extension, define the contours of the jurisdiction of those inferior courts?

Mr. MERRILL. I hadn't thought about that. It would be an interesting argument. The statute doesn't purport to affect the jurisdiction in the sense you are referring to it, of the courts. It confers jurisdiction on the district court, the Court of Appeals, and the Supreme Court. And it doesn't say that it is limiting their jurisdiction or it is regulating the appeals process. It just simply drastically limits the issues that they can consider. I would add in this regard that there is a real question as to what sort of relief these courts can grant. The statute, as I read it, suggests that the only thing the district court can do other than approve the petition is to send the case back to the Secretary of the Treasury for more findings to support his determination. And then when you appeal to the appeals court and the Supreme Court, there is no stay pending appeal. So what can the appeals court and what can the Supreme Court do? I am not sure they can do anything other than send the case back to the Treasury Secretary for more findings. Meanwhile, liquidation is proceeding apace. So it is not clear that this statute gives these courts any authority to overturn the receivership process.

Mr. GRAY. Could I make one additional point?

Mr. BARR. Yes.

Mr. GRAY. Just to respond to something that was said earlier, the restrictions on what the district court can look at, only two of the five factors—two of the seven, excuse me, that they cannot look at five of the factors, that restriction carries on to the Court of Ap-

peals and to the Supreme Court. So the appellate courts are as restricted as the district court in that regard.

Mr. BARR. Mr. Gray, you have opined that you have concerns about Dodd-Frank potentially violating the separation of powers doctrine, and in particular, you have cited the nondelegation doctrine. Can you amplify for the committee your concerns with respect to the nondelegation doctrine?

Mr. GRAY. I think the nondelegation doctrine is violated here, but I don't think that if that were the only problem I would be here, or at least I would have been involved in filing a lawsuit. That is a real problem. But what aggravates it so terribly is the addition of the restrictions on court review. To look at it from a different angle, courts have, since the *Schechter Poultry* case, the so-called "sick chicken case," the courts have never really thrown out a statute like the National Recovery Act wholesale in response to a nondelegation argument, which is that Congress granted too much unguided authority to the Executive Branch.

What they have done is engaged in a doctrine known as the doctrine of constitutional avoidance, where they construe the statute more narrowly so as to avoid the constitutional issues. Now, if someone came along and did this, if someone came along for example and said—some judge that we might be before said, there really is a Tucker right available to go in and claim not just liquidation value but everything you have lost in one of these takeovers, and that is a fully available remedy in the court of claims, I don't think that is what the statute means, but if a court tried to construe it that way, I would view it is a partial victory. But I don't think that is what is available. I think the drafters of this statute were extremely careful in making sure that no avenue was available to raise these issues before they were basically foreclosed in a secret proceeding.

Mr. BARR. My time has expired, but Mr. Chairman, if I could ask just one quick follow-up question to Mr. Gray on that. The reason why I ask about the nondelegation doctrine is that I wanted you to maybe comment on the Consumer Financial Protection Bureau's structure as being particularly unaccountable to the Congress in that it receives its appropriations from the Federal Reserve instead of Congress, and yet Congress has delegated a great deal of rulemaking authority, quasi-legislative power to this agency that is otherwise very unaccountable to the Congress.

Mr. GRAY. That is correct. It has granted huge authority to the CFPB. It has said to the House and Senate, you are out of it, the funding will come from the Fed, which itself is precluded from interfering. You are instructed, not you personally, but the House and Senate Appropriations Committees are actually prohibited from holding hearings on the budget. I don't think the Sergeant at Arms is going to come and arrest anybody, but that is what the statute says. And then it goes on, and this is where, again, separation of powers comes in, it instructs the courts to grant deference to the CFPB as though it were the only agency in town that had anything to do with financial services. That is a very unusual provision as far as I am concerned. I will defer to Professor Merrill if he wants to comment about such a codification of Chevron. But it is a peculiar formulation, and it really does tie the hands of the

courts incredibly in trying to unravel all of this. And of course, as I repeat, you have nothing to say. Now, there is a parallel, of course, in the Orderly Liquidation Authority in the way the courts are specifically precluded from reviewing five of the seven factors, et cetera, given 24 hours, all in secret. And again, you are cut out because the funding authority is actually a tax, I agree with that, is tucked into the bill in the form of an assessment. So you have parallels in both.

Chairman MCHENRY. The gentleman's time has expired. We will now move to Mr. Cleaver, who is batting cleanup today.

The gentleman is recognized for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman. I apologize for being late.

And I thank the witnesses for being here. I appreciate this hearing, because any time we have a distinguished panel, it provides us with an opportunity to learn something that we didn't know or to consider something that we might not have considered. And I have had very positive contact with the Consumer Financial Protection Bureau. We had a rule on the definition of "rural" that a number of people were concerned about in the rural areas of Missouri. We communicated with them for a long period of time, and then finally they responded in a positive and affirmative way.

But I am somewhat concerned about, and I think with members of the judicial intelligentsia here, I can get an answer, but I am not sure that our committee is the right jurisdiction to handle constitutional deficiencies. I am sitting next to a judge, a former judge, and I am not sure, I think the Chair may be an attorney as well. So I am probably the only one in here who is not. But it would seem to me that this would be a matter for the Judiciary Committee. This committee did write the Dodd-Frank Act. I was here at all those meetings, but I am struggling with how we fit in. Can somebody help me?

Mr. GRAY. Let me take a quick stab at that. I think the constitutional problems that have been identified here are problems that must be cured before you can get a cure for the substance abuse of this legislation. You don't need the constitutional analysis to conclude that this legislation has entrenched or perpetuated or aggravated "too-big-to-fail." And the consequences of that are not necessarily constitutional, they are economic, and they are personal, and they are community-related. And they deprive families in the district of the National Bank of Big Springs, Texas, of access to services that the firm is no longer going to be able to provide. Those are economic harms that fall directly on real people. And that is not a constitutional description; that is a description of adversity.

Mr. CLEAVER. I think you are agreeing with me. We have had several hearings on "too-big-to-fail." And by the way, I happen to agree with you, I am very, very concerned about the status of "too-big-to-fail." I think they have gotten bigger. And the fallout would be greater if something happened, we had another economic crisis. But I am just questioning the jurisdiction of the hearing because I don't think—

Mr. MERRILL. If I could respond, Congressman Green made the point that on practically any constitutional issue, you can find

somebody to testify on one side and somebody to testify on the other side. And I would agree with you; I don't think it is this committee's job to sort of keep score as to whether you think this is constitutional or not.

The problem that I am trying to emphasize is that if and when this orderly liquidation process is invoked, there is a very substantial risk that significant stakeholders are going to raise these constitutional objections, and they are going to raise it in a very complicated, difficult, convoluted procedural way, which runs the risk that the whole process is going to be undermined by having those constitutional questions out there.

So my suggestion would be to fix the statute to the extent you can to eliminate those constitutional problems and increase the chance of this statute working.

Mr. MCTAGGART. Congressman, I would add a few points. I guess, obviously, there are policy choices that are embedded within the Act. The classic legislative process of two differing views synthesizing and becoming law is the classic legislative process that the courts recognize and defer to and give a huge presumption of constitutionality as a result of the deliberative process of the Congress.

I guess I differ with the professor in a couple of respects on the policy. With respect to the Orderly Liquidation Authority, from an advocacy standpoint, I would rather have the opportunity to make my case at that point within the judicial process as contrasted to the point that was made under the FDIC resolution authority, which is 10 days after the receivership has been appointed and within 30 days and so forth. That is like trying to unscramble the eggs after the fact. And very few of those lead to any kind of meaningful review, in my opinion. So I think actually the OLA is a better option in terms of if there is a real challenge available from an advocacy standpoint, that is when you want to make it in terms of the timing.

Chairman MCHENRY. The gentleman's time has expired.

Mr. CLEAVER. Thank you, Mr. Chairman.

Chairman MCHENRY. Thank you.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

I would like to thank our distinguished panel for being here today to discuss the constitutional deficiencies and legal uncertainties in the Dodd-Frank Act. You certainly have helped illuminate this debate. And we thank you for that.

And without objection, the hearing is adjourned.

[Whereupon, at 3:27 p.m., the hearing was adjourned.]

A P P E N D I X

July 9, 2013

Hearing before the
U.S. House of Representatives
Committee on Financial Services,
Subcommittee on Oversight and Investigations

"EXAMINING CONSTITUTIONAL DEFICIENCIES AND LEGAL UNCERTAINTIES IN THE DODD-FRANK ACT"

July 9, 2013

Statement of Amb. C. Boyden Gray

I am grateful for the opportunity to testify before the Subcommittee on the constitutional flaws inherent in Titles I and II of the Dodd-Frank Act.[1] I am counsel to several parties in a constitutional challenge to Titles I and II, as well as Title X and the "recess" appointment of Richard Cordray to direct the Consumer Financial Protection Bureau;[2] the president of State National Bank of Big Spring, my client in the lawsuit, testified before this Subcommittee last year.[3]

But my position on Dodd-Frank's unconstitutional provisions long predates the filing of that lawsuit. I have been writing and speaking about Dodd-Frank since its very

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[1] Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[2] *State Nat'l Bank of Big Spring v. Lew*, No. 1:12-cv-01032 (D.D.C. filed June 21, 2012).

[3] The hearing, held on July 19, 2012, was titled *Who's In Your Wallet? Dodd-Frank's Impact on Families, Communities and Small Businesses: Hearing Before the Subcomm. on Oversight & Investigations of the H. Comm. on Financial Servs.*, 112th Cong. 10 (2012) (statement for the record of Jim Purcell, CEO, State National Bank), *available at* http://financialservices.house.gov/uploadedfiles/hhrg-112-ba09-wstate-jpurcell-20120719.pdf.

inception, beginning with a "white paper" published shortly after the bill was signed into law,[4] followed by many articles, speeches, and debates since then.[5]

When President Obama signed Dodd-Frank into law, he said that the law was based on "clear rules and basic safeguards," and that those rules would "make clear that no firm is somehow protected because it is 'too big to fail,' so we don't have another AIG."[6] I wish that that his assurances were true but, regrettably, they are false. As the Dallas Federal Reserve Bank succinctly stated in its 2011 annual report, "[f]or all its bluster, Dodd-Frank leaves" the problem of Too Big to Fail "*entrenched.*"[7]

It is no mere coincidence that Dodd-Frank both entrenches the Too Big To Fail problem and violates the Constitution's system of checks and balances. Rather, those two problems are deeply intertwined: by giving regulators effectively unlimited power, and by removing the checks and balances that ordinarily prevent the abuse of power, Dodd-Frank fosters the very conditions that give rise to Too Big To Fail.

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4 C. Boyden Gray & John Shu, *The Dodd-Frank Wall Street Reform & Consumer Protection Act of 2010: Is It Constitutional?*, 11 ENGAGE: THE JOURNAL OF THE FEDERALIST SOCIETY'S PRACTICE GROUPS Dec. 2010, at 1, *available at* http://www.fed-soc.org/docLib/20101209_BoydenShuDoddFrankWP.pdf.

5 *See, e.g.*, C. Boyden Gray, *Congressional Abdication: Delegation Without Detail and Without Waiver*, 36 HARV. J. L. & PUB. POL'Y 41 (2013); C. Boyden Gray & Jim R. Purcell, *Why Dodd-Frank is Unconstitutional*, WALL. ST. J., June 22, 2012, *available at* http://online.wsj.com/article/SB10001424052702304765304577480451892603234.html; C. Boyden Gray, *'Too Big To Fail' Casts a Long Shadow*, WASH. TIMES, Apr. 18, 2012, *available at* http://www.washingtontimes.com/news/2012/apr/17/gray-too-big-to-fail-casts-a-long-shadow/.

6 President Barack Obama, Remarks by the President at Signing of Dodd-Frank Wall Street Reform and Consumer Protection Act (July 21, 2010), http://www.whitehouse.gov/the-press-office/remarks-president-signing-dodd-frank-wall-street-reform-and-consumer-protection-act.

7 FEDERAL RESERVE BANK OF DALLAS, CHOOSING THE ROAD TO PROSPERITY: WHY WE MUST END TOO BIG TO FAIL—NOW, 2011 ANNUAL REPORT 21, *available at* http://www.dallasfed.org/assets/documents/fed/annual/2011/ar11.pdf (emphasis added).

In that respect, Dodd-Frank is just the latest example of a trend that the nation has experienced many times: when we collapse the separation of powers and commit great authority to regulatory bureaucracies, it inherently favors big businesses over smaller ones. This bias against small business owes in part to the fact that bigger businesses are better able to shoulder large regulatory burdens—or, as JPMorgan Chase's CEO recently characterized Dodd-Frank, the regulatory burden creates a "moat" around big businesses, protecting them from competition by smaller aspiring rivals.[8] But the bias also owes to the fact that bureaucracy tends to expand its own control by dealing primarily, if not exclusively, with an industry's biggest players. No less than Justice Louis Brandeis stressed this, when he joined the Supreme Court's decision to strike down the National Industrial Recovery Act, the New Deal's central program for coordinating big government, big labor, and big business.[9]

The government's natural bias toward big businesses over small competitors can be restrained only by reinvigoration of the Constitution's separation of powers, its checks and balances. In the discussion that follows, I will lay out both the problem of "Too Big To Fail," which Dodd-Frank was supposed to correct, and Dodd-Frank's core constitutional flaws, which have only exacerbated and entrenched Too Big To Fail.

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[8] John Carney, *Surprise! Dodd-Frank Helps JPMorgan Chase*, CNBC.com (Feb. 4, 2013), *available at* http://www.cnbc.com/id/100431660.

[9] "It was Brandeis's old distaste for bigness—in government no less than in industry—summoned back into the open by his concern that the government had gone out of control." MICHAEL HILTZIK, THE NEW DEAL 282 (2011); *see also* MELVIN I. UROFSKY, LOUIS D. BRANDEIS 698 (2009) ("No part of the New Deal went so much against Louis Brandeis's beliefs as did the NIRA . . . The heart of the NIRA revolved around Roosevelt's belief that the crisis of the Depression could revive the spirit of cooperation that he believed marked business-government relations during the Great War. . . . Everyone had realized that the normal rules, such as antitrust laws, made no sense in wartime").

I. Dodd-Frank Entrenches "Too Big To Fail," Conferring Upon Big Banks a Subsidy Worth Billions of Dollars.

It is well established that several large financial institutions were seen as "too big to fail" prior to Dodd-Frank's enactment, and that their "TBTF" status bestowed upon them substantial advantages over their smaller competitors. Simply put, the market believed that certain banks were so big and interconnected that the federal government would intervene to keep them afloat in times of financial crisis. In other words, these "too big to fail" banks were seen as less risky, and their perceived safety enabled these banks to attract investment capital more cheaply than their competitors could.

To be clear, "too big to fail" status was not merely a figment of market imagination; rather, it was firmly rooted in national experience, as federal officials repeatedly intervened in recent decades to prevent the collapse of particular financial firms. In 1998, the Federal Reserve coordinated a rescue of Long Term Capital Management, a prominent hedge fund, in order to prevent shock waves from damaging Wall Street.[10] In 2008, the Federal Reserve bailed out AIG, once again in order to prevent large banks from being injured by the company's collapse.[11]

Indeed, the federal government's implicit protection of "too big to fail" banks was so well known that, during the financial crisis of 2007-2008, bank presidents actively urged the Treasury Secretary to protect them, particularly as Bear Stearns lunged towards collapse. As Secretary Paulson later recalled in his memoir:

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[10] *See, e.g.*, ROGER LOWENSTEIN, WHEN GENIUS FAILED: THE RISE AND FALL OF LONG-TERM CAPITAL MANAGEMENT 185-218 (2001); Roger Lowenstein, *Long-Term Capital: It's a Short-Term Memory*, N.Y. TIMES, Sept. 7, 2008, at BU1, *available at* http://www.nytimes.com/2008/09/07/business/07ltcm.html.

[11] *See, e.g.*, NEIL BAROFSKY, BAILOUT: AN INSIDE ACCOUNT OF HOW WASHINGTON ABANDONED MAIN STREET WHILE RESCUING WALL STREET 179-81 (2012).

> The first call I received was from Lloyd Blankfein, my successor as Goldman Sachs CEO. . . . Lloyd went over the market situation with me, providing a typically analytical and extraordinarily comprehensive overview, but I could hear the fear in his voice. His conclusion was apocalyptic.
>
> The market expected a Bear rescue. If there wasn't one, all hell would break loose, starting in Asia Sunday night and racing through London and New York Monday.[12]

In short, the "too big to fail" banks received immense government financial and regulatory assistance in times of crisis.[13] But even in times of relative peace, big banks enjoyed direct benefits from their "too big to fail" status, in the form of a cost-of-capital advantage. That was an immense subsidy in and of itself, as documented by several economic studies.[14] In 2011, Moody's estimated that in the U.S. the "too big to fail" subsidy amounted to a 50-basis-point cost-of-capital advantage, worth $102 billion.[15] The International Monetary Fund, too, found that banks larger than $100 billion (*i.e.*, the pre-Dodd-Frank standard for implicit "too big to fail" status) enjoyed a 50-basis-point advantage.[16] Economists at the Philadelphia Federal Reserve Bank found that banks paid "at least $15 billion in added premiums" in merger deals to grow their banks above the $100

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[12] HENRY M. PAULSON, JR., ON THE BRINK 106 (2010).

[13] In addition to the aforementioned examples, the banks also lobbied for regulatory intervention—*e.g.*, to prevent "short sellers" from decreasing the price of their shares. *See* ROGER LOWENSTEIN, THE END OF WALL STREET 220 (2010).

[14] In addition to the subsequently mentioned studies, the Bank of England summarized several other studies evaluating this trend. JOSEPH NOSS & RHIANNON SOWERBUTTS, THE IMPLICIT SUBSIDY OF BANKS, BANK OF ENGLAND FINANCIAL STABILITY PAPER NO. 15, at 6 (2012), *available at* http://www.bankofengland.co.uk/publications/Documents/fsr/fs_paper15.pdf.

[15] ZAN LI, ET AL., MOODY'S ANALYTICS, QUANTIFYING THE VALUE OF IMPLICIT GOVERNMENT GUARANTEES FOR LARGE FINANCIAL INSTITUTIONS 14 (2011).

[16] İNCI ÖTKER-ROBE, ET AL., INTERNATIONAL MONETARY FUND, THE TOO-IMPORTANT-TO-FAIL CONUNDRUM: IMPOSSIBLE TO IGNORE AND DIFFICULT TO RESOLVE 6 (2011), *available at* http://www.imf.org/external/pubs/ft/sdn/2011/sdn1112.pdf.

billion mark.[17] More recently, Bloomberg News calculated that the cost-of-capital advantage is worth $83 billion to the too-big-to-fail banks.[18] Such studies spurred Senators Vitter and Brown to ask the GAO to study the economic benefits that large banks "receive as a result of actual or perceived government support."[19]

Again, these were the very subsidies that Dodd-Frank supposedly ended. But, as the Dallas Fed stressed, Dodd-Frank did not end them—it *entrenched* them, in multiple ways:

First, Title I's creation of the Financial Stability Oversight Council (FSOC) turns "too big to fail" status—or, in Dodd-Frank's terms, "systemically important" status—from mere implication to actual, explicit government designation. We need not guess which financial companies are seen by the government as systemically important, because FSOC will tell us. The Connecticut Insurance Commissioner noted this in a recent speech to International Insurance Conference's annual seminar:

> Particularly on the life side, where people are buying a product for a 30- or 40-year promise, you want that financial stability; and if you say as a consumer this designation means the company has more supervision, that's a good thing. It has more capital. That's really good

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17 Elijah Brewer III & Julapa Jagtiani, *How Much Did Banks Pay To Become Too-Big-To-Fail and To Become Systemically Important?*, 43 J FIN. SERVS. RESEARCH 1, 8 (2013), *available at* http://link.springer.com/content/pdf/10.1007%2Fs10693-011-0119-6.pdf.

18 *See, e.g.*, *Why Should Taxpayers Give Big Banks $83 Billion a Year?*," BLOOMBERG VIEW, Feb. 20, 2013, http://www.bloomberg.com/news/2013-02-20/why-should-taxpayers-give-big-banks-83-billion-a-year-.html; *Remember That $83 Billion Bank Subsidy? We Weren't Kidding*, BLOOMBERG VIEW, Feb. 24, 2013, http://www.bloomberg.com/news/2013-02-24/remember-that-83-billion-bank-subsidy-we-weren-t-kidding.html.

19 Letter from Senators Vitter & Brown to Gene Dodaro, Comptroller General of the United States (Jan. 1, 2013), *available at* http://www.fsround.org/fsr/dodd_frank/pdfs/Vitter-Brown-GAO-Study-Request-on-Megabanks.pdf.

> and, as it's potentially too big to fail, so the government is not going to let this company go.[20]

The Commissioner is right, and the proof is in the pudding: When news broke a few weeks ago that GE Capital, AIG, and Prudential had received preliminary "systemic importance" designations from the FSOC, their stock prices immediately *jumped*.[21]

The second way that Dodd-Frank entrenches "too big to fail" also pertains to Title I. The statute further expands the pre-Dodd-Frank universe of "too big to fail" companies by setting the statutory threshold at $50 billion in assets,[22] rather than the $100 billion threshold that previously was seen as the benchmark for implicit too-big-to-fail status.

Third, Title I also expands too-big-to-fail to include not merely big banks, but also "nonbank financial companies" such as insurance companies, hedge funds, and other companies not previously assumed to have government backing.[23]

Fourth, Title II's "Orderly Liquidation Authority" allows the federal government to conduct "back-door bailouts" of too-big-to-fail banks that have invested in troubled financial companies. This is effectively a codification of the AIG episode: if a financial company faces the possibility of default, and that company's failure threatens big banks that have invested in it or are its counterparties, then Title II gives the Treasury

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[20] Commissioner Thomas Leonardi's comments were quoted by Gavin Souter, *Stability, Higher Costs Seen in Systemic Designation for Insurers,* BUSINESS INS., June 19, 2013, http://www.businessinsurance.com/article/20130619/NEWS04/130619774.

[21] Ian Katz & Zachary Tracer, *AIG, Prudential Named Systemically Important by Panel*, BLOOMBERG, June 4, 2013, http://www.bloomberg.com/news/2013-06-03/u-s-regulators-vote-to-label-some-non-banks-systemically-risky.html.

[22] *See* Dodd-Frank Act, Pub. L. No. 111-203, § 165(a)(1), 124 Stat. 1376, 1423 (2010) (codified at 12 U.S.C. § 5365(a)(1)) (setting $50 billion benchmark for bank holding companies); *see also* FSOC, *Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies*, 77 Fed. Reg. 21637, 21643 (Apr. 11, 2012) (setting $50 billion benchmark for nonbank financial companies, under Dodd-Frank § 113).

[23] Dodd-Frank Act § 113.

Secretary and FDIC effectively unlimited power to liquidate (*i.e.*, wind-down or reorganize) the company in a way that favors certain stakeholders over others—even treating some creditors better than other similarly situated creditors, an abrogation of one of the fundamental rules of bankruptcy law[24]—and to do so behind closed doors, completely hidden from public view.

II. Dodd-Frank Violates the Constitution's Separation of Powers by Giving Effectively Open-Ended Power to Unchecked Regulators.

It is no great surprise that big banks would seek to leverage their size, interconnectedness, and other qualities in order to obtain favor from the government. Indeed, that was one of the many great insights that Adam Smith offered in *The Wealth of Nations*: "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices."[25] Perhaps the law cannot prevent them from meeting and conspiring, but at the very least, Smith urged, "it ought to do nothing to facilitate such assemblies, much less to render them necessary."[26]

The solution is simple. The Constitution's separation of powers, its system of checks and balances, was intended to foster a rule of law that would limit government officials' discretion to bestow unlimited favor upon particular classes of businessmen or other interest groups.

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[24] *See, e.g.*, Dodd-Frank Act § 210(b)(4).

[25] ADAM SMITH, 1 AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS, ch. 10, part II (1776). The modern school of "Public Choice Theory," too, offers great insight into government officials' incentives in bailing out big banks. *See generally* J.W. Verret, *The Bailout Through a Public Choice Lens: Government-Controlled Corporations as a Mechanism for Rent Transfer*, 40 SETON HALL L. REV. 1521 (2010).

[26] SMITH, *supra* note 25, at ch. 10, part II.

Moreover, the separation of powers was intended to ensure that the government would remain fully accountable to the people, as Publius explained in Federalist 70:

> It often becomes impossible, amidst mutual accusations, to determine on whom the blame or the punishment of a pernicious measure, or series of pernicious measures, ought really to fall. It is shifted from one to another with so much dexterity, and under such plausible appearances, that the public opinion is left in suspense about the real author. The circumstances which may have led to any national miscarriage or misfortune are sometimes so complicated that, where there are a number of actors who may have had different degrees and kinds of agency, though we may clearly see upon the whole that there has been mismanagement, yet it may be impracticable to pronounce to whose account the evil which may have been incurred is truly chargeable.[27]

The Supreme Court reminded us of this most recently in *Free Enterprise Fund v. Public Company Accounting Oversight Board*, in which the Court struck down the Sarbanes-Oxley Act's attempt to shelter a new independent agency (*i.e.*, the Public Company Accounting Oversight Board, or "PCAOB") within another independent agency (*i.e.*, the Securities and Exchange Commission).[28] As the Court explained, precedents dating back to the New Deal Era had long ago established that Congress could create agencies enjoying some independence from the President, by providing that members of independent commissions could only be removed "for good cause."[29] But those precedents, the Court stressed, marked the outer limits of "independence" that the Constitution allows. Sarbanes-

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[27] Federalist No. 70 (A. Hamilton).

[28] 130 S. Ct. 3138 (2010). To be clear, the Court did not specifically hold that the SEC itself is an "independent agency"; the SEC's organic statute does not expressly insulate the Commissioners from the President's control. Nevertheless, the parties to that case all agreed that the SEC Commissioners do enjoy that degree of independence, and the Court therefore "decide[d] the case with that understanding." *Id.* at 3149.

[29] *Id.* at 3146-47 (citing *Humphrey's Executor v. United States*, 295 U.S. 602 (1935), *United States v. Perkins*, 116 U.S. 483 (1886); *Morrison v. Olson*, 487 U.S. 654 (1988)).

Oxley's double layer of independence, by contrast, required the Court to consider "whether these separate layers of protection may be combined."[30] The answer to that question was, emphatically, "no":

> As explained, we have previously upheld limited restrictions on the President's removal power. . . . The Act before us does something quite different. It not only protects Board members from removal except for good cause, but withdraws from the President any decision on whether that good cause exists. That decision is vested instead in other tenured officers—the Commissioners—none of whom is subject to the President's direct control. The result is a Board that is not accountable to the President, and a President who is not responsible for the Board.
>
> The added layer of tenure protection makes a difference. . . . *This novel structure does not merely add to the Board's independence, but transforms it.* Neither the President, nor anyone directly responsible to him, nor even an officer whose conduct he may review only for good cause, has full control over the Board.[31]

"The added layer of tenure protection makes a difference"; the PCAOB's "novel structure"—its double layer of independence—"does not merely add to the Board's independence, but transforms it." This analysis, which led the Court to strike down Sarbanes-Oxley's unprecedented independent-agency-within-an-independent-agency (and which last week led the D.C. Circuit to strike down a statute delegating legislative power to a private corporation[32]), also counsels in favor of striking down the parts of Dodd-Frank that combine multiple forms of independence to create new agency structures insulated from oversight by *multiple* branches of government. As the plaintiffs urge in *State National Bank of Big Spring v. Lew*, that includes the FSOC and the Orderly Liquidation Authority (OLA), as well as the Consumer Financial Protection Bureau (CFPB). These agencies do not enjoy

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[30] *Id.* at 3147.

[31] *Id.* at 3153-54 (emphasis added).

[32] *Ass'n of Am. Railroads v. U.S. Dep't of Transp.*, No. 12-5204, at pp. 11-14 (D.C. Cir. July 2, 2013).

multiple layers of independence from a single branch of government, as PCAOB did, but they do enjoy layers of independence from multiple branches of government, in a manner that far outpaces anything that the Supreme Court has previously approved.

I have written in detail on the multiple forms of independence that the FSOC, OLA, and CFPB respectively enjoy.[33] But let me briefly summarize the OLA's and FSOC's multiple layers of independence:

A. OLA

The OLA is an inter-agency framework administered primarily by the Treasury Secretary, who commences an "orderly liquidation," and by the FDIC, which carries it out. The Treasury Secretary serves at the pleasure of the president, of course. Of the FDIC's board, one member certainly enjoys the traditional hallmark of independence from the President: the CFPB Director, who enjoys an *ex officio* seat on the FDIC board, may only be removed "for inefficiency, neglect of duty, or malfeasance in office."[34] The remaining four members—three appointed by the President with the Senate's advice and consent, and the *ex officio* Comptroller of the Currency—are not expressly made independent from the President, although they are all appointed for fixed terms and elsewhere in the Code are identified collectively as an "independent regulatory agency."[35]

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[33] Gray & Shu, *supra* note 4; *see also* Second Amended Complaint at ¶¶ 67-255, *State Nat'l Bank of Big Spring v. Lew*, No. 12-1032 (D.D.C. filed Feb. 13, 2013).

[34] 12 U.S.C. § 1812(a)(1)(B) (placing the CFPB director on the FDIC); Dodd-Frank Act, Pub. L. No. 111-203, § 1011(c)(3), 124 Stat. 1376, 1964 (2010) (codified at 12 U.S.C. § 5491) (removal).

[35] 44 U.S.C. § 3502(5) (defining "independent regulatory agency" to include the FDIC); *see also* 12 U.S.C. § 2 (making the Comptroller of the Currency removable by the President "upon reasons to be communicated by him to the Senate"); 12 U.S.C. § 1812 (identifying FDIC board members to include the Comptroller of the Currency and the Director of the CFPB).

The OLA's multiple layers of independence pertain, instead, to its independence from Congress and the courts. Congress exercises no "power of the purse" over the OLA process, which is funded instead either by the assets of the liquidated financial company or by assessments on the financial sector.[36]

And most importantly, Title II imposes truly draconian limitations on judicial oversight. The Treasury Secretary's initial decision to liquidate a company is effectively immune from judicial review in the district courts: a court has only 24 hours to hear the initial appeal of his liquidation decision, and if the court does not issue a final decision on the merits before that time limit expires, then the government wins by default.[37] The public, including the liquidated company's bondholders and shareholders, are categorically prohibited from even knowing that the liquidation process has commenced, until after the case leaves the district court.[38] Once the case leaves the district court, the liquidation process cannot be stayed; the FDIC can liquidate the company while subsequent appeals are still being litigated,[39] which may in practice mean that any appeal will be rendered moot before the Supreme Court gets to consider the case, as happened in the Chrysler reorganization.[40] And throughout all of this, judicial review is truncated not merely in time, but also in scope: the courts may only consider whether the Treasury Secretary was arbitrary and capricious in determining that the liquidated company was "a financial company" and that it was "in

[36] Dodd-Frank Act § 214(b).

[37] *Id.* § 202(a)(1)(A)(v).

[38] *Id.* § 202(a)(1)(A)(iii).

[39] *Id.* § 202(a)(1)(B).

[40] *Indiana State Police Pension Trust v. Chrysler LLC*, 130 S. Ct. 1015, 1015 (2009).

default or in danger of default."[41] The courts are thus denied even their fundamental power to decide whether the Treasury Secretary's decision was unlawful or unconstitutional.

Finally, creditors are deprived even of their ultimate constitutional backstop, the Tucker Act, which traditionally protects the right to just compensation for the government's taking of private property.[42] They must instead plead their cause to the FDIC as receiver, which in turn can limit their recovery to the amount that they theoretically would have received had the company been liquidated under Chapter 7 of the Bankruptcy Code, an utterly hypothetical, alternative-universe framework that offers no meaningful right to financial compensation.[43] Similarly, if the creditor appeals the FDIC's decisions in federal court, then the creditor's recovery is limited to the same artificially capped amount.[44]

In addition to this truly unprecedented combination of independence from Congress and the courts, the OLA also incorporates an effectively open-ended grant of statutory power. The Treasury Secretary administers statutory provisions that are either supremely vague (*e.g.*, the determination whether a company is "in default or in danger of default") or altogether lacking in an intelligible principle (*e.g.*, the determination whether a company's failure would "have serious adverse effects on financial stability").[45] Similarly, the FDIC enjoys unfettered discretion to discriminate among similarly situated creditors,[46] and to repudiate any contracts that it deems "burdensome."[47]

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41 Dodd-Frank Act § 202(a)(1)(A)(iv).

42 *See generally Regional Rail Reorganization Act Cases*, 419 U.S. 102, 125-36 (1974).

43 Dodd-Frank Act § 210(d)-(e).

44 *Id.* § 210(d)(2), (e).

45 *Id.* § 203(b).

46 *Id.* § 210(b)(4).

47 *Id.* § 210(c)(1).

Any one of these features, taken in isolation, might be held constitutional under the Supreme Court's precedents. But taken together they are unprecedented and unconstitutional. And, as the constitutional challenge to Title II further argues, the OLA process's combination of draconian restrictions on judicial review and its lack of any binding uniformity violates both the Fifth Amendment's Due Process Clause and the Constitution's Bankruptcy Clause.

B. FSOC

The FSOC's independence, like the OLA's, is less a matter of presidential oversight than of congressional and judicial oversight. Of the FSOC's ten voting members,[48] one expressly cannot be removed by the President at will (*i.e.*, the CFPB Director), others certainly can be removed at will (*e.g.*, the SEC Chairman, who can be removed from the chairmanship at will), and others fall somewhere in between (*e.g.*, the aforementioned Comptroller of the Currency).[49] Nevertheless, the FSOC also has five nonvoting members, including three selected by *state* authorities,[50] which raises substantial questions under the Constitution's Appointments Clause.

In any event, the FSOC's primary layers of independence pertain to the courts, and to the breadth of its statutory mandate. As with the OLA, the FSOC is not subject to meaningful judicial review. Companies designated as "systemically important" cannot challenge the legality of the FSOC's determination; rather, they may only question whether the FSOC's determination is "arbitrary and capricious."[51] Even more importantly, third

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[48] *Id.* § 111(b)(1).

[49] *See supra* note 35.

[50] Dodd-Frank Act § 111(b)(1).

[51] *Id.* § 113(h).

parties—*e.g.*, competitors who want to prevent a company from being deemed "too big to fail"—have *no* right of judicial review under Title I.

And as with the OLA, the FSOC's statutory mandate is effectively unlimited. While Title I specifies some vague factors that FSOC may consider in deciding whether a particular nonbank financial company is "systemically important,"[52] the statutory provision concludes by stressing that its list is non-exhaustive: the FSOC may designate a nonbank financial company as systemically important based on "any other risk-related factors that the Council deems appropriate."[53]

As with the OLA, any one of these features, taken in isolation, might be held constitutional under the Supreme Court's precedents. But taken together they are unprecedented and unconstitutional.

* * *

We can be thankful that circumstances have not yet given the Treasury Secretary and FDIC an opportunity to fully enforce the OLA,[54] and the FSOC is only now completing its initial round of systemic-importance designations[55] Nevertheless, evidence of

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[52] *Id.* § 113(a)(2).

[53] *Id.* § 113(a)(2)(K).

[54] This is not to say that Title II does not already impart injuries. As the States explain in their constitutional lawsuit, Title II's express abrogation of their previous rights as creditors is an actual injury that gives them standing to challenge Title II in court.

[55] According to news reports, the FSOC has internally designated GE Capital, AIG, and Prudential as the first systemically important nonbank financial companies. Although those designations have yet to be finalized, GE Capital and AIG announced last week that they will not contest their designations; Prudential will request that FSOC internally reconsider its designation. *See* Kate Linebaugh & Erik Holm, *AIG, GE Capital Won't Appeal 'Systemically Important' Label*, WALL ST. J., July 2, 2013, http://online.wsj.com/article/BT-CO-20130702-710096.html.

what problems can arise from their unprecedented independence can be found in the conduct of the other independent agency created by Dodd-Frank: the CFPB.

First, the CFPB, like the OLA, enjoys complete immunity from Congress's power of the purse. (It funds itself by taking hundreds of millions of dollars from the Federal Reserve Board of Governors; Congress is prohibited by statute from even reviewing its budget.[56]) And as this subcommittee knows from experience, the CFPB has not hesitated to wield its independence, refusing to comply with the previous Chairman's justified and reasonable requests for the CFPB's financial statements and forecasts.[57]

Second, without meaningful oversight by either Congress or the courts, the CFPB has had much incentive to interpret its own powers expansively. In a January 24, 2012 hearing before the House Oversight Committee, Director Cordray announced that the CFPB will not attempt to define one of its core statutory terms—"abusive" lending practices—through notice-and-comment rulemaking, and instead will define the term on a case-by-case, *ex post facto* basis.[58] More recently, it was revealed that the CFPB has undertaken a massive "data grab," either spending millions of dollars on consumer financial data purchased from third parties, or by simply demanding that banks to turn data over for

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[56] Dodd-Frank Act § 1017(a)(2).

[57] *See* Rep. Randy Neugebauer, *A $447 Million Consumer Alert*, WALL ST. J., Sept. 20, 2012, http://online.wsj.com/article/SB10000872396390444620104578006182400443070.html.

[58] *How Will the CFPB Function Under Richard Cordray: Hearing Before the Subcomm. on TARP, Financial Services, and Bailouts of Public and Private Programs of the H. Comm. on Oversight and Government Reform*, 112th Cong. (2012) (statement of Richard Cordray) ("[W]e have determined that [the definition of 'abusive'] is going to have to be a fact and circumstances issue; it is not something we are likely to be able to define in the abstract. Probably not useful to try to define a term like that in the abstract.").

free.[59] The Chamber of Commerce's recent letter to the CFPB describes the substantial legal questions raised by the data grab.[60]

Finally, the CFPB has taken steps to expand its authority still further beyond its statutory limits, attempting to regulate aspects of auto loans that Title X expressly excluded from the CFPB's reach. Despite Title X's prohibition against the CFPB "exercis[ing] any rulemaking, supervisory, enforcement or any other authority, including any authority to order assessments, over a motor vehicle dealer that is predominantly engaged in the sale and servicing of motor vehicles, the leasing and servicing of motor vehicles, or both,"[61] the CFPB recently issued a "bulletin" detailing how it will regulate "indirect auto lenders."[62]

The CFPB's attempt to regulate auto dealers engaged in indirect financing is troubling for several reasons. First and foremost, this appears to be a plain attempt to nullify Congress's express protection for auto dealers, who certainly will be affected by this "exercise" of the CFPB's "authority." Second, the CFPB's decision to implement this new policy through a "bulletin," rather than through notice-and-comment rulemaking, subverts the regulatory process itself, by purporting to make new law without an opportunity for the

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59 *See, e.g.*, Carter Dougherty, *U.S. Amasses Data on 10 Million Consumers as Banks Object*, BLOOMBERG, Apr. 17, 2013, http://www.bloomberg.com/news/2013-04-17/u-s-amasses-data-on-10-million-consumers-as-banks-object.html; Carter Dougherty, *Richard Cordray and the CFPB Are Monitoring Your Banking Habits*, BLOOMBERG BUSINESSWEEK, Apr. 25, 2013, http://www.businessweek.com/articles/2013-04-25/richard-cordray-and-the-cfpb-are-monitoring-your-banking-habits.

60 Letter from David T. Hirschmann, President and CEO, U.S. Chamber of Commerce, to Richard Cordray, Director, Consumer Financial Protection Bureau (June 19, 2013), *available at*http://www.cfpbmonitor.com/files/2013/06/chamber-cfpb-data-letter.pdf.

61 Dodd-Frank Act § 1029(a).

62 CFPB Bulletin 2013-02 (Mar. 21, 2013), *available at* http://files.consumerfinance.gov/f/201303_cfpb_march_-Auto-Finance-Bulletin.pdf.

public to express its views, and by attempting to prevent regulated parties from directly appealing the policy in court. Third, by failing to undertake a public notice-and-comment rulemaking, the CFPB offers the public no indication of what its own data and models are; consumers and auto dealers are left instead to conduct their business under the shadow of the CFPB's black box. Finally, the CFPB's unilateral action offers no evidence that the agency is coordinating with the Federal Trade Commissioner and the Federal Reserve Board of Governors, as required by Section 1029 of Dodd-Frank.[63]

I am aware that Members of this Committee recently wrote to Mr. Cordray, expressing their concern over the CFPB's actions, and asking Mr. Cordray for answers to specific questions regarding the CFPB's data and methodology.[64] I am also aware, unfortunately, that Mr. Cordray's response to that letter failed to answer their specific questions.[65] And I am aware of other Members' June 20, 2013 letter to the CFPB's Assistant Director in the Office of Fair Lending and Equal Opportunity, raising questions regarding the CFPB's auto loan guidance, and I look forward to the CFPB's response (if any) with great interest.

But in all of this, I hope that this Subcommittee, and the Committee on Financial Services as a whole, will take the CFPB's conduct as an example of what we may expect from Dodd-Frank's other creations, the FSOC and the OLA. When agencies are

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[63] Dodd-Frank Act § 1029(e) (requiring FTC and the Federal Reserve to coordinate with CFPB's Office of Service Member Affairs to educate service members and their family about financial products offered by motor vehicle dealers).

[64] Letter from Rep. Terri A. Sewell, et al., to Director Richard Cordray (May 28, 2013), *available at* http://www.cfpbmonitor.com/files/2013/05/130530_cfpb_auto_dealer_letter.pdf.

[65] *See* Letter from Director Richard Cordray to Rep. Terri A. Sewell, et al. (June 20, 2013), *available at* http://www.cfpbmonitor.com/files/2013/06/06-21-13_CFPB-Letter-on-Auto-Lending1.pdf.

freed from the Constitution's system of checks and balances, when they are not directly and fully accountable to the Executive, Legislative, and Judicial Branches, those agencies will almost certainly attempt to expand their powers, evade judicial review, and produce regulatory actions that simply lack the quality of regulations promulgated through the rigors of notice-and-comment rulemaking under the watchful eye of congressional and judicial oversight.

Thank you, again, for the opportunity to testify on these critically important issues. I welcome your questions.

Testimony of Timothy R. McTaggart

Good afternoon. My name is Timothy R. McTaggart. I thank you for the invitation to appear before this subcommittee to present testimony on this important topic. I am a partner in the Washington, D.C. office of the law firm, Pepper Hamilton LLP where I head the firm's bank regulatory and consumer finance group. I note that my testimony reflects my views alone, and not those of Pepper Hamilton LLP or its clients. Of course, any errors are to be attributable solely to me.

By way of background, I served as the Bank Commissioner for the state of Delaware from 1994-1999. I served under then-Governor Tom Carper who became the governor in Delaware after serving in the U.S. House of Representatives, including on the then House Banking Committee. Additionally, I served as counsel to the U.S. Senate Banking Committee prior to my service in Delaware. Earlier in my career, after graduating from Harvard

College and Harvard Law School, I joined the legal division at the Board of Governors of the Federal Reserve System in Washington, D.C. The balance of my career has been in private practice in D.C. based law firm offices.

I have attached materials that I have prepared with the assistance of Matthew Silver on many of the topics at issue today. I ask that the summary be included in the record as part of my remarks.

I would offer a few overarching comments pertinent to today's topic concerning the constitutionality of Dodd-Frank Act provisions related to the Financial Services Oversight Council ("FSOC") and the Orderly Liquidation Authority ("OLA"). My written summary also contains references to similar issues regarding the Consumer Financial Protection Bureau ("CFPB"), but I will not focus on the CFPB.

First, the courts have routinely exercised judicial restraint in connection with determining whether Congressionally enacted legislation is unconstitutional. In the summary provided today, the

most recent statistics that we are aware of show fewer than 170 actions being held to be unconstitutional from 1789 through 2002. It is possible that total undercounts more recent activity from the end of the Rehnquist court, and during the Roberts court, but as a matter of historical record starting with Marbury v. Madison, it shows the relatively rare overturning of Congressional action through the nation's history. Moreover, the record shows an absence of economic regulation statutory frameworks being declared unconstitutional.

Second, there undoubtedly are major policy choices embedded and omitted in the Dodd-Frank Act. Of course, a difference in policy choice as reflected in enacted legislation does not make the legislation unconstitutional. There may be lingering important questions about the effectiveness of the Dodd-Frank Act to address major policy challenges such as the "too big to fail" issue, but the debate over the effectiveness of the Dodd-Frank Act does not go to the constitutionality of the Act.

Third, the genius in our American system of government is the separation of powers among the three branches and the checks and balances among the branches. While we often focus on the Executive's power to veto Congressional legislation, or the ability of Congress to check Executive power through oversight, we less frequently focus on the ability of the Congress to check the judiciary by enacting legislation which limits the jurisdiction of the courts and sets standards of review to be followed by the courts. So, Congress has the inherent authority to limit the time period available for judicial review and to set other requirements concerning the standard of review to be applied by the courts in reviewing administrative actions.

It seems to me that the crux of the question being considered by the subcommittee is whether the prior Congress which enacted the Dodd-Frank Act overstepped its bounds to do so. With respect to the Dodd-Frank Act limits on judicial review related to timing and the scope of review in the OLA, I would conclude that Congress sought to ensure that "due process" was afforded to the

affected financial institutions. With respect to the structural choices made by Congress to create the FSOC, I would conclude that Congress did not impermissibly delegate away its authority.

There are a great many topics, including whether the Dodd-Frank Act ended too big to fail and whether the OLA will be a viable alternative to existing Chapter 11 bankruptcy processes for bank holding companies which previously were not included in the FDIC's resolution authority, that the bank regulatory agencies would be the experts to provide testimony.

I am prepared to answer questions, and thank you for the opportunity to testify at this hearing.

Constitutionality Analysis of Certain of the Dodd-Frank Wall Street Reform and Consumer Protection Act's Most Significant Grants of Regulatory Power

Pepper Hamilton LLP
Attorneys at Law

Pepper partner Timothy R. McTaggart, a highly experienced financial services regulatory lawyer and former Delaware State Bank Commissioner, argued for the case that Dodd-Frank is constitutional at a February 15, 2011 policy forum at the Cato Institute, appearing with the Hon. C. Boyden Gray, Former White House Counsel, who took the position the law is unconstitutional. Below is an outline of Mr. McTaggart's presentation.

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I. OVERVIEW

1. Dodd-Frank Act Purposes and Declaration

- The Dodd-Frank Act (the Act or Dodd-Frank) is guided by several broad concepts:
  - a. Wall Street must be strictly regulated to prevent systemic risk and to promote financial stability.
  - b. Large interconnected financial companies are inherently risky.
  - c. Excessive leverage leads to systemic risk.
  - d. A lack of transactional transparency impeded necessary regulatory control.
  - e. Investors lacked information to properly understand the nature of complex risky securities.
  - f. Regulators are capable of carrying out the intent of the Act.

2. Constitutional Issues Under Dodd-Frank

- Several constitutional objections concerning the Act made since its passage[1] include those related to:
  - a. The Financial Stability Oversight Council (FSOC) and its powers and board composition, as set forth in Title I of the Act.

    -The FSOC's three main stated goals are to (1) act as a "systemic regulator," (2) prevent "Too Big To Fail," and (3) prevent future "bank bailouts." (See Section 112 of the Act).
  - b. The Bureau of Consumer Financial Protection (BCFP) and its powers, as set forth in Title X of the Act.

    -The BCFP is tasked with regulating the offering and provisions of consumer financial products or services under the Federal consumer financial laws. The BCFP is considered an Executive agency, as defined in section 105 of title 5, United States Code (See Section 1011 of the Act). One of the BCFP's stated objectives is to protect consumers "from unfair, deceptive, or abusive acts[2] and practices and from discrimination." The BCFP may halt a company or service provider from "committing or engaging in an unfair, deceptive, or abusive act or practice" with respect to offering or transacting in a consumer financial product or service.
  - c. The resolution authority over "covered"[3] "financial companies."

    -Title II of the Act is entitled "Orderly Liquidation Authority", which empowers the FDIC to unwind, for example, a failing investment bank or insurance company (i.e. a company designated a "covered" financial company) without forcing it into bankruptcy and effectively replacing the bankruptcy process. In making use of the resolution authority provided under Title II, the FDIC is to determine that such action is necessary for purposes of the financial stability of the United States, and not for

the purpose of preserving the covered financial company, ensure that management and the members of the board of directors (or body performing similar functions) responsible for the failed condition of the covered financial company is removed, not take an equity interest in the entity, not pay shareholders until all other claims are paid and "ensure that unsecured creditors bear losses in accordance with priority of claim provisions stated in [the Act]."

3. Judicial Restraint

- There has always been a strong legal presumption that the actions of Congress, and in particular those reduced to written law, are constitutional on their face. As of 2002 (the last year of statistics formally compiled by the Federal Government and made publically available)[4] only about 160 federal laws have ever been found by the US Supreme Court to be unconstitutional, in whole or in part – the first such law being the Act of Sept. 24, 1789 (1 Stat. 81, § 13) in the famous case of *Marbury v. Madison*, 5 U.S. (1 Cr.) 137 (1803). A majority of such decisions since then have involved issues of individual rights, civil rights, subversion,[5] state sovereignty, criminal procedure and/or free speech. Some date from the "New Deal" era.[6] Few laws ever declared unconstitutional have dealt with general business regulatory matters.[7]

a. Courts have often dealt with broad and vague statutes by construing them narrowly so as to avoid constitutional difficulties where possible.[8]

II. CONSTITUTIONAL ARGUMENTS[9]

1. Vagueness and Non-Delegation[10] Arguments:

Unconstitutional arguments:

- FSOC: The Act assigns the FSOC the duty of regulating companies whose activities threaten "financial stability" – a term that is used dozens of times but left undefined in the Act. The Act provides that the FSOC will conduct studies present findings and recommendations to the Board of Governors of the Federal Reserve system so that new rules and regulations establishing "prudential standards" for regulated companies may be promulgated. Other undefined terms and phrases include what might constitute a "grave threat to the financial stability of the United States," what might constitute a company "in danger of default" and what might rise to the level of an event that "could create or increase the risk of significant liquidity, credit, or other problems spreading among bank holding companies and nonbank financial companies, financial markets of the United States, or low-income, minority, or underserved communities." Somewhat vague or undefined "catch-all" terms are seen as granting relatively unchecked authority to the FSOC.
- BCFP: The power and authority of the BCFP similarly revolves around vague terms such as "unfair," "deceptive,"[11] "abusive," and "discrimination." The BCFP may define such terms and decide how they are applied to financial products and services.
- Non-delegation: The non-delegation doctrine is derived, in part, from Article I of the US Constitution, which states that "[a]ll legislative Powers herein granted shall be vested in a Congress of the United States". According to various estimates, the Act requires at least 243 new formal rule-makings by 11 different federal agencies, with at least 95 by the SEC, 24 by the BCFP and 56 by the FSOC, rules which will likely total many thousands of pages.[12]

Constitutionality arguments:

- On a practical basis, the likelihood of finding significant provisions of the Act unconstitutional because of general vagueness considerations is highly unlikely, especially with regard to the actions of the FSOC. FSOC takeovers of companies that are claimed to be "threats to financial stability" would likely occur and be challenged during a financial crisis.[13] The existence of a crisis would likely place substantial pressure on judges who, by and large, are not economists and must rely substantially on evidence as presented to them.[14] The FSOC likely has or will make contact with numerous mainstream economists and financiers who believe that the powers of the FSOC are necessary to stabilize the economy in time of crisis and likely has or will engage such individuals to develop persuasive position papers and evidence.

- Many regulatory mandates enacted (such as found in existing securities laws) contain vague or expansive terms that are later defined by bodies such as the SEC. Such mandates are rarely found to have constitutionality problems, particularly if the interpretations of the regulatory body are, on their face, reasonable or at least consistent with the enacting law(s).
- Agencies have made thousands of rules and regulations based on underlying Congressional statutes which contain "open ended" terms. The SEC has well over 100 rules promulgated under the Investment Company Act of 1940 (as amended) alone.[15]
- As noted by Duke Law Professor Kim Krawiec,[16] the political conditions leading to Dodd-Frank were ripe for what could be termed responsibility-shifting delegation. Effectively, what Congress may have been trying to do is not delegate power so much as to try to "harness the expertise of courts and agencies, provide the flexibility to adapt the statute to changing circumstances, or reduce the transaction costs associated with lawmaking" while at the same time avoiding blame for unforeseen errors. As noted, in the article:

  Statutes, like contracts, can be more or less complete, but will inevitably have some gaps and ambiguities, which courts or agencies must fill. A purposely-incomplete statute is not necessarily bad. Statutory incompleteness may allow lawmakers to harness the expertise of courts and agencies, provide the flexibility to adapt the statute to changing circumstances, or reduce the transaction costs associated with lawmaking. For this reason, one tends to observe relatively more congressional delegations in highly technical areas that require much expertise and information and in which technology may change quickly. Financial regulation fits this description on many fronts.

  But lawmakers may also leave statutes incomplete for strategic reasons. When a statute is particularly salient to organized interest groups, the voting public, or both, lawmakers may find it politically advantageous to delegate to another branch of government the authority to fill statutory gaps and ambiguities in an attempt to shift responsibility for the negative impacts of law to other governmental branches. For example, empirical study has shown that Congress delegates more frequently in issue areas where it may be hard to claim credit for any benefits of regulation (because they are widely dispersed or barely noticed), but mistakes can be salient and catastrophic, such as drug and product safety, workplace safety, and nuclear weapons. Alternatively, delegation through an incomplete statute may benefit Congress when powerful interest groups are at odds over legislative language, or when the general public's preferences diverge from those of powerful interest groups on a matter of high public salience.

2. Arguments Concerning Limited Ability For Court Interpretation And Review / Separation of Powers Arguments:

Article 1 Section I of the Constitution gives Congress only those "legislative powers herein granted" and lists those permissible actions in Article I Section 8. The vesting clause in Article II places no limits on the Executive branch, simply stating that, "The Executive Power shall be vested in a President of the United States of America." The Supreme Court holds the "judicial Power" under Article III of the Constitution and has, by tradition and precedent, the ability (often seen as Constitutional) to review the decisions of the other branches of government (since *Marbury v. Madison*). Thus, the roles and abilities of each branch of government, as set forth by the Constitution in broad terms, are separate and distinct. Further, some have argued that by substantially curtailing court review of Orderly Liquidation Authority (OLA) proceedings under the Act, the judicial branch is being largely eliminated as a constitutional check on the other branches of government.

Unconstitutional arguments:

- Under Title II of the Act, the FDIC and the Federal Reserve Board, upon two-thirds vote of each respective board, "shall consider whether to make a written recommendation" as to whether the Secretary of the Treasury should appoint the FDIC as receiver for a financial company under the OLA authority established by the Act. The Act prohibits courts from taking "any action, including any action pursuant to the Securities Investor Protection Act of 1970 or the Bankruptcy Code, to restrain or affect the [receiver's] exercise of powers or functions. . . ." The Act additionally limits any claim against the FDIC as receiver to money damages, and the FDIC has the power to allow, disallow and determine claims. A claimant may sue in U.S. District Court within sixty days, but if the claimant misses the deadline, "the claim shall be deemed to be disallowed. . . such disallowance shall be final, and the claimant shall have no further rights or remedies with respect to such claim." Title II of the Act states that "no court shall have jurisdiction over" any claim or action for payment from, or any action seeking a determination of rights with respect to the assets of the seized entity or any claim relating to any act or omission of the seized entity or the FDIC. Shareholders and creditors of a seized company may have no explicit right to contest a proceeding.[17]

- The FSOC, a body with an "executive" role but also with a statutory ability to promulgate its own internal rules and regulations and arguably the ability to propose and implement a wide range of rules impacting financial companies,[18] is composed of 10 voting and five nonvoting members (the voting members are the Treasury Secretary, who serves as the FSOC chair, and the heads of the Federal Reserve Board, OCC, Bureau of Consumer Financial Protection, SEC, FDIC, CFTC, FHFA, NCUA, and an independent member having insurance expertise; the nonvoting members are the directors of the newly created Office of Financial Research and the Federal Insurance Office along with a state insurance commissioner, a state banking supervisor and a state securities commissioner) has the authority to (1) determine which non-bank financial institutions are subject to Title II seizure and (2) control the activities of any financial institution on a two-thirds vote of its members. The courts are not authorized to review whether the FSOC, in making its determinations and conducting its activities, has correctly interpreted the Act.
- The Treasury is authorized to petition the United States District Court for the District of Columbia to seize banks and any non-bank financial institution that the government thinks is in danger of default and could, in turn, pose a risk to U.S. financial stability.[19] If the entity does not acquiesce or consent to the seizure,[20] the petition proceedings are secret, with a federal district judge given 24 hours[21] to decide "on a strictly confidential basis"[22] whether to allow receivership.
- There is no stay pending judicial review built into the Act. Review of a seizure occurs only if the "board of directors (or body performing similar functions) of the covered financial company does not acquiesce or consent to the appointment of the [FDIC] as receiver, is limited to the question of an entity's soundness. As stated in Section 202 of the Act, "[o]n a strictly confidential basis, and without any prior public disclosure, the [United States District Court for the District of Columbia], after notice to the covered financial company and a hearing in which the covered financial company may oppose the petition, shall determine whether the determination of the Secretary that the covered financial company is in default or in danger of default and satisfies the definition of a financial company under section 201(a)(11) is arbitrary and capricious."[23]

Constitutionality arguments:

- The Orderly Liquidation Authority for systemically important financial institutions like the FDIC resolution authority, gives the FDIC a range of tools to liquidate a large nonbank financial institution, including bank holding companies[24] while also mitigating systemic risk. The resolution authority is simply an alternative insolvency regime.
- Although in cases of an expedited 24 hour District Court processes, the Act attempts to eliminate stays or injunctions, a party can still appeal to a circuit court and ask it to make a determination that the actions of the Treasury were arbitrary and capricious. A successful appeal, if given prompt court attention, would serve as a powerful check on the resolution authority of the Treasury in case it overreaches. The existence of exigent circumstances coupled with the ability to appeal justifies the abbreviated 24 hour "due process" limitation.
- Faced with a 24 hour deadline, a court could make default rulings against the Treasury unless the Treasury agrees to waive any deadline imposed by the Act and/or agrees to implement a plan that would allow a financial institution to break free from government control at a later date without undue difficulty. In effect, should a court find that the 24 hour limitation in a particular instance to be unfair, a court could provide what would amount to a partial injunction in all but name.
- Faced with a 24 hour deadline, a court could simply ask the Treasury for a waiver of the deadline. This is not dissimilar to what is commonly done by Agency staff members when an examiner reviewing an application is faced with having to make a determination within a time frame imposed by statute or regulation and the examiner believes that, given underlying facts, additional review is prudent. It is rare that a party will turn down a reviewer's request for a time extension, in part due to risk that playing "hardball" could result in an unfavorable outcome.
- Contemplating how best to deal with matters brought before the court under the Act, the United States District Court for the District of Columbia has adopted Local Civil Rule 85.[25] Requirements include:

  (1) At least 48 hours prior to filing of a petition under the Act, the Secretary of the Treasury shall provide written notice under seal to the Clerk of the Court that a petition will likely be filed with the Court (thus allowing the court to gear up for appropriate action).

(2) A petition under Act by the Secretary of the Treasury must contain all relevant findings and recommendations under the Act and material must be provided in PDF form on a CD-Rom (thus making review a bit easier than it would be otherwise).

(3) The petition shall be assigned to the Chief Judge or Acting Chief Judge (thus petitions will be directed to someone who has presumably fully reviewed the Act, related precedent and will have experience with matters under the Act).

(4) The financial company named in the petition may file an opposition to the petition under seal and may appear at a hearing to oppose the petition. The opposition shall be served on the Secretary of the Treasury by the most expeditious means available (thus procedures are in place to allow opposition to petition under the OLA authority to be somewhat relaxed).

(5) Each petition and opposition shall be accompanied by a proposed order (thus making a response by a judge in the 24 hour period somewhat easier).

(6) Upon the granting of a petition, the Secretary of the Treasury shall promptly notify the court of the appointment of the receiver. The court shall then issue an Order to Show Cause to the Secretary of the Treasury as to why the proceedings, or any part thereof, shall not be unsealed. Thus, unless the Secretary of the Treasury has good reason why its case should remain secret, the United States District Court for the District of Columbia intends to make all material available to the public.

The above procedures in Local Civil Rule 85, in particular item 1 and 6 provide important safeguards to companies and provide for procedural and substantive due process.

- In recent history, a number of federal courts have accepted, without significant constitutional challenge, a stated lack of authority to review matters, in particular with regard to Guantanamo Bay detainees,[26] for example by reasoning that the power to grant a petition for release of Guantanamo Bay detainees is beyond the Judicial Branch's power as courts do not have the power to override immigration laws and force the executive branch to release non-U.S. legal residents held as prisoners into the United States.
- In *Kucana v. Holder*, 130 S.Ct. 827 (2010),[27] the US Supreme Court recently noted, in a 9-0 decision, that Congress can, via a properly written statute, limit the jurisdiction of the federal courts. In Kucana, although the Court did not find for the government, it did note, "If Congress wanted the jurisdictional bar to encompass decisions specified as discretionary by regulation along with those made discretionary by statute, moreover, Congress could easily have said so." It noted that "[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." *Nken* v. *Holder* 129 S.Ct. 1749 (2009). Thus the current Supreme Court understands that Congress can clearly limit the right of any court to review actions of an administrative body (the case in question revolved around the reviewability of a decision of the Board of Immigration Appeals of the U.S. Department of Justice) without a violation of any separation of powers doctrine.
- While the Act provides that the courts are not authorized to review whether the FSOC has correctly interpreted the Act, any court would find little in the way of statutory direction against any reasonable interpretation of the terms interpreted by the FSOC or the BCFP, especially as the Act specifically provides that courts must apply interpretations of provisions (to the extent that an interpretation of the BCFP exists) as if the BCFP "was the only agency authorized to apply, enforce, interpret, or administer the provisions of such Federal consumer financial law." As per dicta in *Kucana*, Congress has wide discretion in limiting the authority of the courts as long as it does so clearly and unambiguously – and thus a court should respect agency interpretations as provided for in the Act.

3. Secrecy Arguments:

The right of due process and judicial review is of modest value unless information and time is available to actually conduct an appropriate process before a decision is reached or at least the parties involved are provided with the ability to contest the actions of the government after the fact. Some have said that the Act permits the Treasury and the FDIC to potentially act as a secret legislative appropriator, executive and judiciary all in one.

Unconstitutional arguments:

- A court can extinguish the opportunity for judicial review of resolution authority exercised by the FDIC[28] by not taking action for 24 hours, after which the petition is granted automatically and liquidation may commence. Any party who "recklessly

discloses" information concerning the government's seizure or the pending court proceedings faces criminal fines and five years' imprisonment. Certain parties analogize the limited time permitted to decide cases under the financial stability provisions of the Act, combined with the secret nature of certain proceedings, to a "star chamber" arrangement.

- Some have suggested that the process required by the Act that involves levels of secrecy and significant amounts of administrative discretion was designed to permit the kind of favoritism seen in the rescue of bankrupt automakers and the AIG bailout, with an indirect taxpayer subsidy available as the government loans to favored creditors to be repaid by "assessments" on large banks and non-bank financial firms.

Constitutionality arguments:

- To find someone in violation of a provision of the Act within the power of the FSOC or the BCFP, a court would have to make an appropriate finding, such as what might constitute the "reckless disclosure" of information and what disclosures might be protected by existing constitutional rights separate and apart from those legislated by Congress in the Act. As many of the secrecy related provisions are vague, a court could choose to err on the side of the party disclosing "secret" information. *See*, i.e., *United States v. Granderson*, 511 U.S. 39 (1994)[29] (concerning sentencing) that in "circumstances, where the text, structure, and statutory history fail to establish that the Government's position is unambiguously correct, the rule of lenity... resolve[s] the statutory ambiguity in [the impacted party's] favor."
- While some have argued that the secrecy and administrative discretion found in the Act would aid in an AIG type "bailout," others see that that, at a minimum, the Act provides a statutory process and framework to consider the future of possible AIG-like issues before a subject company starts to disintegrate. Actions concerning an AIG-like company taken under the Act might be seen to have greater legal support than those taken in 2008.
- Existing law and court interpretations allows for secrecy in special/exigent circumstances (and even "secret laws"), when arguably such laws and/or procedures are in the interest of the nation in times of danger, financial[30] or otherwise.[31] Rules and regulations under the Act would be, at a minimum published. As noted above, the Act requires at least 243 new formal rulemakings by 11 different federal agencies, with at least 95 by the SEC, 24 by the BCFP and 56 by the FSOC.
- Actions under the OLA authority under the Act are filed under seal. To make use of the OLA authority provided by the Act, a petition would have to be brought to the United States District Court for the District of Columbia. In January, 2011, the United States District Court for the District of Columbia enacted Rule 85, specific procedures for Dodd-Frank matters before the court. On the government's appointment of a receiver for a company under the OLA authority, the Secretary of the Treasury will have to respond to an automatically-generated Order to Show Cause to the Secretary of the Treasury as to why the proceedings in the matter, or any part thereof, shall not be made public.[32] Thus, OLA proceedings, absent good reason, would likely only be "secret" for a short period of time.

4. Composition of Board - Separation of Power Arguments; Appointments Clause:

Unconstitutional arguments:

- Various Agencies and boards under the Act are given considerable power – power which under the Constitution should generally reside with the President or by individuals chosen by the President and confirmed by the Senate.

  The Act delegates power to officials not selected by the President and confirmed by the Senate. The FSOC, which makes determinations about which financial companies are subject to seizure by the government, includes four members who are not appointed by the President, but rather by groups of state officials. As such, depending on interpretational issues, the composition of the FSOC board may be a violation of the Appointments Clause of the Constitution, which states that:

  [the President] shall nominate, and, by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.[33]

  From 1999 to 2008, a change in the statute governing the United States Patent and Trademark Office (USPTO) permitted a number of judges of the Board of Patent Appeals and Interferences and the Trademark Trial and Appeal Board to be appoint-

ed by the USPTO Director. This arrangement was challenged as unconstitutional under the Appointments Clause because the appointing party was not the Head of the Department. In order to avoid the crisis that would result from new challenges to many decisions made in that period, Congress passed a 2008 amendment to the statute which specifies that the Secretary of Commerce is responsible for such appointments, and permitting the Secretary to retroactively appoint those persons named by the USPTO Director.

- In *Buckley v. Valeo*, 424 U.S. 1 (1976),[34] the Supreme Court struck down a provision allowing Congress to name four members of the Federal Election Commission on the grounds that it violated the president's appointments power. In *Bowsher v. Synar*, 478 U.S. 714 (1986)[35] the Supreme Court struck down one provision of the Gramm-Rudman-Hollings balanced budget act giving the comptroller general, a congressional official, a role in enforcing the act's spending reduction requirements.
- The director of the BCFP (who is appointed by the President and confirmed by the Senate) is independent of both the Federal Reserve, which houses and provides most of its funding, and the White House. The Act precludes the House and Senate Appropriations Committees from reviewing the bureau's budget.[36]
- There is an open question as to how much legislative power (re: the various regulations that must be created by executive agencies under the Act) Congress may permissibly delegate to the Executive Branch, while not violating separation of powers principles.

Constitutionality arguments:

- It is open to interpretation as to whether the members of the FSOC Board or the BCFP are "inferior Officers" as the Constitution only specifically notes that "Ambassadors, other public Ministers and Consuls, Judges of the Supreme Court, and all such Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law" are not "inferior" Officers.[37] In the Act, Congress did not see fit to require, "by Law" that members of the FSOC Board or the BCFP be appointed with the "Advice and Consent of the Senate" as required for non-inferior Officers and the conclusion may be reached that the duties and powers of the members of the FSOC Board and the BCFP were deemed by Congress to be that of "inferior Officers." The voting members of the FSOC Board (the 10 of the 15 members who hold voting power) are the Treasury Secretary, who serves as the FSOC chair, and the heads of the Federal Reserve Board, OCC, Bureau of Consumer Financial Protection, SEC, FDIC, CFTC, FHFA, NCUA, and an independent member having insurance expertise and who is appointed by the President[38] with Senate confirmation and meets the criteria of the Appointments Clause.
- The BCFP is headed by a Director appointed by the President with Senate confirmation and is formally an entity within the Federal Reserve. The Director of the BCFP appoints the members of the Consumer Advisory Board.[39]

  In the 2010 case *Free Enterprise Fund v. Public Company Accounting Oversight Board*,[40] the United States Supreme Court heard a challenge to the constitutionality of the Public Company Accounting Oversight Board (PCAOB). The PCAOB was created as part of a series of accounting reforms in the Sarbanes-Oxley Act of 2002 and exists to register public accounting firms, establish auditing and ethical standards, conduct inspections of firms, and issue citations when appropriate or deemed necessary. All public accounting firms are required to register and maintain a certain standard as required by the PCAOB and the PCAOB has expansive powers to govern an entire industry. The PCAOB is composed of five members appointed by the Securities and Exchange Commission. In a 5-4 decision, the Supreme Court refused to invalidate the existence or method of appointment of the PCAOB, saying the board's mere existence did not violate the Constitution (and in particular the Appointments Clause). With some minor modifications pertaining to the possible removal of members of the PCAOB, the court permitted the PCAOB to resume business as usual.
- In the context of separation of powers questions, there is a significant difference between one branch unilaterally grabbing power from another branch and one branch willingly ceding power to another branch to deal with exigent or potentially exigent circumstances. The second case (willingly and seamlessly ceding some degree of power) can be seen as not invoking separation of powers concerns that are significant or material, due to the fact that the "giving branch" is losing power voluntarily, can oversee and manage the power to a degree, and can ultimately take back the power if it should desire to do so (for example, though a modification or a partial repeal of the Act).

5. What if a Portion of the Act Is Found to Be Unconstitutional?

On January 31, 2011, a portion of The *Patient Protection and Affordable Care Act*, Pub. L. No. 111-148, 124 Stat. 119 (2010), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (2010) (*PPACA or Obamacare*) was declared unconstitutional in *Attorney General Pam Bondi, et al. v. United States Department of Health And Human Services, et al.* In a finding by senior federal judge Roger Vinson of the United States District Court for the Northern District of Florida, it was found that (emphasis added):

> For the reasons stated, I must reluctantly conclude that Congress exceeded the bounds of its authority in passing the Act with the individual mandate. That is not to say, of course, that Congress is without power to address the problems and inequities in our health care system. The health care market is more than one sixth of the national economy, and without doubt Congress has the power to reform and regulate this market. That has not been disputed in this case. The principal dispute has been about how Congress chose to exercise that power here.
>
> **Because the individual mandate is unconstitutional and not severable, the entire Act must be declared void.**

The court found that no injunctive relief was needed, as:

> there is a long-standing presumption 'that officials of the Executive Branch will adhere to the law as declared by the court. As a result, the declaratory judgment is the functional equivalent of an injunction.' *See Comm. on Judiciary of U.S. House of Representatives v. Miers*, 542 F.3d 909, 911 (D.C. Cir. 2008); *accord Sanchez-Espinoza v. Reagan*, 770 F.2d 202, 208 n.8 (D.C. Cir. 1985) ("declaratory judgment is, in a context such as this where federal officers are defendants, the practical equivalent of specific relief such as an injunction . . . since it must be presumed that federal officers will adhere to the law as declared by the court") (Scalia, J.)

The Dodd-Frank Act was part of a much longer and more collaborative legislative process, where many provisions were either known or gradually evolved over several months[41] The Act contains both Section 3: "SEC. 3. SEVERABILITY. If any provision of this Act, an amendment made by this Act, or the application of such provision or amendment to any person or circumstance is held to be unconstitutional, the remainder of this Act, the amendments made by this Act, and the application of the provisions of such to any person or circumstance shall not be affected thereby" and Section 542 of Title 3 "Title 3 SEC. 542. SEVERABILITY. If any section or subsection of this subtitle, or any application of such provision to any person or circumstance, is held to be unconstitutional, the remainder of this subtitle, and the application of the provision to any other person or circumstance, shall not be affected."[42]

In the PPACA ruling, Judge Vinson based the nonseverability decision in part on what he believed to be Congressional intent, as the core purpose of the PPACA was to cover more people at lower cost, and given that the invalidation of the mandate that individuals obtain insurance would undermine that core purpose, that Congress would not have passed the rest of the PPACA without the mandate.[43] In the Ruling it is noted that "the severability analysis is 'eased' when there is a severability clause in the statute, such that only 'strong evidence' can overcome it. By necessary implication, the evidence against severability need not be as strong to overcome the general presumption when there is no such clause."

As set forth in detail in the PPACA decision:

> Severability is a doctrine of judicial restraint, and the Supreme Court has applied and reaffirmed that doctrine just this past year: "'**Generally speaking**, when confronting a constitutional flaw in a statute, [courts] try to limit the solution to the problem,' severing any 'problematic portions while leaving the remainder intact.'" Free Enterprise Fund v. Public Co. Accounting Oversight Board, — U.S.—, 130 S. Ct. 3138, 3161, 177 L. Ed. 2d 706 (2010) (citation omitted) (emphasis added). Because the unconstitutionality of one provision of a legislative scheme "does not necessarily defeat or affect the validity of its remaining provisions," the "**normal** rule" is that partial invalidation is proper. Id. (citations omitted) (emphasis added). Where Congress has "enacted a statutory scheme for an obvious purpose, and where Congress has included a series of provisions operating as incentives to achieve that purpose, the invalidation of one of the incentives should not ordinarily cause Congress' overall intent to be frustrated." *New York, supra*, 505 U.S. at 186 (emphasis added). As the emphasized text shows, the foregoing is not a rigid and inflexible rule, but rather it is the general standard that applies in the typical case. However, this is anything but the typical case.
>
> The question of severability ultimately turns on the nature of the statute at issue. For example, if Congress intended a given statute to be viewed as a bundle of separate legislative enactment or a series of short laws, which for purposes of convenience and efficiency were arranged together in a single legislative scheme, it is presumed that any provision declared unconstitutional can be

struck and severed without affecting the remainder of the statute. If, however, the statute is viewed as a carefully-balanced and clockwork-like statutory arrangement comprised of pieces that all work toward one primary legislative goal, and if that goal would be undermined if a central part of the legislation is found to be unconstitutional, then severability is not appropriate. As will be seen, the facts of this case lean heavily toward a finding that the Act is properly viewed as the latter, and not the former.

The standard for determining whether an unconstitutional statutory provision can be severed from the remainder of the statute is well-established, and it consists of a two-part test. First, after finding the challenged provision unconstitutional, the court must determine if the other provisions can function independently and remain "fully operative as a law." See *Free Enterprise Fund, supra,* 130 S. Ct. at 3161. In a statute that is approximately 2,700 pages long and has several hundred sections --- certain of which have only a remote and tangential connection to health care --- it stands to reason that some (perhaps even most) of the remaining provisions can stand alone and function independently of the individual mandate. The defendants have identified several provisions that they believe can function independently: the prohibition on discrimination against providers who will not furnish assisted suicide services; an "Independence at Home" project for chronically ill seniors; a special Medicare enrollment period for disabled veterans; Medicare reimbursement for bone-marrow density tests; and provisions devised to improve women's health, prevent abuse, and ameliorate dementia [Def. Opp. at 40], as well as abstinence education and disease prevention [doc. 74 at 14]. And as was mentioned during oral argument, there is little doubt that the provision in the Act requiring employers to provide a "reasonable break time" and separate room for nursing mothers to go and express breast milk [Act § 4207] can function without the individual mandate.

Importantly, this provision and many others are already in effect and functioning. However, the question is not whether these and the myriad other provisions can function as a technical or practical matter; instead, the "more relevant inquiry" is whether these provisions will comprise a statute that will function "in a manner consistent with the intent of Congress." See *Alaska Airlines, Inc. v. Brock*, 480 U.S. 678, 685, 107 S. Ct. 1476, 94 L. Ed. 2d 661 (1987) (emphasis in original). Thus, the first step in the severability analysis requires (at least to some extent) that I try to infer Congress' intent. Although many of the remaining provisions, as just noted, can most likely function independently of the individual mandate, there is nothing to indicate that they can do so in the manner intended by Congress. The analysis at the second step of the severability test makes that conclusion pretty clear.

At this second step, reviewing courts may look to "the statute's text or historical context" to determine if Congress, had it been presented with a statute that did not contain the struck part, would have preferred to have no statute at all. *See Free Enterprise Fund, supra*, 130 S. Ct. at 3161-62. "Unless it is evident that the Legislature would not have enacted those provisions which are within its power, independently of that which is not, the invalid part may be dropped if what is left is fully operative as a law." *See Alaska Airlines, Inc., supra*, 480 U.S. at 684. But once again, that presupposes that the provisions left over function in a manner consistent with the main objective and purpose of the statute in the first place. Cf. New York, supra, 505 U.S. at 187 (unconstitutional provision held to be severable where the remaining statute "still serves Congress' objective" and the "purpose of the Act is not defeated by the invalidation" of the unconstitutional provision) (emphasis added). While this inquiry "can sometimes be 'elusive'" [Free Enterprise Fund, supra, 130 S. Ct. at 3161], on the unique facts of this particular case, the record seems to strongly indicate that Congress would not have passed the Act in its present form if it had not included the individual mandate. This is because the individual mandate was indisputably essential to what Congress was ultimately seeking to accomplish. It was, in fact, the keystone or lynchpin of the entire health reform effort.

In response to a later motion to "clarify" filed by the Government, Judge Vinson did not revise any of his conclusions, and restated that

"[t]he individual mandate was declared unconstitutional. Because that "essential" provision was unseverable from the rest of the Act, the entire legislation was void. This declaratory judgment was expected to be treated as the 'practical' and 'functional equivalent of an injunction' with respect to the parties to the litigation. This expectation was based on the 'longstanding presumption' that the defendants themselves identified and agreed to be bound by, which provides that a declaratory judgment against federal officials is a de facto injunction. To the extent that the defendants were unable (or believed that they were unable) to comply, it was expected that they would immediately seek a stay of the ruling, and at that point in time present their arguments for why such a stay is necessary, which is the usual and standard procedure. It was not expected that they would effectively ignore the order and declaratory judgment for two and one-half weeks, continue to implement the Act, and only then file a belated motion to 'clarify.'"

However, in his March 3, 2011 clarifying order,[44] Judge Vincent did ultimately decide to grant a stay, "conditioned upon the defendants filing their anticipated appeal within seven (7) calendar days of this order and seeking an expedited appellate review, either in the Court of Appeals or with the Supreme Court under Rule 11 of that Court." The appeal was subsequently filed.[45]

Using the framework of the PPACA decision and applying it to the Act, a court would likely find the vast majority of the Act to be severable, as (a) most provisions can stand alone (in fact, a number of provisions were derived from separate bills that were later incorporated into the text of the Act), and (b) Congress specifically intended provisions of the Act to be severable. From a Constitutional perspective, perhaps the weakest portion of the Act detailed above may be the resolution authority procedures involving an element of secrecy and tight timelines. However, with the "secrecy" elements removed and the 24 hour court determination deadline struck (or even with a few points of United States District Court for the District of Columbia Local Civil Rule 85 expanded), the Orderly Liquidation Authority of the Act would fall significantly closer to level of abilities held by the FDIC prior to the Act (but with a larger group of companies being subject to FDIC power).

ENDNOTES

1 Many of such arguments have been made in the article *The Dodd-Frank Wall Street Reform & Consumer Protection Act of 2010: Is It Constitutional?* by C. Boyden Gray and John Shu and are repeated, noted and/or summarized below. The article and other resources are available at http://www.fed-soc.org/publications/pubid.2012/pub_detail.asp.

2 *See* Section 1031 of the Act. The BCFP does not have the power to declare an act or practice abusive unless it finds that the act or practice (1) materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or (2) takes unreasonable advantage of a consumer lack of understanding of material risks, costs, or conditions of the product or service ; inability of the consumer to protect its interests in selecting or using a consumer financial product or service; and/or the reasonable reliance by the consumer of a party covered by the Act to protect its interests.

3 A "covered financial company" is a company **other than an insured depository institution**, for which the Secretary of the Treasury has determined:

"(1) the financial company is in default or in danger of default;

(2) the failure of the financial company and its resolution under otherwise applicable Federal or State law would have serious adverse effects on financial stability in the United States;

(3) no viable private sector alternative is available to prevent the default of the financial company;

(4) any effect on the claims or interests of creditors, counterparties, and shareholders of the financial company and other market participants as a result of actions to be taken under this title is appropriate, given the impact that any action taken under this title would have on financial stability in the United States;

(5) any action [taken] would avoid or mitigate such adverse effects, taking into consideration the effectiveness of the action in mitigating potential adverse effects on the financial system, the cost to the general fund of the Treasury, and the potential to increase excessive risk taking on the part of creditors, counterparties, and shareholders in the financial company;

(6) a Federal regulatory agency has ordered the financial company to convert all of its convertible debt instruments that are subject to the regulatory order; and

(7) the company satisfies the definition of a "financial company".

4 http://www.gpoaccess.gov/constitution/pdf2002/046.pdf.

5 In the 1950s and 1960s, the Supreme Court decided over 50 cases involving communism and subversion in government. A number pertained to specific federal laws, such as the case of United States v. Robel, 389 U.S. 258 (1967) where a provision of the subversive activities control Act making it unlawful for member of a Communist front organization to work in a defense plant was held to be an overbroad infringement of the right of association protected by the First Amendment.

6 Such as the Joint Resolution of June 5, 1933 (48 Stat. 113, § 1) concerning the abrogation of gold [the metal] clauses in Government obligations that was struck by *Perry v. United States*, 294 U.S. 330 (1935), available at http://supreme.justia.com/

us/294/330/. In *Perry*, the plaintiff held government bonds for the payment of principal and interest "in United States gold coin of the present standard of value", but 48 Stat. 113, § 1 undertook to nullify such gold clauses in obligations of the United States and pay cash only (after the then-current administration had withdrawn gold coins from general circulation). Notably, while the court found the statute unconstitutional, it did not grant the plaintiff the gold he was owed under his bonds or its market value, but only the value in cash declared by the Federal Government (i.e. based on the $20 face value of gold coins of the era rather than the $35 such coins would have on foreign markets or toward the settlement of Government debts abroad).

7 However, the Supreme Court has weighed in as to the limited level of effective judicial authority that may be granted to parties who are not "Article III" judges. In *Northern Pipeline Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), the court opined on the Bankruptcy Act of 1978, which had granted the bankruptcy courts independent jurisdiction over all civil proceedings arising under Title 11 or arising in or related to cases under Title 11 and all "powers of a court of law or equity", except for issuing injunctions against other courts and punishing criminal contempt outside of court (or otherwise punishable by imprisonment). Marathon argued that the Bankruptcy Act of 1978 unconstitutionally conferred Article III judicial power upon judges who lacked life tenure and protection against salary diminution (i.e. non-Article III judges).

As a result of the court's finding that the power granted by the Bankruptcy Act of 1978 to non-Article III judges was unconstitutional, Congress passed a new statute authorizing federal district courts to effectively "refer" bankruptcy cases to the bankruptcy courts, and in so called "non-core" proceedings, required bankruptcy courts to submit proposed findings of fact and conclusions of law to an applicable district court for *de novo* review.

8 See, e.g., Industrial Union Dep't v. American Petroleum Inst., 448 U.S. 607, 645-46 (1980) (plurality opinion) (invalidating an occupational safety and health regulation, and observing that the statute should not be interpreted to authorize enforcement of a standard that is not based on an "understandable" quantification of risk); National Cable Television Ass'n v. United States, 415 U.S. 336, 342 (1974) ("hurdles revealed in [Schechter and J. W. Hampton, Jr. & Co. v. United States] lead us to read the Act narrowly to avoid constitutional problems"), as cited in the article entitled "*Delegation of Legislative Power, The History of the Doctrine of Nondelegability*" available at http://supreme.justia.com/constitution/article-1/03-delegation-of-legislative-power.html.

9 The nondelegation doctrine is derived, in part, from Article I of the US Constitution, which states that "[a]ll legislative Powers herein granted shall be vested in a Congress of the United States". According to various estimates, the Act requires at least 243 new formal rule-makings by 11 different federal agencies, with at least 95 by the SEC, 24 by the BCFP and 56 by the FSOC, rules which will likely total many thousands of pages. Due to the vagueness and undefined nature of many of the key terms in the Act, various agencies, the members of which are not appointed by Congress, will have a significant ability to determine a substantial number of final rules.

10 *See* posting Dodd-Frank and the Non-Delegation Doctrine, available at http://www.professorbainbridge.com/professorbainbridgecom/2010/07/doddfrank-and-the-nondelegation-doctrine.html.

11 There is a great deal of precedent for the use of "unfair" and "deceptive" standards under Title 5 of the Federal Trade Commission Act (15 U.S.C. § 45), which declares that "[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful" and is no more descriptive than the Act, in that it states that "the term "unfair or deceptive acts or practices" includes "acts or practices involving foreign commerce that— (i) cause or are likely to cause reasonably foreseeable injury within the United States; or (ii) involve material conduct occurring within the United States." *See also* http://www.ftc.gov/privacy/privacyinitiatives/promises.html.

12 *See* footnote 11.

13 *See* report of January 13, 2011 of the Special Investor General for the Troubled Asset Relief Program (SIGTARP), available at http://www.sigtarp.gov/reports/audit/2011/Extraordinary%20Financial%20Assistance%20Provided%20to%20Citigroup,%20Inc.pdf, which notes "Treasury Secretary Timothy F. Geithner told SIGTARP that he believed creating effective, purely objective criteria for evaluating systemic risk is not possible, saying "it depends too much on the state of the world at the time. You won't be able to make a judgment about what's systemic and what's not until you know the nature of the shock" the economy is undergoing. He also said that whatever objective criteria were developed in advance, markets and institutions would adjust and "migrate around them." And "[t]he Dodd-Frank Act was intended in part to address the problem of institutions that are 'too big to fail.'

Whether it will successfully address the moral hazard effects of TARP remains to be seen, and there is much important work left to be done. As Secretary Geithner told SIGTARP, while the Dodd-Frank Act gives the Government 'better tools,' and reduced the risk of failures, '[i]n the future we may have to do exceptional things again' if the shock to the financial system is sufficiently large. Secretary Geithner's candor about the prospect of having to 'do exceptional things again' in such an unknowable future crisis is commendable. At the same time, it underscores a TARP legacy, the moral hazard associated with the continued existence of institutions that remain 'too big to fail.'"

14 *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984). If a statute is silent *or ambiguous* with respect to the specific question, the court must review whether the agency's answer is based on a permissible construction of the statute.

15 Current rules promulgated under the Investment Company Act of 1940 are available at http://taft.law.uc.edu/CCL/InvCoRls/index.html

16 *See* posting of July 20, 2010 entitled *Dodd-Frank Financial Reform: "I'll Have the Meatless Entrée, Please"* and available at http://www.thefacultylounge.org/2010/07/dodd-frank-forum-ill-have-the-meatless-entrÃ©e-please.html.

17 It should be noted that the above limitations placed on courts under the Act are not dissimilar to those provided to the FDIC under its pre-Dodd-Frank authority granted under Title 12 of the United States Code and continue to be operative law. The resolution authority under the Act for a non-depository systemically important financial institution simply provides alternative mechanisms to reach the same end. The "Orderly Liquidation Authority" which empowers the FDIC to unwind, for example, a failing investment bank or insurance company without forcing it into bankruptcy requires the FDIC to determine that such action is necessary for purposes of the financial stability of the United States (and not for the purpose of preserving the covered financial company), not take an equity interest in the entity being liquidated, not pay shareholders until all other claims are paid and "ensure that unsecured creditors bear losses in accordance with priority of claim provisions stated in [the Act]."

18 The FSOC has made public a proposed rulemaking whereby an analytical framework would be established for the designating of nonbank financial companies for supervision by the Board of Governors of the Federal Reserve. *See* http://www.treasury.gov/initiatives/Documents/Nonbank%20NPR%20final%2001%2013%2011%20formatted%20for%20FR.pdf. Under the Act, the authority for the FSOC to promulgate rules may be more limited, perhaps largely to rules of the nature set forth in Section 11(e) of the Act "[t]he Council shall adopt such rules as may be necessary for the conduct of the business of the Council. Such rules shall be rules of agency organization, procedure, or practice for purposes of section 553 of title 5, United States Code" with the Federal Reserve Board being provided with the power to implement rules concerning the substantive criteria to be used by the FSOC.

19 *See* definition of "financial company" in Section 201 of the Act. As noted in Section 202(a)(1)(A)(i) of the Act, "[s]ubsequent to a determination by the Secretary under section 203 that a financial company satisfies the criteria in section 203(b), the Secretary shall notify the Corporation and the covered financial company. If the board of directors (or body performing similar functions) of the covered financial company acquiesces or consents to the appointment of the Corporation as receiver, the Secretary shall appoint the Corporation as receiver. If the board of directors (or body performing similar functions) of the covered financial company does not acquiesce or consent to the appointment of the Corporation as receiver, the Secretary shall petition the United States District Court for the District of Columbia for an order authorizing the Secretary to appoint the Corporation as receiver."

20 The Act provides that the Secretary of the Treasury shall notify the FDIC in the case a determination is made to use the resolution authority provided under the Act on a "covered" financial company. "If the board of directors (or body performing similar functions) of the covered financial company acquiesces or consents to the appointment of the [FDIC] as receiver, the Secretary [of the Treasury] shall appoint the [FDIC] as receiver. If the board of directors (or body performing similar functions) of the covered financial company does not acquiesce or consent to the appointment of the [FDIC] Corporation as receiver, the Secretary [of the Treasury] shall petition the United States District Court for the District of Columbia for an order authorizing the Secretary to appoint the Corporation as receiver. [...] The Secretary [of the Treasury] shall present all relevant findings and the recommendation made pursuant to section 203(a) to the Court. The petition shall be filed under seal."

21 Section 202(a)(1)(A)(v) of the Act states: "PETITION GRANTED BY OPERATION OF LAW.— If the Court does not make a determination within 24 hours of receipt of the petition— (I) the petition shall be granted by operation of law; (II) the Secretary shall appoint the Corporation as receiver; and (III) liquidation under this title shall automatically and without further notice or action be commenced and the Corporation may immediately take all actions authorized under this title.

22 Section 202(a)(1)(A)(iii) of the Act states: " DETERMINATION.—On a strictly confidential basis, and without any prior public disclosure, the Court, after notice to the covered financial company and a hearing in which the covered financial company may oppose the petition, shall determine whether the determination of the Secretary that the covered financial company is in default or in danger of default and satisfies the definition of a financial company under section 201(a)(11) is arbitrary and capricious."

23 *See* footnote 21.

24 The new OLA resolution authority does not apply to depository institutions but could be used on the holding company of a depository institution. Other parts of the Act were designed "to streamline and rationalize the supervision of depository institutions and the holding companies of depository institutions".

25 Available at http://www.dcd.uscourts.gov/dcd/sites/dcd/files/DFWSR.pdf.

26 *See* http://www.immigrationforum.org/policy/courts-display/immigration-related-cases-march-2010-update/index.html.

27 Available at http://www.supremecourt.gov/opinions/09pdf/08-911.pdf, noting in part that "If Congress wanted the jurisdictional bar to encompass decisions specified as discretionary by regulation along with those made discretionary by statute [in the matter in question], moreover, Congress could easily have said so."

28 If the United States District Court for the District of Columbia the Court is petitioned by the Secretary of the FDIC in a matter of the resolution authority granted in the Act, "If the Court does not make a determination within 24 hours of receipt of the petition— (I) the petition shall be granted by operation of law; (II) the Secretary shall appoint the Corporation as receiver; and (III) liquidation under this title shall automatically and without further notice or action be commenced and the Corporation may immediately take all actions authorized under this title."

29 Available at http://www.law.cornell.edu/supct/html/92-1662.ZS.html ; Commentary available at http://www.oyez.org/cases/1990-1999/1993/1993_92_1662.

30 See C-Span recorded testimony concerning then-secret meetings between Congress and then Treasury Secretary Henry Paulson in the wake of the Lehman disaster and just prior to the passage of the TARP Program – testimony available at http://dailybail.com/home/kanjorski-asks-paulson-to-describe-his-greatest-fears-from-t.html.

31 *See*, for example, Gilmore v. Gonzalez, 435 F.3d 1125 (9th Cir. 2006), available at http://bulk.resource.org/courts.gov/c/F3/435/435.F3d.1125.04-15736.html. The Supreme Court denied a petition for Certiorari.

The matter involved a lawsuit against various federal agencies and departments as well as against two airlines. Gilmore claimed that being required to show identification for a domestic flight was an unconstitutional restriction of his rights to travel, to petition government, and to speak anonymously. Gilmore also complained about being subject to "secret law" when the airlines and government refused to show the directive under which they were requesting ID.

The district court hearing the case dismissed Gilmore's complaint with prejudice, in part claiming lack of jurisdiction to hear due process arguments. As to other matters, the lower court noted that as the identification policy had been classified as "sensitive security information" and as such did not review any official documentation of the identification policy (rather, for purposes of its jurisdictional ruling, the district court assumed, as Gilmore had alleged, that the identification policy was a Security Directive issued by TSA). The circuit court did review material pertaining to the identification *in camera and ex parte*, but held that there was no constitutional violation because air passengers could still theoretically travel without identification if they instead underwent the more stringent "secondary screening" search.

32 Rule 85 requires that "A petition [by the Treasury] under this Act must contain all relevant findings and recommendations under the Act, and must be filed under seal. The original and one copy of the petition and a PDF version on a CD-ROM shall be tendered to the Clerk. The original and copy of the petition and all related documents shall be submitted securely in an envelope/box appropriate to accommodate the documents. The envelope/box containing such documents shall have a conspicuous notation as follows: "DOCUMENT UNDER SEAL."

33 Available at http://topics.law.cornell.edu/constitution/articleii.

34 Available at http://www.law.cornell.edu/supct/html/historics/USSC_CR_0424_0001_ZS.html.

35 Available at http://www.law.cornell.edu/supct/html/historics/USSC_CR_0478_0714_ZS.html.

26 However, Congress would have authority should the BCFP require funds in excess of 12% of the Federal Reserve System's operating expenses – the Act authorizes up to $200 million of additional funding per year.

37 The Constitution does not define the term "inferior Officers." No official "test" has been devised to determine "inferior" status for officials that are not a named "Head" of a "Department" or specifically provided for in the Constitution. A more facts and circumstance approach is generally taken, i.e. in *Morrison v. Olson*, 487 U.S. 654 (1988) (available at http://caselaw.lp.findlaw.com/cgi-bin/getcase.pl?court=US&vol=487&invol=654) concerning the constitutionality of the independent counsel provisions of the Ethics in Government Act of 1978 which provided for the creation of a special counsel to investigate and if appropriate prosecute certain high-ranking government officials for violations of federal criminal laws. In *Morrison*, the court stated that "[t]he line between 'inferior' and 'principal' officers is one that is far from clear, and the Framers provided little guidance into where it should be drawn. See, e. g., 2 J. Story, Commentaries on the Constitution 1536, pp. 397-398 (3d ed. 1858) ('In the practical course of the government there does not seem to have been any exact line drawn, who are and who are not to be deemed inferior officers, in the sense of the constitution, whose appointment does not necessarily require the concurrence of the senate')." In *Morrison*, the court ultimately held that position in question was indeed "inferior" for purposes of the applicable clause of the Constitution despite the independent discretion to exercise delegated powers afforded an independent counsel, in part due to the fact that a party other than the President (in this case, the Attorney General) could remove such officer, the position was temporary, and the officer was empowered to perform only certain limited and defined duties.

38 *See* http://www.treasury.gov/initiatives/Documents/FAQ%20-%20FinancialStabilityOversightCouncilOctober2010FINALv2.pdf.

39 "In appointing the members of the Consumer Advisory Board, the Director shall seek to assemble experts in consumer protection, financial services, community development, fair lending and civil rights, and consumer financial products or services and representatives of depository institutions that primarily serve underserved communities, and representatives of communities that have been significantly impacted by higher priced mortgage loans, and seek representation of the interests of covered persons and consumers, without regard to party affiliation. Not fewer than 6 members shall be appointed upon the recommendation of the regional Federal Reserve Bank Presidents, on a rotating basis."

40 Opinion available at http://www.supremecourt.gov/opinions/09pdf/08-861.pdf.

41 See, i.e. Dodd-Frank financial regulatory issues discussed in a Pepper Hamilton webinar in late December, 2009 http://www.pepperlaw.com/webinars_update.aspx?ArticleKey=1632 as compared to the final Act signed into law on July 21, 2010.

42 See Severability as Judicial Lawmaking, by David H.Gans, available at http://docs.law.gwu.edu/stdg/gwlr/issues/pdf/Gans%20 76-3.pdf.

43 The PPACA decision of January 31, 2011 includes the following: "I note that the defendants have acknowledged that the individual mandate and the Act's health insurance reforms, including the guaranteed issue and community rating, will rise or fall together as these reforms "cannot be severed from the [individual mandate]." See, e.g., Def. Opp. at 40. As explained in my order on the motion to dismiss: "the defendants concede that [the individual mandate] is absolutely necessary for the Act's insurance market reforms to work as intended. In fact, they refer to it as an 'essential' part of the Act at least fourteen times in their motion to dismiss." Thus, the only question is whether the Act's other, non-health-insurance-related provisions can stand independently or whether they, too, must fall with the individual mandate."

44 Available at http://aca-litigation.wikispaces.com/file/view/Vinson+stay+order.pdf.

45 Copy of appeal available at http://dl.dropbox.com/u/3174287/Notice%20Of%20Appeal.pdf.

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Constitutional Problems Associated with Dodd-Frank Title II

Thomas W. Merrill

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Mr. Chairman and Members of the Committee:

Thank you for the opportunity to appear before you today to discuss constitutional problems associated with the Dodd-Frank Act. My comments are directed to Title II of the Act, which establishes a new "Orderly Liquidation Authority" for systemically significant financial firms. This authority is designed to create a new bankruptcy regime for systemically important financial companies that will eliminate the need for taxpayer bailouts of financial firms deemed too big to fail.

I am currently completing an article, coauthored with Margaret Merrill, addressing the constitutional issues raised by Title II. I have included a copy of the current draft of this article as an appendix to this statement. The article considers both the substantive constitutional issues presented by Title II as well as the procedural impediments the statute creates for getting these issues before a court.

The fundamental point I would make is this. Dodd Frank Title II, as presently written, raises some serious constitutional questions. Anyone opposed having a financial firm liquidated under Title II – this could be a director or officer of the firm, or a creditor of the firm – would have a strong incentive to raise these constitutional objections as a way of stopping the resolution process. Given the novelty and complexity involved in evaluating these objections, this would almost certainly lead to delay and confusion, undermining the purpose and efficacy of Title II. So I strongly urge the Congress to amend the statute to fix the constitutional problems, if Title II is to have a chance of delivering on its promises.

Fortunately, most of the constitutional problems can be fixed without performing radical surgery on the statute. The critical fix is to amend the law to adopt the original House version for commencing a liquidation of a financial firm, rather than the Senate version that was ultimately approved by the Conference Committee. Briefly put, the House version called for administrative appointment of the FDIC as receiver of a distressed systemically significant financial firm, followed by a right to go to court to have the appointment of the receiver set aside. You can call this ex post judicial review. While the Senate version required the same administrative findings, it also required that the appointment of the FDIC as receiver be formally made by the D.C. District Court. You can call this ex ante judicial review.

Ordinarily, there is nothing wrong with ex ante judicial review; indeed, it can offer greater protection against government abuse than ex post review. But in the context of the

failure of a systemically significant financial firm, the Senate recognized that you could not have anything resembling an ordinary judicial trial before appointing a receiver. The publicity and delay would trigger the very financial panic that the orderly liquidation process is designed to prevent.

So what did the Senate do? It tightly constrained the ex ante judicial review. The court proceedings are held in camera – "on a strictly confidential basis." Only the financial firm is informed about the petition to appoint a receiver; other interested parties like employees, creditors, and counterparties are kept in the dark. Indeed, anyone disclosing the pendency of the court proceedings is subject to criminal prosecution. The court has only 24 hours to rule on the petition. It may consider only two out of seven determinations that must be made to commence a receivership. It can review these determinations only under a highly deferential "arbitrary and capricious" standard. And if the court fails to rule within 24 hours, the petition is deemed automatically granted. There can be no stay of the receivership pending appeal.

In other words, the Senate's version of ex ante review – which is the version currently incorporated in the statute – seeks to draw upon the authority of the federal courts before ordering the liquidation of a systemically significant financial firm. But in order to do so while also preserving the need for speed and confidentiality – not to mention the discretion of the executive branch in deciding whether to commence an orderly liquidation – it requires the court to act in a very un-judicial manner. The combination of ex ante review with no notice to stakeholders, 24 hours to make a decision, and tight constraints on the issues that can be considered, creates several serious constitutional problems.

Perhaps the most obvious is due process. Due process does not always require notice and a hearing before someone is deprived of their property. Various emergency situations like a health threat – or a threat of a financial crisis – may allow the government to act in a summary fashion. But if notice and a fair hearing are not made available before the deprivation takes place, the law is crystal clear that there must be notice and a fair hearing promptly afterwards. Dodd Frank, as enacted, provides for a hearing before rather than after the deprivation, but it truncates the notice and the hearing to the point where they are effectively meaningless. I cannot imagine that the Supreme Court would hold that the government can order the mandatory liquidation of a major financial firm without any meaningful notice to affected persons or any opportunity to contest the government's decision before or after the process gets started.

A related problem is Article III of the Constitution. Dodd Frank, not to put too fine a point on it, effectively requires the federal courts to rubber stamp the executive decision to commence an orderly liquidation process. The court gets 24 hours to rule on what is likely to be a highly complex and contested matter, and then is told it must apply a very deferential standard of review and must ignore five of the seven legal determinations that the executive must make before commencing the liquidation process. The courts will not take kindly to being conscripted to act in a manner inconsistent with the proper exercise of the judicial power.

A third problem is the First Amendment. Dodd Frank says you can be sent to jail for up to five years for disclosing the truth about a civil case brought against you by the government. There are of course a variety of circumstances in which judicial proceedings can be kept confidential. But they all involve the consent of the parties involved or preliminary determinations subject to reversal in later proceedings. Dodd Frank requires that once a receiver is appointed by the court, the firm must be liquidated, shareholders must be wiped out, directors must be dismissed, responsible officers fired. The appointment of the receiver is the last act by a court before all these consequences inevitably follow. And it is crime to disclose this to the world. Such a gag rule is unprecedented, and I think would be viewed very skeptically by the courts.

All these problems could be avoided by eliminating the Senate provision for ex ante review and restoring the House provision for ex post review. With ex post review, you can have administrative appointment of the receiver, preserving the confidentiality and the speed necessary to forestall a run on the financial company and the ensuing financial panic. The receiver can immediately stay all collection actions and preferential transfers and more importantly assume or transfer time sensitive qualified financial contracts. All interested parties can then be promptly notified, and any party interested in challenging the appointment of the receiver can do so in court, without any limitation on the issues presented, the standard of review, or the time the court takes to sort out the issues and reach a decision.

Such ex post review, by affording notice and an opportunity for a full and fair hearing after the appointment of a receiver, eliminates the due process problem. It eliminates the Article III problem, because the court would be asked to act in a manner fully consistent with the judicial function. And it eliminates any need for a gag rule, and hence any First Amendment deficiencies.

It is probably true, as a practical matter, that once a receiver is appointed a reviewing court will be reluctant to unwind the process. But the very availability of such ex post review would act as an important safeguard against executive abuse. Making such robust review available would serve to constrain the executive to exercise the vast power bestowed on it in a responsible manner. As such, it would not only eliminate the constitutional problems I have highlighted, but would also provide far more protection for individual rights than Dodd Frank does in its current incarnation.

I thank the Committee for its attention and will be glad to answer any questions.

Appendix

DODD-FRANK ORDERLY LIQUIDATION AUTHORITY: TOO BIG FOR THE CONSTITUTION?

**Thomas W. Merrill*
Margaret L. Merrill****

Introduction

The Dodd-Frank Act[1] is in significant part a response to public outcry over public bailouts of financial firms that are deemed too big to fail. In the financial crisis of 2008-09, the federal government supplied emergency financial support to many financial firms in order to keep them afloat. The fear was that the insolvency of one or more of these firms would trigger a chain reaction by creditors, analogous to a run on the bank, which would in turn have ripple effects throughout the economy. As it happened, the financial system did freeze up for a short time after the Lehman Brothers bankruptcy,[2] which tipped the economy into a deep recession followed by a painfully weak recovery.[3]

Once the immediate crisis subsided, many perceived that large financial firms and their well-paid officers and directors had survived nicely, whereas large numbers of ordinary Americans were suffering from the lingering effects of the downturn. The idea that the federal government would rescue large financial firms with taxpayer dollars, while ordinary citizens lost their jobs and watched their savings evaporate, has produced widespread voter anger. One proposition all politicians seem to agree upon, at least publicly, is that never again should ordinary folks be taxed to prop up giant financial firms deemed too big to fail by the government.[4]

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** Member of the Bar, New York. The authors thank Erik Gerding, Ed Morrison, Henry Monaghan, and participants in a conference at Case Western Law School for helpful suggestions on an earlier draft.

[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) [hereinafter cited as DFA].

[2] The Orderly Liquidation of Lehman Brothers Holdings Inc. under the Dodd-Frank Act, FDIC Quarterly, Vol. 5, No. 2, 3-4 (2011) at http://www.fdic.gov/bank/analytical/quarterly/2011_vol5_2/Article2.pdf.

[3] The Restoring Financial Stability Act of 2010, S. Rep. No. 111-176, at 43- 44 (2010). ("When Lehman Brothers declared bankruptcy, the markets panicked and the crisis escalated. With no other means to resolve large, complex and interconnected financial firms, the government was left with few options other than to provide massive assistance to prop up failing companies in an effort to prevent the crisis from spiraling into a great depression. Despite initial efforts of the government, credit markets froze and the U.S problem spread across the globe. The crisis on Wall Street soon spilled over onto Main Street, touching the lives of most Americans and devastating many.")

[4] Amendment No, 689 to the Concurrent Budget Resolution on the Budget. Fiscal Year 2014, Con. Rec.

In terms of reform, there were a number of possible structural alternatives to public bailouts of financial firms deemed too big to fail. One would be to break up large financial firms, so that no single firm could be said to be too big to fail. This might be accomplished by imposing line of business restrictions, as under the Glass Steagall Act, with companies limited to one line of business, such as commercial banking, investment banking, brokerage, or insurance. Dodd-Frank's so-called Volker rule[5], which limits the ability of banks to engage in proprietary trading, is a limited version of this strategy. Or Congress could impose limits on the maximum assets of financial firms, with mandatory divestiture once the limit is reached. Downsizing presumably would reduce the risk of single rogue institution bringing the entire financial system down when risky bets turn bad.

Another structural solution would be to impose limits on the debt financial firms can take on, as by increasing capital reserve requirements or (in the case of nonbank firms) imposing them for the first time.[6] The higher the capital reserve requirements are, the lower the risk of insolvency, and hence the lower the need for future bailouts. Higher reserve requirements would of course reduce the profitability of the financial sector, which would presumably re-direct assets (and talent) to other sectors. From a social welfare perspective, the tradeoff might be worthwhile – lower profitability for financial firms in return for lower risk of future financial crises that afflict pain on millions of ordinary Americans.

A third structural solution, which has been advanced by bankruptcy scholars,[7] would be to amend the Bankruptcy Code to subject novel financial instruments like repurchase agreements (repos) and derivatives or swaps to the automatic stay and avoidance provisions of the Bankruptcy Code. Interestingly, the law had moved in exactly opposite direction before the financial crisis, with special legislation (pushed by the financial industry) exempting these novel

113th Congress (2013-2014) (Senate - March 22, 2013) (the unanimously approved amendment to the Democrats' doomed 2014 budget proposal, attempts to minimize the advantage that Dodd Frank otherwise bestows on big banks by eliminating subsidies or other funding advantages for Wall Street mega-banks with more than $500 billion in assets).

[5] See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No.111–203, § 619, 24 Stat. 1376 (2010) (Dodd-Frank Act).

[6] The Basel Accords that regulate international commercial banks adopt this strategy. Under the recent Basel III Accords, , effective as of 2015, common equity that banks must keep on hand will increase from 2% to 4.5% of risk-weighted assets, and the so-called "Tier 1 ratio" will increase from 4% to 6%. As of 2019, banks will be required to add a further conservation buffer of 2.5% to both of these metrics. *See* Patrick Slovik & Boris Cournède, *Macroeconomic Impact of Basel III,* OECD Economics Department Working Papers, No. 844, OECD Publishing (2011) at *http://dx.doi.org/10.1787/5kghwnhkkjs8-en*.

[7] David A. Skeel & Thomas H. Jackson, Transaction Consistency and the New Finance in Bankruptcy, 112 Colum. L. Rev. 152 (2012); see also KENNETH E. SCOTT AND JOHN B. TAYLOR, BANKRUPTCY NOT BAILOUT: A SPECIAL CHAPTER 14 (2012) (urging the adoption of a new chapter of the Bankruptcy Code to deal with systemically significant financial firms).

instruments from resolution in bankruptcy.[8] Without the shield of the bankruptcy process, the logical response of counterparties to these instruments when they sense a financial firm is in distress is to race to cash out – exactly the kind of free-for-all that bankruptcy is designed to prevent. It is thus plausible that the special exemption from bankruptcy adopted for repos and swaps contributed if it did not cause Lehman's collapse and the panic that followed.[9] Subjecting these instruments to ordinary bankruptcy powers might solve the too big to fail problem, at least insofar as nonbank financial firms are concerned.

These structural solutions – any one of which could be implemented with a relatively simple piece of legislation – were rejected not because they are bad ideas but because they were adamantly opposed by the financial industry. Clearly, financial firms did not want to be downsized or de-leveraged. It is less clear why the financial industry opposed reforming the Bankruptcy Code to subject novel financial instruments to the automatic stay and avoidance provisions. But the conventional wisdom in the industry is that this would unduly interfere with the operation of the markets in which these instruments are bought and sold.[10] In any event, because each of these solutions faced concerned opposition from big finance, they were never seriously considered by the Treasury Department – which provided the initial draft legislation that became the Dodd Frank Act – or the Congress that adopted it. Firms that are too big to fail are too big to be challenged politically.

Given that these relatively straightforward structural solutions were off the table, how could the politicians square the circle between preventing future taxpayer bailouts of large financial firms while leaving the prerogatives of these firms essentially untouched? The answer is complicated, as revealed at once by looking at the immense length of the Dodd-Frank Act. Some of the measures in the Act are designed to improve the regulation of derivatives and other complex financial instruments thought to have been inadequately regulated before the financial crisis.[11] Others are designed to insure better advance warning of systemic financial risks.[12] Still others are designed to beef up consumer information and protection against overly-aggressive

[8] See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) (Pub.L. 109-8, 119 Stat. 23) at 11 U.S.C. §§ 362(b)(6), (7), (17); 546 (e)-(g); 555; 559; 560; also see Federal Deposit Insurance Reform Act of 2005 (Title II, subtitle B of Pub.L. 109-171, 110 Stat. 9), enacted February 8, 2006, with a companion statute, Federal Deposit Insurance Reform Conforming Amendments Act of 2005, Pub.L. 109-173, 119 Stat. 3601, enacted February 15, 2006).

[9] Skeel and Jackson, *supra* note 7, at 164-5.

[10] *Id.* at 159-162.

[11] *See* DFA, Title VII, §§ 701 -774, (the Wall Street Transparency and Accountability Act of 2010) and Title VIII, §§801-814 (Payment, Clearing, and Settlement Supervision)

[12] *See* DFA, Title I, Subtitle A, §§ 111 – 123 (Financial Stability Oversight Council)

lending and other banking practices.[13] But the fundamental decision not to tinker with the size or profitability of large financial firms, or to subject novel financial instruments to ordinary bankruptcy processes, created challenging design issues in achieving the fundamental objective of eliminating future taxpayer-funded bailouts of financially distressed firms.

The core of the legislative strategy, which is set forth in Title II of Dodd- Frank, is to replace taxpayer bailouts of systemically significant distressed firms with a kind of specialized bankruptcy process, which the Act labels "orderly liquidation." This specialized bankruptcy regime applies uniquely to bank holding companies and other systemically significant nonbank financial firms.[14] (Ordinary banks and savings and loans that take government-insured deposits were already subject to the resolution by receivership or conservatorship, and this authority includes provisions allowing the receiver to take systemic financial risk into account in certain circumstances.[15]) Under this new resolution authority, government agencies are given broad discretion to decide on a case-by-case basis that a large nonbank financial firm is in trouble and that its failure would pose a threat to the economy. This decision leads to a takeover of the firm by a government receiver, typically the Federal Deposit Insurance Corporation (FDIC),[16] which proceeds to run the company as it resolves claims of creditors until the firm is eventually liquidated. Positive-value assets can be transferred to a "bridge financial company" and eventually folded into another firm.[17] If financing is required to meet obligations while the firm

[13] *See* DFA, Title X, §§ 1001 – 1100H (Bureau of Consumer Financial Protection)

[14] There are four categories of financial companies that may be subject to the Title II Liquidation Authority under the DFA. The first category is bank holding companies. *See* DFA, Title II, §203(a)(1)(A), §201(a)(11)(i) and Title I, §102(a)(1). The second category is nonbank financial companies or more specifically companies with at least 85% of their gross revenue or consolidated assets derived from activities that are financial in nature or incidental to financial activity, including the ownership or control of one or more insured depository institutions. *See* DFA, Title II, §203(a)(1)(A), §201(a)(11)(ii)&(iii) and Title I, § 102(a)(4). The third category includes subsidiaries of the financial companies identified in first two categories, except for those subsidiaries that otherwise qualify as insured depository institutions or insurance companies. *See* DFA, Title II, §203(a)(1)(A) & §201(a)(11)(iv). The fourth category includes entities that qualify as brokers and dealers and are accordingly registered with the SEC and members of the SIPC. *See* DFA, Title II, §203(a)(1)(B)&(C) § 201(a)(7).

[15] The FDIC is charged with administering the resolution of failed or capital-deficient government-insured depositary institutions. The payment of deposits and other creditor claims by the FDIC is generally governed by the "least cost resolution rule". *See* 12 U.S.C. § 1823(a)(4)(A). Under certain circumstances, however, the FDIC is allowed to diverge from the priority scheme established by the least cost resolution rule. Specifically, if adherence to the rule would have serious adverse effects on financial stability, the FDIC is allowed to disregard least cost resolution rule and take alternative action in the name of mitigating these adverse effects, including making selective payments to non-depository creditors. *See* 12 U.S.C. § 1823(c)(4)(G).

[16] The Securities Investor Protection Corporation (SIPC) serves as a trustee under a receivership for covered brokers and dealers. DFA § 205.

[17] *See* DFA, Title II, §210(a)(1)(F) and §210(h). Specifically any bridge financial company can be used to assume the liabilities, purchase assets as well as perform any other temporary function which the FDIC is authorized to undertake in § 210(h). *Id.* at § 210(h)(B)(i),(ii)&(iii).

is wound down, the necessary funds will be supplied by the Treasury.[18] The Act nevertheless insists that this funding is not a bailout, because any deficiencies will be financed by wiping out shareholder equity, rejecting claims of unsecured creditors,[19] and, if need be, by imposing special ex post "assessments" on other large financial firms.[20]

In addition to its perceived unfairness, a policy of bailing out firms that are deemed too-big-to-fail is objectionable on the ground that it promotes excessive risk taking. When such a firm makes risky bets that pay off, the gains are captured by top level management and shareholders; but when the firm makes risky bets turn disastrous, the losses are borne by taxpayers. [21] This asymmetry creates a moral hazard of the heads-I-win-tails-you-lose variety. If permanently institutionalized, would likely give rise to too much risk taking by large financial firms.

Title II is supposed to put an end to this moral hazard.[22] The statute includes a number of punitive features designed to deter systemically significant financial firms from engaging in excessively risky behavior.[23] A distressed firm that goes through the Title II process must be "liquidated," its shareholders must be wiped out before creditors take a hit, its directors must be fired, and its officers who were "responsible" for the financial distress must be dismissed.[24] These provisions are designed to assure that the public will not immediately see a firm with the same name, and the same personnel, raking in millions shortly after the resolution process is over.

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[18] *Id.* at §204(d) and §210(n)

[19] *Id.* at §204(a)(1)&(2). The FDIC, along with other applicable enforcement agencies, are also required to ensure "that all parties... having responsibility for the condition of the [failed] financial company bear losses consistent with their responsibility, including actions for damages, restitution, and recoupment of compensation and other gains not compatible with such responsibility." *Id.* at § 204(a)(3).

[20] *Id.* at §210(o); Conference Report on H.R. 4173 the Dodd-Frank Wall Street Reform and Consumer Protection Act, H. Rpt. 111-517, 11th Cong. 2d Sess. (2010) at 865-66.

[21] The problem is compounded by the fact that creditors of firms deemed too big to fail have little incentive to monitor the firm's behavior or to care whether the firm has a reputation for making prudent and sound and investment decisions. *See* Gary H. Stern and Ron J. Feldman, *Too Big To Fail: The Hazards of Bank Bailouts*, Brookings Institution Press, Washington, D.C., p. 17-19 (2004).

[22] The statute states that its basic purpose is "to provide the necessary authority to liquidate failing financial companies that pose a significant risk to the financial stability of the United States in a manner that mitigates such risk and minimizes moral hazard." DFA, § 204(a).

[23] The FDIC must remove the management and board of directors of any covered financial company it decides to unwind pursuant to Title II. *Id.* at § 206(4)&(5). It must also ensure that shareholders of the covered financial company do not receive payment until all other claims as well as the orderly liquidation fund (if such is in fact established) are paid in full. *Id.* at § 206(2).

[24] *Id.* at § 206(4)&(5).

Nevertheless, Title II's orderly resolution process preserves a version of taxpayer-funded socialization of losses. This is because the Treasury is authorized to advance funding to a firm undergoing resolution under Title II, and if, after wiping out shareholders and unsecured creditors, the proceeds obtained from selling the firm's assets are inadequate to reimburse the Treasury, the statute authorizes the Treasury to impose so-called "risk-based assessments" on other large financial firms in order to recoup these monies.[25] These assessments are a tax by any other name. Whether the incidence of this tax will be borne by the shareholders of the assessed financial firms or the public in the form of higher fees for financial services is impossible to determine; almost certainly some of both.[26] In any event, under Dodd-Frank Title II losses created by excessive risk-taking will be borne at least in part by ordinary taxpayers and citizens, as under the regime of bailouts now so widely condemned.

No one seems happy with the complicated compromise embodied in Title II. Small financial firms are aggrieved by the provisions that continue to provide an implicit subsidy for large financial firms, in the form of the socialization of losses in the event they fail. They argue that this implicit subsidy lowers the costs of borrowing to large firms relative to small firms, giving them an unwarranted competitive advantage.[27] Managers and investors of big financial firms are aggrieved by possibility that they will be wiped out if and when they get into trouble sometime in the future. Certainly those who wanted fundamental reform of the financial industry are dissatisfied with the statute's preservation of the essential attributes of the status quo.

[25] DFA, § 210(n)(9).

[26] Tax incidence analysis reflects the well established idea that the entity or individual legally obligated to pay a tax often does not bear the full economic burden of the tax. This is especially true in situations where the taxpayer is able to pass the cost of the tax on to third parties through increased market prices. *See* Jacob Nussim, *The Recovery of Unlawful Taxes*, 28 Va. Tax Rev. 893, 901-902 (2009). A logical extension of this analysis is that the more monopoly power any taxpayer-entity has the more the taxpayer is able to shift the costs of any taxes assessed against it. In the case of any financial institution deemed too big to fail, their market power would suggest that at least some of the costs would be shifted to others.

[27] More recent studies have suggested that this advantage is indeed significant. *See* Kenichi Ueda and Beatrice Weder di Mauro, *Quantifying Structural Subsidy Values for Systemically Important Financial Institutions*, IMF Working Paper (May 2012) available at http://www.imf.org/external/pubs/ft/wp/2012/wp12128.pdf (finding that the subsidy to systemically important financial institutions created by the implicit expectation of state funded bailouts and otherwise embedded in these institution's credit ratings is as much as 80 basis points). "Small as it might sound, 0.8 percentage point makes a big difference. Multiplied by the total liabilities of the 10 largest U.S. banks by assets, it amounts to a taxpayer subsidy of $83 billion a year. To put the figure in perspective, it's tantamount to the government giving the banks about 3 cents of every tax dollar collected." *Why Should Taxpayers Give Big Banks $83 Billion a Year?,* Bloomberg (Feb 20, 2013) available at http://www.bloomberg.com/news/2013-02-20/why-should-taxpayers-give-big-banks-83-billion-a-year-.html.

In keeping with Tocqueville's famous adage that "[s]carcely any political question arises in the United States that is not resolved, sooner or later, into a judicial question,"[28] Dodd-Frank's orderly liquidation authority is now the subject of a lawsuit. Eleven state attorneys general have filed suit in the U.S. District Court for the District of Columbia charging that Title II violates due process, Article III of the Constitution, and the uniformity requirement of the Bankruptcy Clause.[29] On the merits, the contentions are surprisingly strong. Most of the constitutional infirmities in Title II stem from a decision to have the receiver for a systemically significant nonbank financial firm appointed by a federal district judge. In order to confer appointment authority on a federal judge, and yet also prevent the modern-day equivalent of a run on the bank, the statute prescribes a clandestine process in which the district judge is given 24 hours to rule on a petition to appoint a receiver; it prohibits the court from giving notice of the proceedings to creditors or other interested third parties; and it imposes criminal penalties on anyone who publicly discloses the pendency of the proceedings. Moreover, the hapless district judge is entitled to consider only two factual issues under a highly deferential standard of review in deciding whether to order the liquidation of a major financial firm, and is given only 24 hours to do so make the decision, otherwise the petition is deemed automatically granted. For good measure, the statute proscribes any stay pending appeal. In effect, the statute seeks to draw on the prestige of the federal courts in making the appointment of a receiver, while depriving parties with a vital stake in the matter of any notice or meaningful opportunity to be heard, and handcuffing the court from acting in a way that is consistent with judicial authority.

The statute also creates a specialized form of bankruptcy that gives the executive branch of the federal government broad discretion to subject some nonbank financial firms to this special insolvency regime leading to liquidation, while others go through ordinary bankruptcy, which includes the possibility of reorganization. Allowing the executive to pick and choose different resolution regimes for firms in the same industry based on necessarily subjective determinations of the impact of insolvency on "financial stability in the United States"[30] at least arguably violates the uniformity requirement of the Bankruptcy Clause.[31] And within the new regime of orderly liquidation, the statute gives a federal agency – typically the FDIC -- broad discretion to depart from the principle that all creditors of the same class should be treated

[28] Alexis de Tocqueville, DEMOCRACY IN AMERICA, 280 (Philips Bradley ed. 1980 (1835).

[29] State National Bank of Big Spring v. Wolin, United States District Court for the District of Columbia, No. 1:12-cv-01032 (as amended Feb. 19, 2013) (hereafter "*Big Spring 2nd Amended Complaint*"). The eleven states are Alabama, Georgia, Kansas, Michigan, Montana, Nebraska, Ohio, Oklahoma, South Carolina, Texas and West Virginia.

[30] DFA § 203(b)(3)

[31] The Constitution authorizes Congress to establish "*uniform* Laws on the subject of Bankruptcies throughout the United States." U.S. Const. art I, § 8, cl. 4 (emphasis added).

equally.[32] This too arguably contradicts violates received understandings of uniformity in the bankruptcy context.

These constitutional infirmities could easily have been avoided. Ordinary bank receiverships are commenced by an executive appointment of a receiver, followed by a right of plenary judicial review – a process that allows all affected interest holders to challenge the appointment of a receiver after-the-fact, and permits the reviewing court to function in an appropriate judicial manner. This kind of ex post judicial review is undoubtedly constitutional in the context of a statutory regime designed to prevent a financial crisis. In fact, the Administration's proposed legislation, and the House bill, called for a process for appointing a receiver closely modeled on the bank receivership model. For unexplained reasons, however, the Senate rejected this model, and substituted the provisions that ended up in the legislation, calling for judicial appointment of a receiver coupled with draconian limitations on the authority of the court that render the judicial process virtually meaningless. Thus, the constitutional infirmities associated Title II's provisions for appointment of a receiver could fixed simply by amending the statute to incorporate the House provisions on appointment, rather than the substitute insisted upon by the Senate.

Whether the arguable violations of the uniformity requirement of the Bankruptcy Clause could be fixed is harder to say. The central objective of Title II is to give the government a new tool to avoid bailouts or government takeovers of troubled financial firms. Whether such authority can be cabined by predictable rules laid down in advance is debatable. However, the loosely-written provision allowing the FDIC to depart from equal treatment of similarly-situated creditors[33] could almost certainly have been drafted more narrowly. Of course, in today's legislative environment, obtaining these kinds of legislative fixes is may be impossible. Which means the issues may have to be confronted by a court.

We begin by examining the two statutory models for initiating resolution authority that served as a backdrop to the Dodd-Frank Act – bank receivership law and bankruptcy – and summarize the ways in which Dodd-Franks' Title II deviates from both models. We then consider various legal avenues for raising a constitutional challenge to Title II, each of which is problematic. Part III analyzes the due process and Article III objections to Title II in greater detail, including possible strategies for avoiding these difficulties. Part IV turns to the potential constitutional issues under the Bankruptcy Clause and the First Amendment. Part V lists some

[32] DFA § 210(b((4). Departures from equal treatment are authorized if the FDIC determines that this "is necessary" to maximize the value of the liquidated company's assets, continue essential operations, maximize the value of the sale of assets, or minimize losses on the sale of assets. Id. There is no provision for judicial review of such a determination.

[33] DFA § 210(b(4)).

possible takings issues, and provides an analysis of how impairment of security interests might be analyzed under the Takings Clause. A brief conclusion follows.

I. Title II's Orderly Liquidation Authority

Title II of the Dodd-Frank Act sets forth a new "Orderly Liquidation Authority" (OLA) designed to serve as a substitute for future government bailouts of financial firms deemed too big to fail, in the sense that resolution of their affairs under ordinary bankruptcy law or other insolvency laws would threaten the stability of the financial markets. Lehman Brothers is the obvious object lesson here.[34] To avoid financial panic or various contagions analogous to a run-on-the-bank, the statute assumes that the resolution of these systemically-significant firms must occur rapidly and without any advance public notice. Thus, the process of appointing a receiver must occur "on a strictly confidential basis" without any public disclosure.[35] The Administration proposal and the House bill sought to achieve expedition and confidentiality by having the Secretary of the Treasury appoint a receiver, subject to ex post judicial review. The Senate decided at the last minute that the receiver should be appointed by a judge. In order to preserve speed and confidentiality, however, the Senate bill, which was the version enacted, prohibits public disclosure of the judicial proceeding and gives the court designated to appoint the receiver only 24 hours in which to rule.[36] This clandestine process deprives stakeholders of any notice of a process that must lead to liquidation of a major financial firm. And the extremely short deadline renders judicial oversight essentially meaningless, given the complexity of the matters involved. The Senate substitute is a classic example of an unforced legislative error, for it renders the statute vulnerable to constitutional challenge on due process, Article III, and First Amendment grounds.

[34] *See Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation*, White Paper issued by the U.S. Department of the Treasury (June 17, 2009) available at http://www.hm-treasury.gov.uk/d/reforming_financial_markets080709.pdf. ("Treasury White Paper" hereafter) ("The federal government's responses to the impending bankruptcy of Bear Stearns, Lehman Brothers, and AIG were complicated by the lack of a statutory framework for avoiding the disorderly failure of nonbank financial firms, including affiliates of banks or other insured depository institutions. In the absence of such a framework, the government's only avenue to avoid the disorderly failures of Bear Stearns and AIG was the use of the Federal Reserve's lending authority. And this mechanism was insufficient to prevent the bankruptcy of Lehman Brothers, an event which served to demonstrate how disruptive the disorderly failure of a nonbank financial firm can be to the financial system and the economy.")

[35] DFA, § 202(a)(1)(A)(iii).

[36] "If the Court does not make a determination within 24 hours of receipt of the petition – (I) the petition shall be granted by operation of law; (II) the Secretary shall appoint the Corporation as receiver; and (III) liquidation under this title shall automatically and without further notice or action be commenced and the Corporation may immediately take all actions authorized under this title." *Id.* at § 202(a)(1)(A)(v).

The OLA process may never be used. It may remain the proverbial musket in the closet that the government holds in reserve while arranging workouts with creditors or sales or mergers of the troubled firm in lieu of "orderly liquidation."[37] If used, the OLA process may not be contested. The statute specifically invites the directors of a troubled financial firm to consent to OLA, and dangles a carrot in front of directors in the form of promised immunity from any action by shareholders or creditors for "acquiescing in or consenting in good faith to the appointment of the Corporation as receiver."[38] It would take an intrepid director to do battle with the Executive Branch over the fate of a financially troubled firm, knowing that any diminution in financial value attributable to delay could be challenged in future litigation by disgruntled creditors and shareholders, whereas capitulation to the government will result in immunity.

In any event, whether the OLA authority is used or merely threatened, the credibility of the government to use the new procedure will depend importantly on whether the relevant actors perceive this authority to be constitutional. As we shall see, there are several features of Title II that give rise to serious questions on this score.

The basic model for the OLA process is existing law providing for administrative receiverships of FDIC-insured banks. Dodd-Frank takes this bank receivership law and adds to it a number of provisions borrowed from the Bankruptcy Code, which is essentially a judicially-supervised resolution process. As a result, the OLA is an administrative rather than a judicial resolution process, but one that hews more closely to the substantive law of bankruptcy than it does to the substantive law that governs bank receiverships. Many of the constitutional issues raised by Title II stem from the unique provisions that govern the appointment of a receiver under the OLA. These provisions do not follow the template of either bank receivership law or bankruptcy law. Rather, they were adopted by the Senate during the final days of intense negotiation in the Senate over what became the final form of law. Accordingly, we begin with a brief review of the benchmarks established by bank receivership and bankruptcy law, and trace the evolution of the provisions prescribing how an OLA is commenced in the legislative history of Dodd-Frank.

A. Bank Receiverships and Bankruptcy

By way of background, it will be helpful to say a few words about two existing forms of resolution authority – bank receiverships and bankruptcy – and in particular how they are commenced and the extent to which judicial review is available under each form.

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[37] David Skeel, The New Financial Deal: Understanding the Dodd-Frank Act and Its (Unintended) Consequences 139-40 (2011).

[38] DFA, § 207.

Under current practice, banks that become financially distressed are nearly always put into a receivership in which the Federal Deposit Insurance Corporation (FDIC) acts as receiver exercising powers under federal law.[39] It is theoretically possible for state-chartered banks to have a state-appointed receiver, but the FDIC can take over a state receivership if the bank has FDIC-insured deposits, which virtually all banks do.[40] The statutes require either that the FDIC be appointed as receiver by the relevant bank supervising agency (such as the Office of the Comptroller of the Currency in the case of a federally-chartered bank)[41] or that the FDIC appoint itself as receiver if the assets of the federal deposit insurance fund are at risk.[42] Once the FDIC assumes control of the bank as receiver, the bank has a short period of time (typically 30 days) in which to commence an action in federal district court seeking an order dissolving the receivership.[43] The statutes authorizing this form of review include no limits on the issues the court may consider or the time the court may take in rendering a decision. Further, they appear to contemplate that the issues will be resolved on a record made by the court, since there will be no administrative record in the ordinary meaning of the term for the court to review. In other words, judicial review occurs after the receivership is commenced and is de novo as to both fact and law.[44]

What actually happens in a bank receivership, according to recent descriptive accounts, is roughly as follows.[45] The appropriate bank regulatory authority (state or federal) sends the FDIC

[39] Conservatorships are also authorized by law, but are rarely used. The basic difference is that under a receivership the bank's charter is revoked and its assets and liabilities are transferred to other banks or auctioned off; under a conservatorship the conservator takes control of the bank and reorganizes it so that it can resume operations under its existing charter.

[40] See 12 U.S.C. § 1821(c)(4), (5).

[41] See 12 U.S.C. § 1821(c)(2)(i) ("The Corporation may, at the discretion of the supervisory authority, be appointed conservator of any insured Federal depository institution and the Corporation may accept such appointment.")

[42] See 12 U.S.C. § 1821(c)(4) ("Notwithstanding any other provision of Federal law, the law of any State, or the constitution of any State, the Corporation may appoint itself as sole conservator or receiver of any insured State depository institution if..." certain findings (described in 12 U.S.C § 1821(c)(4)(A)&(B)) are made by FDIC in regards to the financial insufficiency of the insured State depository institution at issue.)

[43] 12 U.S.C. § 1821(c)(7). For any national bank the decision to appoint a receiver is to be determined by the OCC at the discretion of the Comptroller. 12 U.S.C. § 191. The OCC's decision to appoint a receiver is generally not subject to judicial review. United States v. Morgenthau, 85 F. 2d 811 (D.C. Circuit 1936), *cert. denied,* 299 U.S. 605 (1935). In addition to the grounds specified 12 U.S.C § 1821, the OCC may also appoint a receiver upon its conclusion that the bank's board of directors consists of less than five members. 12 U.S.C. § 191(2).
[44] *See* 12 U.S.C. § 1821(d)(13)(C) and (d)(13)(D).

[45] The following summary is drawn from Stanley V. Ragalevsky & Sarah J. Ricardi, Anatomy of a Bank Failure, 126 Banking L. J. 867 (2009); John L. Douglas and Randall D. Guynn, Resolution of US Banks and Other Financial Institutions 311-77, in Debt Restructuring (Rodrigo Olivares-Caminal et al eds., Oxford U. Press 2011); Federal Deposit Insurance Corporation, The Resolution Handbook (2003). See also David A. Skeel, Jr., The Law and Finance of Bank and Insurance Insolvency Regulation, 76 Tex. L. Rev. 723, 727-31 (1998).

a "failing bank letter," or the FDIC determines based on its own information that a bank is in distress. The FDIC then sends a "planning team" to the distressed bank to make a confidential assessment of its assets and liabilities. Based on this information, the FDIC develops an appropriate resolution strategy, most commonly a sale to another bank.[46] The FDIC puts together an information package about the bank, which is communicated to a list of potential bidders identified by the FDIC staff. These bidders sign confidentiality agreements and, if they wish, submit bids for the bank or its assets on a secure extranet site. FDIC officials evaluate the bids and recommend the least cost resolution to the FDIC Board. If the Board approves, the FDIC is officially appointed receiver. The appointment typically occurs on a Friday afternoon. Over the weekend, the bank is secured, its books are seized, the locks are changed, and signage is modified; the new bank opens for business on Monday morning.[47] Subsequently, creditors of the failed bank submit claims to the FDIC, which the agency resolves, giving priority to secured creditors and depositors.[48] Any creditor dissatisfied with the FDIC's resolution of its claim can bring an action in federal court seeking review of the agency's determination.[49] Such actions are occasionally brought, but they are rarely successful.[50]

Although judicial review of the decision to commence a receivership is expressly authorized by statute, banks rarely invoke this authority.[51] Indeed, the possibility of judicial review is so remote it is not even mentioned in recent descriptive accounts of bank receiverships. There are powerful practical reasons why banks would not seek ex post judicial review of the appointment of a receiver.[52] Once a receivership has commenced, courts are highly unlikely to

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[46] The disposition of a failing bank in this manner is often referred to as a purchase and assumption transaction ("P&A"), because the healthy bank selected by the FDIC agrees to purchases some portion of the failed bank's assets as well as assume some portion of the failed bank's deposit and other liabilities. *See* Ragalevsky & Ricardi *supra* at 877. P&A transactions made up 34 of the 40 resolutions that were carried out by FDIC from January 2000 through August 2008. *Id. See also* Skeel supra note 37 at 122 (noting that P&A transactions are used 54% of bank failures).

[47] *See* Ragalevasky & Ricardi *supra* note 45 at 885.

[48] See 12 U.S.C. § 1815(e)(2)(C)(ii).

[49] *Id.* at § 1815(e)(3) and § 1821(d)(6).

[50] *See* C. F. Muckenfuss III & Robert C. Eager, *Overview of the FDIC as Conservator or Receiver*, Gibson, Dunn & Crutcher LLP Publication, 6 (2008) available at http://blogs.law.harvard.edu/corpgov/files/2008/10/092608-overview-fdicasconvervator-receiver.pdf (noting that cases reviewing FDIC actions as receiver have largely upheld the FDIC's approach to the conservatorship or receivorship). *See also* Skeel supra note 37 at 123, n.8.

[51] For examples of post-seizure review, see James Madison Limited v. Ludwig, 82 F.3d 1085 (D.C. Cir. 1996); Haralson v. Federal Home Loan Bank Board, 837 F.2d 1123 (D. C. Cir. 1988); McMillian v. F.D.I.C. 81 F.3d 1041 (11th Cir. 1996); Citibank (S.D.), N.A. v. FDIC, 857 F.Supp. 976, 983 (D.D.C. 1993); DPJ Co. Ltd. v. FDIC, 30 F. 3d 247, 250 (1st Cir. 1994); Nashville Lodging Co. v. FDIC, 934 F.Supp. 449 (D.D.C. 1996); FDIC v. Parkway Executive Office Ctr., 1998 WL 18204 (E.D.Pa.).

[52] *See* Skeel supra note 37 at 139.

unwind it. This would create a messy problem of how to reverse transfers of deposits and assets that have already taken place. It is also unclear what if anything a bank would stand to gain by securing a judicial order overturning a receivership. The suit would generate publicity about the regulators' negative assessment of bank's financial condition, causing depositors to flee and potential borrowers to look elsewhere for loans. If the bank was not truly insolvent when the receivership commenced, it probably would be by the time the court set it aside. Nevertheless, even if judicial review is rarely sought, this does not mean it is meaningless. The very existence of the right to seek judicial review undoubtedly helps assure that the power to seize banks will not be abused for illegitimate ends.

The major points to note about bank receivership are, first, the process is almost entirely administrative. The FDIC runs the show from beginning to end. As noted, banks rarely mount a judicial challenge a decision to appoint the FDIC as receiver, and courts play only a minor and episodic role in reviewing the FDIC's resolution of claims once the receivership is underway. Second, the process proceeds in secret until the moment the FDIC seizes control of the bank. Bank regulators and the FDIC make no public announcement that a receivership is being contemplated and they conduct no public hearings before the seizure is announced. Bank officers and directors will know that a receivership is imminent, but it is not in their interest to disclose this. Potential bidders for bank assets are subject to confidentiality agreements and communicate with the FDIC over a secure extranet. This secrecy is justified in the name of avoiding public alarm and a run on deposits and the overriding purpose of minimizing government losses on deposit insurance.

Bankruptcy is very different. It is essentially a judicial process. Federal district courts have original and exclusive jurisdiction over all bankruptcy cases governed by Title 11 of the U.S. Code.[53] District courts routinely refer bankruptcy filings to bankruptcy judges, who are considered "Article I" judges rather than Article III judges.[54] But bankruptcy judges enjoy significant independence and resolve contested matters in the manner of courts, with adversarial public hearings featuring sworn witnesses, briefs, and written opinions. Moreover, bankruptcy courts are regarded as "adjuncts" to district courts, and district courts have the power to withdraw the reference of cases or proceedings from bankruptcy judges, in whole or in part, for good cause.[55] So-called "core" matters that arise under federal bankruptcy law can be decided

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[53] See 28 U.S.C. § 1334(a)

[54] The majority of district courts have standing reference orders in place that automatically refer all bankruptcy matters to the bankruptcy court. See 28 U.S.C. § 157(a). Should it want to intervene in any particular bankruptcy case, a district court can withdraw the reference order and take the matter away from the bankruptcy court. See 28 U.S.C. § 157(d).

[55] See 28 U.S.C. § 157(d). See generally Stern v. Marshall, 131 S.Ct. 2594, 2603-04 (2011) (summarizing the division of authority between district courts and bankruptcy courts under the bankruptcy code).

by bankruptcy judges, subject to review by district courts under an appellate review standard.[56] So-called "non-core" matters that arise under non-bankruptcy law (such as contract and tort law) are subject to de novo review by district courts.[57] Creditors are routinely given actual notice of contested matters in bankruptcy proceedings, and they will be heard, either individually or through creditor committees, before decisions materially affecting their interests are made.

In short, bankruptcy is a predominately judicial form of debt resolution. Bankruptcy judges operate much like other judges, federal district courts retain control over key decisions, and appellate review is available to challenge virtually any judgment reached. Bankruptcy is also an open process. Negotiations of course occur among different classes of creditors behind the scenes. But all affected parties are entitled to notice and to participate in formal decisions.

B. Legislative History of Dodd-Frank's OLA

The process of commencing an OLA proceeding under Title II of Dodd-Frank does not fully conform to either the banking model or the bankruptcy model. The initial draft of what became Title II was contained in the Obama Administration's proposed legislation released on July 22, 2009.[58] Title XII of this draft, entitled "Enhanced Resolution Authority," was largely drawn from existing banking legislation authorizing FDIC receiverships. In keeping with the banking model, the Administration draft provided that a receiver would be appointed administratively, in this case by the Secretary of the Treasury.[59] The draft provided for a system of elaborate administrative checks before such an appointment could be made. The Secretary had to receive the "recommendation" of the Federal Reserve Board and the Board of the FDIC by a two-thirds vote, and the Secretary had to make certain prescribed findings.[60] This was the origin of the so-called "three keys turning" required to unlock the orderly resolution process.[61]

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[56] 28 U.S.C. § 158(a).

[57] 28 U.S.C. § 157(c).

[58] Administration's Combined Draft Legislation for Financial Regulatory Reform,, Division D – Improvements for Financial Crisis Management, Title XII – Enhanced Resolution Authority ("Resolution Authority for Large, Interconnected Financial Companies Act of 2009"), 584-673 (July 22, 2009) at http://www.llsdc.org/attachments/files/252/Dodd-Frank-Act_Admn-Reg-Reform-Bill.pdf (hereafter "Administration's Combined Draft").

[59] *Id.* at § 1203(b) and § 1204(b).

[60] Administration's Combined Draft, § 1203.

[61] This 3 agency or "3-key" endorsement mechanism was previously utilized in the FDIC Improvement Act of 1991 (FDICIA). Specifically in order for the FDIC to diverge from the least cost resolution rule required under FDICIA, the Treasury must determine in consultation with the President, following a recommendation for such action by the FDIC and FED as sanctioned by a two-thirds vote of their respective boards, that such divergence is justified in order to mitigate adverse effects to the financial stability of the economy as a whole. *See* 12 U.S.C. § 1823(c)(4)(G).

The draft also followed banking law in authorizing the seized firm to file a judicial action within 30 days demanding that the receivership be set aside.[62] As under banking law, the Administration's draft language did not restrict the reviewing court in terms of the issues that it was allowed to consider in such a proceeding, nor did it put any time limit on that review. The Administration was undoubtedly aware that such a right of review is almost never exercised in the banking context. Consequently, although it would be of symbolic importance in assuring that the new resolution authority would not be abused, it would have little practical impact on the resolution process.

The House version of what became Dodd-Frank, H.R. 4173, largely tracked the Administration proposal.[63] The House bill followed the Administration draft in providing for administrative appointment of a receiver by the Secretary of the Treasury, and in prescribing the three keys turning before the Secretary could act.[64] Again following the Administration bill, the House provided for a 30-day period to seek judicial review after the receivership commenced.[65]

The Senate had somewhat different ideas. S. 3217, which was proposed by the Democratic leadership on April 15, 2010, followed the House bill in requiring three keys turning before a receiver could be appointed.[66] But it lodged the appointment authority not in the Secretary of the Treasury but in a special panel of three bankruptcy judges drawn from the Bankruptcy Court for the District of Delaware, acting on petition by the Secretary of Treasury.[67] The discretion of the bankruptcy panel was, however, tightly constrained. It could consider only a single issue before granting or denying appointment of a receiver: whether the Secretary's determination that the firm was in default or in danger of default was supported by "substantial evidence."[68]

The only explanation in the Senate Report for adding what might be regarded as a "fourth key turning" was that orderly liquidation of nonbank financial firms should be reserved for truly exceptional cases.[69] The Report stated that the threshold for triggering OLA should be "very

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[62] Administration's Combined Draft, § 1205.

[63] Wall Street Reform and Consumer Protection Act of 2010, H.R. 4173, 11th Cong., 1st Sess. §§ 1601 et seq. (2009).

[64] H.R. 4173, § 1603(a)(1).

[65] H.R. 4173, § 1605.

[66] S. 3217, U.S. Senate, 111th Cong., 2d Sess. (April 29, 2010), § 203.

[67] S. 3217, § 202.

[68] Id., § 202(b)(1)(iv).

[69] The Restoring Financial Stability Act of 2010, S. Rep. No. 111-176, 111th Cong., 2d Sess. (April 30, 2010) at 2.

high," hence, apparently, the rationale for adding "review and determination by a judicial panel,"[70] i.e., the panel of bankruptcy judges. One can speculate further about why a panel of bankruptcy judges was chosen for this role. Bankruptcy judges have expertise in recognizing when firms are in default or in danger of default, and they have a reputation for independence and objectivity. Thus, although not mentioned by the Report, the injection of the panel of bankruptcy judges into the appointment process was presumably thought to enhance the legitimacy of what was otherwise an executive branch determination to liquidate a major nonbank financial firm.

The introduction of this new threshold condition into the orderly liquidation process nevertheless posed a serious practical difficulty relative to the three keys approach advocated by the Administration and adopted in the House bill. The three keys – the Fed, the FDIC, and the Treasury – are all administrative actors, and are conditioned to act in secret, as when banking regulators and the FDIC move to declare a bank receivership. Thus, unless there is a leak, the administrative recommendations and determinations required by the three keys should not trigger a panic in financial markets or a contagion analogous to a run on the bank. Bankruptcy judges, in contrast, operate in an open fashion characteristic of traditional judicial processes. How could the substantial evidence review required of the panel of bankruptcy judges be brought into this process without jeopardizing the confidential nature of the receivership appointment process?

The answer contained in the Senate bill (although never discussed in the Senate report) was the imposition of series of extraordinary constraints on the panel of bankruptcy judges. The petition for appointment of a receiver would be filed under seal and the proceedings before the panel of bankruptcy judges held "[o]n a strictly confidential basis," with criminal penalties for disclosure.[71] Although the financial firm would be notified, creditors, counterparties, and other stakeholders would be kept in the dark. The panel would have to rule very quickly – within 24 hours of the filing of the petition.[72] The Senate bill did not address what happened if the panel failed to make their decision within the requisite 24 hour time period.[73] Once the petition was granted, there could be no stays pending appeal to the courts.[74]

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[70] Id.

[71] S. 3217, supra, §§ 202(b)(1)(A)(iii); 202(b)(1)(C).

[72] Id., § 202(b)(1)(iii). ("On a strictly confidential basis, and without any prior public disclosure, the Panel, after notice to the covered financial company and a hearing in which the covered financial company may oppose the petition, shall determine, within 24 hours of receipt of the petition filed by the Secretary, whether the determination of the Secretary that the covered financial company is in default or in danger of default is supported by substantial evidence.")

[73] Id., § 202(b)(1)(iv)(I)&(II).

[74] Id. § 202(b)(1)(B).

These provisions are jarring if we think of the panel of bankruptcy judges as a court. But the constitutional issues they present are diminished given the status of bankruptcy judges as "Article I" judges. For constitutional purposes, bankruptcy judges are little different than Administrative Law Judges in the Executive Branch.[75] Thus, the role of the panel of bankruptcy judges under the Senate bill was not significantly different from a hypothetical provision requiring a panel of ALJs in the Treasury Department to determine that there is substantial evidence a firm is in default or danger of default.[76] Moreover, the provisions precluding any stay of the panel's order pending appeal are not terribly different from the judicial review provisions under the banking law, which provide for judicial review only after a receivership has commenced.[77] Allowing an appeal without a stay is functionally similar to allowing an appeal only after a receivership has commenced.

There was, however, one important difference in the Senate bill's judicial review provisions. Under the Administration proposal and the House bill, there was no limitation on the legal or factual issues that could be presented to the court in challenging the appointment of a receiver after the receiver was appointed. Under the Senate bill, any appeal to the courts from the determination of the bankruptcy panel was to be limited to whether the Secretary's determination that the firm was in default or in danger of default was supported by substantial evidence. This is a far more restricted right of judicial review than that provided by the bank receivership laws, which put no limit on the issues a reviewing court can consider and appear to contemplate that the review will be de novo as to both fact and law. Of course, as we have seen, the right of judicial review is virtually never exercised in the bank receivership context. Still, a right of judicial review is an important safeguard, and limiting review to a single factual question under a deferential standard of review is a much weaker form of protection against executive abuse than that provided by the banking laws.

Less than a month after the Senate bill was released, Senator Dodd proposed "for himself and Mr. Shelby" – the senior Republican on the Senate Finance Committee who had filed a dissenting report to the Senate bill -- a series of amendments to the Senate bill.[78] The first of

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[75] See Northern Pipeline Construction Company v. Marathon Pipeline Company, 458 U.S. 50, 60-61 (1982) ("It is undisputed that the bankruptcy judges... do not enjoy the protections constitutionally afforded to Art. III judges. The bankruptcy judges do not serve for life subject to their continued 'good Behaviour., Rather, they are appointed for 14-year terms, and can be removed by the judicial council of the circuit in which they serve on grounds of 'incompetency, misconduct, neglect of duty, or physical or mental disability.' Second, the salaries of the bankruptcy judges are not immune from diminution by Congress... In short, there is no doubt that the bankruptcy judges created by the Act are not Art. III judges.")

[76] Such a provision, if not subject to review by the Secretary of the Treasury, might nevertheless give rise to objections under Article II.

[77] 18 U.S.C §1821(c)(7).

[78] Congressional Record 111th Cong., SA 3739 (May 5, 2010).

these amendments made a further critical change in the method of appointing a receiver to commence the orderly liquidation process. Rather than have a panel of bankruptcy judges appoint a receiver on petition by the Secretary of the Treasury, the amendment provided that the receiver was to be appointed by the United States District Court for the District of Columbia. Now, for the first time, the receiver was to be formally appointed by an Article III judge, not an executive branch agency or a panel of "Article I" judges. The modified Senate bill also changed the standard of review to be applied by the District Court from "substantial evidence" to "arbitrary and capricious," and added that the court was to consider whether the firm was a "financial firm" as well as whether it was in default or in danger of default.[79] No explanation was offered for the change. The amendment was adopted and incorporated into the final Senate version of the legislation, described as a substitute version of H.R. 4173.[80] This revised bill was approved by the Senate on May 27, 2010.[81]

The public record is silent as to who proposed that the receiver be appointed by an Article III judge or why they thought this was important. Circumstantial evidence suggests at least one Senator must have insisted on this unusual form of "ex ante review" as a condition of his or her vote. Senator Dodd, the Chairman of the Senate Finance Committee and the floor manager of the legislation in the Senate, needed sixty votes to avoid a filibuster.[82] In order to get to sixty, he had to count on several shaky Democratic votes plus at least two Republicans, including the newly-elected Senator from Massachusetts, Scott Brown.[83] When the divergent House and Senate bills went to the Conference Committee, the House conferees listed as one of the changes it wanted the elimination of the Senate's recently adopted provision for ex ante judicial review.[84] The Senate refused, without explanation.[85] The House then insisted on the change,[86] but the

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[79] Senate Substitute, § 202(a)(1)(A)(iii).

[80] Restoring American Financial Stability Act of 2010, Senate Substitute for H.R. 4173, 111th Cong. , 2nd Sess. (May 20, 2010).

[81] Congressional Record 111th Congress, S4560 (May 27, 2010).

[82] ROBERT KAISER, A CONGRESSIONAL ACT, (Alfred A. Knopf, ed. 2013)

[83] See Jia Lynn Yang, *Scott Brown's Key Vote Gives Massachusetts Firms Clout In Financial Overhaul*, WASH. POST (June 23, 2010).

[84] Wall Street Reform & Consumer Protection Act, conferee deliberations, Title II, House Proposed Offer to Title II (sent to Senate June 17, 2010) at
http://democrats.financialservices.house.gov/FinancialSvcsDemMedia/file/key_issues/Financial_Regulatory_Reform/TITLEII_OFFER.pdf

[85] Wall Street Reform & Consumer Protection Act, conferee deliberations, Senate Counter Offer: Title II, Orderly Liquidation Authority (sent to House on June 17, 2010) at
http://democrats.financialservices.house.gov/singlepages.aspx?NewsID=3&RBID=775.

Senate again refused to relent.[87] The House at that point capitulated. A plausible inference is that the Senate conferees could not have caved in on the provision for appointment authority without endangering the razor-thin margin needed for sixty votes to approve the legislation once it emerged from the Conference Committee. Accordingly, the Senate version, calling for appointment of the FDIC as receiver by an Article III court, was approved by the Conference Committee, adopted by both the House and Senate, and signed by the President.[88]

C. OLA As Enacted

The relevant provisions of Title II, as enacted, can be briefly summarized.

The internal administrative process that precedes the petition to the District Court for the District of Columbia for appointment of a receiver is described by the statute as a "systemic risk determination."[89] The Treasury must undertake an analysis to establish that the triggering conditions warranting orderly liquidation have been met. Specifically, the statute requires the Secretary to make seven affirmative findings before making a determination to seek a receivership:

1. The financial company must be in default or in danger of default.
2. The company satisfies the definition of a financial company.
3. The failure of the financial company would have serious adverse effects on financial stability in the United States.
4. No viable private sector alternative is available to prevent default.

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[86] Wall Street Reform & Consumer Protection Act, conferee deliberations, House Counter Offer: Title II, Orderly Liquidation Authority (sent to Senate on June 23, 2010) at http://democrats.financialservices.house.gov/FinancialSvcsDemMedia/file/key_issues/Financial_Regulatory_Reform/Conference_on_HR_4137/Title_II/Title_II_House_Counteroffer_6_23_2010.pdf.

[87] Wall Street Reform & Consumer Protection Act, conferee deliberations, Senate Counter-Counter Offer: Title II, Orderly Liquidation Authority (sent to House June 24, 2010) at http://democrats.financialservices.house.gov/FinancialSvcsDemMedia/file/key_issues/Financial_Regulatory_Reform/Conference_on_HR_4137/Title_II/Senate_Title_II_Counteroffer_Revised_6_24.pdf.

[88] See Wall Street Reform and Consumer Protection Act – Conference Report (July 15, 2010) at http://thomas.loc.gov/cgi-bin/query/C?r111:./temp/~r111AUEIkn; See also Administration of Barack H. Obama, 2010, *Remarks on Signing the Dodd-Frank Wall Street Reform and Consumer Protection Act* (July 21, 2010) at http://www.gpo.gov/fdsys/pkg/DCPD-201000617/pdf/DCPD-201000617.pdf.

[89] DFA, § 203.

5. Any effect of a receivership on creditors, counterparties, and shareholders would be "appropriate" given the benefits of a receivership in terms of preserving financial stability.

6. Establishing a receivership would avoid or mitigate the adverse effects on stakeholders relative to not undertaking such action.

7. The company has been ordered by regulators to convert all if its convertible debt instruments.[90]

The statute also adopts the three keys turning that initially appeared in the Administration's draft legislation. The Secretary must obtain the written recommendation by a two-thirds vote of the members of both the Federal Reserve Board and the FDIC before a petition is authorized.[91] The statute further provides that the Secretary must consult with the President before filing a petition.[92]

There is no indication in the statute that the covered firm has any right to participate in this administrative process. Conceivably the Treasury could provide by regulation for notice and an opportunity to be heard by affected private interests before any petition for appointment of a receiver is made, which would mitigate what otherwise would appear to be a deficiency of due process.[93] But the statute does not require this, the assumption of the need for secrecy would seem to preclude this, and there is no sign that such regulations are contemplated. The statute does state that the Secretary shall "notify the covered financial company" when he makes a determination to file a petition,[94] and there could be a gap between the Secretary's notification of the "determination" and the filing of the petition in court, which would give the financial company time to prepare for the court proceedings. But again, the statute does not require that the notification of the determination occur before the filing of the petition, and the concern for

[90] DFA, § 203(b).

[91] Different bodies must provide written recommendations if the covered financial firm is a broker/dealer or an insurance company.

[92] DFA, § 203(b).

[93] To date, the Treasury Department has not promulgated any regulations regarding how notice of its receivership determination must be provided to the failing financial company much less whether such notice must also be provided to affiliated parties with significant interests at stake. While the possibility of some future regulation along these lines is not out of the question, given the Treasury's objection to the 48 hour advance notice requirement for any receivership petition to the DC District Court (a requirement contained in the originally issued Local Civil Rule 85), any rule regarding the provision of advance noticed to anyone implicated by the Treasury's receivership decision certainly seems unlikely. See Bankruptcy: Agencies Continue Rulemakings for Clarifying Specific Provisions of Orderly Liquidation Authority, United States Government Accountability Office, Report to Congressional Committees (GAO-12-735), 15-16 (July 2012).

[94] DFA, § 202(a)(1)(A)(i).

swift and secret action would work against giving the covered firm any realistic period of time to prepare to do battle in court.

Once the executive branch decides that a financial firm should be placed in receivership, it files a petition for appointment of a receiver under seal with the District Court for the District of Columbia. The statute provides for stiff criminal penalties for anyone who "recklessly" discloses the determination to file a petition, the content of petition, or "the pendency of the court proceedings."[95] Creditors and other stakeholders receive no notice and, given the criminal prohibition on disclosure, have no way of intervening to defend their interests. If the court does not rule on the petition within 24 hours, it is automatically granted.[96] In effect, the statute contemplates that a covered financial firm will be notified that the Treasury wants it liquidated and it is given the balance of 24 hours to review the Treasury petition and findings, prepare a rebuttal and file it with the court, and convince the court after a hastily convened hearing to reject the petition.[97]

The statute also severely limits the court in terms of what issues it can consider. The court is permitted to consider only the Secretary's determination that the firm is a "financial company" as defined by the Act, and his determination that the firm is "in default or in danger of default."[98] Moreover, the court is limited to considering whether these two determinations are "arbitrary and capricious."[99] The statute provides that if the District Court finds one or both of the Secretary's determinations to be arbitrary and capricious, the court must remand to the Secretary and afford the Secretary "an immediate opportunity to amend and refile the petition."[100] No other relief is mentioned; evidently the Secretary can keep refilling until the District Court grants the petition. An appeal is allowed within 30 days to the D.C. Circuit, and a petition for certiorari is allowed to the Supreme Court within 30 days of a ruling by the D.C. Circuit.[101] But no stay is allowed pending appeal, so the receivership goes forward once the petition is granted, even if the firm files an appeal. The statute again limits the issues that can be

[95] DFA, § 202(a)(C) (carrying a maximum penalty of 5 years imprisonment and a $250,000 fine).

[96] DFA, § 202(a)(1)(A)(v).

[97] The statute directs the District Court for the District of Columbia to adopt rules implementing the provisions for appointment of a receiver. DFA, § 202(b). Those rules were adopted on July 6, 2011. See Local Civil Rule 85, United States District Court for the District of Columbia *as amended on July 6, 2011* (January 19, 2011) at http://www.dcd.uscourts.gov/dcd/sites/ dcd/files/2011_LCvR_85_Dodd-Frank_Amended.pdf (hereafter "Local Civil Rule 85"). For further discussion, see TAN infra.

[98] DFA, § 202(a)(1)(A)(iii).

[99] DFA, § 202(a)(1)(A)(iv)(I)&(II)).

[100] DFA, § 202(a)(1)A)(iv).

[101] DFA, § 202(a)(2)A)(i) & DFA, § 202(a)(2)(B)(i).

considered by the court of appeals or the Supreme Court: they may only inquire whether the findings that the firm is a covered financial firm and is in default or in danger of default are "arbitrary and capricious."[102] The language of the statute is more emphatic in limiting the issues that may be considered on appeal, stating that review "shall be limited" to these two issues.[103]

Once the court grants the petition appointing the FDIC as receiver of the covered financial firm, the process moves out into the open. The statute describes in excruciating detail a special kind of receivership which in some respects resembles an FDIC receivership of a bank, and in other respects resembles ordinary bankruptcy, with the FDIC exercising most of the powers of a debtor in possession or trustee in bankruptcy.[104] Upon being appointed, the FDIC as receiver exercises all the powers of the financial firm, including the power to operate the company, hire and fire employees, and retain the services of third-party service providers.[105] But the FDIC also acts like a bankruptcy court. It can order a stay of further proceedings to collect debts against the covered financial firm,[106] can unwind fraudulent and preferential transactions,[107] can bring actions to collect monies owed to the firm,[108] and considers and resolves claims of various classes of creditors against the firm.[109] If any creditor is dissatisfied with the FDIC's resolution of a claim, it can bring a judicial action in the United States District Court where the covered financial firm has its principal place of business, and the court will rule on the claim.[110] There is, however, no requirement of court approval of other significant actions by the FDIC, such as the creation of a bridge financial company, the sale of assets, or the final liquidation of the covered firm.

II. Constitutional Challenges: The Who and the When

A variety of potential constitutional challenges could be made to Title II's statutory scheme. The secret, 24-hour proceeding in which the FDIC is appointed receiver by the District

[102] DFA, § 202(a)(2)(B)(iv).

[103] DFA, §§ 202(a)(2)(A)(iv); 202(a)(2)(B)(iv).

[104] See generally Douglas G. Baird and Edward R. Morrison, Dodd-Frank for Bankruptcy Lawyers, 19Am. Bankr. Inst. L. Rev. 287 (Winter 2011).

[105] DFA, § 210(a)(1)(A).

[106] DFA, § 210(a)(8).

[107] DFA, § 210(a)(11)(A)&(B).

[108] DFA, § 210(a)(1)(B)(ii).

[109] DFA, § 209 and § 210(a)(2).

[110] DFA, § 210(a)(4).

Court of the District of Columbia can be challenged as violating due process or Article III. The scheme can also be challenged as violating the "uniformity" requirement of the Bankruptcy Clause or the First Amendment. Constitutional challenges under the Takings Clause can also be imagined, depending on how particular issues are resolved during the receivership. But first we must consider who can bring these sorts of constitutional claims and when they might be advanced.

We will discuss three possibilities: (1) raising constitutional claims defensively in the proceeding brought by the Secretary of the Treasury to appoint a receiver; (2) filing an independent action under 28 U.S.C. § 1331 to enjoin the receivership once it is approved (but before it has taken significant steps to unwind the firm); and (3) filing an action to enjoin the appointment of a receiver before the Secretary files a petition to appoint a receiver. This last option is essentially the one being pursued in the complaint recently filed by the state attorneys general.[111]

Ordinarily, raising constitutional claims defensively would be the least problematic course of action. If the government files a legal action in which it demands the defendant's person or property, there is no doubt the defendant can raise any constitutional objections she may have by way of defense.[112] Standing is clearly established: concrete injury has either occurred or is "certainly impending."[113] Jurisdiction is based on the authority invoked by the government in bringing its action.[114] There is no need to demonstrate a cause of action, since the defendant is raising the Constitution by way of defense. The government might try to argue that raising constitutional defenses is here impliedly precluded by statute. Specifically, by limiting review to whether the two determinations are arbitrary and capricious, the statute impliedly precludes consideration of other issues. Given the established canon that implied preclusion of review of constitutional questions is not favored, however, it is difficult to see how this would succeed. It is well established that Congress must speak with clarity before it cuts off constitutional claims, and the Court has said a "grave constitutional question" would be presented if such a clear statement of preclusion were ever encountered.[115] Nothing in Title II

[111] See *Big Spring Second Amended Complaint* supra note 29.

[112] Henry M. Hart, The Power of Congress to Limit the Jurisdiction of Federal Courts: An Exercise in Dialectic, 66 Harv. L. Rev. 1362 (1953).

[113] Clapper v. Amnesty International USA, No. 11-1025 (February 26, 2013), slip op. at 15.

[114] See 28 U.S.C. § 1345.

[115] Johnson v. Robison, 415 U.S. 361 (1974); Webster v. Doe, 486 U.S. 592, 619 (1988).

comes close to a clear statement precluding constitutional defenses.[116] Thus, if and when the Secretary of the Treasury files a petition with the District Court for the District of Columbia asking for the appointment of a receiver to liquidate a financial firm, the firm (and possibly its officers or directors) can interpose constitutional defenses in response to the petition.

The peculiar procedures set forth in Title II greatly complicate this conventional approach. One problem is notice. Some stakeholders will know about the Secretary's petition, namely, the directors and principal officers of the firm targeted for receivership and liquidation. But other stakeholders – including creditors, counterparties, most employees of the firm, and the shareholders of the firm – cannot raise constitutional objections defensively, because Dodd-Frank makes no provision for giving them notice, requires that the court proceedings be conducted "on a strictly confidential basis,"[117] and indeed makes it a criminal offense for anyone who is aware of the proceeding to give any third party notice.[118] If there is no legal way to obtain notice of adverse action by the government, one cannot defend against it, on constitutional or any other grounds. Equally problematic, the district court cannot conceivably give adequate consideration to any constitutional defense in 24 hours. The government will insist that the statute requires adhering to the 24 hour deadline, at which point the petition is deemed automatically granted and no stay is possible. Further, the government would likely claim, action is urgently needed to avert a financial crisis. Faced with a conflict between a strict statutory deadline and government warnings of financial crisis, on the one hand, and its duty to enforce the Constitution, on the other, what is the court going to do?

Conceivably, the court could try to solve the problem by invoking the Constitution as authority to make modest modifications in the statutory procedures. For example, the court could grant a temporary stay of further action on the petition in order to afford an adequate period of time to brief and consider the constitutional issues presented. Remember, at this point the proceedings are confidential and the papers have been filed under seal.[119] If the court is persuaded that the constitutional defenses are serious, it might be willing to grant a short stay, perhaps of a few days, in order to give the issues fuller consideration. If after this period of expedited consideration the court concludes that the statute is unconstitutional in one or more respects, it could order more permanent injunctive relief that would cure the constitutional defect

[116] Other provisions of the Act address questions of judicial review, but they cut off judicial proceedings asserting claims against the firm while it is in receivership – except those specifically allowed -- or actions against the FDIC in its capacity as receiver – again unless expressly allowed. DFA, 210(a)(9)(D); DFA, 210(e).
These provisions do not address review of the Secretary's decision to seek to have a receiver appointed, nor do they address possible constitutional challenges to the Act or any of its provisions.

[117] DFA § 202(a)(1)(A)(iii).

[118] DFA § 202(a)(1)(C).

[119] DFA § 202(a)(1)(A)(ii).

and allow the petition to be considered in a manner consistent with constitutional requirements.[120] This constitutional ruling would, of course, be subject to appeal by the government (including a request for a stay or emergency relief) under the ordinary rules of appellate procedure. This solution is problematic, however, because it requires the court effectively to re-write statute before deciding whether it is constitutional. Also, it also does nothing to provide notice to other stakeholders who may want to raise constitutional objections.

A second approach might be for any stakeholder who is aggrieved by the appointment of a receiver and pending liquidation of the firm to file an independent action in the district court seeking to enjoin the receivership on constitutional grounds. Jurisdiction would be based on 28 U.S.C. § 1331, which applies to actions grounded in the Constitution. Standing would be established by the prospective liquidation of the firm or loss of rights or claims having monetary value. The cause of action could be based on the Administrative Procedure Act (APA), which provides that "[a]gency action made reviewable by statute and final agency action for which there is *no other adequate remedy in a court* are subject to judicial review."[121] The Secretary's decision to petition for a receivership would be final agency action, and Dodd-Frank's draconian 24 hour time limit and requirement that judicial proceedings remain in camera would preclude that statute from affording "an adequate remedy in court." This approach also has the virtue that it would be filed immediately after the receivership is established, and so the automatic stay powers given to the receiver would be in effect, providing a temporary stabilization of the situation and hopefully forestalling financial panic and behavior analogous to a run on the bank.

Unfortunately, Dodd-Frank appears to eliminate this option, at least for some constitutional claims. It says:

> Except as provided in this title, no court may take any action to restrain or affect the exercise of powers or functions of the receiver hereunder, and any remedy against the Corporation or receiver shall be limited to money damages determined in accordance with this title.[122]

This would seem to preclude any action to "restrain or affect" the receiver based on constitutional claims in an action brought under 28 U.S.C. § 1331. Thus, for example, no court could entertain an action to enjoin the receiver on the ground that the statute violates the uniformity requirement of the Bankruptcy Power or the Takings Clause. This preclusion of review, however, might not affect constitutional claims addressed to the initial proceeding in the

[120] An issue of severability would be presented, at least implicitly. But it seems unlikely that the entire Dodd Frank Act should fall on constitutional grounds because of one or more constitutional infirmities in the process for appointing a receiver.

[121] APA, 5 U.S.C. § 704.

[122] DFA, § 210(e).

district court to *appoint* a receiver, including those based on due process, Article III, or the First Amendment. These claims challenge the judicial process to appoint the receiver, and so do not seek to "restrain or affect" the powers of the receiver once appointed. As to defects in the appointment process, a bit of litigational jujitsu might be possible by filing a motion under Rule 60(b) to set aside the final judgment approving the receiver, on the ground that the judgment was obtained under procedures that violate the Constitution.[123] The Rule 60(b) motion would not be governed by the time limits or the gag order of Dodd-Frank,[124] and hence would not encounter the problems that seem to doom any constitutional defense raised in response to petition itself. Still, even if this works for claims directed to the judicial process for appointing a receiver, it would not work for other constitutional objections to Title II.

The third option would be to file an action challenging the constitutionality of the Act before the Secretary files a petition to appoint a receiver. Here, standing would likely be the most serious problem, particularly if the firm or one of its stakeholders bringing the action cannot demonstrate that action by the government is threatened or "certainly impending."[125] It would be necessary to show that the government is seriously contemplating using its OLA to appoint a receiver, but that will be difficult if the government is successful in keeping its internal deliberations secret.

Do the state attorneys general stand on firmer footing in being able to mount a challenge to Title II before it has been applied to any individual firm? Arguably they do. Although the Court has rejected the States' standing to challenge the constitutionality of federal legislation on behalf of their citizens through parens patriae suits,[126] recent decisions suggest growing liberality toward state standing. In *Massachusetts v. EPA*, where the State sought to challenge the government's failure to regulate global warming, the Court spoke mysteriously about States enjoying "special solicitude" relative to private parties in determining standing to sue.[127] More recently, in the Affordable Care Act litigation, serious questions were raised about the States' standing, with the Fourth Circuit ruling that Virginia lacked standing to challenge the individual mandate.[128] The Supreme Court declined to review this ruling, and went on to consider a wide-

[123] See FRCP Rule 60.

[124] *Id.* at 60(c)(1) ("A motion under Rule 60(b) must be made within a reasonable time--and for reasons [set forth at 60(b)](1), (2), and (3) no more than a year after the entry of the judgment or order or the date of the proceeding.")

[125] Clapper v. Amnesty International USA, No. 11-1025 (February 26, 2013), slip op. at 15; Lujan v. Defenders of Wildlife, 504 U.S. 555, 562 (1992).

[126] Massachusetts v. Mellon, 262 U.S. 447 (1923).

[127] 549 U.S. 497, 505 (2007).

[128] Virginia ex el. Cuccinelli v. Sebelius, 656 F.3d 253 (4^{th} Cir. 2011).

ranging challenge to the individual mandate brought by 26 States among others, without uttering a word about standing.[129] This, of course, does not mean the Court found that the states had standing. There were other plaintiffs in the case, including individuals, and the Court may have implicitly concluded they had standing to challenge the mandate. At least in terms of optics, however, the Affordable Care Act litigation lends further support to the idea that state standing is to be quite liberally construed.

The attorney general lawsuit that challenges the constitutionality of Title II of Dodd-Frank rests on the states' interest in their employee pension funds, which include investments in firms that are potentially eligible for liquidation under Title II. Although none of these firms is currently threated with orderly resolution under Dodd-Frank, the states argue that the statute has taken away their federal statutory right to have their interests as creditors treated the same as other similarly-situated creditors.[130] They argue that this abrogation of rights is a present invasion of a legally protected interest, and hence satisfies the Article III requirement of actual immediate injury.[131] The statutory right to equal treatment of creditors, however, is one that will come into play only when a debtor is in default or in danger of default. If the mere existence of a debt were enough to confer standing to challenge a change in the legal treatment of creditors, it would seem that any person should be able to challenge any change in the law that might conceivably affect their interests as creditors sometime in the future. This is clearly not the law.[132] Also an injury caused by Dodd-Frank's authorization of departures from equal treatment of similarly-situated creditors bears no causal relationship to the due process, Article III, and First Amendment objections to the statute.[133] Thus, it is not clear that this alleged injury, even if otherwise sufficient to confer standing, would support standing to challenge the constitutionality of OLA. So we are doubtful that the D.C. Circuit will uphold the states standing to challenge Title II, in the absence of some evidence that OLA is about to be invoked in a way that would affect their financial interests.

Finding a cause of action could also become an issue. The APA, to repeat, provides that "[a]gency action made reviewable by statute and *final agency action* for which there is no other adequate remedy in a court are subject to judicial review."[134] If the Secretary has not made a

[129] National Federal of Independent Business v. Sebelius, 132 S.Ct. 2566 (2012).

[130] State Plaintiffs' Memorandum in Opposition to Defendants' Motion to Dismiss the Second Amended complaint, State National Bank of Big Spring v. Wolin, No. 1:12-cv-0132 (ESH) (filed Feb. 27, 2013) at 16-19.

[131] Id. at 19-24.

[132] Summers v. Earth Island Inst., 555 U.S. 488, 496 (2009); Defenders of Wildlife, 504 U.S. at 572-73.

[133] It is not clear that it even implicates the uniformity requirement of the Bankrutpcy Clause, if that clause is interpreted to require that debtors be treated uniformly, as opposed to creditors. See discussion infra.

[134] APA, 5 U.S.C. § 704.

determination to file a petition, it would be difficult to claim that there is *final* agency action to review. Absent a cause of action under the APA, the cause of action would have to be implied directly from the Constitution, as in *Bivens* and following cases.[135] The Court has been cutting back on these implied rights based on the Constitution. Most relevantly, the Court in *FDIC v. Meyer*[136] held that there is no implied *Bivens* action against a federal administrative agency (the FDIC as it happens) as opposed to individual federal officers. This still leaves open the possibility of an *Ex Parte Young*-style action seeking to enjoin federal officers, such as the Secretary of the Treasury, for threatening to take action alleged to violate the Constitution. There is a debate of sorts, at least in academic circles, about whether an implied right of action can be said to exist even in these circumstances.[137] As things currently stand, however, the *Ex Parte Young* cause of action is good law, and we assume the lower federal courts will continue to treat it as such unless or until the Supreme Court says otherwise. So on this slender reed, there should be an available cause of action for anticipatory relief.

If the standing obstacle can be overcome, this might be the best of the three options. The action would not be subject to the time limits or the notice prohibitions of Dodd-Frank, which only come into play after the petition is filed. And it would not be limited by the preclusion of actions that seek to "restrain or affect" the powers of the receiver, because the receiver would not have been appointed.

Whichever option is chosen, the government would undoubtedly seek to defeat any request for injunctive or declaratory relief on the ground that the firm and its stakeholders will suffer no irreparable injury if the constitutional arguments are postponed until after the OLA process is complete. The doctrinal vehicle for advancing this argument might be the Tucker Act,[138] and the established proposition that takings claims can be postponed until after the government action is complete, provided all the interests at stake can be fully protected by a suit for damages in the Court of Federal Claims under the Tucker Act. Relevant Supreme Court authority, perhaps most notably the *Regional Rail Reorganization Act Cases*,[139] holds that Congress will not be presumed to cut off a Tucker Act remedy absent a clear statement to the contrary. Dodd-Frank contains language that cuts off any remedy against the *FDIC as receiver*

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[135] Bivens v. Six Unknown Fed. Narcotics Agents, 403 U.S. 388 (1971).

[136] 510 U.S. 471 (1994).

[137] See, e.g., John Harrison, Ex Parte Young, 60 Stan. L. Rev. 989 (2008); Ann Woolhandler, The Common Law Origins of Constitutionally Compelled Remedies, 107 Yale L. J. 77 (1997).

[138] 28 U.S.C. § 1491.

[139] Blanchette v. Connecticut General Ins. Corporations, 419 U.S. 102, 126-127 (1974); see also Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1018-1019 (1984); Preseault v. I.C.C., 494 U.S. 1, 13 (1990).

except an action for money damages as authorized by Title II.[140] But the Tucker Act authorizes suits against *the United States* for takings or breach of contract. So perhaps the Tucker Act remedy has not been clearly foreclosed by Dodd-Frank.

The government would likely seek to bolster its no irreparable harm argument by claiming that all the interests at stake are in the nature of fungible financial assets – dollars – and that such interests by their very nature can be vindicated by ex post monetary awards, with interest to reflect the time value of money. Creditors who claim their security interests have been violated, officers who claim their salaries have been wrongfully clawed back, directors deprived of their paid positions – all these aggrieved persons can be made whole by an award of money damages. Unlawful action that can be rectified by a payment of money damages is generally regarded as not presenting the kind of irreparable harm that justifies mandatory relief.[141]

If the only constitutional questions presented were takings claims and impairment of contract claims, and the government's authority were otherwise uncontested, then this argument would be well founded. But if the government's authority to proceed in the manner directed by the statute is challenged on other constitutional grounds, then an ex post award of money damages is not sufficient to vindicate the claim.[142] The Due Process Clause says that no one shall be deprived of property without due process of law. This generally means, at least when conventional property interests are at stake, that a person must be given an opportunity to challenge the legal authority of the government before their property is taken.[143] Thus, if a firm makes a credible contention that government is seeking to have it liquidated in a manner contrary to law, this issue should be resolved before rather than after the government liquidates the firm.

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[140] DFA, 210(e) ("[A]ny remedy against the corporation or receiver shall be limited to money damages determined in accordance with this title.") See also DFA 210(a)(8)(D) ("Except as otherwise provided in this title, no court shall have jurisdiction over...any claim relating to any act or omission of ...the Corporation as receiver."). By and large any claims against the FDIC will involve creditors and others with various rights stemming from their pre-receivership relationship with covered financial company that were extinguished or modified when the company was placed into FDIC receivership pursuant to the OLA.

[141] See Weinberger v. Romero—Barcelo, 456 U.S. 305, 311–313 (1982); Amoco Production Co. v. Gambell, 480 U.S. 531, 542 (1987); eBay Inc. v. MercExchange, L.L.C., 547 U.S. 388, 391 (2006) ("According to well-established principles of equity, a plaintiff seeking a permanent injunction... must demonstrate [,among other things,]... that remedies available at law, such as monetary damages, are inadequate to compensate for that injury...").

[142] Even takings claims are subject to this limiting principle. The Takings Clause has been read to mean that the government can take property only for a public use. Kelo v. City of New London, 545 U.S. 469 (2005). If a property owner contends the taking is not for a public use, then this issue must be resolved before the taking occurs, not afterwards. If the issue is postponed, and the taking is later determined not to be for a public use, then there will be no way to correct the constitutional violation. An award of just compensation cannot remedy a constitutional right that property not be taken, period. We are not suggesting a firm could mount a successful public use argument against a Dodd Frank receivership. The point is more general.

[143] E.g., Connecticut v. Doehr, 501 U.S. 1 (1990).

Once the firm's assets are sold, and it is liquidated, it cannot be put back together again. Claims based on Article III of Constitution, the uniformity requirement of the Bankruptcy Clause, or the First Amendment would also seem to be the sorts of claims that cannot be rectified by ex post awards of damages. At least as to these sorts of constitutional claims, the firm the government wants to liquidate will suffer irreparable harm if the inquiry is postponed until after the liquidation is over.

III. Constitutional Issues – Process Objections

The prospect of appointment of the FDIC to liquidate a firm under Title II would likely trigger deep anxiety by a variety of stakeholders of the targeted firm. Creditors would worry that they will not get their money back, even if it is secured by collateral. Holders of derivatives or swaps would worry that their contracts will be modified or repudiated. Officers and directors would worry that they will be out of a job. Shareholders would be distraught at the prospect of having their investment wiped out. Each of these groups would have an incentive to bolster their position by raising constitutional objections to the OLA process. Arguments conceivably could be advanced under Due Process Clause of the Fifth Amendment, under Article III of the Constitution, under the Uniformity Clause of the Bankruptcy Power, under the First Amendment, and under the Takings Clause of the Fifth Amendment. We consider in this Part process objections that would be brought in the name of due process and Article III.

A. Due Process

In order to establish a violation of due process, a claimant must show that he has an interest in life, liberty or property, that the government is threatening to deprive him of this interest, and that the deprivation will take place without providing the notice or opportunity to be heard required by due process of law.

We assume that all the relevant parties who might feel threatened by the prospect of liquidation of a firm under Title II would satisfy the threshold requirement of having a "property" interest at stake. Due process property includes money and securities. Thus, creditors of all stripes have property for due process purposes in the assets of a debtor firm.[144] Property also includes a paying job, at least if one has an unexpired employment contract that makes one more than an employee at will.[145] Consequently, officers and directors who will lose

[144] See Tulsa Professional Collection Services, Inc. v. Pope, 485 U.S. 478, 485 (1988) (holding that unsecured creditor's claim is "property" for purposes of procedural due process).

[145] Federal Deposit Insurance Corp. v. Mallen, 486 U.S. 230, 240 (1988) ("[A]ppellee's interest in the right to continue to serve as president of the bank and to participate in the conduct of its affairs is a property right protected by the Fifth Amendment Due Process Clause"); Cleveland Bd. Of Education v. Loudermill, 470 U.S. 532, 538-41 (1985).

their positions through an exercise of OLA have due process property, provided they are working under an unexpired employment contract. It is also undeniable that the actions taken by the FDIC in completing an orderly liquidation constitute state action that would deprive these parties of their respective interests.

In assessing what process is due, the Court has tended to treat notice as a requirement distinct from other procedural elements.[146] Actual notice by mail or the equivalent is generally required for any proceeding that will adversely affect the property rights of an affected party, as long as their name and address are "reasonably ascertainable."[147] This would seem to call into question the feature of the statute that makes it a criminal offense to provide notice to anyone other than the firm to be placed into receivership.[148] Shareholders, counterparties, creditors, and officers deemed to be responsible for the financial distress of the firm may have their interests compromised or completely wiped out by the mandatory liquidation of Title II, and yet the statute makes it a crime to provide them with notice that would allow them to voice their objections before that process commences.

The government would undoubtedly point to bank receiverships, where by tradition no formal notice is given before a receiver is appointed and seizes the property. In practice, the appointment of a receiver will typically come as no surprise to the bank and its officers and directors.[149] As the D.C. Circuit has observed, bank regulators ordinarily will have raised concerns about the adequacy of the bank's reserves or other financial issues with bank officers over an extended period of time, giving the bank a clear idea of the relevant issues and an opportunity to respond, however informally.[150] Whether nonbank financial firms will similarly be alerted to the possibility of seizure under Title II through informal communications with regulators is unclear; certainly the statute does not require it. And even if the firm has been given effective notice, this does not mean notice will be given to creditors and other stakeholders, to whom notice is prohibited.

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[146] Jones v. Flowers, 547 US 220, 223 (2006) ("Before a State may take property… the Due Process Clause of the Fourteenth Amendment requires the government to provide the owner notice and opportunity for hearing appropriate to the nature of the case.") (internal punctuation and citations omitted); see also Fuentes v. Shevin, 407 U.S. 67, 80 (1972) ("For more than a century the central meaning of procedural due process has been clear: Parties whose rights are to be affected are entitled to be heard; and in order that they may enjoy that right they must first be notified.") (internal punctuation and citations omitted),

[147] Mennonite Board of Missions v. Adams, 462 U.S. 791, 800 (1983); Mullane v. Central Hanover Brank & Trust Co., 339 U.S. 306, 314 (1950).

[148] DFA, § 202(a)(1)(C).

[149] But see David Zaring, A Lack of Resolution, 60 Emory L. J. 97, 119 (2010) (noting that in 2009 twenty-one banks were closed "without any prior notice by the agency.").

[150] James Madison Limited v. Ludwig, 82 F.3d 1085, 1099-1101 (D. C. Cir. 1996).

The government will inevitably be thrown back on the position that sometimes exigent circumstances require that the government act without giving advance notice, as in a public health emergency. The government will argue that advance notice to all reasonably ascertainable stakeholders cannot be given before a seizure of the firm pursuant to OLA, because this could trigger the very financial panic or instability Dodd-Frank is designed to prevent. Such arguments have been accepted in other emergency contexts, but almost invariably with the caveat that a prompt post-deprivation hearing is available in which the legality of the seizure can be challenged and the property restored to its rightful owner if it turns out the seizure was unwarranted.[151] Justice Jackson, in *Fahey v. Mallonee*, described bank seizure as a "drastic procedure" justified by the "delicate nature of the institution and the impossibility of preserving credit during an investigation."[152] But the procedure at issue[153] provided for extensive hearing rights, including a full particularization of the reasons for the seizure, within a matter of days after the seizure took place.[154] Dodd-Frank's OLA, as amended by the Senate, *eliminates* the right of post-seizure judicial review routinely available (if rarely invoked) in the banking industry. Under Dodd-Frank, creditors who dispute the priority or valuation of their claim as determined by the FDIC can seek judicial review. But the government can point to no provision in the statute giving a post-seizure remedy to any other stakeholders, which will make it much more difficult to justify the absence of notice to these affected persons.

Beyond notice, due process concerns are also presented by the extremely abbreviated 24 hour period between the filing of the petition and the automatic granting of the petition required by Title II. Realistically speaking, it is impossible to imagine that this is adequate time either for the firm to mount an effective defense or for the court to engage in meaningful deliberation about the issues presented.[155] To be sure, the only issues the court is allowed to consider are whether the Secretary acted in an arbitrary and capricious fashion in determining that firm is a "financial

[151] See, e.g., Mallen, supra, 486 U.S. at 24-41; Fahey v. Mallonee, 332 U.S. 255, 253-54 (1947); Coffin Bros. v. Bennett, 277 U.S. 29 (1928); North American Cold Storage Co. v. Chicago, 211 U.S. 306, 314-321 (1908).

[152] 332 U.S. at 253-54.

[153] The procedure being challenged in Fahey v. Mallonee was set forth in Section 5(d) of the Home Owners' Loan Act of 1933, as amended. See 12 U.S.C. §1464(d). This provision gave the Board of the Federal Home Loan Administration the authority to reorganize, consolidate, merge, or liquidate Federal Savings and Loan Associations, including the power to appoint a conservator or a receiver to take charge of the affairs of any such association. *Id.*

[154] 332 U.S. at 252-253.

[155] See Kenneth Scott, *Dodd Frank: Resolution or Expropriation* (2012) at http://media.hoover.org/sites/default-/files/documents/dodd-frank-20120302.pdf. "The Dodd-Frank Act squeezes pre-seizure due process down to the vanishing point." *Id.* at 1.

firm" as defined by the statute,[156] and whether he acted arbitrarily and capriciously in determining that the firm is in default or in danger of default.[157] But if these elements are contested, it is inconceivable that the firm could put together a coherent rebuttal, present it to the court, and that the court could digest the issues and render a well considered decision within such an extremely compressed time period. This is especially true of the finding that the firm is "in default or in danger of default."[158] This could entail an examination of hundreds of disputed accounting issues, many of great complexity.

The process is made more problematic by the lack of clarity about what the drafters of Dodd-Frank understood by an "arbitrary and capricious" standard of review. The APA directs courts to set aside agency action that is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." [159] This standard expressly encompasses questions of law as well as fact. Does the omission of the phrase "otherwise not in accordance with law" in Dodd-Frank mean that the district court may not review disputed questions of law? Such a construction would very likely be unconstitutional. [160] The fundamental objective of the Due Process Clause is to assure that the government deprives persons of their property only in accordance with the law, that is, "due process of law." An attempt by Congress to cut off any ability to challenge the lawfulness of a taking of property – at both the administrative and the judicial level -- would almost certainly contravene due process.

The statute's limitation of review to just two of the seven factors that the Secretary must consider in determining whether to petition for appointment of a receiver creates further due process problems. The statute requires the Secretary to petition for a receivership if he makes seven enumerated determinations listed in the statute.[161] There is no provision for an

[156] DFA, § 201(11). Financial firm means bank holding company, nonbank financial company supervised by the Federal Reserve Board, or any company or subsidiary of a company previously determined by the Fed to be predominately engaged in activities "financial in nature."

[157] As defined by DFA, § 203(c)(4), which sets forth four alternative conditions. Some of these conditions, such as that a bankruptcy case is likely to be promptly commenced, id. § 203(c)(4)(A), might be provable by documentary or testimonial evidence, and could conceivably be resolved in one day – provided the evidence was already in hand. But other conditions, such as that the firm "has incurred, or is likely to incur, losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the company to avoid such depletion," id. 203(c)(4)(B), would seem to require complex expert witness testimony that would be impossible to rebut or sort out in 24 hours.

[158] DFA § 203(b)1); 202(a)(1)(A)(iii).

[159] APA, 5 U.S.C. § 706(2)(A).

[160] See Crowell v. Benson, 285 U.S. 22 (1932); Richard H. Fallon, Jr., Of Legislative Courts, Administrative Agencies, and Article III, 101 Harv. L. Rev. 915, 943-49 (1988).

[161] DFA § 203(b).

administrative hearing on any of the seven issues. The statute provides for judicial scrutiny of only two of the seven determinations, in the 24 hour hearing previously described under the arbitrary and capricious standard of review. How is it possible for the government to seize and liquidate a major financial firm based on five determinations that are never subject to any challenge by the targeted firm? Welfare recipients cannot have their benefits terminated based on determinations made by social workers that the beneficiary is never allowed to contest.[162] Why should financial firms be liquidated without any opportunity to contest the legal determinations that support this action? Some determinations required by Dodd-Frank involve discretionary determinations of the legislative fact variety, such as the finding that resolution of the firm under ordinary bankruptcy law "would have serious adverse effects on financial stability in the United States." [163] But others are highly factual, in the adjudicatory fact sense, e.g., that the financial firm has been ordered to convert all convertible debt instruments.[164] Eliminating all avenues of challenging these determinations, either ex ante or ex post, seems hard to justify as being consistent with due process.

Is it possible to defend the extremely limited review provided by Title II based on the government's paramount interest in preventing financial meltdown? The general due process standard for procedural adequacy is the balancing test of *Mathews v. Eldridge*,[165] which focuses on three variables: (1) the "private interest that will be affected by the official action"; (2) the "risk of an erroneous deprivation of such interest through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards;" and (3) "the Government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirements would entail." The magnitude of the private interest at stake will depend on who is bringing the challenge. The firm and its directors and shareholders may have the weightiest interests. The statute mandates that any firm placed in an OLA receivership must be liquidated and that all shareholder equity must be wiped out before other creditors take a hit. Directors are subject to mandatory dismissal. Directors of systemically significant financial firms may not elicit as much sympathy from the courts as welfare recipients and school janitors,[166] but directorships are paid positions and under the statute the critical decision that determines whether a director keeps or loses her position is the

[162] Cf. Goldberg v. Kelly, 397 U.S. 254 (1970) (requiring elaborate hearing before welfare benefits are terminated).

[163] DFA § 203(b)(2).

[164] DFA § 203(b)(6).

[165] Mathews v. Eldridge, 424 U.S. 319, 335 (1976).

[166] See Goldberg v. Kelly, 397 U.S. 254 (1970) (welfare recipients are entitled to adjudicatory hearing before benefits are terminated given "brutal need" eligible recipients have for such funds); Loudermill, supra (school janitor with undisclosed criminal record entitled to hearing before termination given importance of employment to individual welfare).

appointment of receiver. Once this happens, all directors are automatically terminated.[167] Creditors will have more difficulty arguing that their interest is large, given that Title II gives creditors the right to bring a judicial proceeding to determine the validity of their claims, and establishes a benchmark for compensation equal to what a claimant would receive in a liquidation of the firm.[168] Officers who fear they will be dismissed may be met with the argument that any consideration of this prospect at the time of appointment of a receiver is premature. Dismissal of officers is required only if they are found to be "responsible for the failed condition of the covered financial company"[169] and thus any challenge by officers may not be ripe until the FDIC determines they warrant dismissal.

The Government will undoubtedly argue that the procedures prescribed by Title II serve governmental interests of the highest magnitude. The very short notice and rocket-like hearing are not designed to save on administrative costs, but to prevent a financial panic or contagion analogous to a run on the bank if ordinary judicial procedures were followed. In order to prevent future financial crises caused by the collapse of nonbank financial firms that are too big to fail, Congress determined that the government must be able to seize and liquidate major financial firms in an expeditious, in camera process. Stated in these terms, it is difficult to see how the interests of a single firm or its shareholders and directors in avoiding liquidation can be regarded as outweighing the prevention of an economic crisis. Forced to choose patent unfairness and economic disaster, courts will likely acquiesce in patent unfairness.

Notice, however, that the *Mathews* test appears to contemplate a marginalist inquiry. The primary question is not whether the totality of the private interest outweighs the totality of the governmental interest, but whether "additional or substitute procedural safeguards" would be worth more or less than the "fiscal and administrative burdens that the additional or substitute procedural requirement would entail."[170] In the context of an OLA petition, this implies, for example, that the court should ask whether affording a financial firm, say, an additional 24 hours to mount a defense (with the proceedings remaining under seal) would be worth more in terms of preventing unfairness than the cost to the government and society in terms of increasing the risk of financial disaster. There is, of course, no meaningful way in which a court can answer such a question. This is a problem associated with the risk-utility due process test of *Mathews* more

[167] DFA § 206(5).

[168] DFA, §

[169] DFA 206(4).

[170] Mathews, 424 U.S. at 335.

generally.[171] But posing the question this way would at least increase the odds that the court would agree the statute violates due process.

Given the intractable nature of the *Mathews* balancing test, especially as applied to such a high stakes situation, it is virtually certain that the parties and the court would look to analogous processes in order to decide whether Title II comports with due process. In particular, the government would inevitably emphasize that existing bank receivership laws allow regulators to seize banking companies with no advance judicial process at all.[172]

The problem with this analogy is twofold. First, as emphasized above, the banking statutes provide for de novo judicial review *after* the seizure takes place. Both the Administration's proposed version of OLA and the House bill followed this model, and provided for unrestricted judicial review after the seizure of a systemically significant nonbank financial firm. The Senate, for whatever reasons, eliminated post-seizure review and substituted the extremely limited one-day pre-seizure review limited to just two issues. In so doing, it made it far more difficult to defend the statute against a due process challenge.

Second, the rationale for dispensing with ex ante procedures in the bank receivership context depends in significant part on a quid pro quo or waiver argument keyed to government deposit insurance. The leading precedent is *Fahey v. Mallonee*,[173] which presented a constitutional challenge to the takeover of federally-chartered savings and loan association by the Federal Home Loan Bank Board.[174] Justice Jackson not only alluded to the heightened need for public regulation of banks, given their vulnerability to panics and the impact this can have on the wider economy. He also reasoned that the savings and loan in that case was "estopped" from challenging the law because it had voluntarily sought a federal charter, knowing that a takeover was a possibility if the Bank Board became concerned about its financial condition. As he put it: "It would be intolerable that the Congress should endow an association with the right to conduct a public banking business on certain limitations and that the Court at the behest of those who took advantage from the privilege should remove the limitations intended for public protection."[175]

[171] See, e.g., Jerry L. Mashaw, Administrative Due Process as Social-Cost Accounting, 9 Hofstra L. Rev. 1423 (1981).

[172] 12 C.F.R. 30, FDIC's Notice of Proposed Rulemaking Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (March 15, 2011).

[173] 332 U.S. 245 (1947).

[174] The challenge was grounded in the nondelegation doctrine, but the Court addressed the limited procedural protections in its analysis.

[175] 332 U.S. at 256.

The quid pro quo theme has recurred in more recent cases addressing due process challenges to various administrative actions taken by bank regulators, often with emphasis on the government benefit of deposit insurance, which greatly promotes public confidence in the banking system.[176] Ordinary bank receiverships and related summary actions occur in a context in which the most significant assets of the insolvent bank – the deposits that have been made by its customers – are insured by the federal government. This gives the federal government a very large justification for moving quickly and without advance notice to take over an insolvent bank in order to limit the government's exposure on its insurance obligations. It also allows the government to say that the bank voluntarily assumed the risk of summary action in return for taxpayers largely footing the bill for any missteps or even misconduct by the bank. The banks, one could say, must take the bitter with the sweet.[177]

This sort of quid-pro-quo argument cannot be easily extended to the nonbank financial firms subject to orderly liquidation under Title II.[178] Large non-bank financial firms are not chartered by the government, and do not have anything like the close interaction with regulatory agencies that characterizes banks. They may be subject to oversight by the SEC or the CFTC, but this does not rise to the level of intensity of scrutiny associated with visitorial authority regulators exercise over banks. And of course the government does not formally insure funds and investments held by clients in these nonbank financial firms. Perhaps TARP and the bailout regime could be characterized as one in which the government implicitly guaranteed that systemically significant firms will not be allowed to fail. But Title II is designed to *eliminate* such a guarantee – to make sure the government will never again foot the bill for any capital infusions required by the resolution process. It is much more difficult in this context to claim that the government has delivered enough of the "sweet" to say that firms liquidated under Title II have voluntarily assumed the risk of getting the "bitter." Consequently, it is implausible that the OLA can be justified by the kind of estoppel argument adopted in *Fahey v. Mallonee*.

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[176] FDIC v. Mallen, 486 U.S. 230 (1988) (rejecting due process challenge to rule requiring automatic suspension of bank official indicted for crime); James Madison Ltd. V. Ludwig, 82 F.3d 1085 (D.C. Cir. 1996) (rejecting due process challenge to actions by OCC and FDIC declaring bank holding company insolvent and seizing assets); Bd. of Governors of Federal Reserve Sys. v. DLG Financial Corp., 29 F.3d 993 (5th Cir. 1994) (rejecting due process challenge to preliminary injunction freezing assets of shareholder of corporation for possible violations of Bank Holding Company Act); FDIC v. Bank of Coushatta, 930 F.2d 1122 (5th Cir. 1991) (holding capital directive to bank was unreviewable and that the administrative process that produced the directive and the enforcement order satisfied due process); Spiegel v. Ryan, 946 F.2d 1435 (9th Cir. 1991) (rejecting due process challenge to temporary cease and desist order requiring restitution of $21 million by bank officer pending administrative review); FDIC v. Haralson v. Federal Home Loan Bank Bd., 837 F.2d 1123 (D.C. Cir. 1988) (rejecting due process challenge to appointment of conservator under statute providing for review only after seizure of assets).

[177] Cf. Arnett v. Kennedy, 416 U.S. 134, 152-54 (1974), rejecting a bitter with the sweet argument in the context of a due process challenge. Id. at 166-67 (Powell, J.); id. at 177-78, 185 (White J.); id at 211 (Marshall, J.).

[178] See Zaring, supra, 60 Emory L. J. at 129-30.

Sadly and ironically, the extremely short notice required by the statute will itself produce a litigational advantage for the government that will be extremely difficult to overcome. The government can prepare briefs in advance suggesting the sky will fall if a systemically significant firm is not placed in receivership immediately. The government can also anticipate a due process objection, and can have its briefs, complete with extensive citations to banking cases and public health emergencies, prepared well in advance. The financial firm may be caught by surprise, and find it nearly impossible to rebut these authorities. The violation of due process may itself assure that the due process defense fails. Certainly this will be true for stakeholders who receive no notice at all until the receivership is approved.

The last point to make in connection with the serious due process issues raised by Title II is that they were almost certainly avoidable if Congress had simply followed the Administration draft and the House bill in providing for administrative appointment of a receiver followed by a statutory right to post-seizure judicial review. It is well established that some form of hearing is required before a property owner is conclusively deprived of a protected property interest.[179] That said, it does not necessarily follow that the hearing must occur before the initial taking occurs.[180] Specifically, the timing, nature and procedural requirements of any mandatory hearing under due process clause will depend on a balancing of the competing interests involved, including the importance of the private interest and length or finality of the deprivation at issue, the probability of government error and the importance of governmental interests involved, including the administrative practicality of providing a hearing ex ante and the sufficiency of substitute procedure ex post.[181] Given the substantial public interest in avoiding a financial panic, and the practical constraints on providing advance notice to the numerous creditors with property interests at stake given the need for expedition, it is hard to imagine a court finding ex post review unjustified.

As we have seen, for practical reasons banks only rarely invoke their right to seek post-seizure review. But the availability of such review is an important safeguard against executive abuse of the enormous power conferred by Title II. Post seizure review eliminates the notice problem, because the entire world will know about the appointment of the receiver. And it eliminates the need to ram the proceeding through in 24 hours or to truncate the issues so that only a fraction of the potential points of legal contestation are subject to review. The Senate

[179] See Logan v. Zimmerman Brush Co., 455 U.S. 422, 433-434 (1982); Fuentes v. Shevin, 407 U.S. 67, 80-82 (1972).

[180] See Memphis Light, Gas and Water Division v. Craft, 436 U.S. 1, 19 (1978); Ingraham v. Wright, 430 U.S. 651, 680 (1977); Bragg v. Weaver, 251 U.S. 57, 62 (1919).

[181] Matthews, 424 U.S. at 339-349 (1976); FDIC v. Mallen, 486 U.S. 230, 240-241 (1988).

blundered in thinking that a sham review before appointment of a receiver is preferable to a right to plenary review afterwards.

B. Article III.

The extremely compressed process for obtaining a judicial order establishing an FDIC receivership is also vulnerable to challenge on Article III grounds. Indeed, the Article III objection may strike an even more sympathetic cord with courts than the due process claim, because it implicates the constitutional authority and autonomy of the courts as a separate branch of government.

We hasten to point out that the Article III issue is not the one typically associated with bankruptcy laws, as in *Stern v. Marshall* [182] or *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*[183] In those cases, the Court was concerned with whether the Bankruptcy Court – an Article I tribunal – could resolve what were concededly claims of private right under the common law of contract and tort subject only to deferential review by an Article III district court. The initiation of a Dodd-Frank OLA proceeding, in contrast, would almost surely be classified as one involving public rather than private rights.[184] An OLA action is commenced by a federal official, the Secretary of the Treasury, and it seeks the appointment of a federal agency (typically the FDIC) as receiver. The decision to grant the petition and the standards for conducting the receivership are governed by federal, not by state law. The rationale for the action is grounded in general considerations of the public interest -- to prevent a contagion or panic that would disrupt financial markets and lead to economic distress – not the resolution of claims between private debtors and creditors. The receivership will of course result in the resolution of numerous private claims, but this is secondary or incidental to its primary purpose. Thus, although the Supreme Court has failed to identify any bright line distinction between private and public rights, the OLA action seems rather clearly to fall on the public side of the line. The Court has repeatedly affirmed that public actions need not be tried in Article III courts; Congress has the option of conferring them on either Article III courts or administrative tribunals.[185]

[182] No. 10-179, June 23, 2011.

[183] 458 U.S. 50 (1982).

[184] Thus, we question the analysis in Brent J. Horton, How Dodd-Frank's Orderly Liquidation Authority for Financial Companies Violates Article III of the United States Constitution, 36 J. Corp. L. 369 (2011), which implicitly treats the appointment of a receiver as a matter of private right for Article III purposes.

[185] Murray's Lessee v. The Hoboken Land and Imp. Co., 59 U.S. (18 How.) 272 (1855); Crowell v. Benson, 285 U.S. 22 (1932).

Moreover, in contrast to the claims at issue in *Marshall* and *Northern Pipeline*, the decision to appoint a receiver and initiate a liquidation of a financial firm *is* formally made by an Article III court – the District Court for the District of Columbia -- not by an administrative body or an Article I court. The statute says: "If the Court determines that the determination of the Secretary [on the two reviewable determinations] is not arbrtrary and capricious, *the Court* shall issue an order immediately authorizing the Secretary to appoint the Corporation as receiver of the covered financial company."[186] There is no attempt here to transfer authority away from an Article III court and give it to some other tribunal. The authority to appoint the receiver is formally exercised by the district court.[187] And the statute further elides traditional *Northern Pipeline*-type problems by providing that creditors of the financial firm subject to OLA, if they are dissatisfied by the receiver's resolution of their claims, can bring an action in federal district court and have their claim resolved there. [188] The statute appears to contemplate that these judicial proceedings will be tried de novo, not under a standard of deferential administrative review.

The principal Article III problem we have in mind, rather, is whether a statute that severely restricts an Article III court in terms of the time it is given to consider an important question as well as the scope of the issues it can consider in resolving the question violates Article III. (Perhaps this might be called a separation of powers issue, rather than an Article III issue, to avoid confusion with *Northern Pipeline*-style claims.) In effect, the statute calls upon an Article III court to make a decision of surpassing importance, both to the financial firm and the economy, and yet simultaneously constrains the court to make this decision in such a way that it cannot discharge this duty in a manner consistent with the judicial power established by Article III. One might say that Dodd-Frank commandeers the court to lend its prestige and legitimacy to what is essentially an administrative process without respecting the traditional mode and manner in which courts function.[189] In our view, any court told that it must approve or reject a petition to establish a receivership to liquidate a huge financial firm, and that it has only 24 hours to consider the question, will be very uneasy with its appointed role.

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[186] DFA § 202(a)(1)(iv) (emphasis added).

[187] The matter is admittedly murkier if the district court fails to act within 24 hours. The statute switches to the passive voice and declares that "the petition shall be granted by operation of law" and then adds: "the Secretary shall appoint the Corporation as receiver." DFA § 202(a)(1) (v) (I) & (II). At least arguably, the Secretary is the appointing authority in these circumstances.

[188] DFA § 210(a)(4).

[189] Cf. Printz v. United States, 521 U.S. 898; New York v United States, 505 U.S. 144 (principles of federalism do not permit Congress to commandeer state governments to act as enforcement agents of federal law).

One sign of judicial discomfort is found in the D.C. District Court's Local Rule 85, which was amended to implement Dodd-Frank's in camera procedure for appointment of a receiver.[190] The new Rule provides in part that "[a]t least 48 hours prior to filing the petition, the Secretary shall provide written notice under seal to the Clerk of the Court that a petition will likely be filed with the Court." There is no authority for this advance notice requirement in the statute, although presumably the Treasury will attempt to comply with it. The additional 48 hour notice is evidently designed to facilitate assignment of a judge to the matter and to allow the judge to clear his or her docket for the 24 hour marathon to come. This will relieve some pressure from the judge who must decide the matter, although the content of the petition itself, as well as any objections by the financial firm, will not be made available until the 24 hour clock starts ticking. Local Rule 85 cannot obviate the reality that a single judge must decide whether to order the liquidation of a systemically significant financial firm in a process that is the equivalent of a law school take-home examination.

The Article III objection is exacerbated by the statute's restriction of the court to considering two of the seven threshold determinations that must be resolved before an OLA receivership is established. The court is to consider only whether the Secretary of the Treasury acted arbitrarily and capriciously in finding that the firm met the statutory definition of a "financial company," and whether he acted arbitrarily and capriciously in finding that the firm "is in default or in danger of default." The other five statutory triggering conditions are, according to Dodd-Frank, not to be considered by the court. Yet the judgment the court is asked to render – granting a petition to appoint a receiver leading to mandatory liquidation – necessarily presupposes that all statutory triggering conditions have been met. The court may be uncomfortable rendering a judgment that rests on legal and factual determinations it is not empowered to review. Again, the objective of the statute appears to be to draw upon the prestige of the court as an independent tribunal to legitimize a process that is actually driven by the executive. Courts will not take kindly to being conscripted in this fashion.

There is little precedent to draw upon in considering the Article III claim. The matter is arguably analogous to *Hayburn's Case*,[191] where the courts were asked to render judgments subject to revision by the Executive. This was condemned on the ground that it made the judgments nothing more than advisory opinions.[192] Arguably the same conclusion should follow when the Executive renders a decision that the court is asked to incorporate into a judgment, but without being given the time or the authority to make an independent determination of fact and

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[190] See Local Civil Rule 85 supra note 97.

[191] 2 U.S. (2 Dall.) 408 (1792).

[192] See Richard H. Fallon, Jr., Hart & Wechsler's The Federal Courts and the Federal System 83-90 (6th ed. 2009) (explaining the significance of *Hayburn's Case* for understanding of the role of Article III courts).

law necessary to render a proper judicial judgment. The judicial input in both instances lacks substance, and serves only to transfer a measure of judicial prestige to an executive enterprise. Justice Douglas once warned that a statute which makes "the federal judiciary a rubber stamp for the President" would violate Article III.[193] "If the federal court is to be merely an automaton stamping the papers and Attorney General presents," he wrote, "the judicial function rises to no higher than an IBM machine."[194] His colleagues disagreed with his interpretation of the statute under review, but not with his understanding that such a statute would violate Article III.

The absence of meaningful precedent to assess the Article III claim is both a strength and a weakness. It is a strength insofar as Congress has never before attempted to draw upon the authority of the courts while simultaneously constraining their ability to function as a court in such a dramatic fashion. The unprecedented nature of the judicial appointment provisions of Title II make it suspect. It is a weakness insofar as there is a presumption in favor of the constitutionality of duly-enacted legislation, and courts like to draw upon clear constitutional language or settled authority before rendering a judgment at an enactment of Congress is unconstitutional.

The provisions authorizing an appeal from a district court order appointing a receiver raise further Article III questions. If the district court grants the petition to appoint a receiver, or if the petition is granted as a matter of law because the district court fails to act within 24 hours, the statute says the decision "shall be final, and shall be subject to appeal only in accordance with" the appeal provisions of Title II.[195] The Act then adds: "The decision shall not be subject to any stay or injunction pending appeal."[196] If this last sentence is interpreted to mean that the Court of Appeals (and the Supreme Court on further petition for certiorari) have no authority to enjoin or set aside the decision of the district court once it becomes final, then the "appeal" would have no function other than to render an advisory opinion as to whether the district court acted correctly. This would be a plain violation of Article III. To avoid this conclusion, one must hone in on the word "pending" in the sentence that prohibits any stay or injunction "pending appeal." This should be interpreted to mean that no stay or injunction can be entered while the appeals are *pending*, but once the appeals process is *final*, the appeals court and the Supreme Court have authority to enjoin or set aside the district court decision if they conclude that the Secretary acted arbitrarily and capriciously.[197] As interpreted, this creates a strange go-

[193] United Steelworkers of America v. United States, 361 U.S. 39, 71 (1959) (dissenting opinion).

[194] Id.

[195] DFA, §202(a)(1)(B).

[196] DFA, § 202(a)(1)(B).

[197] We thank Ron Levin for pointing out this problem and its possible solution.

and-stop judicial review process, but this is little different from the post-seizure review provisions of the banking receivership laws, which likewise presume that a receivership can start and then be stopped on an ex post petition for review to a court.

If the statute is interpreted as allowing the Court of Appeals or the Supreme Court to overturn a receivership on appeal or certiorari, and it imposes no time limit on the Court of Appeals or the Supreme Court in reaching the determination whether the Secretary's two findings are arbitrary and capricious, does this solve the Article III problem? It clearly means that these two courts would not be dragooned into rendering decisions in a time period too compressed to allow them to act in a properly judicial fashion. But it would still leave the district court dragooned to act in a manner impossible to discharge in a proper judicial manner. And it would limit the Court of Appeals and the Supreme Court to considering only two of the seven factors that determine whether the Secretary must petition for a receivership. As previously discussed, this presents an independent due process problem, and might be construed as presenting an Article III problem as well, insofar as the Appeals Court and the Supreme Court are being asked to restrict their review to only a subset of the legal issues that lead to the appointment of a receiver. Arguably this too represents an attempt by Congress to exploit the prestige of the judiciary while preventing it from discharging its judicial function in a proper manner.

Can the district court avoid any insult to its judicial independence by simply declining to rule on the petition, in which case it takes effect by operation of law in 24 hours?[198] This would preserve the dignity of the district court, by refusing to lend its prestige to a process that forces the court to act in a non-judicial manner.[199] But the financial firm could still appeal, in which case the Article III question about limiting the courts to reviewing two of seven determinations would still be presented. More seriously, refusing to rule would spare the court at the expense of the parties subject to orderly liquidation. Indeed, by declining to participate, the court would only exacerbate the due process problem. Not only would the parties be denied any post-seizure judicial review, they would not even get the extremely abbreviated pre-seizure review provided by the statute. Seizure of systemically significant financial firms would take place based on the unreviewable say-so of the Executive.

C. Avoidance Anyone?

[198] The Dodd-Frank Act requires the District Court to adopt rules implementing the judicial appointment provisions of the Act. See note 97 supra.

[199] Cf. Korematsu v U.S. 323 US 214, 246 (Jackson, J. concurring) (urging that the Court refrain from upholding or overturning the use of internment camps to avoid establishing a precedent).

Before concluding our consideration of process objections to Title II, another wrinkle should be considered, namely, whether the statute can be construed in such a way as to eliminate the constitutional problem. The potential avoidance move here might be to find that although Dodd-Frank severely limits what the court can consider and how it must consider it, the APA can step in to supplement the court's reviewing authority, and in so doing eliminate possible due process and Article III problems.

Recall again that the statute requires the Secretary to make seven determinations before seeking the appointment of a receiver, and allows the district court to review only two of these determinations. Is it possible that a financial firm facing the appointment of a receiver could obtain review of the other five determinations under the APA – without being shackled by the 24 hour time limit and the arbitrary and capricious standard of review? The APA provides that "[a]gency action made reviewable by statute and final agency action for which there is *no other adequate remedy in a court* are subject to judicial review."[200] This would seem to fit the supposed situation, insofar as there is no other adequate remedy in court if the Secretary has committed legal or factual error with respect to five of the seven determinations. Indeed, insofar as the Dodd-Frank review provisions constrain the court with respect to the two determinations made reviewable – imposing a time so short it effectively deprives a firm of any adequate remedy in court – one could argue that all seven determinations can be reviewed under the APA because the review process prescribed by Dodd-Frank is plainly not "adequate."

Can we say the Secretary's decision to file a petition is "final agency action?" The Supreme Court has instructed that "two conditions must be satisfied for agency action to be 'final': First, the action must mark the consummation of the agency's decision making process...[and] must not be of a tentative or interlocutory nature. And second, the action must be one by which rights or obligations have been determined, or from which legal consequences will flow."[201] The first factor would seem clearly to be met. The Secretary's decision making process culminates in filing a petition to appoint a receiver; he bows out at that point and turns everything over to the court and the FDIC. The second factor is more problematic. In formal terms, the court appoints the receiver, not the Secretary. So the "legal consequences" (which are considerable) flow from the court's decision to grant the petition, not the Secretary's decision to file it. Realistically speaking, however, the Secretary's decision is the one that matters. The court has only very limited grounds for rejecting a petition (and then only by remand to the Secretary for further findings), and only 24 hours to do so. One way to resolve the matter is to focus on the way the statute handcuffs the court by permitting it to review only two of the seven determinations that the Secretary must make before filing a petition. As to the remaining five factors, the Secretary's decision is the last word. As to these factors, the Secretary's decision is

[200] APA, 5 U.S.C. § 704.

[201] Bennett v. Spear, 520 U.S. 154, 177-78 (1997).

fully and effectively "final," since the Dodd Frank Act provides for review by the court of only the other two factors. And the factors that are unreviewable under the Dodd Frank Act are the critical ones the financial firm would ask the court to review under the APA.

A more serious problem is presented by Section 701(a) of the APA, which exempts matters from APA review when "statutes preclude judicial review" or "agency action is committed to agency discretion by law."[202] The government would surely move to dismiss any action seeking review of the five determinations (or all seven) under the APA on the ground that the statute makes them unreviewable. Absent a constitutional avoidance issue, we would regard this as a dispositive objection. The statute does not expressly preclude review of the five determinations. It does say, however, that the district court can only consider two determinations. And the appeals court and the Supreme Court are expressly limited to the two determinations. Courts sometimes say that the inclusion of one type of review should be implicitly regarded as exclusion of other types of review,[203] and that inference is particularly strong under the wording of Dodd-Frank. Once the constitutional avoidance issue is added to the mix, however, it becomes a closer call. Given the substantial due process and Article III arguments that the Dodd-Frank review provisions are unconstitutional, a court would likely strain mightily to avoid such a conclusion by finding that APA review has not been precluded, and that APA review can supplement the procedural deficiencies under Dodd-Frank. A sensible court would of course seek to harmonize APA review with the congressional judgment that the appointment of a receiver must be resolved quickly and confidentially; so the court would set a timetable for APA review that requires considerable dispatch and keeps the matter under seal at least until a final judgment is reached.

The government might also argue that even if review of the five determinations is not precluded by statute, these determinations are committed to agency discretion by law. One common refrain here is that matters are presumptively reviewable as long as there is "law to apply."[204] The five determinations Dodd-Frank sets out for the Secretary to consider (in addition to the two made reviewable by the district court) vary in terms of whether they point more toward a purely discretionary determination by the Secretary or the application of law to fact. Whether the failure of a financial firm would have "serious adverse effects on financial stability in the United States"[205] would seem to be a determination one would want the Secretary of the Treasury to make, not an Article III court. On the other hand, whether "a Federal regulatory agency has ordered the financial firm to convert all of its convertible debt instruments that are

[202] APA, 5 U.S.C. 701(a).

[203] E.g., Block v. Community Nutrition Inst., 467 U.S. 340 (1984).

[204] E.g., Webster v. Doe, 486 U.S. 592 (1988); Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402 (1971).

[205] DFA, § 203(b)(2).

subject to the regulatory order"[206] seems to be abundantly one as to which there is "law to apply." As long as at least one contested determination includes debatable issues of law or fact of the sort that courts often adjudicate, the committed to agency discretion argument would fail, at least in part. Again, the need to avoid deeply unsettling constitutional questions might well tip the balance in favor of finding that at least some determinations are not committed to agency discretion by law.

One potential difficulty with using the APA as an avoidance mechanism would arise if the financial firm subject to a petition for liquidation did not invoke the APA as a basis for review – something easy to overlook if a defense must be organized in less than 24 hours. Perhaps the court could raise this on its own motion, in the interest of avoiding constitutional difficulties. But it would be desirable for the financial firm to ask the court to review the petition under the APA as well as under the Constitution.

IV. Constitutional Issues – Substantive Objections

Dodd-Frank's orderly liquidation authority may be vulnerable on other constitutional grounds that implicate the authority of Congress to mandate the kind of receivership contemplated by Title II. This section looks at two possible Constitutional objections – one grounded in the uniformity requirement of the Bankruptcy Clause and another based on the First Amendment.

A. Uniform Laws of Bankruptcy.

The Constitution confers power on Congress to adopt "uniform Laws on the subject of Bankruptcies throughout the United States."[207] One possible objection to the Dodd-Frank OLA is that it does not constitute a uniform bankruptcy regime. Instead, the government is instructed to determine, on a case-by-case basis, whether to subject a nonbank financial firm to ordinary rules of Bankruptcy, or to switch the firm over to a different track reserved for systemically significant nonbank financial firms. The result is different bankruptcy laws for different financial firms, based on a highly discretionary determination by executive branch agencies as to which is more appropriate. The fact that Title II contains elements significantly more punitive than the ordinary bankruptcy regime makes this discretionary authority especially problematic. A distinct uniformity objection to OLA is that the statute authorizes the FDIC as receiver to treat similarly-situated creditors differently, if it determines that this is necessary to maximize the value of the assets of the firm, initiate or continue operations essential to receivership, or

[206] DFA, § 203(b)(7).

[207] U.S. Const. art. I, § 8, cl. 4.

minimize losses.[208] As we have seen, the state plaintiffs in *Big Spring* cite this potential lack of uniformity as grounds for establishing their standing to challenge the constitutionality of Dodd-Frank.

The reason for the limitation to "uniform laws" in the Bankruptcy Clause is not entirely clear.[209] The leading case, *Railroad Labor Executives Assoc. v. Gibbons*, [210] construed the limitation to mean that Congress has no power to enact a law reorganizing a single debtor. Thus, if Congress were to enact a special law prescribing an orderly liquidation procedure applicable only to a single non-bank financial firm this could be challenged as an unconstitutional exercise of the bankruptcy power under the authority of *Gibbons*. The question is whether a similar conclusion should follow when Congress prescribes a specialized form of bankruptcy for financial firms and gives the executive branch broad discretion to apply this specialized regime rather than otherwise-uniform bankruptcy rules on a case-by-case basis.

In *Gibbons*, the Supreme Court considered the Rock Island Railroad Transition and Employee Assistance Act (RITA), a law passed specifically to address the circumstances of the Rock Island Railroad bankruptcy.[211] Among other things, the law sought to require that the railroad's bankruptcy trustee provide certain economic benefits to railroad employees who were not hired by other railroad carriers. In considering whether this special law was constitutional, the Court addressed two issues. First, whether the Act should be regarded as having been passed pursuant to the Bankruptcy Clause, which requires that laws be "uniform," or could be regarded as having been passed pursuant to the Commerce Clause, which does not include a uniformity requirement.[212] Second, whether the uniformity requirement of the Bankruptcy Clause prohibits a bankruptcy law that applies to only one debtor.

The first issue – whether RITA was enacted pursuant to the Bankruptcy Clause or the Commerce Clause – was critical, because the Court recognized that "if we held that Congress had the power to enact nonuniform bankruptcy laws pursuant to the Commerce Clause, we would eradicate from the Constitution a limitation on the power of Congress to enact bankruptcy laws."[213] It was therefore necessary to determine whether RITA fell within the ambit of the

[208] DFA, 210(b)(4).

[209] The Federalist Papers contain only one sentence about the Bankruptcy Power. See The Federalist No. 42 (Madison) (noting that "[t]he power of establishing uniform laws of bankruptcy, is so intimately connected with the regulation of commerce, and will prevent so many frauds where the parties or their property may lie, or be removed into different states, that the expediency of it seems not likely to be drawn into question.")

[210] 455 U.S. 457, 471 (1982).

[211] 455 U.S. at 462-63.

[212] Id. at 468.

[213] Id. at 469.

bankruptcy power. After surveying its prior decisions, the Court concluded that the bankruptcy power "extends to all cases where the law causes to be distributed, the property of the debtor among his creditors."[214] The power "includes the power to discharge the debtor from his contracts and legal liabilities, as well as to distribute his property."[215] In short, the Court held that any law that discharges the contracts and other legal liabilities of a debtor and distributes the property among creditors is a law adopted pursuant to the bankruptcy power. Under the rationale of *Gibbons*, Title II of Dodd-Frank would have to be regarded as being adopted pursuant to the Bankruptcy Power, and thus is subject to the "uniform laws" requirement.

With respect to the second issue, the Court acknowledged that the uniformity requirement of the Bankruptcy Clause "is not a straightjacket that forbids Congress to distinguish among classes of debtors, nor does it prohibit Congress from recognizing that state laws do not treat commercial transactions in a uniform manner."[216] It also acknowledged that Congress could take into account differences that exist between different parts of the country, and fashion legislation to deal with geographically isolated problems, as it had done in the Conrail bankruptcy.[217] But RITA was a different matter: "The employee protection provisions of RITA cover neither a defined class of debtors nor a particular type of problem, but a particular problem of one bankrupt railroad. Albeit on a rather grand scale, RITA is nothing more than a private bill such as those Congress frequently enacts under its authority to spend money."[218] The Court concluded that "[t]he language of the Bankruptcy Clause itself compels us to hold that such a bankruptcy law is not within the power of Congress to enact."[219]

The Court reinforced this conclusion by examining the history of the Bankruptcy Clause. The Clause was added to the Constitution during deliberations about the problem of affording full faith and credit to the legal actions of other states. Several states had followed the practice of passing private bills to relieve individual debtors, and questions had been raised about whether other states were obliged to recognize relief given by these acts. The Court concluded that the Bankruptcy Clause was adopted to provide Congress with the power to enact uniform

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[214] Id. at 466, quoting *Hanover National Bank v. Moyses*, 186 U.S. 181, 186 (1902).

[215] Id., quoting *Hanover National Bank*, supra, at 188.

[216] Id. at 469.

[217] *See Regional Railroad Reorganization Act Cases*, 419 U.S. 102, 159 (1974).

[218] *Gibbons*, supra, at 470-71.

[219] Id. at 471.

bankruptcy laws enforceable among the states, and that "the Bankruptcy Clause's uniformity requirement was drafted in order to prohibit Congress from enacting private bankruptcy laws."[220]

In light of *Gibbons*, it would be unconstitutional for Congress to enact a law providing special rules applicable solely to the resolution of a specific nonbank financial firm. The same result should follow if Congress delegates authority to the executive branch to adopt specialized rules for the re-organization of a single nonbank financial firm. Congress cannot delegate power to an agency that will overcome a limitation on Congress's own authority to act.[221] Is this Dodd-Frank? Given the extraordinary discretion that the Treasury Department and allied federal agencies have in determining that a financial company should be reorganized under Title II, as opposed to general bankruptcy laws, it certainly comes close. Title II's OLA may never be invoked, or may be invoked so rarely that it is tantamount to a one-off bankruptcy regime. And the decision whether to apply such a regime will left almost entirely to the discretion of the executive branch, under a statute that makes most of its determinations unreviewable.

There is, however, a distinction between Dodd-Frank and a bankruptcy regime that amounts to a private bill. After Dodd-Frank, there are two bankruptcy laws for large nonbank financial firms -- one for most nonbank financial firms (the Bankruptcy Code) and the other for firms deemed by the executive to be too big to fail (Dodd-Frank Title II). Congress has enacted both laws, and they are set forth in the form of general statutes. Congress has further instructed the executive to decide, on an ad hoc basis, which of the two packages of bankruptcy rules should apply in individual cases. If Congress had set forth clear legal criteria for determining when Package A applies as opposed to Package B, and had allowed ordinary judicial review of any decision as to which package to apply, we think this would probably be constitutional. After all, Congress has legislated different approaches to the resolution of insolvency in different industries, like railroads, banks, and insurance companies. This inevitably presents classification questions, which have been resolved using ordinary tools of statutory interpretation.

Dodd-Frank is a less clear case, because the factors for deciding which package of rules apply are highly discretionary and, as previously discussed, the provisions for judicial review are severely truncated. Congress came close to saying: here is a new package of bankruptcy rules for firms that are too big to fail, and you (the executive) decide in your unreviewable discretion which firms fall into that category.[222] It is difficult to describe this as a "uniform law" of

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[220] Id. at 472.

[221] See, e.g., Whitman v. American Trucking Assns., 531 U.S. 457, 473 (2001) (making this point in the context of a nondelegation challenge).

[222] A constitutional purist might insist that Dodd-Frank gives so much discretion to the executive in this regard that it violates the nondelegation doctrine. We do not pursue this inquiry here, because the Court has refused to find a nondelegation violation provided Congress has laid down any kind of standard to govern executive decision making. E.g., Whitman, supra; Fahey v. Mallonee, supra. Dodd-Frank sets forth seven "determinations" that must be made before a receivership is commenced, which is more than enough to meet the lax requirements of the contemporary

bankruptcy, but it presents a different order of problem from the statute invalidated in *Gibbons*. So the uniformity objection would sail into largely uncharted waters. Given that Dodd-Frank sets forth a general regime for resolving the bankruptcy of firms that are too big to fail, and does not seek to dictate special treatment for specific classes of creditors in pending cases, we doubt that the courts would extend *Gibbons* to reach this situation. But the argument cannot be said to be frivolous.

What then about the other uniformity problem cited by the plaintiffs in *Big Spring*: the provision of Dodd-Frank that allows the FDIC to treat similarly-situated creditors differently if this will maximize the value of the firm's assets?[223] Assuming that Dodd-Frank does in fact contemplate that the FDIC can pick and choose among similarly-situated creditors,[224] it is not clear that this would constitute a violation of the "uniform laws" requirement. One can have a law that uniformly provides for dissimilar or even random treatment of similarly-situated claimants. An example might be a bankruptcy law providing that creditors will be selected for payment by lottery. We do not suggest that such a law would be desirable. Uniform treatment of similarly-situated creditors is unquestionably an important *policy* of the bankruptcy laws, since it critical in overcoming the competitive race among creditors to capture a limited pool of assets, which bankruptcy is designed to prevent.[225] Dodd-Frank, by giving the FDIC discretion to treat similarly-situated creditors differently, may stimulate a competitive race to influence federal regulators to favor one creditor over others. Nevertheless, deviation from sound bankruptcy principles does not necessarily equate to a violation of the uniformity requirement. In our view, "uniform Laws" means that one debtor cannot constitutionally be singled out for dissimilar treatment; but it is probably too much of a stretch to say the Constitution requires that all similarly-situated creditors must be treated alike.

B. First Amendment

nondelegation doctrine. To be sure, decisions like *Fahey* have stressed that broad delegations are permissible in part because judicial review is available to hold the executive in check. As previously discussed, judicial review of the decision to seize a firm and put it into receivership is sharply limited under Dodd-Frank. Whether courts will continue to stress the need for judicial review, however, is unclear. See Thomas W. Merrill, Delegation and Judicial Review, 33 Harv. J. L & Pub. Pol'y 73 (2010).

[223] DFA, §210(b)(4).

[224] The statute in fact says that all claimants "that are similarly situated...shall be treated in a similar manner," subject to an exception where the FDIC determines that it is necessary to deviate from equality in order to maximize the value of estate assets. DFA, §210(b)(4). The government argues in *Big Spring* that the exceptions would apply only in narrow circumstances, such as where payment to utilities should be continued to keep the lights on. A narrowing construction to this effect would go a long way toward undermining the premise of the states' argument about dissimilar treatment of creditors. See Defendants' Motion to Dismiss the Second Amended Complaint, State National Bank of Big Spring v. Wolin, No. 1:12-cv-0132 (ESH) (filed Feb. 22, 2013) at 46-48.

[225] See, e.g., Thomas H. Jackson, Avoiding Powers in Bankruptcy, 36 Stan. L. Rev. 725, 758 (1984).

Dodd-Frank is also vulnerable to challenge because it contains a provision imposing stiff criminal penalties on persons who disclose truthful information about pending cases in an Article III judicial proceeding.[226] Of course, judicial proceedings are sometimes conducted in camera, as when a grand jury considers whether to bring a criminal indictment or the government seeks a warrant to search or arrest. And discovery materials or settlement agreements are sometime put under seal, as when the parties stipulate to a confidentiality agreement. But the idea that a defendant can be criminally punished for disclosing truthful facts about an adversarial judicial proceeding the government has brought against the defendant is without precedent.

One can readily imagine circumstances in which Dodd-Frank's statutory gag rule would raise serious First Amendment issues. Suppose a financial firm is notified that a petition has been filed to appoint a receiver to liquidate it under Title II. The firm believes that the petition has been filed because it is on an "enemies list" established by the President to punish firms that have not contributed to his re-election campaign. The firm further concludes that its only hope of salvation is to leak the information about the pending receivership to the press, in an effort to rally opposition to the move. Dodd-Frank seeks to deter such action by imposing criminal punishment of up to five years in prison for speaking out about what is happening.

A First Amendment test of Dodd-Frank's gag rule may never arise, because typically none of the parties to the proceeding to appoint a receiver will have an interest in disclosure. Other than the executive branch officials and the court personnel involved, only the officers and directors of the targeted firm will know about the proceeding, "and they are probably the last ones who would want the petition for a receivership to be disclosed."[227] This is no doubt true in a case where the firm is about to collapse and the government is acting in good faith. But the First Amendment, like other provisions of the Bill of Rights, was adopted on the assumption that the government will not always be operating in good faith. Obviously, Dodd-Frank's criminal penalties for disclosing truthful information about an OLA proceeding could only be challenged by someone who proposes to engage in conduct that would give rise to potential criminal liability.[228] The question is whether its constitutionality would be sustained in such a context.

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[226] DFA, § 202(a) (1)(C).

[227] Baird and Morrison, supra note 104 at 298.

[228] Clapper v. Amnesty International USA, No. 11-1025 (February 26, 2013), would appear to bar an anticipatory challenge to the gag rule by a creditor anxious to receive information about any petition to put a financial firm into receivership.

The government might attempt to argue that the gag rule is analogous to the rules that prohibit witnesses in grand jury proceedings from disclosing their testimony.[229] But grand jury proceedings are not a final determination of criminal liability. If the grand jury returns an indictment, the defendant is free at trial to call relevant witnesses to testify in open court in an effort to be exonerated.[230] In contrast, once a petition to appoint a receiver is approved under Dodd-Frank's OLA, a receivership commences that inevitably leads to mandatory liquidation of the targeted firm, as well as other irrevocable consequences such as the elimination of stockholder equity and the dismissal of all directors. In this sense, the Dodd-Frank gag rule is more analogous to an order closing a public trial, something highly disfavored under the First Amendment.[231]

The government may also seek to analogize the gag rule to the rules of secrecy associated with proceedings to obtain a search warrant, confidentiality agreements, civil commitment proceedings, or juvenile trials. But these secrecy rules can be explained on grounds of consent. Government employees involved in judicial proceedings for issuing warrants or orders for national security wiretaps can be prohibited from disclosing what goes on in these proceedings, because they have explicitly or implicitly agreed to these constraints by accepting public employment.[232] Confidentiality agreements are also based on consent, as where parties agree not to disclose the existence of a civil action or (more commonly) the settlement of a civil action.[233] Civil commitment and juvenile justice proceedings are also often confidential. But here too, typically, the party against whom the action is directed fully supports maintaining the confidentiality of the proceeding. Given that government employees and parties to lawsuits can consent to secrecy, Dodd-Frank's gag rule is presumably justifiable as applied to Treasury Department or FDIC officials, as well as court personnel, because these officials have consented

[229] See Douglas Oil Co. v. Petrol Stops Northwest, 441 U.S. 211, 222 (1979); United States v. Procter & Gamble Co., 356 U.S. 677 (1958).

[230] Cf. Butterworth v. Smith, 494 U.S. 624 (1990) (holding that publication of grand jury testimony may not be prohibited once the term of the grand jury is over).

[231] In the context of criminal trials of adults, the Court has held that even if the prosecutor and the defendant agree to make the proceedings confidential, the First Amendment allows interested third parties (such as the press) to object on First Amendment grounds. See Press-Enter. Co. v. Superior Court, 464 U.S. 501 (1984); Richmond Newspapers, Inc. v. Virginia, 448 U.S. 555 (1980).

[232] See Snepp v. U.S. 444 U.S. 507, 510 n.3 (1980) (holding that the requirement that Snepp get the CIA's approval of any memoir he might write prior to its publication was not an unconstitutional restraint on free speech as Snepp had voluntarily signed an agreement to that effect both upon the commencement of his employment with the CIA and just prior to his departure).

[233] Seattle Times Co. v. Rhinehart, 467 U.S. 20 (1984) (holding protective order prohibiting a newspaper from publishing information which it had obtained through discovery procedures did not offend the First Amendment).

to preserve confidential information that pertains to their public functions.[234] But threatening officers or directors of a targeted firm with criminal punishment for disclosing truthful information about a court proceeding in which they have been involuntarily drawn is different. When the government brings a civil action against a party, and that party seeks to disclose truthful information about the proceeding, there is little precedent suggesting that the party can be criminally punished for doing so.

Perhaps the closest analogy is provided by National Security Letters (NSLs) authorized by the Patriot Act. The Act allows the government to issue NSLs requesting records from wire or electronic communications service providers as part of an investigation of potential terrorist activity, and prohibits the service provider from disclosing that such information has been sought.[235] The Second Circuit has held that there can be a compelling governmental interest in preserving the confidentiality of NSLs. [236] But the court also concluded that relevant First Amendment authority requires that any such restraint on speech must be narrowly tailored to serve the government's interest in confidentiality. The court further concluded that the government must bear the burden of proving, in each case, that there is good reason to believe that disclosure of a NSL would jeopardize a national security investigation.[237]

There are nevertheless significant differences between NSLs and Dodd-Frank's nondisclosure requirement. One question is whether the government interest in preserving the confidentiality of an OLA petition is as compelling as that in preserving the secrecy of an investigation of potential terrorists. If one assumes premature disclosure of an OLA proceeding could trigger a financial panic, the answer is presumably yes. A financial panic would be devastating to national economy, inflicting damage of a different sort than a terrorist attack, but nevertheless something equally to be avoided if at all possible. Another question is whether a case-specific justification of the need for secrecy is required by the First Amendment, as the Second Circuit held in the context of an NSL.[238] Dodd-Frank includes no requirement of a government demonstration of the need for confidentiality in each case in which an OLA proceedings is initiated. Congress apparently assumed that confidentiality would always be required in order to prevent a financial crisis analogous to a run on the bank. But it is not clear this assumption is necessarily correct. One can imagine a case in which a systemically significant nonbank financial firm is already known to be insolvent before an OLA proceeding is

[234] See United States v. National Employees Union, 513 U.S. 454 (1955).

[235] 18 U.S.C. § 2709 (2000).

[236] John Doe, Inc. v. Mukasey, 549 F.3d 861, 878 (2d Cir. 2009).

[237] Id. at 883.

[238] John Doe, Inc., supra, 549 F.3d at 878-881.

commenced, in which case the news would already have been absorbed by the market. It is not at all clear why the gag rule is necessary in such a situation. So perhaps an individualized justification of secrecy is required in the OLA context too.

There is a more fundamental reason why Dodd-Frank's gag rule fails the narrow tailoring requirement. This is because the government had the option of structuring OLA like an ordinary bank receivership, in which plenary judicial review of the decision to appoint a receiver would occur ex post rather than ex ante. Putting the judicial hearing after the receiver is appointed eliminates any need for secrecy, as well as any need for a rush to judgment and the other problems previously considered in connection with a due process or Article III challenge. Once again, we see that the Senate's amendment injecting a federal district court into the process of appointing a receiver was an unforced error generating constitutional problems that could readily have been avoided.

V. Takings Issues

We conclude with some takings issues. Title II contains a number of provisions that conceivably could give rise to takings claims. It is difficult to speak with any certitude about how these might be resolved. Short of outright seizure or destruction of a recognized property right by the government, takings claims are resolved under an ad hoc regime that depends critically on the specific facts presented.[239] We will briefly note some situations that seem especially likely to generate future takings claims, and then offer somewhat more complete analysis of the largest takings issue looming on the horizon: impairment of secured creditor claims in order to avoid taxpayer-funded bailouts.

Tracking the language of the Constitution,[240] takings claims can potentially present four issues: Does the claimant have an interest in "private property"? Has the government "taken" this property? If so, was the taking for a "public use"? And finally, has the government made adequate provision to provide "just compensation" for the taking?

Of these four issues, the "public use" question is probably the least likely to be contested. Most would agree that seizing a firm to prevent or forestall a financial crisis, which is the premise for exercising Title II authority, is a legitimate public use.[241] To be sure, just because

[239] Penn Central Transp. Co. v. New York, 438 U.S. 104, 124 (1978).

[240] "Nor shall private property be taken for public use without just compensation." U.S. CONST. amend. V. For an overview of these issues, see DAVID A. DANA AND THOMAS W. MERRILL, PROPERTY: TAKINGS (2002).

[241] The Supreme Court has defined "public" use broadly to include public benefit or advantage. Kelo v. City of New London, 545 U.S. 469 (20050; see DANA AND MERRILL supra, at 191-209.

the Title II process as a whole satisfies the public use requirement, it does not necessarily follow that every seizure of property undertaken pursuant to a Title II proceeding is also for a public use. Still, assuming there is some nexus between the seizure and the purposes of Title II, a public use challenge will likely fail.[242] The "property," "taking," and "just compensation" issues are more likely to arise, if and when OLA is used and one or more aggrieved stakeholders elects to pursue a takings claim.

A. Some Possible Takings Claims

1. *Assessments.* Given its desire to avoid anything resembling a bailout of failed financial firms, Dodd-Frank provides that if Treasury funds are needed to support a financial firm during the resolution process, these must be repaid. The first source of repayment is the firm's stakeholders – shareholders are wiped out and unsecured creditors will have their claims reduced, if necessary to zero. If this still leaves a debt to the Treasury, then the Act provides that the FDIC can impose "assessments" on a broad list of financial institutions.[243] Those eligible to be tapped include any bank holding company with at least $50 billion in assets, any nonbank financial company subject to systemic risk oversight under Title I, and any other "financial company" with assets of at least $50 billion.[244]

Financial firms that are assessed to pay for the resolution of some other insolvent financial firm may claim that this kind of monetary exaction constitutes an unconstitutional taking of property. Although the principle has not been enforced by the Supreme Court for many decades, there is older authority holding that special assessments disproportionate to any benefits conferred are takings.[245] Today, a threshold question would be whether the imposition of a general monetary liability of this nature can ever be challenged as a taking. In *Eastern Enterprises v. Apfel*,[246] five Justices joining separate opinions thought not; in their view the

[242] Whether a taking is for a public use must ordinarily be resolved before a taking occurs, since if the taking lacks a public use, it should be enjoined. See D. Zackary Hudson, *Eminent Domain Due Process*, 119 YALE L. J. 1280 (2010). Dodd-Frank's OLA provisions offer no clear way to raise the public use issue before the seizure of a financial firm occurs. If a claimant has a legitimate public use objection, this would be an additional constitutional reason to condemn the statute.

[243] DFA, § 210(o)(1)(B).

[244] DFA, § 210(o)(1)(A).

[245] Village of Norwood v. Baker, 172 U.S. 269 (1898); cf. Louisville & Nashville RR. V. Barber Asphalt Paving Co., 197 U.S. 430 (1905) (permitting assessments based on general criteria like frontage footing); see generally Robert C. Ellickson, *Suburban Growth Controls*, 86 YALE L. J. 385, 469-73 (1977).

[246] 524 U.S. 498 (1998); see id. at 540-42 (Kennedy, J. concurring in the judgment and dissenting in part); id. at 554-55 (Breyer, J. dissenting). For a defense of the discrete assets limitation, see Thomas W. Merrill, The Landscape of Constitutional Property, 86 Va. L. Rev. 885, 974-78 (2000).

Takings Clause applies only to interferences with discrete assets. If the Clause does apply, the government would likely argue that liability for such assessments is analogous to a special tax to help redress a problem unique to the industry being taxed, such as a tax on chemical feedstocks to pay for hazardous waste cleanups.[247] Financial firms that object to paying assessments would likely stress the unfairness of forcing them to fund a general public good – avoidance of financial crisis -- when there is no required finding that they were at fault or even causally connected to behavior that gave rise to the crisis. Whether this would succeed if framed as a takings claim is doubtful but not impossible.[248]

2. *Executive Pay Clawbacks.* Dodd-Frank requires the removal of officers of the financial firm if they are found to have been "responsible" for the company's financial failure. It also permits the FDIC to claw back any compensation they received during the two years prior to the start of the receivership.[249] The clawback is not limited to "excessive" compensation, nor is there any statutory requirement of specific misconduct on the part of the officer that produced inflated compensation. To the contrary, the statute instructs the FDIC to weigh the "financial and deterrent benefits" of a clawback against "the cost of executing the recovery."[250] This appears to be close to mandating a clawback whenever it would be cost effective to do so, without regard to the culpability of the officer or the excessive size of the compensation package.

Executives subject to such clawbacks might argue that the statute goes far beyond traditional notions of avoidable preferences and fraudulent conveyances in bankruptcy,[251]and constitutes nothing more than an attempt to expropriate their wealth in order to promote the general good of achieving financial stability. The government would likely argue that Dodd-Frank's executive clawbacks are consistent with recent clawback provisions in the Sarbanes-Oxley Act and the TARP legislation[252] and are broadly equitable and fair. The outcome, again,

[247] An earlier version of the Dodd-Frank Act provided for the creation of such a fund, but this was deleted by the Senate in order to reduce the perception that the statute contemplated "bailouts." CERCLA or Superfund, as originally enacted in 1980, provided for a tax on chemical companies, see 42 U.S.C. 9507(b)(1); this tax, in turn, supplied a fund for cleanup of hazardous waste sites. 42 U.S.C. 9611. The tax expired in 1995 and has not been reauthorized.

[248] For an analogous argument, albeit in a dissenting opinion, see Pennell v. City of San Jose, 485 U.S. 1, 15-16 (1988) (Scalia, J., concurring in part and dissenting in part) (arguing that it is a taking to force landlords to accept reduced rents based on "tenant hardship" for which they bear no responsibility).

[249] DFA, § 210(s)(1).

[250] DFA, § 210(s)(2).

[251] See 11 U.S.C § 547(b)(4)(B) (allowing the trustee to avoid transfers made by the debtor to insiders with one year or less of the debtor filing for bankruptcy); but also see § 547(c) (prohibiting a trustee from avoiding a transfer that was made to any creditor in exchange for new, contemporaneous value given to the debtor).

[252] See Spencer C. Barasch & Sara J. Chesnut, Controversial Uses of the "Clawback" Remedy in the Current Financial Crisis, 72 Tex. B. J. 922 (2009).

is difficult to handicap, and might turn on what a court concludes is the relevant baseline for establishing legitimate expectations about the vulnerability of executives to salary clawbacks. If baseline is that established by the Bankruptcy Code, executive would have a chance of prevailing; if more recent legislation is deemed to the relevant baseline, their chances would diminish.

3. *Revival of Barred Actions.* Dodd-Frank contains an unusual provision allowing the FDIC as receiver to bring tort claims on behalf of the entity in receivership even though the statute of limitations has expired.[253] The purpose is obviously to allow the FDIC to recover funds from former managers and other miscreants perceived to have caused the covered financial firm to experience financial losses. The covered claims include "fraud, intentional misconduct resulting in unjust enrichment, or intentional misconduct resulting in a substantial loss to the covered financial company." Fraud and unjust enrichment are well established common-law causes of action; "intentional misconduct resulting in substantial loss" is not, so the exact scope of this provision is unclear. The statute of limitations must have expired within 5 years of the appointment of the FDIC as receiver in order for the claim to be eligible for revival.

Persons targeted in these cases may claim that reviving a cause of action for damages previously barred by the statute of limitations represents a taking of property. The Supreme Court has sometimes said that reviving actions barred by the statute of limitations would be a taking,[254] but more often has said it is not.[255] Clearly, reviving liabilities previously barred by the statute of limitations interferes with the repose these statutes are designed to promote. Not surprisingly, perhaps, legislative revivals of liability have been declared unconstitutional under provisions other than the Takings Clause.[256] Thus, it is difficult to predict with any confidence how such an action would ultimately be assessed today under a takings challenge.

B. Impairment of Security Interests

[253] DFA, § 210(a)(10)(C).

[254] William Danzer & Co., Inc. v. Gulf & Ship Island R. Co., 268 U.S. 633 (1925).

[255] Chase Securities Corp. v. Donaldson, 325 U.S. 304 (1945); Campbell v. Holt, 115 U.S. 620 (1885). In the latter case the Court distinguished between actions to recover real or personal property, where the passage of the statute of limitations confers a title to property by adverse possession or prescription, and actions to recover of a debt, where the statute merely bars enforcement in court.

[256] See Stogner v. California, 539 U.S. 607 (2003) (holding that once criminal prosecution is barred by statute of limitations, revival of action constitutes an ex post facto law); Plaut v. Spendthrift Farm, Inc., 514 U.S. 211, 217-19 (1995) (holding that once action has been dismissed by federal court as barred by statute of limitations, enactment of a statute that adopts a longer statute of limitations and seeks to reopen judgments violates Article III).

The most significant takings issues potentially implicated by Dodd-Frank involve security interests.[257] In the quest to find sources of funding other than tax revenues to prop up firms undergoing resolution, the House bill, H.R. 4173, provided that certain secured creditors would be required to take a haircut of up to 10 percent of the value of their security interest if "the amounts realized from the dissolution are insufficient to satisfy completely any amounts owed to the United States…."[258] No such provision was included in the Senate bills or the version of the statute as enacted. In a tip of the hat to the House, the final version of the Act did include a section requiring the Financial Stability Oversight Council to conduct a study as to whether secured creditors should be required to take a haircut in future OLA proceedings.[259] The study, which was completed in July 2011, recommended against amending the law to permit impairment of security interests, largely on the ground that the other powers given by the Act are sufficient to avoid future taxpayer bailouts without going after secured creditors.[260] Given the Council's advice, a revision of the law permitting impairment of security interests appears unlikely for the moment. Nevertheless, there is a very real possibility that Congress will demand the impairment of secured creditor rights in some future financial crisis, in the interest of avoiding taxpayer liability.[261]

A security interest is essentially a contingent property right held by a lender in specific assets owned by the borrower.[262] In terms of conventional property forms, security interests are

[257] Unsecured claims are commonly reduced or disallowed in bankruptcy and other insolvency proceedings. A state law that retroactively impaired unsecured creditor rights could give rise to a claim under the Contracts Clause. See Ogden v. Saunders, 25 U.S 213 (1827). But for purposes of the Takings Clause, unsecured claims are regarded as contract rights, not property rights, and hence impairment by the federal government through bankruptcy-proceedings does not give rise to any issue under the Takings Clause. As previously noted, unsecured claims *are* regarded as property for due process purposes. Tulsa Professional Collection Services, Inc. v. Pope, 485 U.S. 478, 485 (1988).

[258] H.R. 4173, § 1609(a)(4)(D)(iv). The interests covered where short term financial contracts secured by securities other than instruments of the United States or interests in land.

[259] DFA, § 215.

[260] Financial Stability Oversight Council, Report to the Congress on Secured Creditor Haircuts (July 2011) at http://www.treasury.gov/initiatives/Documents/report%20to%20congress%20on%20secured%20creditor%20haircuts.pdf.

[261] Recent academic commentary has argued that secured creditors have insufficient incentives to monitor distressed firms, and that eliminating the absolute priority rule for secured creditors would result in better monitoring. See Douglas G. Baird, Security Interests Reconsidered, 80 Va. L. Rev. 2249, 2259 (1994). An earlier generation of scholars worried that secured creditors were likely to leave insufficient assets in a bankrupt enterprise to satisfy the claims of nonadjusting creditors like torts claimants. See, e.g., Lucian A. Bebchuk & Jesse M. Fried, The Uneasy Case for the Priority of Secured Claims in Bankruptcy, 105 Yale L. J. 857 (1996). Both types of arguments presuppose that security interests are not constitutionally protected by the Takings Clause.

[262] See Baird supra at 2257 ("Security interests under Anglo-American law have always been tied to particular assets. A creditor acquired an interest in a particular piece of real and personal property and looked to it first to obtain repayment.")

analogous to executory interests: They are a nonpossessory future interest that may or may not vest, depending on the happening of a future contingency, namely, the borrower's default on the loan. If the loan is repaid in a timely manner, the security interest is released. If the loan is not repaid in a timely manner, this gives the security interest holder the right to seize or compel the sale of the asset in order to generate funds to repay the loan.

Under the Bankruptcy Code, security interests are implicitly treated like property rights that belong to the secured creditor, although the Code studiously avoids labeling them "property." In a liquidation proceeding, a secured creditor is entitled to the full amount of its secured claim.[263] The trustee in bankruptcy can either sell the property subject to the security interest,[264] in which case the security interest follows the property, or can sell the property free of the security interest,[265] with the proceeds of the sale being used to satisfy the secured debt.[266] If the value of the asset is equal to or worth less than the unpaid balance due on the loan, the trustee can abandon the property to the security holder.[267] Security interests are subject to the automatic stay in bankruptcy, which can potentially impair the value of the security.[268] The Code requires that the trustee provide "adequate protection" to secured lenders to minimize losses due to the stay.[269]

Things are more complicated in a reorganization proceeding. Here, the bankruptcy trustee (or debtor in possession) can with the approval of the bankruptcy court decide that the specific asset in which a creditor holds a security interest is necessary to the success of the reorganized firm.[270] In this event, the court can decide to keep the asset for the use of the reorganized firm. If it does so, however, it must perform a valuation of the asset and give the secured creditor a substitute for its property right – a "secured claim to the extent of the value of such creditor's interest."[271] The Code again requires that secured creditors given these substitute rights must be given "adequate protection" that they will receive an "indubitable

[263] Dewsnup v. Timm, 502 U.S. 410, 417 (1992).

[264] 11 U.S.C. § 363(b) & (c).

[265] Id. at § 363(f).

[266] Id. at § 363(j).

[267] Id. at § 554.

[268] Id. at § 362.

[269] Id. at § 363(e).

[270] Id. at § 1123.

[271] 11 U.S.C. § 506(a).

equivalent" to the value of the property in which they previously held a security interest.[272] By allowing the bankruptcy court to substitute other rights of equivalent financial value for the security interest, the Code treats security interests as if they are fungible assets equivalent to money, and hence as something the court is free to exchange for money.

As enacted, the Dodd-Frank Act follows the Bankruptcy Code in recognizing the distinctive status of security interests, and in particular in recognizing that they are entitled to adequate protection without regard to the impact this has on other creditors or on larger objectives such as preventing the collapse of a systemically significant firm.[273] As in the case of the Bankruptcy Code, there is no acknowledgment in Dodd-Frank that security interests are property or that the abrogation of security interests in order to enlarge the pot of assets available for other worthy ends might raise constitutional questions.

Notwithstanding its general posture in favor of preserving security interests, Dodd-Frank Title II deviates in certain respects from the way security interests are treated in bankruptcy. The clearest example concerns setoffs, as when a creditor holds funds of an insolvent debtor which the creditor then seeks to take as full or partial satisfaction of an unpaid claim. The Bankruptcy Code treats setoffs as a type of secured claim; Dodd-Frank does not.[274] Thus, it is foreseeable that some creditor denied treatment of a setoff as a secured claim will argue that this is a taking requiring the government to make up the difference by paying just compensation. The question is whether this type of deviation from the treatment of security interests in bankruptcy, or other reductions in secured creditor rights in the future in response to demands for alternative sources of funding of resolutions of systemically significant firms, could be challenged as a taking.

Under the relevant decisions of the Supreme Court, it is reasonably clear that security interests are "property" protected by the Takings Clause. The issue arose in a series of Depression-era cases under the Frazier-Lemke Act, which allowed farmers to obtain a moratorium on foreclosure and to convert mortgaged farm property into a temporary leasehold.[275] The Court stated unequivocally that mortgages are property and that the Takings Clause applies.[276] It then offered shifting judgments about whether the moratorium and

[272] 11 U.S.C. §§ 362(d)(1); 361; 1129(b)(2)(A) .

[273] DFA, § 210(a)(3)(B) ("The receiver shall allow any claim... which is proved to the satisfaction of the receiver.")

[274] DFA, § 210(a)(7)(B). The Bankruptcy Code does not grant setoff rights per se; creditors' setoff rights are governed by state law. See Citizens Bank v. Strumpf, 516 U.S. 16 (1995). Section 553 of the Bankruptcy Code does however acknowledge that a creditor has the right of setoff under state law and preserves setoff rights. See 11 U.S.C. § 553. Section 506(a) treats valid setoff rights as a secured claim. Id. at § 506(a).

[275] 11 U.S.C 203(s) (1934).

[276] Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 601 - 602 (1935).

conversion was a taking. It struck down the initial version of the Act,[277] but upheld a modified version two years later that shortened the moratorium period.[278] In another widely cited decision, *Armstrong v. United States*, [279] the Court again stated unequivocally that a materialmen's lien is property protected by the Takings Clause. It held that when the United States seized property subject to such a lien with the result that the lien was completely destroyed, this was a taking. Most recently, the Court addressed a provision of the Bankruptcy Code that exempted certain household furnishings from judgment liens. The Court held that the exemption should apply only prospectively and not to liens in existence when the Code was adopted. Relying on its decisions holding mortgages and materialmen's liens to be property, the Court reasoned that judgment liens are "property" and that the complete abrogation of a pre-existing lien by statute would raise "substantial doubt" under the Takings Clause.[280]

Although the Court's decisions collectively establish that security interests are "property" for takings clause purposes, they nevertheless leave many questions unanswered. One question is whether the status of security interests as property is subject to prospective modification by legislation or regulatory pronouncement.[281] There is a strong suggestion in *Security Industrial Bank*, the most recent decision, that prospective override of security interests would not be a taking.[282] This might mean, for example, that creditors who obtain setoff rights after the enactment of Dodd-Frank Title II cannot claim that the failure to treat these rights as property for bankruptcy purposes is a taking, because Title II announced to the world that henceforth they would not be treated as such. Setoff rights are close enough to the line between property and contract rights (which clearly are subject to compromise or even disallowance in bankruptcy) that this kind of re-classification may be permissible. It is less clear whether an announcement by Congress (or a federal agency) modifying the absolute priority given to

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[277] *Id.*

[278] Wright v. Vinton Branch of the Mountain Trust Bank, 300 U.S. 440 (1937).

[279] 364 U.S. 40 (1960).

[280] United States v. Security Indus. Bank, 459 U.S. 70 (1982).

[281] Compare James Stevens Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973 (1983) (arguing that Congress has complete discretion to modify the priority or other treatment of secured creditor rights under the Bankruptcy Clause) with Julia Patterson Forrester, *Bankruptcy Takings*, 51 FLA. L. REV. 851 (1999) (arguing that prospective modification of secured creditor rights that go beyond settled background principles of property law can give rise to takings liability).

[282] The Court specifically reserved the issue whether the Act would apply to liens established after the Act was passed but before it became effective. See *Security Industrial Bank*, 459 U.S. at 82 n.11. But the Court did not reserve the question whether a judgment lien established *after* the Act became fully effective was also susceptible to a takings challenge. Thus, the Court implicitly assumed the provision could be applied in a fully prospective fashion.

security interests in bankruptcy would be enough to immunize the government from any takings claims arising in security interests created thereafter. At least with respect to interests in land, the Court has been reluctant to regard every newly-legislated or regulated land use restriction as an automatic qualification of property, such that persons who acquire restricted property in the future are automatically barred by the restriction.[283] The Court has acknowledged that property rights are qualified by "background principles" of property law, such as the understanding that landowners can be barred from engaging in uses that create nuisances.[284] Apparently, however, only longstanding limitations such as those recognized at common law count as relevant "background principles." This leaves considerable uncertainty about how the Court would respond to a law that prospectively modified the absolute priority of security interests. Delays on foreclosure have been around a long time and presumably qualify as "background principles;"[285] subordination of security interests to the need to avoid taxpayer bailouts might be regarded as a novelty that does not so qualify.

Another question is how haircuts of security interests or other modifications in the rights of security interest holders should be analyzed in terms of total or partial takings. *Armstrong* holds that the total destruction of a security interest is a taking,[286] and this tracks the analysis of *Lucas v. South Carolina Coastal Council*[287] in terms of real estate. But if Congress or the FDIC as receiver shaves ten percent off the principal value of a security interest in order to reimburse the federal treasury for temporary financing, would this be regarded a total taking of ten percent of the security or only a partial taking of ten percent of the security? In the case of land, shaving ten percent off the existing acreage is clearly a total taking of the ten percent.[288] But imposing a use regulation on the land that reduces its value by ten percent is only a partial taking, and is typically not compensable. This might suggest, by analogy, that imposing a ten percent haircut on secured interest holders would be a taking – especially if the purpose is to generate additional revenue for the government. But the matter is obviously debatable.

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[283] See, e.g., Lucas, supra (limiting background principles to common law); Palazzollo v. Rhode Island, 533 U.S. 606 (2001) (declining to recognize a per se rule that land use regulations in effect at the time of purchase qualify property rights); see also Philips v. Washington Legal Foundation, 524 U.S. 156, 163 (1998) (holding that regulatory requirement imposed on client funds held in trust by lawyers did not qualify common law understanding that interest follows principal).

[284] Lucas v. South Carolina Coastal Council, 505 U.S. 1003 (1992).

[285] See Forrester, supra, at 881-84.

[286] Armstrong, supra, 364 U.S. 40 (1960).

[287] 505 U.S. 1003 (1992) (holding regulation that destroys all economically beneficial value of real property is a taking unless it tracks the common law of nuisance in the relevant jurisdiction).

[288] See Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419 (1982) (regulation that permanently transfers control over a small cable box on the roof of a building is categorically a taking).

Yet more questions are presented about what constitutes just compensation when security interests are impaired. For example, must compensation be paid for the time value of money when recovery of the equivalent value of secured interest is delayed? Under the Bankruptcy Code, the Court has held as a matter of statutory construction that value lost due to delay is not compensated.[289] But the matter might come out differently when framed as a takings claim under the Fifth Amendment. The ultimate valuation question is presented by the standard, borrowed from FDIC receivership law,[290] that a secured creditor is entitled to recover at least as much as would have been obtained in a liquidation.[291] This gives rise to a question of what assumption the FDIC (or a reviewing court) is to make about the state of the economy when such a hypothetical liquidation occurs. If Dodd-Frank's OLA only applies to "systemically significant" firms whose failure would lead to financial crisis, are we to assume that the economy is in a state of financial collapse?[292] Does this mean that even if impairment of security interests is a taking, no compensation would be owed?[293] Or to avoid undue speculation, should the FDIC (and the court) take evidence on what the liquidation value would be given state the economy is in when the valuation takes place, which, if Title II works as advertised, would not be a state of total collapse?

Conclusion

The constitutional questions presented by Dodd-Frank's orderly liquidation authority can be seen either as a dark portent of an inverted constitutional order, or as a set of relatively easily avoided mistakes caused by careless last-minute drafting.

The dark vision goes something like this. The U.S. Constitution, like American law more generally, is designed for a world in which the government is seen as a potential threat to private rights, but private rights are not individually significant enough to pose a threat to government or society more generally. The Constitution was not designed for a world in which some privately-owned firms are so "systemically significant" that special rules must be devised to allow the government to take them over and operate them if they take on too much risk and are in danger of collapse. In order to construct a world in which a central function of the government is to

[289] See United Savings Assn. of Texas v. Timbers of Inwood Forest Associates, Ltd., 484 U.S. 365 (1988) (holding that the Bankruptcy Code does not require compensation for the time value of a secured interest).

[290] See 12 U.S.C. § 1821(i) (providing that the maximum liability of the FDIC to a person having a claim against an institution is the amount the claimant would have received if the FDIC had liquidated the institution).

[291] DFA, § 210(d)(2), (3).

[292] Baird and Morrison, supra note 104 at 316.

[293] Cf. Brown v. Legal Foundation of Washington, 538 U.S. 216 (2003) (holding that a taking does not require compensation if the claimant would have received nothing in the absence of the taking).

protect society from firms that are too big to fail, while nevertheless permitting such firms to continue to exist, constitutional rules must be fundamentally adjusted. Conventional norms of due process, understandings about the proper functioning of courts, limits on the legislative power reflected in the Bankruptcy Clause, and even free speech rights must give way. Property rights must be dissolved into a general mass of claim-rights, subject to reallocation by the government in order to advance its perception of the requirements of the general welfare. If the Constitution is supposed to be a bulwark that protects us from government, is Dodd-Frank a foretaste of what to expect when the government becomes the handmaiden of a financial oligarchy?

A more benign vision would stress that most of the constitutional problems we have identified in Dodd-Frank stem from a single ill-considered decision by the Senate to abandon the judicial review provisions in the Administration's draft and the House bill in favor of a novel scheme calling for appointment of a receiver by an Article III court. The Administration draft and the House bill called for administrative appointment of a receiver, coupled with a right of plenary post-seizure judicial review. Had Congress adhered to this conception, which was borrowed from existing banking law, it would have eliminated any serious due process question, any Article III question, and any need for a gag rule that raises potential First Amendment questions. Constitutional issues arising under the Bankruptcy Clause's uniformity requirement could have been laid to rest by drafting a more rule-like and less discretionary conception what type of firm is eligible for resolution under Title II. And the various takings issues could have been avoided or made more manageable by tacking more closely to established common law and bankruptcy law precepts about clawbacks, assessments, and the status of security interests. These enumerated revisions are relatively minor in the larger scheme of things. They suggest that Dodd-Frank's orderly liquidation authority is not too big for the Constitution – if only Congress had given sufficient consideration to the Constitution when it drafted this complex and far-reaching legislation.