

The Dodd-Frank Wall Street Reform & Consumer Protection Act of 2010: Is It Constitutional?

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Letter from the Editor . . .

There has been a great deal of discussion about the Dodd-Frank Wall Street Reform and Consumer Protection Act. By publishing this paper, which challenges the Act on several grounds, mostly constitutional, The Federalist Society seeks to foster further discussion and debate about this Act. To this end, we have included links to relevant materials that take different legal and policy positions on the Act. We do not link to other constitutional positions because this discussion is in too early a stage; as the conversation progresses we will link to those constitutional arguments. As always, The Federalist Society welcomes your responses to these materials. To join the debate, you can e-mail us at info@fed-soc.org.

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Related Links:

Text of Dodd-Frank Wall Street Reform and Consumer Protection Act: http://docs.house.gov/rules/finserv/111_hr4173_finsrvcr.pdf

Testimony of Michael Calhoun, Center for Responsible Lending, Before the House Committee on Financial Services, Sept. 30, 2009: http://financialservices.house.gov/media/file/hearings/111/calhoun_testimony.pdf

Testimony of Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System, Before the House Committee on Financial Services, Oct. 1, 2009: http://financialservices.house.gov/media/file/hearings/111/testimony_of_chairman_bernanke.pdf

Testimony of Timothy F. Geithner, Secretary, U.S. Department of the Treasury, Before the House Committee on Financial Services, Oct. 29, 2009: http://financialservices.house.gov/media/file/hearings/111/geithner_-_treasury.pdf

Testimony of Sheila C. Blair, Chairman, Federal Deposit Insurance Corporation, Before the House Committee on Financial Services, Oct. 29, 2009: <http://financialservices.house.gov/media/file/hearings/111/bair.pdf>

Testimony of Peter J. Wallison, American Enterprise Institute, Before the House Committee on Financial Services, Oct. 29, 2009: http://www.house.gov/apps/list/hearing/financialsvcs_dem/wallison_-_aei.pdf

Statement of Senator Chris Dodd, Opening Senate Banking Committee Markup of Financial Reform Legislation, Nov. 19, 2009: <http://dodd.senate.gov/?q=node/5335>

Testimony of Prof. Todd J. Zywicki, George Mason University School of Law, Before the House Committee on Financial Services, Feb. 26, 2010: http://www.house.gov/apps/list/hearing/financialsvcs_dem/zywicki.pdf

C. Boyden Gray, Op-Ed, *No Checks, No Balance in Reform Law*, WASH. TIMES, Sept. 14, 2010: <http://www.washingtontimes.com/news/2010/sep/14/gray-no-checks-no-balance-in-reform-law/>

President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank” or “the Act”) into law on July 21, 2010.^{2,3} The massive and complex Act is reportedly the result of many compromises.⁴ Dodd-Frank’s intent, according to its title page, is “[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end ‘too big to fail,’ to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.”

Dodd-Frank is extraordinarily complex, appearing to require almost a dozen different federal agencies to complete anywhere between 240 to 540 new sets of rules, along with approximately 145 studies that will very likely affect rulemaking.⁵ This count does not include situations where different agencies create different rules that govern the same activity. This new, expansive regulatory regime prompted former Fed Chairman Alan Greenspan to argue that Dodd-Frank’s “unprecedented complexity” and its “inevitable uncertainty” will negatively impact economic growth, inhibit financial innovation, and “render the rules that will govern a future financial marketplace disturbingly conjectural.”⁶

There has been much debate over whether Dodd-Frank will accomplish its stated intent, but there is also a growing exchange about whether the law is constitutionally infirm, primarily due to separation of powers, vagueness, and due process.⁷ Central to this discussion is the fact that Dodd-Frank grants bureaucracies broad and unchallengeable discretionary authority; we query whether the Act provides effective oversight by any branch of government—the President, Congress, or the Judiciary.

This paper focuses on the constitutional issues which three of the law’s most central grants of regulatory power raise: the Financial Stability Oversight Council (“FSOC”) and its powers in Title I, the Federal Deposit Insurance Corporation’s (“FDIC’s”) related liquidation authority in Title II, and the Bureau of Consumer Financial Protection (“BCFP”) in Title X. But first, to provide background and context, we set forth a brief “primer” on some of the constitutional doctrines that the Act’s critics are beginning to invoke.

THE STRUCTURAL CONSTITUTION: A PRIMER

The U.S. Constitution significantly constrains national government authority by enumerating particular powers, dividing or dispersing decision rights or control among three different branches, and establishing a system

of checks and balances through which, in effect, one government branch’s ambitions counteract the ambitions of the others.

The Framers most feared the lawmaking power, vested in the Legislative Branch alone, although decades of wars and foreign threats helped make the Executive Branch an able competitor for power. The U.S. Supreme Court observed in 1892 “[t]hat Congress cannot delegate power to the President is a principle universally recognized as vital to the integrity and maintenance of the system of government ordained by the Constitution.”⁸ Even Justice Scalia, who is skeptical of the non-delegation doctrine (*see infra*), noted that

“[s]trictly speaking, there is *no* acceptable delegation of legislative power. As John Locke put it almost 300 years ago . . . ‘the *legislative* can have no power to transfer their authority of making laws, and place it in other hands.’”⁹

The Supreme Court, in the last few decades, has been reluctant to strike down broad grants of authority to the Executive. The Court instead preferred to interpret troublesome grants as narrowly as possible in order to avoid constitutional issues. Dodd-Frank, however, so restricts the Judiciary’s ability to interpret the Act that the courts may have no choice but to invoke separation of powers.¹⁰

Dodd-Frank’s limits on oversight do not stop with the Judiciary; the Act also limits the President’s oversight. For example, the Act makes the Director of the Bureau of Consumer Financial Protection (“BCFP”) independent of the Federal Reserve Board, which funds and houses it, and the President. Furthermore, the Act dramatically curtails Congress’ oversight of the BCFP because it provides the BCFP’s funds out of the Fed’s seignorage and prevents both the House and Senate Appropriations Committees from reviewing the BCFP’s funding. When one incorporates the Act’s requiring the Judiciary to defer to however the BCFP Director chooses to rewrite the U.S. consumer laws, it is difficult to discern any lines clearly separating the Branches. As Madison quoted Montesquieu’s admonition in Federalist No. 47, “[w]ere the power of judging joined with the legislative, the life and liberty of the subject would be exposed to arbitrary control, for THE JUDGE would then be THE LEGISLATOR.”¹¹

The Constitution is designed to avoid placing all of the government’s functions in one entity. Dodd-Frank, however, may have accomplished exactly what the Constitution intends to avoid unless the courts correct the

Act. Eliminating the lines of government demarcation also effectively eliminates the lines between government and the private sector. The consequence is the likelihood of “agency capture” by Wall Street elements on the one hand, and, on the other hand, implicit recognition of “Too Big To Fail” along with all of the implicit subsidies which go with a bailout promise. Thus, for any financial entity not in the charmed circle and credit consumers (small, medium, or large), the end result is a major loss of both their ability to compete and their basic freedoms from rent-seeking regulation and competitor-instigated “takings.” Dodd-Frank’s power aggregation reflected in this article is not what the Framers intended.¹²

TITLE I: FINANCIAL STABILITY OVERSIGHT COUNCIL

The Secretary of the Treasury chairs the FSOC.¹³ Other members include the heads of the Securities & Exchange Commission (“SEC”), Commodities Futures Trading Commission (“CFTC”), Federal Housing Finance Agency (“FHFA”), Office of the Comptroller of Currency (“OCC”), Federal Deposit Insurance Corporation (“FDIC”), the BCFP, the Federal Reserve Board, the National Credit Union Administration Board (“NCIU”), and another member with insurance expertise, whom the President appoints by and with the Senate’s advice and consent for a fixed term of six years.¹⁴ The FSOC’s three main goals are to (1) act as a “systemic regulator,” (2) prevent “Too Big To Fail,” and (3) prevent future “bank bailouts.”¹⁵

The FSOC’s power cannot be overstated. For example, with the vote of two-thirds of its voting members and the Treasury Secretary’s affirmative vote,¹⁶ the FSOC can force the Federal Reserve Board to begin supervising U.S. non-bank financial companies pursuant to heightened, but undefined, principles without any guidance from Congress, other than the Act’s giving the FSOC the power to self-determine that either the company is in “material financial distress” or that the company’s “nature, scope, size, scale concentration, interconnectedness, or mix of the activities” “could pose a threat to the financial stability of the United States.”¹⁷ The Volker provisions of section 619 of the Act also subject such non-bank financial companies to the Volcker Rule, even though they have never been criticized for trading activities nor had any government support such as deposit insurance or access to the Federal Reserve Discount Window as bank holding companies did.

While the Act lists ten specific factors for the FSOC to consider in making this determination, such as the

company’s leverage status and off-balance-sheet exposures, it also lists as a factor “any other risk-related factors that the [FSOC] deems appropriate,” which serves as a “catch-all” item to effectively negate the specificity of the preceding ten factors and give the FSOC seemingly unlimited reach.¹⁸ The same applies for the FSOC to require the Federal Reserve Board to begin supervising foreign non-bank financial companies.¹⁹ In essence, Dodd-Frank authorizes the Federal Reserve to seize companies which did not request federal help and do not enjoy Federal subsidies.

The Act also has an “anti-evasion” provision which subjects the financial activities of any U.S. or foreign company to Federal Reserve Board supervision if the FSOC, on the vote of two-thirds of its voting members and the Treasury Secretary’s affirmative vote, determines that (1) the company or its financial activities pose sufficient danger to the financial stability of the United States, and (2) the company is organized or operates in such a manner as to evade Dodd-Frank’s application.²⁰ Again, the FSOC has unlimited power to define and determine the relevant terms, factors, and facts.

Only the FSOC may re-evaluate and/or rescind its determinations.²¹ It cannot rescind its determinations unless the Treasury Secretary votes in the affirmative, even if two-thirds of the voting members determine otherwise, again giving disproportionate power to the Treasury Secretary.²² While the Act lays out a procedure for notice and opportunity for a hearing, the non-bank financial company only has thirty days to request a hearing, and then the FSOC “shall fix a time . . . and place” where the company may submit written materials “or, at the sole discretion of the [FSOC], [give] oral testimony and oral argument.”²³ Furthermore, the FSOC, upon two-thirds vote of its voting members and the affirmative vote of the Treasury Secretary, may “waive or modify” the notice and hearing procedures if it determines that “such waiver or modification is necessary or appropriate to prevent or mitigate threats posed by the nonbank financial company to the financial stability of the United States,” which means that the FSOC has the discretion to ignore the notice and hearing procedures.²⁴

The affected non-bank financial company may petition a U.S. district court to rescind the FSOC’s final determination, but (1) it must do so within thirty days of receiving notice of the final determination, and (2) the court may only review whether the final determination was arbitrary and capricious; it may not hear any statutory or constitutional challenges.²⁵ Because the Act’s language is so vague and broad, and because it leaves so much power

to the FSOC, it is difficult to see how a court could ever find a FSOC action to be arbitrary and capricious under the Act's prima facie language.

The FSOC has the power to make recommendations to the Federal Reserve Board of Governors "concerning the establishment and refinement of prudential standards and reporting and disclosure requirements. . . ." ²⁶ The FSOC, in making these recommendations, may take into consideration capital structure, riskiness, complexity, financial activities (including the financial activities of subsidiaries), size, and any other risk-related factors that the FSOC deems appropriate.²⁷ It may also differentiate among companies at its discretion.²⁸ Again, the FSOC has vague or undefined "catch-all" term to give it unchecked authority.

The FSOC may also "provide for more stringent regulation of a financial activity by issuing recommendations to the primary financial regulatory agencies to apply new or heightened standards . . . for a financial activity or practice conducted by bank holding companies or nonbank financial companies" if the FSOC determines that the activity or practice "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."²⁹ The phrases "could" and "or other problems" again serve as vague or undefined catch-all phrases which negate any specificity of previously delineated risk elements, thereby giving the FSOC unfettered discretion.

If the Federal Reserve Board determines that either a bank holding company with total consolidated assets of at least \$50 billion or a non-bank financial company under Federal Reserve Board supervision poses a "grave threat to the financial stability of the United States," then the FSOC, under the rationale of mitigating risks to financial stability, and upon a two-thirds vote (this time not requiring the Treasury Secretary's affirmative vote), can force the Federal Reserve Board to (1) limit the company's ability to merge, acquire, or consolidate, or otherwise become affiliated with another company; (2) restrict the company's ability to offer financial products; (3) require the company to terminate its activities; (4) impose conditions on the company's business conduct; and (5) require the company to sell or otherwise transfer assets or off-balance-sheet items to unaffiliated entities.³⁰ The FSOC, in other words, has broad discretion to prohibit a company's normal business activities or force it to take actions against its own financial interests. The

Act provides an affected company with abbreviated notice and hearing procedures, with the Federal Reserve Board, in consultation with the FSOC, deciding whether to take oral testimony and oral argument. The Act does not clearly state whether the affected company has any avenue for judicial relief, and if so, under what circumstances and standard.³¹

Title I is likely to prompt disputes over several issues, such as the amount and scope of legislative power which the Act delegates to others. Ever since *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935), the courts have used the constitutional avoidance doctrine to construe statutes—where it is reasonable to do so—in such a way as to avoid invoking non-delegation directly.³² While the courts might be able to follow the same approach with respect to Dodd-Frank, it is not obvious which provisions the courts could narrow because of the delegation's open-ended nature and the severe limits on the scope of judicial review. The Act's few vague standards are likely unenforceable because the Act limits the courts to arbitrary and capricious review, thus precluding the judiciary from fully reviewing those standards and/or the legal authority. The FSOC is therefore left to its own devices to simultaneously exercise legislative, executive, and judicial powers.

Moreover, the Act's curtailing judicial review very likely violates Article III's protection of judicial independence and thus raises separation of powers issues. The Supreme Court has never approved eliminating all judicial review of statutory and constitutional issues raised by government rules.³³ The potential impact of the Act's judicial review limitations has not yet generated wide discussion, and it should.

TITLE II: "ORDERLY LIQUIDATION AUTHORITY"

Under Title II, 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.³⁴ The FDIC and Federal Reserve Board may do so *sua sponte* or at the Treasury Secretary's request,³⁵ and if the Treasury Secretary determines certain factors such as (1) whether the financial company is "in default or in danger of default," (2) that the financial company's failure and resolution under bankruptcy or other resolution authority "would have serious adverse effects on financial stability in the United States,"³⁶ and (3) whether any effect of the government's actions on the claims of creditors, counterparties,

company shareholders, and other market participants are “appropriate,” which is yet another vague term subject both to self-definition and discretionary change.³⁷

Dodd-Frank permits a U.S. district court to review whether Treasury’s determinations are “arbitrary and capricious”—without regard to whether the determination violated the statute or the Constitution—on a “strictly confidential basis” and “without any prior public disclosure,” which presumably means in secret and out of public view and scrutiny.³⁸ In fact, the Treasury Department must file its petition under seal if a company does not acquiesce or consent to the FDIC serving as its receiver.³⁹ Anyone who “recklessly discloses” information about either Treasury’s determination or petition or the “pendency of court proceedings” faces felony criminal penalties of a fine up to \$250,000, five years in prison, or both.⁴⁰

The court must “make a determination within 24 hours of receipt of the petition,” or else (1) the petition shall be granted by operation of law; (2) the Treasury Secretary shall appoint the FDIC as the receiver, and (3) liquidation automatically starts and the FDIC may immediately take all actions authorized under Title II.⁴¹ Twenty-four hours is a very short amount of time for a district court to do anything in an area so complex.⁴² The Act strips a party’s ability to request a stay or injunction pending appeal⁴³ and restricts the appeals process, especially regarding the scope of review, which is limited to whether the Treasury Department was arbitrary and capricious when it determined that the covered financial company was in default or danger of default and satisfied § 201(a)(11)’s definition of a “financial company.”⁴⁴ The Act does not permit the district or circuit courts to review Treasury’s determination of whether default would cause “serious adverse effects” on financial stability “in” the United States.

With respect to the “orderly liquidation of covered brokers and dealers,” Dodd-Frank specifically prohibits courts from taking “any action, including any action pursuant to the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa *et seq.*) or the Bankruptcy Code, to restrain or affect the [receiver’s] exercise of powers or functions. . . .”⁴⁵ The Act also limits any claim against the FDIC as receiver to money damages, and the FDIC has the power to allow, disallow and determine claims.⁴⁶ 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.”⁴⁷

Title II also states that “no court shall have jurisdiction over” (1) 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.⁴⁸ Thus, the shareholders and creditors of the seized company appear to have no rights to contest the proceedings.

These various restrictions on judicial review—suspensions, in effect—go to the heart of the constitutional separation of powers infirmities of all three of the central authorities reviewed in this paper. The basic direction of the Supreme Court’s case law is quite clear, even if details are less precise than in other areas of constitutional jurisprudence. The building block cases—*Crowell v. Benson*, 285 U.S. 22 (1932), *Northern Pipeline Construction Company v. Marathon Pipe Line Company*, 458 U.S. 50 (1982), and their progeny, such as *Thomas v. Union Carbide Agricultural Products*, 473 U.S. 568 (1985) and *Commodity Futures Trading Commission v. Schor*, 478 U.S. 833 (1986)—all make clear that the restrictions on Article III jurisdiction and review in Dodd-Frank generally and Title II specifically runs afoul of the separation of powers protection for the Judiciary’s independence, as well as the Due Process requirements of the Fifth and Fourteenth Amendments.

The key principle is that Article III is likely to require the judiciary’s close attention if the statute in question addresses rights which have been traditionally viewed as common-law commercial rights, but not require the same level of attention if the statute in question addresses regulatory issues which the federal statute created. Even in the latter context, however, there must still be some Article III oversight and review.

The issue in *Crowell* turned on whether the delegation of adjudicative functions to an administrative agency for determining injury awards to claimants under the Longshoremen’s and Harbor Workers’ Compensation Act violated the Article III responsibilities of the admiralty courts.⁴⁹ The Court found the delegation permissible because Article III courts retained broad oversight authority to review factual findings and legal determinations.⁵⁰ The case previewed much of the structure of the administrative state later established under the Administrative Procedure Act, including the provision for judicial review of an agency’s factual and legal determinations.

Fifty years later, when the appellants in *Northern Pipeline* argued that Congress may, pursuant to its Article I powers, create (bankruptcy) courts free of Article III

requirements, the majority observed that “[t]he flaw in appellants’ analysis is that it provides no limiting principle. It thus threatens to supplant completely our system of adjudication in independent Art. III tribunals and replace it with a system of ‘specialized’ legislative courts.”⁵¹ In striking down the bankruptcy regime, the Court contrasted the agency’s statutorily limited fact-finding functions in *Crowell* with the fact that the “bankruptcy courts exercise ‘all of the jurisdiction’ conferred by the Act on the district courts.”⁵² The Court noted, for example, that while the agency’s order in *Crowell* would be set aside “if ‘not supported by the evidence,’ the judgments of the bankruptcy courts are apparently subject to review only under the more deferential ‘clearly erroneous’ standard.”⁵³ The Court noted also that the *Crowell* agency had to go to the district courts for enforcement, while the bankruptcy courts “issue final judgments, which are binding and enforceable even in the absence of an appeal.”⁵⁴

Dodd-Frank’s resolution authority provisions cannot pass muster under the Court’s precedent for preserving the central requirements of Article III oversight. Title II of Dodd-Frank strips Article III courts of the right to review whether Treasury’s designation of receivership for FDIC resolution is consistent with Dodd-Frank or the Constitution.⁵⁵ This effectively gives the FDIC virtually exclusive authority to resolve issues that were previously the province of the Article III courts. Dodd-Frank limits the district court to arbitrary and capricious review, and further requires the district court to conduct that review in secret and complete it within 24 hours, which is an impossible task given the usual complexity of resolution cases.⁵⁶ Furthermore, the Act strips the district court of its usual authority to grant a stay pending appeal.⁵⁷ The Act also prevents the courts from reviewing Treasury’s factual determination whether a financial company’s default would have any impact on the financial stability of the United States as a condition of seizing the bank at the outset.⁵⁸

The Act’s broker-dealer review limitations go further and give the FDIC what appears to be exclusive authority to allow, disallow, and determine claims, permit claimants only 60 days to sue, and strip shareholders and creditors of the seized broker-dealer of any right to contest the FDIC rulings under the Bankruptcy Code or otherwise.

Dodd-Frank’s judicial review provisions starkly contrast with the judicial provisions in the *Thomas* case, where the issue was “whether Article III of the constitution prohibits Congress from selecting binding arbitration with only limited judicial review as the mechanism for resolving disputes among participants in FIFRA’s [Federal

Insecticide, Fungicide, and Rodenticide Act, 7 U.S.C. § 136 *et seq.*] pesticide registration scheme.”⁵⁹

The Court made clear that, under FIFRA, a party’s submitting at the outset to arbitration was voluntary, stating that “the only potential object of judicial enforcement power is the . . . [pesticide] registrant who explicitly consents to have his rights determined by arbitration.”⁶⁰

Even so, the court noted that FIFRA “limits but does not preclude review of the arbitration proceeding by an Article III court,” preserved judicial review of constitutional error, and, at a minimum, protected “against arbitrators who abuse or exceed their powers or willfully misconstrue their mandate under the governing law.”⁶¹ Justice Brennan’s concurring opinion (which Justices Marshall and Blackmun joined) likened the arbitrator’s exercise of authority in this regulatory context to “the characteristics of a standard agency adjudication.”⁶² In Justice Brennan’s view, FIFRA satisfied Article III’s mandates because Article III courts had “the authority to invalidate an arbitrator’s decision when that decision exceeds the arbitrator’s authority or exhibits a manifest disregard for the governing law,” thus preserving “the judicial authority over questions of law.”⁶³

In Dodd-Frank, however, Article III courts have no ability to review compliance with either the Act or the Constitution in the context of adjudicating rights historically considered more “private” or commercial in nature than FIFRA’s federally created obligations. If one also considers the Act’s standardless and vague grant of authority to the FSOC, FDIC, and Treasury, together with the delegated judicial power, the result resembles “[t]he accumulation of all powers, legislative, executive, and judiciary, in the same hands,” which Madison declared was the “very definition of tyranny.”⁶⁴

Dodd-Frank’s challenge to the Judiciary’s independence complicates questions about the scope of the delegation of legislative power to the Executive. As noted *supra*, courts generally seek to construe statutes narrowly in order to avoid non-delegation and other constitutional issues. In *Whitman v. American Trucking Associations, Inc.*, the Supreme Court narrowly construed the Clean Air Act to avoid a potential delegation problem at the Environmental Protection Agency.⁶⁵ The Court also rejected the “idea that an agency can cure an unconstitutionally standardless delegation of power by declining to exercise some of that power,” describing it as “internally contradictory” and further stating that the “very choice of which portion to exercise . . . would *itself* be an exercise of the forbidden legislative authority.

Whether the statute delegates legislative power is a question for the courts, and an agency's voluntary self-denial has no bearing upon the answer."⁶⁶ Dodd-Frank, however, virtually guarantees the exercise of that forbidden authority because it removes the courts' ability to render statutory interpretations that are the sole province of the courts.⁶⁷

The Supreme Court's jurisprudence indicates that observing Article III powers is most important when "private" as opposed to regulatory rights are at stake, such as the commercial bankruptcy issues in Dodd-Frank's Title II. The Act is potentially infirm under a *Northern Pipeline* analysis because the Act essentially overrides the bankruptcy code and its judicial review options, thus inappropriately authorizing agency bureaucrats and political appointees instead of the impartial judiciary to determine basic contract rights. As a result, Dodd-Frank potentially undermines the very basis of capital markets altogether.

TITLE X: BUREAU OF CONSUMER FINANCIAL PROTECTION

The Bureau of Consumer Financial Protection ("BCFP") is an executive agency whose mandate is to "regulate the offering and provision of consumer financial products or services under the Federal consumer financial laws."⁶⁸ Essentially, it has the authority to implement and enforce all consumer-related laws involving finance and credit, and thus will dictate credit allocation in the U.S. economy.⁶⁹ The BCFP has the power to administer, enforce and implement federal consumer financial law with exclusive rulemaking authority, which means that it has the unconstitutional power to define and determine, for example, what is or is not a financial product, halt certain conduct, and enforce its own regulations.⁷⁰ The courts must defer to the BCFP regarding the meaning or interpretation of any provision of federal consumer financial law.⁷¹ Only the FSOC may set aside a BCFP final regulation, and only if the FSOC decides upon a two-thirds vote that the regulation in question endangers the U.S. banking or financial system.⁷² The BCFP may exempt any entity, product, or service so long as it determines that it is "necessary or appropriate" to do so.⁷³ Because only the BCFP determines what is "necessary or appropriate," both of which are vague, undefined terms, this is susceptible to challenge either as a violation of due process or an impermissible encroachment on Article III. The relevant analytical approach here is under *Northern Pipeline*, where the Court criticized the statutorily-required deference review standard as too limited.⁷⁴

One of the BCFP's stated objectives is to protect consumers "from unfair, deceptive, or abusive acts and practices and from discrimination."⁷⁵ 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.⁷⁶ In fact, Dodd-Frank makes it unlawful for consumer financial product companies or service providers to "engage in any unfair, deceptive, or abusive act or practice."⁷⁷ The Act extends this liability to any entity that "knowingly or recklessly provide[d] substantial assistance" to the offender.⁷⁸

One immediate litigation "red flag" is that the Act does not clearly define vague terms such as "unfair," "deceptive," "abusive," and "discrimination." BCFP is vested with the sole discretion to decide what those terms mean and how they are applied to consumer financial products and services and the consumer financial industry.⁷⁹ For example, Dodd-Frank defines an act or practice as "abusive" if it "materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service," or if it takes "unreasonable advantage" of a consumer's "lack of understanding" of the "material risks, costs, or conditions of the product or service" or a consumer's "inability" to protect his own interests "in selecting or using a consumer financial product or service."⁸⁰ Given that each and every consumer has different abilities to understand a term, condition, material risk, and cost; and each and every consumer has varying levels of ability—or desire—to protect his own interests, the Act's standard can readily be caricatured as "we know it when we see it." Moreover, the Act does not seem to include the concepts of deception or fraud with respect to the term "abusive," which would mean that the BCFP could still declare illegal products and services whose terms, conditions, risks and costs are fully disclosed, so long as the BCFP labels them "abusive." Moreover, the BCFP's charter is so vast that its power could be characterized as including the practical authority to re-write consumer financial protection laws if it chooses to do so. Accordingly, it is reasonable to argue that Congress must do the re-writing, not an agency that escapes meaningful oversight.

Those challenging Dodd-Frank will maintain that Congress structured the BCFP in such a way that it unconstitutionally escapes both Article I and Article II oversight. The key is that the Act houses the BCFP within the Federal Reserve, thereby placing one protected entity (the BCFP) within another (the Fed).⁸¹

Congress does not have the power of the purse

over the BCFP because the BCFP director determines his own budget, which the Federal Reserve Board “shall transfer to the [BCFP] from the combined earnings of the Federal Reserve System.”⁸² The maximum budget amount is 12% of the Federal Reserve System’s operating expenses.⁸³ The BCFP’s funds from the Federal Reserve System “shall not be subject to review by the Committees on Appropriations of the House of Representatives and the Senate.”⁸⁴ The BCFP director also has wide discretion over the management, use, and disbursement of several separate funds, such as the “Consumer Financial Protection Fund.”⁸⁵ If the BCFP needs more money than what the Federal Reserve System provides, Dodd-Frank authorizes Congress to appropriate \$200 million to the BCFP for five fiscal years (FY 2010 – FY 2014), for a total of \$1 billion.⁸⁶ Presumably Congress would have oversight authority for that \$200 million per year appropriation, although the Act is unclear on that issue and pre-authorized the money.⁸⁷

The Federal Reserve Board may delegate to the BCFP the power to examine entities subject to the Federal Reserve Board’s jurisdiction for compliance with the federal consumer financial laws.⁸⁸ The Federal Reserve Board, however, has no oversight or purse powers over the BCFP. For example, the Federal Reserve Board may not (1) intervene in any BCFP matter or proceeding, (2) appoint, direct, or remove any BCFP officer or employee, nor (3) merge or consolidate the BCFP or its functions and/or responsibilities with any part of the Federal Reserve Board or the Federal Reserve banks.⁸⁹ Furthermore, the Federal Reserve Board may not delay, prevent, or review any BCFP rule or order.⁹⁰

Some litigants will characterize the BCFP as escaping Article II oversight as well, and litigants will therefore likely invoke the Appointments Clause. The President appoints the BCFP’s director, with and by Senate advice and consent.⁹¹ The director may appoint, direct, and determine the number of all BCFP employees.⁹² The director has a five-year fixed term.⁹³ The President may remove the director only for cause.⁹⁴ The BCFP director is thus protected under *Humphrey’s Executor v. United States*, 295 U.S. 602 (1935), and its progeny.⁹⁵

The U.S. Supreme Court recently spoke on an Appointments Clause issue in *Free Enterprise Fund v. Public Company Accounting Oversight Board*, 130 S. Ct. 3138 (Jun. 28, 2010). There, the Court ruled SOX’s PCAOB structure unconstitutional because the SEC, not the President, appointed the PCAOB members; therefore, there were two tiers of protection: the SEC could not remove PCAOB members without cause, and

the President could not remove SEC members without cause.⁹⁶ The Court’s remedy was to sever the second layer of “good cause” protection such that the SEC could remove PCAOB members without cause.⁹⁷ Such a remedy would not work with the BCFP, however, because Dodd-Frank forbids the Federal Reserve Board from appointing, directing, or removing any BCFP officer or employee.⁹⁸ It is worth noting that the SEC and PCAOB, unlike the BCFP, are subject to congressional appropriations and review authority, as well as normal judicial review.

The BCFP’s internal structure is also potentially constitutionally suspect. The BCFP director is to create a Consumer Advisory Board and appoint its members, although the Act is not clear as to how many members comprise the Consumer Advisory Board.⁹⁹ The Act mandates, however, that “not fewer than 6 members shall be appointed upon the recommendation of the regional Federal Reserve Bank Presidents, on a rotating basis.”¹⁰⁰ Therefore, it appears that the BCFP director may not appoint whomever he or she believes is most qualified. Also, the BCFP, with its sole director, is different from agencies such as the SEC, the FTC, the Federal Communications Commission, the Federal Election Commission, *et al.* Those agencies are structured as collegial bodies, *id est* a group of members, often bipartisan, who make the agency’s ultimate decisions. Thus, the BCFP director does not have an internal structural check, and escapes both presidential and congressional oversight.

OTHER ISSUES

Dodd-Frank eliminates, or at least weakens, subsidiary pre-emption.¹⁰¹ Courts likely will have to consider whether this conflicts with *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1 (2007), where the Court held that OCC regulations, promulgated under the National Bank Act, 12 U.S.C. § 1, *et seq.*, pre-empted the State of Michigan’s mortgage lending laws, and thus Michigan could not regulate a national bank’s wholly-owned subsidiary.¹⁰²

Dodd-Frank might even trigger some equal protection challenges. For example, the Act amends § 22(a) of the Commodities Exchange Act (7 U.S.C. § 25(a)) and, by fixing the terms of long-term swaps, provides legal certainty for them.¹⁰³ However, the Act does not contain a parallel provision for security-based swaps, even though these swaps are similarly situated.¹⁰⁴ Additionally, the Act’s derivative exceptions grant certain counterparties greater rights than ordinary creditors, and the FDIC may disburse more money to some creditors over other creditors which are similarly situated.¹⁰⁵ The FDIC may

also make additional payments to certain creditors at its discretion during liquidation, even if that amount is more than those selected creditors are owed.¹⁰⁶ Similarly-situated creditors are therefore not treated similarly.

Recently TCF Financial Corp. (“TCF”), a large regional bank based in Wayzata, Minnesota, sued the Federal Reserve and Fed Chairman Ben Bernanke to block the Fed’s expected interchange or “swipe” fee restrictions under Dodd-Frank § 1075, often referred to as the “Durbin Amendment.”^{107, 108} § 1075 exempts banks with assets of less than \$10 billion. TCF primarily alleges that § 1075 violates the Takings and Equal Protection clauses because it unfairly targets large financial institutions, unfairly prevents large banks from recouping fees and investments from their checking account and debit card businesses, and forces large banks to provide certain services below cost.¹⁰⁹

SUMMARY

The Dodd-Frank debate began as a policy dispute over its effectiveness in resolving the financial crisis or preventing a future one, but it will likely soon turn into disputes over constitutional infirmity. For example, does the law present such vagueness and uncertainty that it is a source of irreparable harm? Is the law an unprecedented breach of an array of structural constitutional protections that constrain government power and prevent an undue concentration of authority in any one part of government? Do the courts have the authority to oversee legal issues constitutionally committed to the independent judiciary? And even if the authority is there, does the legislation contain inappropriate limiting principles for the courts to apply? A Dodd-Frank challenge is sure to present these and other fundamental questions.

Endnotes

1 C. Boyden Gray is an attorney in Washington, D.C. He served as Counsel to Vice-President and then President George H.W. Bush from 1981 – 1993, and as U.S. Ambassador to the European Union under President George W. Bush, among many other prestigious positions. John Shu is an attorney in Newport Beach, California. He also served both President George H.W. Bush and President George W. Bush, and was a law clerk to Judge Paul Roney, U.S. Court of Appeals for the 11th Circuit. The authors wish to thank Brian Brooks for his contributions to this paper.

2 See, e.g., Ronald D. Orol, *Obama Signs Sweeping Bank-Reform Bill Into Law*, MARKETWATCH, Jul. 21, 2010, available at <http://www.marketwatch.com/story/story/print?guid=2B007AF9-98C4-46BD-B7B6-09545EF8ADEF>.

3 The law is named after Senator Chris Dodd and Congressman Barney Frank.

4 See, e.g., Binyamin Appelbaum, *Lawmakers At Impasse On Trading*, THE NEW YORK TIMES, June 23, 2010, available at <http://www.nytimes.com/2010/06/24/business/24regulate.html>; and Jim Puzzanghera, *Congressional Negotiators Wrap Up Work On Financial Reform Legislation*, THE LOS ANGELES TIMES, June 26, 2010, available at <http://articles.latimes.com/2010/jun/26/business/la-fi-financial-reform-20100626>.

5 As a comparison, the Sarbanes-Oxley Act of 2002 (“SOX”) required only 16 new rules.

6 Alan Greenspan, *Fear Undermines America’s Recovery*, THE FINANCIAL TIMES, Oct. 6, 2010 (emphasis added), available at www.ft.com/cms/s/0/4524339a-d17a-11df-96d1-00144feabdc0.html.

7 One key reason why Dodd-Frank will unlikely accomplish its intent is because Wall Street’s compensation incentives have not changed, and thus Wall Street’s senior executives have little economic incentive to closely monitor the risks their companies take and to make sure that those risks are prudent. This year Wall Street is preparing a record high \$144 billion for compensation and almost \$.50 of every dollar earned goes towards compensation. Regardless of whether Wall Street’s compensation incentives are correct as a matter of policy, the Act does not effectively address the fact that the United States remains in the position of privatizing Wall Street’s profits while socializing Wall Street’s risks. Dodd-Frank also does not sufficiently account for the key roles that federal housing policy and government-sponsored entities such as the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) played in causing the financial crisis which spawned the Act.

8 *Field v. Clark*, 143 U.S. 649, 692 (1892).

9 *Mistretta v. United States*, 488 US 361, 419-20 (1989) (Scalia, J., dissenting) (citing J. Locke, 2nd Treatise of Gov’t 87 (R. Cox ed. 1982) (emphasis in original)).

10 See *infra*.

11 THE FEDERALIST NO. 47 (James Madison).

12 Nelson D. Schwartz, *Financial Leaders Expect Shift of Power After Elections*, THE NEW YORK TIMES, Nov. 1, 2010, available at <http://nyti.ms/9oUz0z>.

13 Dodd-Frank, § 111(b)(1)(A).

14 Dodd-Frank, § 111(b)(1) and § 111(c)(1).

15 Dodd-Frank, § 112(a)(1).

16 Thus giving the Treasury Secretary disproportionate power over the FSOC.

17 Dodd-Frank, § 113(a)(1).

18 Dodd-Frank, § 113(a)(2).

19 Dodd-Frank, § 113(b).

20 Dodd-Frank, § 113(c).

21 Dodd-Frank, § 113(d).

22 Dodd-Frank, § 113(d)(2).

23 Dodd-Frank, § 113(e).

24 Dodd-Frank, § 113(f).

25 Dodd-Frank, § 113(h).

26 Dodd-Frank, § 115(a)(1).

27 Dodd-Frank, § 115(a)(2)(A) (emphasis added).

28 Dodd-Frank, § 115(a)(2)(A).

29 Dodd-Frank, § 120(a) (emphasis added).

- 30 Dodd-Frank, § 121(a).
- 31 Courts generally review an administrative agency's decision on an arbitrary and capricious standard, *id est* whether the agency's action is reasonable and based on a proper consideration of the circumstances, and generally give that agency what is known as *Chevron* deference. *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984). The classic *Chevron* two-step test is where a reviewing court determines (1) whether Congress spoke directly to the precise question at issue (Congress' unambiguously expressed intent controls); and (2) if the statute is silent or *ambiguous* (emphasis added) with respect to the specific question, the court must review whether the agency's answer is based on a permissible construction of the statute. Here, the Act is so ambiguous in so many different places that courts will have a tough time reviewing an agency's actions, and the Act's vagueness and lack of parameters cause the "arbitrary and capricious" standard to become virtually meaningless in this context. *See also Natural Res. Def. Council, Inc. v. U.S. Emtl. Prot. Agency*, 966 F.2d 1292, 1297 (9th Cir. 1992).
- 32 *See also Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457 (2001); *see generally* Cass R. Sunstein, *Is OSHA Unconstitutional?*, 94 VA. L. REV. 1407 (Oct. 2008).
- 33 *See infra*, and *Thomas v. Union Carbide Agric. Prods. Co.*, 473 U.S. 568, 594 (1985).
- 34 Dodd-Frank, § 203(a)(1).
- 35 *Id.*
- 36 Interestingly, Dodd-Frank § 203(b) does not speak to the financial stability of the United States, but rather to the financial stability in the United States. Other sections refer to the financial stability of the United States. *See, e.g.*, Dodd-Frank § 204(a).
- 37 Dodd-Frank, § 203(b).
- 38 Dodd-Frank, § 202(a)(1)(A)(iii).
- 39 Dodd-Frank, § 202(a)(1)(A)(ii).
- 40 Dodd-Frank, § 202(a)(1)(C).
- 41 Dodd-Frank, § 202(a)(1)(A)(v).
- 42 *See, e.g.*, Andrew Clevenger, *Holder: Federal Judicial System "Stressed To The Breaking Point,"* THE CHARLESTON GAZETTE, Sept. 28, 2010, available at <http://blogs.wvgazette.com/watchdog/2010/09/28/holder-federal-judicial-system-stressed-to-the-breaking-point>; Dahlia Lithwick & Carl Tobias, *Vacant Stares: Why Don't Americans Worry About How An Understaffed Federal Bench Is Hazardous To Their Health?*, SLATE, Sept. 27, 2010, available at <http://www.slate.com/id/2268466>; and Jonathan Cole, *Citizens Lose When Judicial Vacancies Are Left In Limbo*, THE TENNESSEAN, Oct. 10, 2010, available at <http://www.tennessean.com/article/20101010/OPINION01/10100376/1008/Citizens+lose+when+judicial+vacancies+are+left+in+limbo>.
- 43 Dodd-Frank, § 202(a)(1)(B).
- 44 Dodd-Frank, § 202(a)(2).
- 45 Dodd-Frank, § 205(c).
- 46 Dodd-Frank, §§ 205(e), 210(a)(1), 210(a)(2).
- 47 Dodd-Frank, § 210(a)(4).
- 48 Dodd-Frank, § 202(a)(9)(D).
- 49 *Crowell v. Benson*, 285 U.S. 22, 36-37 (1932).
- 50 *Id.* at 60-61.
- 51 *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 73 (1982).
- 52 *Id.* at 85 (emphasis in original) (citations omitted).
- 53 *Id.* (citation omitted).
- 54 *Id.* at 86 (citations omitted).
- 55 *See supra*.
- 56 *See supra*.
- 57 Dodd-Frank, § 202(a)(1)(B).
- 58 *See supra*.
- 59 *Thomas v. Union Carbide Agric. Prods. Co.*, 473 U.S. 568, 571 (1985).
- 60 *Id.* at 592.
- 61 *Id.*
- 62 *Id.* at 600-01 (citations omitted) (Brennan, J., dissenting).
- 63 *Id.* at 601-02 (citations omitted).
- 64 THE FEDERALIST NO. 47 (James Madison).
- 65 *Whitman v. Am. Trucking Ass'ns, Inc.*, 531 U.S. 457, 473 (2001).
- 66 *Id.* at 472-73 (citations omitted) (emphasis in original).
- 67 *But cf Reg'l Rail Reorg. Act Cases*, 419 U.S. 102 (1974) (due process takings claims, in some circumstances, can be satisfied collaterally in the Court of Claims).
- 68 Dodd-Frank, § 1011(a).
- 69 There are certain exceptions, such as § 1029 (auto dealers, which was one of the compromises needed for the law's passage), and § 1075 (interchange fees, *a.k.a.* the Durbin Amendment). *See infra*.
- 70 Dodd-Frank, §§ 1022(a), (b)(1), (b)(2), (b)(4). *See supra* re: the FDIC's exclusive resolution authority.
- 71 Dodd-Frank, § 1022(b)(4).
- 72 Dodd-Frank, § 1023.
- 73 Dodd-Frank, § 1022(b)(3)(A) (emphasis added).
- 74 *N. Pipeline*, 458 U.S. at 85-7.
- 75 Dodd-Frank, § 1021(b)(2).
- 76 Dodd-Frank, § 1031.
- 77 Dodd-Frank, § 1036(a)(1)(B).
- 78 Dodd-Frank, § 1036(a)(3).
- 79 *See, e.g.*, Dodd-Frank, §§ 1022(a), (b)(1), (b)(2), (b)(4).
- 80 Dodd-Frank, § 1031(d).
- 81 Dodd-Frank, § 1011(a).
- 82 Dodd-Frank, § 1017(a)(1).
- 83 Dodd-Frank, § 1017(a)(2). The percentage is 10% for fiscal year 2011 (more than \$600 million), 11% for FY 2012, and 12% for FY 2013 and beyond, plus the percent increase in the employment cost index.
- 84 Dodd-Frank, § 1017(a)(2)(C).
- 85 *See, e.g.*, Dodd-Frank, §§ 1017(b), (c).
- 86 Dodd-Frank, § 1017(e)(2).
- 87 Oddly, the Act requires that the BCFP director prepare reports and appear before Congress regarding, *inter alia*, "a justification of the budget request of the previous year." *See, e.g.*, Dodd-Frank, § 1016(c)(2).
- 88 Dodd-Frank, § 1012(c)(1).
- 89 Dodd-Frank, § 1012(c)(2).
- 90 Dodd-Frank, § 1012(c)(3).

- 91 Dodd-Frank, § 1011(b)(2).
- 92 Dodd-Frank, § 1013(a)(1)(A).
- 93 Dodd-Frank, § 1011(c)(1).
- 94 Dodd-Frank, § 1011(c)(3), which states that “[t]he President may remove the Director for inefficiency, neglect of duty, or malfeasance in office.”
- 95 Furthermore, agencies whose heads have fixed terms, such as the Director of the Federal Bureau of Investigation (10-year term), are usually housed within an Executive Branch cabinet department which is accountable to the cabinet secretary and the President (*e.g.* the FBI is housed within the Department of Justice).
- 96 *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 130 S. Ct. 3138, 3151-55 (Jun. 28, 2010).
- 97 *Id.* at 3161.
- 98 Dodd-Frank, § 1012(c)(2).
- 99 Dodd-Frank, § 1014(a).
- 100 Dodd-Frank, § 1014(b).
- 101 Dodd-Frank, § 1044.
- 102 *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1, 11 (2007).
- 103 Dodd-Frank’s § 739.
- 104 Oddly, the Act specifically mentions security-based swaps elsewhere. *See, e.g.*, Dodd-Frank § 803(7)(B)(vii).
- 105 *See generally*, Dodd-Frank, Title VII.
- 106 *See generally*, Dodd-Frank, Title II.
- 107 Named after Senator Dick Durbin (D-IL), who managed to get his provision through without any hearings or debate.
- 108 The case is *TCF Nat’l Bank v. Bernanke*, 10-CV-04149 (Dist. S.D. Oct. 12, 2010).
- 109 According to TCF’s most recent annual balance sheet, it has total assets of nearly \$18 billion. *See*, TCF’s Dec. 31., 2009 annual balance sheet, *available at* <http://ir.tcfexpress.com/phoenix.zhtml?c=95289&tp=irol-fundBalanceA>.

