Un-Constitutionality of the Dodd-Frank Act

*Michael I.C. Nwogugu**

Abstract

'Restoring American Financial Stability Act' of 2010 ('RAFSA' or the 'Dodd-Frank Act') was the first set of statutes in any country that attempted to simultaneously address the Global Financial Crisis, the national securities law framework, the structure of the executive branch of the federal government, and delegation of powers to federal government agencies (to the detriment of state governments). Other countries have enacted statutes that are similar to RAFSA. However, RAFSA and similar statutes in many countries are inefficient and have failed to address the fundamental problems in financial systems, and parts of RAFSA are unconstitutional.

Keywords: Dodd-Frank Act, enforcement games, systemic risk, financial services regulation, constitutional law.

A Introduction

In July 2010, the US Congress enacted the Restoring American Financial Stability Act of 2010 ('RAFSA' or the 'Dodd-Frank Act'),[1] which consists of several individual distinct statutes and substantially changes the nature and effects of Federalism and pre-emption in the United States – RAFSA grants more powers to the federal government to regulate more financial services, but because the statute leaves critical details up to the US SEC and the US Federal Reserve System, sec-

* Address: Enugu, Enugu State, Nigeria. E-mail: mcn2225@gmail.com; mcn2225@aol.com. Phone: 234-909-606-8162.

1 *See* Summary of Financial Stability Act of 2010, available at <http://banking.senate.gov/public/_files/FinancialReformSummaryAsFiled.pdf>, accessed 1 July 2013 and *see* D. Polk, *Summary of the Restoring American Financial Stability Act, Passed by the Senate on 20 May 2010*, 2010, at <www.davispolk.com/sites/default/files/files/Publication/fc30f0b3-3db4-4181-a44e-3b3e54853b6f/Preview/PublicationAttachment/19c8367f-0467-4f3d-8492-010c9692578c/052210_Davis_Polk_Senate_Bill_as_Passed_Summary.pdf>; or *see* s. 3217, 'Restoring American Financial Stability Act of 2010', available at <http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:s3217as.txt.pdf>, accessed 1 July 2013. *See* also <http://dpc.senate.gov/docs/lb-111-2-64.html>, accessed 1 July 2013; Administration's Financial Regulatory Reform Bill, 2009 and 2010, available at <www.llsdc.org/Admin-Bill/>, accessed 1 July 2013; 'Financial Overhaul Bill Has Many Rules', available at <www.lvrj.com/business/bill-has-many-rules--critics-97836159.html>, accessed 1 July 2013; G. Jones, B. Klutsey & K. Christ, *Speed Bankruptcy: A Firewall to Future Crises*, Working Paper No. 10-02, Mercatus Center at George Mason University, January 2010; Congressional Research Service– Summary of 'Restoring American Financial Stability Act of 2010' at Financial Stability Act of 2010 (introduced on 15 April 2010).

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tions of RAFSA may be challenged in court on constitutional grounds as void for vagueness. RAFSA has affected and is likely to continue to affect legislation and adjudication in many countries because many such countries' constitutions are based on the US constitution (and were either enacted or amended within the last 20 years). Other countries have enacted statutes that are similar to RAFSA[2] – the United Kingdom introduced the Vickers Report, which is similar to the Volcker Rule. Canada, Brazil, and Asian countries have also introduced similar statutes. The European Union enacted the European Market Infrastructure Regulation ('EMIR'),[3] the Markets in Financial Instruments Directive II and related Regulation ('MiFID II' and 'MIFIR'),[4] the new Capital Requirements Directive and Regulation ('CRD IV'),[5] and other statutes. RAFSA may also be relevant to Commonwealth Countries because like the United States, their legal systems and constitutional principles are based on the British legal system. The governments and citizens of the United Kingdom, Canada, India, and other Commonwealth countries have significant investments in the United States; US commercial and investment banks (which are subject to RAFSA) are very active in the UK capital markets and many Commonwealth countries. The shares of many companies based in Commonwealth countries are listed in the United States. The Global Financial Crisis has significantly affected many Commonwealth Countries (like the United Kingdom, India, Canada, Australia, etc).

B Existing Literature

According to Davis Polk, as of the beginning of July 2013, a total of 279 RAFSA rule-making requirement deadlines had passed.[6] Of these 279 passed deadlines, 175 (62.7%) have been missed and 104 (37.3%) have been met with finalised rules. In addition, 155 (38.9%) of the 398 total required rulemakings have been finalised, while 127 (31.9%) rulemaking requirements have not yet been proposed. Nwogugu analyzed the deficiencies and failures in RAFSA.[7]

2 *See* Shearman & Sterling, *Dodd-Frank, UK, EU, & Other Regulatory Reforms*, 2013, available at <www.shearman.com/dodd-frank/>, accessed 1 July 2013.

3 Regulation 648/2012 on OTC derivatives, central counterparties and trade repositories [2012] OJ L201/1.

4 *See* FSA (UK), Review of The *Markets in Financial Instruments Directive II*, 2012, available at <www.fsa.gov.uk/about/what/international/mifid>. *See* also DIRECTIVE 2008/10/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 11 March 2008, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:076:0033:0036:EN:PDF>.

5 Directive 2006/48 relating to the taking up and pursuit of the business of credit institutions [2006] OJ L177/1.

6 D. Polk, Dodd Frank Progress Report, July 2013, available at <www.davispolk.com/Dodd-Frank-Rulemaking-Progress-Report/>.

7 M. Nwogugu, 'Failure of The Dodd-Frank Act', 2010; rev. 2014, forthcoming in *Journal Of Financial Crime* (2015).

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Some authors have criticised RAFSA and noted the following weaknesses: (1) RAFSA does not eliminate the *too-big-to-fail phenomenon*[8] and does not help to reduce systemic risk significantly[9] (given that the Global Financial Crisis was caused by 'universal banks' who incurred more than US $8 Trillion of operating losses between 2007 and 2012, allowing large banks to remain large is probably

8 *See* R. Natter, *Does Dodd-Frank End Too Big to Fail?* (RAFSA did not end the too-big-to-fail phenomenon), July 2011, available at <www.bsnlawfirm.com/newsletter/OP0711_3.pdf>; J. Noss & R. Sowerbutts, 'The Implicit Subsidy of Banks', Bank of England Financial Stability Paper No. 15, 2012, p. 6, available at <www.bankofengland.co.uk/publications/Documents/fsr/fs_paper15.pdf>; Z. Li *et al.*, 'Moody's Analytics', *Quantifying the Value of Implicit Government Guarantees for Large Financial Institutions*, Vol. 14, 2011; I. Otker-Robe *et al.*, *The Too-Important-to-Fail Conundrum: Impossible to Ignore and Difficult to Resolve*, Vol. 6 (International Monetary Fund), 2011, available at <www.imf.org/external/pubs/ft/sdn/2011/sdn1112.pdf>; E. Brewer III & J. Jagtiani, 'How Much Did Banks Pay to Become Too-Big-to-Fail and to Become Systemically Important?', *J Fin. Servs. Research*, Vol. 43, No. 1, 2013, p. 8, available at <http://link.springer.com/content/pdf/10.1007%2Fs10693-011-0119-6.pdf>; L. Schmid, 'Living Wills: Will They Fail to Remedy "Too Big to Fail"?', *The Columbia Journal of European Law Online*, No. 18, 2012, pp. 69-79, available at <www.cjel.net/wp-content/uploads/2012/09/Schmid_69-80.pdf>; R.W. Fisher, *Correcting 'Dodd-Frank' to Actually End 'Too Big to Fail'*, June 2013. Statement before the Committee on Financial Services, U.S. House of Representatives Hearing on "Examining How the Dodd-Frank Act Could Result in More Taxpayer-Funded Bailouts", Washington, DC, 26 June 2013, available at <www.dallasfed.org/news/speeches/fisher/2013/fs130626.cfm>.

9 *See* B.S. Sharfman, 'Using the Law to Reduce Systemic Risk', Journal of Corporation Law, Vol. 36, No. 3, 2011, pp. 607-634, available at <http://works.bepress.com/bernard_sharfman/19> (noting that the approach taken in RAFSA to reduce systemic risk is incomplete partly because RAFSA is backward-looking, and does not take into consideration that, financial innovation will lead to the development of new financial sector business models that are potentially unsustainable; and RAFSA does not focus on and regulate practices that encourage financial sector participants to use unsustainable business models); J.L. Allen, 'Derivatives Clearinghouses and Systemic Risk: A Bankruptcy and Dodd-Frank Analysis', *Stanford Law Review*, Vol. 64, No. 4, 2012 (states that under RAFSA, Central Clearing Houses can increase systemic risk); M. Labonte, CRS Report for Congress Prepared for Members and Committees of Congress – The Dodd-Frank Wall Street Reform and Consumer Protection Act: Systemic Risk and the Federal Reserve, August 2010, available at <www.llsdc.org/attachments/files/240/CRS-R41384.pdf>; J. Coffee, 'The Political Economy of Dodd-Frank: Why Financial Reform Tends to Be Frustrated and Systemic Risk Perpetuated', *Cornell Law Review*, Vol. 97, 2012, pp. 1019-1029, available at <www.lawschool.cornell.edu/research/cornell-law-review/upload/Coffee-final-2.pdf>, accessed 1 July 2013; 'The Dodd-Frank Act Too Big Not to Fail', *The Economist*, 18 February 2012, available at <www.economist.com/node/21547784>, accessed 1 July 2013; A. Simon, *Dodd-Frank at Two: Bad for Business and the Constitution*, July 2012.

error[10]); (2) RAFSA increases transaction costs and compliance costs;[11] (3) RAFSA effectively grants excessive power to the US Federal Reserve;[12] (4) RAFSA did not make the US SEC a self-funded agency, and this limits the SEC's scope and powers;[13] (5) US congress can still limit RAFSA by underfunding it;[14] (6) RAFSA has not created any meaningful economic growth in the US;[15] (7) RAFSA did not remedy the inefficiencies in executive compensation in financial services companies

10 *See* A. Wilmarth, 'The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis', *Connecticut Law Review*, Vol. 41, 2009, pp. 963-983.

11 *See* Accenture, 'US Financial Regulatory Reform: Cost or Opportunity?', *Impact of The Dodd-Frank Wall Street Reform Act*, 2010 (predicting that it will cost the US financial services industry $3-$5 Billion between 2010 and 2013 to implement RAFSA; and that the annual operating profits of the hardest hit firms could fall by 20%-30%; and that RAFSA will produce new operational challenges and pose significant strategic questions about how firms will prop up their return on equity while absorbing the cost of more reporting to regulators, a more expensive cost of capital and the loss of some of their most profitable businesses; and Accenture's June 2010 poll of 101 financial industry executives found that nearly half (49 percent) thought their profits would decrease as a result of RAFSA), available at <www.accenture.com/SiteCollectionDocuments/PDF/Accenture_US_Financial_Regulatory_Reform.pdf>; *see* also P. Wallison, 'Four Years of Dodd-Frank Damage', *Wall Street Journal*, 20 July 2014, available at <www.wsj.com/articles/peter-wallison-four-years-of-dodd-frank-damage-1405893333>; The Economist 2012; L. Switzer & E. Sheahan-Lee, 'The Impact of Dodd-Frank Regulation of OTC Derivative Markets and the Volcker Rule on International Versus US Banks: New Evidence' (RAFSA imposes costs on US banks while foreign international banks avoid such costs), May 2013.

12 *See* E. Schnidman, 'Why the Federal Reserve Is Dodd-Frank's Big Winner', *Harvard Business Law Review Online*, Vol. 1, 2011, pp. 88-93 (noting that the post-crisis financial system structure fails to look dramatically different than before; and the major change in the post-crisis financial regulatory system is a US Federal Reserve that has excessive powers; and that there is a weaker Consumer Financial Protection Bureau that is housed in the US Federal Reserve rather than as a stand-alone agency). Available at <www.hblr.org/2011/06/why-the-federal-reserve-is-dodd-franks-big-winner/>; or <www.hblr.org/?p=1203>.

13 *See Top Securities Lawyers Call for Self-Funded S.E.C.*, available at <http://dealbook.nytimes.com/2010/06/11/top-securities-lawyers-call-for-self-funded-s-e-c> (RAFSA failed to make the US SEC a self-funded agency, and the omission severely limits the SEC's scope and power).

14 *See* B. Carton, *How Can Congress Kill Dodd-Frank? By Underfunding It*, <www.securitiesdocket.com/2011/01/20/how-can-congress-kill-dodd-frank-by-underfunding-it>.

15 *See* A. Khademian, 'The Financial Crisis: A Retrospective', *Public Administration Review*, Vol. 71, No. 6, 2013, pp. 841-849 (the enactment of RAFSA and the US government's infusion of more than $600 Billion into the US economy between 2009 and 2012 did not result in any meaningful economic growth in the US).

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and SIFIs;[16] (8) RAFSA omitted some key legislation;[17] (9) the orderly Liquidation Authority is inefficient;[18] (10) RAFSA makes it difficult for small companies to raise capital;[19] (11) RAFSA does not adequately address the members of the Boards of Directors' obligations that pertain to risk management;[20] (12) RAFSA is

16 *See* S. Sepe, 'Making Sense of Executive Compensation', *Delaware Journal of Corporate Law*, Vol. 36, pp. 189-199 (*RAFSA* fails to meet the goal of remedying inefficiencies within the organisational structure of the public corporation that hamper adoption of optimal mixed payment schedules; and also noting that in enacting RAFSA, the US Congress has failed to accurately answer three basic questions which are: (i) what are the key problems that plague executive compensation, (ii) what is the possible solution, and (iii) what is the role of regulation in implementing the solution?); *see* J.R. Brown, Jr., 'Dodd-Frank, Compensation Ratios, and the Expanding Role of Shareholders in the Governance Process', *Harv. Bus. L. Rev. Online*, Vol. 2, No. 91, 2011, <www.hblr.org/?p=1751>.

17 *See* M.S. Barr, 'The Financial Crisis and the Path of Reform', *Yale Journal on Regulation*, Vol. 29, No. 1, 2012, pp. 91-119 (describing various weaknesses and omissions in RAFSA – such as the failure to consolidate government regulatory agencies; inadequate regulation of money market funds; inadequate regulation of government sponsored entities; capital and liquidity requirements; regulation of SIFIs).

18 *See* P. Lee, 'The Dodd Frank Act Orderly Liquidation Authority: A Preliminary Analysis and Critique – PART II', *The Banking Law Journal*, Vol. 128, No. 10, 2011, pp. 867-915 (describing some inefficiencies inherent in the Orderly Liquidation Authority).

19 *See* 'Small Biz Has Big Stake in Dodd-Frank Changes', available at <www.hartfordbusiness.com/article/20130617/PRINTEDITION/306139922/small-biz-has-big-stake-in-dodd-frank-changes> (the article states in part "...The Small Business Capital Access and Job Preservation Act (H.R. 1105) seeks to modify certain aspects of the Dodd-Frank Wall Street Reform and Consumer Protection Act that are inappropriate for private equity firms, particularly middle market private equity firms. H.R. 1105 will address the many unintended consequences of Dodd-Frank that impede the flow of capital to small businesses and do not provide any protection to investors or the financial system as a whole...").

20 *See* K. Johnson, 'Addressing Gaps in the Dodd Frank Act: Directors' Risk Management Oversight Obligations', *University of Michigan Journal of Law Reform*, Vol. 45, No. 1, 2011, pp. 55-65.

inefficient;[21] and (13) transparency and potentially harmful disclosure[22] – RAFSA created an intolerable level of uncertainty as to whether information that financial services companies disclose to government agencies will be kept confidential. Nwogugu noted that Asset Securitization is unconstitutional,[23] and has analysed problems inherent in the LIBOR/EURIBOR/SHIBOR rate-setting mechanisms (which were not addressed by RAFSA).[24]

21 *See* J.N. Gordon & C. Muller, 'Confronting Financial Crisis: Dodd-Frank's Dangers and the Case for a Systemic Emergency Fund', *Yale Journal on Regulation*, Vol. 28, 2011, pp. 151-191; K. Summe, 'An Evaluation of the U.S. Regulatory Response to Systemic Risk and Failure Posed by Derivatives', *Harv. Bus. L. Rev. Online*, Vol. 4, No. 76, 2014, <www.hblr.org/?p=3779>. *See* also H. Peirce & J. Broughel (Eds.), *Dodd-Frank: What It Does and Why It's Flawed*, Mercatus Center, George Mason University, USA, 2012. Available at <http://mercatus.org/sites/default/files/publication/dodd-frank-FINAL.pdf>. This document states that:

- i The US FSOC has not played an effective coordinating role in the crucial initial years of regulatory implementation of Dodd-Frank;
- ii Designating specific firms as systemically important creates a market expectation that designated firms are too big to fail and thus dulls market discipline;
- iii The US Federal Reserve's bank-centric regulatory model will not work for non-banks;
- iv The structure of the OFR enables it to operate without the accountability expected to apply to government agencies and without adequate safeguards on data;
- v Once a company is in resolution, the FDIC has broad discretion, without effective checks, to determine how creditors' claims are handled;
- vi Expansion of deposit insurance decreases effective market restraint of bank risk taking and may yield greater systemic instability;
- vii Title III adds a new layer of bureaucracy at each financial regulator;
- viii SEC resources will be diverted from monitoring advisers who manage the assets of average retail investors to monitoring the assets of wealthy investors who invest in private funds;
- ix Regulators have devised an unnecessarily costly compliance regime for private funds, the costs of which will be passed on to investors;
- x Designating insurance companies as systemic aggravates the too-big-to-fail problem and introduces an inexperienced regulator in the insurance space without solving the insurance regulatory failures in evidence at entities like AIG;
- xi Title VI consolidates an inordinate amount of regulatory power in the Fed, despite the Fed's past regulatory failures;
- xii Title IV increases the likelihood that the US Federal Reserve and other regulators will prop up failing financial firms in the future;
- xiii Because the statutory language is ambiguous and the proposed rules are even more so, the Volcker Rule could make it difficult for banks to engage in legitimate hedging and market-making activities. Market liquidity could suffer;
- xiv Title VII fragments regulation of OTC derivatives markets by assigning responsibility to two regulatory agencies; and it imposes a regulatory scheme that better suits a highly liquid retail market;
- xv Regulators' overly aggressive, uncoordinated, and inadequately analyzed approach to implementation of Title VII increases the likelihood that new rules will have harmful unintended effects).

22 A. Nazreth & M. Tahyar, 'Transparency and Confidentiality in the Post Financial Crisis World – Where to Strike the Balance?', *Harvard Business Law Review*, Vol. 1, 2011, pp. 145-155, available at <www.hblr.org/download/HBLR_1_1/Nazareth_Tahyer-Transparency_Confidentiality.pdf>.

23 M. Nwogugu, 'Asset Securitization Is Unonstitutional and Should Be Banned', *in* M. Nwogugu, *Risk In The Real Estate Markets*, John Wiley 2012.

24 M. Nwogugu, 'A Critique of LIBOR/EURIBOR/SHIBOR Rate-Setting Processes; And New Recommendations', *Journal Of International Banking Law & Regulation*, 2014c.

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Greene[25] noted some of the problems inherent in RAFSA such as the following:

- failure to deal with regulatory fragmentation which refers to having too many government agencies – however, Greene was not specific and did not state which government agencies should have been combined, restructured, or eliminated;
- failure to address *international coordination* – regulatory arbitrage remains an issue – and funding resolution and bailout expenditures have been a point of international divergence; there is also a serious question about whether Dodd-Frank will undermine the competitive position of major US financial institutions because some sections of Dodd Frank act such as the Volcker Rule will not be followed in other key jurisdictions such as the European Union;
- being overly optimistic in dealing with too-big-to-fail;
- it does not restrict size by growth, only by acquisition (but the five largest US financial institutions have grown 20 per cent since the onset of the Global Financial crisis and as of 2011, they had over $6 trillion in assets);
- it implies that size is not necessarily the only concern but size can be critical, because of the contagion effect of failure;
- the Swiss approach to regulation is based on the theory that capital assessment and organisational simplicity are the solution, not activity restriction or size limitations – RAFSA takes almost an opposite approach;
- RAFSA does not address the issue of moral hazard adequately – and despite the many provisions to monitor and reduce systemic risk, it remains unlikely that the US Government will allow an institution that is the size of one of the United States's five largest financial institutions to fail, especially in the absence of effective coordinated and consistent resolution mechanisms in key markets (and such firms will continue to have financing advantages that only increase the likelihood of their failure).

Hansberry noted that RAFSA distorted the Foreign Corrupt Practices Act ('FCPA').[26] Coffee reviewed various reasons why RAFSA has failed including moral hazard, executive compensation, excessive focus on the too-big-to-fail dilemma, and cognitive deficits.[27] *The Economist*,[28] Simon,[29] Morrison and Foerster,[30] Gray

25 *See* E. Greene, 'Dodd-Frank and the Future of Financial Regulation', *Harvard Business Law Review*, Vol. 2, 2011, pp. 79-89.

26 H. Hansberry, 'In Spite of Its Good Intentions, the Dodd-Frank Act Has Created an FCPA Monster', *Journal of Criminal Law & Criminology*, Vol. 102, No. 1, 2012.

27 Coffee 2012.

28 The Economist 2012.

29 Simon 2012.

30 Morrison & Foerster, *The Dodd-Frank Act: A Cheat Sheet*, 2012, available at <www.mofo.com/files/Uploads/Images/SummaryDoddFrankAct.pdf>, accessed 1 July 2013.

and Shu[31] and other authors[32] stated that RAFSA may be unconstitutional (but for reasons different from those stated in this article), and that sections of RAFSA are vague,[33] and violate the *Appointments Clause*,[34] the *Takings Clause*,[35] the *Sepa-*

31 C. Gray & J. Shu, 'The Dodd-Frank Wall Street Reform & Consumer Protection Act of 2010: Is It Constitutional?', *Journal of the Federalist Society's Practice Groups*, Vol. 11, No. 3, December 2010, available at <www.fed-soc.org/doclib/20101209_BoydenShuDoddFrankWP.pdf>, accessed 1 July 2013.

32 *See* C. Hall & S. Kazman, 'Eight More States Join Constitutional Challenge to Dodd-Frank Act: Eleven States Now Challenge Dodd-Frank's Orderly Liquidation Authority, Which Exacerbates "Too Big To Fail" and Puts State Pensions and Other Funds at Risk', 13 February 2013, available at: <https://cei.org/news-releases/eight-more-states-join-constitutional-challenge-dodd-frank-act>; C. Gray & J. Purcell, 'Why Dodd-Frank Is Unconstitutional: The Financial Regulations Signed into Law in 2010 Do Not Honor Checks and Balances. They Eliminate Them', *Wall Street Journal*, 21 June 2012, available at <www.wsj.com/articles/SB10001424052702304765304577480451892603234>; T. McTaggart & M. Silver, 'Constitutionality Analysis of Certain of the Dodd-Frank Wall Street Reform and Consumer Protection Act's Most Significant Grants of Regulatory Power', 2011, available at <www.pepperlaw.com/pdfs/McTaggart_CatoInstitutePresentation_021511.pdf>; US House Hearing, 113 Congress, *Examining Constitutional Deficiencies and Legal Uncertainties In The Dodd Frank Act*, Hearing before the Subcommittee on Oversight and Investigations of the Committee on Financial Services, US House of Representatives One Hundred Thirteenth Congress, First Session, 9 July 2013, available at <www.gpo.gov/fdsys/pkg/CHRG-113hhrg82859/html/CHRG-113hhrg82859.htm>; D. Addington, *Congress Should Promptly Repeal or Fix Unwarranted Provisions of the Dodd-Frank Act*, 2011, available at <www.heritage.org/research/reports/2011/10/congress-should-promptly-repeal-or-fix-unwarranted-provisions-of-the-dodd-frank-act>.

33 *See* Gray & Shu 2010, and A. Rabinovitch, 'Constitutional Challenges to Dodd-Frank', *Antitrust Bulletin*, Vol. 58, No. 4, 22 December 2013, pp. 635-640. Some authors noted that in sections of RAFSA that pertain to the US FSOC, phrases such as "financial stability of the United States", "other problems" and "material financial distress" are undefined, over-broad and vague.

34 K. Barnett, 'The Consumer Financial Protection Bureau's Appointment with Trouble', *American University Law Review*, Vol. 60, 2011, pp. 1459-1463 (discussing the violation of the *Appointments Clause* that is inherent in the appointment of the Deputy Director of the CFPB). *See* also Rabinovitch 2013 (discussing the violation of the *Appointments Clause* that is inherent in the appointment of the Deputy Director of the CFPB).

35 Rabinovitch 2013 (discussing the violation of the *Takings Clause* that is inherent in the Durbin Amendment).

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ration-Of-Powers Doctrine[36] and Article-Three[37] of the US Constitution. Heritage Foundation and National Association of Criminal Defense Lawyers ('NACDL'),[38]

36 *See* Rabinovitch 2013 (noting that RAFSA violates the *Separation-Of-Powers Doctrine*); M. Van Oppen & D. Van Wert, 'There's No Place Like Home: The Constitutionality of the SEC's In-House Courts', 28 October 2014, available at <http://blogs.orrick.com/securities-litigation/2014/10/28/theres-no-place-like-home-the-constitutionality-of-the-secs-in-house-courts/> (questioning the constitutionality of the US SEC's adjudicatory powers); Nwogugu 2012, pp. 264-265 (noting that the US SEC's and the US IRS's rule-making and adjudicatory powers constitute violations of the *Separation-of-Powers* Doctrine).
RAFSA didn't eliminate the adjudicatory powers of the US SEC. Several authors noted that RAFSA violates the Non-delegation Doctrine because it unconstitutionally delegates legislative power to the US Financial Stability Oversight Council (FSOC) and the CFPB in contravention of Article-One of the U.S. Constitution. RAFSA violates the *Separation Of Powers Doctrine* because it grants both Rule-Making and enforcement powers to the US FSOC and to the Consumer Financial Protection Bureau; and grants adjudicative powers to the CFPB. The sections of RAFSA that created the Consumer Financial Protection Bureau (CFPB) violates the U.S. Constitution because the US Congress doesn't appropriate the budget of the CFPB.

37 B. Horton, 'How Dodd-Frank's Orderly Liquidation Authority for Financial Companies Violates Article III of the United States Constitution', *Journal of Corporation Law*, Vol. 36, No. 4, 2011, p. 869, and Rabinovitch 2013.
Several authors noted that RAFSA violates *Article-Three* of the US Constitution because it restricts judicial review of actions of the CFPB and the FDIC (Federal Deposit Insurance Corporation). RAFSA limits US District Courts to "arbitrary and capricious" review of FDIC and CFPB actions and thus, grants these agencies exclusive authority to resolve issues that were previously handled by Article III courts.

38 Heritage Foundation and National Association of Criminal Defense Lawyers ('NACDL'), *Without Intent: How Congress Is Eroding the Criminal Intent Requirement in Federal Law*, 2010a, available at <www.nacdl.org/withoutintent>, accessed 1 July 2013.

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NACDL,[39] NACDL,[40] and Joslyn[41] have questioned the criminal law provisions in RAFSA. American Action Forum[42] and Elliot[43] questioned the extent of regulations of both the size of banks and trading of derivatives (two critical issues that led to the Global Financial Crisis). Schwarcz critiqued RAFSA's ability to reduce systemic risk.[44] Rose & Walker noted the lack of adequate cost-benefit analysis for statutes like RAFSA.[45]

I A Critique of Roe (2013)

Roe attempted to analyse the problems inherent in Central Clearing Houses ('CCHs') within the context of RAFSA,[46] but the following are the errors and omissions in the Roe study:

- The analysis of setoff is almost irrelevant in this context because: (1) in the US, the application of Setoff varies across different US bankruptcy courts (there has not been consistency) and US Bankruptcy Courts have broad discretion to grant or deny setoff,[47] and to rescind setoffs that occur within the ninety-day period immediately before the filing of bankruptcy; (2) in the US, the applicability of setoff varies according to state law (some states have a common-law right of setoff), particularly in cases or circumstances where state law is deemed to preempt sections of the US Bankruptcy Code; (3) the efficiency and applicability of setoff also depends on the percentage of claims

39 National Association of Criminal Defense Lawyers ('NACDL'), *NACDL on HR 4173-Recommendations (recommendations for reforming Dodd-Frank Conference Report [HR 4173])*, 2010b, available at <www.nacdl.org/public.nsf/86871e9e0d470e3185257006006e5f55/b5224f126c7e41cb8525773f0074136f/$FILE/NACDL%20on%20HR4173.pdf>, accessed 1 July 2013. Also available at <www.nacdl.org/criminaldefense.aspx?id=9920>. NACDL (2010b) criticised specific sections of RAFSA as follows:

    i Section 202(a)(1)(C) – is over-criminalised and has inadequate *mens rea* requirement and should be deleted.
    ii Section 741 – covers material that is already covered in the federal mail fraud and wire fraud codes; and weakens the *mens rea* requirements; and should be deleted.
    iii Section 747(B)(5) – does not provide adequate notice; is somewhat vague; and has inadequate *mens rea* requirement and should be deleted.
    iv Section 747 (amends 7 USC 6c(a) by adding "(7) use of swaps to Defraud") – this statute duplicates existing federal aiding-and-abetting and conspiracy statutes; weakens the men area requirement and should be deleted.
    v Section 1036(3) – this statute duplicates existing federal aiding-and-abetting and conspiracy statutes; does not have adequate men area requirement; and should be deleted.
    vi The following statutes lack adequate *mens rea* requirements: Section 723; section 768(b); section 724; section 728; section 731; section 733 section 975(a)(1); section 764; section 753(b); section 746; section 747; section 724(a); section 730; section 929; section 975(a)(5); section 1036(1;2;3).
    vii The following sections of RAFSA are over-broad or vague: Section 746; section 975; and section 934.
    viii The following sections of RAFSA constitute inappropriate regulatory criminalisation: section 730; section 929; and section 1036.
    ix Sections that require conforming amendments – sections 763 &764 at pages 387 and 409 repeat many of the aforementioned offenses, and should be amended to conform to recommended changes.

40 National Association of Criminal Defense Lawyers ('NACDL'), *Criminal Provisions in HR 4173* (list of the criminal provisions in Dodd-Frank Conference Report [HR 4173]), 2010c.

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held by each party, *i.e.* unsecured and secured; (4) the efficiency of setoff depends on the liquidity of assets and claims of the CCH customers and the transparency of financial statements and disclosures of CCH customers; (5) as noted in the existing literature, the application of setoff creates the potential for inequitable and/or impermissible improvement of the position of some creditors to the detriment of other creditors (in terms of priority).

- The analysis does not cover the issue of collateral deposits required from clients by CCH members.
- The analysis does not cover the effects of 'intermediation' and 'selective transaction processing' by CCH members and the associated social welfare

41 T. Joslyn, *Criminal Provisions in the Dodd-Frank Wall Street Reform & Consumer Protection Act* (The Federalist Society for Law and Public Policy Studies), December 2010, available at <www.fed-soc.org/doclib/20101210_NFIPCrimProvisionsinDoddFrank.pdf>. Joslyn summarised the criminal offenses covered by RAFSA as follows:

i *Disclosures*: Section 202(a)(1)(C)[3].
ii *Clearing and Indexing of Swap Transactions*: Section 723(a)(2)[6] (This offense and many similar offenses covered by RAFSA will be *enforced under 7 U.S.C. § 13(a)(5))*.
iii Swap Registration and Segregation Requirements: Section 724(a)[7].
iv *Registration Requirement for Swap Data Repositories*: Section 728.
v *Reporting Requirement for Large Swap Traders*: Section 730[11].
vi *Registration for Swap Dealers and Major Swap Participants*: Section 731[12].
vii *Registration Requirement for Swap Execution Facilities*: Section 733[13].
viii *Fraud and False Statements*: Section 741[14].
ix *Insider Trading*: Section 746[15] broadens the criminal insider trading prohibition already in the federal code.
x *Anti-disruptive Practices Provision*: Section 747[16].
xi *Violations of Cease and Desist Orders*: Section 753[17].
xii *Securities Registration Requirement*: Section 764[18].
xiii *Transactions with Ineligible Participants*: Section 768[21].
xiv *Margin Lending*: Section 929[22].
xv *Violations Reporting Requirement for Rating Agencies*: Section 934[23].
xvi *Regulation of Municipal Advisors*: Section 975(a)(1)[24].
xvii *Municipal Advisor Fraud*: Section 975(a)(5)[25].
xviii *Bureau of Consumer Financial Protection (BCFP) – Unlawful Acts*: Section 1036[27].

42 American Action Forum, *The Senate Financial Regulatory Reform Bill*, April 2010, available at <http://americanactionforum.org/files/FinRegBill1_0.pdf>, accessed 1 July 2013; D. Elliot, *Evaluating Key Aspects of Senator Dodd's Revised Financial Reform Bill*, The Brookings Institution, 15 March 2010.

43 Elliot 2010.

44 S.L. Schwarcz, 'Identifying and Managing Systemic Risk: An Assessment of Our Progress', *Harvard Business Law Review Online*, Vol. 1, 2011, pp. 94-103, available at <www.hblr.org/?p=1412>, accessed 1 July 2013.

45 P. Rose & C. Walker, 'Dodd-Frank Regulators, Cost-Benefit Analysis, and Agency Capture', *Stanford Law Review Online*, Vol. 66, 2013 (noting the lack of adequate cost-benefit analysis before the enactment of statutes like RAFSA).

46 M. Roe, 'The Dodd-Frank Act's Maginot Line: Clearinghouse Construction', *California Law Review*, forthcoming.

47 *See In re: HAL*, Inc., 122 F.3d 851 (CA9, 1997); B. Caughey, *A Creditor's Right to Setoff: When Does a Creditor Impermissibly Improve Its Position*?, 2011, available at <www.icemiller.com/publications/Creditor%27s_Right_to_Setoff_ABI.pdf>.

costs. Selective transaction processing discriminates among clients of CCH members.
- The study does not analyse the effects of credit ratings on collateral requirements – *i.e.* Collateral sought by both the CCH (from CCH members) and CCH members (from clients). The rating agency lags in updating credit ratings and absolute errors in credit ratings affects the efficiency of CCHs.
- While the study insists that CCHs merely 're-distribute' risk in the financial system, the study does not trace the path of such re-distribution in both the financial system and the real economy.
- Contrary to the Roe study, a substantial portion of systemic risk arises from the real economy. A significant percentage (both by absolute number and by transaction volume) of clients of CCH members are companies in the real sector.
- The Roe study repeats much of what already exists in the literature – there is no new information. The Roe analysis does not offer any solutions to the weaknesses of CCHs.

II A Critique of Boyden & Shu (2010)

Boyden & Shu is relevant because it attempted to show that RAFSA is unconstitutional, but misconstrued some issues (and other common-law jurisdiction that enacted similar statutes are likely to face the same constitutional law questions). Boyden and Shu focused on three of RAFSA's most central grants of regulatory power which are as follows:
- 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.

Boyden and Shu significantly misconstrued the following:
- The amount and scope of power granted to Article-Three courts (and such powers cannot be over-ridden by statutes, particularly whereas in the case of matters covered by RAFSA, common law commercial rights are involved).
- The difference between administrative rule-making and legislation (particularly where administrative agency rule-making is subject to review by courts).
- The nature of 'delegation' among the executive, legislative, and judicial branches of government (particularly where the matters are specialised and complex, and transaction costs time-spent can be reduced by delegation with the possibility of judicial review, and/or delegation reduces/eliminates knowledge gaps (where the adjudicator has insufficient expertise); and/or delegation substantially reduces harmful contagion and information effects.
- The differences between 'adjudication' and 'judicial power' – not all 'adjudication' requires an exercise of judicial power; in many instances, the exercise of Article-Two 'executive Power' and 'judicial Power' are functionally and legally the same.

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The legislative history of, and the stated purposes of, RAFSA indicates that the US Congress did not intend that RAFSA function as an amendment of the US Constitution; only a Constitutional Amendment can reduce or modify the powers of Article-Three courts in the US in the ways that Boyden & Shu have alleged. Article-Three of the US Constitution bars the US Congress from establishing under its Article-One powers, 'legislative courts' (or government agencies that have adjudicative powers) to exercise jurisdiction over all matters arising under the bankruptcy laws or similar financial laws.

The Boyden and Shu conclusion that the powers of the FSOC are excessive and that its procedures may violate substantive and procedural due process rights, and that a court is unlikely to find an FSOC action to be arbitrary and capricious under the Act's prima facie language, are very much false and unfounded. These assertions presume and/or imply that the federal district courts are biased. The discretions granted to the FSOC by RAFSA are not materially different from the statutory discretions that similarly placed government agencies are granted. Such discretion does not overly interfere or burden commerce, fairness, and financial stability, and any abuses of discretion can be corrected by federal district courts which have Article-Three powers. The FSOC's power to limit and control transactions (such as mergers; acquisitions; etc.) by both bank and non-bank financial companies is necessary to maintain financial stability, and any abuse of discretion is subject to review in federal courts which can declare all or parts of the statute to be unconstitutional and can also decide on its own scope of judicial review regardless of the scope of judicial review that the statute prescribes. The Boyden and Shu claim that 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, is also inaccurate because that statement does not differentiate between permitted and normal administrative agency rule-making on one hand, and on the other hand, regular legislation. It is normal for legislatures that don't have the detail or expertise required to establish complete specialised standards, to delegate such rulemaking to government agencies for further rule-making.[48] Contrary to Boyden and Shu, the FSOC does not have any executive powers, does not 'legislate' (distinct from administrative rule-making), and does not have adjudicative powers. Thus, there is no issue of violation of the separation-of-powers clause.

According to Boyden and Shu, Title-II appears to preclude or restrict the federal courts' jurisdiction over claims brought by the shareholders and creditors of a company that has been seized under the Orderly Liquidation Authority ('OLA'). On the contrary, most elements of OLA do not violate procedural due process and the reality is that in some circumstances:

- The risk posed by such entities to the financial system may require immediate and time-constrained resolution which courts typically cannot provide.
- The risk posed by such entities to the financial system can far outweigh any benefit that can be gained from litigation, particularly where litigation has adverse information effects (*i.e.* news about litigation reduces the reputation,

48 *See* the Administrative Procedure Act, 5 U.S.C.§551; *Vermont Yankee Nuclear Power Corp v. Natural Resources Defense Council* (1978) 98 S. Ct. 1197; 435 U.S. 519.

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or credit ratings, or perceived credit quality, or stock prices of companies in the industry) or where litigation takes a long time to resolve and can cause harmful contagion.
- Litigation is socially, psychologically, and economically expensive and can significantly increase transaction costs in financial transactions and the financial services industry.
- Each of the government agencies that are charged with exercising OLA powers have in-house counsel and economists that are very knowledgeable about the financial services industry and systemic risk (sometimes more knowledgeable than courts). Hence the theory of delegation (from the judicial branch to the executive branch) can be said to apply and is justifiable.[49]

Contrary to Boyden and Shu, any restrictions on Article-Three jurisdiction and review that are imposed by RAFSA generally and Title-II specifically do not contravene the separation of powers clause of the US Constitution but in the worst case, may violate the procedural due process clause of the US Constitution. Furthermore, Article-Three grants US federal district courts the power to review such statutes on their terms and according to their chosen standards, to determine whether they are unconstitutional.[50] Indeed Boyden and Shu stated that:

> ...The key principle is that Article-Three 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...

Many matters covered by RAFSA address common-law commercial rights.

Contrary to Boyden and Shu:
- Title II of RAFSA does not strip Article-Three courts of the right to review whether the US Treasury's designation of receivership for FDIC resolution is consistent with RAFSA or the Constitution. RAFSA cannot not limit the US district court to arbitrary and capricious review or any type of review. Article-Three courts can review cases based on their own chosen standards and can declare all or part of the statute to be unconstitutional.
- Although RAFSA requires the US district court to conduct the review of Title-II actions in secret and complete it within 24 hours, the US federal district court has the power to unilaterally extend the time within which it will perform such reviews (and the court can request that the US Treasury waive the 24-hour requirement). Any alleged abuse of discretion or violation of Title-II

49 *See Crowell v. Benson* (1932) 285 U.S. 22, pp. 36-37; *Whitman v. Am Trucking Ass'ns Inc* (2001) 531 U.S. 457, p. 473; C. Stern, 'What's a Constitution among Friends? – Un-Balancing Article III', *University of Pennsylvania Law Review*, Vol. 146, pp. 1043-1053; L. Smith, *A Note on Non-Article III Courts*, available at <www.heritage.org/constitution/#!/articles/3/essays/106/a-note-on-non-article-iii-courts>.

50 *See Northern Pipeline Constr Co v. Marathon Pipe Line Co* (1982) 458 U.S. 50, p. 73.

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by the federal district court is subject to appeal in the US federal appeals courts.

- While RAFSA states that it strips the federal district court of its usual authority to grant a stay pending appeal – such court has the power to declare such measure to be unconstitutional.
- While RAFSA states that it prevents the courts from reviewing the US Treasury's factual determination about whether a financial company's default will affect the financial stability of the United States as a condition of seizing the financial company, under Article-Three and *Northern Pipeline Construction Co. v. Marathon Pipe Line Co*, the federal district courts have the power to review such actions, regardless of what RAFSA states.
- RAFSA states that the courts are not authorised to review whether the FSOC has correctly interpreted the Act, and also specifically states 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 authorised to apply, enforce, interpret, or administer the provisions of such Federal consumer financial law". *Kucana v. Holder*[51] can be distinguished from cases and issues that pertain to RAFSA, which can be highly complex and specialised (and require the expert knowledge of economists).
- The public disclosure or announcement of pending or actual liquidation of financial services firms often has adverse information effects and financial contagion effects (as shown in the bankruptcy of Lehman Brothers) which may far outweigh any benefits of government intervention. In fact, it is more likely that public announcement of government intervention (mandated by OLA) will create panic and drastically reduce liquidity and asset prices in financial markets, all of which would defeat the aims of the government.
- Contrary to Boyden and Shu, RAFSA is not potentially unconstitutional under *Northern Pipeline*[52] because RAFSA's actual or implied restrictions on, or preclusion of the US bankruptcy code and its judicial review options, can be reviewed by and declared unconstitutional by an Article-Three court. Furthermore, given the significant social welfare, psychological, and economic costs of corporate bankruptcy in the United States and the possible resulting financial contagion that exacerbates systemic risk (and the fact that the typical US Bankruptcy Judge and US Bankruptcy Trustee are also functional equivalents of the 'agency bureaucrats' or 'political appointees' that Boyden & Shu described) and given the fact that such 'agency bureaucrats' have specialised knowledge about the financial services industry (which Bankruptcy courts often don't have), any implicit delegation of quasi-judicial authority to government agencies by RAFSA may be justified. Corporate bankruptcy carries substantial stigma which affects not only the subject company but its major suppliers and similarly situated companies in the same industry. Lawsuits take a long time to resolve, and dissemination of news about lawsuits

51 *Kucana v. Holder*, 130 S.Ct. 827 (2010) (implying that through enactment of statutes, the US Congress can limit the jurisdiction of the federal courts).

52 *Northern Pipeline Constr Co v. Marathon Pipe Line Co* (1982) 458 U.S. 50, p. 73.

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> (and bankruptcy cases in particular) tends to increase cost-of-capital and the perceived risks of both transactions and companies. Lawsuits also directly and indirectly increase the government's monitoring and enforcement costs, and perpetrators will typically change their tactics to avoid detection.

The Boyden and Shu comment to the effect that the activities of Bureau of Consumer Financial Protection ('BCFP') are unconstitutional is also unwarranted. The delegation of rule-making and quasi adjudication to the BCFP is justifiable because the matters are complex, judicial review may cause or increase financial contagion, courts may not have adequate knowledge or resources to handle such matters, and overall Social Welfare can be improved by such delegation (and the US Congress can withdraw such delegation).

The Boyden & Shu assertions that key sections of RAFSA are possibly void for vagueness are un-warranted and completely un-supported. First, while the *Void-for-vagueness Doctrine* is used only in the context of criminal law statutes, Boyden & Shu attempted to apply this doctrine to parts of RAFSA that are not criminal statutes. Second, the history and legislative intent of RAFSA indicates that many sections of RAFSA were not intended to be final directives, but rather, in its various sections, RAFSA was 'transient' or 'temporary' legislation that specifically requested that government agencies conduct further studies and enact additional rules and statutes. Some of these additional rules/statutes presumably require specialised knowledge and deliberation that were not available in, or could not be effectively done within the US Congress. Third, even where the sections of RAFSA mentioned by Boyden & Shu (as being void for vagueness) were intended to be a 'statutory directive', RAFSA defines which persons are regulated, the prohibited conduct and the applicable penalties, and the procedures that should be followed in enforcement and/or adjudication. Fourth, any actual or implied delegation of authority by RAFSA to government agencies is typically subject to judicial review by Article-Three courts, and any authority delegated to federal district courts is also subject to review by federal appellate courts. Fifth, historically and in most cases, the US Supreme Court has found statutes to be void for vagueness only where the application of the statute in question has also caused an ancillary violation of a person's civil rights or personal liberty. *Hoffman Estates v. The Flipside, Hoffman Estates, Inc.*;[53] and *City Of Mesquite v. Aladdin's Castle, Inc.*;[54] and Hadfield[55] address the *Void-for-Vagueness Doctrine*. Sixth, Boyden & Shu seem to take issue with the degree of specification or definitiveness of RAFSA – but this is really a matter of semantics and not function, and in such circumstances and context (*i.e.* Global Financial Crisis; political bickering; budget deficits; public-approval ratings; etc.), it may have been difficult to develop better definitions.

53 *Hoffman Estates v. The Flipside, Hoffman Estates, Inc.*, (1982) 455 U.S. 489. *Gonzales v. Carhart*, (2007) 550 U.S. 124, 168. *Hill v. Colorado*, (2000) 530 U.S. 703. *Tuilaepa v. California*, (1994) 512 U.S. 967. *Gentile v. State Bar of Nev.*, (1991) 501 U.S. 1030. *Skilling v. United States*, (2010)130 S. Ct. 2896, 2934.

54 *City Of Mesquite vs. Aladdin's Castle, Inc.*, (1982) 455 U.S. 283.

55 G.K. Hadfield, 'Weighing the Value of Vagueness: An Economic Perspective on Precision in the Law', *California Law Review*, Vol. 82, 1994, pp. 541-550.

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The following is a summary of how RAFSA violates various Clauses of the US Constitution.

C RAFSA Contravenes Various Constitutional-Law Principles

RAFSA contravenes various Constitutional law principles that are well accepted in common-law countries.[56] Under the US Constitution, the relevant State Actions are as follows:

- the enactment of RAFSA; and
- the required mandatory compliance with sections of RAFSA.

As stated above, Joslyn summarised some possible constitutional law problems which are as follows: (1) RAFSA is constitutionally suspect to the extent it creates crimes but allows the precise contours of the criminal conduct to be defined by unelected regulatory authorities; (2) in the US, traditional police powers reside at the state-government level, which makes US states more appropriate enforcers of criminal penalties (rather than federal investigative/police agencies such as the FBI); (3) many of the criminal provisions in RAFSA were drafted in an overly broad or vague manner, which creates the problems of fair notice and violations of the due process clauses of the US Constitution.[57]

I Substantive Due Process Clause.

The federal government has an affirmative duty to enact effective laws, risk regulations, and statutes that will reduce bankruptcy risk, systemic risk, and financial contagion; and the Government breached this duty by enacting RAFSA. Under the *State Action* and Constitutional Tort theories explained and or introduced in

56 *See* Gray & Purcell 2012; H.K. Downs, M.B. Salser & D.B. Long, *Recent Constitutional Challenges to Dodd-Frank*, 2013, available at <www.johnstonbarton.com/wp-content/uploads/2013/04/Recent-Constitutional-Challenges-to-Dodd-Frank.pdf>; 'Texas Community Bank, Seniors And Free Enterprise Groups File Suit Challenging Dodd-Frank – Unchecked Power of Consumer Financial Protection Board Unconstitutional', available at <http://cei.org/doddfrank>; D. Addington, 'Congress Should Promptly Repeal or Fix Un-Warranted Provisions of the Dodd-Frank Act', Heritage Foundation – Backgrounder #2615, 13 October 2011, available at <www.heritage.org/research/reports/2011/10/congress-should-promptly-repeal-or-fix-unwarranted-provisions-of-the-dodd-frank-act>. The 'Non-delegation doctrine' is derived from Article-One 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, RAFSA requires more than 250 (two hundred and fifty) new formal rule-makings by eleven different federal government agencies, with at last twenty five new rules to be enacted by the BCFP and at least fifty new rules by the FSOC, and at least ninety new rules by the SEC. However, it seems that it has been generally acceptable for US federal government agencies (such as the US SEC) to create rules based on statutes (that may be considered open-ended) enacted by the US Congress; *see* also S. Bainbridge, *Dodd-Frank and the Non-Delegation Doctrine*, 2010, available at <www.professorbainbridge.com/professorbainbridgecom/2010/07/doddfrank-and-the-nondelegation-doctrine.html>.

57 Joslyn 2010.

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Tushnet,[58] Kania,[59] Gardbuam,[60] Jamison,[61] Ellman,[62] Heinzerling,[63] Burnham,[64] Nwogugu[65] and Currie,[66] the failure of RAFSA to enact the various statutes that are required for the protection of investors and for overall financial stability constitutes actionable Constitutional Torts.

The Financial Stability Act of 2010 ('FSA') contravenes Substantive Due Process principles because it grants the US Federal Reserve the power to liquidate financial institutions (deemed to be in default or in danger of default, and whose failure will have adverse consequences on the US economy) in a special proceeding in the US District Court for the District of Columbia (the 'Orderly Liquidation

58 M. Tushnet, 'The Issue of State Action/Horizontal Effect in Comparative Constitutional Law', *International Journal of Constitutional Law*, Vol. 1, No. 1, 2003, pp. 79-98; *Brentwood Academy v. Tennessee Secondary School Athletic Ass'n* (2001) 531 U.S. 288; J. Shapiro, 'Snake Pits and Unseen Actors: Constitutional Liability For Indirect Harm', *University of Cincinnati Law Review*, Vol. 62, 1994, pp. 883-897; C.B. Whitman, 'Government Responsibility for Constitutional Torts', *Michigan Law Review*, Vol. 85, 1986, pp. 225-245.

59 R. Kania, 'A Theory of Negligence for Constitutional Torts', *Yale Law Journal*, Vol. 92, 1983, pp. 683-693.

60 S. Gardbaum, 'Where the (State) Action Is', *Int. J. Constitutional Law*, Vol. 4, 2006, pp. 760-779.

61 F. Jamison, 'State Constitutional Law – Freedom of Speech – A Tightening of the Reins', *Rutgers Law Journal*, Vol. 39, 2008, pp. 969-979 (describing the history of the state action requirement; and comparing state and federal constitutions in the US).

62 S. Ellman, 'Constitutional Confluence: American "State Action; Law and the Application of South Africa's Socio-Economic Rights Guarantees to Private Actors"', *New York Law School Law Review*, Vol. 45, 2001.

63 L.E. Heinzerling, 'Actionable Inaction: Section 1983 Liability for Failure to Act', *University of Chicago Law Review*, Vol. 53, 1986, pp. 1048-1061.

64 W. Burnham, 'Separating Constitutional and Common Law Torts: A Critique and a Proposed Constitutional Theory of Duty', *Minnesota Law Review*, Vol. 73, 1989, pp. 515-525.

65 M. Nwogugu, *Risk in the Global Real Estate Market*, John Wiley 2012 (introducing the "*Substitution Theory*" (p. 198) and the "*Substantial Inducement Theory*" (p. 9)).

66 D. Currie, 'Positive and Negative Constitutional Rights', *University of Chicago Law Review*, Vol. 53, No. 3, 1986, pp. 864-890.

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Authority' or 'OLA')[67] (Financial Stability Act of 2010). Karmel[68] and Fisher[69] noted some of the weaknesses in OLA. The FSOC selects financial companies that are subject to seizure by the government. In OLA, the US Treasury, the FDIC, and the US Federal Reserve can agree to put a financial institution into an orderly liquidation process in a US District Court for the District of Columbia wherein the Court must agree that the company is insolvent within 24 hours, in order for the liquidation process to begin. OLA is essentially an alternative insolvency regime (an alternative to traditional bankruptcy processes), and Court proceedings under OLA are filed under seal and in a petition brought to the United States District Court for the District of Columbia (the US District court for the District of

67 *See* 12 U.S.C. § 5394 (Dodd-Frank Act § 214) (this clause prevents any future government bailouts for struggling financial institutions); T. Woo, 'A Comparison of Liquidation Regimes: Dodd-Frank's Orderly Liquidation Authority and the Securities Investor Protection Act', *Brooklyn Journal of Corporate, Financial & Commercial Law*, Vol. 6, No. 1, 2011, pp. 47-78, available at <www.brooklaw.edu/~/media/PDF/LawJournals/CFC_PDF/cfc_vol_6i.ashx>; S. Ben-Ishai & S.J. Lubben, 'A Comparative Study of Bankruptcy as Bailout', *Brooklyn Journal of Corporate, Financial & Commercial Law*, Vol. 6, No. 1, 2011, pp. 79-102, available at <www.brooklaw.edu/~/media/PDF/LawJournals/CFC_PDF/cfc_vol_6i.ashx>; J.H. Smolinsky, 'Retooling General Motors: Defending an Innovative Use of the Bankruptcy Code to Save America's Auto Industry', *Brooklyn Journal of Corporate, Financial & Commercial Law*, Vol. 6, No. 1, 2011, pp. 103-136, available at <www.brooklaw.edu/~/media/PDF/LawJournals/CFC_PDF/cfc_vol_6i.ashx>; B. Goddard, 'The New World Order: Financial Guaranty Company Restructuring and Traditional Insurance Insolvency Principles', *Brooklyn Journal of Corporate, Financial & Commercial Law*, Vol. 6, No. 1, 2011, pp. 137-170; C. Paulus, 'The New German System of Rescuing Banks', *Brooklyn Journal of Corporate, Financial & Commercial Law*, Vol. 6, No. 1, 2011, pp. 171-181, available at <www.brooklaw.edu/~/media/PDF/LawJournals/CFC_PDF/cfc_vol_6i.ashx>; Natter (B. Sivon & R. Natter) 2011; J.N. Gordon & C. Muller, 'Avoiding Eight-Alarm Fires in the Political Economy of Systemic Risk Management', Columbia Law & Economics Working Paper No. 369, 2010; European Corporate Governance Inst. – Finance Working Paper No. 277, 2010, available at <http://ssrn.com/abstract_id=1553880>; J. Noss & R. Sowerbutts, 'The Implicit Subsidy of Banks', Bank of England Financial Stability Paper No. 15, 2012, p. 6, available at <www.bankofengland.co.uk/publications/Documents/fsr/fs_paper15.pdf>; Otker-Robe *et al.* 2011; E. Brewer & J. Jagtiani, 'How Much Did Banks Pay to Become Too-Big-to-Fail and to Become Systemically Important?', *Journal of Financial Services Research*, Vol. 43, No. 1, 2013, pp. 8-12, available at <http://link.springer.com/content/pdf/10.1007%2Fs10693-011-0119-6.pdf>; Schmid 2012; Gordon & Muller 2011; T.H. Jackson, 'Chapter 11F', *in* K.E. Scott, G.P. Schultz & J.B. Taylor (Eds.), *A Proposal for the Use of Bankruptcy to Resolve Financial Institutions, in Ending Government Bailouts As We Know Them*, 2009, p. 217; M. Cihak & E. Nier, 'The Need for Special Resolution Regimes for Financial Institutions – The Case of the European Union', *Harvard Business Law Review*, Vol. 2, pp. 398-408, available at <www.hblr.org/wp-content/uploads/2012/11/HLB206_Special-Resolution.pdf>; J.W. Markham, Jr., 'Lessons for Competition Law from the Economic Crisis: The Prospect for Antitrust Responses to the "Too Big to Fail" Phenomenon', *Fordham J. Corp. & Fin. L.*, Vol. 16, 2011, pp. 261-262 ("Antitrust law could make a greater contribution in resolving this public-policy problem if Congress enacted or the judiciary forged more robust rules preventing and dismantling unwieldy corporate size in excess of any plausible scale efficiency justification"); A. Reeves & M. Stucke, 'Behavioral Antitrust', *Ind. L.J.*, Vol. 86, 2011, pp. 1527, 1541 (defining drip pricing).

68 R. Karmel, 'An Orderly Liquidation Authority Is Not the Solution to Too-Big-to-Fail', *Brooklyn Journal of Corporate, Financial & Commercial Law*, Vol. 6, No. 1, 2011, pp. 1-46, available at <www.brooklaw.edu/~/media/PDF/LawJournals/CFC_PDF/cfc_vol_6i.ashx>.

69 Fisher 2013.

Columbia has changed its local rules – to effectively modify OLA).[70] Where the expedited 24-hour US District Court process is used, OLA attempts to eliminate stays or injunctions, the US District court can extend the 24-hour deadline (or rule that the 24-hour deadline is unfair), and although the subject company and its creditors don't participate in the US District Court proceedings, a party can appeal the US District court's decision to a US Federal Court of Appeals on the basis that the actions of the FDIC, the US Federal Reserve, and the US Treasury were arbitrary and/or constitutes abuse-of-discretion.

OLA grants the US Fed and the US Treasury excessive power and discretion over financial institutions and non-bank business entities – OLA is somewhat vague and does not state specific minimum criteria for selection of business entities for liquidation, and the US Fed's and the US Treasury's interpretation of 'management of systemic risk' and 'threat to financial stability' may be politically motivated and/or may deviate from the US Congress's legislative intent when OLA was drafted. Because many financial institutions rely heavily on their reputation and brand equity, it is likely that OLA will compel government agencies and courts to:

- focus on business entities that have substantial reputation and brand equity – and neglect less visible financial institutions that are sometimes more relevant, and
- focus on 'direct financial contracts' which are more easily provable in court, rather than the often more important 'indirect financial contracts' and chains-of-insurance.

The FSA contravenes Substantive Due Process because it grants the US Federal Reserve the power to break-up firms that are deemed to be too large and that pose a risk to the financial system (the '*Break-up Procedure*'). In the cases of the both the OLA and the Break-up Procedure, the government's interest in regulating the economy to reduce systemic risk is far outweighed by the following:

- the subjectivity and vagueness inherent in the FSA (OLA and the Break-up Procedure),
- potentially disastrous consequences of liquidating or breaking up a firm that does not pose a threat to the economy, and
- the Liquidation Procedure and the Break-Up Procedure have substantial information effects that can adversely affect the credit ratings, perceived credit quality, and stock prices of associated companies or companies in the same industry.

II Procedural Due Process Clause

The *Breakup Procedure* grants the US Fed excessive discretion over financial institutions. The key issue is that while firms may pose a risk due to their perceived or actual economic impact, the FSA does not establish objective standards for deter-

70 The United States District Court for the District of Columbia has adopted Local Civil Rule 85. Available at <www.dcd.uscourts.gov/dcd/sites/dcd/files/DFWSR.pdf>. It may be argued that these procedures in Local Civil Rule 85, effectively modify OLA and provide for procedural and substantive due process.

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mining the adverse economic impact of a firm. Also, some authors have stated that there has been inadequate cost-benefit analysis in processes for enactment of financial regulations/laws[71] – and such inadequacies may also exist in application of RAFSA. See the discussions of the *Procedural Due Process Clause* of the US Constitution in Nwogugu.[72] In the cases of both the *Liquidation Procedure* and the *Break-up Procedure*, the government's interest in regulating the economy to reduce systemic risk is far outweighed by the following:

- potentially disastrous consequences of breaking up a firm that does not pose a threat to the economy,
- the *Break-Up Procedure* has or can have substantial information effects (that can adversely affect the credit ratings, perceived credit quality, and stock prices of associated companies or companies in the same industry), and
- the potential for abuse of discretion by the US Treasury, US Federal Reserve, and/or the FDIC.

III Right-to-Contract Clause

The OLA and the *Break-up Procedure* constitute violations of the Right-to-Contract Clause[73] because they prevent companies from contracting as they see fit and force companies into legal processes that reduce or eliminate their rights to contract with others. These legal processes also reduce these subject companies' opportunity set. The Government's interest in facilitating financial stability and reducing systemic risk is far outweighed by the adverse subjectivity of the *Liquidation Procedure* and the *Break-up Procedure*, and the damaging effects of False-positives (healthy firms are forcibly liquidated or broken-up; and/or liquidations and break-ups are biased or politically motivated) and the adverse information effects the Liquidation Procedure and the Break-up Procedure. In the financial services industry, liquidations and break-ups have substantial information content (because many firms are linked by financial contracts) and are very likely to result in a significant decline in liquidity of markets (as occurred during the Global Financial crisis of 2008-2010). The Government's interest in regulating institutions and companies is far outweighed by the following factors:

- The potentially destructive effects of the wide discretion granted to the US Fed to liquidate or break-up firms.
- The potentially adverse effects of the Liquidation Procedure and the Break-up Procedure on competition in financial services industry and other industries. These processes are likely to reduce competition and, instead, can promote collusion, price-fixing, and refusals-to-deal.
- The potentially destructive effects of financial contagion when certain firms (with good reputations and/or many contracts with other firms) are liquidated or broken-up.

71 *See* Rose & Walker 2013.

72 Nwogugu 2012.

73 *See* the discussions of the *Right-To-Contract Clause* in Nwogugu 2012.

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There are other alternatives for the government to control or limit the size of large 'risky' firms – such as the following: (1) increasing the minimum-capital requirements for both financial institutions and non-financial firms that sell financial products (and perhaps physically segregating all or a portion of such capital at the US Federal Reserve or the US Treasury); (2) limitations on the scope of activities of banks and non-bank 'financial companies'; or (3) implementing a system of penalties for financial services companies that increase systemic risk and implementing a system of incentives for companies that reduce systemic risk. Similarly, there are other alternatives to outright liquidation of firms that are deemed to be financially distressed or too risky.

RAFSA violates the Contract Clause of the US Constitution because it amends the Securities Exchange Act of 1934 to expressly require that sponsors of securitisations must retain at least 5 per cent of the risk of the assets and ABS. This '*Retention Requirement*' restricts firms from contracting with third parties. The *Retention Requirement* is ineffective. For example, a sponsor firm has a pool of US $500 million of bad assets and wants to get rid of the assets via securitisation, and the sponsor sells all the resulting ABS. Regardless of whether the sponsor retains five percent or fifty percent of the risk of the US $500 million pool, the sponsor has achieved its objective of transferring the risk of bad risky assets to investors. Hence, the *Retention Requirement* serves no purpose. The *Retention Requirement* provides substantial incentives for sponsors to increase systemic risk because it compels them:

- to seek and purchase third-party credit enhancement for the underlying loans/assets or of the retained ABS (which simply distributes the risk within the financial system and creates a credit-chain) – and the sponsor's mere searches for third party credit enhancement has or can have substantial information content that can cause harmful financial contagion,
- to include the riskiest assets in the ABS tranches that are sold to investors – and retain 5 per cent of the tranches backed by the least-risky assets;
- to inflate ABS prices, and to inflate the prices of collateral sold to the Securitisation Trust (in order to reduce the true quantities/volumes of ABS that they have to retain); and
- to treat the *Retention Requirement* as merely a cost of doing business rather than a deterrence measure that can have punitive effects.

The above-mentioned restrictions on contract rights of persons do not serve any meaningful purpose and are far outweighed by the distorted and adverse incentives that they create.

The Consumer Financial Protection Act of 2010 ('CFPA') violates the Contracts Clause because it amends the Truth In Lending Act ('TILA') to prohibit certain prepayment penalties. Lenders incur transaction costs and monitoring costs to originate, monitor, and service loans and prepayment penalties are designed to ensure that lenders retain the economic benefits of providing loans. Without adequate prepayment penalties, lenders will have much less incentives to provide loans, and their profit margins can decline substantially. In such circumstances, these lenders are more likely to increase interest rates they charge for loans, in

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order to maintain their profits. Most banks/lenders generate most of their profits from net interest margins. Hence, eliminating prepayment penalties will have adverse economic effects on banks/lenders, prospective borrowers, and the economy, all of which will outweigh the government's interest in regulating financial institutions and financial services.

This prohibition on prepayment penalties effectively restricts firms and lenders from contracting with third parties, and unfairly discriminates between: (1) lenders of different sizes and reputations – in terms of their ability to afford and absorb the risk of lack of prepayment penalties; (2) any pair of lenders that have different quality of assets; (3) lenders that have the knowledge and capability to pass on prepayment penalties in other forms to borrowers and the lenders that do not have such knowledge and capability; and (4) lenders that have the knowledge and capability to hedge prepayment risk and the lenders that do not have such knowledge.

IV Equal Protection Clause

The *Liquidation Procedure* and the *Break-up Procedure* of the FSA violates the Equal Protection Clause[74] of the US Constitution because:

- the procedures unfairly discriminate between financial institutions and non-financial services firms (who sell financial products and whose default may have adverse consequences on the economy – such as large retailing companies, captive finance subsidiaries of international conglomerates, captive insurance subsidiaries etc);
- the procedures unfairly discriminate between firms that focus on, or provide financial services, and firms that provide other non-financial services/products (whose financial distress or default may have adverse consequences on the economy);
- the procedures unfairly discriminate between large and visible financial institutions that are subject to reputation penalties and smaller or less-visible financial institutions that may have the same economic impact;
- the procedures unfairly discriminate between large financial services firms that pose a threat to financial stability and small financial services firms that pose the same magnitude of threat/risk to financial stability.

RAFSA's express protection of the existing dual banking system in the United States constitutes a violation of the Equal Protection Clause because RAFSA:

- causes unfair discrimination between banks that are registered in different states and, thus, are subject to different banking laws;
- unfairly discriminates between large national/international banks and small/local/regional banks that are often subject to different sets of regulations but provide the same or similar services to individuals and organisations (unfairly discriminates between federally chartered and state-chartered banks that provide the same or similar services to individuals and organisations); and

74 *See* the discussions of the *Equal Protection Clause* of the US Constitution in Nwogugu 2012.

- unfairly discriminates between banks that afford the transaction costs of interstate commerce and those that cannot.

RAFSA (Private Fund Investment Advisers Registration Act of 2010 – 'PFIARA') requires that some types of hedge funds register with the US SEC and be subject to SEC regulation (*i.e.* hedge funds that have more than $100 million of assets). The PFIARA's registration requirement for hedge funds violates the Equal Protection Clause because:

- It unfairly discriminates between hedge funds that have more than $100 million in assets but have low economic impact on markets and hedge funds that have less than $100 million of assets but have large economic and psychological impact on markets and/or large trading volumes.
- It unfairly discriminates between hedge funds that have more than $100 million of assets and non-financial companies that trade substantially in derivatives and securities (such as commodities firms, agriculture companies, energy companies, large retailers that offer financial products) but are not deemed to be hedge funds.
- It unfairly discriminates between hedge funds that have more than $100 million of assets and securities brokerage firms that have less than $100 million of assets – but act as agents and have the same or greater trading volume and economic impact as the regulated/qualifying hedge funds.
- It unfairly discriminates between hedge funds that have more than $100 million of assets but have different capital structure – *i.e.* one hedge fund may be using 1:50 debt leverage (achieved by borrowing and/or shorting bonds and/or trading derivatives), while the other hedge fund may have only a 1:1 leverage (trades in only cash market without leverage).

The current oligopoly in the global accounting/auditing industry has adverse effects on risk regulation and global financial stability. RAFSA's failure to break-up the oligopoly in the accounting/auditing industry constitutes a violation of the Equal Protection doctrine. The omission in RAFSA unfairly discriminates between:

- companies that can afford the services of the Big-Four accounting firms and companies that cannot afford to hire the Big-Four accounting firms,
- companies in industries where auditor reputation is critical and, on the other hand, companies in industries where auditor reputation is not critical, and
- small accounting firms who do not enjoy the benefits of the prevailing 'reputation-based auditing' and, on the other hand, the Big-Four accounting firms.

The Consumer Financial Protection Act of 2010 ('CFPA') of RAFSA violates the Equal Protection Contracts Clause because it amends the Truth In Lending Act ('TILA') to prohibit certain prepayment penalties. Lenders incur transaction costs and monitoring costs to originate, monitor, and service loans and prepayment penalties are designed to ensure that lenders retain the economic benefits of providing loans. Without adequate prepayment penalties, lenders will have much less incentives to provide loans, and their profit margins will decline substantially – most banks generate most of their profits from Net Interest Margins. Hence,

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eliminating prepayment penalties will have adverse economic effects on banks. The prohibition on prepayment penalties unfairly discriminates between (1) borrowers whose loans have prepayment penalties and borrowers whose loans do not have such provisions, (2) banks that focus on providing loans with prepayment penalties (mostly small and mid-sized banks and banks that rely in Interest Income) and banks that do not provide loans with prepayment penalties (typically larger banks with more diversified sources of income).

Nwogugu explained weaknesses inherent in the US FSOC's non-bank SIFI criteria; and also introduced more efficient criteria.[75] The US FSOC's non-bank SIFI Criteria doesn't address asset management companies and REITs – but as explained in Nwogugu, REIT shares/interests are derivatives and can cause systemic risk;[76] and as explained in Nwogugu, REITs have inherent Corporate Governance deficiencies.[77] The US FSOC's 'non-bank SIFI Criteria' violates the Equal Protection Clause because the criteria cause a high probability of false negatives and false positives (as explained above), and:

i The 'Absolute Size Criteria' (*i.e.* the US FSOC's minimum size cut-off for non-bank SIFIs is $50 billion of assets), unfairly discriminates between firms whose annual revenues are less than $50 billion (more than $50 billion) but otherwise are systemically very important, as explained above, and firms whose revenues are below $50 billion (more than $50 billion) and are not systemically important, as explained above.
ii The 'Absolute Debt Burden Criteria' (*i.e.* $20 billion of debt is the FSOC's minimum cut-off for non-bank SIFIs) unfairly discriminates between firms whose total debts are less than $20 billion (more than $20 billion) but otherwise are systemically very important, as explained above, and firms whose total debts are above 20 billion (less than $20 billion) and are not systemically important, as explained above.
iii The outstanding 'Derivatives liabilities Criteria' (the US FSOC's cut-off for derivatives liabilities is a minimum of $3.5 billion after accounting for cash collateral and netting agreements) unfairly discriminates between firms whose total debts are less than $20 billion (more than $20 billion) but otherwise are systemically very important, as explained above, and firms whose total debts are above 20 billion (less than $20 billion) and are not systemically important, as explained above.
iv The 'CDS Criteria' ($30 billion or more in gross notional credit default swaps for which the company is a party) unfairly discriminates between firms whose CDS contracts have a combined notional value that is less than $30 billion (more than $30 billion) but are systemically very important, as explained in

75 M. Nwogugu, '"Netting", The Liquidity Coverage Ratio; And the US FSOC's Non-SIFI Criteria, and New Recommendations', *Banking Law Journal*, 2014a.

76 M. Nwogugu, 'REIT Shares/Interests Are Derivatives Instruments; And REITs Are SIFIs', *Pratt's Journal of Bankruptcy Law*, 2014b.

77 M. Nwogugu, 'Some Corporate Governance Problems Pertaining to REITs – Part One', *Journal of International Banking Law & Regulation*, Vol. 23, No. 2, 2008a, pp. 71-89; and M. Nwogugu, 'Some Corporate Governance Problems Pertaining to REITs – Part Two', *Journal Of International Banking Law & Regulation*, Vol. 23, No. 3, 2008b, pp. 142-162.

the section on FSOC criteria, and firms whose CDS contracts have a notion value that more than 30 billion (less than $30 billion) and are not systemically important, as explained above.

v The 'Leverage Criteria' (an assets-to-equity leverage ratio that exceeds 15:1) unfairly discriminates between firms whose assets-to-equity leverage ratio is less than 15:1 (more than 15:1) but otherwise are systemically very important, as explained herein in the section on FSOC criteria, and firms whose assets-to-equity leverage ratio exceeds 15:1 (less than 15:1) but are not systemically important, as explained above.

vi The 'Short-term Debt Criteria' (the ratio of short-term debt to total consolidated assets exceeds ten percent) discriminates between firms whose short-term-debt-to total-assets ratio is less than ten percent (more than ten percent) but otherwise are systemically very important, as explained above, and firms whose short-term-debt-to total-assets ratio is greater than ten percent (less than ten percent) and are not systemically important, as explained above.

V *Interstate Commerce Clause*

RAFSA (*Enhancing Financial Institutions Safety and Soundness Act of 2010* – 'EFISSA') expressly prohibits the issuance of charters for federal savings and Loan Associations, and thus violates the Interstate Commerce Clause, because:

- EFISSA unduly burdens interstate commerce by subjecting S&Ls and their customers to state regulation of S&Ls,
- EFISSA shifts the regulation of S&Ls to states and hence creates discrimination between S&Ls that are regulated by and/or registered in different states (in terms of transaction costs, compliance costs, and opportunity set),
- EFISSA prevents and limits the growth of S&Ls.

See the discussions of the *Interstate Commerce Clause* of the US Constitution in Nwogugu.[78] The express protection of the current dual banking system by RAFSA constitutes a violation of the Interstate Commerce Clause, because it increases transactions costs of banks and their customers that are located in different states, and it increases transaction costs and compliance costs of banks that are involved in interstate commerce.

Given that banking (even at the local level) is very much an international business, and the direct/indirect links/contracts among banks are continuing to increase, the RAFSA/EFISSA provisions substantially limits Interstate Commerce.

The CFPA's prohibition of prepayment penalties burdens interstate commerce because it creates or can create adverse tax consequences for: (1) lenders that are located in states where the costs of hedging prepayment risk and/or losses from early prepayment are classified as tax-deductible expenses, or are not classified as such; (2) lenders that are located in states where the existence or non-existence of prepayment penalties affects the classification of the loan for tax or accounting purposes; (3) lenders that are located in states where prepay-

78 Nwogugu 2012.

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ment penalties are treated as capital gains or taxable income, or are not treated as such; and/or (4) lenders that are located in states where the existence or non-existence of prepayment penalties affects the contract rights of the lenders and borrowers.

RAFSA's express protection of the existing 'dual banking' system in the US (*i.e.* different banking laws at both the federal government and state government levels) also burdens interstate commerce because: (1) it creates different amounts of transaction costs, compliance costs, and operating costs for state-chartered and federally chartered banks that are otherwise similar; (2) it discriminates between banks that have only in-state operations and banks that have multi-state operations; and (3) it discriminates between banks that combine banking and insurance services and banks that do not.

VI The Takings Clause

The above mentioned discriminatory classifications inherent in RAFSA also constitute violations of the *Takings Clause* of the US Constitution with respect to the associated "protected classes". See the *Takings* theories introduced in Nwogugu.[79] The Takings involved include the traditional *Regulatory Takings Doctrine* (when the government's excessive regulation of the use of property results in a deprivation of rights).

D Conclusion

Given the foregoing, RAFSA is not only operationally, politically and economically deficient but also many parts of RAFSA are unconstitutional and should be substantially modified. RAFSA (and the $600+ billion that the US government invested in the US economy between 2009 and 2013) has not created much needed economic growth in the US and has not stimulated US capital markets. Instead, RAFSA has increased uncertainty, transaction costs and compliance costs for financial services companies, non-financial companies, and federal and state governments. In hindsight, RAFSA continues to be a tax on corporate entities and a fee-bonanza for Washington DC lobbyists, law firms, and financial services consultants. While the concepts, legislative intent, and initiative embodied in RAFSA are laudable and perhaps were overdue, the benefits of some parts of RAFSA remain questionable and are yet to emerge.

79 *See* Nwogugu 2012, pp. 109, 144, 190, 246.

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