Will Dodd-Frank Act End Up In Supreme Court?

Law360, New York (October 04, 2012, 3:11 PM ET) -- In 2010, Congress passed and President Obama signed a significant piece of financial reform legislation, known as the Dodd-Frank Act. One component of the act was the creation of an orderly liquidation authority, which combines aspects of Federal Deposit Insurance Corporation receiverships with certain provisions of the Bankruptcy Code, to quickly address situations where the failure or potential failure of a financial institution poses a serious risk to the broader American economy.

On June 21, 2012, a Texas bank along with the Competitive Enterprise Institute and the 60 Plus Association Inc. filed a lawsuit in the United States District Court for the District of Columbia challenging numerous provisions of the act on various constitutional grounds. On Sept. 20, 2012, the attorneys general of Michigan, Oklahoma and South Carolina joined the lawsuit with an amended complaint specifically addressing the constitutionality of the orderly liquidation authority.[1]

The attorneys general argue that they have standing as creditors of institutions which may be subject to the orderly liquidation authority through the investments of each state's pension funds. This lawsuit is still in the early stages, and the United States has not yet filed a response, and will not do so until at least Oct. 26, but it is possible that this lawsuit may follow a similar path to that taken by lawsuits filed against the Patient Protection and Affordable Care Act, which reached the U.S. Supreme Court in 2012.

Title II of the act is the orderly liquidation authority, which allows the U.S. Treasury Department secretary to order the liquidation of a nonbank financial institution once he receives a recommendation from a two-thirds vote of the Federal Reserve Board and the FDIC, and determines that, among other things, the failure of the institution would have "serious adverse effects on financial stability" in the United States.[2]

Once the treasury secretary invokes his or her powers under the orderly liquidation authority, the FDIC will take over the financial institution in question and either liquidate it, or take other actions it deems appropriate, including selling the institution in order to protect the broader United States economy. The attorneys general argue in the amended complaint that certain provisions of the orderly liquidation authority violate the Constitution's separation of powers, due process, and bankruptcy uniformity provisions.

The decision to invoke the orderly liquidation authority may not be undone by either Congress or the president.[3] Furthermore, judicial review of that decision is also strictly limited.[4] If the troubled institution does not agree to the liquidation, the secretary must file a petition to allow it in the United States District Court for the District of Columbia, and that court must review the petition and rule on it within 24 hours. If it does not rule within 24 hours, the petition is granted by operation of law.

Second, the hearing must be confidential, with no public disclosure beforehand. Third, the court is only entitled to review the secretary's determinations that the institution is a "financial company" within the meaning of the act, and whether it is default or in danger of defaulting.

Fourth, the court may only use an arbitrary and capricious standard to review the limited determinations it is entitled to make. Fifth, appellate review is similarly limited to the same grounds and standard as the district court's review. There is also no provision for a stay pending appeal, meaning that the liquidation could occur while the appeal is pending, rendering it moot. These limitations on separate and co-equal branches of the government give rise to the AGs' separation of powers argument.

Creditors and other parties in interest who could be affected by the determination to liquidate an institution are not permitted to play any role in the process. In fact, because of the Act's prohibition on disclosure of a hearing related to an orderly liquidation proceeding, they will not even know of such an event until after it occurs. This limitation on the participation of creditors forms the basis of the AGs' due process argument.

The complaint also alleges that the act allows the FDIC to use its own discretion in determining the priority of claims that it will pay, further bolstering the plaintiffs' argument that the act violates due process with respect to the creditors of the institutions which may be subject to the orderly liquidation authority. Finally, the attorneys general allege that the orderly liquidation authority constitutes an exercise of Congress' bankruptcy powers, but it creates a nonuniform system of bankruptcy where the FDIC may use discretion when dealing with creditors, which may result in similarly situated creditors being treated differently.

The constitutional questions highlighted by the amended complaint have been recognized since the act was signed into law two years ago, however, some did not believe that they were significant enough to pose a serious challenge to the act.[5] For example, despite the concerns about the limits on the judicial review of a decision to invoke the orderly liquidation authority as discussed above, Baird and Morrison ultimately concluded that this sort of limited review is within the power of Congress and is not unprecedented.[6]

This is similar to the initial consensus of many academics regarding the potential constitutional challenges to the Affordable Care Act, that is, that there was no serious constitutional challenge to be had.[7] Ultimately, of course, there were serious constitutional questions with respect to the Affordable Care Act, which split courts of appeal and were resolved in the Supreme Court.

However, while it is possible that the amended complaint filed by the attorneys general will reach the Supreme Court, it is far from clear that that will be the outcome, or that its path will follow the path of the Affordable Care Act.

First, and most notably, there are unlikely to be multiple challenges to the act. Unlike the Affordable Care Act, which was the subject of numerous challenges throughout the country, the act limits the judicial review of decisions made under it to the United States District Court for the District of Columbia, with appeals limited to the Court of Appeals for the District of Columbia. This most likely eliminates the chance of the circuit split that pushed the Affordable Care Act to the Supreme Court.

Furthermore, the issues implicated in the orderly liquidation authority are not issues that affect the everyday American and are not likely to get the same attention both by politicians and the media as the issues presented by the Affordable Care Act did.

It is too early to predict what the United States' response to this lawsuit will be and whether the challenge to the act's orderly liquidation authority will move beyond this initial district court lawsuit. However, recent history has shown that constitutional challenges that seem to many to be of dubious merit at the outset may ultimately make their way to the Supreme Court.

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