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Now's The Time To Promote Legal Challenges To Dodd-Frank

Jim Powell

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While legal challenges to ObamaCare are making news as they as they head toward the U.S. Supreme Court, what can be done about the Wall Street Reform and Consumer Protection Act (Dodd-Frank)? This, of course, is President Obama's 2,319-page law that's unleashing a firestorm of regulations. They restrict revenues in the financial services business, and some of the perverse consequences became apparent when Bank of America announced it will have to lay off some 30,000 employees.

Dodd-Frank was billed as an effort to prevent another financial meltdown, but what emerged from Congress didn't do anything about the Federal Reserve's cheap money policy that gave people strong incentives to load up on debt. Nor did Dodd-Frank do anything about Fannie Mae or Freddie Mac, the government-sponsored enterprises that subsidized several trillion dollars worth of subprime mortgages, giving originators incentives to churn them out and giving investment banks incentives to package them into junk securities.

Challenging a Dodd-Frank regulation involves suing the agency that issued it. Most of the Dodd-Frank regulations come from the Securities & Exchange Commission and the Commodities Future Trading Commission. Other principal sources are the Federal Reserve and the Consumer Financial Protection Bureau. A half-dozen more federal agencies are issuing Dodd-Frank regulations, too.

It's an uphill struggle. In October 2010, TCF National Bank (Wayzata, Minnesota) filed a lawsuit challenging the constitutionality of an amendment to Dodd-Frank, proposed by Illinois Democratic Senator Richard Durbin after he apparently had been lobbied by a constituent, Walgreens CEO Gregory Wasson. The aim of the amendment was to push some debit card transaction costs from retailers onto their banks that assume consumer credit risks and process transactions. The amendment authorized Federal Reserve price controls on "interchange" fees that retailers are charged by their banks when consumers use debit cards. The price controls would have reduced debit card interchange fees by as much as 80%.

This would have made it difficult for TCF, the 12th largest U.S. debit card issuer, to cover the costs of operating their debit card business. Altogether, the price controls

would affect about 60 of the largest banks, including Bank of America, issuing debit cards that account for more sales than credit cards.

TCF argued that the price controls amounted to a regulatory taking of their revenue without due process and just compensation, violating the Fifth Amendment of the Constitution. TCF sought an injunction to suspend price controls until constitutional issues were resolved – a long and costly process. If TCF prevailed, the same constitutional challenge could be mounted against Dodd-Frank's other price control provisions, such as those applying to loan origination fees.

Unfortunately, the District Court of South Dakota ruled that a business deserved constitutional protection against a regulatory taking of its revenue only if it were a public utility – a monopoly – but a business like TCF in a competitive market didn't deserve such constitutional protection. This bizarre decision was upheld by the U.S. Court of Appeals for the Eighth Circuit. TCF's bid for an injunction was denied, the bank gave up on its lawsuit, and the price controls will go into effect on October 1. TCF's annual revenue losses could be over $50 million, and there's concern about layoffs.

In the opinion of New York University law professor, and Forbes.com contributor, Richard Epstein a leading authority on regulatory takings cases who had represented TCF: "Nobody in the history of rate regulation has ever thought that competitive firms should be more vulnerable to government expropriation than firms that possess monopoly power. Yet that was the explicit assumption driving this case."

The price controls are already causing trouble as price controls always do. Banks are scrambling to recoup lost revenue from interchange fees. Credit card fees are going up. Free checking accounts are on their way out. Some banks are believed to be issuing debit cards only when customers maintain high enough balances for the accounts to be profitable. Debit card reward programs are being discontinued. There's talk about limiting the size of debit card purchases in an effort to limit fraud risks that used to be covered by market-rate interchange fees. Ironically, all this could harm the very retailers who promoted price controls, by reducing the volume of business done with debit cards and credit cards, which wouldn't be entirely made up by going back to cash and checks.

Meanwhile, another legal challenge involves a proposed new SEC regulation mandated by Dodd-Frank. The regulation would make it easier for interest groups – notably labor unions – to get their officials on corporate boards and push their own agenda rather than trying to maximize value for all shareholders. Eugene Scalia, of Gibson Dunn's Washington office, represented the plaintiffs, the U.S. Chamber of Commerce and the Business Roundtable.

On July 22, the U.S. Court of Appeals for the District of Columbia Circuit held that the regulation couldn't be sustained until the SEC complied with the National Securities Markets Improvement Act (1996). In particular, the SEC must consider "whether [a proposed regulation] will promote efficiency, competition and capital formation" – a requirement that the SEC has generally downplayed if not ignored. Without economic

analysis, the court held, a regulation could be voided as “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.” This was the third recent case in which the SEC has been rebuked for failing to take into account the likely economic consequences of a proposed regulation. The S.E.C. announced that it won’t contest the decision.

The SEC’s setback could dramatically slow down the implementation of regulations required by Dodd-Frank. After a proposed regulation is announced, affected parties have one to three months to submit comments. The volume of submissions is reportedly going up as prospective litigants provide more and more evidence about how they would be harmed — evidence that S.E.C. must adequately account for or see more of its regulations shot down during subsequent litigation.

Although Dodd-Frank has some 330 provisions that require or permit federal agencies to issue regulations, in most cases it doesn’t provide guidelines for rule-making. But often other laws do. For example, the Securities Exchange Act (1934) and the Investment Company Act (1940) require that regulators consider the likely impact of a proposed regulation on efficiency, competition and capital formation. The Administrative Procedure Act (1946) also provides constraints which, if ignored, might provide a basis for challenging Dodd-Frank regulations.

Legal victories would help those in Congress who have supported bills to repeal Dodd-Frank. But the repeal movement is most likely to gain momentum as evidence accumulates that it is causing enormous harm – not least, higher unemployment.