A COMMENT ON METZGER AND ZARING: THE QUICKSILVER PROBLEM

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I
INTRODUCTION

It is a pleasure to comment on the fine institutional studies in this issue by Gillian Metzger and David Zaring.[1] Professor Metzger explores the many ways in which financial regulation, as reflected in the regulatory functions of the Federal Reserve (the Fed), differs from mainstream administrative law, as represented by the Environmental Protection Agency (EPA). She describes the historical roots of the divergence, explains how it has persisted over time, and offers some intriguing thoughts about the possibilities for convergence in the future. Professor Zaring paints a fascinating portrait of the Federal Open Market Committee (FOMC), the entity within the Fed that determines national monetary policy. Drawing upon transcripts of FOMC meetings during the Alan Greenspan era, he concludes that internal custom provides a more important constraint on the Committee's behavior than formal administrative law does.

A common theme of both the Metzger and Zaring studies is that financial regulators differ from ordinary administrative agencies on the familiar dimensions of accountability and transparency. Both the Fed and the FOMC are highly independent, effectively immune from presidential oversight, and largely free to ignore Congress because they are funded out of their own operations. They operate under vague statutory mandates that confer enormous discretion. There is no public participation in the Fed's oversight of banks or the FOMC's setting of monetary policy. As Professor Zaring notes, judicial review is almost completely absent.[2] Moreover, most of the critical functions performed by the Fed and the FOMC are shrouded in secrecy. Meetings of the Fed and the FOMC are closed to the public, the results of bank examinations are confidential, the monetary policy directives of the FOMC are not disclosed until they are no longer in effect, and the transcripts of these meetings remain under wraps for five years.

What is missing from both studies is the identification of a key attribute of

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1. Gillian E. Metzger, *Through the Looking Glass to a Shared Reflection: The Evolving Relationship Between Administrative Law and Financial Regulation*, 78 LAW & CONTEMP. PROBS., no. 3, 2015 at 129; David Zaring, *Law and Custom on the Federal Open Market Committee*, 78 LAW & CONTEMP. PROBS., no. 3, 2015 at 157.

2. *See* Zaring, *supra* note 1, at 175–76.

financial regulation that helps explain these departures from traditional administrative law. Financial regulation concerns activity that has very low exit costs. What is being regulated is money, money substitutes (like money market funds and short-term repurchase agreements), and other financial assets, such as bonds, stocks, and derivatives. Financial regulation is concerned with the ultimate in slippery stuff; financial instruments are like quicksilver that can wiggle out of your grasp at a moment's notice.[3] This attribute exerts a pervasive influence on the nature of financial regulation, rendering it difficult in many circumstances to adopt ordinary norms of administrative law. There seems to be no prospect of this changing in the foreseeable future, and therefore it is unlikely that a complete convergence between financial regulation and other forms of administrative law will occur.

II

EXIT COSTS AND THE NATURE OF REGULATION

Ordinary administrative law developed in the context of activities that either had no exit option or very high exit costs. Railroads are the pioneering example, as they were the subject of the first major federal regulatory statute—the Interstate Commerce Act.[4] Railroads have large fixed costs and are literally nailed to the ground. The only way to exit from the industry is to go bankrupt. Other public utilities, like electric and gas distribution companies, share similar features. Professor Metzger takes EPA rulemaking as the paradigm of modern administrative law, which reflects the thinking of most administrative law scholars.[5] EPA regulations, no less than rate regulations by the Interstate Commerce Commission and public-service commission orders, target facilities that have high fixed costs and little ability to relocate in the short run, such as coal-burning power plants and automobile assembly and distribution facilities. The externalities associated with these facilities are chronic and cumulative, so the EPA can take its time in figuring out what the regulatory response should be. Even accidental releases or spills happen with some regularity, and the response options can usually be plotted out in advance.

When the subject of regulation has very high exit costs, like railroads, power plants, and automobile factories do, what kind of administrative process results? A very elaborate, inclusive, deliberate, multistaged, heavily lawyered decision making process. It begins with extensive consultation inside the agency and the administration, including informal soundings of interest groups and outside experts. If a consensus is reached to move forward, teams of specialists, advised by lawyers, work out a proposed policy. A massive document called a

3. Quicksilver is the somewhat archaic name for the metal mercury. The name is sometimes used allusively "with reference to the quick motion of which the metal is capable." *Quicksilver*, OXFORD ENGLISH DICTIONARY (2d ed. 1989) (second definition).

4. See Joseph D. Kearney & Thomas W. Merrill, *The Great Transformation of Regulated Industries Law*, 98 COLUM. L. REV. 1323, 1330–34 (1998).

5. Metzger, *supra* note 1, at 133–34.

Notice of Proposed Rulemaking (NOPR) is prepared that discloses the agency's proposed action and the data and studies justifying it.[6] The NOPR elicits hundreds of comments from interest groups, written by other specialists and lawyers. The comments are subject to painstaking analysis by agency staff, and responses are written by more lawyers. Cost-benefit studies are prepared by economists, reviewed by more lawyers, and submitted to the Office of Management and Budget. Then the whole thing is subject to judicial review, with rounds of briefs written by yet more lawyers, oral arguments, and petitions for rehearing. The process is slow, deliberate, relatively inclusive, relatively transparent, and highly legalistic. Whether or not it produces good policy, it produces a policy that is very elaborately justified.

Financial regulation is pervasively different because the subject matter of the regulation has very low or no exit costs. It is quicksilver. Money has always been portable, fungible, and exchangeable. The modern era has seen a proliferation of innovations that have made effective regulation even more elusive: the development of multiple forms of financial assets that serve as money substitutes; comprehensive digitalization of financial interests; electronic exchanges; floating exchange rates; and the globalization of financial markets—all have given the term "liquidity" new meaning. Financial assets trade at lightning speed around the clock and around the world. Fortunes can be made and lost in an instant. As Roberta Romano has put it, financial institutions operate "in [a] dynamic and uncertain environment."[7] Given all the uncertainty, human psychology—not just fear and greed, but also herd mentality—plays a huge role, and one that is hard to keep under control.

The paradigmatic problem for financial regulation is the run on the bank, made familiar in the movie *It's a Wonderful Life*.[8] Depositors in the local savings and loan hear rumors that the bank has experienced some serious loan losses. They begin to wonder if they will get their deposits back. So they start to line up to withdraw their funds. Soon other people see the line and start to ask what is going on. The line gets longer and the savings and loan quickly runs out of cash. The panic spreads to the other banks in town, and they run out of cash. Then it spreads to the next town. Pretty soon you have a full-fledged liquidity crisis and an economic depression. The collapse of Lehman Brothers was the same story, only it involved fancy financial instruments like repos and swaps bought and sold by traders with Ivy League degrees and ridiculously high salaries. These traders began to worry that Lehman had too much invested in mortgage-backed securities, which were suddenly hard to price given the fall in housing prices and rise in foreclosures. Those who had made short-term loans to Lehman secured by mortgage-backed securities started to cash out. Soon the

6. Jack M. Beerman & Gary Lawson, *Reprocessing Vermont Yankee*, 75 GEO. WASH. L. REV. 856, 893–900 (2007).

7. Roberta Romano, *For Diversity in the International Regulation of Financial Institutions: Critiquing and Recalibrating the Basel Architecture*, 31 YALE J. ON REG. 1, 24 (2014).

8. IT'S A WONDERFUL LIFE (Liberty Films 1946).

rush was on, and Lehman was unable to meet all the demands for redemptions. It had to declare bankruptcy, capital markets froze up, and a worldwide recession followed.[9]

Ordinary, EPA-style administrative law cannot be adopted in this kind of environment. Financial regulation requires rapid decisionmaking, secrecy, and a single locus of authority, at least when the response to regulation may be to quickly move assets to other instruments or markets that are less regulated or even unregulated. There is no time for long disclosure documents, comments by interest groups, responses to comments, or lawyerly deliberation. The paradigmatic features of administrative law developed in EPA regulation must give way to something else—something like closed-door meetings, take-it-or-leave-it deals, and rapid intervention.

Financial regulation has always exhibited these attributes, and it always will, unless and until the government can figure out how to control the entrance in and exit from financial markets.

III
FOUR EXAMPLES OF THE QUICKSILVER PROBLEM

Traditional precepts of administrative law give way in the face of the imperatives of financial regulation and its pervasive concern with the quicksilver problem. The selection of the following four examples is pure serendipity: they just happen to be aspects of financial regulation that have crossed my path over the years. Nevertheless, they are unified by a concern that the application of traditional precepts of administrative law would trigger a rapid response in financial markets, which would undermine the regulators' objectives. Hence ordinary administrative law must be displaced by something else. That something else is secretive, nonparticipatory, and resistant to ordinary modes of control designed to preserve the rule of law.

A. The Freedom of Information Act

The Freedom of Information Act (FOIA), enacted in 1966, adopts a simple rule-like structure: Every person is entitled to obtain any "record" in the hands of a government agency unless one of nine enumerated exemptions applies.[10] One of the exemptions, Exemption 5, concerns agency memoranda that would not be available by law to a party in litigation with the agency. This exemption is understood to cover "predecisional" communications among agency employees, but not final decisions made by agencies that reflect policy determinations.[11] To the contrary, the Act requires that "statements of general

9. On the impact of the Lehman bankruptcy, see Report of Anton R. Valukas, Examiner, vol. 1 at 13–14, *In re* Lehman Bros. Holdings Inc., No. 08-13555 (JMP) (Bankr. S.D.N.Y. 2010).

10. Adm'r, Fed. Aviation Admin. v. Robertson, 422 U.S. 255, 262 (1975). The Act is codified at 5 U.S.C. § 552(b) (2012).

11. *See, e.g.*, Nat'l Labor Relations Bd. v. Sears, Roebuck & Co., 421 U.S. 132, 153–57 (1975).

policy . . . formulated and adopted by the agency" must be "currently publish[ed] in the Federal Register for the guidance of the public."[12]

For many years, the FOMC, the entity described in detail by Professor Zaring, has been in charge of setting national monetary policy.[13] The committee meets eight times a year, receives reports from the Federal Reserve staff, engages in a discussion about the state of the economy, and attempts to agree on the objectives for the growth in the money supply and the level of interest rates until the next periodic meeting.[14] After the meeting, the committee prepares a document called the Domestic Policy Directive, which contains instructions to the open market desk at the New York Federal Reserve Bank for government traders to follow in buying and selling government securities during the ensuing period in order to adjust the money supply and interest rates.[15] The Domestic Policy Directive is a final decision of the FOMC, and it sets very important government policy for the ensuing period—one that has major implications for investors and the economy more generally.

Unlike other final policy decisions rendered by government agencies, however, FOMC Directives remain secret as long as they remain in effect.[16] The FOMC regards the instructions in the Directive as confidential, and believes, with good reason, that public disclosure would have an immediate "announcement effect"—market participants would adjust virtually instantaneously to knowledge about the government's buy–sell instructions to its trading desk for the next period. Rather than effectuating a gradual transition in interest rates in response to changes in supply or demand for debt instruments due to the Fed's trading activity, rates would jump or fall immediately based on anticipated changes in the supply or demand for government debt. The increased volatility in interest rates would arguably increase the riskiness of debt, which in turn might cause all rates to edge slightly higher than would otherwise be the case if the government trading desk could execute the Directive without immediate disclosure of the strategy.

There is no exemption in FOIA that obviously applies to the FOMC's Domestic Policy Directives. In testimony before a House committee, before FOIA was enacted, the Treasury Department warned that the draft legislation would not exempt "[i]nformation as to purchases by the Federal Reserve System . . . of Government securities in the market," which, if "prematurely disclosed," could have "serious effects on the orderly handling of the Government's financing requirements."[17] But Congress did not see fit to adopt

12. 5 U.S.C. § 552(a)(1)(D) (2012).

13. *See generally* Zaring, *supra* note 1.

14. *Id.* at 159.

15. *Id*. at 163.

16. Federal Open Market Committee v. Merrill, 443 U.S. 340, 342–43 (1979) (citing 12 C.F.R. § 271.5 (1978)). The current regulations merely cite the statutory grounds for exempting information from disclosure under FOIA, apparently because the Supreme Court in *Merrill* upheld the delayed release of the Directives under Exemption 5. *See* 12 C.F.R. § 271.7 (2014).

17. *Hearings on H.R. 5012, etc., Before the Foreign Operations and Gov't Info. Subcomm. of the H.*

an exception for instructions related to purchases or sales of government securities by the Fed. Had the government pressed for an exemption, it likely would have been granted.[18] Other than this one passing statement in the House hearing, however, there is no evidence that the government made any effort to secure such an exemption.

When a law student at Georgetown University Law Center named David Merrill (no relation to the author) filed a FOIA request demanding the release of the monthly Domestic Policy Directives, the government forcefully responded that the consequences would be deleterious.[19] Immediate release "would make it difficult to implement limited or gradual changes in monetary policy."[20] The announcement effect of the release "would result in sudden price and interest rate movements, which might be considerably larger than the Committee contemplated and might be beyond the power of the FOMC or the Federal Reserve to control."[21] The government also suggested that immediate release would favor large institutional investors, "who would have the means to analyze the information quickly and act rapidly in buying or selling securities," at the expense of small investors.[22]

Legally speaking, the government had no coherent argument supporting its policy of secrecy. It suggested variously that the Domestic Policy Directives were exempt from disclosure as "internal personnel rules or practices" or as "predecisional communications."[23] These arguments were quickly rejected by the lower courts because the Directives are final statements of policy.[24] Alternatively, the government argued that nondisclosure was warranted because the Directives were "official information" or contained "confidential information" analogous to investigatory files.[25] This argument was contrary to the prevailing understanding of FOIA as a rule-based statute consisting of a basic command (disclose) and nine carefully drawn exemptions, and it was also summarily rejected.[26] Both the district court and the court of appeals concluded that the plain language of the statute admitted of no answer other than that the Domestic Policy Directives must be disclosed as soon as they are promulgated.[27]

The FOMC was understandably distraught by this conclusion. It persuaded

Comm. on Gov't Operations, 89th Cong. 49 (1965) (statement of Fred Burton Smith).

18. The U.S. Postal Service secured a special exemption in 1970 for "information of a commercial nature, including trade secrets, whether or not obtained from a person outside the Postal Service, which under good business practice would not be publicly disclosed." 39 U.S.C. § 410(c)(2) (2012).

19. *Merrill*, 443 U.S. at 347 (1979).

20. *Id.* at 349.

21. *Id.*

22. *Id.*

23. Merrill v. Federal Open Market Committee, 413 F. Supp. 494, 501–02 ((D.D.C. 1976).

24. Federal Open Market Committee v. Merrill, 565 F.2d 778, 783 (D.C. Cir. 1977); *Merrill*, 413 F. Supp. at 503.

25. *Merrill*, 565 F.2d at 786–87.

26. *Id*.

27. *Id.* at 787; *Merrill* 413 F. Supp. at 506–07.

the Solicitor General to seek and obtain Supreme Court review. When the case reached the Court, the government pulled out all the stops, emphasizing that great disruption to government's monetary policy would result if the decisions of the lower courts were upheld.[28] The Court obliged by creating what was in effect a new exemption under FOIA for Domestic Market Directives.[29] The opinion, which one casebook describes as "tortuous,"[30] created the new exemption by elaborating on the language of Exemption 5, which speaks of matters that would not be disclosed in litigation with a nongovernmental party. The Court reasoned that the Federal Rules of Civil Procedure authorize courts to issue orders protecting "confidential . . . commercial information,"[31] and the Directives could be regarded as a confidential instruction by the government to its broker.[32] The Directives would therefore be eligible for a protective order in litigation and hence were eligible for temporary protection under Exemption 5. Under this theory, the Directives would remain exempt only as long as the instructions remained in effect and hence would have to be disclosed after the period covered by the Directive lapsed. In effect, as the dissent argued, the Court created a new category of information subject to temporary exemption under FOIA, which had no clear foundation in the text of the Act.[33]

Given the lack of support for an exemption for Domestic Policy Directives in the text or legislative history of FOIA, how did the government convince the Court to create one? The government successfully persuaded the Court that the ability of financial markets to respond almost instantly to the disclosure of information made it imperative to keep the Directives confidential for the short time in which they remain in effect. In other words, the quicksilver nature of the markets trading in government securities required a different approach to disclosure of the FOMC's final Directives than the one that FOIA mandated for all other agencies. Ideally, one would expect Congress to enact an express exemption covering the FOMC Directives. But the Court was unwilling to risk the disruption to federal monetary policy that might be created while waiting for Congress to act. So it carved out a special rule for information disclosure by an agency engaged in financial regulation.

B. The Fed's "Doomsday Book"

In his recent memoir about the financial crisis, Timothy Geithner, who served as President of the New York Federal Reserve Bank during the most intense days of the crisis and as Secretary of the Treasury in the aftermath,

28. Brief for Petitioner at 26–29, Fed. Open Mkt. Comm. of the Fed. Reserve Sys. v. Merrill, 443 U.S. 355 (1979) (No. 77-1387).

29. *Merrill*, 443 U.S. at 355–60.

30. JERRY L. MASHAW ET AL., ADMINISTRATIVE LAW: THE AMERICAN PUBLIC LAW SYSTEM 747 (6th ed. 2009). I should disclose that I assisted Justice Blackmun, author of the "tortuous" opinion for the Court, as his law clerk.

31. FED. R. CIV. P. 26(c)(1)(G).

32. *Merrill*, 443 U.S. at 355–57.

33. *Id.* at 365–67 (Stevens, J., dissenting) (joined by Stewart, J.).

made reference to a binder in his office at the New York Bank that was informally known as the "Doomsday Book."[34] This he characterized as a collection of "information" about the Federal Reserve's "emergency powers" or its "firefighting equipment,"[35] and he indicated that the book had been prepared, at least in part, by the Bank's general counsel.[36] In recent litigation against the United States brought by shareholders of AIG, seeking compensation for the allegedly punitive terms imposed on the insurance giant in 2008 in return for a government bailout,[37] the plaintiffs have sought to obtain copies of the Doomsday Book and introduce it into evidence.[38] They claim that the book is relevant to showing that the government knowingly exceeded the scope of its legal authority in imposing conditions on AIG that were far more severe than those established for other financial firms that also received government bailouts at about the same time.[39] The government has vigorously opposed any use of the Doomsday Book in the trial and has argued that it must be kept under seal.[40]

We of course do not know what is in the Doomsday Book because its existence and contents were secret until it was mentioned in the Geithner memoir. Based on Geithner's descriptions, it appears that the Book consists of various memoranda prepared over the years discussing possible legal interpretations of the Fed's statutory authority.[41] Presumably, the government is claiming that the Book is privileged as an attorney–client communication. Whether this argument succeeds remains to be seen. Some courts have restricted the privilege to communications that reflect confidences transmitted by the client to the attorney;[42] the Book appears to be a collection of advisory memos from attorneys (and possibly others) to whomever happens to be in a position of responsibility at the moment at the Federal Reserve Bank. Other courts have cautioned against extending the privilege automatically to the government, noting that the privilege "stands squarely in conflict with the strong public interest in an open and honest government."[43]

However the matter is resolved, it seems odd from the perspective of ordinary administrative law that an agency would maintain a book filled with interpretations of its legal authority that is kept secret from the public. The

34. TIMOTHY F. GEITHNER, STRESS TEST: REFLECTIONS ON FINANCIAL CRISES 83, 151 (2014).

35. *Id.*

36. *Id.*

37. *See generally* Starr International Co., Inc. v. United States, 111 Fed. Cl. 459 (2013).

38. Binyamin Appelbaum, *Fed Is Silent on Blueprint Used to Fight A.I.G. Crisis*, N.Y. TIMES, Oct. 15, 2014, at B1–B5.

39. *Id.*

40. *Id*.

41. *See* GEITHNER, *supra* note 34.

42. *See, e.g.*, Mead Data Cent., Inc. v. United States Dep't of the Air Force, 566 F.2d 242, 253 (D.C. Cir. 1977).

43. EDNA SELAN EPSTEIN, THE ATTORNEY–CLIENT PRIVILEGE AND THE WORK-PRODUCT DOCTRINE 129 (4th ed. 2001).

Administrative Procedure Act (APA) provides that opinions, statements of policy, interpretations, staff manuals, or "instructions to staff that affect a member of the public" may be "relied on, used, or cited as precedent by an agency against a party other than an agency only if" it has been published and indexed in accordance with the APA.[44] These "publication rules," as Peter Strauss calls them, have been heralded on the ground that "[c]itizens are better off if they can know about these instructions and rely on agency positions, with the assurance of equal treatment such central advice permits, than if they are remitted to the discretion of local agents and to 'secret law.'"[45] How then is it that the Federal Reserve keeps a book of legal opinions and interpretations of its authority that it is committed to keeping secret?

The answer, of course, is that the Fed does not want to publicly disclose its understanding of the outer limits of its legal authority because this might be gamed by financial firms in ways that would increase the difficultly and cost of dealing with future financial crises. As Professor Zaring has noted elsewhere, the government's approach to financial crises has been to cut deals with major players in distress.[46] Given this deal-making approach, the Fed does not want to disclose the Doomsday Book, because it would be in a position akin to a poker player whose cards have already been laid on the table. The reason for the deal-making approach, rather than a more public, across-the-board, and previously announced policy, relates back to the quicksilver problem. If copies of the Doomsday Book sat in the offices of every lawyer for every major financial firm, those firms would be able to restructure their holdings in periods of distress in ways that might make it easier (or harder, depending on the firm's objectives) for the Fed to intervene in a future crisis. Given the mutability of the holdings of the parties that it may have to rescue or seize, the Fed cannot afford to be forthcoming about its understanding of the limits of its legal authority.

C. Judicial Review of the Appointment of Financial Receivers

When the federal government developed deposit insurance to prevent runs on banks, the government insisted that it needed the power to put banks into receivership without any advance notice to creditors and without any judicial hearing before the receiver was appointed.[47] Quick action without the ordinary trappings of administrative law was necessary to minimize losses to taxpayers before deposit insurance claims started to mount up. The Supreme Court upheld these types of executive seizures in *Fahey v. Mallonee* on a quid pro quo theory—the bank gets the benefits of the federal scheme; in return, the feds get

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44. 5 U.S.C. § 552(a) (2012).

45. Peter L. Strauss, *Publication Rules in the Rulemaking Spectrum: Assuring Proper Respect for an Essential Element*, 53 ADMIN. L. REV. 803, 808 (2001).

46. *See generally* Steven Davidoff & David Zaring, *Regulation by Deal: The Government's Response to the Financial Crisis*, 61 ADMIN. L. REV. 463 (2009).

47. Banking Act of 1933, 48 Stat. 162, 172–75.

authority to seize the bank if they suspect it is going under.[48] The Court insisted that executive seizures were permissible, however, only because the bank could demand a prompt judicial hearing after the seizure, in which a court could order the receivership dissolved.[49] This has almost never happened, basically because the government has not abused the power to seize insolvent banks. But the safeguard has been there nevertheless.

When Congress passed the Dodd–Frank Wall Street Reform and Consumer Protection Act (the Dodd–Frank Act) in 2010,[50] it decided it was necessary to create similar seizure authority for companies like Lehman and AIG, described as systemically significant nonbank financial companies.[51] The Lehman story in particular suggested that the shadow banking system was susceptible to the modern equivalent of a run on the bank, and so a power to take over these nonbank firms was needed to prevent future meltdowns. The Senate was a bit queasy about adopting the Federal Deposit Insurance Corporation (FDIC) receivership model wholesale, however, in part there is no deposit insurance quid pro quo for these nonbank financial firms. [52] Congress eventually settled on an internal executive process to deliberate over whether an "orderly liquidation" is required, followed by a petition to a federal district court in Washington D.C. to grant the appointment authority. The court's approval would presumably enhance the legitimacy of the process, which was designed to lead inexorably to the liquidation of a Fortune 500 financial firm.

Asking an Article III court to bless the seizure, however, posed a problem. The executive deliberations leading up to a proposed seizure would be conducted in secret, and hence would not trigger a panic in the financial markets analogous to what happened in the Lehman bankruptcy. But a normal judicial hearing in an Article III court would give rise to massive publicity, and the damage would be done before the court could act. The solution? Make the judicial process secret, just like the executive deliberation.[53] Reinforce the secrecy by imposing stiff criminal sanctions on anyone who discloses that the hearing is taking place.[54] Require the judge to rule in twenty-four hours.[55] Limit

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48. Fahey v. Mallonee, 332 U.S. 245, 256 (1947) (noting the doctrine that "one who utilizes an Act to gain advantages of corporate existence is estopped from questioning the validity of its vital conditions").

49. *See id.*

50. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (codified as amended in scattered sections of 12 U.S.C.).

51. U.S. Dep't of the Treasury, *Financial Regulatory Reform, A New Foundation: Rebuilding Supervision and Regulation* 76–77 (2009), *available at* http://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf.

52. For discussion of the relevant legislative history, see generally Thomas W. Merrill & Margaret L. Merrill, *Dodd–Frank's Orderly Liquidation Authority: Too Big for the Constitution*, 163 U. PENN. L. REV. 165, 173 (2014).

53. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 202(a), 124 Stat. 1376, 1446 (2010) (codified at 12 U.S.C. § 5382(a)(1)(A).

54. *Id*. at § 5382(a)(1)(C).

55. *Id*. at § 5382(a) (1) (A)(v).

the judge to reviewing only two out of the seven factors that have to be established before a receivership can begin.[56] Limit the judge to considering whether the Treasury's findings with respect to these two factors were "arbitrary and capricious."[57] Prohibit any stays pending appeal.[58] And bar any court from entering injunctive relief against the receiver once the appointment is made.[59]

All this, needless to say, is wildly inconsistent with ordinary norms of administrative law and judicial review of agency action. The court is drafted to bless a complicated and highly consequential executive judgment by engaging in what amounts to a twenty-four-hour take-home examination, with the exception that the firm targeted for liquidation has to use the first half or more of the twenty-four hours writing the questions for the judge to decide. Meanwhile, other stakeholders, such as creditors, stockholders, employees, or lease holders—who might prefer bankruptcy and Chapter 11 reorganization to Dodd–Frank liquidation—are given no notice or opportunity to be heard. They can get an administrative hearing and judicial review later as to whether their "claim" meets a minimum standard of value in liquidation. But they have no right to a hearing, ex ante or ex post, on whether liquidation was necessary in the first place.[60]

What we see here is an extreme example of the distortion of the norms of administrative law when paired with the regulation of financial assets, with their low exit costs and the consequent danger of runs by creditors. This particular deviation from ordinary administrative law was unnecessary, given the alternative of seizing first and offering the opportunity for plenary judicial hearing immediately afterwards.[61] But once Congress decided that ex ante judicial approval was required, the norms of judicial review were tossed out the door—and they had to be, given the quicksilver nature of financial instruments and the stampede for the exits that would occur if normal judicial review had been authorized.

D. Ex Post Judicial Review of Financial Receiverships

The final example involves issues that arise once seizure of a financial firm has taken place and the firm is being operated by a government agency like the FDIC acting as receiver or conservator. Conservatorship and receivership, as they have evolved in the banking and finance industries, often work at cross purposes with traditional administrative law in ways that go beyond the mechanism for appointing the conservator or receiver. Traditionally, conservators and receivers were appointed by courts of equity, which retained

56. *Id*. at § 5382(a)(1)(A) (iv).
57. *Id*.
58. *Id*. at § 5382(a)(1)(B).
59. *Id*. at § 5390(e).
60. Merrill & Merrill, *supra* note 52, at 204–15.
61. *Id*. at 215.

oversight over them.[62] So if someone did not like what a receiver or conservator did, he could complain to the court and potentially get it corrected. Because of concern with large losses of federal deposit insurance and bailout funds injected into the financial system, modern financial conservators and receivers answer to the federal executive branch, not to the courts.[63] Consequently, financial conservators and receivers have enormous discretion in how they manage and potentially wind down the firms under their charge. They hire and fire managers, buy and sell assets, and rejigger capital structures, all with virtually no process that resembles administrative law and no judicial oversight. The model is executive command and control, as opposed to participation, deliberation, and lawyerly justification.

Consistent with the managerial model of receiverships and conservatorships, the federal statutes that authorize these executive seizures provide that no court can award equitable or declaratory relief against the federal receiver or conservator once the appointment is made.[64] This express preclusion of review makes sense, given the need to muster all the assets of the insolvent firm and establish an orderly process for resolving the claims of creditors. The automatic stay under the Bankruptcy Code performs a similar function.[65] A problem arises, however, when the government receiver or conservator makes decisions with far-reaching regulatory implications. Preclusion of review in this context means that government decisions that have a regulatory objective will have been immunized from any review under the APA.[66]

The story of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Incorporation (Freddie Mac), two federally chartered corporations, commonly called government-sponsored enterprises (GSEs), illustrates the problem. Fannie Mae and Freddie Mac are critical to the functioning of the home mortgage market. They buy up mortgages, bundle them together, and sell them to investors with guarantees.[67] Given their quasi-official status and implicit government backing, they have had an advantage in raising capital, which has given them an enormous share of the market for securitized mortgages both before and after the financial crisis of 2007–2008, now well over ninety percent.[68] During the financial crisis, Fannie Mae and

62. See, e.g., Garrard Glenn, *The Basis of the Federal Receivership,* 25 COLUM. L. REV. 434 (1925).

63. Merrill & Merrill, *supra* note 52, at 176–80.

64. *See* 12 U.S.C. § 1821(j) (2012) (the Federal Deposit Insurance Corporation); 12 U.S.C. § 4617(f) (2012) (the Housing and Economic Recovery Act of 2008); 12 U.S.C. § 5390(e) (2012) (the Dodd–Frank Act).

65. DOUGLAS G. BAIRD, ELEMENTS OF BANKRUPTCY 195–210 (6th ed. 2014).

66. The only relief authorized by the APA is equitable or declaratory in nature. 5 U.S.C. § 702 (2012) (authorizing judicial review under the APA only for actions "seeking relief other than money damages"). Under the receivership statutes, in contrast, the sole path to the courts is by challenging the government receiver's resolution of a claim for money (e.g., by a creditor), which means that relief is limited to ex post claims for money damages.

67. *Fannie Mae*, FANNIE MAE, http://www.fanniemae.com/portal/index.html (last visited Apr. 10, 2015).

68. Freddie Mac, *Freddie Mac Update*, February 2015 at 10 (reporting that in 2014 federal GSEs

Freddie Mac took a huge hit, unsurprising given their central role in the mortgage industry.[69] The government responded by enacting the Housing and Economic Recovery Act of 2008 (HERA) to facilitate a government seizure and bailout of the GSEs, which occurred in 2008.[70] The mechanism was nominally a conservatorship, with a specialized federal agency, the Federal Housing Finance Agency (FHFA) effectively taking over the management of Fannie Mae and Freddie Mac.[71]

What is remarkable about the Fannie Mae and Freddie Mac story is that the government has used its resolution authority, coupled with the preclusion of review, to effectively nationalize these two entities.[72] The government has not sought to liquidate the firms, as would happen in a receivership. Nor has it sought to put them back on their feet as private entities, as would be the goal under a conservatorship. Instead, the government has decided to continue operating Fannie Mae and Freddie Mac as bundlers and insurers of mortgages, and to skim off 100% of the profits (which are currently considerable) as a "dividend" payable to the U.S. Treasury.[73] This is what would happen if the government were to nationalize these firms and operate them as state-owned enterprises. Because of the preclusion-of-review statute, however, a federal district judge has recently held that the decision to nationalize Fannie Mae and Freddie Mac is immune from all review under the APA.[74] The decision is certain to be appealed, so this may not be the last word on the future of Fannie Mae and Freddie Mac. But it surely confirms the draconian implications of the preclusion-of-review statute.

Even at a more mundane level, the preclusion of review can have dramatic implications in terms of eliminating APA review of decisions made by financial regulators. A recent Second Circuit decision, *Town of Babylon v. Federal Housing Finance Agency*,[75] is an illustrative example. At the urging of national environmental groups, various municipalities around the country have adopted what are called Property Assessed Clean Energy (PACE) programs.[76] Under these programs, the towns advance money to homeowners to make their homes more energy efficient, thereby conserving energy and reducing greenhouse gas

were responsible for 97 percent of mortgage backed security issuance).

69. *Id*. at 13 (noting large draws of capital from Treasury in 2008).

70. Pub. L. No. 110-289, 122 Stat. 2654.

71. Zachary A. Goldfarb et al., *Treasury to Rescue Fannie and Freddie*, WASH. POST, Sept 7, 2008, at B1.

72. *See* Gibson, Dunn & Crutcher LLP, *Fannie, Freddie Investors File Suit Challenging U.S. Treasury's 2012 "Sweep Amendment," available at* http://images.politico.com/global/2013/07/07/treasury_suit_announcement.pdf.

73. *See Third Amendment to Amended and Restated Senior Preferred Stock Protection Agreement*, *available at* http://www.treasury.gov/press-center/press-releases/Documents/Fannie.Mac.Amendement.pdf.

74. Perry Capital LLC v. Lew, 2014 WL 4829559, at *24 (D. D.C. Sept. 30, 2014).

75. 699 F.3d 221 (2d Cir. 2012).

76. *Id.* at 225.

emissions.[77] The homeowners agree to pay off the advance by remitting monthly assessments to the city. If the homeowner defaults, the unpaid assessments are treated as a tax lien owed to the town, having priority over a conventional first mortgage. Although the sums involved are small, FHFA did not like the idea of having a lien with higher priority inserted above mortgages insured by Fannie Mae and Freddie Mac.[78] So without any kind of hearing or public process, it issued letters directing Fannie Mae and Freddie Mac to refuse to insure any mortgage that participated in a PACE program.[79] Given Fannie Mae's and Freddie Mac's domination of the market, this effectively killed the programs. The Town of Babylon in New York sued, alleging that the peremptory move by FHFA violated the APA and National Environmental Policy Act.[80]

One might think this would be an easy case; after all, there was no notice, no hearing, no transparency, and no legal justification. It turned out not to be so, however, largely because FHFA invoked the preclusion-of-review statute.[81] The petitioners objected that the ban on PACE financing was issued in FHFA's capacity as regulator, not as conservator.[82] But the Second Circuit did not recognize that distinction.[83] FHFA was effectively running Fannie Mae and Freddie Mac as conservator, and could tell them what kind of mortgages to accept and reject as long as they remained in conservatorship. In effect, a decision of potentially national significance involving environmental and energy policy could be taken unilaterally by FHFA without any of the consultation, deliberation, or justification usually associated with modern administrative law, simply because a financial conservatorship was involved.

It could be said that the preclusion-of-review statute that protects financial conservators and receivers needs to be modified to inject more of the administrative law paradigm into government management of major financial institutions when their decisions have regulatory overtones. Doing this, however, may not be so easy. Suppose FHFA launches a big rulemaking proceeding to consider whether to allow Fannie Mae and Freddie Mac to insure mortgages subject to PACE liens. The very prospect of such a decision may cause potential investors in mortgages bundled by Fannie Mae and Freddie Mac to get out their spreadsheets and start worrying about what the implications may be for the value of their investments. This concern may require Fannie Mae and Freddie Mac to amend their guarantees, which may cause Fannie Mae and Freddie Mac to raise their fees for insuring mortgages, which, in turn, may cause mortgagees to look elsewhere for mortgage-bundling services. The ripple effects may be rapid, hard to calculate in advance, and difficult to undo once a

77. *Id.*
78. *Id.*
79. *Id.* at 225–26.
80. *Id.* at 226–27.
81. 12 U.S.C. § 4617(f) (2012).
82. *Babylon*, 699 F.3d at 227–28.
83. *See id.* at 227 (affirming lower court's decision).

decision is made. In other words, the quicksilver problem may mean it is necessary to insulate the government from APA review once it decides to effect a de facto nationalization of major financial entities that operate in financial markets.

IV
CONCLUSION

As the foregoing examples suggest, the low exit costs that characterize financial markets are significantly responsible for the strange version of administrative law that applies to financial regulation. I do not intend to assert any deterministic thesis. History and path dependency clearly matter. It is unquestionably true, for example, that historical decisions such as that to include regional presidents of the Fed banks on the FOMC have had a lasting effect on the emergence of what appears to be a bizarre regulatory body. Nevertheless, the distinction between industries characterized by high versus low exit costs has considerable explanatory power, and can help explain not only why financial regulation includes so many exceptions to ordinary precepts of administrative law, but also why financial regulation suffers from a general deficit of accountability and transparency.

The concept of exit costs may have broader explanatory implications as well. It can help explain the demise of railroad-rate regulation and the significant deregulation in other transportation industries, because the development of competitive alternatives dramatically lowered the exit costs to consumers in these industries.[84] It can also help explain the demise of labor unions in manufacturing, given the reduced costs of exit from domestic manufacturing production associated with globalized trade.[85]

Attention to exit costs also reveals that process-intensive administrative law may be possible, even in industries whose technologies otherwise are characterized by low exit costs, provided that the government has other ways to control entrance in and exit from a market. For example, in the pharmaceutical industry, it does not seem that moving in and out of markets is inherently costly, at least not on the scale of railroads and power plants. But because new drugs generally require premarketing approval from the Food and Drug Administration, entrance to the market is conditioned on compliance with an elaborate administrative process. Conceivably, something similar could emerge in the financial industry, especially if it evolves toward domination by a small handful of large firms. Perhaps the Dodd–Frank Act can be viewed as taking steps in this direction, for example, through its process for designating certain firms as "systemically significant" and subjecting them to heightened oversight,

84. *See* Thomas W. Merrill, *The Interstate Commerce Act, Administered Contracts, and the Illusion of Comprehensive Regulation*, 95 MARQ. L. REV. 1141, 1148–49 (2012).

85. *See*, *e.g.*, Samuel Estreicher, *Trade Unionism and Globalization: The Demise of Voluntarism?* 54 ST. LOUIS U. L. J. 415 (2010).

and through its requirement that organized exchanges be developed for transactions in derivatives that will facilitate greater regulation of such transactions.

In the end, however, I would not bet against the ingenuity of the finance industry in figuring out how to work around these kinds of efforts to corral financial assets. When we peer through the looking glass at financial regulation, to adopt Professor Metzger's metaphor, we discover that the mirror is backed with quicksilver. This creates a distorted image, because when the temperature starts to rise, the quicksilver melts away.