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Court Rules Against the Federal Reserve: Requirement to Disclose Borrower Information

On August 24, 2009, Chief U.S. District Judge Loretta Preska ruled that the Board of Governors of the Federal Reserve System (the "Board") has until August 31 to disclose information about banks and other financial institutions that have borrowed from the Federal Reserve discount window. *Bloomberg LP v. Board of Governors of the Federal Reserve System*, No. 08-CV-9595 (S.D.N.Y. Aug. 24, 2009). The Board has requested a stay of the case while it is appealed to the Second Circuit Court of Appeals in New York. The Board argued that banks and financial institutions that have borrowed from the discount window will suffer irreparable harm if information about their loans is publicly released. But the court, using established precedent under the Freedom of Information Act ("FOIA"), determined that the Board had not sufficiently justified its reliance on exemptions from disclosure under FOIA. If the decision stands, it could cause financial institutions and others that have used the Board's emergency lending facilities to lessen or stop their use of those facilities, which would defeat the purpose of establishing them and remove an important tool from the Government's arsenal of weapons against financial panic. This alert explains the basis for the decision and discusses its implications.

Introduction

A key component of the Federal Reserve's operations is the "discount window" of the 12 Federal Reserve Banks. Borrowing from the discount window provides liquidity to qualifying depository institutions. The Reserve Banks, with Board approval, set the interest rates for discount window borrowing, known as the discount rate. The discount rates are published as well as aggregate information disclosing total amounts of loans by Reserve Bank, but the names of borrowers and information about their borrowing is not.

In the wake of the 2007-08 credit crisis, the Board authorized the Federal Reserve Bank of New York (the "FRBNY") to create several loan facilities to relieve the pressures and provide liquidity to qualifying banks and financial institutions. Consistent with prior discount window practice, the Board publishes only the aggregate loan amounts and not any other information about the loans.

Seeking to compel broader disclosure, Bloomberg, L.P. ("Bloomberg"), a financial software, news and data company, filed two requests with the Board under FOIA in April and May 2008 for detailed information concerning (i) the FRBNY's loans to JP Morgan Chase &

Co. in connection with the proposed acquisition of Bear Stearns Cos. and (ii) loans made under the discount window facilities then in effect. After having been repeatedly rebuffed by the Board as to aspects of the request, Bloomberg turned to the courts. The facts and ruling of the case are discussed below.

Bloomberg's FOIA Requests

FOIA, 5 U.S.C. § 552, provides that any person has a right of access to records of the Federal government unless the records (or any portion of the records) are protected from disclosure by one of FOIA's nine exemptions or by one of three special law enforcement record exclusions. Federal courts usually construe these exemptions narrowly, requiring the government agency subject to a FOIA request to fully disclose the information.

The Board has promulgated regulations regarding FOIA compliance and maintains personnel to respond to FOIA requests. However, the FRBNY does not consider itself subject to FOIA and accordingly has no published FOIA regulations.

Under a FOIA request made to a Federal agency, any person may request full or partial disclosure of previously unreleased information and documents controlled by the agency. When the agency receives a FOIA request, it is obligated to (i) conduct an adequate search using reasonable efforts; (ii) provide the information requested, unless it falls within a FOIA exemption; and (iii) provide any information that can reasonably be segregated from the exempt information.[1]

Among the nine exemptions, the exemptions relevant to this case are exemptions 4 and 5, which state:

> (4) **Trade secrets; commercial or financial information.** Any matter that is a trade secret or that constitutes commercial or financial information obtained from a person and that is privileged or confidential.
>
> (5) **Inter- or intra-agency memorandums**. Information contained in inter- or intra-agency memorandums or letters that would not be available by law to a party (other than an agency) in litigation with an agency.

In response to the FOIA requests, the Board granted in part and denied in part Bloomberg's request. The Board located and granted Bloomberg's request for "records, including contracts with outside entities, that show the employees or entities being used to price the relevant securities and to conduct the process the lending." The Board, however, refused to disclose the other information claiming it fits under the purview of exemptions 4 and 5. Most of the relevant information was in the files of the FRBNY, and the Board argued that the files at the FRBNY were not information in the possession of the Board; while the Board is clearly an agency of the Federal government and generally supervises the Reserve Banks, the Banks themselves are separately chartered as corporations and their shares are owned by those banks that are members of the Federal Reserve System. Accordingly, the Board did not search the FRBNY files. Summary data concerning loans made by the FRBNY during the relevant period in 2008 was in the Board's files; the information consisted of the amounts of loans, the type of lending program borrowed from, and loan origination and maturity dates, but not information about requests for loans or the nature of the pledged collateral. The Board stated that under exemptions 4 and 5, the release of these documents will reveal trade secrets and intra-agency memorandums that should be kept confidential because the sensitive information in the documents will create competitive harm to the Board's borrowers.

District Court's Ruling

In a 47-page opinion, Judge Preska rejected the Board's argument that disclosing the names of the loan recipients would cast a stigma on the borrowers:

> "The Board would seemingly sweep within the scope of exemption 4 all information about borrowers that anyone throughout the entire marketplace might

[1] 5 U.S.C. §§ 552(a)(3), 552(b) (2006).

> consider to be negative. The exemption cannot stand such inflation . . .The Board essentially speculates on how a borrower might enter a downward spiral of financial instability if its participation in the Federal Reserve lending programs were to be disclosed . . . Conjecture, without evidence of imminent harm, simply fails to meet the Board's burden of showing that exemption 4 applies."

Judge Preska ruled that the Board improperly withheld its records by performing an inadequate search and must turn them over within five business days, and must also search for additional records at the FRBNY in order to fully comply with the FOIA requests. She relied in part on a Board regulation that provides that certain files of Reserve Banks are files of the Board. The parties were given until September 14, 2009 to confer and inform the court how they plan to proceed in conducting a search of FRBNY records.

Under exemption 4, the court stated that "the withheld record must (i) contain information that is a 'trade secret' or 'commercial or financial' in character, (ii) be 'obtained from a person,' and (iii) be 'privileged and confidential.'" The documents were commercial and financial in character, but Bloomberg and the Board disagreed over whether it was from a person and privileged or confidential. The court stated that it was neither and denied the use of exemption 4.

Under exemption 5, the court stated that the Board did not meet its burden of showing that the documents would not be available to a party in litigation. Thus, the court denied the Board's use of the exemption.

On August 27, the Board asked Judge Preska to stay her order until the Court of Appeals acts on its appeal, which was accompanied by a supporting declaration of The Clearing House Association LLC. In its appeal, the Board stated that it and the banks would suffer "irreparable harm" if details of the loans were made public.

Repercussions

At this point, the case does not directly apply to information concerning borrowers under the panoply of facilities created after the Lehman collapse in September 2008, and accordingly disclosure of the information in this case would be limited. But if the decision is upheld, then the Board would have a much harder time justifying nondisclosure of future FOIA requests (which may be filed by anyone in the world) for all such information.

Not only would this likely create concerns among parties that have borrowed in the past, on the belief that this information would not be disclosed, but it could create a reluctance to borrow in the future. This could cripple the effectiveness of a broad range of FRBNY and other Reserve Bank lending and credit facilities, since their reason for existing is to allow parties to obtain liquidity that market failures have caused to be unavailable anywhere else. One of the reasons that the Board created the Term Auction Facility in December 2007 was to overcome banks' concern that their use of the discount window carried a stigma; this stigma was thought to exist even though the fact of the borrowing was not made public. Public disclosure would likely deepen this concern, especially if such borrowing were perceived as a sign of financial weakness rather than a short-term liquidity problem.

The Board might be able to blunt the effect of an adverse decision by taking two steps: limiting the amount of information in its direct possession, and by revising the regulation cited by the Court that certain Reserve Bank files are Board files. However, it is difficult for the Board to do its job if it does not have such information, and designing a system so that they would have access to the information without retaining it in its files would create logistic and legal problems. More importantly, inquirers might file FOIA requests directly with the Reserve Banks. This would put front and center a question on which courts have split for decades, whether Reserve Banks are agencies for FOIA and other purposes.

Absent a decision favorable to the Board on appeal, the range of issues presented by Bloomberg's FOIA action could be put to bed by Congress amending FOIA to exempt information about discount window borrowing. Yet a majority of the U.S. Senate voted in April in favor of the proposition that the Board should disclose the identity of borrowing firms, how much the assistance was worth, and what the firm did with the money; Congress may be in no mood to tighten FOIA at this juncture.

We plan to follow this case and issue additional alerts as the case proceeds.

Azam H. Aziz
New York
+1.212.848.8154
aaziz@shearman.com

Donna M. Parisi
New York
+1.212.848.7367
dparisi@shearman.com

Bradley K. Sabel
New York
+1.212.848.8410
bsabel@shearman.com

Nathan J. Greene
New York
+1.212.848.4668
nathan.greene@shearman.com

M. Holland West
New York
+1.212.848.4579
holland.west@shearman.com

Gregg Rozansky
New York
+1.212.848.4055
gregg.rozansky@shearman.com

Christian Gloger
New York
+1.212.848.8241
christian.gloger@shearman.com

Michael J. Blankenship
New York
+1.212.848.8531
michael.blankenship@shearman.com