BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

December 30, 1977

CONFIDENTIAL (FR)
CLASS II - FOMC

TO: Federal Open Market Committee

FROM: Thomas J. O'Connell TJOC

SUBJECT: Merrill v. Federal Open Market Committee -- Update of Information Re Petition for Writ of Certiorari.

FOR INFORMATION ONLY

The Committee has been previously advised of efforts on its behalf seeking affirmative action by the Solicitor General to file a petition for writ of certiorari to the Supreme Court from the adverse decision rendered by the Court of Appeals. Committee members earlier received copies of correspondence addressed to the Department of Justice on behalf of the Committee by the Committee's General Counsel and by Assistant Secretary of the Treasury, Roger Altman, urging the filing of a certiorari petition. For the Committee's information, there are additionally enclosed a copy of a supporting letter addressed to the Department of Justice by Charles L. Schultze, Chairman, Council of Economic Advisers, and a copy of a Memorandum transmitted to the Solicitor General by the Assistant Attorney General, Civil Division, recommending against the filing of a petition for certiorari.

The Civil Division Memorandum is an intra-department document which, to my knowledge, has not been made public.

It is the practice of the Solicitor General to review the recommendation of the Civil Division, as well as any supporting or opposing positions submitted in a given case. The Solicitor General then makes a determination of whether or not to petition the Supreme Court for review of a given decision. Although the Board has, on a previous occasion, successfully urged the Solicitor General to seek Supreme Court review in a case in which the Department's Civil Division has recommended negatively, it is reasonably assumed that the position of the Department's Civil Division is customarily given greater weight by the Solicitor General than other submissions.

Regarding the applicable time schedule with respect to this matter, the Committee is currently under a January 3 expiration date for the present stay of the Court of Appeals mandate. After that date, the Committee would be expected to comply with the ruling of the Court of Appeals issued on November 10 with respect to public disclosure of its domestic policy directive. There has been filed on the Committee's behalf a motion for further stay of the Appellate Court mandate for 30 additional days, or until and including February 2, 1978. Prior to the February 2 date, it is anticipated that the Solicitor General will determine his position with respect to any petition for ceriorari.

Attachment

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

December 30, 1977

Dear Ms. Babcock:

I am writing to support the petition of the Federal Open Market Committee (FOMC) for a writ of certiorari in connection with suit brought by David R. Merrill against the FOMC (No. 761389, D. C. Circ. No. 10, 1977) to force immediate disclosure of the FOMC Directive.

Implementation of the Nation's monetary policy by the Federal Reserve System is presently accomplished largely through open market operations in U. S. Government securities. These operations are conducted with a view to providing supplies of money and credit, and a climate in financial markets, consistent with stable economic growth at relatively stable prices.

Accomplishing this objective sometimes requires substantial movements of interest rates and prices of financial assets in response to changes in underlying economic conditions. The marked advantage of open market operations, as opposed to use of other instruments of monetary policy employed both in the United States and in other countries, is that necessary changes in financial market conditions can be brought about gradually. Abrupt changes in the costs of borrowing -- and the associated adjustments that occur in the prices of common stocks -- would be unsettling to business and other borrowers.

It is difficult to predict with any confidence the probable reaction of financial markets to immediate release of the Directive. There are two potential problems, however, that require careful consideration.

First, the announcement by the FOMC that it intended to increase or decrease the Federal funds rate -- the interest rate on overnight loans from one commercial bank to another -- would elicit a relatively abrupt adjustment of market interest rates to levels deemed consistent with the FOMC's announced target for the Federal funds rate. This could be a problem for the conduct of debt management by the Treasury Department, since the number of financing operations required to manage the Federal debt effectively is so large that avoidance of any financing operations during such periods might not be possible.

Second, and potentially the more serious problem, is the fact that efforts of the Federal Reserve to avoid disruption of markets might interefere with the timely implementation of monetary policy consistent with the needs of the economy. One of the most difficult tasks faced by a central bank occurs when interest rates must be increased in the interest of curbing inflation. If the monetary policy actions needed to promote economic stability should, at a particular time, require a significant increase in interest rates, immediate release of the FOMC Directive would be headlined in the financial press. The Federal Reserve is subject to substantial criticism and adverse reactions to such moves. The pressures on the Federal Reserve not to take such action would be heightened by immediate publication of the Directive. Over the long term, this could make the conduct of monetary policy more difficult than it already is.

These concerns are serious enough to warrant consideration by the Supreme Court of whether both the costs and benefits of disclosure have been properly weighed. The Council of Economic Advisers therefore supports the FOMC's petition for a writ of certiorari.

Sincerely yours,

Charles L. Schultze

Ms. Barbara Allen Babcock
Assistant Attorney General
Civil Division
United States Department of Justice
Washington, D. C. 20530

EAB:IJ:TGWilson:pc
145-105-125

20 DEC 1977

MEMORANDUM FOR THE SOLICITOR GENERAL

Re: David R. Merrill v. The Federal Open Market Committee of the Federal Reserve System (C.A.D.C., No. 76-1379)

TIME LIMITS

The judgment of the court of appeals was entered November 10, 1977. A petition for writ of certiorari must be filed by February 8, 1978. A stay of the mandate of the court of appeals will expire on December 30, 1977.

RECOMMENDATIONS

The Federal Reserve Board recommends the filing of a petition for writ of certiorari.

The Department of the Treasury recommends the filing of a petition for writ of certiorari.

I recommend against the filing of a petition for writ of certiorari.

QUESTION PRESENTED

Whether instructions by the Federal Open Market Committee of the Federal Reserve System to the Manager of its Open Market Account, which guide his actions in buying or selling securities on the open market in furtherance of the nation's economic goals, are exempt from disclosure under the Freedom of Information Act, 5 U.S.C. 552, by virtue of exemption 5 of the Act, 5 U.S.C. 552(b)(5).

STATUTE AND REGULATION INVOLVED

The pertinent portions of the Freedom of Information Act and 12 C.F.R. 271.5 are set out at pages 2-4 of our main brief in this case, which is attached.

STATEMENT

This is a Freedom of Information Act suit brought to compel the Federal Open Market Committee ("FOMC") of the Federal Reserve System to disclose records of policy action concerning the FOMC's open market operations. The only records remaining at issue are the Domestic Policy Directive and other statements and interpretations of policy.

1. The FOMC, which is composed of members of the Board of Governors of the Federal Reserve System and five representatives of the Federal Reserve Banks, is charged by the Federal Reserve Act with the coordination of open market operations. 12 U.S.C. 263. Open market operations, the most important monetary policy instrument utilized by the System to help achieve the nation's economic goals, are employed to influence the availability and cost of bank reserves, bank credit, and money. This is normally accomplished when the System's Open Market Account Manager, an officer of the Federal Reserve Bank of New York, purchases or sells certain securities in the open market. These transactions have a broad and direct effect upon the level of the reserves of member banks, which in turn necessarily influences both the ability of banks to make loans and investments, and interest rates. The open market operations are used in conjunction with other major economic tools, but, unlike those other tools, are intended to have a gradual effect upon market conditions and the level of bank reserves.

2. At its monthly meetings, which are held in the middle of each month, the FOMC produces a Domestic Policy Directive which is immediately provided to the System Account Manager to guide him in the open market operations until the FOMC meets again. Until recently, approximately 45 days after each FOMC meeting, pursuant to its rules, the FOMC would publish the Domestic Policy Directive in the Federal Register. Following the district court's decision, the Board decided to make the

Directive available within a few days of the next month's meeting. Each meeting of the FOMC also results in an expression of the FOMC's objectives for the monetary and credit aggregates, which are stated as a tolerance range for certain economic indicators. 1/

In transacting business for the System Account, the Manager deals with about 25 dealers who actively make markets in U.S. government and federal agency securities and who compete with one another for the available business. Roughly half of those dealers are departments of large commercial banks; the others include large investment firms and smaller firms specializing in government securities. All dealers buy principally, if not exclusively, for their own accounts.

3. In this suit the FOMC contends, through affidavits which are contained in the attached court of appeals appendix, that there is a substantial likelihood that the immediate release of this material could: (1) lead to exaggerated market reactions that interfere with the orderly execution of FOMC's monetary policy, and thus substantially damage the nation's economic stability; and (2) enable speculators and other knowledgeable market participants to gain unfair advantages.

The district court held that the FOMC's disclosure of records of its policy actions was not justified by exemption 5 of the FOI Act because the records were not pre-decisional but were the decisions themselves. The court therefore ordered the FOMC to cease enforcing its regulations insofar as it required deferred release of policy actions; to publish the Domestic Policy Directive in the Federal Register upon adoption; and to make other policy actions, including statements and interpretations of policy, publicly available upon adoption.

On appeal the court of appeals affirmed. The court held that the Domestic Policy Directive and the tolerance ranges are final decisions and thus do not fall within exemption 5's protection of pre-decisional material. The court of appeals

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1/ These statements of policy are described in greater detail in our main brief.

rejected our argument that even if the materials are considered to be final decisions that nevertheless exemption 5 offers protection from premature disclosure to certain final decisions. The court of appeals could find no relevant rule of civil discovery which would protect this type of material from disclosure in a civil discovery context. The court stated that in light of the Act's philosophy of disclosure, "we decline to create, by rough analogy, a privilege not in existence at the time FOIA was enacted, and then incorporate this privilege into an exception to the overriding command of that Act" (Slip Op. 17). The court concluded by stating that if public policy warranted the nondisclosure of this material, the remedy was with Congress and not the court.

DISCUSSION

In this case we have always recognized that our legal position was not strong and that there was no clear judicial authority for withholding the Domestic Policy Directive and the tolerance ranges. Frankly, we had hoped that by emphasizing the harm that would result from nondisclosure, the court would find in our favor as long as we supplied a not unreasonable legal theory. It appears, however, from reading the court of appeals' decision that the court was not sufficiently impressed with our contention that significant harm would result from the disclosure of these materials. Since the unanimous panel of the court of appeals contained judges who are generally receptive to the government's contentions, we have no reason to believe that our arguments would find any greater acceptance in the Supreme Court.

1. Exemption 5 of the Freedom of Information Act permits the nondisclosure of "inter-agency or intra-agency memorandums or letters which would not be available by law to a party other than an agency in litigation with the agency." 5 U.S.C. 552(b)(5). This exemption roughly incorporates the rules of discovery and protects internal government documents that would not "routinely be disclosed to a private party through the discovery process in litigation with the agency." H. R. Rep. No. 1497, 89th Cong., 2d Sess. (1966), p. 10.

The only issue that might warrant Supreme Court review is our contention that exemption 5 protects even some final decisions from premature disclosure. 2/ Our argument on this point, which is set out in detail in our attached brief at pages 23-25, is supported by language in the House Report on the Freedom of Information Act. That report states that "a government agency cannot always operate effectively if it is required to disclose documents or information which it has received or generated before it completes the process of awarding a contract or issuing an order, decision or regulation" and that exemption 5 "is intended to exempt from disclosure this and other information and records wherever necessary." H. R. Rep. No. 1497, supra, p. 10.

The court of appeals concluded that the legislative history merely indicated that in some cases disclosure may be delayed until the effective date of a plan or decision, but that the effective date of the policies in this case was the day they were adopted by the Board of Governors. While we think that it could be reasonably argued that policies such as involved here may be withheld until they are no longer operational, we have no clear authority to show that the court of appeals' view of the matter was incorrect.

2. As we stated above, our strategy in the court of appeals was to attempt to convince the Court that great harm would result if these matters had to be disclosed. Accordingly, we relied heavily on affidavits filed in this case which, like the FOMC's recommendation, contend strongly that serious harm to the FOMC's operations will result from immediate disclosure. A close examination of the FOMC's affidavits, however, reflects that the adverse consequences are possibilities rather than strong probabilities. As a result the court of appeals in this case did not appear to be impressed with our assertion that serious harm will result from disclosure.

2/ There is no basis for seeking review of the court of appeals' holding that the Domestic Policy Directive and the tolerance ranges are final decisions. These matters are voted on by the FOMC and are intended to guide the Account Manager in his operations.

While we are sympathetic to the FOMC's concerns, it is unlikely that the Supreme Court will be any more impressed with our showing than the court of appeals. 3/

CONCLUSION

For the foregoing reasons, I recommend against the filing of a petition for writ of certiorari.

BARBARA ALLEN BABCOCK
Assistant Attorney General
Civil Division

By:
Irving Jaffe
Deputy Assistant Attorney General

3/ As suggested by the court's opinion, the FOMC has already begun to seek legislation addressing this problem. While the outlook for such legislation is favorable, because of the Congressional recess, final action is not possible prior to the expiration of the current stay of mandate on December 30, 1977, or even an additional thirty-day stay of mandate.