PHILIP A. WALLACH

LEGALITY, LEGITIMACY,
AND THE RESPONSES
TO THE 2008
FINANCIAL CRISIS

TO THE EDGE

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Legality, Legitimacy, and the Responses to the 2008 Financial Crisis

Philip A. Wallach

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For Vera

Simply stated, the bright new financial system—for all its talented participants, for all its rich rewards—has failed the test of the market place. To meet the challenge, the Federal Reserve judged it necessary to take actions that extend to the very edge of its lawful and implied powers, transcending certain long embedded central banking principles and practices. . . . The immediate response to the crisis has been to resort to untested emergency powers of the Federal Reserve. Out of perceived necessity, sweeping powers have been exercised in a manner that is neither natural nor comfortable for a central bank.

—Paul Volcker, *Remarks to the Economic Club of New York*, April 8, 2008

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To the Edge

1

Introduction: Law, Legitimacy, and Crisis Government

Consider the following three descriptions of government responses to the financial crisis:

—Because they wanted access to money without having to get the legislature's approval, government officials interpreted an old statute in a fairly far-fetched way to commit up to $50 billion to guarantee that private investors would bear no risk of losses.

—Pursuant to the terms of a law just passed, the government offered banks an investment of capital at fairly favorable terms.

—The government left undisturbed several contracts between a private firm and its employees, concluding that it was legally obligated to do so.

From these descriptions, you might naturally imagine that outside observers would be outraged at the first action for its twisting of the law and accepting of the second and third for their clear compliance. After all, respect for the rule of law is one of the hallmarks of our system of government.

You would be very wrong. The first action described, through which the Treasury Department made a crucial intervention to support the money market industry at the peak of the financial crisis in September 2008, occasioned almost no criticism at the time and has quickly receded into historical memory. The second action, which was the first major use of the crisis-inspired Emergency Economic Stabilization Act (EESA, better known as TARP) passed in October 2008, received scathing criticism both from those who felt the government was effectively running roughshod over private firms' rights and from those who felt that the particular nature of the action was an inappropriate use of the resources

allocated by the law. Years later, neither group of critics has been much mollified; angry accusations of Godfather-style extortion and bait-and-switch deception persist, if at a lower volume. The third action, in which the government decided in March 2009 that it could take no legally valid action to stop bonus payments to employees at the mostly government-owned insurance giant AIG, inspired the most fearsome public outcry of the whole crisis. A public whose sense of fairness was deeply offended was profoundly unmoved by professions of legal limitations—though, as it turned out, elected officials were somewhat more sensitive to what the law required, ultimately leading them to step away from the most legally problematic actions under consideration.

This book attempts to shed light on this divergence between legality and legitimacy during crises. It does so by offering a comprehensive account of the government's responses to the financial crisis of 2008 and the political and legal controversies that surrounded them. Throughout, it attempts to accurately describe how the public reacted to each action and analyze why certain issues aroused so much more anger than others.

As with any exploration of recent history, the events described still inspire strong and conflicting feelings. Their place in history is in the early stages of being determined, and so partisans of various interpretations are likely to denounce those who fail to ratify their own views. In the case of the recent crisis, two polar extreme views are now vying for contention. For some, it is all but self-evident that what the government did during the crisis was outrageous and that the so-called bailouts were a fundamental betrayal of the public trust as well as a perversion of both statutory and constitutional law. At the other end of the spectrum, some will profess astonishment at the idea that the government's actions deserve further scrutiny, either in a legal or political sense. They believe everything that the government did was perfectly above board and that it is downright petty to quibble over insubstantial legal trifles at this point in time, especially given how well these programs turned out to perform.

There is little purpose in coyly hiding my own views. As the crisis unfolded in 2008 and 2009, much of what the government was doing struck me as legally unjustifiable and worrying. I was skeptical that "loans" would ever be paid back, or even that the policymakers involved believed that they would be; as a result, many of the government's actions struck me as illicit forms of spending. As those loans were paid back at levels that showed my initial thinking was mistaken, and as I learned more about the details of the responses and the history of other crisis responses, I became considerably less distressed, and more convinced that discretion ought to be welcomed, at least in limited circumstances. There are many choices that remain troubling to me, and my

judgments are sure to be evident throughout the book. But the main purpose of the book is not to simply argue for a particular judgment about each of the various crisis responses. Convincing either of the two types of critics noted above of the merits of my judgments is not my priority.

Instead, my aim is to illuminate for readers of all perspectives some of the dynamics of establishing legitimacy during a financial crisis, especially the role of law in that process. Responding to crises—whether military or financial—raises several dilemmas for a country's leaders. Relying on already existing legal authorities may be insufficient to meet the challenges, and exigency may make obtaining new ones impossible. History generally esteems leaders who seize these moments and respond forcefully, whether in strict compliance with the law or not.

Some scholars thus conclude that legal constraints have come to play almost no role in shaping the legitimacy of responses to crisis, but I reject that view.[1] Especially when leaders enjoy little public trust, bold crisis actions may be regarded as illegitimate if they flaunt the law. Although it is easy to overestimate the importance of the rule of law in crises, complying with the law remains one important factor for legitimacy. And achieving legitimacy is often a necessary prerequisite to successfully responding to a crisis.

I argue that legality is neither necessary nor sufficient to establish an action's legitimacy during a crisis. If "it's against the law" is the only argument against an action, then this legalistic point will be little impediment to establishing legitimacy. From the other direction, if an action lacks legitimacy for various reasons, declaring that it is consistent with the law (or even legally mandatory) will not always confer legitimacy on it. Indeed, I argue that there is no single factor that can reliably secure legitimacy for a crisis response. Obedience to established law, democratic support, trust in crisis leaders, and a widespread sense that those leaders will be held accountable for any abuses will all contribute to legitimacy, but none of these factors is indispensable. Looking to the future, I recommend both a greater investment in clear legal limitations and a realistic acceptance of law's limitations as embodied by a limited but substantial discretionary fund to be used at the executive branch's disposal to combat financial crises.

To begin to explain these claims, the concept of legitimacy I employ demands some clarification at the outset.

What Is Legitimacy?

There are two ways of thinking about legitimacy: normatively or as a positive social fact. Academic political theorists and armchair moralists alike most often engage in the normative enterprise: developing standards of legitimacy

that government actions must meet and evaluating particular actions with regard to these standards. (Lawyers focus on the somewhat unusual normative standard of legality, to which I return shortly.) To anyone who has ever argued about the legitimacy of government actions in normative terms, it should be obvious that judgments about legitimacy are often sharply conflicting. This is true even when discussions clearly distinguish between "actions that are legitimate" and "actions that I approve of," which many do not.

Treating legitimacy as a social fact, as I do in this book, is somewhat more conceptually difficult. Following Max Weber's empirical approach, this approach does not deny normativity but says that the social scientist interested in legitimacy ought to understand its emergence as it happens, rather than as the practitioners of "legal dogmatics" say it ought to.[2]

In a sense, legitimacy as a social fact can be understood as the aggregate product of all of the normative arguments—including arguments that never actually happen and that people perhaps are not even prepared to have. That statement requires some unpacking.

Legitimacy as a social fact is necessarily a collective phenomenon. If every person were an independent-minded political theorist and a perfect observer of every government action, then political legitimacy writ large could probably be fairly characterized as an aggregated sum of all citizens' judgments about legitimacy.[3] As long as time and attention are scarce, however, a real citizenry can never approach this (rather dystopian-sounding) ideal. Rather, certain shared ideas about legitimacy shape widespread perceptions, both because citizens apply them in similar ways and because elite opinion leaders apply them and have others adopt their judgments as authoritative. This application of ideas to particular instances is hardly ever a matter of applying well-defined logic, though. Instead, opinion at every level of engagement is shaped by a contest of rhetorical framings, selective attention to facts, and group affinity; opinion leaders seeking audiences for their own views about legitimacy are sensitive to which arguments gain currency and thus are also followers of broad sensibilities.

Legitimacy for the whole polity is thus an emergent and path-dependent phenomenon, characterized by dozens of feedback mechanisms that involve those who develop criticisms, those who rebut them, and those who determine their own judgments about these debates and determine their own level of engagement with them. Predicting social legitimacy in advance is generally a fool's errand, as so much depends on how arguments play out in real time; that said, it is far from random, and there are characteristics of actions that usually contribute or detract from their legitimacy in predictable ways. These

characteristics correspond to normative conceptions of legitimacy held by many people—but I must emphasize that I do not prejudge whether people will actually apply those factors in every case (let alone whether they should). Indeed, one of the book's contributions is to show how missing certain legitimating factors often thought of as absolutely crucial—including legality—can turn out not to create legitimacy problems.

By studying at what points a lack of legitimacy produced political strife during the recent crisis, I draw useful lessons about what policymakers can do to improve the legitimacy of their future actions. But I have no illusion that these lessons will be anything other than helpful heuristics: probabilistically useful but by no means a recipe for certain success.[4] Politics, in its most universal sense, is about determining what collective actions are legitimate, and nobody should imagine that it can be reduced to a simple science—it is, after all, properly thought of as the art of the possible.

That I offer no scientifically rigorous way of ascertaining legitimacy after the fact will undoubtedly worry those who crave certainty. In part to satisfy such worries, I frequently make use of public opinion data obtained through polling, and it can often provide a useful indicator. But the questions asked by pollsters are generally too vague and haphazardly deployed to give a clear sense of reactions to specific policies; and even if I had been able to conduct my own polls consistently, I would not argue that legitimacy is equivalent to public opinion. This is because polling obscures the huge variations in the intensity of people's investments in understanding political developments. This is well understood, but little dwelt upon, by students of political behavior, who nevertheless often confine themselves to the kinds of questions that polling data are able to speak to more or less adequately.[5]

In studying the debates surrounding the responses to the financial crisis, it is important to emphasize several facts that are rarely acknowledged, perhaps because doing so seems unscholarly: that it is difficult, time consuming, confusing, and often boring to penetrate the mass of information about these complicated events. This is true even for those of us who invest large parts of our lives poring over particulars. (Indeed, there are a few matters that probably deserve treatment in this book but managed to evade coverage because of their technical slipperiness.)[6] Treating these features of our political life as merely incidental unnecessarily renders scholarly discussions less realistic.

This book frankly acknowledges that lack of attention and ignorance are the defining features of most people's relationship to particular governmental actions. These actions' legitimacy will be a function of the interaction of underlying attitudes about government with (generally unfocused) exposure to

the playing out of arguments among a small elite. The most common underlying attitudes are blanket cynicism, blanket trust (quite uncommon today), and blanket indifference, each of which has the power to wipe out the impact of any debate. More consequential for determining society-wide legitimacy are those people more able to adjust their judgments about a policy's legitimacy in response to ongoing elite debates, at least some of the time, and therefore to vary their levels of "specific support" from one policy action to another.[7] The relevant elite is one of knowledge and opinion; especially in the age of the Internet, it is open to those who decide to invest their time and energy—at least in part. Our national conversations are still disproportionately centered in a few newspapers, and those who have access to the opinion pages of the *New York Times* and the *Wall Street Journal* have greater ability than the rest of us to affect judgments about legitimacy.

To make this at least a little more concrete: The median citizen, or even the median voter, probably understands little about the role played by the Treasury or the Federal Reserve in responding to the financial crisis. The median engaged citizen has never heard of Maiden Lane LLC, let alone pondered its legal justification. Even the median member of Congress must find a great deal about the government's response to the crisis quite obscure. Policies such as "the auto bailouts" are far more widely opined about—although many of those most willing to stake out a position on the legitimacy of a policy like that one, the politics of which ended up polarized along partisan lines, may be unable to say with any specificity what the intervention consisted of. But it would be wrong to infer that there is no *there* there when it comes to determining legitimacy: as chapter 5 shows, the contentious debates among experts about the legitimacy of the Chrysler bankruptcy are extremely substantive and illuminating, and the hard-hitting legal criticisms offered at the elite level manifested themselves as a greater willingness among Republicans to pound the table about the issue.

Although not formally systematized, the book's approach to legitimacy nevertheless attempts to distinguish levels of critical reactions. Legitimacy is clearly not a binary variable, though it is sometimes discussed in that way. Instead, there is a spectrum, with actions inspiring violent revolution on one end and actions hailed with unanimous acclamation on the other. Intermediate cases are not so easily deemed to possess or lack legitimacy: if a substantial minority angrily complains that an action is illegitimate but is not angry or well mobilized enough to effectively oppose it; if most people raise their eyebrows when learning of an action but then reluctantly acquiesce; if a few people are upset by an action but most are not even aware of it. To place

different actions on this spectrum, I consult a variety of sources, gauging the intensity of the reaction among journalistic commentators, blogging academics, and angry commenters across the web. Activity in Congress is a crucial barometer: if an issue is never raised by some legislator hoping to make a name for himself through hard-hitting oversight, it probably failed to make much of an impression on the broader public. If it inspires table-pounding hearings or the introduction or even passage of bills, then worries about legitimacy were more consequential.

My own judgments about levels of legitimacy are certainly contestable, but I have no axe to grind on this score; nothing in this book is meant to reveal to readers an elegant theoretical relationship between certain characteristics of government action and legitimacy.[8] Instead, I offer four closely intertwined legitimating factors, each of which can be expected to contribute to or detract from legitimacy: legality, democratic legitimacy, trust, and accountability. I briefly introduce these factors here and go on to explore how they are implicated during crises in chapter 2.

Four Legitimating Factors

The first, and often most important, factor in determining a government action's legitimacy is its legality. For an action to be legitimized as legal, it must have a valid legal pedigree. That is, it must be authorized by a law that itself originates from a widely accepted source of law.

Where this deep acceptance comes from is a difficult question in its own right and has inspired a great many valuable treatises in the philosophy of law, but I largely put such questions aside.[9] In the contemporary United States, the accepted root source is generally the constitution of a state or of the federal government, and in political practice this does not occasion much controversy.

Instead, disagreements are rooted in the fact that the Constitution and the manifold statutes passed under its auspices are ambiguous, and so it is often difficult to say with certainty whether an action is legal. Those who carry out the action are almost certain to insist that they have legal sanction, but this does not make it so. Neither is a critic's insistence that an action is unsupported by law proof of anything. Laws are not self-interpreting, which means that the practical constraining force of statutory provisions will depend in large part on whether the initial interpretation can be contested and remedied, usually in court.[10] This can be especially consequential if the executive branch is willing to furnish creative, expansive statutory interpretations of existing statutes to justify its conduct.[11] Courts, or a legislature refining

the scope of the law through amendment, can provide some clarity. But we should not expect courts to provide once-and-for-all answers that will be convincing to all parties. Rather, questions of legal compliance can acquire a political character, such that sometimes legality comes to be subject to adjudication by wider audiences.

Legality also has a process component: not only the substance of government actions but also the manner of their formulation is crucial to establishing legality. At least in the United States, with both constitutional guarantees of due process and Administrative Procedure Act guarantees of fair hearings, if an action is improperly generated it may well be illegal. Such attention to process is at the heart of what is usually called the rule of law (which is examined more closely in chapter 2). Government actions will lack legal process legitimacy if they seem to be generated by the caprice of government officials rather than through reasoned, publicly justifiable modes of decisionmaking. Such a failure signifies more than a breach of legal etiquette: there is an expectation that the discipline of reason-giving promotes more-just outcomes.[12] If, in reviewing government actions, courts fail to protect these deeper values and become thought of as mere rubber stamps for government actions, allowing executive branch officials to do whatever they please, then legal process will no longer confer legitimacy.

The second legitimating factor, democratic legitimacy, often flows naturally from legality. Widespread agreement on the propriety of an action—or pervasive indifference about it—should mean that its democratic bona fides can be solidly established by linking it to a law passed by duly elected legislators, who are thought to represent the popular will well enough. Even when there is more dissent, this process often works smoothly: representative legislatures are supposed to meaningfully deliberate about a topic, virtually represent the interests of all of the country's people, and produce a compromise that can be accepted as the fruit of a well-established process. The legislature can thus act as the key legitimating organ of government.

But compliance with legality might fail to produce democratic legitimacy for several reasons. First, the legislators themselves might lose voters' confidence as a representative body. If large portions of the public believe legislators to be corrupted or unrepresentative of their interests, they will have no reason to accept the outcomes of the latter's deliberations as legitimate.[13] Second, even if the legislature generally retains some confidence, some of its actions might be derided as abominations of process. If many citizens have the sense that some legal change was effected by circumventing required processes through parliamentary trickery, then it may be seen as tainted fruit—legal in

the sense of being on the law books but nevertheless illegitimate with reference to democratic values.[14] If the system is perceived as hijacked, its official sanctioning will be worth little.

Finally, and most important, nothing can effectively force a democratic public to treat actions produced even by immaculate processes as legitimate. In some instances, people disregard legal formalities and instead judge an action's legitimacy far more directly. Even with perfect legal pedigrees, some actions may be rejected as abhorrent. Just as important, some crisis actions without proper legal justification may nevertheless be accepted as legitimate. If a society faces an existential threat, actions taken in response may strike people as inherently legitimate, no matter how precipitate. To give two of the clearest examples, defensive war tends to strike people as inherently legitimate, as does the practice of instituting severely coercive quarantines in response to the emergence of deadly outbreaks of disease.[15] Because they understand this reaction to claims of necessity, leaders have incentives to overstate the seriousness of emergencies or even invent them—which means that their ability to gain democratic legitimacy through such appeals will depend on their credibility with the public.

That brings us to the third legitimating factor: trust. When citizens put their faith in the particular persons holding offices rather than simply depend on institutional mechanisms, it does not necessarily mean the "rule of men"—although in its starkest form, in which a polity submits to what Weber calls "charismatic authority," it could.[16] Far short of that, trusted officeholders can be given limited discretion to wield state power on behalf of the common good. Because the necessary trust depends on belief in both the possibility and existence of public-spiritedness, cynicism about the nature of politics owing to a perception that leaders have been corrupted erodes trust-based legitimacy.

Many modern liberal thinkers, especially those of a legalistic bent, have argued that trusting in the goodness of our leaders and therefore leaving them unfettered by legal constraints has no place in the American variety of the rule of law. James Madison's famous prescription in *Federalist* No. 51, that men not being angels, "ambition must be made to counteract ambition," certainly represents a skeptical stance.[17] But while distrust of those in power certainly has deep roots in American political thought, the attempt to entirely expel the need for trust overstates things and actually represents a significant departure from the classical liberal tradition, which emphasized residual prerogative powers.

As Clement Fatovic describes, modern Western political thought traditionally recognized what Machiavelli called *fortuna*: the idea that contingency is

the one constant in politics. In response, political theorists usually saw the need to rely, at least in part, on energetic and virtuous executives who could respond to emergencies as they arose. The more trust the leader merited, in this view, the greater the scope of the allowable discretion and the greater the polity's capacity to meet the challenges of fortuna. Far from denying this fact, classical liberal theorists including Locke, Hume, Blackstone, and the American framers all believed there was a place for an executive prerogative power within a well-functioning state that would complement, rather than threaten, the rule of law that controlled during normal circumstances.[18] Locke's chapter on prerogative in his *Second Treatise* may seem jarring to those who think of him as the champion of a constrained sovereign, but it admits quite an expansive prerogative:

> This power, whilst employed for the benefit of the community, and suitably to the trust and ends of the government, is undoubted prerogative, and never is questioned: for the people are very seldom or never scrupulous or nice in the point; they are far from examining prerogative, whilst it is in any tolerable degree employed for the use it was meant, that is, for the good of the people, and not manifestly against it: but if there comes to be a question between the executive power and the people, about a thing claimed as a prerogative; the tendency of the exercise of such prerogative to the good or hurt of the people, will easily decide that question.[19]

For Locke, trust in the sovereign is the key variable: for a leader who has the people's trust, power to act apart from the law on behalf of the common good not only should be expansive but as a sociological fact will be expansive.

For the authors of *The Federalist Papers*, trust plays a far more important role than Madison's No. 51 suggests. This is, in the first place, a function of the circumstances under which the Constitution emerged: not having been charged specifically with offering a new charter of government, Madison in *Federalist* No. 40 defends the need to advance collective interests through changes "instituted by some *informal and unauthorized propositions*, made by some patriotic and respectable citizen or number of citizens."[20] In Alexander Hamilton's brief for "energy in the executive" in *Federalist* No. 70, he offers that "the ingredients which constitute safety in the republican sense are a due dependence on the people, and a due responsibility," implying a reciprocal trust between the people and their leaders.[21] And in sparely defining the responsibilities of the president, the framers were influenced considerably by the trust they had in the man they rightly assumed would be the first

occupant of that office, George Washington. Rather than supplanting the need for trust, institutional checks would complement the need for virtuous leaders, especially in the presidency.[22]

The fourth and final legitimating factor is accountability. Recognizing that ex ante process constraints may not be able to fully legitimate government actions, legitimacy can be conferred by the willingness of officials to have their actions subjected to ex post scrutiny and themselves to some kind of ultimate accountability. Accountability legitimacy suffers if citizens sense that officials act with de jure or de facto impunity, such that they may be thought of as above the law and unanswerable to politics.

Using accountability mechanisms to produce legitimacy is a natural substitute when trust is in short supply, as embodied in the maxim that Ronald Reagan made famous: "Trust, but verify." Ex post accountability can take either legal or political forms. Legally, it may include personal liability for officials if they have used their positions of authority to pursue illegitimate ends—though "illegitimate" here clearly begs the question. Politically, it may include oversight hearings and reviews designed to elicit facts that were obscure to the public as actions were being taken, thus allowing citizens to make good use of their democratic control in the future. To the extent a government official actively courts responsibility, by some form of the declaration that "the buck stops here," and presents himself or herself as accountable, this may lend legitimacy.

Perhaps paradoxically, being more accountable can thus make a government official or institution more powerful. If citizens know that actions will ultimately be minutely scrutinized, they will extend greater trust as they are taken, even if the actions seem problematic. This accountability can be self-produced by the government, but it can also come from external sources. As I show in chapters 2 and 6, the existence of a "synopticon" made up of both government inspectors general and private reporters, lawyers, and others enables the government to be more assertive than it might otherwise be.

Identifying these four factors that contribute to legitimacy is not meant to provide some sort of unassailable taxonomy of how things really are in the world, such that one action is legitimated under one category and requires proper categorization. There is clearly overlap between them, and different categorizations can be easily proposed.[23] But if legitimacy remains a slippery phenomenon, this should not deter our study of it. Our government's ability to respond to crises in ways the public regards as legitimate is among the most important aspects of our political system, one that may well determine its very ability to survive. While making judgments about what actually produces legitimacy is difficult, it is not impossible, and the difficulty must be met head

on. Even if we cannot hope to arrive at a single dependable recipe for achieving legitimacy in normal times or in crises, examination of the ways in which particular government actions affected legitimacy can give us insights into the how and why of legitimation.

Why Does Legitimacy Matter?

Why does all this matter? Americans in the post–cold war world sometimes have a difficult time believing that our current system of government could meet any fate other than perpetual motion, but this is a dangerously complacent illusion. More than at any time in the past quarter century, we are beginning to hear murmurings about exhaustion of American government and the relative inferiority of our constitutional system. These impressions are fueled in large part by discontent with the responses to the financial crisis.

This is not a wholly novel situation for the country. As Ira Katznelson argues in *Fear Itself*, the struggle to legitimate America's system of government was the overarching theme of politics in the 1930s, and the success of these efforts was not at all a foregone conclusion. Indeed, conducting the nation's affairs against the backdrop of widespread disaffection forced America's leaders into several troubling compromises and alliances that left an unfortunate legacy.[24] Many of the conditions that made the 1930s such a perilous decade for democracy in America and in Europe seem remote today, but the comparison is not one that should be shrugged off lightly. Our form of government's ability to secure legitimacy over the past seventy-five years has been one of its greatest assets, but it should not be thought of as a permanent quality of American life incapable of being squandered. Rejection of our form of government is far from imminent, but neither is it unthinkable.[25] Even if the country manages to steer well clear of governmental collapse, diminished legitimacy can potentially handicap what a government is able to accomplish. As James Gibson puts it, legitimacy "is a reservoir of good-will that allows the institutions of government to go against what people may want at the moment without suffering debilitating consequences" and thus one of the most important enablers of long-term thinking in moments of calm and crisis alike.[26]

In spite of its obvious importance, the process of legitimation in many modern democracies, and certainly our own, is quite haphazard and uncertain. It is too often an afterthought for government officials who imagine they have a kind of Rooseveltian mandate that they actually lack and who do not think of maintaining and improving the government's legitimacy as their own responsibility. Government lawyers attempt to ensure that their clients do not

make choices blatantly at odds with the law, but as this book explores, this effort is often insufficient to deliver legitimacy, especially in a crisis. Political advisers, and political principals themselves, can and must think about legitimacy, but they consider it alongside what seem like far more pressing questions of what policies will be effective at advancing their underlying political aims—that is, what should be done.

Many readers—especially those who have worked on crisis responses from within government—may think that there is not much to be gained by separating legitimacy from efficacy, as efficacy is the most important determinant of legitimacy. (This is the view advanced by former Treasury secretary Timothy Geithner, discussed in chapter 5.) That is too simplistic, even if it is often right.

A government's legitimacy undoubtedly has more to do with the overall conditions in the country than any other factor: surely the best thing 2008 crisis fighters could have done for our system's long-term legitimacy was to successfully overcome crisis and return the nation to economic growth. Throughout the book there is extensive discussion of the trade-offs that may exist between choosing efficacious actions likely to improve overall conditions—and thus improve legitimacy in the long run—and choosing actions likely to produce worse overall outcomes but achieve greater legitimacy in the short run.

But some steps can be taken to improve specific actions' legitimacy and the legitimacy of a whole crisis response strategy. Keeping in mind the risks posed by diminished legitimacy, policymakers should be far more attentive to achieving legitimacy for their policies than they were in the crisis.

Nor are legitimacy and efficacy always in tension; indeed, just as often, a government can't have one without the other. Both at the government-wide level and at the level of specific policies, a lack of legitimacy can impede effective action. Policies that lack legitimacy are more likely to be implemented half-heartedly or quickly reversed. A lack of legitimacy translates into a lack of dependability; especially in our system, policy is always contingent on politics. We can therefore see a reinforcing virtuous cycle—political legitimacy begets policy efficacy begets political legitimacy—or a downward spiral—policy failure destroys political legitimacy, making the possibility of future policy success more remote.

If any doubt the intrinsic importance of government legitimacy, then, its instrumental importance to effective government action ought to convince them that it is a subject worthy of attention.

One aim of this book is to make the consideration of legitimacy somewhat less haphazard by systematically considering how the crisis responses affect it.

My hope is that even if policymakers understandably do not make achieving legitimacy their primary objective, by taking the lessons of the recent crisis into account they will be able to more consciously improve the legitimacy of their future crisis actions.

The Limits of the Law

In shaping this advice, the book aims to convey a realistic sense of what the law can do to determine crisis actions and provide crisis legitimacy. For both purposes, legal and political commentators have a tendency to overstate law's powers.

First, although many speak of law as if it provides the entire basis for government action, law does not and cannot control all of the actions taken by government officials. This is in part because of limitations in legislative foresight and drafting ability and in part the consequence of intentional decisions to endow the executive branch with discretionary power capable of responding prudently to new conditions. Both the unintentional and conscious limitations of law are heightened in a crisis, when rapid reaction and creativity are at a premium. I argue that only unusually clear legal limitations provide dependable restrictions on government actions during crises—though I emphasize that there are indeed plenty of legal provisions that fit this bill.

I also highlight the way crisis conditions create space for meaningful exercises of power on the margins of legality—what I call "soft power." As a crisis unfolds, top officials sometimes find they have the ability to steer the course of events by such subtle means as expressing their opinion, passing information from one party to another, convening meetings, and (somewhat less subtly) cajoling to encourage or opaquely threatening to discourage certain legal, private actions. Throughout the book, I take the inevitability of such "soft" actions for granted; anyone who proposes that officials will (or even should) entirely refrain from these behaviors merely because they do not straightforwardly emanate from legal commands is being naive—or, more likely, faux naive. That said, there is no question that exercises of soft power can easily shade into problematic coercion or even abuse of power. There is a fine line between suggesting that a course of action is likely to lead to bad results and further intimating that the state's (discretionary) legal powers will ensure those bad results. Offers are acceptable even when they create awkward choices; offers that can't be refused are presumably beyond the pale. But that line is difficult to discern clearly, and many of the responses to the financial crisis go to the edge of this boundary or beyond. On this score, I mostly preach

resignation: government officials are almost certain to use soft power in ways their friends see as boldly but righteously pushing the envelope and their adversaries see as crossing the line.

Soft power has historically been especially important in responding to financial crises. In the financial crisis of 1907—the second most serious of the twentieth century—it was the private magnate J. Pierpont Morgan who used his soft power most aggressively, hastily organizing the threatened financial trusts into a consortium patterned after regular banks' clearing houses and bullying and cajoling other financiers who were reluctant to put themselves at risk. Less important, President Theodore Roosevelt also used legally unanchored soft power to give Morgan the blessing of the White House.[27] Although many felt Morgan had beneficently acted as the savior of Wall Street, and by extension the nation's economy, it would be an understatement to say that he lacked the public's trust. And so while the actions of the rescue were based entirely on voluntary actions, they lacked legitimacy in the eyes of the broader American public. Congress held extensive hearings investigating possible improprieties and self-dealing, during which the possibility was raised that Wall Street had engineered the whole panic for its own gain.

But uses of soft power do not always create legitimacy problems. In 1998 Wall Street's health was threatened by the imminent demise of the much-celebrated hedge fund Long-Term Capital Management (LTCM). To overcome the coordination problem faced by the many firms that would be exposed to a chaotic failure of LTCM, the Federal Reserve stepped forward to act as a convener of the major investment banks. With the Fed's encouragement, fourteen banks worked out a rescue plan through which they would collectively infuse $3.65 billion into the faltering firm and thereby avoid the fallout from having to unwind all of its trades. The Fed had been forced to use none of the heavy weapons in its legal arsenal, instead finding a way to effectively stave off a wide financial crisis wholly through soft power. Though many expressed worries that the Fed's actions created moral hazard by fostering the impression that it would step in to prevent any catastrophic failures, in general the legitimacy of the Fed's successful light-touch intervention was rarely questioned.[28]

If law cannot be expected to provide the legitimating basis for every crisis response, its limitations are evident from the other direction too: especially in crises, obeying the law is no guarantee of legitimacy. The 1930s again provide an instructive example: as financial crisis and the Great Depression gripped the nation, legality had no more devoted servant than President Herbert Hoover, who famously believed in the power of voluntary private

action to combat the economic downturn. While he sometimes sought and secured limited legal changes to promote desired private investments (as with the Reconstruction Finance Corporation), Hoover mostly remained steadfastly devoted to keeping the federal government's role limited. Voters clearly signaled that course of action's lack of legitimacy in 1932 when they gave Hoover what remains the worst electoral defeat for any incumbent president in American history.

Hoover's successor, Franklin Roosevelt, struck a very different posture toward the law.[29] In his inaugural address, he declared that the nation's economic problems should be treated "as we would treat the emergency of a war,"[30] and he proceeded to go well past the edges of his office's normal legal powers in the manner of a wartime leader, declaring a national bank holiday on thin legal authority,[31] devaluing the dollar against gold and then cavalierly setting its price over breakfast each morning,[32] and frequently riding roughshod over normal legislative procedure as he extracted concessions of discretionary authority from Congress.[33] In his storied fireside chats Roosevelt deftly secured democratic legitimacy for these policies even when they obviously strained against the edges of the law. To this day there are many who would portray Roosevelt's actions as tyrannical, but from the start they have always been a distinct minority; three reelections and a lovely monument on the National Mall attest to Roosevelt's general stature. Hoover's name, meanwhile, retains its power as an epithet in American politics even after eighty years. When crises come, adherence to legality is no assurance of legitimacy; and aggressively pushing the boundaries of what is legal is no guarantee of illegitimacy.

Though none of its principal figures are likely to become as cherished as Roosevelt or as forsaken as Hoover, the recent financial crisis made the divergence of legitimacy and legality glaringly clear. As noted at the opening to this chapter, two of the actions that engendered the greatest outrage—the failure to rescue Lehman Brothers and the decision to honor AIG's preexisting bonus contracts—involved bowing to apparent legal limits. Perhaps justly, people apparently had the sense that if acting differently required bending the law, a truly committed group of crisis responders would have found a way to bend it. Conversely, the most aggressive legal maneuvers, such as the Treasury's guarantee of money market funds or the Fed's massive purchases of commercial paper, sometimes elicited barely a peep. I seek to explain the circumstances in which law will most successfully bind—not surprisingly, when it clearly sets the shape and outer limits of executive conduct—and to ponder how we can productively create space for decidedly unlawlike decisionmaking.

Plan of the Book

The book seeks to illuminate when and why legality and legitimacy split apart. It begins, in chapter 2, by giving fairly abstract consideration to this question. I consider how and why law and legitimacy may become competitors in crises and present different options for attending to legitimation during crises, including a resolute adherence to law, a derivation of expansive legal authorities "inherent" in the law, an abandonment of law in favor of plebiscitarian acclamation, and frank admission of extralegal action. Finally, I turn to the most common form of harmonizing law and legitimacy in modern times, the enabling act, in which a legislature transfers crisis policymaking powers to the executive branch while attempting to set temporal and substantive limits on the use of that power. I argue that courts have a difficult time enforcing any but the clearest limitations during crises, pushing legislatures to create alternative mechanisms to effectively hold accountable executives empowered by enabling acts.

The book then moves on to a detailed examination of the responses to the financial crisis of 2008. Chapter 3 covers events from mid-2007 through the climactic month of September 2008, showing how Ben Bernanke led the Federal Reserve to use its long-dormant crisis powers in unprecedented ways to limit the effects of the failure of Bear Stearns. I dub the seemingly unpredictable pattern of responses "adhocracy": the government's most important crisis responses flowed not from deliberation of lawmakers but from hurried decisions of unelected officials deriving their authorities from obscure sources.[34] An exception to this pattern was the response to the deterioration of the two giant government-sponsored enterprises, Fannie Mae and Freddie Mac, which flowed from legislation passed in July 2008. This example illustrates the limits of legislation in conferring legitimacy: simply being armed with recently passed legislation proved insufficient to clearly delimit the government's response or to prevent serious challenges to the action's legitimacy. September 2008 saw a brief resurgence in the importance (and hazards) of legal constraints with the fall of Lehman Brothers, and then a crescendo of adhocracy in the Fed's rescue of AIG, the Treasury's backstopping of money market funds, and a handful of other hastily arranged interventions. Once again, legality and legitimacy sharply diverged, with some of the crisis fighters' most legally questionable decisions receiving the least scrutiny.

Congress finally took a central role in determining the shape of the crisis response when it passed the Emergency Economic Stabilization Act of 2008, better known as TARP, at the beginning of October 2008. Chapter 4 begins

with an extended look at the rancorous battle over that act. Contrary to many people's characterizations, Congress's deliberations were neither insubstantial nor fruitless: before acceding to Treasury secretary Henry Paulson's historic request for $700 billion, they added several accountability mechanisms that would consequentially shape the political environment constraining the uses of the money. The chapter also shows how willing Congress was to allow the secretary to determine how these funds would be spent, flexibility that would be quickly used as the initial plan for asset purchases gave way to bank recapitalization. It then considers the accusations that TARP represented an illegitimate bait and switch. I also look at the way adhocracy continued alongside TARP in the late Bush administration in the handling of the sales of Wachovia and Merrill Lynch, the creation of new Fed programs, a deepening of the commitment to support AIG, and the Federal Deposit Insurance Corporation–led creation of a universal bank guarantee. Finally, I examine how TARP was extended to the auto industry after Congress decided against passing auto-specific legislation in December 2008, in spite of the fact that this use of TARP went well beyond what the enabling act was intended to provide for. I argue that the commitment of administrations of both parties to the use of TARP for the auto industry limited the extent to which the basic legitimacy of that choice was questioned.

Chapter 5 follows the continuation of all of these crisis responses into the Obama administration. It examines the auto bailouts and bankruptcies, which inspired some of the bitterest legal confrontations of all the crisis responses. I show how claims of legality can be used to lend legitimacy to otherwise unpopular political decisions. The chapter considers the difficult balancing act between legality and legitimacy that the government faced in its role as a corporate shareholder, both in the case of General Motors and in the case of many banks. I also examine the legal disputes surrounding AIG and the government-sponsored enterprises, explaining how the legally motivated decision not to wipe out private shareholders of these rescued corporations eventually created dilemmas pitting legal requirements against the demands of legitimacy. I explain why judicial involvement (still ongoing) is likely to be relatively insignificant compared with political accountability mechanisms. A similar dynamic in the case of contractually obligated bonus payments at AIG led to the most heated showdown between law and legality in March 2009—with legality proving the victor in this case. The chapter then examines the distinctive elements of the Obama administration's strategy as laid out by Treasury secretary Timothy Geithner and the efficacy problems that a lack of legitimacy caused. I argue that the administration would have benefited from a

willingness to prioritize legitimacy, even when it might have conflicted with its beliefs about the surest way to fend off the financial crisis.

Chapter 6 revisits the years of crisis response through the lens of the various accountability mechanisms at work, including special bodies created by TARP such as the Special Inspector General for TARP and Congressional Oversight Panel as well as existing institutions such as the Government Accountability Office and the news media. It argues that by scrutinizing and criticizing the actions of the Fed and the Treasury these bodies helped to legitimize them in a backhanded manner: in spite of their best efforts, they never exposed any evidence of bad faith or self-dealing among the crisis fighters. Nevertheless, I consider the ways in which these agents of accountability also left lingering scars in the crisis fighters' legitimacy, with special attention to questions of the overall cost of the crisis responses and the accusations that the rescue of AIG was engineered as a "backdoor bailout" of Wall Street investment banks.

Chapter 7 offers concluding thoughts about where legality and legitimacy stand in the wake of the crisis. It examines the damaged legitimacy of the government's crisis responses, with special attention to two mass emanations of the nation's legitimacy concerns about the crisis response, the Tea Party and Occupy Wall Street movements, each of which channeled concerns about the legitimacy of crisis responses into demands for reform, especially of the Fed. I then look at how the Dodd-Frank Act enacted new legal constraints on future crisis responders, concluding that several of its alterations should be understood as a coherent prioritization of legitimation. I also take stock of the role that law played throughout the crisis, concluding that it is a mistake to discount it as irrelevant. Finally, I make several recommendations to help future crisis fighters better secure their legitimacy, including a stronger relationship with Congress, greater investment in making processes transparent and in educating the public about the nature of crisis responses, a greater willingness for Congress to proscribe certain conduct through explicit prohibitions, and, finally, an accommodation of the law's limits through a clearly delimited but accountable slush fund available to combat financial crises.

Caveats

Before turning to the substance, it is worth briefly noting what this book is not. Most important, this is not a book about why crises happen or how they can be prevented. Those questions are now the objects of impressive amounts of attention, both in and out of academia. Some people are so focused on assigning blame for a failure to prevent the crisis to deregulation, affordable

housing policy, or whatever other cause is their bête noire that they may find a failure to address these questions to be a grave offense, but I must simply plead guilty to it. I have chosen to focus my attention on the legal and political dynamics of crisis response.

Nor does the book offer a personality-driven narrative; many excellent firsthand and journalistic accounts have already covered that ground. Chapters 3 and 4 do provide mostly chronological coverage of the events of 2008, but where others understandably emphasize a good story, I emphasize precise legal detail so as to be able to carefully consider legal disputes.

As noted above, this book is also not meant either as a condemnation of or an apologia for the crisis responses. In both cases, this is likely to be a disappointment to some readers. But the book may seem especially misguided to those who bring strong prior beliefs that the bailouts did nothing to help the financial system or broader economy—either because the interventions chosen were badly misguided or because the threat posed by the financial crisis was highly exaggerated. Conventional wisdom has already largely rejected these views, and I accept the general consensus in favor of the revisionist accounts.

Finally, this book omits a discussion of a large and important topic that is central to legal questions surrounding the response to the financial crisis: prosecutors' choices about whether to bring charges, settle cases, and seek criminal convictions for the conduct of financial institutions that contributed to the crisis. This would make an excellent topic for a different book written by someone whose legal expertise about mortgage fraud, fiduciary duties, and consumer protection issues far exceeds my own. Several subjects cry out for an analysis that combines both legal and political elements, including the legal treatment of "robo-signing," the Mortgage Electronic Registration Systems corporation, and the failures to enforce existing regulations leading up to crisis that have led critics to discern a widely followed doctrine of "too big to prosecute." Although I occasionally note the way that negative feelings about these developments affect overall perceptions of government legitimacy, others are more qualified to offer in-depth analyses of these issues.

2

When Legality and Legitimacy Diverge

Legitimation of government actions in modern democracies can occur in several different ways in normal times. If there is a sufficiently large majority among the electorate on an issue, satisfying their desires will produce legitimacy. But this is the exception rather than the rule; on most issues, preferences are much more amorphous and underdeveloped, such that legitimacy must be produced through more indirect processes. Simplest is when the people have a strong sense that the government's decisions emanate from genuinely representative legislators, who faithfully discern the will of the people. But generally speaking, Western democracies suffered from a legitimacy deficit for decades preceding the financial crisis, with legislators being seen as either unrepresentative, feckless, or both. When most government decisions seem to be in the hands of unelected bureaucrats, worries about a disconnect between the polity and the state can undermine the regime's legitimacy.

This erosion of confidence can be dealt with in many ways during normal times, especially through an emphasis on legal process requirements and rule-based constraints. Even a government laboring under the suspicions of its citizens may have its actions accepted as legitimate if they are subjected to a process understood to produce acceptable outcomes, with the legislative and judicial procedures that collectively constitute the rule of law being the primary mechanisms.

But legitimation in a crisis raises a challenge: precisely because of the time-sensitive nature of emergency, reliance on normal processes is perceived as untenable. If a society has enough faith in its leaders—or strong enough

reasons to put aside its doubts, as in the case of rallying 'round the flag after an attack on the homeland—then it might find ways to waive normal procedural constraints and allow its leaders to act on their best judgment. Flexibility, expediency, and dispatch could thus be temporarily prioritized over predictability, process, and deliberation without necessarily causing any legitimacy crisis. Where faith in political leaders is lacking, however, the polity confronts a classic dilemma: adhere closely to the preexisting legal structures of normal times and risk inadequately meeting the crisis or extend extraordinary powers and risk enabling abuse of power.

Schmitt's Challenge

This basic tension between the stability (but also brittleness) of law and the flexibility (but also capriciousness) of unconstrained improvisation is one of the most ancient in republican political thought and practice. As Machiavelli put it, the challenge is to devise some institutional design capable of avoiding the Scylla and Charybdis of political suicide—legal "hyperfidelity" on one side and legal disintegration brought on by resorts to outright illegality on the other.[1] In modern times, the tension has been explored most sharply by Carl Schmitt, the Weimar and Nazi legal theorist, through both his incisive writings and the disturbing example he set by embracing the rise of the Nazis, about which I say more below.

Schmitt saw legality and legitimacy as competitors and disdained the modern liberal state's obsession with the former, which he believed resulted from an unhealthy preoccupation of overly theoretical academics. Schmitt conceded that in calm, normal times legality might be sufficient to order the affairs of state in a way acceptable to a pluralist, disunited public, but he argued that legality would prove much too stiff to effectively handle emergencies (or even the tasks of economic management, for which states increasingly took responsibility as he wrote, in 1932).[2] Liberal societies would therefore turn to an "administrative" form of government based on ad hoc decrees, but these would lack the virtues even of legality and have no basis for being accepted as legitimate apart from their practical success.[3] Governments would haphazardly attempt legitimation through whatever arguments were available, searching "indiscriminately for legalizations, legitimations, and sanctions, making use of them as [they find] them." But this process would erode citizens' belief in the deep congruence between "law and statute, justice and legality, substance and process," call into question their faith in the basic premises of the rule of law, and ultimately destabilize the whole order. Given

the likely combination of inefficacy and fraying legitimacy, the door would be opened to a more plebiscitary form of legitimacy to replace the existing government, in which a charismatic leader grabs hold of state power to popular acclaim.[4] Schmitt saw this leader-centered solution to the problem of legitimation as inevitable and as theoretically appealing: all of the state's actions would emanate from the authoritative will of a ruling head of state free of the incapacitating fetters of legality and able to pursue legitimacy directly.[5] Executive-centered government would then reap the full advantages of its unitary nature and decisiveness and of the personal charisma of the leader, in whom the people place their trust.[6]

In his earlier *Political Theology*, Schmitt famously declares, "Sovereign is he who decides on the exception."[7] By this, he meant that a legal order that could be suspended could not embody the ultimate source of authority in a society. Instead, whoever (or whichever institution) was practically empowered to set aside normal legal rules and act on behalf of the people occupied the real seat of power. In Schmitt's view, attempts by liberal orders to fence in exception and tame it as a part of the normal legal fabric are doomed to fail.[8] The best the legal order can do is choose the person who will have the power to declare an exception—that is, to say that the legal order must ultimately give way to a more potent and unconstrained exercise of power.[9]

Schmitt's writings—which have a deliberately oracular feel—are simultaneously positive and normative. They offer prophecies of what will be and simultaneously a moral justification of the changed basis of government. Even if Schmitt's moral apologetics can safely be rejected as repugnant, his positive diagnosis and predictions, which proved all too prescient for Germany in the 1930s, remain deeply threatening. The liberal and constitutional Weimar Republic in which he lived sought to tame the exception by building emergency powers into its constitutional order, thinking that it could avail itself of limited and self-contained episodes of emergency government without abandoning the commitment to democracy. While this formula proved workable and useful in the early 1920s, Schmitt's visions of the exception swallowing the norm were realized in 1930, when emergency decrees became the main instrument of governance in Germany and ultimately, after the election of Adolf Hitler as chancellor in 1933, provided the means to dismantle the republican form of government altogether.[10]

For those of us who are members of liberal societies that cherish the rule of law, Schmitt's challenge is that our regime may prove incapable not only of effectively combating crises but also of producing legitimacy in the wake of crises. Even if policymakers manage to string together a series of crisis responses

that might be judged good enough by some standard, they may find that citizens reject their actions as illegitimate.

Schmitt's challenge is discussed most often among contemporary theorists of crisis responses in the national security realm, especially since September 11, 2001. But the dynamic described is every bit as relevant for financial crisis responses. Indeed, legitimacy problems may be even more acute in financial crises because there is not a clear external enemy to blame for damages; since "the system" (which can be thought of as the complex interaction of government and market actors) seems to be failing, underlying legitimacy will be damaged even as it is most valuable.

That was certainly the case in the financial crisis of 2008, which greatly exacerbated already festering legitimacy problems, bringing citizens' trust in their governments to all-time lows. The already unpopular George W. Bush saw his approval rating fall to a remarkable 24 percent in October 2008.[11] For the first time in decades, most people in the United States in 2009 characterized their level of confidence in the country's political leaders as "not very much" or "none at all."[12] A variety of journalists and academics, including some with impeccable establishment credentials such as former World Bank chief economist Joseph Stiglitz, began to question the legitimacy of America's political economy at its deepest foundations, talking darkly of "the end of capitalism."[13]

Chapters 3 through 6 provide an extensive concrete examination of the legitimacy problems faced by the crisis responders in 2008 and beyond, but first in the remainder of this chapter I consider the problems of crisis legitimation at a somewhat more abstract level. I work through several types of strategies for responding to Schmitt's challenge: resolute legalism, Schmitt's own response of plebiscitary democracy, use of prerogative, and enabling acts.

Resolute Legalism or Naive Legalism?

The first way one might respond to Schmitt's challenge is to reject its basic premise about the divergence between legality and legitimacy in crises. In other words, one might deny that there is anything about a thoroughly legalistic order that makes it unequal to the task of meeting crises and therefore insist that normal legal processes are plastic enough to safeguard the state without ever having to declare any kind of exception. As the point is often rhetorically framed, the rule of law is not a fair-weather principle but one that ought to guide liberal governments even—or perhaps especially—in difficult moments, when adherence to the law seems to be most costly.

Evaluating this argument requires a quick unpacking of "the rule of law"—a phrase so wholesome sounding that hardly anyone is ever openly against it but one that often takes on so many different ideas about the proper way for government to conduct itself as to become mystifying. The basics seem simple. Living under the rule of law means having "a government of laws, not men"—a concept dating back at least to Aristotle.[14] The core of the rule of law is that government officials are limited to exercising legally well defined and predictable powers of office rather than being licensed to act as they see fit and that laws that affect citizens should be "publicly and prospectively promulgated and publicly administered in the courts."[15] The antithesis of the rule of law is the subjection of citizens to the unchecked caprice of government officials.[16] Compliance with the rule of law is a central source of legitimacy for modern governments.

Using this framework leads to two very different conceptions of the rule of law. The "thin" rule of law is concerned solely with procedural questions and requires only that governments follow the rules in making and enforcing laws; it posits that the rule of law is just about legality. Others worry that such a conception allows all sorts of abuses to be covered with a veneer of legality, such that the law can become a vehicle for injustice; these observers say that rule of law must be something more than "rule by law."[17] For them, the "thick" rule of law requires that rules prescribed by law be clear, limited, predictable, neutral in their application to all citizens, fair, and supported by reasoned justification. These qualities must not only be aspirational goals but should be pursued concretely through the use of procedural guarantees enforced by courts. The resulting rule of law allows citizens to plan their affairs with a high degree of confidence in how they will be treated by government in the future, maximizing their autonomy and freedom.[18]

As Schmitt argues, both of these conceptions present serious difficulties during crises. If there is a commitment only to the thin rule of law, then the law's constraining force may be lifted with alarming rapidity: the legislature can simply pass a law authorizing whatever actions the executive deems necessary to combat the crisis. This is simply Schmitt's exception in action, with legitimacy unlikely to flow from the legislature having given its consent since it is effectively abdicating its control over state power. I return to this kind of wholesale delegation of power below; for now it is enough to say that if this strategy is to be regarded as legitimate, it will not be because of its formal legal virtues.

The thick rule of law, with its emphasis on process controls and predictability, necessarily entails more substantial constraints on what the government can do in response to crises and therefore is better able to actually safeguard

people's ideas of what is just and right. But these virtues can quickly come to be seen as vices in emergencies, as fidelity to ideals of process may be crippling to the ability to respond efficaciously.[19] Purportedly essential government improvisation, which can be responsive to current conditions as the static law cannot, will seem to some as arbitrary and might therefore be obstructed by adhering to the rule of law. This may even frustrate the principle of democratic sovereignty if officials are precluded from taking actions that large majorities would approve of even absent observance of normal processes.[20]

To avoid these difficulties, many theorists of the rule of law admit that "everything government does" is a far larger category than "things government does through law." As Hamilton notes in *Federalist* No. 72, the "administration of government" is the largely independent province of the executive, including such weighty matters as "the actual conduct of foreign negotiations, the preparatory plans of finance, the application and disbursement of the public moneys in conformity to the general appropriations of the legislature, the arrangement of the army and navy, the directions of the operations of war."[21] For Max Weber, *government* or *administration* similarly implies pursuit of "concrete objectives of a political, ethical, utilitarian, or some other kind" distinct from merely giving force to the laws.[22] Both F. A. Hayek and Lon Fuller warned of the potential harms to the overall vitality of the rule of law that would result from the confused impression that everything the government does aspires to the real generality that characterizes laws.[23]

Emergencies make this point especially salient. Arguably, fidelity to the law is not the first obligation of the state when facing existential threats. As Joseph Barthélemy puts it, "The law is made for the state, not the state for the law. . . . *Salus populi suprema lex esto*."[24] If survival is a deeper imperative than legal fidelity, this complicates the applicability of the rule of law during emergencies. Even many theorists who insist on the importance of legality concede Schmitt's point that legality and legitimacy may diverge in crises. To the extent that they hope governments will honor the underlying principles of the rule of law in their pursuit of legitimacy, they will need to identify processes other than mere legality.

Before considering what these processes might be, we should consider those who are more dogged in their defense of legality in crises. Proponents of this view concede that, as an empirical matter, it is true that governments do seek to evade their legal responsibilities through declarations of emergency, but they argue that it is wrong to infer from this fact that such declarations are a necessary part of the political order. From this perspective, legalism simply needs more determined defenders against those who opportunistically use

emergencies to expand their power, as well as thoughtful institutional reforms to ensure that existing government structures are indeed capable of solving a diverse array of problems.[25]

This legalistic response to Schmitt ultimately rests on an empirical premise that is difficult to verify: namely, that law can reliably limit discretion and ultimately stop any political actor from getting outside of the legal system. The historical record makes this claim seem quite dubious. Explicit declarations of exceptions are frequent throughout history, but perhaps even more important, a willingness to use the language of legalism has hardly proved a reliable safeguard of the real substance of legal limits.[26] Simply saying that officials should care more about legalism does not seem likely to change much if their crisis responses are attuned to deeper political imperatives.

The history of financial crises in America provides an important body of evidence in this vein, and it gives a sobering view on the practical limits of rule-based legal protections. Throughout the nation's history, banks have suffered from runs, in which deposit holders demand their gold or currency (depending on the era), as is their legal right. Adhering to the law would have unambiguous consequences: the running depositors (who are exhibiting perfectly rational behavior given the circumstances) should be allowed to make their desired withdrawals, even if this spells the ruin of the bank.

But the shortcoming of this approach is obvious: banks may be wiped out that would otherwise be solvent, making large portions of their depositors worse off compared with a situation in which the laws guaranteeing redemption on demand are suspended. This has long been clear to American courts, which over the course of the nineteenth century developed a fairly consistent norm: banks should not be made to fail in crises simply because of the rule of law, and liquidation is to be avoided if at all possible. As Gary Gorton describes in his *Misunderstanding Financial Crises*, courts have allowed suspensions of conversion to specie (even when this was explicitly required by banks' charters), bank holidays (officially mandated closings designed to thwart runs), mortgage suspensions, and other devices meant to relieve banks from their normal legal responsibilities during moments of panic.

In many cases, these decisions were facilitated by crisis-inspired state legislation (many times in seeming contravention of the U.S. Constitution's contract clause), but at other times courts acted more independently and emphasized that judgment of a bank's underlying solvency—the necessary precondition for it to be worth saving from liquidation—could only be determined within the context presented rather than defined by any clearly predefined rule.[27] Reflecting decades later on one of the most important court cases in

this context, *Livingston* v. *Bank of New York* (1857), the renowned American sociologist William Graham Sumner noted that the court's acquiescence to the bank's self-protective actions "illustrated that dilemma of legislation in which a restriction to be effective must be intensely severe, and if it is intensely severe, proves impracticable when it is needed."[28]

That insight squarely frames the dilemma for stalwart legalists: it seems that an insistence on making laws ever clearer so as to close off opportunities for misinterpretation is often self-defeating, because at some point the actors charged with application of the clear rules may decide to go against them. Ex ante commitment to full predictability through formalism by the law's framers gives way to unpredictable outcomes ex post as formal rules are undermined by practice. Law's ability to constrain may be frustrated either by problematic stretching of the law, in which an interpretation purportedly consistent with the legal language produces outcomes inconsistent with the law's intent, or by simple abandonment, in which the all-too-clear dictates of the law are set aside as impracticable in the moment.

The ability of law to structure and limit crisis responses is thus limited, meaning that legality cannot be the whole basis for legitimacy during crises. Schmitt was right: "the exception," whether structured as a formal and centralized suspension of normal law or in the form of selective application by decentralized actors, undermines the law's claim to be the sole universal legitimator.

If legality and legitimacy are driven apart in crises, the question then becomes what sort of role law can and should play in shaping and legitimating crisis responses. Potentially, it might play very little role, with legitimacy being achieved without explicit sanction from the law. Law might be reduced to a rhetorical veil, explicitly disavowed, or used in a limited manner to promote legitimacy in indirect ways. I address each of these possibilities in turn.

Finding Expansive Authorities "within" the Law

The first possibility is for executive branch leaders to claim legal authorities for whatever actions they choose to take, ostensibly by finding justification within the law but possibly by effectively circumventing it. Under this approach, political leaders do not disavow legal constraints as either feeble or impracticable but rather embrace the law as an instrument that—rightly understood, of course—empowers them to pursue necessary crisis responses. Justifications might be framed in terms of statutory grants of authority or in terms of implied constitutional legal authorities of the executive branch.

This last position has a long history in American legal debates going back to the founding. Alexander Hamilton served as an energetic advocate for the position that Article II of the Constitution was the foundation for a strong and even expansive executive branch. Reasoning from the ambiguous text, in *Federalist* No. 23 Hamilton argued that the central government's powers to preserve peace and defend against external and internal enemies "ought to exist without limitation, *because it is impossible to foresee or to define the extent and variety of national exigencies, and the correspondent extent and variety of the means which may be necessary to satisfy them.*"[29] This theory would later be deepened by Theodore Roosevelt, whose stewardship ideal of the presidency saw the chief executive as having an affirmative duty to take all actions necessary to protect the public good, excepting only those specifically prohibited by the Constitution or by Congress.[30] He rejected "the view that what was imperatively necessary for the Nation could not be done by the President unless he could find some specific authorization to do it."[31] Presidents Abraham Lincoln and Franklin Roosevelt both based many wartime actions on their inherent constitutional authorities, with the later Roosevelt explicitly declaring that he was empowered to take necessary actions to preserve the country's safety even without congressional cooperation.[32]

The natural question about such a posture from executive branch officials is this: What can make such a seemingly limitless claim to power legitimate in the eyes of citizens? If legality is more or less clearly rendered irrelevant—if the exception swallows the rule—legitimacy must come from other sources. In some cases, it might be derived from trust attached to a specific political figure who clearly takes responsibility for the actions. That trust might be extended because of the leader's personal charismatic authority, but it might also be extended by virtue of the leader's place in the democratic system. Especially for American presidents, the unique claim to represent the country's whole electorate by virtue of their national election affords an ability to make claims of democratic legitimacy. Because the president is responsible to the whole people and can be reined in by the next election, citizens need not worry about abuse; even if legal constraint is absent, political constraint is meaningful and ultimately legitimating.

This is the theory laid out by Eric Posner and Adrian Vermeule in their recent book, *The Executive Unbound*. They argue that a "Schmittian" sort of lawlessness is inevitable in modern government, both in responding to emergencies such as terrorist attacks and financial crises and in the normal functioning of administrative agencies.[33] Because the executive branch is both the first and last mover in addressing problems, it can ultimately work its will

no matter what the statutory language, exploiting exceptions in the form of legal lacunae ("black holes") and ambiguous standards ("grey holes") to reach its desired end.[34] But they are unconcerned by this development because, like Schmitt, they think that legality (or what they dub "liberal legalism") is vastly overrated; and, like Schmitt, they think that the need for executive branch actors to secure legitimacy through other channels exerts its own steady discipline. By their lights, legal constraint and democratic process are distracting myths—perhaps usefully so, as they explicitly advocate "hypocritical lip-service to the rule of law" to appease the legality minded—but political constraints (including elections but also more subtle channels of influence for public opinion) are real and important.[35]

Posner and Vermeule are essentially advocating an embrace of Schmitt's plebiscitarian model of crisis leadership—but in doing so they fail to take Schmitt's challenge seriously enough. They seem to worry very little about how legitimacy might be actually achieved in moments of crisis, mostly assuming that the "Schmittian" executive branch, unbothered by the lack of formalized legal sanction for all of its actions, is good at producing legitimacy, especially in a crisis. But as noted, Schmitt himself doubted that an "administrative" state governing principally through ad hoc decrees could provide any truly compelling ethos with which to legitimate itself. To the extent that people find the ad hoc coercion advanced through legally unanchored decrees unacceptable, the administrative state is bound to lose its legitimacy. Perhaps, contrary to the authors' implication, their use of the adjective "Schmittian" should be thought of as directly analogous to the way that people use the adjective "Orwellian." That is, Schmitt's work shows the deeply problematic nature of this way of thinking.

Just as troubling as Schmitt's powerful argument against complacency is his disturbing personal example, which presents an even more obvious reason to hesitate before accepting the demise of legal constraint as an unobjectionable feature of the modern state. Doubting the ability of a legalistic or administrative state to legitimate itself, Schmitt embraced the "governmental state," in which all authority emanated from one person drawing on charismatic authority and defining the interests of the people in reference to external enemies.[36] This was a natural fit for Adolf Hitler and the Nazi Party, and for a time Schmitt became the regime's favored legal theorist.[37] With just a brief parenthetical, Posner and Vermeule shrug off this part of Schmitt's legacy as fundamentally unconnected to his thinking about the exception.[38] But their own nonchalance about legitimacy leaves a vacuum to be filled, and simply assuming that modern states can never be fertile ground for an

extremist executive to wield state power in problematic ways is troubling, to say the least.

But even without envisioning any dystopian futures for America, there is another reason to be troubled by Posner and Vermeule's lack of interest in the whys and wherefores of legitimation: in many contexts, their contemptuous and openly hypocritical posture of tolerance but not respect for the law may backfire and destroy the trust that executive branch leaders need to operate effectively. Using the law as a veneer may fool some of the people some of the time, establishing some degree of legality-based legitimacy, but there is also a strong potential for resentment at having been effectively misled.

The example of the George W. Bush administration in fighting the post-9/11 war on terror provides strong evidence of this effect. Top executive branch staff and lawyers believed that the executive branch was entitled to act almost without constraint purely on the basis of constitutional powers when its commander-in-chief power was implicated—that is, that inherent in the law was a conferral of power that could legitimate nearly any action taken in defense of the country.[39] Emboldened by this legal philosophy, the administration took many decisions unilaterally, without much effort to ensure the political legitimacy or policy prudence of its decisions.[40] In November 2001 President Bush acted by executive order to create military commissions to try noncitizens charged with terrorist offenses, in spite of the lack of any clear statutory authority on which to do so.[41] In 2002 the Office of Legal Counsel infamously justified the use of various harsh interrogation methods, which many people characterized as torture, through an appeal to constitutionally based executive power, in spite of significant conflicts with existing statutes and the Geneva Conventions.[42] Throughout the period after 9/11, the administration's intelligence-gathering operations were undeterred by frequent conflicts with the requirements of the Foreign Intelligence Surveillance Act.

The aggressiveness of this approach itself eroded trust in the administration, diminishing the legitimacy of its actions—as did the insistence of many experts that the administration's claims of inherent legal authority were improper. As a result, many of the policies undertaken by the administration eventually came under intense scrutiny from both Congress and the courts. Far from leading to an executive branch flexible and energetic enough to decisively deal with the challenges of a new sort of war with nonstate actors, the unilateralism at the heart of the Bush administration's strategy led to a series of bruising legal conflicts in which both Congress and courts became periodic adversaries and which generally left actors in the executive branch scrambling for more broadly acceptable grounds for legitimation.[43]

If citizens respond negatively to the executive branch's blanket claims of legitimacy derived from law for national security emergencies, they are perhaps all the more likely to do so in other contexts, such as financial crises. The basic contours of war (especially defensive) invite a clearly understandable narrative: support our ability to respond forcefully and rapidly or risk imminent destruction. In a financial crisis, similar arguments about the need for unlimited trust are much harder to make, as fewer citizens will be able to understand the precise nature of the dangers and, with money at the heart of the story, crude heuristics point to suspicion instead of solidarity.

Explicitly Acting Outside the Law

Another option exists—at least in theory—for crisis responders who believe they can legitimate their actions by appealing to qualities other than legality: they can forthrightly declare that acting in the national interest requires them to go beyond their legal powers or even to break the law. This legitimation strategy of extralegal action, which I follow Clement Fatovic in calling the "Jeffersonian" approach, does not argue that some deep-seated prerogative power renders the action effectively legal; rather, it insists that these public-spirited lawbreakers be held to account, either facing prosecution or civil liability or receiving formal, retroactive indemnification through an act of Congress. Prerogative actions on behalf of the common good are thus to be encouraged as a natural part of political life, but they should never be thought of as a part of the normal legal order.[44] As Jefferson famously wrote,

> A strict observance of the law is doubtless *one* of the high duties of a good citizen, but it is not *the highest*. The laws of necessity, of self-preservation, of saving our country when in danger, are of higher obligation. To lose our country by a scrupulous adherence to written law, would be to lose the law itself, with life, liberty, property and all those who are enjoying them with us; thus absurdly sacrificing the ends to the means.[45]

The Jeffersonian approach to legitimation worries that stretching the law to accommodate extraordinary executive actions saps the law's ability to act as a meaningful constraint, so that extralegality is to be preferred at times, notwithstanding the danger that such excursions outside the law will lead to a contagion of illegality.

One can find several instances in American history that conform to this model—though all are antique. Faced with the potential defection of his troops during the harsh winter of 1776–77, General George Washington acted

without legal basis or prior legislative approval to offer his soldiers raises and bonuses, noting that he "thought it no time to stand upon trifles." His decision was later ratified by Congress.[46] As president, Jefferson himself demonstrated his willingness to act beyond what he thought the law clearly authorized on behalf of the public good. First, faced with the unusual opportunity to double the size of the nation with the Louisiana Purchase, Jefferson overcame his natural hesitancy and legal reservations to act decisively (in spite of serious political opposition).[47] Jefferson provided another example of extralegal action in response to a naval incident with the British warship HMS *Leopard* in 1807, including spending funds without appropriations for necessary munitions.[48] In reporting his actions to Congress in his annual message, he indicated confidence that they would approve his actions[49] and was rewarded: Congress made the needed appropriation to support Jefferson and added a proviso to future military appropriations authorizing the president to shift appropriated dollars while Congress was out of session if it was necessary in his judgment.[50]

Most colorfully, as the War of 1812 came to an end in 1815, General Andrew Jackson defiantly maintained martial law in New Orleans even after news of peace spread. He arrested people he considered dangerous without evidence, and he imprisoned a local federal judge who resisted for "aiding and abetting mutiny." After finally relinquishing control, Jackson willingly submitted himself to the judgment of civilian courts and was found guilty of contempt of court and fined $1,000. Jackson, carried in triumph from the courtroom by supporters, took this fairly light punishment as vindication of his actions, and as a former president in 1846 he actually got Congress to repay his fine (along with 6 percent yearly interest).[51]

The Civil War provides the most striking examples of working outside of and beyond the laws to cope with national emergency. Facing secession of the South in April 1861, less than a month after his inauguration, Lincoln acted as the unilateral government of the United States for nearly three months. He called on Congress to convene on July 4, 1861, giving himself time to act as the sole policymaker during the crucial early months of the war, during which time he called forth the militia, created a naval blockade of Southern ports, enlarged the navy, expanded the enlistment of the army and navy (clearly invading congressional powers), sent unappropriated funds to unauthorized private citizens (again, clearly against the Constitution), pledged the credit of the United States for $250 million, declared the power to close the mails to those he suspected of disloyalty, and authorized the suspension of habeas corpus anywhere near the emerging line of battle (even though Article I, Section 9 of the Constitution stated that it was Congress's role to do so).[52]

Though he often claimed deep inherent constitutional authority to take these actions, Lincoln generally adopted the Jeffersonian style of subjecting his actions to ex post congressional judgment where he seemed to have trespassed on Congress's powers. In presenting his case to Congress, he made one of the most forceful arguments for extraordinary executive powers that America has ever seen. Lincoln saw America's crisis as having universal implications for the question of whether republics are inherently doomed to be undermined by the violent machinations of a frustrated minority and asked, "Must a government, of necessity, be too *strong* for the liberties of its own people, or too *weak* to maintain its own existence?" He insisted that each of his actions had been taken out of true necessity and was justified by his duty to defend the Constitution, the laws of which were effectively being canceled in the seceding states. Acknowledging that some people nevertheless questioned the legal propriety of some of his actions, even accusing him of directly breaking the law, Lincoln famously countered, "To state the question more directly, are all the laws, *but one*, to go unexecuted, and the government itself go to pieces, lest that one be violated?"[53] Congress offered its approval a month later.[54]

The key feature of the Jeffersonian legitimation strategy is its emphasis on accountability: the claim of necessity does not automatically disburden an official from legal responsibility. Instead, officials must face the judgment of their fellow citizens, either through a jury trial or through the action of their representatives. If the action is judged inappropriate, criminal liability or impeachment would follow naturally—though of course the original action might not be reversed very easily. In principle, this ex post review should keep officials honest as they consider whether their situation really demands a prerogative-like departure from the law, but in practice it might end up turning on whether the official had the trust (and esteem) of the people.[55]

Does the Jeffersonian approach to legitimation have a place in modern political life? Several political theorists have recently argued that it does. Where Schmitt thought that liberal societies that abide by the rule of law could only be discredited by extralegal actions, these theorists argue that such actions can fit productively within liberal democratic regimes, adding resilience without sacrificing basic values of representativeness and accountability.[56]

Although this argument has considerable theoretical appeal, in practice it must overcome some 150 years of American history in which extralegal, prerogative-like justification has played almost no role. With the massive institutionalization of legalism in twenty-first-century America, extralegal actions may have lost whatever appeal they had in the nineteenth; both principal decisionmakers and their subordinates are now deeply committed to protecting

themselves legally at all times. At the same time, there is a larger residuum of statutory powers that executive branch actors can draw on to legally justify their actions.[57] Consequently, telling elected officials that they ought to consider extralegal action is easy, but creating incentives for them to listen may be quite difficult.

After considering the many ways in which government officials stretched their legal powers in responding to the financial crisis, I return to the question of whether they might have better achieved legitimacy by departing from the law in chapter 7.

Enabling Acts

Rather than claiming deep implicit reservoirs of power within the law or forthrightly going outside of it, the executive branch's more common crisis-response strategy is to seek explicit empowerment through the law. The executive branch hopes the legislature will give it the unambiguous power to devise the means of crisis response for itself, so that it may reap the benefits of its quick decisionmaking while having the legitimating backing of the people's representatives. The most complete transfers of power along these lines might be thought of as what Clinton Rossiter calls "constitutional dictatorships," akin to the Roman republic's institution of time-limited emergency dictators empowered to restore the status quo ante—generally by vanquishing the armed foe threatening Rome.[58] In modern times, legal transfers of power to the executive are generally carried out through more limited enabling acts, through which the legislature defines the outer edges of the executive's extraordinary powers both temporally and in terms of permitted types of actions.

Ex Ante Controls and Ex Post Accountability through Enabling Acts

Although enabling acts generally fail to ensure the promise of rule of law, not of men, they seek to produce legitimacy in several ways. First, they at least tie the executive branch's actions to a particular grant of legal authority, preserving the thin rule of law. The legislature lends its powers subject to recall rather than abdicating its responsibility altogether, preserving its ability to act as a meaningful check on abuses. That implies that legislators give their implicit blessing to the executive's actions as long as they deign to leave the enabling act in place, conferring some degree of democratic legitimacy.

That is the theory—but it has important practical shortcomings, especially in the context of America's political institutions. Laws once passed cannot always easily be repealed, even if majorities of representatives desire them

to be. Less formally, it will always be difficult for legislators to defy executive branch officials with superior information when those officials claim to be taking actions strictly necessary to the country's best interests, even when these claims seem exaggerated. To address these practical difficulties and be accepted as legitimate, then, enabling acts almost always seek to combine their grants of power with ex ante controls and limitations as well as ex post accountability mechanisms, both legal and political.[59]

In America, setting outer limits on enabling acts and supplying the executive branch with some substantive guidance is a constitutional necessity under the nondelegation doctrine. Although only two laws, both enacted in the 1930s, have ever been struck down on nondelegation grounds, the doctrine remains at least putatively alive. Courts have been consistently deferential to enabling acts, but they have made it clear that "delegation run riot," leading to power "unconfined and vagrant," will not be allowed.[60] In chapter 4, I discuss the efforts of some scholars to legally discredit the TARP program on these grounds.

Apart from doctrinal concerns, enabling acts will generally be regarded as more legitimate when they are clearly targeted to solving a particular problem rather than setting up the executive branch as a plenary lawmaker. The paradigmatic case is winning a war, and nearly all of the most sweeping enabling acts of modern times have been designed to facilitate mobilization and centralized organization during wartime.[61] Should these outlast their primary objective—or should the scope of the conflict prove much larger than the public anticipated when powers were delegated—they may nevertheless come in for criticism as illegitimate, as in the case of the Gulf of Tonkin Resolution.[62] The longer enabling acts last, the more likely there is to be concern that they facilitate pursuit of political ends unrelated to the act's original purpose, which would better be subjected to the normal legitimating process of democratic deliberation. As a result, time limits that require, at minimum, a recommitment to the act's purposes by the legislature are an important feature of many enabling acts.

Just as important for securing legitimacy for enabling acts are mechanisms built in to promote transparency in decisionmaking processes and the potential for ex post review. By facilitating accountability, these embody the maxim of trust but verify; they recognize that if extraordinary powers are going to be given to those in the executive branch, extraordinary care must be taken to assure citizens that those powers are being appropriately exercised on behalf of the public good. Reporting, record-keeping, and reason-giving requirements all ensure that there will be material available for retrospective evaluation,

including by Congress and by courts. Procedures for appeals, inspectors general, and fast-tracked judicial review all aim to make certain that reviews will happen, thereby discouraging any hopes of undetected abuses. Notably, the Supreme Court has found that inclusion of such requirements can mitigate any potential concerns about undisciplined delegation.[63]

The net result of creating such mechanisms may be surprising: by accepting certain limitations and being subjected to harsh critical scrutiny, government officials may find themselves made more powerful than they would have been had they managed to conceal their decisions from the public eye, because citizens—including a skeptical press corps—will be more willing to extend trust where they have good reason to believe they are not being duped. Jack Goldsmith has made this point forcefully for national security policy in his recent book, *Power and Constraint*. He argues that a system in which the many observe the powerful center and thereby keep it honest, which he dubs a "synopticon," delivers more legitimacy for the protracted struggle against terrorism than the inherent-powers-based go-it-alone strategy of the early Bush years ever could.[64]

Abuses of Enabling Acts and Their Remedies

Properly engineered, with attention to creating limits and mechanisms to prevent or remedy abuse, enabling acts thus seem a promising means of facilitating legitimate and effective crisis responses—a happy medium between too rigid legalism and too prone-to-abuse efforts to leave law behind entirely. But they can be problematic in practice. The balance between flexibility and constraint may be wrongly struck. This will come to light through experience: either the powers conferred will be exposed as too limited or they will be used for purposes distressing to the legislative coalition that chose to delegate in the first place.

Another problem is that by offering executive branch actors an alternative form of legal justification, enabling acts can create incentives to interact rather opportunistically with the legislature. Basically, executives can go fishing for new legal powers from the legislature and see whether they like the reaction. If they do not, they will simply invoke the enabling act as providing all the necessary legal basis for their desired action. For example, Britain's cabinet was given extraordinary, if vaguely defined, powers during World War I by the Defence of the Realm Act of 1914. The cabinet developed the habit of sending requests for new powers to Parliament, with the expectation (usually fulfilled) that it would grant them with little delay. But if members of Parliament demurred such that there was a serious prospect of delay, the cabinet would

quickly withdraw the proposed legislation and establish equivalent measures through regulation promulgated under its expansive enabling act. The legislature was essentially reduced to an optional rubber stamp, making a mockery of its ability to confer meaningful democratic legitimacy; appearances of legislative responsibility were maintained, but they became a mere façade.[65] It may be possible to mitigate this problem by better defining the enabling act's purposes and limits, but of course a legislature under severe time pressure may have a hard time achieving precision.

A related problem can develop if the powers conferred by enabling acts accumulate into a residuum of legal powers, available to be used by the executive branch whenever full cooperation with the legislature looks slow, cumbersome, or otherwise unappealing. This became a major issue in the United States in the post–World War II era. Without too much critical attention, Congress gradually built up an edifice of statutory emergency provisions that significantly empowered the president, so that by 1973, these would total 470 different provisions of federal law.[66] Such provisions, combined with the never-terminated proclamation of emergency from the beginning of the Korean War in 1950, provided the legal basis for a variety of cold-war presidential actions that would otherwise have been impossible.[67] For example, President Kennedy began the embargo of Cuba by issuing rules under the Trading with the Enemy Act (of World War I vintage), with the needed condition of emergency provided by Truman's leftover Korean War declaration.[68] President Johnson followed the same template in 1968 to address balance of payments problems, limiting the amount of foreign direct investment that citizens and business would be allowed to make.[69] Finally, post-Vietnam, post-Watergate disillusionment with the executive branch led to a backlash, with Congress passing several laws designed to end this emergency-facilitated executive dominance, including the War Powers Resolution of 1973 (passed over Nixon's veto), which limited the president's ability to commit troops without congressional approval to sixty days; the National Emergencies Act of 1976, which ended most old emergencies, restricted the duration of emergencies to two years, and created procedural requirements in invoking new emergencies;[70] and the International Emergency Economic Powers Act of 1977, designed to limit broad uses of the Trading with the Enemy Act to wartime.

Broadly setting out procedural requirements for enabling acts and specifically limiting them by time period seem to jointly solve the problem of residual powers from enabling acts, but unfortunately this expectation has often been disappointed. The laws passed in the 1970s are widely viewed as failures, their procedural requirements usually overlooked and almost never

enforced on a reluctant executive.[71] Such process reforms can only safeguard rule-of-law values if their prescribed processes are actually observed; otherwise, they represent a possibly deceptive sort of window dressing. More generally, constraints can only matter when they can be practically brought to bear in a timely manner; that is most likely to happen when requirements are crystal clear and actions' compliance with those requirements can be scrutinized immediately.

When constraints are violated, our natural inclination is to imagine that courts will be the venue for enforcement—and in normal times, this is mostly accurate.[72] For crisis actions, though, expectations that the judiciary can hold its own as a coequal branch are often disappointed. In moments of national emergencies, courts are often exposed as inadequate, their lack of purse and sword proving decisive in moments when the other branches feel that deference to their robed fellow public servants must give way to more pressing necessities. When the Supreme Court sought to repudiate Abraham Lincoln's suspension of habeas corpus in 1861, it went so far as to hold the commanding officer in custody of prisoner John Merryman in contempt and authorizing a posse comitatus to detain him. But—not to their surprise—the court found its judgment ineffectual; the army continued, on Lincoln's orders, to hold the prisoner without charging him. Chief Justice Roger Taney closed his opinion by saying, "I have exercised all the power which the constitution and laws confer upon me, but that power has been resisted by a force too strong for me to overcome."[73]

The court found itself in danger of a similar embarrassment during World War II, when it was asked to review the legally questionable detention of several German saboteurs—but was also apparently told that they would be executed regardless of the court's decision. Eager to avoid a constitutional crisis, the justices unanimously deferred to the president's decision to subject the prisoners to a military tribunal.[74] Fully aware of their limitations, courts have been famously deferential to wartime decisions, either approving the executive's ability to decide the issue or finding ways to avoid sitting in judgment through exercise of passive virtues, especially when armed conflicts remain unresolved.[75]

Courts are often somewhat bolder once the worst of the emergency has passed, but the importance of their actions for shaping in-crisis behavior is less than clear. Reviewing Lincoln's instantiation of martial law and second suspension of habeas corpus, the Supreme Court found, in *Ex Parte Milligan,* that the application of martial law to civilians where civil authorities were still functioning was unconstitutional.[76] Some scholars and jurists have celebrated *Milligan* as an important precedent confirming the endurance of

legal ideals during wartime,[77] but the decision was not handed down until 1866, when the action's strategic purpose was long fulfilled, the war over, and Lincoln in his grave. As Edward Corwin writes, "To suppose that such fustian would be of greater influence in determining presidential procedure in a future great emergency than precedents backed by the monumental reputation of Lincoln would be merely childish."[78] Similarly, the Supreme Court found enough mettle to repudiate ongoing Japanese internment in 1944 and imposition of martial law in Hawaii in 1946—in both cases well after anxieties about the fate of the free world had largely subsided.[79] Such after-the-fact finger wagging is often celebrated as redeeming the polity's better self and perhaps provides a valuable means of rebuilding the legitimacy of normality after a crisis, but it is likely to have limited practical importance during the crisis.

It would be wrong, however, to leave the impression that courts never effectively enforce legal limitations on an executive branch that is making claims of necessity. When it has good reason to believe that the executive branch is directly contradicting the will of Congress, the judiciary is capable of successfully standing up even to a determined president. The iconic case standing for precisely this point is *Youngstown Sheet & Tube Co.* v. *Sawyer*, in which the court weighed the legality of President Truman's seizure of the nation's steel mills, which he claimed was necessary to the nation's continuing efforts in the Korean War.[80] The court ruled Truman's action unlawful, the key factor being that he had no statutory basis for his action and in fact was acting in a way that Congress had debated and explicitly rejected when it passed the Taft-Hartley Act in 1947 (over Truman's veto).[81]

Justice Robert Jackson's concurrence elaborated on this point and provides what many scholars consider the controlling three-prong framework for thinking about presidential assertions of emergency power: First, the president's authority is greatest when he carries out Congress's command; in those cases, he very nearly personifies the federal sovereignty. Second, there is a "zone of twilight" in which Congress has not acted but the president may have independent or concurrent powers he can exercise. Third, "When the President takes measures incompatible with the expressed or implied will of Congress, his power is at its lowest ebb, for then he can rely only upon his own constitutional powers minus any constitutional powers of Congress over the matter."[82] In setting out this frame of analysis, Jackson was well aware of the challenges for the rule of law posed by crisis and was quite circumspect about the courts' ability to protect the legislature's special role in providing democratic legitimacy:

> I have no illusion that any decision by this Court can keep power in the hands of Congress if it is not wise and timely in meeting its problems. A crisis that challenges the President equally, or perhaps primarily, challenges Congress. If not good law, there was worldly wisdom in the maxim attributed to Napoleon that "the tools belong to the man who can use them." We may say that power to legislate for emergencies belongs in the hands of Congress, but only Congress itself can prevent power from slipping through its fingers.[83]

In other words, courts are at their strongest when Congress has been at its clearest and most forceful; where it fails to speak for itself or leaves only muddy ideas of the constraints it means to impose, the executive will define its own limits.

Since courts are limited in their ability to provide effective in-crisis checks on executive action, Congress often seeks to fashion nonjudicial means of disciplining the executive's crisis discretion, both by increasing real-time scrutiny of actions and by ensuring that officials will be held accountable for their decisions ex post, as discussed above. By means of such features, crafted through legal provisions of the enabling acts, the legislature can shape the political environment in which choices are made. The legal provisions of an act thus play an important role in its legitimation even when they eschew explicit direction or constraint; not all conferrals of discretion are created equal.

Schmitt's Challenge and the Financial Crisis of 2008

As the following chapters show, the production of legitimacy in response to crises in twenty-first-century America is every bit as haphazard as Schmitt predicted: with law proving slow and difficult to adapt with precision, officials in the executive branch cobbled together authorities where they could find them and often sought legitimacy as an afterthought. But the lack of attention to legitimation, while worrying in many ways, has not led to a broader social destabilization or a full-blown rejection of the government's legitimacy—let alone to the rise of a charismatic plebiscitary leader claiming to speak on behalf of the whole people.

Instead, a combination of factors has managed to produce good-enough legitimacy for many crisis responses. The most important of these is probably programmatic success: when a response clearly serves the public interests at little cost, it is unlikely to cause too much consternation, and many of the responses to the crisis of 2008 meet this criterion. Policies that deliver

ambiguous outcomes or failures provide a harder test for legitimation, and the record is mixed. In some cases—such as the Public-Private Investment Program, discussed in chapter 5—legitimation mostly failed, to the detriment of the program's efficacy. In other cases, however, a combination of legitimation techniques was more successful. Legal authorities drawn from enabling acts—sometimes rather creatively—gave some sense of democratic legitimacy to official actions. Provisions of these enabling acts were also used to fashion accountability mechanisms, fulfilling the prescription of trust but verify, often through rather informal political means rather than rule-based legal ones. Law also proved capable of setting some hard limits on crisis responders' conduct when it spoke with sufficient clarity.

But to understand the interplay of legality and legitimacy in the responses to the financial crisis of 2008, all of this is better shown in concrete detail than told in the abstract.

3

Embracing Adhocracy

President George W. Bush's second term was hardly an era of good feelings for national politicians. Citizens were fed up with the deteriorating war in Iraq, the poorly coordinated response to Hurricane Katrina, and what they perceived as a Republican majority in Congress more attuned to the needs of K Street lobbyists than mainstream America. In the 2006 mid-term elections, they would register their call for change loud and clear, giving Democrats control of both chambers of Congress for the first time since 1994.

And yet for all that discontent, in purely economic terms the middle years of the past decade offered much for Americans to celebrate. Although job growth was slower than hoped for in the wake of the tech bubble's bursting, there were many good indicators: fifteen years of nearly uninterrupted economic growth had increased real GDP by two-thirds, inflation had been tame since the mid-1980s, and housing prices had been climbing steadily to dizzying heights. As a result of seemingly dependable price increases and low interest rates, mortgage lenders were freer with their money than ever before, and homeownership rates reached historic highs just shy of 70 percent.[1] Leading economists regularly debated whether a "great moderation" of economic cycles had permanently arrived to lessen the stresses of modern economic life.[2] While the 1970s and savings-and-loan debacle had undoubtedly been trying and the bursting of the tech bubble deflating, it had been nearly three generations since the United States economic system had experienced a major crack-up, and many hoped and expected it never would again. Especially since the end of the cold war, American economic dominance was unquestionably without rival.

Timeline for Events Discussed in Chapter 3

- December 17, 2007: Fed creates Term Auction Facility (TAF)
- March 11, 2008: Fed creates Term Securities Lending Facility (TSLF)
- March 16, 2008: Fed creates Primary Dealer Credit Facility (PDCF)
- March 24, 2008: New York Fed provides financing to facilitate JPMorgan's acquisition of Bear Stearns through Maiden Lane LLC
- July 30, 2008: President Bush signs Housing and Economic Recovery Act of 2008 (HERA) into law
- September 7, 2008: Federal Housing Finance Agency places government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, in government conservatorship with backing from Treasury
- September 15, 2008: Lehman Brothers files for bankruptcy
- September 16, 2008: Fed rescues AIG with $85 billion secured loan
- September 16, 2008: Reserve Primary Money Market Fund "breaks the buck"
- September 19, 2008: Fed creates Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF)
- September 19, 2008: To stop run on money markets, Treasury announces guarantee program using up to $50 billion from the Exchange Stabilization Fund (ESF); opens September 29
- September 22, 2008: Fed approves applications from Morgan Stanley and Goldman Sachs to become bank holding companies

The beginning of the end for this belle epoque came in 2006 as the rise in housing prices that had seemed so unstoppable finally stopped.[3] Because U.S. housing debt—securitized and packaged into tranches, many of which appeared resistant to nearly any risk—had become a key staple of financial markets everywhere, the end of this housing boom would prove catastrophic and panic inducing. Not only did the sliced-and-diced mortgages no longer seem benign, many of them were rapidly exposed as fraudulent or spectacularly ill conceived. Exposure to America's housing sector was nearly ubiquitous, not only among America's own banks but around the world. So, too, was financial collapse.

The beginning of the crisis came on August 9, 2007, when the French bank BNP Paribas suspended withdrawals of three of its funds that had heavily invested in U.S. mortgages. Investors were spooked, wondering what

other funds would be next, and began a twenty-first-century equivalent to an old-fashioned bank run.[4] In September, England's Northern Rock (a bank with £100 billion in assets) faltered, complete with a 1929-style line of panicked depositors. The Bank of England vacillated about the proper response, weighing legal constraints and economic merits as the bank's health declined. The run ended only when Alistair Darling, the chancellor of the exchequer, declared that Britain's government would stand behind the bank's commitments; the bank would be nationalized in February 2008.[5]

Exploring the interplay between legality and legitimacy in shaping the crisis responses across the world would be a valuable scholarly endeavor; the crisis was truly a global one.[6] But this book's aims are squarely parochial, and so it presently turns to the specific actions of the American crisis responders at the Fed, the Treasury, and the Federal Deposit and Insurance Corporation (FDIC).

The Early Crisis Response and Bear Stearns: Legal Creativity Unleashed

Although the Fed always stands ready to provide liquidity to its member banks by lending through its discount window, banks generally shy away from this source of credit unless they face failure without it because of the fear that their borrowing will become known and stigmatize them as unsound, thereby compounding their problems. To try to avoid this stigma, in December 2007 the Fed decided to try a variant of the usual discount window procedure, in which borrowers must individually approach the Fed. They created the Term Auction Facility, through which it would auction credit based on market conditions. Since the credit was obtained through a competitive bidding process, the Fed hoped that participating institutions would simply be seen as prudently taking advantage of a good deal rather than desperately seeking the help of the lender of last resort. This aggressive lending, which could be made against a broader range of collateral than regular open market operations, was legally uncontroversial and apparently somewhat effective in expanding Fed lending.[7]

Nevertheless, the crisis significantly worsened in early March 2008 when Bear Stearns, the nation's seventh-largest investment bank, faced the modern equivalent of a bank run. With rumors swirling about the bank's solvency, lenders were no longer willing to extend them the very short term repo funding necessary to finance its operations. The firm's cash reserves began the week of March 10 at $18 billion, but over the next few days they would rapidly dwindle, and by the end of the week they were nearly exhausted as customers withdrew their business and counterparties demanded increases in collateral.[8]

On March 11, the Fed responded to this deterioration by announcing the creation of the Term Securities Lending Facility, through which it committed to lend to primary dealers up to $200 billion in Treasury securities against a wide variety of collateral, including high-rated mortgage-backed securities of the sort that the market had begun to doubt.[9] Commentary on the creation of TSLF, both positive and negative, focused on whether the Fed's action would be successful in restoring confidence and whether it would expose the Fed to credit risk.[10] No one seemed to wonder about its precise legal basis or to immediately realize the significance of the fact that the loans (to be selected through an auction process) would be to primary dealers—a group that included securities broker-dealers as well as banks.

But the legal considerations underpinning the TSLF were momentous, as they brought into play an emergency enabling act for the Federal Reserve. The Fed justified its innovation through the invocation of § 13(3) of the Federal Reserve Act—though it did not actually say so in its announcement.[11] This lack of forthrightness is understandable given that this paragraph of the Federal Reserve Act applied only in "unusual and exigent circumstances" and had not been used to justify any actual lending since 1934. By reviving such a little-used legal authority, the Fed risked signaling to the market that the crisis was much worse than generally understood, creating a self-fulfilling prophesy, and nothing in the statutory language required a public declaration.[12]

Understanding just how extraordinary the Fed's decision to use its § 13(3) power was requires a brief historical backtrack to the Fed's responses to the Great Depression. In 1932 Congress amended the Federal Reserve Act to give the central bank significantly more discretion in providing credit during a crisis. Whereas previously the Fed could only make "discounts"—loans to banks issued only against a small range of very high quality collateral—after the amendment the Fed could make "advances" where collateral securing the loan was "to the satisfaction of the Federal Reserve bank." The new § 13(3) went farther still, allowing lending to nonbanks, subject only to the requirements that there be "unusual and exigent circumstances" and that the nonbank be "unable to secure adequate credit accommodations from other banking institutions."[13] The Fed's authorities were expanded even more by a provision in the Emergency Banking Act of 1933, which allowed it to make ninety-day advances to nonbanks, and a provision of the Industrial Advances Act of 1934, which added a § 13(b) that allowed unsecured loans to commercial businesses. The Fed made modest use of each of these powers during the Depression, making just $1.5 million in loans under § 13(3) but several hundred million in loans under 13(b). Over the subsequent decades, the Fed came to believe

that making unsecured commercial loans was problematic and recommended that Congress repeal § 13(b), which it did in 1958.[14] Section 13(3) was invoked to enable lending that never actually took place during market disruptions in 1966 and 1969. Perhaps responding to fears resulting from the short-lived stock market crash of 1987, Congress included an amendment to §13(3) in the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). With little debate, Congress expanded the kinds of loans that could be made under § 13(3)—a decision that would prove critical in 2008.[15]

The Federal Reserve's legal powers to make loans are generally not subject to the same repeated exegesis in courts as other statutory provisions (including the Fed's powers of regulatory supervision). Courts have generally shied away from subjecting the Fed's monetary policy decisions to judicial scrutiny, noting the need for the central bank to respond in real time to rapidly changing conditions, for which the judicial process is wholly unsuited.[16] And while the Fed has done a great deal in recent years to make its rate-setting monetary policy decisions more transparent, there has been no corresponding effort to elucidate the legal framework that the Fed applies to extraordinary crisis actions.

As a result, in this rather arcane and usually obscure corner of the law, there is considerable ambiguity about the precise practical meaning of the laws setting the outer limits of the Fed's powers. Those opinions about the scope of § 13(3) that did exist before the Fed's use of the provision in 2008 generally supported extremely broad discretion.[17] A treatise by the Fed's general counsel in 1973 was of the opinion that the bank was nevertheless required, in the spirit of its role as lender of last resort, to make loans only to creditworthy borrowers.[18]

In other words, the nature of the Fed's emergency legal powers is ambiguous, even to expert Fed watchers; the enabling act that gives the central bank the power to aggressively intervene during emergencies is opaque and relies on rather vague, discretionary formulations to impose constraints. Throughout the crisis, the Fed would thus be able to argue—mostly convincingly—that its actions had a legal basis. But many observers would wonder—perhaps quite fairly—whether this kind of thin legality should be regarded as the basis for legitimacy, given its apparent inability to discipline official action.

Returning now to the action in March 2008: to invoke § 13(3) as a justification for creating the TSLF, the Board of Governors of the Federal Reserve was required to make a finding of unusual and exigent circumstances by a supermajority vote. According to the general counsel of the New York Fed, Thomas Baxter, they took this determination seriously yet had little trouble reaching the conclusion that current circumstances warranted the

extraordinary step.[19] Lending to nonbanks was, according to one Fed staffer, "crossing the Rubicon or at least a very large tributary."[20]

The creation of the TSLF had been in the works even before Bear Stearns' precipitous fall began. Unfortunately, many market participants thought that the Fed's action was prompted by a judgment that Bear's failure was imminent, a perception that may have hastened the bank's demise. Bear found its cash reserves exhausted by the close of business on Thursday, March 13. Facing imminent bankruptcy, it sought an overnight loan of $30 billion from J.P. Morgan Chase (JPMorgan), the only bank large enough and familiar enough with Bear's operations to possibly make such a huge loan to the investment bank with so little notice.[21]

The bankers at JPMorgan would only consider making this massive loan to Bear Stearns with outside help—the only realistic option being assistance from the Federal Reserve Bank of New York (New York Fed, or FRBNY). The New York Fed's president, Timothy Geithner, had previously been privately informed of Bear's precarious situation and agreed that allowing the bank to fail overnight would be a disaster. Late into the night of Thursday, March 13, Geithner conferred with members of the Federal Reserve Board of Governors, who would once again need to invoke § 13(3) to make any loan to Bear Stearns possible. The Board of Governors scrambled to organize a meeting in the early morning of Friday, March 14.

Section 13(3) requires the support of at least five members of the board—but at that time, there were only five members total (with two seats on the seven-member board vacant). One of the members of the board, Frederick Mishkin, was just then traveling internationally and could not be reached, forcing the board to invoke another emergency provision, § 11(r)(2), which was added in the wake of 9/11 and allows the board to proceed by unanimous vote with fewer than five members if "action on the matter is necessary to prevent, correct, or mitigate serious harm to the economy or the stability of the financial system of the United States." The board had already determined it believed these conditions were satisfied when it invoked § 13(3), and so it had little trouble making this determination again for the purposes of § 11(r)(2).[22] By unanimous vote, the shorthanded Board of Governors approved a nonrecourse loan of $12.9 billion through the New York Fed's discount window to Bear Stearns via JPMorgan, secured by $13.8 billion in Bear Stearns assets. The loan was made, ambiguously, for a period "not to exceed" twenty-eight days.[23]

This action was not taken lightly. Even given the extreme time pressure and the Federal Reserve lawyers' conviction that the Fed would be acting within

the scope of its powers, on an early morning conference call Ben Bernanke, chair of the Federal Reserve, told Treasury secretary Henry Paulson that the Fed was willing to proceed only with the support of the Treasury Department. In other words, legalities aside, the Fed felt it needed to be blessed by an official more directly accountable to voters, and it was willing to treat this political constraint as binding. Paulson, who had been CEO of Goldman Sachs before reluctantly agreeing to become President Bush's third Treasury secretary in 2006, quickly consulted with the president, who gave his approval, and relayed the Treasury's support back to the Fed, in spite of his feeling unsure whether he possessed any legal authority as Treasury secretary to indemnify the Fed.[24] Over the weekend, Paulson would go on the Sunday talk shows to emphatically declare his support, saying that the Fed's intervention "was not a difficult decision. It was the right decision." Interestingly, instant reactions included Senator Charles Schumer (D-N.Y.) chastising the Bush administration for "behaving like Herbert Hoover," that is, not doing enough to aggressively combat the mounting crisis.[25]

There would be little chance for more considered reactions to the Fed's loan, because in the end it lasted just one business day.[26] Having closely examined Bear's liquidity situation, by the end of Friday the Fed and Secretary Paulson decided that there was little chance that the loan would be enough to keep the bank afloat as of Monday morning. They therefore decided that the language of "up to 28 days" would, at their discretion, mean just one day; Bear Stearns would be forced to repay the loan on Monday, March 17. They broke the news to Bear Stearns executives, telling them that their options now consisted of engineering a buyout by Sunday night or filing for bankruptcy on Monday morning. In practical terms, everyone understood there was little choice but to have JPMorgan act as purchaser. As Rodgin Cohen of Sullivan and Cromwell, who acted on behalf of Bear's board, put it, "The gun was absolutely to their head at that point."[27] By using its discretion in this way—unquestionably within its legal rights—the Federal Reserve could effectively dictate how events would play out. Geithner used more soft power toward the same end, cajoling JPMorgan chair Jamie Dimon to make the purchase and reprise Pierpont Morgan's 1907 "historic role as a savior of Wall Street." As was the case of the Long-Term Capital Management (LTCM) rescue in 1998, "Such requests from the central bank are difficult to refuse."[28]

Nevertheless, JPMorgan's due diligence over Saturday night left its leaders discouraged; Dimon told Geithner Sunday morning that JPMorgan could not make an offer for the firm consistent with its duty to protect its shareholders. However, when Geithner asked him whether the deal could go through with

some kind of assistance from the Fed, Dimon was receptive, and Sunday was spent frantically working out details: JPMorgan would immediately guarantee all of Bear's transactions and, pending shareholder approval, buy Bear Stearns for $2 a share. The New York Fed would provide a $30 billion loan against collateral of hard-to-value Bear Stearns assets nominally worth $30 billion.[29] If the assets were worth less, the Fed would take a loss; if they were worth more, the loan would be paid back with interest.[30]

It is worth noting here the Fed's creation of the Primary Dealer Credit Facility, which also took place on the evening of March 16.[31] The new facility would open direct Fed lending to primary dealers (the investment banks through which the Federal Reserve trades), a group that would have included Bear Stearns. Bear's executives were scandalized that the Fed would make these funds available only after telling Bear Stearns that it had no option but to agree to a JPMorgan buyout. Geithner would later defend the decision, saying that Bear would not have had sufficient collateral to be eligible;[32] but of course, if it had had access to the PDCF, it is possible that its collateral would not have been drained so rapidly. When discretionary decisions are made in a reactive, ad hoc manner, they necessarily create impressions of arbitrariness or favoritism.

Turning to the Bear Stearns deal itself one finds several noteworthy legal features. First, the Fed was directly put at risk of a loss in this deal because of the loan being nonrecourse. Becoming so closely wound up in a single transaction and taking on this level of risk were both dramatic departures from standard operating procedure for the Fed, which normally holds collateral but also keeps its borrowers on the hook for the full value of their loans. By exposing itself to such a clear possibility of a loss, the Fed invited charges that it was basically subsidizing the deal, thus going beyond the confines of its monetary policy or lender-of-last-resort functions and into the realm of fiscal policy.[33] This distinction was not immediately apparent, though. Phillip Swagel, who was assistant secretary for economic policy, later noted that "it took some time before the political class realized that the Fed had not just lent J.P. Morgan money to buy Bear Stearns, but in effect now owned the downside of a portfolio of $29 billion of possibly dodgy assets."[34] Before taking this step, the Fed sought to ensure the legitimacy of its action by receiving the blessing of the secretary of the Treasury. Paulson at first hoped that the Treasury Department could simply officially stand behind the Fed's deal, but he was told by his general counsel, Robert Hoyt, that the Anti-Deficiency Act very clearly barred the Treasury from committing any funds without congressional appropriation. Unable to provide formal support, Paulson insightfully concluded, "What the Fed really needed from the executive branch was political—not

legal—protection." He indicated his approval of the Fed's actions in a letter to Geithner that he referred to as the "all money is green" letter, in which he made it clear that his support was given in full knowledge that if the Fed lost money on the deal, it would have smaller operating profits to turn over to the Treasury, and that therefore the taxpayer was ultimately on the hook.[35] The letter would not become public information until April, when it was submitted to Congress for oversight hearings. It showed that the Treasury and the Fed were in tune with each other on the need for extraordinary actions, probably increasing the democratic legitimacy of the Fed's actions by suggesting the actions were ultimately an expression of the president's will.

Next, Paulson pressured JPMorgan to lower the price it was offering for Bear Stearns. With the Fed's help, JPMorgan was prepared to offer $4 a share for the investment bank, but Paulson strongly encouraged JPMorgan to offer only $2 a share to send a stronger signal to other firms that bailouts would not come on desirable terms—a message that Paulson made quite explicit in a television appearance on Monday, March 17. Unsurprisingly, the executives and board members at Bear were livid at what they felt was an unduly punitive figure, especially since their firm's stock had traded at more than $60 a share just a few days earlier.[36] Recalling his conversation with Dimon, Paulson insists that he "stressed that the decision on price was JPMorgan's. It wasn't my place to dictate terms."[37] Still, as with pushing JPMorgan to the bargaining table in the first place, such influence undoubtedly carries a great deal of weight even if it remains soft power; given the importance of the Treasury secretary's approval for purposes of ensuring legitimacy, strong encouragement may be perceived as mandatory instruction, potentially raising concerns about inappropriate government dictation of private matters. Paulson's penchant for driving a hard bargain, developed during his long ascendance to the top of Goldman Sachs, took on a very different valence once he was secretary of the Treasury.

To facilitate the purchase, the Board of Governors was obliged to grant several temporary regulatory exemptions that would otherwise have been prohibited. Section 23A of the Federal Reserve Act, enforced by Regulation W, normally prohibits transactions between a member bank and its affiliates if the transaction is too large relative to the bank's capital and also "prohibits a bank from purchasing a low-quality asset from an affiliate."[38] In their meeting approving the transaction on March 16, the board waived these requirements up to certain limits for JPMorgan, pursuant to a finding that the exemption was in the "public interest and consistent with the purposes" of § 23A. Arguably, the exemption was not consistent with those purposes, which are

to ensure the safety and soundness of the member bank; JPMorgan would undoubtedly be taking on a significant risk by acquiring Bear.[39] Similarly, the board gave another eighteen-month exemption to JPMorgan for its risk-based capital requirements.[40] These decisions have received relatively little attention, perhaps because § 23A exemptions are relatively common,[41] but they show that when statutes build in some discretion for regulators to make exceptions, that discretion is likely to be taken advantage of during crises, whether or not the stated reason for allowing exceptions is a good fit.

Finally, the original Bear Stearns deal had several possible defects under Delaware corporate law (which was controlling because both firms were chartered as Delaware corporations). Because JPMorgan wanted to ensure that the deal would go through, the firm's lawyers had included several deal-protection devices in their offer, some of which were probably contrary to Delaware law.[42] On the other side, Bear Stearns' board of directors had a fiduciary duty under Delaware law to maximize the value of the firm for its shareholders. Given their seeming conviction that the firm was worth much more than $2 a share, this obligation was arguably breached.[43] That claim was made immediately, as shareholders filed suit against Bear Stearns and its directors. JPMorgan would reportedly set aside $6 billion to cover Bear-related litigation.[44]

In the event, few of these legal questions would be probed deeply. Instead, this deal would prove extremely short lived. (The lawsuits would end up coming to nothing.)[45] It turned out that JPMorgan's lawyers inadvertently structured the deal so that JPMorgan's guarantee of Bear Stearns' positions would be good for an entire year even if Bear's shareholders repeatedly rejected the buyout. That meant that, at least in theory, Bear Stearns might be able to survive to find a better offer while gaining the benefit of JPMorgan's support. At the same time, Bear Stearns' funding situation continued to worsen on Monday, March 17, as potential counterparties had reason to worry that the deal would not go through, and there were reasons to be skeptical that JPMorgan was truly contractually obligated to provide Bear with funding. Both sides, therefore, had strong incentives to restructure the deal, which they did on March 24: JPMorgan would offer $10 a share, while getting 39.5 percent of Bear's diluted shares, nearly ensuring that it could push approval of the deal through.[46] At the same time, the Federal Reserve also renegotiated its deal.[47] Instead of a direct loan to JPMorgan of $30 billion, now the Fed, once again acting through § 13(3), would loan $29 billion to a special purpose vehicle (SPV) it would create, dubbed Maiden Lane LLC (after the name of the street running behind the New York Fed's Liberty Street building). JPMorgan would make a $1 billion subordinated loan to Maiden Lane, meaning that it would

now take the first $1 billion in losses on the hard-to-value portfolio, while the Fed would still be exposed to the remaining $29 billion.[48]

This new deal—which met with far less resistance from Bear Stearns shareholders and employees and would win easy approval by 84 percent of voting shares on May 29[49]—was, if anything, more legally remarkable than its predecessor. Some of the Delaware law defects were worked out, minimizing the risk of a legal challenge from that direction.[50] Much more interesting and consequential was the Fed's creation of the Maiden Lane SPV, which instantly attracted notice as legally questionable. In *Businessweek*, Peter Coy wrote, "The Federal Reserve has stretched its mandate up, down, and sideways to prevent a financial market deluge. Now it appears to be stretching the English language a bit as well" by making a purchase that could only barely be construed as a loan.[51] As he and many other observers noted, Maiden Lane's ownership structure made the New York Fed the residual claimant on the assets. As Vincent Reinhart, formerly a top staffer at the Fed, put it, "That doesn't look to me like a loan. That looks like equity."[52] The New York Fed's own general counsel, Thomas Baxter, would later acknowledge that the "remarkable marriage" of § 13(3) authority and the technology of creating an SPV made for a "powerful [new] tool" for the central bank. The invention of this maneuver represented a pivotal moment, as the Fed would use it again later in the financial crisis. Said Baxter in 2009, "Obviously, the Federal Reserve must and will act within the bounds of the law, but we will interpret our legal mandate in a manner that facilitates our policy objectives, and sometimes this may require innovation, and a departure from the usual ways of doing business."[53]

The Fed's SPV creation would continue to attract criticism, including from legal scholars, in the years to come. One law professor concluded that the Fed's actions were illegal "trickery" and condemned the Fed's willingness to set up "off-the-books shadow companies to avoid its restrictions under the [Federal Reserve] Act. The legislative power of Congress cannot be circumvented merely by creating an LLC."[54] Another legal scholar, less judgmentally, concluded that the transaction was contrary to the law because it elided the distinction between loan and purchase and twisted the § 13(3) requirement that the firm receiving the loan be in need of credit that it could not secure in the private market, which was not clearly true of Maiden Lane (rather than Bear Stearns).[55]

What became of these legal criticisms, which amount to a fairly substantial attack on the legitimacy of the Federal Reserve's actions, in real time? Congress immediately called oversight hearings to question the Fed's actions. Bernanke testified before the Joint Economic Committee on April 2 and, with Geithner,

before the Senate Banking Committee on April 3. Bernanke told legislators that a Bear Stearns failure would likely have caused the nation's "extremely complex and interconnected" financial system to deteriorate and justified the Fed's support for Bear Stearns "through JPMorgan" and "in close consultation with the Treasury Department," as well as the creation of the PDCF.[56] The Joint Committee's chair, Senator Schumer, roundly supported the Fed's action in a way that suggests the legitimacy that it enjoyed as an apparently necessary move:

> It is hard to disagree with the need to take quick and dramatic action to spare our financial system of the risk of the kind of meltdown we saw in the Great Depression. Those who in retrospect say they wouldn't have acted, in my judgment, are showing an unfortunate degree of intellectual arrogance and maybe even some disingenuousness. To look into the abyss of imminent financial collapse or the potential and do nothing is irresponsible.

Not all of the feedback was so positive. Schumer and many of his colleagues chastised the Fed for failing to help struggling homeowners even as it acted with such dispatch in preventing Bear's failure. The ranking member, Senator Sam Brownback (R-Kans.), explicitly thanked Bernanke for his "strong and decisive leadership" but worried about what kinds of precedents the action set and whether taxpayer funds would be at greater risk in the future. But apart from harangues by Representative Ron Paul (R-Tex.) and Senator Jim Bunning (R-Ky.) about the grave dangers posed by mixing government and business, criticisms were fairly tame.[57]

The legal nature of the Fed's actions was only lightly touched on in either hearing. When pressed, Bernanke insisted that the Fed's action was simply a loan, and Geithner would also characterize the action as simple lending against collateral, directly in line with the Fed's traditional role as lender of last resort.[58] Bernanke even managed some levity on the subject. When asked, "What bullets does the Federal Reserve have left in its guns, traditional or otherwise?" Bernanke quipped, "Well, we've been pretty creative up till now."[59]

Probably the most noteworthy criticism of the Fed's means of action came from former Federal Reserve chair Paul Volcker, who on April 8 characterized the Fed's actions as "extend[ing] *to the very edge* of its lawful and implied powers, transcending in the process certain long-embedded central banking principles and practices . . . in a manner that is neither natural nor comfortable for a central bank."[60] Given Volcker's public stature and his obvious sympathy for the Fed, this statement provided a strong indicator of just how aggressive

the Fed had become and perhaps heightened worries about the legal propriety of its actions.

For purposes of this discussion, there is little to be gained by trying to adjudicate between the action's legal critics and defenders. There were serious grounds on which to question the legality of the Fed's creative response, but, in spite of Volcker's grave warning, these concerns largely failed to gain traction among the political class. For example, the three major presidential candidates remaining in the 2008 contest had essentially no public comments about the Fed's action.[61] Instead, trust in the Federal Reserve meant that legislators (and, to the extent it noted the details, the public) were willing to tolerate some degree of legal creativity, even if it seemed to involve stretching the central bank's powers.

Indeed, if this message did not come through to the leaders of the Fed and the Treasury as a tacit implication of Congress's mostly friendly reception, it was later made quite explicit. Before a July 10 hearing House Financial Services Committee chair Barney Frank (D-Mass.) privately told Paulson and Bernanke, "Take an expansive view of your powers, and I won't criticize you for that. If you need more power, don't ask us to give it to you until you're sure we can do it. The last thing we need now is for you to ask us for something and we say no" (in David Wessel's paraphrase). Because Paulson thought that the chance of reworking the regulatory or crisis powers of America's financial system during the course of a presidential election campaign was remote, he understood this as an instruction to continue to meet any difficulties with improvised expansive interpretations of existing legal authorities.[62]

The portrait that emerges from March 2008, then, is of the Fed and the Treasury acting as close partners, with the Fed contributing a creative, often legally irregular reading of its powers under § 13(3) and the Treasury contributing political cover. Their actions met with mostly hands-off oversight by Congress. Criticism of the bold new policies centered not on legal concerns or a lack of legitimacy but rather on prudential, policy-related concerns about creating moral hazard—concerns that were certainly shared by those making the decisions.

But it is also important to note that some laws did create hard constraints that were respected, especially the Anti-Deficiency Act's prohibition on commitment of Treasury money without explicit congressional backing. All available evidence suggests that the Fed also took the statutory requirements for invoking § 13(3) quite seriously, including the requirement to lend only against good collateral. Although it was difficult to tell in real time whether the Fed had meaningfully scrutinized the assets taken on by Maiden Lane,

much of the profound cynicism expressed at the time was apparently misguided. With the benefit of hindsight, we know that by June 2012 Maiden Lane LLC would have sufficient proceeds from the sale of its assets to pay back the New York Fed with interest for its $29 billion loan; by November 2012 it would also pay back JPMorgan's $1 billion loan with interest. That leaves the New York Fed to reap some additional benefits as the remaining assets are sold off—which is the most un-loan-like and therefore potentially legally problematic aspect of the deal, but a legal oddity that ultimately redounds to the benefit of the taxpayer.[63] Perhaps needless to say, there has been little grumbling that JPMorgan was deprived of these proceeds.

At the same time, the way in which law affected policymakers was clearly altered substantially by the press of events. As important as the formal interpretation of their legal powers was, just as important was the way that Paulson and Geithner projected soft power without any formal legal authority, especially in pushing for JPMorgan to take on the risk of absorbing Bear Stearns and then in attempting to push the sale price lower. During the hectic weeks in which the transaction was being hammered out, deal-making took on a fluid character that was ill suited to more deliberative, law-like processes.[64] The New York Fed's willingness to exploit the developing situation allowed it to opportunistically renegotiate more favorable terms for its involvement—recalling, in some ways, a use of prerogative power, in which the sovereign may depart from the law to serve the common good. For defenders of a strong version of the thick rule of law, this is unsurprisingly unacceptable. Said one Fed critic later, "Defenders of the rule of law, who in general decry the arbitrary rule of men, should specifically decry the rule of central bankers."[65] But at least at this juncture in the crisis, such concerns about legitimacy were confined to a small minority. Senator Schumer perhaps best characterized the prevailing attitude: "When you're staring into the abyss, you don't quibble about details."[66]

The Attempt to Bring Law to the GSEs

Over the summer, the Fed expanded the access and duration of liquidity offered by the TAF, the TSLF, and the PDCF. Although there were still many worrying signs, several problematic institutions were dealt with relatively smoothly. With the Fed's approval, one of the nation's largest troubled financial institutions, Countrywide Financial, was acquired by Bank of America, providing at least a temporary solution to its woes.[67] In July, the FDIC managed the largest bank failure in its history by closing IndyMac Bank without sparking any larger panic.[68]

The summer's larger concerns centered on the two government-sponsored enterprises at the heart of the nation's mortgage financing system, Fannie Mae and Freddie Mac. Fannie and Freddie are unique institutions in America's financial landscape, occupying a gray area between public and private, and in recent decades their very existence has created special problems for the rule of law. Fannie Mae, formally the Federal National Mortgage Association, was established as a government agency in 1938 to purchase, hold, and sell loans insured by another Depression-era creation, the Federal Housing Administration (FHA), its purchases providing liquidity to mortgage lenders and thereby supporting the nation's sagging real estate market.[69] In 1954 Congress converted Fannie from a government agency to a private, mixed-ownership corporation in which the federal government held preferred stock and private investors held common stock, while continuing to grant the company certain regulatory advantages and tax exemptions.[70] In 1968, at the behest of President Johnson, who hoped to ameliorate growing deficits by moving most of Fannie Mae's business off the federal government's budget, the Housing and Urban Development Act split the company into a government part (the Government National Mortgage Association, or Ginnie Mae) and a for-profit, publicly traded incarnation of Fannie Mae that nevertheless retained some of its public mission in the form of requirements to support mortgages for low-income borrowers.[71] Responding to continuing weakness in the housing market, Congress passed the Emergency Home Finance Act of 1970, which created Freddie Mac (formally, the Federal Home Loan Mortgage Company), an institution mirroring Fannie Mae but originally focused on thrifts and owned by the Federal Home Loan Banks.[72] Freddie took an even more Fannie-like shape in 1989, when Congress made it a for-profit, shareholder-owned corporation as well.[73]

At that point, the status of the twin GSEs was ambiguous and contested: they were legally private firms, compelled by law to forswear any government backing in their securities offerings,[74] and yet most market participants believed they enjoyed an "implied" government guarantee. This implication existed in part because of assessments that Fannie and Freddie were too big or too systemic to fail. By 2008 Fannie and Freddie held $1.4 trillion in assets and guaranteed $3.5 trillion of mortgage-backed securities, and their debt was used as collateral in financial transactions around the world.[75] Just as important were legal characteristics of the two firms that suggested the government would ultimately stand behind their debts, including their government charters; their exemptions from the jurisdiction of the Securities and Exchange Commission (SEC), various lobbying restrictions, and state and local taxes;

directors of Fannie Mae appointed directly by the president; their line of credit with the U.S. Treasury; and the special treatment of their securities under collateral and capital requirements, which treated agency debt more like Treasuries than like risky private bonds.[76] And although formal statements from Congress and from the GSEs themselves always clearly disavowed any guarantee, when raising money from investors the GSE representatives' not-so-coy message was "the government will stand behind us" should it ever come to that.[77] This ambivalence served many interests in Washington: Fannie and Freddie were extremely profitable, in part because of the presumption that they were government backed, and they were also among the most generous patrons in federal politics.[78] But it clashed with the aspiration of making government actions rule based and predictable, as a vocal group of critics pointed out repeatedly.[79]

As the financial crisis deepened in 2008, Fannie's and Freddie's fates, which were of so much consequence to markets, would hinge on the political will of a few key policymakers in a position to come to their aid—which they proved very willing to do as the GSEs' situation worsened. The Fed announced it would provide liquidity to the GSEs if necessary,[80] the Treasury announced it would seek to increase the GSEs' credit line,[81] and the SEC banned naked short selling of Fannie and Freddie securities and other primary dealers.[82] These were all maneuvers designed to forestall failure and thereby avoid the question of what would happen in the case of a GSE failure.

At the urging of Secretary Paulson, Congress also took targeted action to address the question of how the government could deal with faltering GSEs, as well as strengthening the regulatory oversight of the two firms. After a back-and-forth legislative process, strong majorities quickly passed the Housing and Economic Recovery Act of 2008,[83] and despite reservations about parts of the bill, President Bush signed it into law on July 30, 2008.[84] Described by Senator Christopher Dodd (D-Conn.) as "the most important piece of housing legislation in a generation,"[85] the law was composed mainly of a variety of measures designed to support the housing market. It took two steps meant to fortify and backstop the GSEs. First, for an eighteen-month period, it conferred on the secretary of the Treasury extremely broad discretion to consensually purchase the firms' assets if he determined that doing so was necessary to stabilize financial markets. Second, it changed the GSE regulatory oversight structure, creating a new bureaucracy charged with assessing the GSEs' finances, called the Federal Housing Finance Agency (FHFA), and empowered it to put the firms into conservatorship or receivership without consulting Congress if needed.[86] Seeing emergency looming, Congress passed

fairly expansive enabling acts, though perhaps few legislators realized at the time how extensive or consequential the power they had granted would be.

At a July 15 Senate Banking Committee hearing, Paulson faced some skeptical questioning about the "unprecedented grant of authority to purchase GSE debt and stocks," including the lack of a dollar limit on the support the Treasury could provide for Fannie and Freddie. Paulson emphasized that the new authority would be limited to eighteen months and vowed to act in consultation with Congress, while still insisting that creating a formal requirement of legislative approval would diminish the value of the power. He memorably explained why maximizing the Treasury's discretion was the right choice:

> If you are used to thinking about the issues, it is very intuitive, that if you have got a squirt gun in your pocket, you may have to take it out. If you have got a bazooka and people know you have got it, you may not have to take it out. You are not likely to take it out. I just say that by having something that is unspecified, it will increase confidence. And by increasing confidence it will greatly reduce the likelihood it will ever be used.[87]

In other words, emphasizing clearer legal limits would actually decrease the usefulness of the government's new tools. Simply showing a willingness to trust the executive branch's discretion might, in itself, lend legitimacy to the effort to prop up the GSEs and thereby avert a difficult market problem.

Unfortunately, Paulson's logic notwithstanding, the bazooka given by HERA would be tested much sooner than anyone anticipated. Immediately following the law's passage, FHFA and the Treasury engaged a team from Morgan Stanley to conduct an extensive review of the GSEs' finances. They found that the GSEs were, at best, teetering on the edge of insolvency.[88] Throughout August, financial markets seemed to render the same judgment: Fannie's and Freddie's common stock prices declined even as access to bond markets remained available, signaling that investors believed the firms were probably insolvent but that their debt would be fully backed through government intervention.[89] Because HERA had failed to resolve the crucial ambiguity about the GSEs' relationship with the federal government, in late summer 2008 their legal futures remained profoundly uncertain.[90]

At a meeting on Thursday, September 4, followed by a consultation with President Bush, Paulson, Bernanke, and FHFA head James Lockhart decided that this ambiguity needed to be resolved immediately. Paulson believed that the federal government should use the power given to it by HERA to immediately seize control of the GSEs and force their boards of directors to oust

management without delay. Paulson recalls his update to President Bush: "We're going to move quickly and take them by surprise. The first sound they'll hear is their heads hitting the floor."[91] The plan was to secure board acquiescence by presenting them with the "choice" between accepting government conservatorship along with Treasury support and trying to stay afloat with no Treasury support while the FHFA took steps to force them into conservatorship in a messy legal battle.[92] Fannie's and Freddie's chief executives, Daniel Mudd and Richard Syron, were called to the FHFA on September 5, where Paulson and Lockhart presented the government's offer, later fairly described as a "Hobson's choice."[93] Both companies' boards acquiesced to FHFA conservatorship and on Monday, September 7, Mudd and Syron were replaced and the FHFA assumed the power of the boards of directors.

The Treasury concurrently took three steps: it committed up to $100 billion for each firm, as needed, to maintain a positive net worth at each, in exchange for 1 million shares of senior preferred stock and warrants to buy up to 79.9 percent of diluted common stock at a nominal price; it created a program to buy GSE debt, thereby signifying that debt holders could fully expect repayment to continue; and it created a program to purchase GSE-backed mortgage-backed securities (MBSs), designed to promote stability in the mortgage market.[94] As a result of the preferred share agreement, common shareholders lost their voting rights and saw the value of their investments nearly erased, and were often described as having been "wiped out."[95] Equity markets, and especially financial stocks, reacted jubilantly when they reopened on Monday, apparently hopeful that the GSEs' new status would bring stability.[96]

But several issues cast a shadow over the legitimacy of this maneuver—which was, in the estimation of its architects, "bold," necessary, and eventually effective in bringing stability to U.S. housing markets but which others believe severely jolted the financial system because of its suddenness.[97] First was the Treasury's high-handed style in dictating the terms of the takeover. Although the FHFA was charged by HERA with making the choice to put the institutions into conservatorship, it was clearly pushed into exercising this power quite suddenly. Paulson also dealt rather curtly with the concerns of Fannie Mae's leaders, who insisted that their firm had been better managed and better prepared for difficult times than its sister institution and should therefore be treated differently. Paulson demurred, saying that because investors treated the two companies as identical twins, they could not be given different treatment.[98] Paulson seems to have taken a certain relish in ensuring the boards' ultimate irrelevance. Because the GSEs' boards ultimately

accepted Paulson's terms, these actions remained in the realm of soft power, but the arbitrariness concerns they raise are no less real for that. With so much legal ambiguity left even after HERA, the government's choices would need to draw their legitimacy from some source other than the law, and so the impression that the GSEs were treated capriciously created a potentially serious legitimacy problem.

Second, and potentially more serious, the Treasury's involvement with the GSEs was supposed to be time-limited by HERA, which gave authorities only through the end of 2009. Indeed, in selling the proposed legislation to Congress, Paulson had emphasized the time limit. But the senior preferred shares agreement effectively committed the Treasury to prop up Fannie and Freddie in perpetuity. Although it was not immediately understood by markets, those at the Treasury thought of the twin \$100 billion commitments, which they called "keepwells," as effectively representing unlimited explicit guarantees of the two firms.[99] Nor was the amount of \$100 billion—chosen without much deliberation—meant to pose a serious constraint; when the institutions needed more, the amounts were amended to \$200 billion each in December 2009.[100] While the Treasury's other programs for buying GSE debt and GSE-backed MBSs did wind down at the end of 2009, the slack was more than taken up by Federal Reserve programs (generally referred to as quantitative easing, or QE) for buying those assets, first initiated in November 2008 and later renewed.[101] In fully committing the government to indefinite support for Fannie and Freddie, executive branch officials showed little concern for the legal constraints built into HERA's enabling acts, apparently thinking that the inherent legitimacy of supporting America's housing market was sufficient to justify their actions in the eyes of the broad public.

These actions also pose questions of procedural legitimacy, and in this case there were private individuals and corporations who were in a position to bring charges that the government's actions had specifically harmed them, namely the GSEs' shareholders. Far from resolving the troublesome ambiguous legal status of Fannie and Freddie, the actions of September 2008 made the legal status even more tangled. Contrary to the frequent talk of having "wiped out" shareholders, no shares were actually extinguished in the September 7 move, and one reason the GSE boards were willing to sign off was that they thought they were saving at least some part of shareholders' equity by agreeing to the government rescue. Conservatorship, which was the government's chosen legal form of intervention, entails a duty to "conserve" an institution's value for the sake of its owners, and while the federal government instantly became the largest owner, the GSEs' previous owners stayed in the

picture. Under HERA, the FHFA had the power to put the GSEs into receivership instead, which would have meant potentially dismantling the firms and selling off their assets, but the logistical difficulties of carrying out this approach without decimating the housing market discouraged its use in 2008. As noted in chapter 5, however, private shareholders have been treated as little more than legal technicalities in the debate over Fannie's and Freddie's future, and eventually their legally ambiguous situation would lead them to take legal action. At the same time as shareholders were losing most of the value of their investments, bondholders were asked to give up nothing, although asking junior debt holders to absorb losses comparable to those of preferred shareholders in insolvency is common. Preferred stockholders, including many pension plans and small regional banks, were deeply angered by what they felt was an arbitrary choice that disfavored them.[102]

Of more pressing importance than these legal issues, which would mostly have to wait to receive analytical scrutiny, was the immediate political backlash against the rescue of the GSEs. As James B. Stewart later put it, "The bailouts had brought into rare alignment the Republican right wing, averse to any tampering with the free market, and the Democratic left, outraged by the government rescue of Wall Street's overpaid élite."[103] Senator Jim Bunning (R-Ky.) called the move "a calamity for our free market system," summing up, "Simply put, it is socialism." Nouriel Roubini, a left-leaning economist who had become a prominent commentator, similarly declared that "Comrades Bush, Paulson and Bernanke have now turned the USA into the USSRA—the United Socialist State Republic of America," in which "profits are privatized and losses are socialized."[104] Paulson was reportedly shaken by these criticisms.[105]

In short, the government's rescue of the GSEs is an object lesson in the way that even a new and targeted delegation of legal authorities to deal with a problem can fail to confer clarity, a sense of limits, and, ultimately, legitimacy.

Lehman Brothers: The Perils of Observing Legal Limitations

It was in this atmosphere of public criticism that policymakers were faced with their next challenge: Lehman Brothers, the country's fourth-largest investment bank and the one that people worried was most vulnerable after the downfall of Bear Stearns, increasingly faced a crisis of confidence and consequent liquidity problems.[106] As a primary dealer, Lehman had access to the PDCF—a point it emphasized to investors as it tried to distinguish itself from Bear Stearns. The institution also hoped to gain access to the Fed's discount window by becoming a bank holding company, but Geithner at the New York

Fed had rejected that move over the summer as "gimmicky." Similarly, the Fed had demurred when Lehman sought to offer lower-quality collateral for access to liquidity from the Fed.[107]

Barring a miraculous capital raise for Lehman, the question the week of September 8 became whether the Fed would engineer a rescue of the bank as it had done for Bear Stearns. On September 9, Geithner had a team at the FRBNY work up a memo comparing and contrasting the context around Bear Stearns' failure and Lehman's.[108] Lehman was considerably larger, but several other considerations made saving it seem less crucial: Bear's heavy involvement in the credit default swap (CDS) market might have made its failure more complicated; its downfall gave markets six months to respond to the evident risks of a foreseeable investment bank failure; the Fed's emergency programs now provided a cushion; and the political climate had clearly created a strong incentive to say "enough is enough" rather than appear as a bottomless crisis-relief fund.[109] Senator Richard Shelby (R-Ala.) colorfully warned the Fed to think twice before orchestrating another rescue: "I hope they will not use all their powers or all their rabbits in doing this."[110] On the other hand, many seasoned observers felt it was fairly obvious that, however they might posture, policymakers would ultimately end up providing a rescue rather than risking the turmoil of an unstructured bankruptcy.[111] Predicting the government's choices had become a matter not of knowing transparent rules or standards that it would apply but of intuitively understanding the thought processes of top decisionmakers—a situation that increasingly and precariously made legitimacy contingent on the success of decisions rather than appeals to normal institutional processes.

In the event, those who thought that political opposition to bailouts and economic anxiety about creating moral hazard would deter policymakers from acting as they had in March were largely correct. On the morning of Friday, September 12, Paulson allowed his staff to leak anonymous reports to the press indicating that no government aid would be forthcoming for Lehman and spread the same message in private.[112] That evening, Paulson and Geithner convened a group of leading banks' CEOs in hopes of facilitating a wholly private solution, of the sort that had resolved the near crisis presented by LTCM's failure in 1998. Paulson's message to these captains of finance was unequivocal: there would be no help that required taxpayers to bear any risk; Wall Street needed to sort this mess out for itself. Later interviews with Paulson would reveal this to be at least part bluff: policymakers would have been willing to consider committing some support to a buyer of Lehman if the opportunity presented itself, notwithstanding their declarations to the

contrary. Their desire to avoid the public's ire at another bailout was real, and powerful; but just as important was their need to establish their bona fides as tough dealmakers, and showing their willingness to steer clear of involvement altogether was the best way of doing so.[113]

What followed was an intense weekend of attempted deal-making, as a solution was sought in which one bank would buy Lehman's core businesses and a consortium of banks would collectively provide financing for troublesome assets that would be spun off. Hoping to entice Bank of America to take the lead role, the Fed offered to relax regulatory capital requirements for the bank in the wake of the deal, but the firm's leaders still decided by Saturday that Lehman's balance sheet was too big a risk for them to take on—especially as they found a more attractive target in Merrill Lynch, the next most vulnerable investment bank, which Bank of America arranged to purchase for $50 billion over the weekend.[114]

With Bank of America out, the only interested buyer was London-based Barclays, and a mad rush was made to arrange private supplemental financing to enable a deal. On Sunday, after a marathon negotiating session involving all of Wall Street's major firms, it appeared that an acquisition before the opening of markets on Monday morning would be possible. But this moment of relief was short lived. The proposed deal faced a seemingly unanticipated legal constraint from Barclays' primary regulator, the U.K.'s Financial Services Authority (FSA). Hector Sants, head of the FSA, told Barclays and the American policymakers that he would not approve any deal in which Barclays guaranteed all of Lehman's risk while the details of the deal were being finalized (as JPMorgan had done in the case of its purchase of Bear Stearns); he indicated that things might be different if the New York Fed itself would guarantee trading obligations, but those at the Fed insisted that § 13(3) provided them no such authority.[115] Furthermore, the FSA said that it could not waive the requirement for a shareholder vote to approve Barclays' action. Although he was evasive on the question of whether the FSA could ever approve a restructured deal, Sants's message clearly meant that it would be impossible to have a deal in place right away—which in effect ensured that no deal could happen at all, as the run on Lehman seemed sure to bankrupt the firm in short order.[116] It appears that the British were using these legal impediments as cover to scuttle a deal that they badly wanted not to go through for policy reasons; Alistair Darling, who was chancellor of the exchequer during the crisis, revealed in 2010 that he had effectively vetoed the deal behind the scenes.[117]

With no purchaser for Lehman, the Fed now found its legal options significantly limited—even if it wanted to facilitate a deal in the mold of

JPMorgan-Bear Stearns, there was no longer any deal to facilitate. Seeing that Lehman would not receive a wholly or primarily private sector rescue, top policymakers shifted gears quite rapidly: they now asserted that, given Lehman's insolvency, they had no available legal resources with which to support the firm. According to the Fed, § 13(3) could not ride to the rescue in this case, as Lehman lacked good collateral to lend against—an explanation that remains controversial but does have distinguished defenders apart from those immediately involved.[118] Having made this choice, it then insisted that the firm file for bankruptcy immediately, so as to gain legal protection from a disorderly run as the markets reopened. Facing intense pressure from the FRBNY's general counsel Thomas Baxter and somewhat uneasily applied pressure from their primary regulator, SEC chair Christopher Cox, Lehman's board unanimously voted for bankruptcy on Sunday night, and the filing was made in the wee hours of Monday, September 15.[119] Unbeknownst to Lehman's directors, the Fed's Board of Governors simultaneously acted to expand the collateral accepted by the PDCF and the TSLF and granted a temporary blanket exception to § 23A for the purposes of providing liquidity in the repo markets.[120] In other words, they undertook the very actions that Lehman had requested over the summer—but only after they ensured that Lehman's failure was certain. Needless to say, Lehman's leadership was furious at the arbitrariness of these decisions, which they believed cost its firm a shot at survival,[121] just as Bear Stearns' leadership had bitterly resented the creation of the PDCF and the TSLF in the wake of its firm's expiration.

Most political observers were oblivious or indifferent to this unfairness, though. Instead, the Fed and the Treasury found their "decision" not to provide aid to Lehman elicited praise from most corners of the commentariat. For a brief moment, nonaction looked good in comparison with adhocracy, and adhering to putative legal constraints seemed poised to deliver legitimacy. The long tradition (discussed in chapter 2) of avoiding financial liquidations by any means necessary was forsaken—and the public largely applauded. The *New York Times* editorial page found the Fed's standing pat "oddly reassuring."[122] Though worried about the fallout, the *Wall Street Journal* averred that "Treasury Secretary Hank Paulson's refusal to blink won't get any second guessing from us."[123] At the *New Republic*, Clay Risen praised the move as showing "there are limits to the government's largesse," which should allow it in the future to "dictate new rules from a position of strength, acting as the tough-talking Dutch uncle, rather than the doting grandmother."[124] The Shadow Financial Regulatory Committee, a group of conservative economists and policy analysts, sent their "congratulations" to policymakers for refusing

to provide direct support to Lehman, emphasizing the need to minimize moral hazard and taxpayer exposure.[125] On the campaign trail, John McCain released a statement saying he was "glad to see that the Federal Reserve and the Treasury Department have said no to using taxpayer money to bailout Lehman Brothers."[126] Behind the scenes, several members of the Fed's rate-setting Open Market Committee agreed, characterizing Lehman's demise as a positive development at the September 16 meeting. But, contrary to some commentators' suggestions, members of the Federal Open Market Committee did not uniformly see Lehman's bankruptcy as a cause for celebration.[127]

Plenty of others were more circumspect in trying to sort out the governing principles of the adhocracy. Had the Fed run up against the limits of what it could do absent new legislation, or had it simply decided to make an example?[128] In a news conference on Monday, September 15, Paulson seemed to explicitly affirm the latter view. When asked what made Lehman different from Bear Stearns, the Treasury secretary responded, "The situation in March and the situation and the facts around Bear Stearns were very, very different to the situation we are looking at here in September. And I never once considered that it was appropriate to put taxpayer money on the line in resolving Lehman Brothers."[129] While Paulson felt that this statement was technically correct, since there was ultimately no deal to act as a vehicle for federal intervention in September as there had been in March, he would later come to regret his wording, which many understood as meaning the government had drawn a line in the sand and would eschew any further aid. In his memoir, he laments the tension between the need to project market-strengthening confidence and the imperative to be transparent and honest about the government's thinking; the tensions between efficacy and legitimacy were only just beginning.[130] In this case, by failing to be forthright about the legal difficulties that scuttled the attempt to avoid a Lehman bankruptcy, he made it even more difficult for outsiders to understand the nature of the government's thinking or the likely limitations of its power, and he ultimately lost some measure of public trust. This was especially true because the very next day, after seeming to have taken a stand against bailouts, the government would make its most dramatic intervention yet by rescuing the insurance giant AIG.

AIG: Adhocracy Embraced

In contrast to the struggles of the investment banks or the GSEs, both of which were widely discussed throughout 2008, the demise of AIG came as a major shock. American International Group (AIG) was the world's fifth-largest

insurance company in 2007, with $110 billion in revenues. Its holding company owned a small thrift, which brought it under the regulatory auspices of the Office of Thrift Supervision, while insurance subsidiaries were regulated by state-level regulators—a combination that would soon be exposed as entirely inadequate to oversee such a complex, sprawling firm.[131]

Two of AIG's business units had exposed the firm to extraordinary risks in the years preceding the financial crisis. First, AIG's financial products division took on massive exposure to subprime mortgages by writing credit default swaps on highly rated MBSs, effectively insuring a wide variety of counterparties against losses even in the (seemingly) extremely unlikely event that AAA-rated MBSs declined in value. Second, AIG ran a securities lending operation in which it lent securities in exchange for cash. While this would normally carry minimal risk, AIG then invested the cash in various MBSs that left it massively exposed to downturns in the housing market.[132]

When problems in the subprime market began in 2007, AIG began to face challenges despite its huge and largely healthy balance sheet. This was partly because of the company's direct exposure to losses, but more important because many of its CDS contracts were written to require AIG to post more collateral with its counterparty if the credit rating of the underlying securities was downgraded, creating a massive demand for liquidity. The company was also forced to post more collateral if its own credit rating was downgraded, which happened in May 2008.[133] In summer 2008, AIG's CEO, Robert Willumstad, decided that the firm would need help to survive this liquidity crunch and turned to the New York Fed. Geithner was reluctant to get involved with an insurance company in any capacity and said that AIG should not expect any help.[134] Despite this stance, in August his staff began studying what kind of aid they could offer AIG.[135]

In the wake of Fannie's and Freddie's bailout, AIG's situation threatened to rapidly spiral out of control. Once again downgraded, AIG was forced to post tens of billions in collateral in the second week of September, and, as its liquidity was exhausted, bankruptcy seemed close at hand.[136] Willumstad once more approached Geithner on September 9 and found him somewhat more receptive, but yet again met with admonitions to seek a private sector solution, a line Geithner would maintain throughout the week, even as AIG's stock price plummeted.[137]

As it simultaneously sought to raise new capital, AIG looked to benefit from some regulatory forbearance from the New York State Insurance Department. Normally, AIG's insurance subsidiaries faced their own strict capital requirements that prevented them from providing liquidity to their

parent company, but given the circumstances strict legal fidelity seemed counterproductive to Superintendent Eric Dinallo, who convinced New York governor David Paterson to allow AIG access to $20 billion in collateral on September 13 (as the Fed attempted to orchestrate a private sector solution for Lehman Brothers).[138]

This bending of normal rules would prove insufficient, though, to fill the yawning gap in AIG's funding (and in fact, AIG never accessed the capital that it had been authorized to use).[139] As Lehman was nearly saved and then went under, AIG was hurtling toward its own end and increasingly turned to Geithner and Paulson for some kind of assistance. While FRBNY staff had been sketching out ways of potentially assisting AIG over the weekend, top policymakers turned their attention away from Lehman and to the reeling insurer only after the Barclays purchase of Lehman had fallen through on the evening of Sunday, September 14.[140] All that evening and through most of Monday, September 15, Geithner told AIG's management that it had to engineer a private sector solution rather than rely on the Fed. Just as the CEOs of leading banks had been asked to orchestrate a Lehman rescue over the weekend, they were now asked to come up with a financing package that could keep AIG afloat—without any help from the Fed.[141]

Although AIG had been told it would receive no direct relief from the government, the firm hoped that it could at least have the benefit of soft power exercised on its behalf to slow its downward spiral. Willumstad and other top leaders wanted top policymakers to pressure the ratings agency Moody's to refrain from further downgrading AIG on Monday, since a downgrade would exacerbate the firm's problems and arguably create the outcome it was seeking to avoid. In the event, however, Treasury's Dan Jester (a former Goldman Sachs banker whom Paulson had recruited to the department to serve during the crisis) proved reluctant to do more than plaintively explain that more time would be helpful; as Andrew Ross Sorkin puts it, he was "clearly uncomfortable playing the heavy," and so this bit of soft power was too soft to be effective.[142] Partially as a result, the hole in AIG's financing grew to $60 billion over the course of the day. The private bankers sought to form a financing consortium that would provide $75 billion, but this ultimately proved fruitless. By the end of Monday, AIG looked sunk and the private bailout was aborted; Tuesday, September 16, would see either help from the government or bankruptcy.

In the wee hours of Tuesday, top policymakers absorbed this development and abruptly changed course. They decided that risking an AIG bankruptcy was totally unacceptable given the deterioration of the markets in the wake

of Lehman's bankruptcy filing; it seemed to top officials that there was no real choice to be made. They awoke Tuesday to once again fashion a last-minute rescue plan of a massively complex financial institution. Willumstad and AIG's other leaders began the day thinking they would have to file for bankruptcy protection but were cryptically told by Geithner, "Don't do it. I'll get back to you."[143]

Still acutely aware of the issue of moral hazard, some FRBNY staff attempted to devise a scheme by which AIG's holding company could fail while its subsidiaries were kept alive by government aid. But they thought an act of Congress would be necessary to enable such an intervention, which made the suggestion moot given the urgency of the situation—demonstrating again that some legal limitations do bind, often quite inconveniently.[144] Instead, lacking time to engineer a wholly novel rescue plan, Geithner sought help from the bankers who had tried to fashion a private rescue, largely using their work.[145] The result was a rescue reminiscent of the one devised for the GSEs. Once again unanimously invoking § 13(3), the Board of Governors approved a secured loan from the FRBNY to AIG for $85 billion, with all of AIG's assets serving as collateral, a very high interest rate of around 12.5 percent, and with warrants issued for 79.9 percent of diluted common shares.[146] In addition, AIG would have to cease writing CDSs except as specifically approved by the FRBNY, which would also make its lending contingent on its remaining "reasonably satisfied in all respects" with AIG's corporate governance.[147] Geithner told Willumstad it was a take-it-or-leave-it offer and stuck to that line when AIG's board hesitated later in the day; seeing no real choice, they would approve it, 10-1, later that evening. Paulson, meanwhile, delivered the news to Willumstad that he would be expected to resign and persuaded him to renounce his $22 million severance.[148] The need to obtain shareholder approval for the deal was easily circumvented in this case because AIG's corporate charter contained a "blank-check" provision allowing it to issue preferred stock without limit.[149]

Opinions about the AIG bailout were sharply divided. On one hand, the terms struck many as fairly harsh: the government was taking majority ownership in—many would say effectively nationalizing—what some believed was still a valuable company, as well as demanding punitive rates of interest for the financing it would provide.[150] Indeed, from the perspective of Hank Greenberg, AIG's former CEO and still one of its largest shareholders in 2008, the "deal" offered by the government in fact represented an unconstitutional taking of private wealth by the government—one of the premises now forming the basis of a $25 billion lawsuit against the government, discussed in chapter 5.

On the other hand, the close consultation with private bankers coupled with the decision to keep the firm afloat compounded the widespread impression that the government was working for "banking insiders at the expense of accountability and transparency."[151] For many commentators, the interest rate on the loan and the alleged value of the firm's different business lines were irrelevant; the bottom line was that the government had decided to directly and massively expose taxpayers to the downside risks of the failure of a firm that apparently could not survive on its own, all while signaling to market participants that they could expect to be made whole on all their dealings regardless of the viability of their counterparty.[152] It would not be long before critics began to characterize AIG's rescue as a "backdoor bailout" of Wall Street firms that were dangerously exposed to the insurer's failure, complete with strong innuendos about Treasury secretary Paulson's lingering sympathies for his old firm, Goldman Sachs.[153] Indeed, Paulson's Wall Street background became a distinct liability for the crisis fighters' trustworthiness.[154] Chapter 6 explores these charges of a backdoor bailout at length.

A few commentators would separately question whether the government went beyond its legal powers in its rescue of AIG, although this question never became the central point of contention in public debates. Two respected law professors immediately asserted that the Fed was illegitimately stretching the provisions of § 13(3) by effectively making an unauthorized purchase in the guise of a loan, though they both assumed that there would be no legal consequences for this action, perhaps because "a Schmittian state of exception is in play."[155] At least one other professor later defended the Fed's action as a permissible and indeed natural interpretation of § 13(3), answering the "purchase-in-substance" criticism by explaining that the Fed's senior credit position would act in a very debt-like manner.[156]

But the loudest outcry stemmed from the seemingly irreconcilable choices, made in the course of just two days, concerning the fates of Lehman Brothers and AIG. Critics were dumbfounded by the turnaround, and many thought that the combination laid bare the unprincipled and ad hoc nature of the government's decisionmaking. Justifying the government's decisions in terms of fairness or procedural regularity had clearly become very difficult. Even beyond that, many commentators now began to wonder if they could trust top policymakers to act coherently or efficaciously. The Fed strenuously contested this critique, insisting that it believed the value of the collateral it was receiving from AIG made the situation entirely distinguishable from that of Lehman—and, with the benefit of hindsight, we can at least say that it was right to see AIG as possessing real value. At the time of the original rescue

and in the years immediately following, though, the Fed's rationale was often viewed as a fig leaf and the contrast with Lehman's fate described as "a remarkable turnaround by the Bush administration and Mr. Paulson."[157] Legislators echoed the same concerns. Representative Roy Blunt (R-Mo.) lamented that Congress had been caught unawares by the bailout, "and said House Republicans are struggling to 'understand a coherent strategy' about which firms get rescued and which ones don't."[158] Speaker of the House Nancy Pelosi (D-Calif.) rhetorically asked, "Why does one person have the right to grant $85 billion in a bailout without the scrutiny and transparency the American people deserve?"

Pelosi's reaction came in the wake of a remarkable meeting between Paulson, Bernanke, and top congressional leaders on the evening of September 16. Wanting to bring the nation's legislators up to speed, the Treasury secretary and Federal Reserve chair gave a short lesson on the Fed's recent actions and their legal basis. The message from Senate Majority Leader Harry Reid (D-Nev.) was clear: "We've listened, but don't go out and tell people that we've approved this. This is your responsibility." When Barney Frank asked them if the Fed even had $80 billion available, Bernanke replied, "Well, we have $800 billion." According to Frank, that was the first time most of the congressional leaders realized the potential scope of the Fed's powers using § 13(3).[159] Apparently, this revelation, when taken in conjunction with the hard-to-understand pairing of Lehman and AIG, inspired the first stirrings of a movement to rein in Fed and Treasury discretion; Frank soon said that although he considered Ben Bernanke a "responsible and thoughtful person," he nevertheless felt that "no one in a democracy, unelected, should have $800 billion to spend as he sees fit."[160] That reaction would escalate in response to the government's next intervention—which may have been the most legally problematic but also the most practically efficacious one of the whole crisis.

Rescuing the Money Market Mutual Funds: The Apogee of Adhocracy

At the same time AIG was in its moment of distress, Lehman's bankruptcy was also sending shockwaves through the usually staid world of money market mutual funds (MMFs). Money markets, unlike normal mutual funds, pegged their net asset value at a constant value; shares remained redeemable at $1.00 each and paid varying dividends based on investment performance. Since their invention in the early 1970s, only one small MMF had ever dipped below par value, or "broken the buck."[161] Depositors, therefore, thought of their MMFs as having basically no risk of absolute losses.[162]

Money market mutual funds had begun to run into serious troubles beginning in the autumn of 2007, though, as their extensive holdings in various structured investment vehicles threatened to go sour. Some funds would have been forced to break the buck but for infusions of aid from parent companies. Foreshadowing the events of 2008, Secretary Paulson attempted to assemble a private sector consortium to deal with this problem, but in the end it never got off the ground.[163] Nevertheless, through all the difficulties of 2008 the MMF industry had not fallen off a cliff; indeed, because the investments it offered were perceived by most investors as rock solid, it continued to attract investment.

On September 16, all that changed. The Reserve Primary Fund, which was the first and oldest MMF, was forced to devalue its holdings of Lehman Brothers' commercial paper with face value of $785 million—1.2 percent of the fund's $62.4 billion in total holdings. The fund's directors had been banking on the incorrect belief that the government would not allow Lehman Brothers to fail after its March rescue of Bear Stearns, and they at first attempted to write down only part of the value of the Lehman paper. But investors in the fund (rightly) thought that it would be unable to maintain its par value and began what amounted to a modern-day bank run, submitting $10.8 billion in redemption requests on Monday, September 15. That amount exhausted the fund's liquidity, leading to suspension of redemption,[164] which in turn led to an additional $29 billion in redemption requests on Tuesday, September 16. That afternoon, the fund's directors decided they had no choice but to declare that the fund had broken the buck, with shares now valued at $0.97.[165]

The demise of the Reserve Primary Fund led to a general panic in the MMF market, with investors who depended on the safety of their investments fleeing to safer instruments—$170 billion left the MMF market over the course of the week, and three-month Treasury yields plummeted to a breathtaking 0.03 percent on Wednesday, September 17.[166] By one estimate, twenty-nine other MMFs would have broken the buck had they not received support from their sponsor institutions.[167] The emptying out of MMFs in turn imperiled the nation's commercial paper markets in which large firms sought very short term financing, and suddenly there was a very real prospect that blue-chip American companies would be unable to raise the cash needed to finance their ongoing operations and could even miss their payrolls in short order.[168]

Turning their attention to this unexpected development after they had dealt with AIG on Tuesday, Paulson, Bernanke, and the other crisis fighters were aghast. The already horrifying financial crisis now threatened to become

a full-blown economic meltdown, and they were determined to take decisive action to change the momentum. They moved simultaneously on several different fronts (which I treat slightly out of chronological order).

The SEC imposed a ban on short selling on September 18[169]—a move that immediately attracted vehement policy criticisms[170] but stood on fairly firm legal ground and largely won political approval. Pursuant to § 12(k)(2) of the Securities Exchange Act of 1934, upon a finding of emergency the commission could temporarily regulate or even prohibit the trading of securities should it find that doing so was necessary to protect the public interest. Yet again, an expansive Depression-era enabling act endowed an arm of the federal government with extraordinary powers, which it now put to use.[171]

Under the protection of the SEC's ban, the crisis fighters also made an unsuccessful attempt to simplify the Wall Street investment banking scene through soft power, with Geithner pushing hard for Morgan Stanley and Goldman Sachs to find big-bank merger partners. Although the Treasury and the Fed had no power to compel such outcomes, they pushed Morgan CEO John Mack and Goldman CEO Lloyd Blankfein quite insistently to find buyers, even if it meant taking a nominal price for their recently valuable firms. These proddings led to serious discussions between Wachovia and Morgan Stanley, and then Wachovia and Goldman Sachs, over the weekend of September 20 and 21, but in the end the two investment banks decided that no offer was sufficiently attractive to merit taking to their boards.[172] Instead, both institutions sought out capital injections from other investors.

They also both decided to convert their companies into bank holding companies (BHCs), and each institution rapidly worked up applications submitted on Saturday, September 21. As noted earlier in this chapter, over the summer Lehman Brothers had floated the idea of gaining some extra access to capital (in the form of deposits) by becoming a BHC, but FRBNY president Geithner rejected the move as "gimmicky." Apparently Geithner and the other leaders' mindset had changed considerably by September, however, because the Fed approved the applications from both Morgan Stanley and Goldman Sachs the very next day.[173] In approving the applications, the Fed was able to take advantage of several "unusual and exigent circumstances" clauses in its Regulation Y, governing the organization of BHCs, to enable expedited review and notice periods.[174] This rapid conversion of Morgan Stanley and Goldman Sachs seems to have been a modest success. Many people got the (basically incorrect) impression that by having their parent companies become BHCs, the main Wall Street broker-dealer businesses would gain permanent and direct access to the Fed's discount window.[175] Probably far more important, though, was the

signal that the Fed's rapid action sent to market participants; according to one Goldman executive, "It was as if the Fed had drawn a circle and proclaimed that everyone inside it would live."[176] Where Lehman had found itself outside the circle, Morgan and Goldman would be among the protected. With the government apparently standing behind them, both institutions landed significant new investments: Warren Buffett invested $5 billion in Goldman, and the Japanese firm Mitsubishi invested $9 billion in Morgan Stanley.[177]

The Fed also worked quickly to open yet another broad-based special facility. Testing the very limits of acronyming, the Fed announced the Asset-Backed Commercial Paper (ABCP) Money Market Mutual Fund (MMMF) Liquidity Facility—shortened to the AMLF—on September 19. The new program would make nonrecourse loans to U.S. depositories that bought highly rated, dollar-denominated ABCP from distressed MMFs and use the assets themselves as collateral, thereby enabling the MMFs to quickly sell off assets to meet redemptions and reassuring MMF investors that their funds were solid enough not to run on.[178] Once again, the Fed justified its action with reference to § 13(3).[179] Two legal concerns about the AMLF were raised, albeit neither with much follow-through. First, at least initially, some worried that the Fed might be lending against inadequate, poor-quality collateral—especially since it was easy to wonder whether even highly rated ABCPs might turn out to be worthless at that time. Since the loans were nonrecourse, the Fed's exposure could turn out to be very large.[180] Second, as with the Maiden Lane SPV, one can argue that the Fed was skirting the requirement to lend only to borrowers who were themselves unable to secure credit through normal channels. In this case, it was the MMFs who were the ultimate targets of relief, but the loans made by the program were dispersed to banks buying their assets.[181] The program was heavily used, with $150 billion lent out in just its first ten days, and would be wound down without losses.[182] Perhaps because of this success—or perhaps thanks to the shield of its atrocious acronym and the obscurity that went with it—the AMLF's terms never received much scrutiny.

The same pattern played out far more strikingly as the Treasury devised a plan to directly aid MMFs. Paulson delegated the task of devising a response to the MMF crisis to Steve Shafran, another Goldman Sachs alumnus who was then serving as a senior adviser to the Treasury secretary. Shafran and his team came up with several ideas that Paulson felt would be insufficiently bold to stop the run and then presented the idea of tapping into the Exchange Stabilization Fund. According to Paulson, when he heard this "inspired idea," "I slapped my desk. It was exactly what I was looking for—the strong step the situation required: something dramatic that would prevent an impending

implosion of $3.5 trillion in money market funds."[183] The chief virtue of this course of action was that the ESF could be used with only the president's approval—Congress would not need to sign on, which meant that the plan could be executed much faster.

The ESF was a product of yet another Great Depression law, the Gold Reserve Act of 1934, which empowered the executive branch to deal with rapidly changing financial conditions. Its initial purpose was to stabilize the exchange rates between the dollar (the price of which was then pegged against gold) and foreign currencies (which were mostly not). Its design was based on a British near equivalent, the Exchange Equalisation Account, which operated in a shadowy manner without reporting to the House of Commons—and which many Americans suspected was surreptitiously working to devalue the British pound, inspiring them to want their own shadowy currency warriors. The ESF was to be self-financing, report only to the president, and intervene secretly in currency markets. As the world's monetary regime shifted over the ensuing decades, the ESF reinvented its purpose in several ways, including establishing itself as a stabilizing lender to foreign governments and thus acting as a tool of American foreign policy. Over the years, it lent to a wide variety of countries, with its most frequent recipient being Mexico. The ESF rarely attracted public attention, although Congress did amend its charter to include various reporting and audit requirements in the 1970s.[184]

Before 2008 the ESF's most prominent use came in 1995, when Treasury secretary Robert Rubin and President Clinton sought to provide significant assistance to Mexico to combat a financial crisis there. Finding congressional majorities opposed to providing aid, Rubin decided to make a $20 billion loan (by far the largest in the fund's history) to America's southern neighbor, thereby circumventing the need for congressional approval.[185] Although Republican congressional leaders and Federal Reserve chair Alan Greenspan supported this maneuver, it enraged many other legislators; reflecting the concerns of many, Representative Henry Gonzalez (D-Tex.) called the ESF a "$25 billion slush fund that lacks accountability" and sought to rescind the Treasury's unilateral authority over it.[186] This unease was translated into only limited further constraints, however: Congress passed the Mexican Debt Disclosure Act in April 1995, requiring a range of documents to be delivered to Congress before Mexico could receive any more assistance from the ESF, but other than that left the fund intact.[187]

The ESF, then, had a history of being used in ways that were probably distant from the intent of its original framers. Paulson's decision to use the fund to guarantee investments in MMFs was nevertheless quite unprecedented. Never before had the fund been used to issue guarantees of any kind; it could

do so only because of a change in 1970 that allowed it to deal in "other instruments of credit and securities" in addition to "gold [and] foreign exchange" to stabilize the value of America's currency. The guarantees, according to the government, would be a kind of "other instrument of credit" and would surely "stabilize" the value of the currency as a result of stabilizing the economy more broadly.[188] (The next line after making this argument may well have been "nudge nudge, wink wink.") This farcically thin legal justification was developed during exchanges between the Treasury and the White House on the evening of Thursday, September 18, when legal fastidiousness was clearly not a primary concern.[189] It is understandable that some would conclude that the ESF was "a pile of cash that can be used for whatever."[190] As Robert Hoyt, the Treasury's general counsel, would later reflect, it "was a bit of a legal stretch to say how that [use of the ESF to guarantee MMFs] related to the exchange rates, but we said, well, if you knew what would have happened if we hadn't done this, you would understand."[191] In presenting the idea to his colleagues at the Fed and the SEC, Paulson prefaced his remarks by telling them, "This is the economic equivalent of war," and in his memoir he would recall President Bush focusing first and foremost on "whether it will work" rather than on the legal or political strengths of the plan. There is a certain pride, and perhaps exhilaration, in Paulson's account: "Almost everyone liked the idea, but some were concerned that we were moving too fast. But frankly we had no choice but to fly by the seat of our pants, making it up as we went along. The alternative, waiting till we had figured out every angle, was untenable."[192]

Still, it would be a mistake to think that law was entirely put aside during this critical time of the crisis. Although the situation's direness might have provided the rationale for a Jeffersonian extralegal action coupled with a frank claim of responsibility, no such move was ever seriously contemplated. Instead, the law continued to play a central role in crisis responders' thinking. First, as noted earlier, the reason that the Treasury needed to go looking for a pot of money with loose controls was that it fundamentally respected the Anti-Deficiency Act's prohibition on spending from its main accounts without a congressional appropriation. Second, since there had never been a party with standing to challenge the operations of the ESF, it had never been scrutinized by courts. As a result, there was no case law delineating permissible interpretations of the underlying statute.[193] The Treasury may have been using the ESF in a novel and frankly unintended manner, but the ESF was in fact a fund created to be used in a somewhat shadowy way. Perhaps its very existence was an affront to a thick notion of the rule of law, but in putting it to use to guarantee money markets the Treasury was taking advantage of an already

existing hole rather than defying any solid conventional understanding of its legal limitations.

Apart from legal questions, the Treasury struggled to work out the details of a sensible and maximally effective program as fast as possible after rather vaguely announcing the program on Friday, September 19.[194] It soon found that conventional bankers were furious; they felt that smart investors would now be incentivized to move their money to MMFs, which were apparently to receive unlimited insurance, while FDIC insurance only covered accounts up to $100,000.[195] That complaint was forcefully communicated by FDIC chair Sheila Bair, who convinced the Treasury to limit the program's coverage exclusively to MMF holdings in existence at the time of the announcement of the program on September 19.[196] (Though it seems to have received little criticism, this aspect of the program is a monstrosity in terms of equity, or providing similar protection to similarly situated citizens. Though obviously sensible, it purely advantaged those who held their funds in MMFs at the time of the program's announcement in a way not obviously consistent with the thick rule of law.) The terms of the program, dubbed the Temporary Guarantee Program for Money Market Funds (TGPMMF) soon became clearer: MMFs would have to voluntarily enter the program by paying a risk-based premium, at which point all holdings present on September 19 would be guaranteed to be redeemable at par.[197] From the time of the announcement, the program provided confidence to the markets, and the hope was always that the funds would never actually have to be drawn upon. As it played out, the biggest funds quickly signed up for the program, and over time some 1,486 MMFs participated, with $3.2 trillion in assets—covering 93 percent of all assets in the MMF market.[198]

Reactions to this dramatic move would generally be tinged with a touch of disbelief—commentators would marvel at the Treasury Department's chutzpah in repurposing the ESF far more boldly than Rubin and Clinton had done in 1995. But reactions were nevertheless mostly positive. In a late-September meeting with President Bush, candidate John McCain "encouraged him to use [the ESF] as creatively as possible."[199] When Paulson was called to testify before oversight committees in both the Senate and House the week after the announcement, he was only briefly asked about the program. Representative Paul Kanjorski (D-Pa.) complained briefly about the Treasury's lack of transparency; Paulson conceded, "There is a lot we all could do to explain how this relates to ordinary Americans and we need to do a better job of explaining that."[200] That was the most dramatic any discussion on the issue ever became in Congress.

With no public debate on the issue, when Congress passed legislation at the beginning of October 2008 (discussed in chapter 4) it included a provision

ensuring that the Treasury would reimburse the ESF for any money used by the TGPMMF and preventing a similar use in the future. Senator Dodd explained that the Treasury's program, which would last only a single year, should be left in place, but the ESF should be preserved in the future for international stabilization needs.[201] Puzzlingly, the amendment prohibits only an identical use of the ESF to support money market funds rather than more broadly banning domestic uses.[202] In other words, having seen the ESF used as an emergency slush fund, Congress decided to say, "The slush fund can never again be used in precisely this way," rather than to work seriously to tightly constrain the ESF's purposes.

Since the change, the ESF has been little mentioned, and this decisive episode has largely receded from public memory of the crisis.[203] The action's legal dubiousness was apparently offset by its success: the crisis showed its most terrifying aspect and was (at least partially) repelled by bold, if arcane and perhaps legally strained, action. In some of the Internet's more conspiratorial corners, one can find rumblings about the ESF being the "architect of the world's monetary system" and financier of a "worldwide propaganda network."[204]

Apart from such marginalized murmurings, however, the episode seems to epitomize the old saying "Nothing succeeds like success." Law-stretching ingenuity neatly and costlessly defused a major threat to the real economy; it is hard to see how the plan's engineers deserve anything but congratulations, which is what they have mostly received from those who noticed. And yet Congress was annoyed enough by the legal stretching to explicitly prohibit a repeat performance in the future—even as it left the ESF's pot of money available to use for other purposes. This looks like just about the worst of both worlds for Congress: the fact of a lawfully questionable success was viewed askance by Congress, probably out of a sense of institutional pride, and a gesture was made to express discontent. But that gesture provides nothing like effective constraint for the future and instead asks only that the particular success never be repeated. Rather than confronting its own limitations through a forthright shaping of executives' crisis powers or seeking to overcome its limitations through detailed guidance, the legislature stuck its head in the sand. I return to this point in chapter 7, proposing that a frank embrace of a carefully limited slush fund would be a more realistic and efficacious way for Congress to realistically control the parameters of emergency commitments of funds.

The final major step in the crisis fighters' plan to arrest the development of the crisis was to seek broader legitimacy through congressional conferral of new legal powers. The fight over this new enabling act gave rise to one of the most robust discussions of executive powers during the crisis.

4

Laying Out a Broad TARP

The most important part of Secretary of the Treasury Henry Paulson's recovery plan was to ask Congress for a broadly empowering, minimally constraining enabling act giving the Treasury access to hundreds of billions of dollars. His request was framed in catastrophic terms: Congress was told to fork over the money or watch the world's financial markets fall to pieces. Congress would quickly demonstrate that it had no intention of being dictated to or of becoming a rubber stamp for an unaccountable executive branch whose occupants enjoyed a low degree of trust. Before the enabling act ever saw a vote it had several important restrictions and accountability mechanisms attached to it, and when it was put to a vote, the House rejected it. When that provoked a massive downturn in asset prices, Congress quickly reconsidered: the now more apparent desperation of the situation restored some willingness to trust the executive branch, if for no other reason than a feeling that there were no other viable choices. The Emergency Economic Stabilization Act of 2008—generally referred to as TARP (Troubled Asset Relief Program)—became law at the beginning of October 2008.

But the law proved to be limited, both in its ability to define the range of the government's responses and its ability to confer legitimacy. The massive expansion of the Treasury's legal authorities under TARP did not put a stop to the adhocracy that the Treasury and the Fed had embraced in September, with improvisation based on older legal authorities continuing alongside the implementation of TARP's main programs. Those programs proved hugely controversial, especially because they diverged sharply from Paulson's professed

Timeline for Events Discussed in Chapter 4

- September 20, 2008: Treasury presents Paulson plan to Congress
- September 29, 2008: House votes down amended version of the Paulson plan, the Emergency Economic Stabilization Act of 2008 (EESA), followed by market crash
- October 3, 2008: After Senate passes revised version of EESA on October 1, House follows suit and President Bush signs it into law, creating the Troubled Asset Relief Program (TARP)
- October 8, 2008: Fed authorizes Federal Reserve Bank of New York (FRBNY) to borrow up to $37.8 billion in investment grade securities from AIG in exchange for cash collateral
- October 12, 2008: Wells Fargo acquires Wachovia with Federal Deposit Insurance Corporation (FDIC) approval
- October 14, 2008: FDIC creates Temporary Liquidity Guarantee Program (TLGP)
- October 14, 2008: Treasury announces that main use of TARP will be equity injections into banks, through the Capital Purchase Program (CPP)
- October 27, 2008: Fed creates Commercial Paper Funding Facility (CPFF)
- November 10, 2008: Fed and Treasury announce restructuring of their arrangement with AIG
- November 23, 2008: Fed, FDIC, and Treasury announce rescue of Citigroup
- December 19, 2008: After Congress does not pass dedicated auto bailout, President Bush announces TARP will be used for Automobile Industry Financing Program (AIFP), giving bridge loans to General Motors and Chrysler
- January 1, 2009: Bank of America completes purchase of Merrill Lynch
- January 15, 2009: Congress votes against blocking the use of the second tranche of TARP funds
- January 16, 2009: Fed, Treasury, and FDIC announce additional aid package to Bank of America

vision for the law; TARP was a "troubled asset relief program" that would only very belatedly have anything to do with troubled assets.

Nearly as much as during the chaos of September, the final months of the Bush administration featured a mad scramble for useful responses to the crisis, with legal authorities put to use wherever they could be found and legitimacy sought haphazardly with limited success.

Going to Congress for an Enabling Act

Throughout the summer, the predominant belief among those at the Treasury had been that going to Congress to seek expanded powers would be fruitless and deeply counterproductive if Congress demurred. The expectation was that, in the absence of a clearly imminent emergency justifying the transfer of power to an administration of the opposite party, Democratic leaders would resist updating the law.[1] But after Lehman's fall and the run on the money markets, Paulson and Ben Bernanke felt they were scraping up against the edges of their legal capacities and had no choice but to turn to the legislature. In conjunction with President Bush, they decided to go to Congress to ask to be empowered to take an expanded range of actions.[2]

This choice was risky for the same reason it had been during the summer: explicit rejection by Congress could leave both the Treasury and the Fed weaker than they had been before. Democratic legitimacy, once explicitly sought, would either be augmented or severely damaged. But the opportunity to gain control of the situation was widely seen as crucial to stopping the crisis: on Thursday, September 18, on the strength of rumors about overtures to Congress, the Dow Jones Industrial Average jumped 617 points from its daily low to close nearly 4 percent higher.[3] On meeting with congressional leaders that evening, Bernanke and Paulson were determined to make the most of their chance.

Meeting in House Speaker Nancy Pelosi's conference room, Bernanke painted a bleak picture for the legislators: without action, unemployment would jump from its current 6 percent to 8 or 9 percent, stocks would drop much further, General Motors (GM) would go bankrupt, and the meltdown that ensued would encompass the whole global financial system, which would mean a new Great Depression. Paulson would later reflect that this "was enough at the time to leave the members of Congress ashen-faced." When Paulson was asked what failure to act would entail, he gravely replied, "May God help us all."[4] Shaken, nearly all of the leadership were convinced of the need for congressional action by the end of the meeting.

The Treasury secretary and the chairman of the Federal Reserve had set out to frighten congressional leaders into action, and it is worth examining why they largely succeeded in doing so. As discussed in chapter 2, much of the difficulty in mobilizing a modern government against a crisis is in making everyone believe that the crisis is genuine rather than a manufactured pretense meant to justify consolidation of power by the would-be crisis fighters. This determination will undoubtedly rest in part on objective facts about the world, but facts do not present themselves neutrally to be weighed. Instead,

members of the executive branch often possesses considerable informational advantages and is the source of facts to be considered by legislators and by the broader public. Their credibility—that is, their possession of trust-based legitimacy—is thus of the highest importance.

Bernanke's professional background therefore took on a special importance. Having made his name as a distinguished academic economist in large part by writing about the policy mistakes that had made the Great Depression so damaging, Bernanke brought an unmatched intellectual credibility to fighting the twenty-first-century version. He was also perceived as largely apolitical and free of conflicts of interests, having devoted his career to scholarship and public service. Bernanke's background as an academic expert on the Great Depression gave him a unique credibility in claiming that the crisis that emerged in 2008 was the most severe since the crisis that had confronted Herbert Hoover and Franklin Roosevelt. The enduring ignominy for Hoover (and, much more esoterically, for an insufficiently activist Federal Reserve) and esteem for Roosevelt cast a long shadow, and Bernanke was able to bring that history to bear on congressional leaders like nobody else could have. Nevertheless, it would be a long road from the meeting on September 18 to actual congressional action, and both Paulson's and Bernanke's trustworthiness would be called into question many times—with less elite audiences much less disposed to give the crisis fighters the benefit of the doubt.

The first occasion for this was Paulson's introduction of a strikingly short legislative proposal that the Treasury presented to Congress on September 20.[5] Just 849 words long, the so-called Paulson plan was quite spare even within the genre of enabling acts. It authorized the Treasury secretary to organize a system for purchasing mortgage-related assets, providing a nonexclusive list of powers that could be used to this end and providing just two overarching "considerations" meant to guide action under the law: stabilizing the financial markets and banking system and protecting the taxpayer. The secretary's power would be constrained only by a program length of two years and by the maximum dollar amount permitted to be outstanding at any time: a staggering $700 billion. In one section that would attract a great deal of criticism, the proposal announced that "decisions by the Secretary pursuant to the authority of this Act are non-reviewable and committed to agency discretion, and may not be reviewed by any court of law or any administrative agency." Reporting to Congress would be required, but the substance of these reports was unspecified.

As soon as it was released, this brief document generated nearly unanimous and emphatic outrage. Leaders from both political parties, including

presidential candidates John McCain and Barack Obama, indicated that any bill empowering the executive branch on such a massive scale would require many more oversight mechanisms to prevent potential abuses. Said Christopher Dodd (D-Conn.), chair of the Senate Banking Committee, "One of the things that got us into this mess was the lack of accountability and the lack of oversight that was occurring, and I don't think we want to repeat those mistakes with a program of this magnitude." Speaker Pelosi took up a cry that was to echo repeatedly during the debate to come: "We will not simply hand over a $700 billion blank check."[6] A considerably more hostile message came loud and clear from sources closer to the political grassroots, both left and right, culminating in a public demonstration in New York City against the bailout drawing several hundreds.[7] Elite opinion was more mixed, with around two hundred conservative economists signing a public letter opposing Paulson's plan and encouraging the drafting of a clearer alternative.[8] On the other hand, former Federal Reserve chair Alan Greenspan publicly supported the plan, saying that it embodied "the traditional form" of support for struggling financial institutions during a crisis.[9]

Congress Weighs the TARP

While critics of the legislative process contend that there was insufficient deliberation in Congress for a bill of such monumental importance, the legislature filled hundreds of pages of the *Congressional Record* with debates (both in committee hearings and floor debates) over the bailout—largely meaningful ones. From the beginning, legislators made it quite clear that their involvement would mean substantial input. Opening a Senate Banking Committee hearing on September 23, Senator Dodd declared that the Paulson plan was "stunning and unprecedented in its scope—and lack of detail, I might add. . . . After reading this proposal, I can only conclude that it is not just our economy that is at risk but our Constitution as well."[10] Ranking member Richard Shelby (R-Ala.) condemned the "series of ad hoc measures" that had been employed to control the crisis to that point and said that the Paulson plan would simply facilitate more of the same "but on a much grander scale."[11] A chorus of senators spoke of the need for oversight, leading Paulson to tell them that his short proposal had been meant as a jumping-off point rather than as a final plan; he said he felt it would have been "presumptuous" for Treasury to shape oversight provisions independently of Congress but that the Treasury strongly welcomed provision of "oversight," "protection," and "transparency."[12]

In that hearing and in the floor debates that followed, there was a vigorous debate about whether the powers proposed for the Treasury secretary were

adequately defined and constrained. Dozens of members condemned a blank-check approach, and some went further in characterizing Paulson's proposal as a "power grab" for the executive branch. Perhaps most hyperbolically, Representative Thaddeus McCotter (R-Mich.) decried the Paulson plan as giving "the Treasury Secretary and the Chairman of the Federal Reserve unlimited powers—the likes of which Stalin and Mao killed people for."[13] For some members, any "bailout" program would be unacceptable no matter how it was structured, with a large contingent of Republicans believing it represented an irreversible step toward the destruction of America's free market economy.[14] Another group of legislators, mostly Democrats, focused on fairness concerns: any bill that would end up enriching the very bankers apparently at fault for the crisis would be a miscarriage of justice. For some of these members, helping "Wall Street" in any way was simply too abhorrent to consider;[15] for others, if the bill contained provisions restricting executives' compensation, it might pass muster.

Many members focused on improving the bill's legitimacy by adding significant accountability mechanisms. First, members took great exception to the section of the Paulson plan that entirely exempted the Treasury Department's decisions from judicial review. Among others, Senator Dick Durbin (D-Ill.) denounced the idea that the secretary would be "above the law" and not "accountable for conflicts of interest."[16] Other mechanisms ensured that Congress would remain involved after the program was started. Rather than simply releasing the requested $700 billion on passage of the bill, legislators favored a tranched release structure for the funds, requiring the secretary to go back to Congress after exhausting a portion of the funds and explain why accessing the remaining funds was necessary.[17] Other members looked to strengthen congressional reporting requirements so that Congress could know, "not on a quarterly basis but on a daily basis, what the Treasury is doing and how the program is working."[18] Another provision dubbed "recoupment" required that if, after five years, the program had resulted in a loss to the Treasury, the secretary would be required to propose to Congress a strategy for "recouping" the taxpayers' losses.[19] Finally, several special oversight bodies were proposed. As chapter 6 explores, many of these accountability mechanisms turned out to be quite consequential in shaping the ongoing political environment for TARP; others, neglected by Congress, would never amount to much.

For other members, the most important determinant of support was their trust in Paulson and Bernanke or lack thereof. A surprisingly large number of members went out of their way to praise the public-spiritedness and good

faith of both men, and their stewardship may actually have been sufficient to win some support. Senator Evan Bayh (D-Ind.) recalled the dire warning that Bernanke had issued and said that "coming from a man who I think . . . it is safe to say is not known for engaging in hyperbole, this tended to focus the mind."[20] Senator Pete Domenici (R-N.M.) gushed over Bernanke's credentials as a scholar of the Great Depression and even claimed (rather bizarrely) that Paulson was "not a long-term Wall Streeter."[21] Barney Frank said he "regard[ed] them both as men of high integrity and total commitment to the national interest," professing his belief in their interpretation of recent events.[22]

For another group of legislators, however, Paulson's associations with Wall Street led to a decidedly unfavorable impression. Among others, Senator Bernie Sanders (I-Vt.) noted Paulson's then-record $38 million bonus in 2005, calling it an example of "the ugly greed we have seen among many of the wealthiest people in this country in the last few years."[23] Representative Peter DeFazio (D-Ore.) called Paulson "compromised . . . because of his relationship with Goldman Sachs and Wall Street, not with Main Street America."[24] Representative Lynn Woolsey (D-Calif.) questioned why the Bush administration, which had proved its incompetence and had only three months remaining in office, should be trusted to be responsible with any money at all.[25] Representative Paul Broun (R-Ga.) was unable to shake the impression that "this essentially is Mr. Paulson's bill to help his friends."[26] Recollections of the hasty decision to support the Bush administration's push for the Iraq war also diminished trust in Paulson's message of emergency. Representative Lloyd Doggett (D-Tex.) invoked Iraq and said the current bill was "fueled by fear and hinges on haste."[27] Representative Pete Stark (D-Calif.) would later say that Paulson's invocation of crisis was his "way to scare us, as Colin Powell tried to scare us some years ago by saying if we didn't vote for an ill-conceived war we'd see terrorists on the streets."[28] Others were put off simply by the impression that warnings of dire consequences failing immediate action lacked credibility; these warnings had "a kind of breathless quality," according to Senator Byron Dorgan (D-N.D.), while Senator Bob Corker (R-Tenn.) worried that despite their expertise, Paulson and Bernanke were showing "a deer-in-the-headlights mentality."[29]

Concerns about democratic legitimacy took several forms. Several members angrily noted what may have been the most historically unusual aspect of the push for this enabling act: far from stamping the crisis response with his own personality (as Lincoln, Wilson, and Roosevelt had done), President Bush remained entirely in the background as Paulson proposed the initial plan.[30] This may have been a prudent choice by the president, given his

abysmal ratings (somewhere in the neighborhood of 30 percent approval, 66 percent disapproval at the time).[31] Bush quietly helped to engineer a lobbying campaign of House Republicans, but at first he remained publicly silent.[32] But many legislators felt that if this expansive enabling act was going to empower the executive branch to deal with the crisis, the president was failing to fulfill his responsibility to shoulder some of the burden of legitimizing it with the broader public.[33] Bush responded, addressing the American people on September 24. He brandished his Nixon-goes-to-China trustworthiness, saying that "my natural instinct is to oppose government intervention" before insisting that the moment's crisis called for extraordinary measures.[34]

Fortunately, the lame-duck president had some help in producing broad democratic legitimacy from the two contenders to be the next president. On September 24, Senator McCain took the unusual (and, some thought, stunt-like) step of suspending his campaign, including canceling all events and advertising until Congress had reached a solution. He also joined with Senator Obama to issue a joint statement urging a quick compromise, in which the two rivals attempted to frame the issue as a purely bipartisan issue.[35] While many were unmoved by the gesture—which generated an extraordinarily unproductive meeting between the two candidates and President Bush—apparently it seemed like an important sign to others: leading up to the House's vote on the bill, Representative Adam Putnam (R-Fla.) noted McCain and Obama's cooperation as evidence of the situation's extraordinary nature and urged his colleagues to support what he saw as a genuinely bipartisan measure.[36]

Voting on TARP

The House moved to vote on the measure, dubbed the Emergency Economic Stabilization Act of 2008, on September 29. Many members commended the bipartisan work improving the bill that had taken place in the preceding days. While acknowledging that the final product was not perfect, Representative Paul Ryan (R-Wisc.) touted the "107 pages of taxpayer protection" added to Paulson's original three-page plan and urged members to put aside their reservations and rise to the moment. He warned that doing otherwise risked reliving the mistakes of Herbert Hoover.[37] Others were unmoved by the legislators' additions, and many retained the sense that Paulson was being made unaccountable: as Representative John Culberson (R-Tex.) put it, "We're essentially creating a King Henry here."[38] Others reported a defect in democratic process: they thought the debates were altogether too rushed and stage-managed by congressional leadership. Republican backbenchers felt especially neglected.[39]

The vote did not go as leadership planned: even after keeping the roll call vote open for about half an hour so that arms could be twisted, the first version of the bill went down in defeat, 205–228. The Republican administration's key crisis response was defeated mostly by members of its own party: Republicans were only 65–133 for the bill, while Democrats supported it 140–95.[40] The bipartisan coalition that had defeated the bill was briefly exultant: Representative Marcy Kaptur (D-Ohio) proclaimed, "The American people were actually heard, and fear was put on the shelf as we stopped hasty action that Wall Street powerhouses had attempted to ram through this Congress."[41] But their enthusiasm would soon be dampened by the markets' reaction: the Dow Jones plummeted 778 points on news of the plan's defeat, the largest single-day drop in the index's history.[42]

Given the urgency implied by this market reaction, congressional leaders decided to keep the bill basically intact while adding various sweeteners to it and presenting a united front for passage. Senate Minority Leader Mitch McConnell (R-Ky.) said, "The message from the markets yesterday was clear. . . . So we will get the job done, we will get it done this week, and I think, hopefully, that will reassure the American people that Congress can rise to the occasion—act like grownups, if you will—and get the job done for all of our People."[43] Obama and McCain joined their voices again, each saying that the moment should inspire rising above politics.[44] The message was clear: the urgency of the situation meant that EESA should be accepted despite any reservations about the trustworthiness of those who would wield its huge discretionary powers.

The Senate debated its own version of the bill on October 1, returning to many of the earlier themes about accountability. The Paulson plan had been a "blank check," but the changes made to the bill made it much more responsible.[45] Dissenting voices similar to those in the House were heard, but they came from a much smaller portion of the chamber's members. Additional measures attached to the bill included a popular increase of the Federal Deposit Insurance Corporation (FDIC) coverage limit from $100,000 to $250,000 per account, Alternative Minimum Tax relief (a perennial favorite), and many other smaller baubles, the most infamous of which was a tax benefit for "certain wooden arrows designed for use by children" inserted to please Oregon's senators.[46] The Senate vote was not close: their version passed 74–25, with 41 Democrats and 33 Republicans in favor.[47]

The House rapidly took up this version of the law, continuing its debate amid much more torrid lobbying. Now that a wide variety of "goodies" had been attached to EESA, a huge number of interest groups that had been

uninterested in the first vote were now lobbying for its passage.[48] Other members attested that they were persuaded by constituents to switch their votes to favor the bill; most vividly, Representative Zack Wamp (R-Tenn.) explained, "Monday, I cast a blue collar vote for the American people, shook the foundations of Wall Street, demanding more accountability. But today, I'm going to cast a red, white and blue collar vote with my hand over my heart for this country because things are really bad and we don't have any choice. We're out of choices, our backs are up against the wall."[49] Others attested to the way that the importance of the law substituted for the need for more process-derived legitimacy, saying that Congress could not "afford" the "luxury" of more deliberation.[50] Some members, including many of the Congressional Black Caucus, were also apparently persuaded that the bill would provide significant foreclosure relief and consequently decided to support passage.[51] The House passed the Senate's version of the law on October 3, 263–171, with 172 Democrats and 91 Republicans (slightly less than half) supporting passage.[52]

Assessing EESA

How did the bill that ultimately became law compare with the original Paulson plan? Aside from all the sweeteners added into the other titles of EESA, the main title, referred to as the Troubled Asset Relief Program, retained some of the original broad language conferring a huge degree of discretionary power on the Treasury secretary. In setting up the program, the secretary would be "authorized to take such actions as the Secretary deems necessary to carry out the authorities in this Act, including, without limitation," hiring personnel, entering into contracts, working with outside firms, establishing special purpose vehicles (SPVs), and issuing regulations.[53] Representative Louis Gohmert (R-Tex.) complained, "You will see in the bill, those that bothered to read it, over and over 'as the Secretary determines,' 'as the Secretary determines,'" and he was not wrong to view such language as expanding Paulson's scope for improvisation.[54]

Beyond this asked-for delegation of the power to determine the program's design, the version of TARP passed into law actually empowered Paulson more than he had requested in several important ways. First, several Republican members had been convinced that the best policy choice available to the Treasury would be to insure risky assets while charging a premium. Although Paulson had not favored a scheme of this sort, TARP gave him the power to create such a program.[55] Second, the law defined the "financial institutions" allowed to be targeted by the program with almost laughable imprecision: "the term 'financial institution' means any institution, including but not limited to,

any bank, savings association, credit union, security broker or dealer, or insurance company, established and regulated under the laws of the United States."[56] Third, rather than authorizing only purchases of mortgage-related assets, Congress empowered the program to acquire other "troubled assets" including "any other financial instrument that the Secretary, after consultation with the Chairman of [the Fed], determines the purchase of which is necessary to promote financial market stability," requiring only congressional notification.[57]

Perhaps because they seemed too arcane to interest the voting public much, these changes—which would turn out to be hugely significant—received relatively little scrutiny in the congressional debates. It is not quite fair to say that they were entirely unnoted: in the Senate Banking Committee hearing, Senator Jim Bunning (R-Ky.) rather confrontationally asked Paulson why non-mortgage-related assets needed to be included, but Paulson largely dodged, saying that mortgage-related assets would remain the central focus of the program.[58] Leading into the second House vote, Barney Frank made sure to emphasize that the secretary would have the power to take equity stakes in financial companies so that the taxpayer could benefit from appreciation resulting from government support.[59] Senator Tom Harkin (D-Iowa) nevertheless expressed disappointment that the decision as to whether to take equity stakes in companies was left to the secretary's discretion—but his skepticism about the secretary's willingness to use this power would turn out to be mistaken.[60]

What of Representative Ryan's claim that the Paulson plan was disciplined by "107 pages" of taxpayer protections? The number is hyperbole, but the final TARP law did provide quite a bit more explicit guidance about the goals that the program was to serve as well as substantive requirements governing the use of funds. Several of the proposed features discussed above became law, including tranched release of funds, recoupment, extensive reporting requirements, and oversight by the Government Accountability Office (GAO) as well as by two newly created bodies—a Special Inspector General for TARP (SIGTARP) and a Congressional Oversight Panel (COP). Paulson's initial attempt to exempt the program from judicial review was rejected, creating at least an abstract possibility that TARP officials could be taken to court for their decisions. Like the initial Paulson plan, TARP would be limited to two years at most. A couple of restrictions were additionally imposed to limit the kinds of actions taken by the Fed and the Treasury before the creation of TARP, including additional reporting requirements for uses of § 13(3) and the restriction on the use of the Exchange Stabilization Fund discussed in chapter 3.[61]

Congress's final version of TARP also imposed several substantive requirements—although arguably these became so numerous and so lacking in prescribed prioritization that they left the secretary free to justify nearly any course of action by choosing among them. The law announced its overarching "purposes" as enabling the secretary to "restore liquidity and stability to the financial system" while attempting to satisfy four other criteria: protecting savings and home values, promoting economic growth and homeownership, maximizing taxpayer returns for the program, and providing public accountability. It also provided nine "considerations" that the secretary was required to be mindful of in the course of execution, many of which emphasized the need to serve Main Street in various ways. Somewhat more decisively, the law required that steps be taken to "prevent unjust enrichment," limit executive compensation in any firm participating in its programs, minimize long-term program costs including by taking warrants, and work to mitigate foreclosure problems and provide aid to homeowners.[62] Though these may have been feeble as legal constraints, many critics of TARP would take these substantive requirements quite seriously in evaluating the legitimacy of the program's administration.

Is TARP Constitutional?

Several commentators on the political right have vigorously argued that TARP is so open ended that it runs afoul of the nondelegation doctrine (noted in chapter 2) by effectively conferring "nearly plenary legislative power" on the executive branch.[63] "TARP," Gary Lawson writes, "is a constitutional monstrosity," the ostensible restrictions in which "essentially instruct the Secretary to promote goodness and niceness and to avoid badness and meanness."[64] John Samples of the Cato Institute argued that "the raw materials of a[n] intelligible principle were not enough to preserve the rule of law or separation of powers in this case."[65] The activist group FreedomWorks styled its complaints as a legal challenge to TARP, which it called the biggest delegation since the Supreme Court's only invalidation of statutes under the nondelegation doctrine in the 1930s.[66]

These denunciations of TARP's legitimacy by way of its defects in legality were of little practical importance, gaining limited currency even among conservative legal academics for several reasons. First, the nondelegation doctrine has been rather thoroughly declawed over the years by the courts, and the lack of intelligibility of TARP's guiding principles is difficult to distinguish from other laws whose vague instructions to the executive have been upheld. Second, they fail to consider the mode of analysis pioneered by the Supreme

Court in *Yakus* v. *United States*, which evaluates the permissibility of delegations with reference to whether there have been adequate mechanisms for oversight and accountability introduced into a policy's processes.[67] The sections of TARP just discussed may have been less potent than many desired, but as a formal matter it is unfair to say that Congress had created an executive body immune from ongoing scrutiny or oversight after it worked to provide a large number of mechanisms to this end. Finally, the critics generally fail to acknowledge previous enabling acts enacted at moments of critical emergency in American history and thus paint TARP as more unprecedented than it actually was. As noted in chapter 2, while no American act ever went so far as Britain's Defence of the Realm Act, there is a long history of conferring extensive powers on the executive during times of both national security crises and financial crises. Even in historical perspective, TARP's price tag surely justified sticker shock, but the truth is that the program's scope was less extensive and less potentially invasive than many of its predecessors (including the World War II–era Office of Price Administration sustained in *Yakus*). After all, TARP would only be purchasing assets from voluntary sellers, not forcibly expropriating or commandeering anyone's property.

Samples has separately argued that we should think of Congress as having fallen down on the job, having provided a patina of accountability without exercising any real control—indeed, while actually increasing the scope of the delegation given to the Treasury secretary. This case is more carefully argued and somewhat stronger; he was right to question how strong the constraints provided by tranched release of funds, recoupment, and judicial review would prove to be. But his harsh judgment of Congress, which he ultimately finds "was weak and helpless in the face of a crisis," is unfair when we take a broader perspective that moves beyond concerns of legal doctrine and legalistic constraint to questions of legitimacy more broadly conceived.[68] First, Samples gives little consideration to whether expanding the scope of the powers conferred on the Treasury secretary might have been a sound policy choice, given the fluid nature of the crisis. There is a strong argument to be made that it was. Second, and deeper, Samples also misses the ways in which Congress's final version of TARP made the program's operation contingent on its continuing legitimacy in the eyes of legislators and the public. As chapter 6 discusses at length, the special oversight bodies created by TARP would prove to be zealous watchdogs, aggressively bringing scrutiny to the decisions made under the program. As Eric Posner and Adrian Vermeule rightly point out, an absence of effective and sharply binding legal constraints does not necessarily imply an absence of all constraint—political constraints may be a

more important regulator of official behavior. What Posner and Vermeule miss, however, is that legislative choices often importantly shape the political environment in which a law exists. The oversight provisions in TARP and its substantive requirements fit this description, so that writing them off as irrelevant is a mistake.

Adhocracy Continued: Improvisation Parallel to TARP

Before going on to consider how TARP was actually put to use, we must first consider several other developments that occurred as the legislative battle played out, each of which demonstrates the perils—but also the promise—of improvisational adhocracy.

In late September, two more of America's largest banks found themselves facing insolvency, undone by their mortgage-related investments gone bad: Washington Mutual (WaMu) and Wachovia. WaMu, the nation's largest savings and loan, was seized and auctioned off to JPMorgan by its regulator, the Office of Thrift Supervision, with relatively little controversy.[69] Dealing with Wachovia, which had been the nation's fourth-largest commercial bank until an ill-conceived purchase hobbled it, would be more complicated and contentious.[70] The bank hoped it could be sold off without any government involvement but failed to snag a buyer willing to act alone. Morgan Stanley and Goldman Sachs went off to become bank holding companies in their own right; Citi would only make an offer for Wachovia's retail banking operations if it could get government assistance; and Wells Fargo appeared poised to buy the whole corporation without involving the government, but it withdrew its offer almost immediately after making it when it discovered areas of concern in Wachovia's commercial loan book.[71]

At this point, regulators intervened to ensure Wachovia's survival. Since Wachovia was a commercial bank (as Bear Stearns, Fannie Mae and Freddie Mac, Lehman, and AIG had not been), the FDIC would play the leading role, but this would not be a normal bank resolution in which a bank failed, closed, and could then quickly have its assets auctioned off. Instead, the FDIC, the Fed, and the Treasury determined that Wachovia posed a systemic risk to financial markets and would have the FDIC make use of its seldom-invoked open-bank assistance power to keep Wachovia open while it was sold off, with the FDIC guaranteeing some portion of future losses.[72] Crucially and unusually, the Treasury promised to use its discretionary power to extend the FDIC a special line of credit to cover any losses from this maneuver, thereby preventing depletion of the FDIC's Deposit Insurance Fund.[73] With this offer of

government assistance extended, an overnight auction attracted bids from Citi and Wells Fargo and from Wachovia itself in a self-rescue plan.[74] The FDIC chose Citi's bid as the winner, as the giant bank agreed to take the first $42 billion in losses before the FDIC guaranteed $312 billion more. Citi would transfer $12 billion in preferred stock and warrants to the FDIC in exchange for the protection, as well as paying $1 a share to Wachovia's shareholders.[75] After Wachovia's general counsel was persuaded to hastily sign a broadly outlined term sheet and temporary exclusivity agreement committing the bank to negotiate a deal, it seemed that all that was left was for the lawyers to work out the final terms.[76]

The situation abruptly changed several days later when Wells Fargo reentered the picture, now offering to buy Wachovia whole for $7 a share without government assistance. Wells Fargo had upped its estimate of Wachovia's value, not least because it learned that a long-discussed interpretation of tax rules for bank mergers had just been formalized by the IRS, allowing it to receive immediate favorable tax treatment of whatever losses purchasing Wachovia might cause it to incur.[77] The move was controversial, with some tax experts and congressional staffers believing it to be an illegal attempt to favor banks at taxpayer expense. But nobody decided to contest what the Treasury described as "part of our overall effort to provide relief" during the worst days of the crisis, and such an arcane matter of tax law attracted quite limited notice.[78] (The Treasury's inspector general eventually conducted a full inquiry and concluded there had been no misconduct.)[79]

Although regulators at the Fed had previously blessed the Citi-Wachovia merger, they thought that Wells Fargo's offer was compelling enough to demand consideration, leaving the final decision with the FDIC.[80] Sheila Bair, the FDIC's chair, had no inclination to stop the new offer from going forward, especially since it would relieve the FDIC of a large exposure to potential losses. She also felt she lacked the power to do so, since the Citi deal had not been finalized and Wachovia's board still had an obligation to serve the interests of its shareholders.[81] Given the $6 a share extra compared with the Citi offer, Wachovia's board rapidly approved Wells Fargo's offer.

Citi and its CEO, Vikram Pandit, were stunned and angered by this development, which they said violated Wachovia's contractual obligations to negotiate exclusively with Citi and represented a breach of faith by both Wachovia and the government. But Wachovia had entered into a much firmer commitment with Wells Fargo than it ever had with Citi, and Bair felt she had no reason or authority to intervene. She released a terse and somewhat ambiguous statement on behalf of the FDIC stating that it would still be prepared

to stand behind the Citi deal if necessary.[82] Citi immediately alleged tortious interference with their exclusivity agreement by Wells Fargo and breach of contract by Wachovia and unsuccessfully attempted to enjoin the merger.[83]

Citi found an ally among the government crisis fighters in New York Fed president Timothy Geithner, who was "apoplectic" as he denounced the abandonment of Citi's bid. He feared that the government's credibility as a dealmaker would be fatally undercut by such a public reversal, saying, "You cannot run a government in a financial crisis like this. . . . You can't let people rebid every time the world changes."[84] In other words, the banks' estimate of the government's trustworthiness would be eroded by the failure to insist on the original deal made with Citi. In conditions of adhocracy, where law offers no certainty or security in dealing with the government, its reputation for straightforwardness and reliability are the keys to its legitimacy; chapter 5 discusses some of the costs that losing this legitimacy had.

But if Geithner's concern was a sensible one, his advocacy on Citi's behalf would strike many people as exacerbating rather than mitigating the problem. Although Geithner had spent his career in government, first at the Treasury and then at the New York Fed, he was often seen as a creature of Wall Street. Bair and many others felt Geithner was biased in favor of Citi (perhaps because of personal connections with top bankers there) and saw his angry outburst as evidence of arbitrariness and favoritism; ultimately he and Citi relented,[85] and the Wachovia–Wells Fargo merger went forward with the Fed's approval on October 12.[86] Once again, the government's attempt to navigate choppy waters without a clear legal map left bad feelings in its wake.

Although the law did not manage to dispel a sense of arbitrariness, one little-noticed provision of TARP did prove consequential. Section 126(c) of the law, apparently a late addition at the FDIC's behest (but not consciously targeted at the Wachovia-Citi deal), made third-party contractual provisions affecting transactions in which the FDIC would be a participant unenforceable, "as such enforcement or liability shall be contrary to public policy." Although Citi's lawyers thought that this provision was irrelevant to the case, since the FDIC ended up uninvolved, others would see the provision as directly relevant. Perhaps with this obstacle in mind, Citi ultimately settled its suit for $100 million in November 2010, a small payoff compared with the $60 billion it had initially sought.[87] Law may not have provided clarity or legitimacy, but it still shaped outcomes in important ways.

Following TARP's passage and Wells Fargo's purchase of Wachovia, ambiguity about the government's actions still reigned supreme in early October 2008. While the Treasury figured out how it would use the massive new

authorities it was granted by TARP, the Federal Reserve once again added to its acronym-laden stable of emergency facilities. On October 7, it announced that it would be creating a Commercial Paper Funding Facility (CPFF), which would open for business by the end of the month. The CPFF would provide a complementary approach to the money market fund rescues; whereas those programs sought to provide direct support for the faltering money markets so crucial to buying commercial paper, the CPFF would provide a parallel public stream of funding to purchase commercial paper directly.[88]

In devising a way to execute this function, the Fed returned to the legal maneuver it had pioneered in March to facilitate the purchase of Bear Stearns. It now created another special purpose vehicle, CPFF LLC, which would use funds loaned from the discount window at the New York Fed to directly purchase high-quality commercial paper of three-month duration. Acting through the CPFF, then, the New York Fed "effectively extended access to the Federal Reserve's discount window to issuers of commercial paper, even if these issuers were not chartered as commercial banks." The CPFF would purchase both asset-backed commercial paper and non-asset-backed commercial paper. In the case of the former, the underlying assets would act as security, thereby fulfilling the Fed's collateralization requirement. In the case of the latter, however, the Fed's risk would be secured by charging a 100 basis point fee. In this way, the Fed would argue, it was essentially replicating the haircut dynamic of discount-window lending.[89]

If the Fed's March maneuver had taken it "to the very edge" of its legal powers, as former chair Paul Volcker had suggested, the CPFF arguably took it well into the realm of outright disregard for the law. In its program design, the CPFF raised all of the same legal issues that Maiden Lane had seven months earlier. Once again, one could ask exactly where the Fed derived its power to create SPVs; whether the power in § 13(3) actually allowed lending to such a corporation, given the requirement that the Fed lend only to firms that had tried and failed to raise funding through other means; and, most fundamental, whether the Fed had designed a way to circumvent the spirit of its statutory limitations by effecting purchases rather than making loans. These issues attracted some immediate criticism as well as later academic scrutiny.[90] But the CPFF was arguably even more legally problematic because it purchased non-asset-backed commercial paper secured only by an up-front fee amounting to a small portion of the risk taken. That seems contrary to the spirit of the law requiring that the instruments discounted by the Fed "must be endorsed or secured."[91] It also dealt, for the first time, with nonfinancial firms.[92] If the Fed's hoary enabling acts allowed it to create the CPFF, what practical

limitations were there on its ability to create novel bond-buying facilities with nonfinancial beneficiaries?

The Fed and its defenders countered with two legal arguments seeking to establish the legality of these actions. The first was that the "Fed's generative authority to build and regulate credit markets should be interpreted broadly, as both Congress and the Fed have done" historically.[93] Basically, the scope of the Fed's authority to act as lender of last resort should be understood as evolving to keep up with changing market conditions. Because of the importance of the commercial paper market to both the financial system and the real economy in 2008, it was quite proper for the Fed to creatively devise methods of supporting it through extension of the discount window through its SPV.[94] More specifically, the Fed's legal team also argued that the Fed had been adequately secured.[95] After all, its loans were to CPFF LLC, not to the issuers of commercial paper;[96] and the statute merely requires that the loans be secured to the Fed's own satisfaction. The Fed could claim that it was satisfied—and with the benefit of hindsight, that claim does not look unreasonable; when the program ended in early 2010, it had netted a $5 billion profit.[97]

Whatever the legal merits of these arguments, no politician or advocacy group ever effectively made a public issue of the CPFF's apparent legal defects; in fact, the program's broader legitimacy suffered only glancing blows. Some commentators questioned whether continued Fed heroics were really necessary given the recent passage of TARP or whether its "scrambling" could create a sense of confidence.[98] But the CPFF soon achieved more lasting legitimacy through terrific policy success. The commercial paper market, which had fallen precipitously in September 2008, made extensive use of the facility late in the year. At its peak in January 2009, the SPV held some $351 billion in commercial paper—more than 20 percent of the entire outstanding paper issued—and this intervention helped to significantly lower the effective interest rates that issuers paid.[99] And, as noted, the program would eventually end with a profit, always a good way to ensure taxpayer acceptance. To the extent that anyone challenged the program's legitimacy later, it would be because of the identity of users of the CPFF. Unbeknownst to the public until after the program's end in 2010, 68 percent of all the paper it bought was issued by foreign-owned firms, the three leading users of the program being UBS, Dexia, and Barclays.[100] Since these firms all had subsidiaries chartered in the United States, their participation was fully allowed by the program's rules. But the Fed's giving so much aid to foreigners opened it to criticism from various corners, as discussed more in chapter 5.

The CPFF's announcement was the first time that the Fed served notice that its creativity would not come to an end simply because the Treasury had been empowered by Congress—though it would be far from the last. Indeed, the Fed also took another legally peculiar step in early October that has received little notice. The $85 billion loan made to AIG in September, which had been marked by ungenerous terms, turned out to be insufficient to ensure the company's liquidity going forward, and the Fed altered its arrangement to help keep AIG afloat. Invoking § 13(3) as usual, on October 8 the Board of Governors approved creation of a Securities Borrowing Facility for AIG.[101] As noted in chapter 3, one of the biggest sources of AIG's problems had been its securities lending program in which it lent securities out in exchange for cash; the trouble came from reinvesting this cash in overvalued mortgage-backed securities (MBSs). Now AIG found itself coming back into possession of all the illiquid securities it had lent, creating a challenge for the cash-strapped company. With the new facility, the Fed agreed to replace the borrowers who had deserted AIG's securities lending program by *borrowing* up to $37.8 billion in investment-grade securities from AIG in return for cash collateral. That meant that the loan would technically be from AIG to the Fed, although § 13(3) creates power for the Fed to make loans, not take them. The transaction may have been structured this way to comply with New York state insurance law provisions governing acceptable collateral for loans to insurance companies.[102] It would certainly be easy to argue that, technicalities aside, the Fed was giving out cash with the expectation of receiving it back with interest in the future, while taking securities as collateral, and nothing could be more loan-like than that. This technical oddity, and the program itself, received almost no specific criticism in the coming years, perhaps unsurprising considering that the program was ended in December 2008 with no losses for the Fed.[103] But it shows once again how legality and legitimacy diverge in crises, with not many people apparently concerned about legal niceties when the stakes are high enough.[104]

The FDIC Joins In

Legality would once again lose out to a sense of necessity and efficacy in the next round of improvisation, led somewhat reluctantly by the FDIC. The FDIC's chair, Sheila Bair, enthusiastically subscribed to the agency's somewhat conservative insurance fund mindset that made her and the agency reluctant to get involved in the efflorescence of legal creativity. But even after the passage of TARP, the financial and legal resources possessed by the FDIC made it

an attractive vehicle through which to expand the policy response to the crisis, and so the Fed and the Treasury successfully pressured Bair to take some bold steps—although she retained the sense that participating in the bailouts was "the most distasteful thing I have ever done in public life" and would subsequently become an influential critic of many crisis responses.[105]

The FDIC is authorized to "make loans to, to make deposits in, to purchase the assets or securities of, to assume the liabilities of, or to make contributions to, any insured depository institution" in several circumstances, including during times of financial instability when action could be "taken in order to lessen the risk to the Corporation posed by such insured depository institution under such threat of instability."[106] It is normally constrained to exercise this power only if it determines that doing so will be the "least costly approach," but this constraint can be waived if two-thirds of the FDIC board, two-thirds of the Federal Reserve Board of Governors, and the Treasury secretary (in consultation with the president) all make a determination of emergency. In that case, the FDIC is empowered to take necessary actions to address systemic risks without minimizing costs and later to make a special assessment on the banking system to recover any costs.[107]

Invoking this authority and getting the necessary approval from the Fed and the Treasury, the FDIC designed an ambitious and far-reaching two-pronged program, called the Temporary Liquidity Guarantee Program (TLGP). Through the first part, called the Debt Guarantee Program, the FDIC would guarantee newly issued senior bank debt for up to three years. Through the second part, called the Transaction Account Guarantee Program, the FDIC would make its deposit insurance coverage—which had recently been increased by EESA to $250,000 per account—unlimited for non-interest-bearing business accounts. Both programs would be implemented temporarily across the board and without any fee, but they would soon begin charging participant banks fees while allowing opt-outs—limitations that Bair says were included only at her insistence.[108] Essentially, the program represented a massive expansion of the FDIC's insurance of the banking industry: banks' bonds would join deposits as covered, and the coverage for deposits would become much more comprehensive.

The TLGP caused two kinds of consternation. First, the FDIC had pushed lawmakers to expand its deposit insurance far more than they actually chose to do in EESA, and it was rebuffed, but rather than accept the judgment of the democratically elected legislators, it now chose, less than a month later, to circumvent their decision through a highly contestable legal interpretation of its power.[109] That process seems deeply problematic. On policy grounds,

some economists worried that confidence in the FDIC might be undermined by an uncapped guarantee.[110] Second, the FDIC's legal interpretation apparently stretched its statute in ways quite unanticipated by those who wrote it. Richard Carnell, who was senior counsel for the Senate Banking Committee when it amended the Federal Deposit Insurance Act in the early 1990s, said that the portions of the law invoked were meant to govern the FDIC's relationship with specific banks. Using them as the basis for the sweeping programs launched by the TLGP "turned the statute on its head," according to Carnell.[111]

But as with the Treasury's money market rescue and the Fed's CPFF, success bred legitimacy for the TLGP, and complaints along these lines never gained much traction. It seemed like an intuitive way to strengthen the banking system, especially since European nations had recently made deposit insurance unlimited and offered bond guarantees.[112] More important, the program was enormously popular with banks of all kinds, and commentators universally believed it helped to support lending activity during the downturn. For the Debt Guarantee Program, 56 percent of eligible institutions opted to pay the fee for guarantees. The program collected more than $10 billion in fees for guarantees exceeding $300 billion in senior bank debt. The Transaction Account Guarantee was paid for by around 86 percent of eligible institutions.[113]

The program was the source of one major controversy, which revolved around which kind of institutions would be eligible to participate. The FDIC always claimed that the program would not lead it into a role as commercial financier (as opposed to a supporter of bank safety), but it decided that it would give access to the Debt Guarantee Program not only to banks but also to bank affiliates on a case-by-case basis. This decision led to the acceptance of the program's single largest user, GE Capital, which was affiliated with two Utah savings and loans.[114] GE Capital ended up issuing more than $70 billion of FDIC-guaranteed debt in exchange for more than $1 billion in fees.[115] Understandably, some of GE Capital's competitors who were not granted admission to the program resented what they saw as a triumph of political connections here, and the incident eventually led to a 2009 exposé article from ProPublica and the *Washington Post*.[116] By that point the TLGP was a staple of the crisis response, however, and this limited complaint did not derail its operation; indeed, the program was extended twice before expiring at the end of 2010.[117] Though they left a lingering sense of unfairness, the more successful of adhocracy's improvisations largely escaped legitimacy problems. The harder test would come with programs that were much less clearly successful.

The Capital Purchase Program: Was TARP a Bait and Switch?

Returning now to the events of 2008, the Treasury's TARP strategy took shape in the week after the law's passage on October 3, 2008, and was unveiled to top government officials on Sunday, October 12. Paulson delivered a bombshell: the first $250 billion of TARP funds would not be used for purchasing "troubled assets" at all. The plan to buy MBSs, on which the sales pitch to Congress had centered, was too unwieldy and slow to try, given continued deterioration of financial markets. Instead, the Treasury formulated a plan to directly inject capital into banks through equity investments, beginning with the most systemically important institutions. The terms would be fairly generous to the banks, so as to attract their participation and to avoid any impression that the Treasury was making a hostile takeover—that is, nationalizing the banks.[118]

After convincing some of his more skeptical colleagues of the plan's details, Paulson set up a meeting with the CEOs of America's nine most systematically important banks for the next day.[119] Wanting to have the advantage of surprise, as he had with the takeover of Fannie Mae and Freddie Mac a month earlier, Paulson and his staff divulged no information to the banks. Creating what was surely one of the most lasting images of the crisis, these bank heads were simply summoned to Washington. They all obliged, and on the afternoon of October 13 they received a presentation of the government's plan from Paulson, Bernanke, Geithner, and Bair.[120]

The crisis fighters announced a three-pronged initiative: the Fed would be rolling out its CPFF and the FDIC its TLGP, and the Treasury would be making $125 billion worth of capital investments in the nine banks with TARP money as the first part of what would be known as the Capital Purchase Program (CPP). Each of the banks would receive the money with identical terms, thereby signaling uniform confidence in all of these systemically important firms. Another $125 billion would then be used to make investments in smaller banks deemed healthy.

The CEOs were taken aback, apparently shocked and awed by the prospect of having the government become a direct investor. Nor were they pleased by Paulson's threatening tone when he told them that if they rejected this capital, any needed future aid would come with punitive terms.[121] Some nevertheless quickly accepted the capital, because they felt it was coming fairly cheap: the government would receive nonvoting preferred shares and receive a 5 percent dividend (which would reset to 9 percent after five years) along with warrants to purchase shares of common stock. The investments would be locked in for

three years, after which the banks could buy back the equity.[122] Others balked at what they saw as an ultimatum, especially Wells Fargo's CEO, Richard Kovacevich, who challenged Paulson and insisted that his bank was uninterested in participating. According to Andrew Ross Sorkin's reporting, Paulson then reached another level of threat, staring Kovacevich down as he told him, "Your regulator is sitting right there. And you're going to get a call tomorrow morning telling you you're undercapitalized and that you won't be able to raise money in the private markets."[123] Three hours later, all of the CEOs had signed term sheets after conferring with their boards.

Before considering the CPP itself, this exercise of soft power demands a brief comment. Such official conduct sits uneasily with the thick rule of law, which holds that regulatory enforcement ought to be predictable and neutrally administered, not contingent on firms making unrelated "voluntary" agreements with the government. It would have required extraordinary fortitude—and possibly a blameworthy neglect of his fiduciary duty to his shareholders' interests—for Kovacevich and Wells Fargo to withhold their assent in this setting. If this was short of an offer they couldn't refuse, it was right up to the edge. This may be the inevitable flipside to delegating discretionary crisis power, but if so it should be regarded as a distinct downside.

The contracts that the big banks entered into had some unusual provisions that also sat uneasily with the thick rule of law. The contracts specifically allowed for unilateral alteration of terms by the federal government if Congress decided to pass new legislation, thereby eliminating any threat of contract clause litigation. Litigation threats against the government were also limited by clauses stating that the recipient institutions waived the right to challenge any of the regulations enforcing executive compensation provisions.[124] Concerns about these kinds of process irregularities are significantly diminished by the fact that the banks entered into these arrangements voluntarily. But for those whose primary concern was the government's willingness to badger private firms, these provisions highlight how far the government was from acting within the rule of law as usually conceived, even when it was apparently engaged in handing out taxpayer resources.

Unsurprisingly, the broader public's criticism of the CPP after it was unveiled on October 14 focused on different concerns. Some criticisms were purely on policy grounds: at least some market observers thought that Paulson's original plan to buy up troubled assets would have provided hugely valuable information in otherwise stalled markets, and they felt it was a mistake to simply abandon that path in favor of propping up weak financial institutions.[125] Renowned economic historian Anna Schwartz said that the Treasury's

"ad hoc" approach made it impossible for market participants to predict official actions and that its pivot on the use of TARP funds merely exacerbated this problem.[126]

More pertinent here, some critics questioned the legitimacy of the Treasury's use of TARP funds. As the Treasury persisted in its decision not to pursue any MBS purchasing plan over the months that followed, many found the Troubled Assets Relief Program's failure to provide any troubled asset relief to be a less-than-charming irony. Though he was writing several years later, populist journalist Matt Taibbi of *Rolling Stone* serves as a representative example:

> Within days of passage, the Fed and the Treasury unilaterally decided to abandon the planned purchase of toxic assets in favor of direct injections of billions in cash into companies like Goldman and Citigroup. Overnight, Section 109 [and its possibility of support for struggling homeowners] was unceremoniously ditched, and what was pitched as a bailout of both banks and homeowners instantly became a bank-only operation—marking the first in a long series of moves in which bailout officials either casually ignored or openly defied their own promises with regard to TARP.[127]

Former Fed vice chair Alan Blinder presented a more refined version of this complaint to Congress in November 2008, testifying that while none of the actions the Treasury had taken was directly contrary to the law's requirements, "zero allocations of funds" to asset purchases was hard to view as "really consistent with either the sprit or the letter of law."[128]

Several legislators shared these concerns, and the standard way of formulating the criticism was to wonder, sometimes obliquely and sometimes quite explicitly, whether Secretary Paulson and the other leaders had engaged in a bait and switch by selling TARP as one thing but then transforming it into something else. Representative Gary Ackerman (D-N.Y.) told Paulson, "It seems to be the second largest bait-and-switch scheme that history has ever seen, second only to the reasons given us to vote for the invasion of Iraq."[129] Even some members who applauded the shift to equity injections on policy grounds felt they needed to question the Treasury's reversal.[130] Notably, this particular concern was not shared by the leaders of either party. Paulson had received their blessing before committing to the equity purchases, and Financial Services Committee chair Spencer Bachus (R-Ala.) publicly defended him from the charge of bait and switch, insisting that the final TARP law had been explicitly designed to allow the Treasury to make capital injections.[131]

A fair reading of the record supports this defense. Paulson consistently defended himself from charges of deception with a straightforward explanation: in mid-September, when his team formulated the asset-purchase plan, it looked both workable and large enough to meet the crisis as they then perceived it. In the weeks that followed, the crisis escalated and it became clear that an asset-purchase program would be neither fast nor impactful enough to justify spending the Treasury's scarce resources on it.[132] When Paulson was asked by reporters if he had deceived Congress by abandoning the original vision of asset purchases, he defiantly replied, "I will never apologize for changing an approach or strategy when the facts change."[133] Still, the politics of TARP's passage do make it possible to imagine a Machiavellian streak at work here. As Phillip Swagel, who was assistant secretary for economic policy under Paulson, explained, if the Treasury secretary had initially argued directly in favor of capital injections, that proposal might have been branded as "nationalization" and overwhelmingly opposed by House Republicans. As it turned out, Paulson had been spared the political onus of making that case directly. Swagel maintains that this was a case of being lucky rather than being good, and Paulson's statements throughout back up this assessment.[134] In any case, despite some continued grumbling about a bait and switch, this complaint about TARP largely faded away.

Two other more substantial criticisms of TARP were pursued much more doggedly. The first of these is the claim that the Treasury Department was derelict in its statutory responsibilities under EESA to mitigate America's foreclosure crisis. A wave of foreclosures had become apparent beginning in 2007, leading to several government responses, but these were widely believed to be grossly inadequate. An industry-led effort called the Hope Now Alliance, created in 2007, claimed to have prompted nearly 3 million mortgage workouts between July 2007 and November 2008, but the average modification seems to have been a mere rescheduling of payments rather than a significant restructuring or principal reduction, and re-defaults were common.[135] As one critic put it, the core philosophy behind Hope Now seemed to be, "Do whatever you want and call it a loan modification."[136] A more ambitious official program, the Hope for Homeowners Program, was included in the July 2008 Housing and Economic Recovery Act (HERA) and made available up to $300 billion to support loan guarantees made by the Federal Housing Administration (FHA). Intended to help some 400,000 homeowners restructure their loans, the program's restrictions on eligible loans rendered it almost entirely useless. Voluntary take-up was minimal, with applications in the hundreds.[137]

Against this backdrop of ineffective action, hopes were high that the Treasury would use TARP funds to support a far more impactful program of foreclosure mitigation. As the Treasury got the CPP up and running but failed to take action on the housing front, anger at Paulson began to mount. At November congressional hearings, members of Congress made it clear that they felt the lack of a plan to aid homeowners was unacceptable. Barney Frank insisted that "very explicit language was included to provide for mortgage foreclosure and mortgage foreclosure diminution as one of the purposes" and said that including this language was a key selling point of the bill for lawmakers. He cited §§ 109 and 110 of EESA as creating both the power and the responsibility for the Treasury to act and said that non-TARP activities were no substitute for Treasury action.[138] Representative Maxine Waters (D-Calif.) told Paulson she was aghast that Paulson "took it upon [him]self to absolutely ignore the authority and the direction that this Congress had given [him]" and noted that promises of foreclosure relief had been especially important to securing the votes of members of the Congressional Black Caucus.[139]

Paulson sometimes attempted to project some sympathy with the idea that more needed to be done on foreclosure mitigation and cited the existing non-TARP programs, but he was quite defiant in defending how TARP funds were being used. Despite the protestations of the legislators, he declared he had "reservations" about "spending TARP resources to directly subsidize foreclosure mitigation because this is different than the original investment intent." At some points, he and others at the Treasury seemed to be suggesting that, contrary to the belief of legislators, TARP money could not legally be used to support loan modifications, a perspective that frustrated critics to no end.[140] When criticized for the contrast between the Treasury's willingness to sink money into AIG (discussed in the next section) and its reluctance to take on foreclosure risk, Paulson insisted there was a clear, principled difference: AIG was vital to stabilizing the financial system in a way that helping underwater homeowners would not be. Paulson conceded that if the Treasury had pursued his original asset-purchasing plan, the law Congress passed would force it to take steps to prevent foreclosures on the mortgages contained in the MBSs acquired. But that plan was not being put into effect, and the CPP did not give the Treasury control over the operations of the banks in which it invested.[141]

The second significant point of criticism of the Treasury's execution of TARP was its inability to say exactly what banks were doing with the money that taxpayers had invested. Many were concerned that banks were simply "hoarding" their capital rather than lending it out and thus supporting

commercial activity.[142] The program might well be producing safer banks, but this was a raw deal for the broader public if it did not translate into a support for economic recovery.[143] Many critics harbored darker suspicions than hoarding, worrying that banks were simply passing taxpayer-invested dollars through to shareholders in the form of unearned dividends or to executives in the form of unearned bonuses.[144] Some also worried that TARP funds were being used to sponsor financial empire–building by favored banks. This was the charge when Cleveland-based National City Bank found itself fighting for survival and was unable to secure TARP funding, leading to its sale to TARP-supported, Pittsburgh-based PNC Bank.[145] Paulson and others at the Treasury were mostly unconcerned by the uncertainty surrounding the use of funds, though. Infuriating their critics, their position was that money's fungibility made attempting to track specific use of TARP funds a fruitless endeavor.[146]

The controversies over foreclosure mitigation and the tracking of TARP funds are both important in their own right and would outlast Paulson's tenure as Treasury secretary; chapters 5 and 6 have more to say about both. But the criticisms are also evidence of a gulf between the thinking of the executive and legislative branches that is crucial to understanding the legitimacy of the crisis response in the years after 2008. As Treasury secretary, Paulson was charged with containing the financial crisis, and his daily uptake of information from the markets made him acutely aware of the possibility that things could get much worse than they were. He consequently developed a nearly monomaniacal focus on containing the financial aspects of the crisis, rather than the broader economic fallout. From his initial proposal onward, Paulson was determined to direct all of the firepower available to him toward this purpose, and therefore he felt that diverting any of TARP's funds (which he feared might be too limited) toward foreclosure relief was an unnecessary risk.[147] Similarly, imposing reporting requirements on TARP recipients that would make their use of funds more accountable to taxpayer-endorsed purposes seemed to be a stumbling block to the primary purpose of supporting the banks and staving off crisis.[148] From Paulson's perspective, TARP was about crisis fighting, and remaining faithful to the law's spirit required doggedly pursuing stability first and foremost—even to the exclusion of other concerns indicated by the statute's text, which represented wishful thinking as much as a viable plan of action.

Legislators saw things much differently, fairly representing their constituents' concerns. For regular people and for members of Congress, the financial crisis was abstract and hard to relate to directly, but foreclosures and a shortage of lending to local businesses were all too real. So, too, was the prospect

that ordinary people's hard-earned pay was being unceremoniously handed over to rich financiers, the unfairness of which would impress anybody. As a result, TARP's legitimacy rested not primarily on its hard-to-feel impact on financial stability but on its ability to help people with far more visible problems and establish processes to ensure fairness, accountability, and a certainty that taxpayers were not being fleeced (as so many commentators regularly suggested). Paulson's seeming indifference to these concerns infuriated many people, who came to distrust him and to doubt just about every aspect of TARP's legitimacy.

AIG, Continued

Trust in both the Treasury and the Fed may have suffered somewhat further in November, when they were forced to make significant adjustments to the Fed's September AIG bailout. That hastily improvised rescue had epitomized the qualities of adhocracy, but at least it had had what many saw as the redeeming feature of clearly punishing AIG through harsh terms. By November, those terms were making it difficult for the insurance company to stay liquid, and so a new improvisatory adjustment was required. Newly available TARP funds increased the options available, and the Fed and the Treasury worked in close conjunction to devise a new set of terms.

On November 10, the two agencies jointly announced a much-changed arrangement with AIG. The Treasury would invest $40 billion of TARP funds in AIG in exchange for senior preferred stock paying 10 percent.[149] This investment would make AIG subject to various TARP requirements, including restrictions on executive compensation.[150] The company would use the funds to pay down its outstanding debt to the Fed, and the FRBNY's original credit facility would be shrunk from $85 billion to $60 billion. At that lower level of support, it would also charge much lower rates: around 5 percent for loaned funds (down from around 10 percent), and 0.75 percent on undrawn funds (down from 8.5 percent). The facility's duration would also be increased from two to five years.[151]

The Fed (through the FRBNY) would also create two new § 13(3) facilities to provide assistance to AIG, which would eventually be dubbed Maiden Lane II and Maiden Lane III. Maiden Lane II, in the mold of the original Maiden Lane that had been used to help JPMorgan acquire Bear Stearns, featured a Fed-created SPV funded by a Fed loan ($22.5 billion) and a small subordinated loan from AIG ($1 billion), which would purchase hard-to-value MBSs from AIG's securities lending collateral

portfolio. (This would end the need for the peculiar lending-to-the-Fed facility that had been created in October, which would be terminated.)[152] Unlike Maiden Lane I, where JPMorgan could only have its loan repaid with interest, any residual gains for Maiden Lane II would be shared between the FRBNY and AIG.[153]

Maiden Lane III was a similarly structured SPV, funded by a $30 billion loan from the FRBNY and a $5 billion subordinate loan from AIG, but its purpose was quite different. Some of AIG's most dangerous exposure to losses was through the credit default swaps (CDSs) its financial products division had written on various collateralized debt obligations (CDOs) held by a variety of counterparties. To reduce this exposure—and to stop collateral calls that created difficult liquidity problems for AIG—Maiden Lane III would buy the underlying CDOs, allowing the CDSs to be unwound. Once again, if the FRBNY's loan and AIG's loan were both repaid with interest, residual gains would be split between the two.[154]

Maiden Lanes II and III were vulnerable to the same legal objections as the original Maiden Lane or the CPFF: the entity receiving the loan was not the party actually unable to secure credit, as § 13(3) requires, and the transaction seemed to be more a purchase than a loan.[155] The same law professor who found Maiden Lane I to be an offensive, "illegal" power grab similarly opined that the SPVs created to aid AIG were "at best, a surreptitious attempt to circumvent the meaning of the Federal Reserve Act and, at worst, an intentional and purposeful violation of the law."[156] But as with Maiden Lane I and the CPFF, these legal criticisms were articulated only years later and to little fanfare. This may have been because people accepted the FRBNY's claim that creating SPVs on behalf of promoting financial stability falls within the Fed's incidental powers.[157] More plausibly, the absence of a strong protest against Maiden Lanes II and III can (again) be attributed to the success of the programs. Although they were derided as giveaways unlikely to be paid back when they were created, both would eventually repay their loans to the New York Fed in full and then produce modest additional gains split between AIG and the Fed.[158]

Although the Fed's legal ability to create these Maiden Lanes never excited much controversy, the actions of Maiden Lane III inspired some of the most intense criticism of the whole crisis. Critics alleged that the intervention was designed as an illegitimate "backdoor bailout" of AIG's CDS counterparties, which included many of America's (and Europe's) largest financial institutions. Because this issue was the subject of one of the Congressional Oversight Panel's most involved reports, discussion is reserved for chapter 6.

Rescuing Citi

The government's crisis fighters found that their string of epic weekend rescues had not yet come to a close in late November, when Citigroup found itself struggling to survive. After being outbid in its effort to acquire Wachovia and its huge base of deposits, Citi came under increasing scrutiny. Markets began to wonder whether it simply had too many bad mortgage-related assets on its books to survive, even after it received its $25 billion equity injection from the CPP.[159] Citi's share price tumbled in November, going from $13.99 on November 3 to an intraday low of $3.05 on November 21. Its credit default swap spreads, a measure of the perceived riskiness of its debt, doubled during that same time, clearly marking Citi as the weakest of the country's big banks and raising worries about a run on the bank by its creditors and counterparties.[160]

In devising a plan to help Citi, Paulson, Bernanke, and Geithner hoped to once again receive help from the FDIC. In the first instance, this required making another determination of systemic importance so that the FDIC's involvement could support the objective of financial stability rather than minimizing costs. That determination was first discussed by the Fed's Board of Governors on November 20, and the consensus was that finding Citi to be systemic was an easy call; the designation was made official on November 23. Although there was somewhat more angst among the board of the FDIC and Bair as to the lack of process in making the determination, they too voted unanimously to find that Citi presented a serious risk to the whole financial system.[161] This decision struck most observers as unremarkable: Citi had some $2 trillion in assets and was counterparty to nearly $37 trillion in derivatives trades.[162] Nevertheless, some critics, most notably former secretary of labor Robert Reich, extended the "Wall Street over Main Street" trope to question whether there was any principled basis for extending additional aid to the bank while the government was doing so little to help commercial businesses, and especially the automakers.[163] The Special Inspector General for TARP would also later criticize the ad hoc nature of the systemic risk determination, saying that there were serious concerns about whether these decisions "were being made fairly and with consistent criteria," though the report conceded that the exigency of the situation in late November made the "ad hoc character" of the choice unsurprising and saw no reason to question its veracity.[164]

The details of joint Fed-Treasury-FDIC intervention were negotiated with Citi over the weekend of November 21. Citi was asked to offer its own rescue proposal, which it did, followed by the government countering with a

considerably less generous take-it-or-leave-it offer. The final deal had two main components. The first part was an additional $20 billion capital injection using TARP funds in the mold of the CPP, in exchange for which the Treasury would receive preferred shares paying 8 percent. The second component was more novel. Citi would move $306 billion in distressed assets into a "ring fence." Losses on these assets would be shared according to a carefully created structure: Citi would bear the first $29 billion and 10 percent of all additional losses; the government would cover the remaining 90 percent of losses, with the Treasury providing $5 billion in TARP funds first, the FDIC providing $10 billion second, and the remainder guaranteed by the promise of a loan from the Fed if necessary. In exchange for this guarantee, which was enabled by the insurance program Republicans had gotten written into § 102 of EESA, Citi would pay an additional $7 billion fee in the form of preferred stock. At the time, officials calculated Citi's first-loss position so that it exceeded expected losses. As a condition for this aid, Citi would have to agree to executive compensation restrictions beyond those in the CPP, a prohibition on issuing dividends greater than $0.01 a share for three years, and cooperation with the FDIC in carrying out a mortgage modification program for the loans in the ring fence.[165] After Citi accepted this package (some of its leaders doing so reluctantly because of the dilution of shareholders' equity), markets reacted positively, with the company's share price nearly doubling to $5.95 on November 24.[166]

Nobody questioned the intervention's legality, which seemed to be clearly established by EESA, but a wide range of critics savaged the bailout's legitimacy on several other grounds. Many bloggers and journalists suggested that the deal was far too kind to Citi, whose shareholders, they felt, should have been completely wiped out.[167] The government's assertion that the ring-fencing agreement was unlikely to result in large losses for taxpayers met with widespread incredulity. In understanding the government's relationship with Citi, many observers found it impossible to extend the government any trust at all. The very existence of the massive firm was understood as the result of special treatment by government, since the original merger between Citibank and Traveler's Group had required regulatory forbearance before the passage of the Gramm-Leach-Bliley Act in 1999. The relationship between Citi and former secretary of the Treasury and Citigroup chairman Robert Rubin—a Geithner mentor and the ur-figure for those who saw Wall Street as exerting an inappropriate political influence—also raised many eyebrows. Consequently, trust-based legitimacy was sorely lacking (or perhaps factored in as a negative, shading into suspicions of out-and-out corruption) in dealings with Citi.

Remarkably, this was the case even among the crisis fighters themselves, as Sheila Bair repeatedly found herself asking whether the government's choices were being specially tailored to Citi's needs.[168] A final major criticism was that the bailout was set up for failure, both in terms of achieving stability for Citi and in terms of providing broader stability to the market through establishing a transparent and reliable standard for government intervention.[169] This criticism of the action's legitimacy would turn out to be prescient, as Citi's troubles would be a continuing source of distress into the Obama administration.

Bank of America and Merrill Lynch

Following Citi's rescue, yet another of America's largest banks came under pressure. This time it was Bank of America (BofA), which had been viewed as a strong institution back in September when it agreed to acquire Merrill Lynch for $50 billion just before Lehman's demise. That acquisition, though, had become a source of major problems for BofA. The deal was approved by the Fed in late November and by shareholders of both companies on December 5, and it was set to be consummated at the beginning of the new year.[170] But in the weeks that followed approval it rapidly became clear that Merrill faced the prospect of losses larger than anyone had expected. Who knew what, and when, is a source of controversy, but BofA's then-CEO Ken Lewis claims it was only on December 14 that he learned of the magnitude of the problem: in just over a week, estimates of Merrill's fourth-quarter losses ballooned from an already staggering $7 billion to $12 billion.[171] These revisions were large enough to give BofA's leadership pause, and they seriously considered invoking the clause in the merger agreement that would allow them to back out (or potentially renegotiate) as a result of a material adverse change (MAC clause).

Lewis contacted Treasury secretary Paulson on December 17 to tell him about the contemplated invocation of the MAC clause. Paulson summoned Lewis to Washington that day, and he and Bernanke encouraged the CEO to "stand down" while they considered the potential ramifications.[172] At a series of meetings and conversations over the following days, Paulson, Bernanke, and Federal Reserve general counsel Scott Alvarez delivered a clear message to Lewis: invoking the MAC clause would be a horrible mistake that BofA should avoid at all costs.[173] This warning was framed in several ways: first, they warned that the resultant uncertainty about Merrill's future could potentially destabilize the whole financial system; second, they warned that attempting to back out of the deal could erode confidence in BofA's leadership, which had

after all touted the merger as a major victory, and potentially lead to a run on the bank; and third, they argued that invoking the MAC clause was unlikely to succeed in Delaware courts and therefore had no upside for the bank.[174] When, in spite of these warnings, Lewis was apparently still wavering, Paulson put a sharper edge on these suggestions: in a phone conversation on December 21, he pointedly reminded Lewis that showing exceptionally bad judgment (as invoking the MAC clause would do) could be grounds for the Federal Reserve to exercise its powers as a prudential regulator and remove the bank's top management. This ominous remark was delivered alongside vague assurances that the Treasury and the Fed were collectively committed to ensuring the stability of the postmerger BofA–Merrill Lynch.[175]

These insinuations of both stick and carrot were sufficient to convince Lewis and his board not to invoke the MAC clause. The merger was completed on January 1, 2009, with the purchase price (determined through a stock swap) actually working out to $19 billion because of declines in both firms' share prices since September. On January 9, the combined company received the $10 billion capital investment that the CPP had allocated to Merrill.[176] But neither BofA nor its regulators believed that this would be sufficient to decisively stabilize the bank, and so they entered into negotiations for further aid in early January. On January 16, an additional aid package was announced, closely mimicking the one engineered for Citi. The Treasury would invest an additional $20 billion in TARP funds in exchange for preferred shares, and the Treasury, the Fed, and the FDIC would together provide an asset guarantee (or ring fence) for a pool of $118 billion in assets. Like Citi, BofA agreed to executive compensation restrictions more stringent than those faced by all TARP recipients and would be unable to pay dividends greater than $0.01 a share.[177] (In the end, BofA decided in May 2009 that it wanted to walk away from the asset guarantee program, which had never been finalized. The government allowed it to do so for a $425 million termination fee.)[178]

Like Citi's deal from November, nothing about this aid package was particularly difficult to justify as a matter of formal legal powers under EESA. Nevertheless, the interactions between BofA and the government leading up to the deal became the focus of intense criticism. On January 17, the *Wall Street Journal*'s headline ran "Mugging Bank of America; No Good Financial Deed Goes Unpunished," declaring the final merger to be a "shotgun wedding." By the paper's reckoning, Lewis's effort to protect shareholders was "vetoed by his most important shareholder, the feds."[179] In late February, in a deposition for the office of the New York attorney general, Lewis's portrayal

of his December 21 conversation with Paulson made it seem that Paulson had not been so oblique in issuing a "threat" to the bank's management if it went forward with invoking the MAC clause.[180]

That inspired a new round of scrutiny, which would culminate in five hearings (an unusually large number) by the House Committee on Oversight and Government Reform in 2009, during which legislators promoted two competing narratives. Republicans on the committee were mostly concerned that the crisis fighters had abused their power by making a threat and thus creating "a climate of fear and intimidation by government officials."[181] Lewis made a somewhat disappointing witness for them, as by the time of his committee hearing he was giving a bullish account of the merger and refused to say that the threat of removal had motivated his decision to bring it to fruition. Rather, he reported that the intensity of Paulson's warnings, conveyed by talk of the Fed removing management, had genuinely swayed him on the merits.[182] On the other side of the aisle, Democrats tried to advance a counternarrative in which Lewis had cynically exploited the situation to extract additional support from the government, a charge that the CEO flatly denied.[183]

Was the government crisis fighters' "persuasion" of Lewis so reminiscent of Vito Corleone's "offer he can't refuse" as to represent a troubling transgression against the rule of law? Bernanke's and Paulson's warnings remained in the realm of cheap talk, and so as a formal matter Lewis could have simply rejected their advice and accepted the consequences. But that would have required a tremendous tolerance for risk. As with the initial injection of TARP money, this exercise of soft power raises serious questions about whether there are enough effective constraints on the government's willingness to use (or possibly abuse) discretionary power as a cudgel. That said, Paulson's warning that invoking the MAC clause could have been counterproductive and legally futile may well have been sound advice, and none of the government's critics have ever refuted it convincingly. Surely it cannot be deeply problematic for government officials to offer good legal advice to a regulated bank's CEO—even if they are not overly friendly in doing so. Once again, official imperiousness in wielding crisis power is not terribly attractive, but some amount may be inevitable, and its presence need not be seen as discrediting otherwise useful exercises of discretionary power.

Spreading the TARP over the Auto Industry

At the same time as they were ensuring that Bank of America would stay the course in its acquisition of Merrill Lynch, officials at the Treasury were also occupied with a matter that was far more public and politically charged:

the rescue of two of America's three largest automobile manufacturers, General Motors and Chrysler. Throughout the fall, both companies' problems were frequently talked about in Washington. In September, as the GSEs and Lehman were faltering, the automakers used an aggressive lobbying campaign to get Congress to fund a loan guarantee program for factory retooling, which had previously been authorized but not funded.[184] That campaign was successful, with the request kept separate from the bruising fight over TARP. Congress provided $25 billion in funding for these guarantees in an appropriations bill passed on September 27.[185]

That program's terms were fairly tightly specified, however, and so they provided no immediate prospect for relieving the companies' increasingly urgent liquidity problems; GM and Chrysler were back in Washington by mid-October looking for more flexible aid. Rick Wagoner, GM's CEO, met with Treasury secretary Paulson and Commerce secretary Carlos Gutierrez the morning of October 13—just hours before Paulson had his meeting unveiling the CPP to the big banks' CEOs. Given how much else was on his plate at that moment, it is perhaps unsurprising that he gave Wagoner a fairly cold reception, saying quite clearly that the money in TARP was allocated to aid the financial sector, not industrial companies.[186] Paulson also expressed this sentiment publicly at several points throughout the fall, including during his November 18 testimony to the House Financial Services Committee—though, tellingly, he would not make a hard commitment to a narrow definition of the financial institutions eligible for TARP aid.[187] Behind the scenes, though Paulson was genuinely against using TARP to help the automakers, he was understandably reluctant to have his tenure end with the high-profile failure of two of America's iconic companies, and so he asked his staff to secretly prepare plans to address an imminent bankruptcy filing.[188]

The automakers thus turned the bulk of their efforts to persuading Congress to provide them targeted relief, either by explicitly instructing Paulson to use TARP funds or by repurposing the already-approved loan guarantee program. Their efforts became entangled in a political thicket: Republicans were not eager to provide aid at all, since they felt doing so was essentially a gift to the United Automobile Workers (UAW), and Democrats were not willing to abandon the retooling requirement for the earlier loans.[189] Helping the automakers consistently polled poorly, with majorities opposed to providing additional aid.[190] Nevertheless, for the industrial Midwest this was a crucial issue; the *Detroit Free Press* addressed an editorial to Congress telling how catastrophic an industry failure would be and declaring, "You don't want all this blood on your hands. No one could."[191] It was also hard to explain

convincingly why financial services companies in distress were so much more deserving of the federal government's help than automakers.

Aid for the automakers did seem somewhat more palatable if it came with some kind of requirement that they restructure their operations to achieve long-term viability.[192] Such a plan was worked out in early December and considered in a special session of Congress. House Democrats and a handful of Rust Belt Republicans passed a bill to make $14 billion in loans available to GM and Chrysler on December 10.[193] The lobbying effort could not impel the supermajoritarian Senate to action, however. Republicans in the chamber felt that the conditions being imposed on the two firms were not nearly stringent enough to effectively spur turnarounds, so that the loan money would essentially be going to waste. Senator Bob Corker attempted to fashion a compromise with stronger demands, including the engagement of some credible third party to oversee the restructuring efforts, but in the end he and Democratic leaders were unable to come to a compromise regarding wage cuts for unionized workers, and the Senate recessed without any prospect of action.[194]

As soon as hopes for new legislation were dashed, the Bush administration came under tremendous pressure to deliver some form of relief that did not require congressional cooperation. For weeks, Speaker Pelosi, Senate Majority Leader Harry Reid, Senator Dodd, and other Democrats had been obliquely or openly calling for use of TARP funds to tide the automakers over to the next administration. President-elect Obama communicated a similar message, making it clear to his predecessor's administration that keeping the automakers afloat was a top priority.[195] Presumably this vocal communication of "ought" implied "can"; that is, these legislators (and the future president) were making a strong statement to the effect that EESA authorized use of some of the $700 billion to support automakers.

President Bush's lame-duck administration was internally conflicted about what to do at this point. Many of Bush's inner circle felt that a loan would only be postponing the inevitability of bankruptcy and that the delay a loan could buy would ultimately change little. Others, including Paulson, felt that the administration had little real choice. In Paulson's mind, it was "an unpleasant decision" rather than a "difficult" one, and the Treasury quickly moved to reassure markets that some solution would be forthcoming.[196] Bush tipped his hand and explained his thinking in an interview on December 18, when he indicated the importance of avoiding a "disorderly bankruptcy" for the still fragile financial markets. He also noted, "I feel an obligation to my successor. I've thought about what it would be like for me to become President during

this period. . . . I believe that good policy is not to dump him a major catastrophe in his first day of office."[197] On December 19, the president announced that the government would offer bridge loans lasting three months to the two companies, giving them a chance to get their houses in order to proceed with restructurings, whether in or out of bankruptcy.[198] Some requirements would apply, though not as stringent or binding as Senate Republicans had insisted on.[199] The so-called Automobile Industry Financing Program (AIFP) was added to TARP's menagerie of acronyms, and it committed to issuing $13.4 billion in loans to GM and $4 billion to Chrysler.[200]

Given the administration's earlier expressions of doubt about using TARP funds for the automakers, some have seen this reversal as a blatant self-contradiction and a sign of contempt for the law. This is not entirely fair; Paulson had clearly expressed his belief that TARP was not best applied to autos, but he was careful never to totally foreclose on the possibility. Treasury's eventual position had also lately gotten a boost from the many politicians urging use of TARP money as well as from the comptroller general and the GAO's general counsel, both of whom testified that TARP could be used to provide assistance to the automakers.[201]

That being said, there are serious grounds for criticism of TARP's application to the automakers on statutory interpretation grounds.[202] As noted above in the discussion of the passage of EESA, the law is written to give remarkable amounts of discretion to the Treasury secretary—far more than Paulson originally asked for. Most empowering is the conferral of authority to "purchase . . . troubled assets from any financial institution, on such terms and conditions as are determined by the Secretary."[203] The two key terms here are defined, but not in a terribly helpful way. *Troubled assets* can be mortgage-backed instruments or "any other financial instrument that the Secretary, after consultation with the [Fed] Chairman, determines the purchase of which is necessary to promote financial market stability."[204] *Financial institution* is defined as "any institution, including, but not limited to, any bank, savings association, credit union, security broker or dealer, or insurance company, established and regulated under the laws of the United States . . . and having significant operations in the United States."[205] As Gary Lawson points out, a literal-minded textualist can read this last definition as including "any institution" based in the country. He notes that such logic would necessarily embrace "antique dealers [and] ballet troupes," effectively allowing the secretary to apply the TARP program to any institution of his choosing.[206] A more sophisticated reading, it would seem, would require that financial institutions actually be financial in some important way.

Critics of TARP have drawn two rather contradictory implications. Some have argued that Secretary Paulson and President Bush simply violated the law by applying EESA to automakers. A fair reading of the definitions would certainly make it possible to help the automakers' financing arms—Chrysler Financial and General Motors Acceptance Corporation (GMAC), which would indeed receive aid before long—but helping GM and Chrysler themselves was so clearly contrary to the law's spirit as to make it illegal.[207] Undercutting this charge, other critics have admitted the literal applicability of the law and simply taken the TARP bailout of automakers to signify the utter limitlessness of the secretary's power under the act.[208]

Whichever group is correct, what is striking is how meager the reaction against the application of TARP to the automakers was. The companies' restructurings would become the subjects of intense controversy, and polling data indicate that aid to the automakers was never particularly popular. Still, few people mobilized to prevent their access to the program. Before the announcement of the move, twenty-six Republican House members issued a letter expressing their belief that the move was impermissible, but their opposition failed to gain traction once the move had been made.[209]

Several factors probably helped improve the perceived legitimacy of making TARP funds available to the automakers. First, many Americans were sold on helping the companies as a matter of real necessity. Even some who were against bailouts in the abstract felt that as long as the financial sector was getting so much aid, it was only fair to extend a helping hand to the auto industry as well. Second, no court ever challenged the administration's interpretation, despite having the opportunity to do so in Chrysler's bankruptcy proceeding. Third, the key legislative architects of TARP vocally supported the move, perhaps imparting some democratic legitimacy to it despite the inability to move legislation through the Senate. Most important, however, is surely the fact that it was a Republican administration that initiated the intervention with the support of the incoming Democratic administration. With neither party able to exploit the issue for clean and easy partisan gain, it largely receded into the background.

This last point extends as well to another controversial issue under TARP at the end of the Bush administration: the release of the final $350 billion of TARP funding. The program's tranched funding structure required the president to officially notify Congress of the Treasury's need for the second half of the allocated $700 billion, with Congress having a chance to stop the money from being released if both houses passed a joint resolution of disapproval.[210] Paulson and his team had vacillated about whether it would be necessary for

them to seek access to the additional funding, which they were hesitant to do given the strong anti-bailout mood in Congress. Once the need to support the automakers became clear, though, Paulson worried about scraping against the unraised $350 billion limit and told Nancy Pelosi he was contemplating seeking release of the additional funds, but she warned him not to, for fear that a congressional majority would reject the request.[211] Bush's administration thus went ahead with the creation of the AIFP without requesting the additional funds and in fact made additional commitments to GMAC ($5 billion) and Chrysler Financial ($1.5 billion) under the program.

Finally on January 8, President-elect Obama asked Bush to secure the release of the second half of the funds.[212] Bush gave Congress the official notification on January 12 and then had to see whether the House and Senate would pass a joint resolution of disapproval. If they did, he could still veto their action to gain access to the funds, but this scenario would be truly disastrous for the program's democratic legitimacy. Both administrations worked to lobby Congress, with Larry Summers (Obama's incoming head of the National Economic Council) writing a letter assuring Congress that the new administration would take steps to use the money effectively and responsibly, including initiating a massive foreclosure relief effort.[213] Bernanke and other top Fed officials joined this effort.[214] On January 15, the Senate (including new members elected in the fall elections) voted against blocking the funds, 52–42, with all but nine Democrats aligned with six Republicans in the majority.[215] Once again, bipartisan support from the executive branch was absolutely crucial to maintaining democratic legitimacy.

Examining the crisis fighters' 2008 actions as a whole, several features are striking. First, the searches for legal justifications and broader legitimacy were both remarkably haphazard; when one road was blocked, another was quickly tried with little hesitation. Law failed to define or constrain the overall scope of executive action but in several ways continued to play a key role in defining the parameters of available responses. Second, soft power was often used aggressively in ways that fit uneasily with our self-image as a nation of laws, not of men. Because the applicable enabling acts and regulatory statutes entailed significant discretion on the part of the crisis fighter–regulators, it is hard to imagine how their combination of cajoling and threatening could have been prevented; probably it is fair to understand these unseemly exercises of power as the inevitable accompaniment of otherwise valuable flexibility. Finally, simply staying within the bounds of the law proved insufficient to produce legitimacy. Instead, actions going right up to the edge of the law's limits—and sometimes seemingly over—often achieved considerable legitimacy, especially

when they successfully contributed to the effort to turn back the crisis. And it is striking how many of the programs put into motion in 2008 turned out to be successes—unquestionably including the TGPMMF, the AMLF, Maiden Lanes, the CPFF, and the TLGP. These programs were instrumental in preventing the crisis from becoming a truly apocalyptic cataclysm and earned legitimacy as a result of this signal success.

In some respects, the legitimation problem would become more difficult during the Obama administration, precisely because the worst-case scenarios looked increasingly unlikely as many of the original interventions helped to turn the tide. As efficacy became harder to see clearly, legitimacy and efficacy would increasingly come to compete with each other as policy objectives for the crisis fighters—who would have to operate with a greatly spent-down reservoir of trust as they proceeded.

5

Adhocracy Continued in the Obama Administration

The transition from the Bush administration to the Obama administration in January 2009 raised many questions about how the approach to crisis response might change. After all, the centerpiece of candidate Obama's campaign message was bringing change to Washington's way of doing things, and many people imagined that the new president could make 2009 reminiscent of 1933, a decisive break with the past.

But the Bush administration had very clearly avoided Hoover's path of inaction, and, much to the disappointment of those who disliked its policies, the Obama administration overwhelmingly chose to continue them rather than repudiate them. The president chose Timothy Geithner, who had clearly been the third among the crisis fighters in 2008, to be his Treasury secretary, and in 2010 he would reappoint Ben Bernanke as chair of the Board of Governors of the Federal Reserve, thereby using these key appointments to choose continuity.[1] At least as far as the center of power in Washington goes, it is hard to imagine a more striking affirmation of the legitimacy of the approach of 2008 than this.

If the approach remained largely consistent, the political environment in which the crisis responses would be judged changed decisively in 2009 and beyond. Stunned acceptance of rapidly improvised bailouts often turned to resentful rejection, and outside of Washington the legitimacy of the crisis responses eroded even as they seemed to be restoring some degree of normalcy to the nation's financial markets. The government's approach was also increasingly challenged on grounds of legality, with the government's not-quite-nationalization strategy creating several legally awkward situations. This

Timeline of Events Discussed in Chapter 5

- November 25, 2008: Fed announces creation of Term Asset-Backed Securities Loan Facility (TALF)
- February 10, 2009: Geithner announces Obama administration plan, including stress tests and the Public-Private Investment Program (PPIP), to terrible reception
- February 17, 2009: American Reinvestment and Recovery Act passes, including additional executive compensation restrictions for Troubled Assets Recovery Plan participants
- February 17, 2009: General Motors (GM) and Chrysler submit restructuring proposals to Obama administration
- February 18, 2009: Obama announces plan to help housing market, focusing on foreclosure mitigation programs
- March 19, 2009: Responding to public anger, House overwhelmingly passes 90 percent tax on AIG bonuses, but Senate does not follow
- March 23, 2009: Additional PPIP details announced, followed by scathing criticisms
- March 30, 2009: Obama administration rejects restructuring plans of both GM and Chrysler
- April 30, 2009: Obama administration approves new Chrysler plan involving Fiat; some secured creditors sue
- May 7, 2009: Results of bank stress tests released
- May 20, 2009: Helping Families Save their Homes Act signed into law, includes amendments to constrain PPIP
- June 1, 2009: Obama administration approves new GM plan
- June 10, 2009: Chrysler § 363 (bankruptcy) sale closes, just forty-two days after its filing
- December 24, 2009: Treasury announces it will uncap its potential purchases of securities issued by Fannie Mae and Freddie Mac
- September 30, 2010: AIG, New York Fed, and Treasury jointly announce new "recapitalization" agreement
- August 2012: Third Amendments to GSE conservatorships, implementing dividend sweep that sends all profits to Treasury without paying down principal owed; shareholders sue
- September–October 2014: Trial over AIG rescue in Court of Federal Claims

chapter explores how these legality and legitimacy concerns boiled over with regard to the government's handling of the auto bankruptcies; the conduct of the government as shareholder, especially with AIG, Citi, and the government-sponsored enterprises; the ongoing controversy over how much should be done to mitigate residential foreclosures; and the continued creative use of legal authorities by the Fed and Treasury. Chapter 6 revisits the same time period through the lens of oversight and accountability mechanisms, and chapter 7 takes stock of the overall status of legality and legitimacy in the wake of the crisis, with special attention to the changes to crisis powers made in the Dodd-Frank Act.

Chrysler and General Motors

After the Bush administration decided to use Troubled Asset Relief Program (TARP) money for loans to keep Chrysler and General Motors (GM) afloat, the incoming Obama administration's first big choice was what to do with the two faltering industrial giants. As auto sales plummeted, it quickly became clear that the $17 billion already loaned would not last long, and Obama's team had the unpleasant sense that the two companies could become money pits with poor prospects of ever repaying taxpayers' generosity. Under the terms of the Bush administration loans, both companies were required to submit reorganization plans by February 17, but many observers doubted that either company would embrace the deep changes necessary to return to commercial viability.[2]

Upon taking office, Obama's staff quickly assembled a team tasked with evaluating GM's and Chrysler's plans and determining the best path forward. The leader of this group was Steven Rattner, a private equity investor and important Democratic donor who had agreed to serve as counselor to Treasury secretary Geithner. When the media took to calling Rattner the "car czar," Obama organized a Presidential Task Force on the Auto Industry headed by Geithner and National Economic Council chair Larry Summers to emphasize that overseeing the auto manufacturers would be a top administration priority, with Rattner clearly subordinate to Obama's principal advisers. As Rattner describes in his memoir, *Overhaul*, most final decisions throughout the process were effectively made by Summers (as Geithner had his hands full with other matters); only the largest decisions were presented to Obama for a final decision.

From the beginning, Rattner thought the companies' outstanding obligations were completely unmanageable without going through the bankruptcy

process. He hoped that could facilitate rapid sales of the companies' good assets to new incarnations, leaving the burden of unserviceable debt behind and avoiding a disorderly across-the-board liquidation that would consign the iconic American brands to the dustbin of history.[3] Although a broad spectrum of commentators supported some kind of managed bankruptcy—former and future presidential candidate Mitt Romney prominent among them[4]—the word "bankruptcy" was still politically frightening. Even if embraced, the devil would be in the details of the restructuring.

Rattner's Team Auto, as they called themselves, found GM's and Chrysler's February submissions wanting, with neither firm's management facing up to the magnitude of changes needed.[5] Rattner and his colleagues judged Chrysler to be nearly unsalvageable, though narrowly worth saving for the sake of preventing job losses.[6] GM's case seemed more hopeful, but nearly everyone in the government was convinced its top management was deeply dysfunctional and was determined to reject any plan that did not feature a significant shake-up. In a March 30 speech, President Obama declared his administration's intention to resist the tendency to "paper over" problems and "kick tough choices down the road" and issued an ultimatum: GM and Chrysler would need to quickly submit new plans and could expect to face liquidation if their submissions failed to satisfy the government.[7]

To ensure that neither company would crash and burn while revising its restructuring plan, the Obama administration agreed to provide each with additional loans: $500 million for thirty days for Chrysler and up to $5 billion for sixty days for GM.[8] (The governments of Canada and Ontario would also contribute.) It also announced that it would be guaranteeing GM and Chrysler car warranties, thereby keeping consumers from fleeing to competitors because of warranty concerns, providing an estimated $1.1 billion for this purpose.[9] During March, the Auto Task Force had also acted to ensure that neither giant would be undone by the unexpected bankruptcy of a key supplier by creating the Auto Supplier Support Program, which could loan up to $5 billion to the automakers to support ongoing purchases from suppliers.[10] All of this new aid money came from the Automobile Industry Financing Program (AIFP) in TARP; Obama's team hardly gave a second thought to the legal propriety of using TARP for these firms.[11]

Through April and May, Chrysler and GM worked furiously to devise plans that would pass muster with the Auto Task Force and the president and also win the approval of key stakeholders, including bondholders, other creditors, and the United Automobile Workers (UAW) union. By the end of its thirty-day reprieve, Chrysler had come to an agreement with the Italian

auto company Fiat that Team Auto was ready to bless; on April 30, Obama triumphantly announced that the company would go through a rapid bankruptcy process and emerge new and improved.[12] It would receive debtor-in-possession (DIP) financing from the Treasury to the tune of $8 billion, in exchange for which the taxpayers would become equity holders in the new company. GM followed in Chrysler's footsteps a month later, with the president announcing its restructuring on June 1.[13] A quick bankruptcy would allow a reincarnated GM to emerge, with the Treasury again providing DIP financing—this time an additional $30.1 billion—in exchange for a large equity share in the new company, around $7 billion in notes, and $2.1 billion in preferred stock.[14]

How these bankruptcies were arranged, and what became of the two companies afterward, remain among the most contentious aspects of all the bailouts; charges of illegality and illegitimacy abound. I treat their stories in turn.

Given to Fiat by Fiat?

Throughout the first half of 2009, Chrysler and the government consistently assumed that the automaker's last best hope was a partnership of some kind with Fiat. A simple sale to the Italian company might have been preferable, but Fiat and its flamboyant CEO, Sergio Marchionne, made it clear that they would not commit any cash to Chrysler's restructuring, seeing it as too large a risk. Instead, Fiat essentially offered to run Chrysler and give it attractive intellectual property in exchange for partial ownership in a reincarnated, low-debt "New Chrysler."[15]

The Auto Task Force shared Marchionne's sense that the existing version of Chrysler was saddled with too much debt to survive and therefore pushed it toward bankruptcy reorganization. There were two main legal options for bankruptcy: a standard chapter 11 reorganization, in which the company would continue running while it worked out its debts through the bankruptcy court and then eventually reemerged as viable; or a § 363 sale, which would take advantage of a part of the bankruptcy code allowing a rapid sale of intact business divisions to a new owner, the proceeds of which could then be put toward the debts of the original firm.[16] Because a § 363 sale could more quickly produce an unencumbered company, it became the preferred option. "Old Chrysler" would sell nearly all of its valuable businesses to a freshly created "New Chrysler" in exchange for cash that could be disbursed to its first-in-line secured creditors—who by 2009 understood that Chrysler did not have enough value to repay the full $6.9 billion they were owed. There was also a significant legal constraint on a § 363 sale: it could not be a sub rosa reorganization plan. In other words, if the whole effect of the sale was to

reorganize the company at the expense of previously secured creditors (with JPMorgan, the largest among them, the contractually designed negotiator), the sale could be rejected and a traditional chapter 11 process required.

Hanging over the possibility of a § 363 sale was the question of what should happen to Chrysler's unsecured creditors. The largest of these was the UAW's health care trust fund for its retired workers. Chrysler and GM had, earlier in the decade, made a pact with the UAW that would end their open-ended exposure to retiree health benefits in exchange for large, up-front cash payments to the trust. Chrysler owed $8.8 billion to the fund, but this debt was unsecured, and so in a normal chapter 11 proceeding it would be paid only if the secured creditors were first made whole—an unlikely prospect. The possibility of ending up with nothing gave the UAW an incentive to make serious concessions at the negotiating table. On the other hand, it was hard to envision getting New Chrysler off the ground without retaining most of Old Chrysler's UAW employees, and this fact gave the UAW leverage. Bankruptcy thus became a balancing act between the legally empowered secured creditors and the economically empowered UAW.

Team Auto felt that since the government was the only viable DIP lender for Chrysler, it could drive a hard bargain with the secured creditors, giving them only what they could expect if Chrysler went into liquidation. It stunned them with its first offer: just $1 billion, amounting to 14 cents on the dollar for the face value of their bonds. For this amount, the secured creditors were prepared to take their chances in bankruptcy court. Rattner next made a take-it-or-leave-it offer of $2 billion in cash on April 28. Most secured creditors (by holdings) voted to accept this offer, though several holdouts voted against. On April 29, JPMorgan's negotiators told Rattner that if he sweetened the deal with an extra $500 million, they might get full buy-in from all the creditors; Rattner made a fast-expiring offer for an extra $250 million, but in the end about twenty small debt holders (mostly hedge funds) refused to agree and resolved to take their cases to court. The $2 billion offer would be voted through by the majority of the secured creditors, though, giving the secured creditors about 29 cents on the dollar for their claims.[17] In his April 30 speech, President Obama denounced those who had refused the offer, saying, "I don't stand with those who held out when everybody else is making sacrifices" and accused them of demanding "an unjustified taxpayer-funded bailout."[18]

At the same time, the unsecured claim of the UAW's retiree health trust was receiving much better treatment: it would get from New Chrysler a $4.6 billion obligation and a 67.7 percent equity stake (nonvoting).[19] Although it did not get the certainty of cash, as the secured creditors did, its unsecured

claim was likely to be worth more than 50 cents on the dollar and could even potentially be fully paid off.[20] In exchange, the UAW agreed to allow more future hires of lower-paid, unpensioned workers by New Chrysler, as well as promising not to strike for the next few years.[21] When the secured creditors angrily demanded an explanation as to why they received such inferior treatment, they were apparently told, "You don't need banks and bondholders to make cars."[22]

This outcome was greeted by a scathing reaction in the business press for several reasons. First, although it was true that the majority of secured creditors had, through their JPMorgan agent, approved of the sale to New Chrysler, many observers pointed to a rather serious conflict of interest: the four largest creditors were all TARP recipients and may have been reluctant to sour their relationship with their benefactor by pursuing a full vindication of their rights.[23] Second, not surprisingly, many leading conservative and libertarian legal commentators were outraged by the apparent violation of prioritization rules to favor the UAW's interests. According to Richard Epstein, the whole thing amounted to "an illegal taking of property from one group of creditors for the benefit of another, which should be struck down on both statutory and constitutional grounds."[24] Todd Zywicki, who would become one of the most persistent critics of the Chrysler bankruptcy, said the Obama administration's behavior was reminiscent of Hugo Chávez and warned, "The government's threats and bare-knuckle tactics set an ominous precedent for the treatment of those considered insufficiently responsive to its desires."[25] Harvard Law School bankruptcy professor Mark Roe criticized the administration and the bankruptcy court for failing to solicit any bids for Chrysler and for disallowing any bids that would have treated the UAW less generously; because of this omission, it was impossible to say with any certainty whether secured creditors received a fair value for their claims.[26]

Many critics also saw the sale as an impermissible use of § 363 to facilitate a sub rosa reorganization.[27] A deep exploration of this issue is beyond the scope of this work, but what we can say for sure is that courts were not sympathetic to the criticism. Although nearly all of the dissident creditors dropped their claims after the $2 billion sale was agreed on, their counsel soldiered on with a group of several Indiana police pension funds as their new client. Indiana's state treasurer, Richard Mourdock, had decided that the funds had a cause worth taking a stand for and was determined to get vindication in court.[28]

He would not get it: in the Southern District of New York Bankruptcy Court, where the action was filed, Judge Robert Gonzalez issued a decision fully supporting the propriety of the § 363 sale, emphasizing the unusual

need for quick action to preserve the firm's value and secure the (potentially expiring) offer for taxpayer support. In his judgment, the creditors had no evidence to support their contention that they could have expected a higher payment from Old Chrysler, and they had no valid claim on New Chrysler, which could choose to take on whatever contracts or debts it determined necessary for running its business. Gonzalez also found that even if none of these facts were true, the pension funds' claim would still fail because they were contractually bound to abide by the decisions made by their trustee, JPMorgan.[29] The Second Circuit Court of Appeals quickly affirmed on very similar grounds—and, notably, declined to decide the "interesting and unresolved constitutional issues concerning the scope of the [Treasury] Secretary's authority under TARP and the use of TARP money to bail out an automobile manufacturer," rejecting the claim as lacking standing.[30] Responding to the Indiana pension fund's petition for cert and a temporary injunction, Justice Ruth Bader Ginsburg issued a temporary stay on June 8, but the next day that was vacated and the court declined to issue a permanent stay, explicitly stating that it was not offering an opinion on the merits of the case.[31]

The § 363 sale closed remarkably fast on June 10, just forty-two days after the initial filing.[32] In an extremely strange ending to the legal proceedings, the Supreme Court unanimously issued "a short, cryptic decision" in December 2009 granting cert and vacating the judgment of the lower courts but with instructions to dismiss the case as moot.[33] Though it is difficult to know for sure, this may signal the Court's desire to disavow the Second Circuit's § 363 interpretation, and the delayed reaction could have come from the familiar judicial desire not to intervene too onerously in the executive branch's crisis actions.[34]

Glossing over several complexities, GM's bankruptcy would closely follow the Chrysler template, though without any foreign partner. Old GM sold nearly all of its assets in a § 363 sale to New GM, which (using funding provided by the Treasury) paid $30.1 billion and issued 10 percent of its equity to the old company (plus warrants for 15 percent more at a high price), worth an estimated $7.4 billion. That was more than enough money to completely repay secured creditors, which made up a relatively small share of GM debt holders, as well as leaving some value for unsecured creditors, making this bankruptcy somewhat less contentious even though there was so much more taxpayer money involved.[35] Once again, the new company made a large commitment to the UAW's retiree health trust, despite its having been unsecured, giving it 17.5 percent of equity in New GM (and 2.5 percent more warrants), a $2.5 billion note, and $6.5 billion in preferred stock. The Treasury became a

61 percent equity holder in New GM, as well as receiving $7.1 billion in notes and $2.1 billion in preferred stock.[36]

A few commentators singled out issues with GM's bankruptcy. Ralph Nader, a shareholder of Old GM, denounced the process for having "a small, largely unaccountable, ad hoc task force made up of a handful of Wall Street expats" deciding the company's future.[37] Many critics have argued that the UAW was treated too gently, having to make hardly any concessions to strike a deal with New GM, and Rattner would later express regret that the Auto Task Force had not been more aggressive on this front.[38] Similarly, union workers of Delphi, a bankrupt former GM subsidiary, would receive pension top-ups from New GM, even as nonunion workers were left to collect lower payouts from the Pension Benefit Guarantee Corporation (PBGC), which limits the extent of the government's guarantee. Many commentators found this disparate treatment objectionable.[39] As with Chrysler, there was also concern that the § 363 sale was being used to perform a sub rosa reorganization, thus impermissibly avoiding the normal chapter 11 process. Once again, none of the complaints gained traction in court, with bankruptcy judge Robert Gerber approving all aspects of the § 363 sale, citing *Chrysler* as precedent.[40] Litigation over the main deal went no further.[41]

Are the critics right that the relatively favorable treatment of the UAW trust compared with other creditors represents a gross violation of the rule of law by violating well-established bankruptcy rules? Their allegation is that these deals were utterly without genuine legal legitimacy and represented illegitimate catering to special interests.[42] These substantial complaints seem to have resonated with the mass public, most of whom fairly consistently told pollsters they were opposed to helping the automakers.[43]

Notwithstanding these serious concerns, it is unsurprising that the judiciary signed off on both bankruptcies as permissible and that the Obama administration was willing to defend its choices and even tout them as signature achievements in the 2012 election. All of the judges who ruled on the bankruptcies accepted that the car companies were doomed without the government's help and thus faced no real choice but to accept the government's terms and conditions; they further accepted that creditors would have been far worse off if the companies had gone into chapter 11. Because of the decision not to hold open auctions for the firms, the truth of this assertion will forever be impossible to establish with certainty. But it should not be treated as far-fetched. Critics have never been able to present concrete alternatives that would have better served creditors, and most creditors did sign off on the deals. Given these firms' willingness to vocally criticize some of the

government's other crisis actions, the idea that they were coerced into endorsing the auto bailout is highly speculative.[44] There is a strong irony: many who believe the government was eager to run roughshod over the interests of banks as automaker creditors simultaneously believe that the government was giving those very same banks historically unprecedented largesse as TARP recipients.

But if complaints about legality and process legitimacy are muted by the parties' grudgingly forthcoming consent, basic concerns about fairness linger. Unionized autoworkers are mostly quite highly compensated, and while creditors have no special legal standing to protest favorable government treatment of them, taxpayers have every right to wonder whether this use of public funds really served the common good.[45] If the government's interventions are best understood as first giving creditors a fair value for their claims and subsequently turning over large amounts of money to the UAW for the sake of labor peace and job preservation, this second decision is clearly a political one. Bankruptcy's rule-based neutrality no longer provides any cover for such a decision, although Obama's Auto Task Force was at pains to make it seem as if all of its negotiations flowed out of the bankruptcy process.

Establishing the deals with the UAW as "political" simply opens a different conversation about their legitimacy: Were they really important for the nation as a whole? Particulars here are hard to pin down, but they matter. Since the payments were largely to support UAW retirees' health benefits, were they really necessary to keep current UAW workers on the job?[46] On the other side, even for those who celebrate the virtues of creative destruction, it is possible that the government was saving taxpayers money by keeping Chrysler and GM operating smoothly, as relevant considerations included the safety net support that newly unemployed workers would draw on.[47] For some Americans, union busting in the midst of an economic downturn would no doubt have been welcome; but perhaps it is understandable that Rattner and his team felt it was impossible to ask their Democratic president to follow in the footsteps of Ronald Reagan in his 1981 showdown with air traffic controllers.[48] Not surprisingly in the current political context, these considerations have led many people to attempt to transmute the whole issue of support for the automakers into a sharply partisan one; a right-wing commentator even attempted to let President Bush off the hook by claiming he later professed regret at his administration's original intervention, though that does not appear to be true.[49]

In the midst of a crisis, citizens want the government to get its hands dirty to minimize the fallout; citizens also want the government to keep its hands clean, not favoring any particular interest over others. Sometimes there are

distinct constituencies for these competing positions; just as often individuals have both of these impulses simultaneously, even as they pull in opposite directions. As the government acts, doing more for some (more politically favored) interests than others, it will want to portray itself as acting in the (of course apolitical) best interests of the general public, but this posture of neutrality will almost certainly be, shall we say, artificial. As the saying goes, hypocrisy is the tribute vice pays to virtue. So, too, declarations of fealty to the common good are the tribute that highly political crisis acts pay to the idea of neutral government.

For those who reject the underlying politics behind the auto interventions, the potent mixture of serious legal concerns, relatively hostile public opinion, and a credible allegation of politicization have combined to put the Chrysler and, to a lesser extent, GM bankruptcies near the top of their list of illegitimate crisis abuses. Because of the government's involvement, the bankruptcies seem to be unfortunate missed opportunities for deeper and more lasting restructurings. For those who share the president's solicitude toward the UAW, however, the bankruptcy processes seem legitimate, in terms of both process and substantive merit. In February 2012, Obama spoke to the UAW and said of critics, "They're out there talking about you like you're some special interest that needs to be beaten down. Since when are hard-working men and women who are putting in a hard day's work every day, since when are they special interests? Since when is the idea that we look out for one another a bad thing?"[50] Many political analysts felt that Obama's touting of this message ("Osama bin Laden is dead, and General Motors is alive") was one of the keys to his 2012 reelection, especially in Ohio.[51] The debate will continue; never the twain shall meet.

Flirting with "Government Motors"

The government's involvement with General Motors' bankruptcy ultimately engendered less criticism than its ongoing involvement—or, some would say, interference—with the company's management. In his March 30 speech rejecting Chrysler's and GM's original restructuring proposals, President Obama explicitly disavowed having any desire or intention of "running GM," but on that very same day GM's CEO Rick Wagoner resigned at the administration's request.[52] From the beginning of the Auto Task Force's dealings with GM, then, many in the business world feared that, professions of a hands-off philosophy aside, the federal government would seek to advance its various policy priorities or even ideas about corporate management through a kind of twenty-first-century "state capitalism."

Wagoner's resignation presented the first of many Rorschach tests about the government's involvement. Beginning in the Bush administration, Wagoner had always told government crisis fighters that he would step aside if they believed doing so would be best for GM's future. But when Rattner delivered the news to him that the Auto Task Force had decided to take him up on this offer, he was apparently shocked and infuriated.[53] Some press reports characterized Wagoner as being "pushed out," with the move seeming to signal "a level of government involvement in business perhaps not seen since the Great Depression."[54] Many admirers of Wagoner would remain aghast that his contributions toward turning GM around were so unceremoniously dismissed.[55]

Whether one finds this episode troubling depends on which aspects of legitimacy are emphasized. On one hand, no specific legal authority was needed for Team Auto to make a nonbinding request that Wagoner leave, and so legality seems to be a nonissue. On the other hand, there is a sense that without any process to discipline decisionmaking, the decision may have been capricious, a product of prejudgment by Rattner and others in the Obama administration who were committed to the idea of ousting key members of GM's management from the start of their engagement.[56] At the very least, it is difficult to evaluate the nature or quality of the decisionmaking process that led Team Auto to this stance. Given the opacity of the thinking, it is probably impossible to dispel a lingering sense of arbitrariness for those who contest the task force's judgment.

Potentially more troubling are various questions about how the government's ownership of GM stock may have led to use of its influence on the company's strategic decisions as a way to advance various administration policies or to reward favored constituencies or allies. Team Auto had contemplated the political hazards of taking on a majority share of ownership for the government but decided that giving the government equity was the best way to ensure that the New GM would not find itself undercapitalized and teetering on the brink of bankruptcy from its creation.[57] Keenly aware of the concerns about government micromanaging commercial businesses, Summers's deputy, Diana Farrell, prepared a report in March 2009 attempting to articulate "rules of the road" for the administration's decisionmaking as a "reluctant shareholder." It envisioned a three-stage process in which the government would be as active as any private investor during the restructuring process, then become strictly hands off once new management was in place, and finally seek to sell its stake and exit "as soon as practicable."[58] In spite of this stance, many wondered if the new reality was, "What (the Obama administration thinks) is good for America is (perforce) good for GM," a concern conveyed by the

easily applied nickname Government Motors. When the sale of most of Old GM's assets to New GM went through, President Obama emphasized the activist phase, saying, "I think that like any investor, the American taxpayer has a right to scrutinize what's being proposed and make sure that their money is not just being thrown down the drain."[59]

From the beginning, worries about politics driving business decisions colored judgments about the government's involvement; a large share of Americans probably find the idea of a state-run auto company inherently illegitimate, quite apart from any questions as to how the ownership stake was acquired. A *Washington Post* editorial opined that "the political manipulation of the company has probably only just begun; Democratic Rep. Eliot L. Engel (N.Y.), for example, has declared that the government should require GM to install 'flex fuel' technology in its cars."[60] Such worries seemed to be validated early on. Though unreported in the press, the Obama administration effectively vetoed GM's plan to move its headquarters from Detroit to suburban Warren, arguing that it would simply be too devastating to Detroit to lose the tax revenue. The administration also dictated to GM that it needed to make deep cuts to executive pensions, although it took pains to "maintain the fiction that such decisions were being made by GM."[61]

Attracting considerable public notice, in early June Barney Frank angrily tore into GM's new CEO, Fritz Henderson, because of the announcement that a parts depot in his district would close in late 2011; Henderson agreed to delay that closing, later explaining to Rattner that he thought he had no real choice given Frank's status as chair of the House Financial Services Committee.[62] Predictably, this led to denunciations of "the latest self-appointed car czar" by conservatives and to other political officials following with their own requests, though the company vowed it would make its future decisions based on its own internal criteria.[63] Although critics have pointed to a few other instances in which political interference affected supply chain decisions, it seems that GM mostly adhered to its promise.[64]

It is difficult to assess how much the administration may have forced fuel-efficiency standards onto GM (or Chrysler) through its ownership positions. Several critics allege a simple quid pro quo: the whole bailout of GM was premised on an understanding that the company would reorient itself in an environmentally friendly direction, regardless of the economic soundness of that choice.[65] Such charges are long on innuendo and short on specific instances in which the company was compelled to change its plans. There is no question that a whole host of policies—some predating the Obama administration and plenty more put into place in 2009 and beyond—existed to steer automakers

toward fuel efficiency. Some observers have confusedly lumped together fuel efficiency standards emerging from a joint rulemaking by the Environmental Protection Agency and National Highway Transportation Safety Administration with the Auto Task Force's work, but there is no reason to think of them as integrally related (or even as GM or Chrysler specific).[66]

Some of the most heated controversy about the legitimacy of the government's involvement centered on the issue of car dealership closings. Both Chrysler and GM believed that paring down their networks of dealers would improve their efficiency, but of course dealers—who tend to be politically influential in congressional districts across the nation—rejected this analysis and pointed to the job losses that closings would entail. Lawmakers intervened directly on behalf of their constituents in several documented instances and probably many more that went unreported.[67] In this case, the Obama administration's Auto Task Force was on the opposite side: they had rejected the pace of dealership closings in both companies' original restructuring proposals as too slow and insisted that the companies use bankruptcy as an opportunity to rapidly implement needed consolidation.[68] The Special Inspector General for TARP (SIGTARP) would later issue a report sharply critical of Team Auto's decisionmaking process, saying that it was insufficiently thorough in deciding about the efficiencies of widespread and rapid closures and insufficiently sensitive to the societal costs of job losses in a weak economy.[69] There was a clear conflict between thinking of the government's interventions under TARP's broad umbrella as a way to ensure specific companies' viability and thinking of TARP's purpose as supporting the economy more broadly—which was often the case in 2009.

Congress would prove itself capable of mobilizing on behalf of its vision in the case of the dealers, passing a measure in December 2009 that allowed every dealer closed to seek arbitration and possibly win reinstatement.[70] Critics certainly have ample grounds for wondering whether GM and Chrysler would have encountered similar "interference" had they been forced through normal chapter 11 bankruptcies without government involvement—although few seem to note that the overall effect of the "distortion" is somewhat ambiguous, given the push and pull in opposing directions by Team Auto and Congress. Regardless of the merits, the final process that emerged bore the stamp of democratic process legitimacy.

In the months following GM's bankruptcy, critics of the Obama administration's involvement in the auto industry sometimes formulated their critiques as jeremiads warning of a permanent illegitimate expansion of state economic control. George Will penned a typical example: "Do they have an

aspiration that they dare not speak? Do they hope that state capitalism will be irreversible—that wherever government has asserted the primacy of politics, the primacy will be permanent?"[71]

Such fears of a state-directed economy may have helped shape the Obama administration's approach to GM, which was quite the opposite. The government originally aimed to sell at least 5 percent of its GM stock each year and totally divest within eight years; then sought to sell its ownership stake and collect on its loans ahead of schedule; then supported hurrying GM's initial public offering in advance of the 2010 elections; and ultimately exited entirely at a price that locked in a loss, rather than wait to see if growth at the company could allow it to break even on its investment.[72] The strong desire to avoid looking like a corporatist, nationalizing state may have thus had appreciable fiscal costs for taxpayers—but may also have had a significant upside in limiting the scope for potential government favoritism, which, all things considered, remained fairly modest.

Managing Difficult Acquisitions: Government as Shareholder and Defendant

The government's headaches as GM's majority shareholder mostly paled in comparison with those it experienced as 79.9 percent owner of AIG and the GSEs. In each case, the public's sense that the government had effectively nationalized these firms led to expectations that they would be managed for the benefit of taxpayers and perhaps in pursuit of other policy goals as well. But the government had not wiped out private shareholders at AIG, Fannie Mae, or Freddie Mae; for a number of complicated legal reasons, it had left them and their boards in place, constraining the available range of legal options for the government-supported firms. The tension between these expectations and constraints led to some of the most serious legitimacy problems of all the crisis responses.

AIG: The Battle of the Bonuses, and Lingering Challenges from Old Owners

The Fed's actions in September 2008 made AIG the largest single recipient of government support, and the November 2008 restructuring of the support, including a commitment of a large portion of TARP funds, had signaled the government's determination to keep the company afloat even if it had to do so on less punitive terms. The government's commitment deepened again with a second restructuring announced at the beginning of March 2009 (and

implemented in April), which came on the heels of AIG's announcement that it had recorded a net loss of $61.7 billion in the fourth quarter of 2008—the largest quarterly loss for any firm in American history.[73] Once again the terms of AIG's aid became more generous: AIG's required dividend payments due on the government's preferred stock would no longer accumulate if unpaid for a year; the Treasury would make up to $30 billion more available to be drawn down in exchange for more preferred stock; and AIG would be allowed to repay its Fed loans at a further reduced rate using common stock of two healthy subsidiaries, using yet another special-purpose-vehicle (SPV) mechanism for the purpose.[74] The grand total available to AIG (solely through firm-specific aid) now reached $182.5 billion.

At just this moment, AIG became the focal point for the financial crisis's most intense outpouring of public rage, which centered on the question of employee compensation at bailed-out firms. During March 2009, declarations of illegitimacy proliferated, and at least for a moment it looked as though this backlash might fundamentally constrain and alter the government's approach to the whole crisis.

To understand the public's outcry and the legal status of compensation at firms receiving government aid, it is necessary to briefly backtrack. As discussed in chapter 4, one of Congress's most prominent concerns in passing TARP was that controls be put in place to restrict executive pay. Quite appropriately, legislators strongly feared giving their support to a law that would essentially transfer wealth from the taxpaying public to wealthy denizens of Wall Street who were apparently culpable for causing the crisis in the first place—it is hard to imagine any policy more likely to be regarded as fundamentally abhorrent and illegitimate. As a result, early drafts of TARP contained fairly broad restrictions on executive pay for firms receiving aid and would have allowed extensive government review of pay packages. During the negotiations over the bill, these restrictions were significantly narrowed at the behest of the Bush administration. Treasury secretary Henry Paulson, especially, worried that stringent compensation controls would discourage participation from the very banks that needed to be enticed into availing themselves of aid.[75] In the final version that became law, the toughest restrictions (in § 111 of the Emergency Economic Stabilization Act [EESA]) applied only to those firms that sold troubled assets to the Treasury—which of course turned out to be an empty set when the Treasury abandoned its original plan to buy up hard-to-value assets and decided to use TARP for capital infusions instead.[76] Critics of TARP felt this was yet another instance in which Paulson and his team had effectively duped

Congress, and they made tightening compensation restrictions a top priority in late 2008 and early 2009.

Their campaign succeeded: President Obama's massive stimulus law, the American Reinvestment and Recovery Act (ARRA), passed on February 17, 2009, considerably amended TARP's executive compensation and corporate governance requirements, broadening their applicability and tightening their restrictions.[77] Bonuses, other than restricted stock, to a firm's senior executives and some of its highest paid employees were prohibited—though with an important exception for "any bonus payment required to be paid pursuant to a written employment contract executed on or before February 11, 2009."[78] Notably, Congress also attached to these changes the ability for firms to repay their TARP commitments early: while they were originally obligated to keep the capital from the Capital Purchase Program (CPP) for three years, under the ARRA-amended version they would be allowed to repay and exit, thus avoiding the tightened executive compensation limits, as soon as the Treasury secretary and their relevant regulator deemed them sufficiently rehabilitated to stand alone.[79]

This amendment to TARP soon proved to be insufficiently zealous in restricting bonuses to satisfy the public, however: in early March, AIG announced its plan to pay thousands of prenegotiated retention bonuses totaling hundreds of millions of dollars, including to employees in the AIG financial products division that had jeopardized the firm's survival and necessitated its rescue. The public greeted this news with incredulous anger: How could these employees deserve these rewards, which were enabled by government largesse?[80]

Although Geithner thought the contractual obligations were binding, others in the administration, including Obama himself, shared the public's outrage and pushed for some kind of action.[81] As a result, Geithner apparently told AIG's top managers that the bonuses were a bridge too far and should be renegotiated; on March 16, the president himself joined the chorus of critics, telling an audience of small-business owners that he shared their anger at the unfairness of the payments and pledging that Geithner would do everything legally possible to limit payments.[82] In spite of these stirrings, Treasury lawyers indicated that they saw no viable options for simply barring the payments, which clearly fell within the exception for preexisting contracts. National Economic Council chair Larry Summers followed Obama's harsh words with a televised assurance that "we are a country of law. . . . The government cannot just abrogate contracts."[83]

The House of Representatives, which responded to the public outcry with remarkable alacrity, sought to change the legal options available. A spate of

bills directly targeting AIG's bonuses was introduced, including the ambitiously titled End Government Reimbursement of Excessive Executive Disbursements (End GREED) Act.[84] Most of these received little attention, but legislators showed themselves capable of far more than mere posturing by rallying around a "bill to impose a 90 percent additional tax on bonuses received from certain TARP recipients," introduced March 18 by Representative Charles Rangel (D-N.Y.) and passed on March 19 by an overwhelming 328–93 majority.[85] Concerns were raised by a variety of commentators and legislators that the confiscatory tax would run afoul of the Constitution's prohibition on bills of attainder, but many others brushed these worries aside and urged on the Senate.[86] President Obama was noncommittally supportive, at least initially: "I don't want to quell anger. I think people are right to be angry. I'm angry," Obama told reporters, but he stopped short of promising his signature.[87]

As the Senate considered action, New York's attorney general, Andrew Cuomo, aggressively played another angle by using his state's fraudulent conveyance doctrine, which prohibited firms with very little capital (usually those in bankruptcy) from making some kinds of payments. Although his usage was arcane and not clearly supported by the law, the threat of action in state courts was enough to convince AIG to be cooperative in sharing its documents with Cuomo, as well as forming its own review committee.[88] Cuomo also subpoenaed the names of all those who received bonuses and apparently threatened to release those names to the public.[89]

The threats of official action, coupled with AIG CEO Edward Liddy's pleas, caused many of the bonus recipients to voluntarily return their payments.[90] Some recipients reported that they feared for their safety, as they had received threats of violence, and sought to keep their names from being made public by giving back the money; this included nine of the ten largest recipients, who collectively returned $50 million.[91] Some employees resigned from AIG, including the AIG financial products executive, vice president Jake DeSantis, who left with an angry New York Times op-ed that denounced Cuomo's willingness to conduct a trial by public opinion.[92] Not surprisingly, for some AIG critics, such departures were hailed, with suggestions that they might make the company less able to manage its complex positions dismissed as absurd.[93]

Soon enough, the feverish campaign against the AIG bonuses lost steam, probably in part thanks to the returned bonus payments. The Senate never took up the bonus tax in earnest.[94] Nor did it take up another House measure, passed in the lower chamber on April 2, that would have authorized

the Treasury to ban all "unreasonable and excessive" compensation at TARP recipients.[95] After his initial signs of support, President Obama mostly kept his distance from the original proposal and its successors. The administration instead opted to use existing authorities to devise a review process for executive compensation headed by Kenneth Feinberg, which became operational in June 2009.[96] Obama also met with the CEOs of big banks and encouraged them to tell their story to the public more effectively as a way of gaining broader sympathy for the bailouts.[97] In short, the world turned, and the wave of public outcry that made the AIG bonuses the central focus of national attention receded.

Reflecting on the furor, what can be said about legitimacy and legality? To a striking extent, they were at cross-purposes. The citizenry's strongest feelings of illegitimacy were rooted in deep concerns about fairness; quite understandably, people were offended by the idea that they were sending their tax dollars to Washington only to see them sent out the door to the very same AIG employees who had helped to cause or at least exacerbate the crisis (regardless of whether this was precisely true). Against these powerful feelings, protestations about legal obligations and limitations originally seemed quite feeble. The correctness of the Treasury lawyers' logic was not really the issue.[98] Instead, the public reasoned backward from the perceived unfairness: it was wrong to pay the bonuses out, and the government's position as majority shareholder of AIG made this offense one of commission. If de facto nationalization did not yield the de jure power to ensure justice, what good was it? If the government was to have any legitimacy, it needed to stop this outrage, legality be damned.

And yet the intensity of these feelings of illegitimacy subsided—in part because they had their intended effect through extralegal channels, leading many AIG employees to feel cowed into returning their bonuses. Legality acted as a significant restraint on official action during the burst of high-intensity demands on legislators. While even the president seemed briefly tempted to promise a result regardless of its legal permissibility, in the end the legal concerns were decisive: AIG was not merely an arm of the government; its existing contracts were considered binding (though, of course, not beyond the reach of "voluntary" renegotiation); and the law itself proved resistant to quick alteration, in true Madisonian fashion.

Even after the dust had settled, few people had much sympathy for the AIG bonus recipients, and therefore few have celebrated the final outcome as a triumph for the rule of law. Instead, some have seen the partial, extralegal victory for bonus opponents as a prelude to the delegitimation of democratic

capitalism and have even linked the anti-banker mood evident in March 2009 to the eventual "expropriation of Chrysler's secured creditors."[99] This seems quite overheated. Instead, the bonus fight shows us both the limitations and the usefulness of the rule of law: government officials were able to make soft threats of how they would use their discretionary power, and (combined with a truly enraged public) this was enough to instill real fear. Officials were stopped, however, from giving force to the full effect of popular anger by a commitment to abide by legal limits.[100]

Having weathered this storm, throughout 2009 AIG looked for opportunities to sell off valuable subsidiaries and restructure its operations to move toward repayment of its debts to the Federal Reserve Bank of New York (FRBNY) and the Treasury. Although it required some legal maneuvering, including a reverse stock split, the government was eventually able to convert its preferred shares into a 79.9 percent share of diluted common stock.[101] That conversion did not actually take place for some time, though, and AIG's support from various government programs remained basically intact throughout 2009 and most of 2010. In December 2009, the New York Fed restructured its support, reducing its revolving credit facility from $60 billion to $25 billion and taking a preferred interest in the subsidiary-backed SPVs; AIG then sold one of the subsidiaries (ALICO) to MetLife in March 2010 (with the sale completed in November 2010) and sold the other (AIA) in a public offering in October 2010.[102] The New York Fed, the Treasury Department, and AIG jointly announced another major restructuring on September 30, 2010, which would be implemented in January 2011. This "recapitalization" agreement paid back the revolving credit facility completely and used the proceeds from the two large sales to pay down its other commitment to the Fed, reducing the New York Fed's outstanding commitments to AIG to just its Maiden Lanes II and III; and it exchanged all of the Treasury's various preferred shares into common shares, leaving the Treasury with 92.1 percent of all of the common shares.[103] Those would be gradually sold off over the course of 2011 and 2012, leading to a triumphant declaration in December 2012 that the government had completely sold off its shares—finally bringing in $22.7 billion more than it had given out through its various programs.[104]

Defending the AIG Rescue in Court

As AIG was on the way to independence, its stock price rising and its prospects for totally repaying the government's investment looking far better than almost any bailout critic (or defender, for that matter) had expected, many began to view the government's involvement with the firm in a more positive

light. This most certainly did not include Hank Greenberg, AIG's former CEO and main architect, who had been forced to leave the firm in 2005 but remained CEO of Starr International—still AIG's single largest shareholder (though far from a majority) going into the fall of 2008. From the outset of the intervention, Greenberg had claimed that AIG was being uniquely scapegoated and improperly undervalued by the government. He formalized that grievance in two legal cases Starr filed in 2011 against both the FRBNY and the U.S. Treasury, contending that AIG shareholders' wealth was unconstitutionally and illegally expropriated when the government diluted their shares by taking equity in the firm.[105] Greenberg's lawyer, David Boies, proclaimed, "What these lawsuits say is that in our country, not even the government is above the law."[106] The case against the New York Fed was dismissed in November 2012, with Southern District of New York judge Paul Engelmayer conceding that "Starr's Amended Complaint paints a portrait of government treachery worthy of an Oliver Stone movie" but finding that the FRBNY owed no fiduciary duty to AIG's shareholders and in any case could have no civil liability for carrying out its statutorily mandated duties.[107]

Starr's action against the Treasury, filed in the Court of Federal Claims (which has jurisdiction in cases seeking damages from the federal government), largely survived the government's motion to dismiss, however.[108] Greenberg attempted to rally AIG's leadership to Starr's cause only to be quite publicly rebuffed. Robert Benmosche, AIG's new CEO, told the public that "a deal's a deal" and that the company was "thanking America and we have to go forward."[109] Nevertheless, shareholders as of September 22, 2008, and June 30, 2009—the dates of the original agreement and the reverse stock split, respectively—were granted class-action status, with Starr as lead plaintiff.[110] This case survived the government's attempt to get it dismissed as moot, though Starr's motion to bring derivative claims on AIG's behalf was rejected.[111] It then featured a battle as to whether Federal Reserve chair Bernanke could be forced to give a deposition under oath—a requirement the Fed fought bitterly, worried about the precedent it would set. The trial judge ruled that Bernanke could be forced, but that decision was reversed in the Court of Appeals for the Federal Circuit.[112] Having avoided a binding obligation, Bernanke agreed to give a deposition once he had left office, and did so on February 27, 2014.[113]

Starr's complaints are too numerous to evaluate here in any detail, but the main thrust of his action is clear enough: AIG was a valuable company that should have been given liquidity assistance without extreme demands; its shareholders were improperly cut out of a process that ended up diluting their shares without their legally required consent; the government used AIG as a

vehicle for a backdoor bailout of favored investment banks that were counterparties on AIG's credit default swaps; and, taken as a whole, the government's actions amounted to an unconstitutional taking. Specifically, Starr argued that the Federal Reserve exceeded its powers under § 13(3) by forcing AIG to grant warrants for common shares that would give the government part of the company regardless of whether AIG repaid its loans. From Starr's point of view, this structure could not possibly be construed as collateral, and therefore did not fit within the § 13(3) emergency loan power.[114] All of these complaints survived the government's motion for dismissal, paving the way for a lively trial held in late 2014.[115] As of this writing the case, set to produce an opinion in 2015, remains one of the largest question marks remaining about what will become of the 2008 crisis responses.

Fannie and Freddie: From Money Pits to Cash Cows

The GSEs, Fannie Mae and Freddie Mac, followed a path that parallels AIG's in many respects. As the companies recovered from the depths of the crisis, the government restructured their operations, with the last of these restructurings leading the old shareholders to charge that the government had impermissibly expropriated their wealth.

In the first month of the Obama administration, the first restructuring of the commitment to Fannie and Freddie was to change the amounts available to each firm from $100 billion to $200 billion. With both companies recording huge losses in late 2008 and expecting more to come in 2009, the original commitments looked potentially inadequate, and Treasury secretary Geithner and Federal Housing Finance Agency (FHFA) director James Lockhart together decided that ensuring market confidence in the institutions required sending a clear signal that the government would help them to absorb far larger losses than originally anticipated.[116] Before the end of the year, the Treasury expanded that commitment even further. Under § 1117 of the Housing and Economic Recovery Act (HERA),Treasury's authority to purchase GSE securities was to expire on December 31, 2009. The Treasury interpreted this as merely requiring that it set its maximum possible level of commitment by the deadline and decided that the most prudent course would be to uncap its support entirely. They announced the change on December 24, leading some critics, like Representative Scott Garrett (R-N.J.), to condemn the government's willingness to write a "blank check."[117]

Congress spent some time debating the GSEs' fate in the lead-up to passing the Dodd-Frank Act in mid-2010. The Senate considered a provision entitled the GSE Bailout Elimination and Taxpayer Protection Act, which

would have set a deadline for ending conservatorship, forcing the companies either to be privatized or to be put into receivership within two years, but voted it down 43-56.[118] Ultimately the Dodd-Frank Act did little to address the status of Fannie and Freddie, which persisted in conservatorship with little clarity about their future. In the absence of legislation, the FHFA attempted to clarify the terms and conditions of conservatorship for the companies and their shareholders with a rulemaking proposed in July 2010 (and finalized June 2011).[119] The Treasury also released a report to Congress in February 2011 laying out a path toward winding down the government's commitment to the GSEs, but this was largely prospective and contingent on passing future reforms.[120] Meanwhile, both Fannie and Freddie seemed caught in an endless loop of having to borrow more from the Treasury to pay 10 percent dividends on the Treasury's preferred shares.[121]

Clarity of a sort finally came in August 2012, when the Treasury and the FHFA decided to implement the so-called Third Amendments. Rather than paying the Treasury a 10 percent dividend, the GSEs would now have a quarterly "net worth sweep" that sent whatever profits it earned each quarter to the Treasury—without, however, having that money go toward reducing Treasury's overall commitment. According to the Treasury, this would ensure that "every dollar of earnings that Fannie Mae and Freddie Mac generate will be used to benefit taxpayers for their investment in those firms" and deliver on the administration's previous commitment to wind down the GSEs by preventing them from "rebuild[ing] capital, and return[ing] to the market in their prior form."[122] This arrangement could, at least initially, be presented as an improvement on the status quo for the GSEs, since it would relieve strain on their cash flow if they continued to generate losses—and so the Third Amendments were at least arguably consistent with the FHFA's responsibilities as conservator.

But that understanding soon became quite difficult to square with the GSEs' actual experience that followed: both Fannie and Freddie soon became extremely profitable, only to see all of their profits "swept" into the Treasury without reducing the Treasury's stake in the firms, so that conservatorship seems likely to stretch on indefinitely. This is so even after Fannie and Freddie have sent more to the Treasury than the Treasury sunk into them—which (at least by some accounts) came to pass early in 2014.[123] In spite of this profitability, the old shareholders (who are still partial owners of the firms) seem to have no prospect of reaping gains from any of the GSEs' profits.

Needless to say, the old shareholders have mounted a vigorous political and legal campaign to contest this state of affairs, rallying several prominent commentators to their cause. Richard Epstein denounced the Third Amendments

as "grand theft Treasury," arguing that the government's actions have "been marred by grave legal violations of bedrock principles underlying corporate, administrative, and constitutional law."[124] Ralph Nader, himself a shareholder and a one-time critic of the GSEs' complicated relationship with the government, has organized a group called Shareholder Respect to "help Fannie and Freddie shareholders escape financial limbo," holding events to publicize shareholders' cause and petitioning Treasury secretary Jack Lew for relief.[125] There are more than a dozen cases proceeding against the government in the Court of Federal Claims and the District Court for the District of Columbia, some of which challenge only the Third Amendments and others of which question the whole conservatorship arrangement. The cases advance a dizzying array of legal challenges, including unconstitutional taking, violation of the Administrative Procedure Act, exceeding statutory authority under HERA, and FHFA breach of contract or fiduciary duty as conservator.[126] As of this writing, these cases show no sign of going away. Advocates of the shareholders' position hope that vindication in court can "partially repair the rule of law," and they are also waging an energetic political campaign to have Congress act on their behalf if it undertakes GSE reform.[127]

The Legal Perils of Not-Quite-Nationalization

As in the AIG litigation, the questions raised about the government's conduct in the challenges against the Third Amendments cannot be shrugged off as mere nuisances.[128] In its role as majority shareholder of AIG and the GSEs, the government-as-de-facto-nationalizer does seem to have put the interests of taxpayers ahead of the companies and their preexisting shareholders, even though the government-as-de-jure-non-nationalizer lacked any clear basis for doing so. As chapter 2 shows, courts are likely to tread very lightly when evaluating government actions taken in the midst of serious emergencies, making these cases far from clear winners for the plaintiffs—although perhaps the best thing the private litigants have going for them is that their legal actions are taking place long after the worst of the crisis has subsided, such that a court could rebuke the government without jeopardizing the nation's economic well-being.

As these cases proceed, their public reception is perhaps just as important and revealing as their ultimate outcome will be. In short, though the old shareholders have mounted an impressive public relations campaign (especially in the case of the GSEs), their causes engender little broad public sympathy. Far from finding any champions in Congress, none of legislators' varied GSE reform proposals would provide relief to the old shareholders, and most would end up

officially wiping them out.[129] Numerous hearings on the fate of the GSEs have highlighted the problems with "a never-ending conservatorship," but sympathy for the plight of the shareholders has been quite limited.[130] Because the companies they owned participated so directly in bringing on the financial crisis, even if the shareholders can make strong cases that their treatment was inconsistent with the rule of law, they have a hard time claiming the mantle of democratic legitimacy. The public's idea of justice demands that the law should have been different, not that they should have been given their legal due.

What we are seeing, in short, is the playing out of the consequences of the government attempting to serve politically popular ends through legally inadequate means. "Nationalization" was widely debated as the crisis deepened, and commentators often spoke as though the GSEs and AIG, especially, had been simply "nationalized." But this is a term with no precise legal meaning, and the government became the majority shareholder in Fannie, Freddie, and AIG in September 2008 through legal mechanisms that were poorly suited to wiping out existing shareholders' claims on the companies' future value. At the time, estimating that future value as positive was generally viewed as Pollyannaish, and so these questions did not seem pressing.

Happily, the outlook improved and the government found itself defending its legal maneuvers against the preexisting, diluted-but-still-legally-empowered shareholders, who have complaints. The Federal Reserve's emergency lending power under § 13(3) is meant to provide liquidity to institutions in need against good collateral, at a penalty rate of interest. Given AIG's precariousness in September 2008, it was difficult to say whether it had sufficient amounts of good collateral to permit the Fed to make a loan, and its corporate officers decided they were willing to sign away 79.9 percent of their company's equity to ensure it was a worthwhile risk for the Fed. That may have been a fair accommodation to the exigency of the moment, and it may ultimately be found consistent with the statute's requirements—but there is no question that it fits awkwardly with the legal mechanism being used.

The mismatch between legal mechanism and ultimate aims is even clearer in the case of the GSEs—in spite of the fact that Congress acted in summer 2008 to pass the HERA and empower the newly created FHFA with options for dealing with the GSEs' failure. Based on its subsequent actions, it seems clear that the government never wanted to see existing shareholders recover any value if the companies were restored to financial health through government assistance. This is even more obvious once one accounts for the fact that so-called vulture funds have bought up much of the GSE stock on the cheap in hopes of reaping a windfall after a legal victory, leading commentators to

see the shareholder litigants "playing the role of Robin Hood, when [they are] in fact, the Sheriff of Nottingham."[131]

Why, then, did the government use conservatorship, when HERA also gave it the option of putting the companies into receivership (which would have entailed liquidation)? Paulson gave one insight into this question, revealing that the government's crisis fighters initially leaned toward receivership but found that it would entail too much risk in the midst of the crisis. They worried that it would prove destabilizing as firms wondered if the GSE mortgage guarantees would hold, and receivership would cause the firms to lose their hedging contracts, potentially costing taxpayers billions.[132] In addition, taking a share of 80 percent or more would have forced the government to consolidate Fannie's and Freddie's $4.9 *trillion* in obligations onto the government's balance sheet—which, given the peculiarities of America's federal debt ceiling, might have been illegal without further congressional action and was certainly politically untenable.[133] Even in retrospect, with all the legal and political difficulties now surrounding the GSEs in clear focus, those who decided on conservatorship are likely to believe that they made the least bad decision available to them at the time, with the burden for figuring out the legal difficulties properly falling on Congress.

How the pending cases are ultimately resolved may tell us something about what the rule of law, in its most formal sense, means to the modern judiciary in the wake of a serious crisis. Probably the most likely outcome is a strong show of deference to the judgments of executive branch crisis fighters wielding powerful enabling acts. On the other hand, there may be limits to deference to executive branch crisis fighters—half a decade after the fact, anyhow. Supposing the shareholders prevail in court, it would nevertheless be a mistake to overvalue these precedents for future crisis fighters. As with Lincoln in *Ex Parte Milligan* and FDR with *Ex parte Endo* and *Duncan* v. *Kahanamoku*, after-the-fact legal repudiation years after pivotal decisions will pale against towering immediate needs; as Edward Corwin put it regarding *Milligan*, if a crisis response succeeds and thus acquires the stamp of legitimacy for posterity, "such fustian" from the judiciary is unlikely to carry much weight. The government may be belatedly forced to acknowledge that its legal tools were not formally equal to the uses to which they were put, and it may even have to pay some compensation as a result—but since the crisis fighters all became vocal advocates of altering and expanding the legal tools available to them for combating future difficulties, these defeats would be of limited import; future crisis fighters will have little extra incentive to allow worries about litigious Monday morning quarterbacks to affect their decisions.

Avoiding Nationalization of the Big Banks

As the new Obama administration struggled to define its relationships with AIG and the GSEs, which its predecessor had taken majority ownership of back in 2008, an equally important challenge was determining what the government's relationship should be with those firms that had given the Treasury minority ownership positions through the TARP's main capital injection program, the CPP. As economic suffering spread and stock markets remained in free fall in the early months of 2009, that original round of capital injections into the banking system struck most observers as inadequate, leading to a lively debate about how the crisis fighters should adjust their approach.

Perhaps the central question in this debate was to nationalize or not to nationalize. Examples from abroad, including Sweden in the early 1990s and the United Kingdom in 2008, led many commentators to insist that the fastest and most effective way to recapitalize the banking system was for the government to completely buy out existing shareholders (at fire-sale prices), replace the banks' management, restructure their operations, and finally sell their equity back to the private sector once they had been rendered systemically unthreatening.[134] Muddying the debate, both sides tended to be legally imprecise about what "nationalization" really meant. The word itself tended to conjure up images of Mitterand-era France's takeover of the banking system with the intention of making it a permanent state holding, but that was never really an option seriously considered in America—which, after all, retained its self-image as a land of free markets in spite of the government's recent crisis interventions.[135] For those who moved beyond the terminological question, a few key questions stood out: What form should the government's investment in banks take? How involved should the government be in managing the day-to-day operations of the banks? What should happen to existing shareholders?[136] As the preceding discussions of the automakers, AIG, and the GSEs make clear, such issues had the potential to present considerable legal and political difficulties.

Expected to emerge from this fray with a clear path forward for the banking system, Geithner, now Treasury secretary, presented the new administration's Financial Stability Plan to the Senate Banking Committee on February 10, 2009.[137] The plan contained several elements: a Public-Private Investment Program (PPIP), a Fed plan to spur consumer lending, and a vague promise to "launch a comprehensive housing program" (each of which is discussed in the next section).[138] Perhaps most central, Geithner announced that the Treasury, rather than launching any kind of blanket nationalization program,

would "stress test" the nation's largest banks, determine how badly undercapitalized they would be in the face of persistently difficult economic conditions, and require them to raise private capital to fill any funding gap. Any bank that could not quickly find adequate private funding would have to take an injection of government capital by issuing convertible preferred stock paying 9 percent dividends to the taxpayers.[139] The Treasury hoped that by releasing the stress test results publicly they would help restore confidence and thereby restart private capital flows.

As he made this announcement, Geithner was already on shaky ground because of personal income tax issues that had marred his confirmation hearings; he also lacked Bernanke's professorial credibility or Paulson's battle-tested gravitas, and he had had scant public-facing experience.[140] His presentation went over like a lead balloon, with the Dow Jones Industrial Average falling 382 points in response.[141] Critics felt Geithner's speech was woodenly delivered, vague, and too much a mere continuation of earlier TARP and Fed efforts that seemed to fall short of restoring confidence. Ranking member Senator Richard Shelby asked Geithner whether the main point of his speech was "aggravating economic problems by contributing to the marketplace uncertainty about what steps the government will take," and the next day he called the plan "unacceptable to Congress, unacceptable to the American people."[142] When the dissatisfaction over the Treasury secretary's plan was combined with the anger over the AIG bonuses in March, calls for Geithner's resignation or firing became commonplace. Trust in the administration's ability to figure out its not-quite-nationalization plan was almost nonexistent, and the legitimacy of its policies was in serious doubt. As the stress tests began, many commentators preemptively dismissed them as "fudge tests" meant to create false confidence through use of insufficiently strenuous assumptions.[143]

While the stress tests were being designed and implemented, the Treasury simultaneously took less-trumpeted steps to shore up Citigroup—which had not been restored to stability by the ring-fencing arrangement negotiated in November 2008. At the end of February, the Treasury announced it would convert $25 billion of its preferred stock under the CPP into common shares, thereby rendering the bank better capitalized and increasing the taxpayers' ownership share of the bank. When those transactions took place (at the end of July), the Treasury would become the firm's largest single shareholder, with 33.6 percent of common equity.[144]

On May 7 the stress test results were publicly released. Ten of the nineteen participating banks were told they needed to raise capital; their plans would be due in June, and a total of $75 billion in capital raises were required by

November.[145] Among the banks with the greatest need were Bank of America and Citi—which would have found themselves with even larger holes to fill had they not both received large infusions of government capital already.[146] Much to the surprise of critics, banks immediately sought and found new capital, raising most of what was required within two weeks.[147] Bank of America alone would raise $26 billion before the end of May, mostly by selling new common shares.[148] Only one firm, General Motors Acceptance Corporation (GMAC), found itself unable to attract sufficient private investment to meet its stress test–revealed need. The Treasury ultimately decided to provide the auto finance company with financing through the previously used AIFP rather than through the new financing program associated with the stress tests—which would end in November 2009 without ever having made a single investment.[149]

The stress test thus became the program that allowed the Obama administration to avoid nationalizing the banks—to the dismay of those critics who felt that asserting government control over the banking sector would be the surest road back to economic health, and to the pleasant surprise of those who had believed that Geithner's plan was a surreptitious means of nationalization. This avoidance was quite deliberate: the administration had had a robust (but nonpublic) debate on nationalization in March, culminating in a Larry Summers memo that argued against nationalization as legally impossible, likely to create the very panic it was intended to avoid, and risky for the government if banks were to see a medium-term loss of value.[150] Taking advantage of the amendment to TARP in the stimulus law, many banks sought to exit the program by repaying the government as soon as possible; for the ten large banks deemed adequately capitalized by the stress tests, including JPMorgan and Morgan Stanley, this meant full repayment in June 2009, which effectively freed them from the program's restrictions on executive compensation.[151] Smaller banks followed, with repayments beginning in March and accelerating over the summer.[152] Even the two most problematic large banks, Bank of America and Citi, began their exits in late 2009. Bank of America repurchased $45 billion of government-held preferred stock on December 9, and the government sold its remaining warrants in March 2010.[153] After Citi was given another stress test, it entered into a complex negotiation with its regulators in December and also charted its exit, terminating its ring-fence agreement and making significant repayments that month; the Treasury sold off its common shares gradually over the course of 2010.[154]

By avoiding large-scale nationalization, the government largely spared itself from a host of difficult questions about government ownership of banks—but

not entirely. Minority ownership raised its own questions: What should be the objective of the holdings? Should the government attempt to exert control over the banks' boards or their day-to-day management? How and when should sales be timed? Should peripheral political goals be sought through ownership? Should steps be taken to minimize potential conflicts of interest between government-as-shareholder and government-as-regulator? When the FDIC took control of the failed IndyMac, it explicitly pursued an agenda of mortgage modification for the bank's holdings, leading many to wonder if the government would seek similar concessions at firms of which it was a partial owner.[155] Corporate law scholars raised many questions about the legal peculiarities of having the government as a major shareholder, including the puzzle of how the government was to reconcile its EESA-mandated duty to maximize shareholder value with the government's preference to minimize its entanglement in the private sector and exit as soon as practicable.[156]

Especially problematic was the case of Citi, where the government could be plausibly characterized as a controlling shareholder. Normally, controlling shareholders of state-chartered corporations owe fiduciary duties to their fellow shareholders, but the government's sovereign immunity would shield it from any lawsuits under state law. While some framework law existed to shape the government's role as partial owner of federally chartered institutions, these had not exactly proved models of clarity, as the example of the GSEs had shown. And in any case, they had nothing to say about the peculiar situation in which the federal government was a shareholder in a state-chartered corporation.[157] As a rule, the government seems to have erred on the side of minimizing its formal involvement as a shareholder, although it remains difficult to assess exactly how much it used "soft-control mechanisms" to exert influence.[158] Some observers, including Sheila Bair, felt that the government's reluctance to more aggressively dictate changes to Citi's management or corporate structure was again evidence of arbitrary and unfair government favoritism on its behalf; for them, it was obvious that government should use its leverage as shareholder to facilitate the breakup of Citi.[159] Legitimacy concerns about the government's relationship with Citi remain among the sorest.

At several points in 2009, Congress moved toward providing additional legal clarity about the government's shareholder role, but ultimately it failed to pass any legislation. One House bill would have formally conferred a "right of repayment for well-capitalized institutions" similar to what the Geithner Treasury ultimately recognized.[160] Others would have totally prohibited executive branch officials from influencing TARP recipients' management decisions or forced the government's shares to be held by independent trusts (as its AIG

shares were).[161] The Treasury's conduct apparently mitigated the pressing need for clarifying legislation, but this remains an area where the rule of law would be better served by a clearly articulated set of expectations established before difficult crisis choices balancing the competing priorities of fairness and efficacy must be made.

Geithner's Paradox, or Legitimacy Squandered?

As Paulson and others initiated their policy responses to the crisis in 2008, they were continuously dogged by the perception that they were bailing out Wall Street but ignoring Main Street. A major question facing the Obama administration—and Treasury secretary Geithner most of all—was whether they would capitalize on the new president's broad appeal and change that image. As discussed in chapter 4, one of the central complaints against the Bush administration's implementation of TARP was its neglect of relief for individual homeowners struggling to fend off foreclosure. For those looking to the new administration to turn over a new leaf, housing policy under TARP thus took on great importance, both substantive and symbolic. Would the administration find a way to facilitate principal reductions for underwater homeowners? Would it be able to force mortgage servicers, whom many people saw as partially culpable, to share the burden felt by struggling homeowners?

In his poorly received February 10, 2009, speech, Geithner had made only the vaguest gestures at the administration's intent to reboot the housing programs inherited from the Bush administration. President Obama personally announced his team's plan on housing in a February 18 speech in Mesa, Arizona, one of the epicenters of the foreclosure crisis. Touting some of the provisions passed as part of the stimulus plan the day before, he also announced a new set of programs he said would help 7 million to 9 million families restructure their mortgages or refinance—all without helping "speculators" who made risky bets on investment properties. The plan included an additional $200 billion commitment to the GSEs (discussed above); a refinancing of mortgages held by the GSEs; and a program, which became known as the Home Affordable Modification Program (HAMP), to subsidize modifications of subprime loans held by private mortgage servicers.[162] Altogether, this was billed as a $275 billion plan.[163]

As much as the administration hoped to meet the great expectations of those looking for government to help Main Street, it also wanted badly to avoid destabilizing banks by forcing mortgage losses onto them. Perhaps even more politically salient, it wanted to avoid having its actions

characterized as a bailout of those who had irresponsibly taken out mortgages without any realistic hope of repaying them. This hazard was vividly illustrated the day after Obama's announcement. In spite of the president's insistence that the new programs would not give any aid to speculators, CNBC host Rick Santelli took to the airwaves to denounce subsidizing "losers' mortgages," protesting against making honest citizens who had lived within their means "pay for [their] neighbor's mortgages that has an extra bathroom and can't pay their bills."[164] He concluded this oration with a call for a Chicago Tea Party to protest the policies and thus helped launch a movement that would become one of the primary vessels for denigrating the crisis response's legitimacy. Fear of being seen as the benefactor of debtors who had foolishly bought McMansions had been one of the chief deterrents to the Bush administration acting on foreclosure relief, and—in spite of Obama's lofty February speech—it would soon become clear that this was a point of continuity in the new administration.[165]

In addition to this political consideration working against modifications, there were also a host of legal obstacles to large-scale action. The powers conferred by EESA (§ 109) were all about facilitating modifications rather than forcing them on unwilling servicers. The government was empowered to help "prevent avoidable foreclosures," but for mortgages deeply under water (where the home's current market value was far below the remaining debt) it was unclear whether foreclosure could be avoided. These limitations were reflected in HAMP's design: all modifications would have to be entered into voluntarily. Because of the structure of various mortgage-backed securities, holders of AAA-tranche bonds were unlikely to have any incentive to do so.[166] Attentive to these legal issues, Congress debated new legislation to improve the legal climate for modifications in the early months of 2009, for example by shielding servicers who agreed to modifications from potential liability. These efforts culminated in the passage of the Helping Families Save Their Homes Act of 2009.[167] However, in the version that ultimately passed, Congress eschewed modifying the personal bankruptcy code to allow "cramdowns" of mortgages by bankruptcy judges, in which mortgage terms might be modified without the bank's consent. This may have been underwater mortgage holders' best chance at gaining negotiating leverage, and it meant that the widespread foreclosure relief acts of the 1930s would not be repeated.[168]

For both political and legal reasons, then, the administration would fall well short of its ambitious goals. Though it was expected to provide permanent relief to 3 million to 4 million homeowners, HAMP had only 362,348 trial modifications and a measly 1,711 permanent modifications in its first

six months. Beginning in July 2009, Secretary Geithner and HUD secretary Shaun Donovan intensified their campaign, attempting to increase participation through "jawboning and report cards." But the results would remain disappointing. By March 2010, the administration could boast just 231,801 permanent modifications—and even that number, an order of magnitude short of the stated goal, probably overstated its success, as many of the modifications gave little help to the debtors and were likely to produce re-defaults.[169] At various points, the administration attempted to spin the programs as modest successes, for example, heralding their 500,000th trial modification in October 2009 as a significant milestone.[170] But critics were quite unmoved, pointing out that the program's original goal was stated in terms of permanent modifications.[171] Two years on, conventional wisdom was that the programs were failures.[172]

Neil Barofsky, the special inspector general for TARP, became an especially bitter critic, accusing the administration of adopting a metric that had little to do with impact on the economy.[173] Barofsky would escalate his criticisms of the administration's housing policy as he left office in early 2011, declaring HAMP "a colossal failure" and condemning TARP's failure in terms of its "Main-Street oriented goals" of helping homeowners. As he saw things, the consequences of these failures were profound:

> In the final analysis, it has been the Treasury's broken promises that have turned TARP—which was instrumental in saving the financial system at a relatively modest cost to taxpayers—into a program commonly viewed as little more than a giveaway to Wall Street executives.
>
> It wasn't meant to be that. Indeed, Treasury's mismanagement of TARP and its disregard for TARP's Main Street goals—whether born of incompetence, timidity in the face of a crisis or a mindset too closely aligned with the banks it was supposed to rein in—may have so damaged the credibility of the government as a whole that future policy makers may be politically unable to take the necessary steps to save the system the next time a crisis arises. This avoidable political reality might just be TARP's most lasting, and unfortunate, legacy.[174]

Barofsky would deepen and extend this criticism in his 2012 book, *Bailout*.[175] The impact of his criticism is considered further in the next chapter, but here it is worth pausing to consider the import of his accusation: Did the Treasury's failure to deliver on its promises to homeowners damage its legitimacy so profoundly that its political ability to combat financial crises effectively was permanently impaired?

Geithner himself has attempted to answer this question firmly in the negative. While sometimes admitting that the Treasury could have done a better job communicating its reasoning to the public, he has mostly given a pugnacious defense of the Treasury's priorities.[176] From his perspective, a finance minister or secretary is likely to "screw up financial crises because the politics are horrible, and that deters action. They are slow and late and tentative and weak because they are scared to death of the politics. But sometimes a policymaker has to say, I'll take pain now against pain later."[177] In other words, when politics and economics clash, a proper sense of duty should lead a crisis fighter to choose economics without regret. Highlighting the tension even more clearly, in late 2011 Geithner mused, "The central paradox of financial crises is that what feels just and fair is the opposite of what's required for a just and fair outcome."[178] Presumably, Geithner views the "just and fair outcome" for most citizens as being achievable only in a growing, prosperous economy; during a crisis, figuring out a way to produce that outcome requires a certain willingness to disregard "what feels just and fair" in terms of punishing bankers who brought on the crisis (including by redistributing wealth from them to distressed homeowners). Doing the emotionally satisfying thing will do nothing to help bring about the desired outcome and thus must be resisted as counterproductive, whatever the apparent political costs of this choice.

There are reasons to think that Geithner has overstated a crisis fighter's ability to separate the political and the economic cleanly and underappreciated the ways in which efficacy depends on maintaining legitimacy. For evidence, we need not wait for the next financial crisis; instead, we can see how a loss of legitimacy constrained the Fed's and the Treasury's ability to successfully improvise further crisis responses.

The Legitimacy Deficit's Costs: Adhocracy Constrained

After so much innovation in creating new programs, most people believed that the original vision of TARP as an asset-purchasing program was long rendered moot. But remarkably, in early 2009 the decision was made to design and implement a troubled-asset relief program. The crisis fighters hoped that getting hard-to-value assets off of banks' books would facilitate recapitalization and restore confidence, while the purchasing program would help establish prices in the still-dysfunctional market, potentially fostering private trading. In his February 10 speech, Geithner announced that the Treasury, the Fed, the FDIC, and the private sector would combine their efforts through a Public-Private Investment Program (PPIP).[179]

The mechanics of PPIP, revealed beginning in late March, were unquestionably arcane—and, depending on one's view of the program, possibly ingenious or grotesque. The program would involve partnerships between private investors and the Treasury, which would take equal equity stakes in pools of mortgages they would buy from banks. They would lever their investment with debt financing provided by the Treasury, the Fed, and the FDIC, potentially magnifying their gains even if the mortgages recovered only partially. By making private sector, profit-seeking fund managers the decisionmakers for the investment funds, the government hoped it could credibly establish fair prices and ensure that the government did not overpay for assets.[180] The announced scope of the program was surprisingly large: by drawing in private investors as well as using Fed and FDIC financing, just $75 billion to $100 billion from TARP would support a program designed to make anywhere from $500 billion up to $1 trillion of asset purchases.[181]

The legal creativity of these financing arrangements deserves further elaboration. Financing was designed to run through two distinct subprograms. The Legacy Securities Program allowed its participating funds to use debt financing provided by the Federal Reserve's Term Asset-Backed Securities Loan Facility (TALF), which was announced on November 25, 2008, went into operation in March 2009, and would ultimately run through March 2010. It provided nonrecourse loans against various kinds of non-mortgage-backed assets, including investment-grade securitized credit card, auto, and student loans (and, later, commercial mortgage-backed securities). Although the assets were haircut, the program's terms were designed to offer an attractive rate of return for these asset classes, thus promoting liquidity in the markets for those assets.[182] (The structure of TALF is every bit as arcane as PPIP's, even involving yet another SPV; but I will spare the reader these details, because the program, which was a resounding success, engendered little controversy.)[183] Through TALF, private investors approved to participate in PPIP could effectively turn some kinds of illiquid securities into levered investments in mortgage-backed securities.[184] Although the details were sufficiently opaque to resist becoming popular news, the government—through the totality of its programs—had come to take on a very complicated intermediation function.

The larger PPIP subprogram was to be the Legacy Loans Program, in which investors would buy pools of heretofore unsecuritized mortgages with the help of an FDIC guarantee. Investors participating in this program would match their equity investments with debt instruments guaranteed by the FDIC.[185] Firms selling assets would receive a mix of cash and FDIC-backed notes, which would greatly benefit them in terms of meeting their regulatory capital

requirements.[186] The FDIC's involvement in PPIP thus built on the expansive legal interpretation of its powers that had gone into the Temporary Liquidity Guarantee Program; once again, the agency decided that its broad responsibility for insuring the health of its regulated banks justified its unorthodox role as guarantor of financial assets.

On hearing of these seemingly generous financing options for asset buyers participating in PPIP, financial markets were positively giddy—the Dow shot up nearly 500 points, or nearly 7 percent—but criticism from a wide range of commentators was scathing.[187] Some focused on the basic question of whether the program was, more or less, a mechanism for transferring taxpayer wealth to private investors, who seemed not to have to take on much risk at all to potentially reap large upside gains. Paul Krugman dismissed PPIP as "cash for trash" and "financial hocus-pocus," insisting that it would amount to a taxpayer giveaway.[188] Joseph Stiglitz dubbed it "ersatz capitalism," in which losers were made whole through taxpayer subsidization.[189] Other worries were tied to the operational details of the programs, the complexities of which seemed to create considerable opportunities for gaming the system, including the awkward possibility that banks could figure out how to make government-financed purchases of their own assets.[190] Jeffrey Sachs worried about the potential for self-dealing and condemned the "lack of the most minimal transparency so far about the rules, risks, and procedures of this trillion-dollar plan." He continued, "Also incredible is the apparent lack of any oversight by Congress, reinforcing the sense that the fix is in or that at best we are all sitting ducks."[191] In its April report to Congress, SIGTARP energetically pursued these concerns, warning of vulnerabilities to fraud, money laundering, and rampant conflicts of interest inherent in PPIP's program design, as well as voicing concerns about the interactions between PPIP and TALF.[192]

In perhaps the most prominent criticism of any of the FDIC's crisis responses, Andrew Ross Sorkin, of the *New York Times*, penned a mordant critique of the agency's role in PPIP, which he said "could politely be called mission creep." Sorkin suggested that the FDIC's interpretation of its statutory powers was probably impermissible, especially since the agency seemed to be running afoul of a clear requirement that it avoid taking on any obligation greater than $30 billion. The FDIC apparently rated its own risk from its PPIP guarantees as effectively zero and thus argued it was within its legal duties, but, as Sorkin pointed out, this logic appeared to justify unlimited guarantees as long as the agency was willing to assert it would not record losses. Given the taxpayers' ultimate backstop for the FDIC, this was clearly a

matter of great import, and Sorkin found it remarkable that this "TARP 2.0" could be implemented without any congressional involvement.[193]

The legitimacy of PPIP was being questioned from all directions, and the combined weight of these criticisms ended up taking its toll. Congress actually mobilized in response to these concerns to take action with surprising speed, adding provisions incorporating some SIGTARP suggestions as amendments to the Helping Families Save Their Homes Act, passed into law on May 20, 2009.[194] But rather than viewing PPIP as purified of its defects, potential participants were made especially wary by this quick legislative intervention: if participants were likely to be saddled with extra requirements so easily, they were worried about the hard-to-quantify political risks of becoming involved with the program at all.[195] Given that the program continued to be the object of intense criticism—including further ones from the SIGTARP, who felt that the changes were beneficial but insufficient—potential participants wondered whether PPIP involvement would entail government imposition of compensation limits, restrictions on techniques for collecting on mortgages in default, or other as yet unimagined requirements.[196]

At least partially as a result, the wildly ambitious hopes for PPIP were badly disappointed. The Legacy Loans Program, meant to use FDIC guarantees, never got off the ground. One small pilot program was launched in September 2009, but it failed to jumpstart the larger program, which was done in by delays in required Treasury approvals, investors' worries about being required to participate in HAMP, and sellers' reluctance to book accounting losses.[197] The Legacy Securities Program fared somewhat better but never grew to anywhere near the originally contemplated scale. By October, approved private funds looked to buy some $12 billion in troubled assets using $3 billion in private equity.[198] By the close of the funding period in June 2010, total funding was up to $29.2 billion, and it appeared both the government and private investors could expect positive returns on their equity investments of about 15.5 percent.[199] The Treasury mustered a defense of the program as having helped restore liquidity to mortgage-backed security markets, but like the much-heralded mortgage programs, it was orders of magnitude smaller than originally promised.

Geithner's approach to crisis fighting was posited on the belief that if the government pursued the right economic approach, political legitimacy would eventually follow—even if only in the history books. The difficult experience with PPIP shows the shortcomings of this approach to legitimacy: failing to actively make the case for legitimacy left the Treasury and its partners in the program less able to find participants than they otherwise might have been. To

be fair, the Treasury itself became aware of these issues, and mid-level officials conducted active outreach programs designed to assure potential participants that the government was willing "to adhere to the 'rules of the game.'" This pitch succeeded in at least a few cases.[200] Nor can it be said that the failure to invest in legitimacy somehow proved fatal to the Treasury's larger stability plan. Still, PPIP's short history shows how political legitimacy can sometimes be a necessary element of policy efficacy even in the short run.

Retrospective Legitimacy through Success?

Over the course of 2009 and 2010, as Obama, Geithner, and Bernanke executed their myriad plans for crisis response, two things became clear. First, the size of the economic downturn caused by the crisis was far worse than originally appreciated, and the country would be mired in a disappointing economic recovery for some time. Second, from mid-2009 onward, America was no longer teetering on the brink of an unprecedented financial meltdown. As the economic crisis took on gravely distressing dimensions (in spite of the officially designated end to economic recession in June 2009), the financial crisis receded. By early 2010, many commentators had come to see the stress tests as a pivotal factor in restoring America's banking system to relative normalcy (even as peer institutions abroad struggled).[201] As time went by, it became clear that the worst cost projections for the extraordinary interventions by the Treasury, the Fed, and the FDIC would not be realized; indeed, it became possible to argue about whether the government would "turn a profit" on its crisis interventions (which chapter 6 discusses).

The financial system's recovery has conferred a great deal of retrospective legitimacy on the crisis fighters' efforts. By this book's writing in 2014, the widespread anti-bailout fervor of March 2009 looks very distant, notwithstanding the continued scorn for TARP shared by a large portion of the public. The crisis responses do not enjoy anything approaching acclamation at this juncture, but the conversation has largely moved on. This progression can sometimes feel inevitable, but we should carefully consider a counterfactual world in which the financial system's recovery was weaker and slower. Since adhocracy failed to provide any basis for the legitimacy of many crisis responses other than their success, many actions that ultimately failed to capture the public's imagination in a state of modest recovery might have become full-blown scandals in a world of double-dip recession.

There is a strong case to be made that the collective underinvestment in political legitimacy of the Treasury, the Fed, and others created a serious

potential for a political-economic crisis in 2009 and 2010 that could have compounded the existing financial one. The public's trust in government reached a historic nadir during this period, as illustrated by the fervor of the Occupy Wall Street and Tea Party movements; in early 2010, 60 percent of Americans disapproved of aid to banks compared with 32 percent who approved, and those who felt that TARP and the auto bailouts actually hurt America's economy significantly outnumbered those who felt they had helped.[202] As a result, the executive branch already found working with Congress to adjust the available crisis-response tools to be practically impossible.[203] In the counterfactual world in which the crisis proved to be worse—easy to imagine, given the volatile Eurozone crisis and Greece's near default—this inability to produce legitimacy through normal political channels could have been extremely damaging, both in terms of the ability to combat the crisis successfully and in terms of the crisis fighters' ability to retain some degree of democratic legitimacy. It is all too easy to imagine an ensuing downward spiral of inefficacy feeding illegitimacy feeding further inefficacy.

To ensure that our country never reaps such a whirlwind, we can and should do more than wish for a different kind of crisis leadership. (Geithner himself would adapt quite a bit during his time as Treasury secretary; in the words of one commentator, by 2010 he "had clearly become more supple at aligning his agenda with the political zeitgeist, rather than colliding with it kamikaze-style.")[204] We must think about the kinds of accountability mechanisms that can be put into place to respond to and channel deep public discontent with official crisis responses. Chapter 6 turns to this task by examining the accountability mechanisms we did have, and chapter 7 offers recommendations for the future.

6

Accountability Mechanisms

One of the most important ways that government officials can legitimate their crisis actions is to allow them to be subjected to meaningful and consequential ex post judgment. Even if trust is in short supply, a sense of genuine accountability can alleviate suspicions and support legitimacy by making citizens confident that abuses of crisis authorities will be rooted out and corrected. Accountability might come through formal legal adjudication and remedy, but just as often accountability mechanisms are more overtly political, meant to compensate for the limits of legality and give voice to citizens' sense of right and wrong in a less rules-based forum.

The huge variety of policy responses to the financial crisis of 2008 engineered by the Treasury, the Federal Reserve, and the Federal Deposit Insurance Corporation were subjected to a number of formal and informal accountability mechanisms. These naturally included normal courts—but as chapter 5 discusses in relation to the litigation over the handling of AIG and the government-sponsored enterprises, the judiciary often proves too slow and too deferential to decisions made during crises to provide really robust accountability. Also included were permanent government oversight institutions, meant to provide accountability in normal times as well as crisis, and several accountability bodies created during the crisis. Finally, nongovernmental groups also provided important forms of accountability, including a broad spectrum of traditional media, investigative journalists, and bloggers scrutinizing government actions.

Timeline of Events Discussed in Chapter 6

- October 2008: Emergency Economic Stability Act (ESSA) creates Congressional Oversight Panel (COP) and Special Inspector General for TARP (SIGTARP) to provide additional oversight for the Troubled Asset Relief Program
- November 25, 2008: To further support AIG, Fed creates Maiden Lane III, which will inspire "backdoor bailout" criticisms
- May 20, 2009: Financial Crisis Inquiry Commission (FCIC) created by Fraud Enforcement and Recovery Act
- July 20, 2009: SIGTARP releases report suggesting "total potential Federal Government support could reach up to $23.7 trillion"
- September 9, 2009: COP releases report on the use of TARP funds in the automotive industry
- September 17, 2009: FCIC holds its first public hearing
- June 10, 2010: COP releases report on government involvement in AIG
- January 2011: FCIC releases final report
- October 2011: Government Accountability Office releases report on Maiden Lane III
- November 27, 2011: Bloomberg News releases "Secret Loans" story, the fruit of a successful Freedom of Information Act lawsuit against the Fed
- January 2013: Treasury claims 93 percent TARP repayment, heralds overall crisis program gains

Each of these accountability mechanisms constrained executive branch actions by guarding against certain kinds of abuses or unauthorized exercises of power, but the total effect of the whole collection of mechanisms is something more than a bundle of constraints. A regime's actions that are scrutinized and criticized by credible accountability mechanisms are received differently by the general public than actions that seem to be shielded from public scrutiny. The existence of a wide array of constraints can legitimate a regime and ultimately make it more powerful than it would have been otherwise, as Jack Goldsmith has argued in the national security context in his book *Power and Constraint*.[1] Because ordinary citizens and even members of Congress do not possess sufficient resources or knowledge to thoroughly review crisis actions themselves, their ability to trust the government's actions will depend on having dedicated monitors assess those actions.

The Treasury and the Federal Reserve were often resentful of the kinds of accountability that official watchdogs tried to impose on them, which they often felt were opportunistic and shallow. In this chapter, I argue that they should nevertheless be grateful to have been subjected to the probing and criticism. When a multitude of eyes watch what the government does—what Goldsmith calls a "synopticon" (in a reversal of Bentham's panopticon)—its actions can achieve legitimacy far more effectively than if deals are made in "smoke-filled rooms." If aspiring Woodwards and Bernsteins looking to make their careers by exposing a scandal settle for fairly minor complaints about appearances of impropriety, that should reassure skeptics far more than professions of goodwill ever could.

This principle has its limits. A great many of the criticisms that the Fed and the Treasury faced were meant to impugn their integrity, establish their subservience to moneyed interests, and delegitimize them as institutions. Some of these attacks left their mark, and to this day both the Treasury and the Fed have legitimacy problems that might well hobble their ability to respond to a future crisis. Nevertheless, I argue that the best way to address this problem and build the credibility necessary to act effectively during crises is to actively embrace changes that make their processes more legible and accountable. I argue that the Fed's tradition of legal opacity, especially, is an impediment to its ability to establish broad legitimacy in this highly polarized age.

I proceed by offering portraits of the officially sanctioned watchers; reviewing the effects of the accountability mechanisms included in EESA; examining the media's role; and finally examining two case studies to see how the variety of accountability mechanisms interacted with regard to two explosive questions: whether the government's rescue of AIG should be understood as a "backdoor bailout" of Wall Street's investment banks, and how much the government's crisis responses ultimately cost taxpayers.

SIGTARP: Legitimacy through Adversarial Scrutiny

Congress created the Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) in § 121 of the Emergency Economic Stability Act (EESA), embracing a modern proclivity for creating independent inspectors general charged with auditing government books and processes. The inspector general, to be appointed by the president and confirmed by the Senate, would specifically be responsible for collecting detailed information about any program created under TARP and reporting to Congress and

would have a sizable initial budget of $50 million to build an office capable of carrying out his duties.

During the Treasury's initial rollout of the Capital Purchase Program (CPP), the office of SIGTARP was unfilled. Finally, in mid-November President Bush nominated Neil Barofsky, a federal prosecutor from the Southern District of New York who had established his reputation by winning cases against Colombian drug lords and a high-profile white-collar criminal. Barofsky, a Democrat, was confirmed in early December 2008 and was described as "not an expert on either the bailout or being an inspector general. Nonetheless, he seems to relish the opportunity to follow the dollars wherever they might lead."[2]

By his own account, Barofsky sought to avoid the typical inspector general's focus on audits, and, bringing to bear his prosecutorial mindset, he developed a fairly adversarial relationship with the Treasury. Although at first he warmed to advice that he should, Goldilocks-like, seek to be neither a "lapdog" nor a "junkyard dog" but rather a just-right "watchdog," before long he decided to follow the advice of Senator Max Baucus (D-Mont.), who told him that he should be "as mean as a junkyard dog" if he hoped to have a significant impact on the Treasury's decisionmaking.[3] As a result, Barofsky sought to build SIGTARP into an accountability mechanism that did far more than ensure that the Treasury was dotting its *i*'s and crossing its *t*'s. He aimed to conduct serious investigations that would lead to criminal prosecutions of anyone who attempted to defraud TARP, which eventually resulted in 212 prosecutions and 146 convictions, including the highest profile criminal conviction of anyone connected with subprime lending.[4]

Probably more consequentially, Barofsky also used his SIGTARP perch to write reports that would garner media attention, spur congressional interest, and thus force the Treasury to take notice of SIGTARP's criticisms. These criticisms were nearly all substantive rather than legal—which meant that, at least for official conduct, SIGTARP became an enforcer of certain kinds of legitimacy-based constraints rather than legal ones. From his perspective, this was the result of the extraordinary breadth written into EESA, which in his interpretation gave the Treasury a legal basis to "do whatever they want, whenever they want."[5] In Barofsky's view, only by bringing political pressure to bear could he hope to force the bank-friendly Treasury to be accountable to taxpayers for its use of their money in TARP. By successfully courting congressional support, SIGTARP was able to officially expand its scope and eventually built a staff of around 170.[6]

The agency's first major clash with the Treasury Department, spanning the tenures of Henry Paulson and Timothy Geithner, focused on whether the

Treasury was taking appropriate steps to understand the uses banks were making of the capital injected by the CPP. Although nothing in the TARP statute specifically required such steps, Barofsky felt that failing to actively monitor uses of program funds had opened the door to fraud and left taxpayers with no way of evaluating the administration's claims that TARP was supporting the American economy. Most Treasury officials believed it was nonsensical to ask exactly how TARP money was being used because of money's fungibility: banks' activities would be calibrated based on their whole capital profile, such that saying whether the marginal dollar received from TARP was itself lent out would be futile. Furthermore, Treasury officials felt it would be a costly mistake to allow such questions to delay getting needed funds into the banking system—a concern Barofsky felt was entirely without merit.[7]

Barofsky's determination to institute some kind of monitoring regime outlasted the Treasury's initial rebuff, and it is instructive to see how he eventually broke through on the issue. At Barofsky's suggestion, Representative Steve LaTourette (R-Ohio) sponsored legislation, the TARP Accountability Act of 2008, that would have mandated reporting on "new lending that is attributable to" TARP support "to the extent possible."[8] When that bill failed to progress, SIGTARP organized its own open-ended survey of CPP recipients. A July report on this effort trumpeted, "SIGTARP Survey Demonstrates That Banks Can Provide Meaningful Information on Their Use of TARP Funds." Perhaps not surprisingly, an overwhelming majority of banks said that TARP funds allowed them to lend more or resist reductions in lending, but SIGTARP highlighted other uses reported, including making investments and acquiring other financial institutions, which it felt made ongoing Treasury monitoring especially important.[9]

On the very same day it released this report, SIGTARP leaked a key result from its July 2009 quarterly report to Congress (which was formally released the following day). Setting itself the "ambitious goal" of contextualizing TARP's massively expanded scope within the whole array of government programs, SIGTARP announced that "total potential Federal Government support could reach up to $23.7 trillion."[10] The calculations producing this number were remarkably misleading. First, without making its technique's shortcomings adequately clear, the report summed several entirely different kinds of commitments—arguably incommensurable ones that ought not to have been combined. These included all the Federal Reserve's loans, its purchases of mortgage-backed securities (MBSs), Fed and Federal Deposit Insurance Corporation (FDIC) credit guarantees, TARP loans, support for GSE commitments, and, in a tiny percentage of instances, actual spending. While

the body of the report dutifully noted that "amounts may include overlapping agency liabilities, 'implied guarantees,' and unfunded initiatives" and warned the reader that the figures "have not been evaluated to provide an estimate of likely net costs to the taxpayer," these caveats sometimes appeared in fine print, and they were not featured in the report's executive summary.[11]

Second, some of the amounts included were quite dubious. For instance, for the guarantee of the money market funds, although the Treasury had only made $50 billion available to make good on its guarantee, the figure that SIGTARP used to represent the Treasury's support was $3.355 trillion—the amount of all outstanding money market funds existing at the time.[12] "Potential support," as reported, thus meant something quite different from legal obligations, but this was less than crystal clear from SIGTARP's report. Finally, the report made no attempt at all to value the collateral being held against many of these commitments, implying that governmental institutions had taken on far more risk than they really had. Again, notes in the fine print admitted this, but the casual reader would be unlikely to dwell on such seeming minutiae.

Predictably, the report's mind-bogglingly large number inspired headlines, only some of which were incredulous. Others broadcast SIGTARP's message quite faithfully, quoting Barofsky about the Treasury's failures to follow SIGTARP's transparency and accountability recommendations and allowing Representative Darrell Issa (R-Calif.) to drive the message home with an accusation that the Obama administration had broken its promises of accountability.[13] In his book, Barofsky expresses a bit of regret about not making the caveats more clear and about having the report leak out but concludes that he did not regret releasing the figure. Indeed, he writes that "doing so had raised awareness about the dangers still lurking in the financial system in just the way I'd hoped."[14] In other words, this was a tremendously successful publicity stunt for SIGTARP, which helped it gain leverage over the resistant Treasury Department. Eventually, the Treasury would acquiesce to Barofsky's demand for monitoring of TARP funds, worn down by his persistence and convinced that, at worst, the effort would amount to a small waste of resources. The results of this Use of Capital Survey generally supported the idea that TARP had supported lending—though this did not exactly represent a triumph of social scientific exactitude.[15]

As chapter 5 explains, Barofsky's aggressive approach did sometimes bear fruit: along with a wide spectrum of unofficial critics, SIGTARP energetically denounced the early versions of the Public-Private Investment Program (PPIP) as conducive to fraud, conflicts of interest, and money laundering. Along with quickly enacting many of SIGTARP's recommendations into law,

the unanimously adopted Ensign-Boxer amendment to the Helping Families Save Their Homes Act allocated an additional $15 million to SIGTARP to facilitate its supervision of any nonrecourse loans made under TARP.[16] Barofsky would ultimately feel somewhat ambivalent about his agency's role in hobbling PPIP, thus preventing Geithner's Treasury from realizing the original vision for TARP, but he felt that the blame ultimately rested with the Treasury for being so resistant to SIGTARP input at the planning stage.[17] It is worth noting again the way in which trust and ex ante legitimacy became necessary ingredients for some kinds of policy success, suggesting that achieving accountability ex post cannot always offer a substitute.

At some point in his tenure, Barofsky's reliance on the media to broadcast his criticisms became even more pronounced, leading to several testy exchanges played out in public.[18] Contesting SIGTARP's frequent warnings about the likelihood of AIG costing the government money, as the Treasury rolled out more optimistic estimates it said of SIGTARP, "Some people just don't like movies with happy endings" and argued that the watchdog had "sought to generate a false controversy over AIG to try and grab a few, cheap headlines."[19] Barofsky was astonished that the Treasury Department would so openly treat him as a "political enemy," and in late 2010 he began to contemplate resigning. Before going, however, he sought to "use the SIGTARP bully pulpit . . . to focus more attention on the serious limitations of the Dodd-Frank Act," which he felt utterly failed to address the threat posed by the idea of too big to fail and relied far too heavily on discretionary enforcement by "blind, or willfully blind" regulators.[20] Through the lens of examining the government's support for Citi, a January 2011 report focused on the ways in which the government's actions had "undoubtedly contributed to the increased moral hazard that has been a direct byproduct of TARP," as well as casting doubt on Dodd-Frank's solutions to the problem, which seemed inadequate, especially in light of Geithner's reluctance to specify an exact set of rules for identifying systemically important financial institutions.[21]

As an institution, SIGTARP lost much of its efficacy after Barofsky's departure, but Barofsky himself remained in the news as a freelance critic of the administration's TARP policies, culminating in the release of his book, *Bailout*, in summer 2012. Throughout, Barofsky styles himself as an outsider attempting to discipline a bailout-friendly system dominated by insiders, and, strikingly, he ends with an explicit denunciation of the government's basic legitimacy in the financial arena. Welcoming "the widespread anger" he believes resulted from the Treasury's failure to follow SIGTARP's recommendations, he says that the American people are right to lose faith in their

government: "Only with this appropriate and justified rage can we sow the seeds for the types of reform that will one day break our system free from the corrupting grasp of the megabanks. It is my own anger that compelled me to write this book, and I hope that in some small way it can help put us on that path."[22]

But for all of Barofsky's vitriol, his restraint is perhaps just as important. A deeply sympathetic reader—a former staffer of iconoclastic Representative Alan Grayson (D-Fla.)—cheered Barofsky's angry message and the way his actions at SIGTARP provided support for "suspicions that Treasury was handing taxpayer money over to the banks." But he also offered criticism of Barofsky's memoir:

> If there's one problem with the book, it's that Barofsky never follows this analogy to its logical conclusion. Treasury's programs, he says, are inept, incompetent, wasteful, intellectually captured, etc. [The Justice Department] is afraid to prosecute big cases, unable to go after bankers, etc. Various Treasury officials were deceptive in proposing various programs or engaged in spin or outright lies. But Barofsky never comes out and says either that the Bush or Obama administration pursued policies that were corrupt, for ulterior motives that would accrue to their personal gain. He never argues that TARP itself was itself a scam, or that the lawyers at the Justice Department will personally profit from their government work protecting the banks.[23]

This is absolutely correct: neither SIGTARP's reports nor Barofsky's book ever point to out-and-out corruption of the sort that could fairly be characterized as "handing money over to the banks." Indeed, though they are sharply critical of the Treasury's decisionmaking processes (or the lack thereof), most SIGTARP reports include admissions that the Treasury's actions were probably substantively correct, or at least quite defensible. The Citi report, for example, airs frustration about the improvisational nature of the interventions on behalf of the huge bank, but prominently concedes that, "given the urgent nature of the crisis surrounding Citigroup, the ad hoc character of the systemic risk determination is not surprising, and SIGTARP found no evidence that the determination was incorrect."[24]

Given Barofsky's oppositional stance to the administration and the incentives his role created for him, the self-proclaimed "junkyard dog's" failure to bark more loudly speaks volumes. Barofsky could have dramatically raised his and SIGTARP's profile if, at any point, a report had credibly alleged scandalous behavior within the administration. Especially as the Tea Party

and Occupy Wall Street movements developed, an unabashed embrace of anti-bailout sentiment could have won him legions of adoring fans. Paradoxically, then, because SIGTARP's angry denunciation of TARP's administration was unmatched by a declaration that the government's intervention was, at bottom, an illegitimate giveaway, his efforts may have produced a kind of accountability legitimacy that a less hostile inspector could not have. Barofsky himself would surely reject this way of thinking: from his perspective, the failures to invest in foreclosure mitigation or decisively act against too-big-to-fail banks *were* scandalous. That neither Paulson nor Geithner literally had his hand in the till hardly exonerates them or their institution, which Barofsky sees as having negligently left the door open for a future crisis. Now in private practice as an attorney, Barofsky remains a vocal critic of the bailout. Still, when the stakes were highest, Barofsky did not deliver the message that taxpayers were being robbed blind by Wall Street; indeed, throughout his book, he consistently avers that his adversaries at the Treasury were acting in good faith, even if he believes their thinking was distorted by bank-favoring cognitive capture. Considering their source, such appraisals carry significant weight; the junkyard dog that didn't bark is a powerful indicator.

The Other COP on the Beat: Elizabeth Warren's Backhanded Legitimation

Running parallel to the SIGTARP story is that of the Congressional Oversight Panel (COP), also created by EESA for the purpose of providing accountability for TARP.[25] Embedded within the legislative branch and reporting to the House and Senate Oversight Committees, COP consisted of five members appointed by the party leaders in each chamber (producing a split of three Democratic and two Republican appointees). By statute, COP was charged with writing reports about regulatory reform, the effectiveness of foreclosure mitigation, and various aspects of the asset-buying program (which was never fully realized). Beyond these few demands, the panel had a fairly open-ended mandate, and like SIGTARP, it quickly evolved into a substantive critic of administration policy that sought to amplify its efforts through the press.

The panel's first appointments were made on November 14, when Democrats appointed Richard H. Neiman, New York's state banking superintendent; Damon Silvers, associate general counsel of the AFL-CIO; and Elizabeth Warren, then a Harvard bankruptcy law professor. Republicans soon after added Representative Jeb Hensarling (Tex.) and Senator Judd Gregg (N.H.), though the latter soon withdrew and was replaced a month later by lame-duck

senator John Sununu (N.H.).[26] The panel's members elected Warren as chair, and she became far and away its most prominent voice. Throughout its existence, its key reports received dissents from the Republicans on the panel.

From the beginning of her tenure, Warren offered a political critique of TARP with two main components. First, unless aid could be offered to ordinary American households, the economy would remain stagnant, but she doubted whether "the people directing the bailout see that as their job."[27] In other words, if the bailouts failed to provide substantial direct support for ordinary Americans—probably through foreclosure mitigation efforts—they should not be considered legitimate. Second, Warren and the panel's Democrat-appointed majority consistently questioned whether crisis responses maximized the upside value for taxpayers. The COP's first report pointedly asked, "Are the terms [received by the Treasury] comparable to those received in recent private transactions, such as those with Warren Buffett and the Abu Dhabi Investment Authority?"[28] Explaining that the Treasury seemed to be demanding a much lower price than these private sources of capital, the COP report implied that the government was being careless with its largesse as it sought to recapitalize the banking system. Expanding on this theme, at other points in its report the COP suggested that the Treasury was utterly lacking a coherent strategy, thereby preventing it from acting efficiently on behalf of broadly shared economic stability.[29]

Like SIGTARP, after some early meetings with the Treasury failed to establish a sense of cooperation, COP fell into a sharply adversarial relationship with the Treasury Department. Its second report, in January 2009, gave a point-by-point rebuttal of the department's responses to the panel's original report; in addition to noting dozens of points of disagreement, it also separately highlighted each question to which the department under Paulson's leadership had been unresponsive.[30] In this report, and others issued in March and October, COP sought to make it clear that in failing to support a significant foreclosure mitigation program, the Treasury was failing to uphold its statutory responsibilities under TARP.[31] In both the January rebuttal report and a February report, the panel relentlessly reiterated its belief that the Treasury was failing to drive a hard enough bargain on behalf of American taxpayers.[32]

Along with articulating its two core themes, COP also served as a launching pad for Warren's financial reform agenda. In her many years as a scholar of America's consumer bankruptcy system, Warren had consistently argued that consumers received far too little protection from predatory lenders; not surprisingly, in fulfilling the panel's requirement to assess the need for regulatory

reform, Warren sought to draw attention to the plight of ordinary debtors and advocate for stronger consumer-oriented regulation at both the federal and state levels.[33]

She would be exceptionally successful at advancing this broader goal, becoming a favorite of progressive critics of the bailouts and finding outlets in the popular press as a way of advancing her agenda. As she put it in her 2014 memoir, Warren felt some trepidation in taking the COP role, fearing that it might be confined to "writing boring reports that would gather dust while the economy tumbled over a cliff." In overcoming this possible limitation, the lesson she took away was this: "When you have no real power, go public—really public. The public is where the real power is."[34] Channeling public distress allowed Warren to successfully advocate for the creation of a Consumer Financial Protection Agency, which would eventually be one of the main achievements of the Dodd-Frank Act.[35] As the new agency's most prominent champion, she would later become special adviser to the president, charged with setting up the agency. Republican opposition discouraged her appointment as head of the agency, but she continued her political ascent by successfully running for the U.S. Senate in 2012.[36]

Like Barofsky as SIGTARP, Warren's political incentives as head of the Congressional Oversight Panel gave her every reason to be critical of the administration, and she generally embraced her critical role. And yet, also like Barofsky, she stopped well short of denouncing TARP as corrupt or even as a failure, and in many ways COP's willingness to support the Obama administration's efforts acted as an important legitimator. Whereas SIGTARP had been sharply critical of the Obama administration's handling of the auto bankruptcies, COP's report, issued in September 2009, painted a fairly flattering portrait of Team Auto, which Warren felt had been right to drive a hard bargain in negotiations on taxpayers' behalf.[37] A December 2009 report, while offering a barrage of criticisms and lamenting the lack of decisionmaking clarity at the Treasury, nevertheless emphasized that TARP should "be credited with stopping an economic panic," leading to favorable press coverage for the beleaguered bailout program.[38]

The last major report during Warren's tenure on the panel, issued in September 2010, again acknowledged TARP's success in stabilizing financial markets. It went on to consider the ways in which TARP's deep unpopularity constrained its efficacy and went so far as to wonder whether "the greatest consequence of the TARP may be that the government has lost some of its ability to respond to financial crises."[39] Rather acidly, the report observes that the public's scorn for the program might be rooted in valid concerns about its

implementation (doubtful) or its failure to prevent ordinary Americans from experiencing acute economic distress (likely), and it suggests ways in which the government might improve the program's legitimacy through good measurement. This extended meditation on TARP's legitimacy was clearly meant as a rebuke to the Obama administration's handling of the program. But once again, the admission that TARP achieved its primary objectives spoke loudly.[40]

Warren departed in fall 2010 to devote her attention to the newly created Consumer Financial Protection Bureau, and she was replaced as chair of the panel by outgoing senator Ted Kaufman (D-Del.), who had used his appointed term in large part to call for the breakup of America's largest banks.[41] By the time of its final report, in March 2011, the panel was obliged to grudgingly acknowledge the enormous improvement in the financial outlook for TARP: once projected to cost $356 billion, total costs were then estimated at $25 billion. In spite of that, the report was mostly negative, putting a special emphasis on the ways in which TARP exacerbated the problem of "too big to fail."[42]

The closing words of its executive summary nevertheless lend support to my argument here. Noting the many ways in which TARP implementation was positively influenced by the many accountability mechanisms devoted to overseeing it, the report concludes, "An enduring lesson of the TARP is that extraordinary government programs can benefit from, and indeed may require, extraordinary oversight."[43] For all its complaints about the program's shortcomings, the panel recognizes the way in which its own existence helped to contribute accountability legitimacy to the overall effort.

Before moving on to other accountability mechanisms, it is worth briefly considering a counterfactual: What if SIGTARP or COP had been headed by Republicans? Clearly, one reason some might think that both crisis watchdogs failed to go after the administration with more zeal is that they were, in the end, members of the same political party. Barofsky and Warren both stood to make reputational gains by staking out adversarial positions against the administration, and they did so, helping to establish Warren as a rising political star. In contrast, had they simply acted as ratifiers, they would have been assured near anonymity. But a Republican in the same position would have had this same incentive compounded, because his attacks on the Obama administration could have been whole-heartedly embraced by his party's top leaders. For those who want maximally adversarial accountability, then, installing someone from the out-party seems desirable. As the example of the Government Accountability Office (GAO) shows, however, there are reasons to think that less adversarial accountability mechanisms might be equally productive.

The GAO's Mundane Accountability

The Government Accountability Office served as another mechanism providing scrutiny of crisis responses. Far less adversarial than the specially created SIGTARP or COP, the GAO brought to bear its existing capacity and experience, generally allowing it to contribute to accountability legitimacy in a more cooperative way.

Although the GAO's scrutiny can be directed to any matter of government operations by a request of a member of Congress, during the crisis the agency was guided largely by special statutory grants of investigative authority conferred by EESA. Section 116 of the law charged the GAO with overseeing and assessing how well TARP met its goals, how well the program implemented internal controls, what its activities looked like, what kinds of assets it acquired, how efficient its operations were, whether it complied with the relevant laws, how well it prevented fraud, and whether its contracting procedures prevented favoritism. To carry out these extensive responsibilities, the law allowed the GAO to embed personnel within the Treasury and gave them broad access to program records, required GAO audits, and made it a statutory requirement for the Treasury to address any deficiencies it identified.

Because of its large existing capacity, the GAO's accountability efforts regarding TARP began as soon as the law was passed, and many of its efforts should be understood as providing the Treasury with accountability capacity that it would not otherwise have been able to build given the rapidity with which events were unfolding. Acting Comptroller Gene Dodaro announced his agency's close cooperation with Secretary Paulson just eleven days after TARP's passage, and GAO employees were involved not only in scrutinizing Treasury choices but also in making initial program design choices so as to ensure integrity.[44]

The existence of this basically cooperative dynamic does not mean that the GAO and the Treasury worked seamlessly together; indeed, like SIGTARP and COP, the GAO often made the most progress when it released and publicized critical reports, received news coverage, and thus generated political pressure on the Treasury to devote its own resources to ensuring its operations' legitimacy. A GAO report in early December 2008 contained a laundry list of internal controls the Treasury would need to implement to protect itself against any possible corruption.[45] News coverage emphasized the report's criticisms, which in turn put elected officials on the offensive: said Speaker Nancy Pelosi, "The GAO's discouraging report makes clear that the Treasury Department's implementation of the [rescue plan] is insufficiently transparent and is

not accountable to American taxpayers."[46] A follow-up GAO report made it clear that the Treasury had largely responded to the recommendations, while simultaneously reapplying pressure about the need to better clarify TARP's purposes and overall strategy.[47] This process repeated itself several times: the GAO pushing for various controls, amplifying its concerns in the realm of public discourse, winning some compliance by the Treasury, and pushing for more, sometimes in concert with the other bailout watchdogs.[48]

Perhaps in part because of the successes of its early efforts, the GAO's reports during the later stages of crisis response tended to largely affirm the integrity of the programs it oversaw. A review of the CPP screening of applicants mostly concluded that the process had been fair and offered a few recommendations for regularizing firms' exit from the program.[49] Regular TARP audits concluded that the program was, "in all material respects," effectively controlled, appropriately documented, and in compliance with the law.[50]

The GAO's audits of the Federal Reserve were substantially more fraught; because they came out of the Dodd-Frank Act, they are discussed in chapter 7.

The Financial Crisis Inquiry Commission: The Resounding Rebuke That Wasn't

The third crisis-generated accountability mechanism was the Financial Crisis Inquiry Commission (FCIC). In the fallout from the events of September 2008, members of both parties quickly suggested forming a congressionally sponsored inquiry into the causes of the crisis along the lines of the much-lauded 9/11 Commission.[51] Given Congress's many other priorities, however, the FCIC was not passed into law until May 2009, did not hold its first public hearing until January 2010, and did not publish its official report until January 2011—six months after passage of the Dodd-Frank Act, which many had originally hoped it would inform.[52]

From its creation, the FCIC suffered from an identity crisis. Inspired by the 9/11 Commission's success, Congress had created a bipartisan body (with six Democratic and four Republican appointees), hoping that its members could produce a unified, coherent, and broadly accepted account of what had gone wrong and what should be done about it. But it had also saddled the commission with a list of twenty-two particular factors it was obliged to investigate, making it difficult to focus on any more compact theory. More important, congressional leaders chose commissioners who were likely to have a difficult time generating agreement. The panel's chair, former California treasurer Phil Angelides, and its vice chair, former Republican House member Bill Thomas,

were both veterans of partisan politics not known for their ability to bridge political divides. One member, Peter Wallison of the American Enterprise Institute, brought to his role on the FCIC a well-publicized commitment to a particular view of the crisis, making it unlikely that he would be able to compromise with others on the panel inclined to play down that theory (which features Fannie Mae and Freddie Mac as the central instigators of the crisis).[53]

One could imagine the commissioners overcoming the difficulties presented by this choice of personnel, but in the event the panel suffered continuous difficulties that damaged its credibility and relevancy. Staff attrition detracted from its effectiveness. The panel lost its staff director in May 2010, and its choice for a replacement, who came directly from a staff role at the Federal Reserve, caused many critics to question the group's ability to objectively evaluate one of the institutions thought to be at the center of the crisis. And partisan rifts remained unhealed.[54] By December 2010, it was clear that the panel's Democrats and Republicans would be unable to agree on a final diagnosis for the crisis or even on an appropriate vocabulary.[55]

When the final report was issued in January 2011, it received the backing only of the six Democratic commissioners; three of the four Republicans issued their own report, and Wallison issued his own. Beyond noting this conspicuous fracturing of the panel, reports covering the FCIC's final report emphasized the huge variety of actors and forces assigned blame for their contribution to the crisis; less charitably, others said it was "missing [a] bottom line" or "part rehash, part mishmash."[56] Many of these criticisms were hyperbolic; the FCIC report is a valuable resource that has helped to inform many of this book's discussions. But overall, it is fair to say that the report failed to crystallize any single narrative about the crisis or the responses to it and so failed to significantly affect the legitimacy of the responses. Unlike the Pecora Commission, which in 1932 helped to solidify a single political narrative about the causes of the stock market crash of 1929 and thus to launch successful legislative reform efforts, the FCIC's contribution was far more ambiguous and, ultimately, ineffectual.[57]

Muckrakers in the Twenty-First Century

As important as official government self-scrutiny was, perhaps the most powerful force attempting to hold the crisis responders accountable to the public was the so-called fourth estate: the press. News coverage of the financial crisis was ubiquitous in late 2008 and early 2009. Media scrutiny of the government's crisis decisions also reflected the vastly changed media environment

of the early twenty-first century: alongside traditional print journalists there was a profusion of coverage on the Internet, creating what some have dubbed the fifth estate: bloggers (who range from former government officials and tenured academics to alienated pseudonymous citizens), online journalists, and many others who define themselves explicitly in opposition to the "mainstream media." Prior levels of trust in the American government varied enormously across all types of media, meaning that particular actions nearly always generated both sympathetic defenses and cynical denunciations, with the latter especially prevalent on the Internet. It seems likely that the responses to financial crisis generated more words of readily available criticism than any other government actions in history, simply because of the explosion in the number of people able to gain a public platform. A full survey of the media environment is well beyond the scope of this study, but it is worth noting the role played by a few particular sources answering to very different audiences.

One is ProPublica, a nonprofit investigative journalism outfit established and funded through charitable donations. Founded in 2007 with the backing of former CEOs of a major mortgage lender, ProPublica in a sense came into being to do deep-dive reporting on the financial crisis and its fallout, and it would successfully place stories generated by its reporters in major media outlets throughout the crisis.[58] Beginning in late 2008, ProPublica produced a frequently updated bailout tracker that attempted to completely track government spending by collecting information from banks' filings with the Securities and Exchange Commission (SEC) as well as an *Eye on the Bailout* blog tracking potential abuses.[59] Sharing one of SIGTARP's and COP's central focuses, the organization also chronicled the failure of foreclosure mitigation efforts to help many underwater mortgage holders and indeed showed how the programs mistreated and harmed many intended beneficiaries.[60] Reporters Jesse Eisinger and Jake Bernstein won a Pulitzer Prize for their exposé "The Wall Street Money Machine," focusing on how banks' self-dealing inflated bankers' bonuses and exacerbated the crisis, as well as the SEC's failure to adequately check this behavior, and they became prominent critics of the Obama administration's policies.[61] Considered a bold experiment in media funding, ProPublica shows that our society values the ability to hold the government accountable even without the incentive of profit.

Far more typically, however, calling the government's legitimacy into question was part of a time-honored tradition of selling copy. Probably the most successful journalist in this endeavor was Matt Taibbi, whose *Rolling Stone* articles and scathing denunciation of America's "Griftopia" brought him

widespread notoriety and best-seller status. In an immortal bit of prose styling, Taibbi wrote of Goldman Sachs, "The world's most powerful investment bank is a great vampire squid wrapped around the face of humanity, relentlessly jamming its blood funnel into anything that smells like money."[62] Such good-and-evil portraits of the financial crisis, which consistently cast government officials as corrupt purveyors of "crony capitalism," had broad appeal and helped to spread the critique of the government's legitimacy to a mass audience, especially in the development of the Occupy Wall Street movement.

At a far more refined level, many academics sought broad audiences among citizens and policymakers by writing accessible critiques of the crisis responses. Perhaps the most ubiquitous among these professor-bloggers were Simon Johnson, the former chief economist of the International Monetary Fund, and his frequent coauthor, James Kwak. Johnson and Kwak offered the most carefully developed version of the thesis that the banks had effectively captured America's regulatory and political systems to serve their own purposes, resulting in a kind of self-serving oligarchy.[63] They offered scathing criticism of the stress tests, indefatigable focus on the moral hazard that the condition of "too big to fail" created for banks, and a moral and economic condemnation of executive compensation schemes that enriched financial firms' managers without forcing them to effectively bear the costs of risks.[64] As a reform agenda, they encouraged breaking up the largest banks and significantly raising the capital requirements for banks.[65] With Johnson awarded permanent space at the *New York Times*, throughout the later stages of the crisis he acted as an important validating mechanism for challenges to the government's legitimacy that might otherwise have been regarded as outside of the mainstream.

Finally, perhaps the most surprising presence among the accountability journalists was Bloomberg News. Hardly known for its iconoclasm as an organization, several journalists at Bloomberg consistently subjected the totality of the government's financial rescue to scrutiny, making headlines with their grand totals. First, in March 2009, a headline announced, "Financial Rescue Nears GDP as Pledges Top $12.8 Trillion." This money "spent, lent or committed" worked out to "$42,105 for every man, woman and child in the U.S.," they rather breathlessly reported.[66] In an attempt to deepen their coverage of the Federal Reserve, they filed a Freedom of Information Act (FOIA) request about the identity of the loan recipients of the Fed's discount window and § 13(3) programs, arguing that no valid privacy concern prevented loan recipients' identities from being released to interested citizens. The Federal Reserve denied these requests in December 2008, leading Bloomberg to successfully sue: first a district court in 2009 and then the

Second Circuit Court of Appeals in 2010 ordered that the Fed comply with Bloomberg's FOIA request.[67]

The fruit of this victory was a triumphantly delivered exposé in late 2011, which began, "The Federal Reserve and the big banks fought for more than two years to keep details of the largest bailout in U.S. history a secret. Now, the rest of the world can see what it was missing." Bloomberg's big reveal was that the Fed had made "secret loans" to the tune of $1.2 trillion on a single day in December 2008 and "had committed $7.77 trillion as of March 2009 to rescuing the financial system." Although by that time Bloomberg could see that the loans had nearly all been paid back with interest, and without losses to the Fed (and thus to taxpayers), its reporters nevertheless skillfully found ways to hint at a pernicious effect: "Details suggest taxpayers paid a price beyond dollars as the secret funding helped preserve a broken status quo and enabled the biggest banks to grow even bigger." More concretely, the authors confidently asserted that the loans represented a $13 billion gift to the banks by giving them access to liquidity at below-market rates.

The report became a rallying point for bailout opponents, including former special inspector general Barofsky and former COP member Kaufman, both of whom were quoted as saying that the public's lack of knowledge about the Fed's programs had effectively crippled the effort to pass robust financial reform.[68] Gretchen Morgenson of the *New York Times* ran a story that (quite incorrectly) amplified the claims, reporting that "among all the rescue programs set up by the Fed, $7.77 trillion in commitments were outstanding as of March 2009, Bloomberg said" and claiming that Bloomberg's evidence was sufficient to see that key financial institutions were insolvent.[69] Jon Stewart soon told his viewers that the Fed had lent out $7.77 trillion.[70] Completing the game of telephone, a headline on the right-wing *Daily Caller* proclaimed (anachronistically) that "Congress was unaware of $7.77 trillion in secret Fed loans ahead of TARP vote."[71]

This cascade of bad publicity, which threatened to sully the Fed's legitimacy at a time when the cessation of the crisis made the institution hopeful that it could recover its reputation, earned a rather peevish rebuke directly from Chair Bernanke. In a publicly released letter addressed to Congress's banking committees (and accompanied by a four-page memo prepared by the Fed's staff), he condemned "a variety of egregious errors and mistakes" in the recent articles—none of which he deigned to mention by name or specifically rebut—and insisted that the Fed had adequately disclosed its lending to Congress and to the public at all times, as required by EESA.[72] The Fed explained that full, real-time disclosure of borrower identities would have

risked stigmatizing institutions that availed themselves of the Fed's liquidity support, thereby making it more difficult for the central bank to arrest the spread of the crisis. It also explained why the various figures attached to the Fed's total "commitments" were "wildly inaccurate," arguing that it is inappropriate to sum a series of revolving loans as if they are cumulative. Finally, the memo rejected the Bloomberg claim that banks derived $13 billion in benefits from access to money at below-market rates, insisting that the Fed had made its loans at penalty rates—but it provided no substantiation for this assertion.

By failing to offer more specifics in this instance, and by adopting what many saw as a supercilious tone, the Fed missed a huge opportunity to justify its institutional legitimacy to the public. Because the Fed's letter had vaguely referred to all critics even though Bloomberg was clearly its main target, Bloomberg was able to issue a detailed, rhetorically effective rebuttal disputing whether the Fed's arguments really applied to what it had written.[73] As blogger Felix Salmon argued, the Fed's lack of specificity in defending itself was especially difficult to understand in the case of Bloomberg's claim about $13 billion in ill-gotten profits. Remarkably, he noted, "Bloomberg's methodology doesn't actually take into account the interest rates charged by the Fed at all!" Rather, it simply imputes profits to the borrowers by presuming that all of the borrowed money was lent out and earned standard rates of profits for the banks.[74] Given critical public interest in its setting of penalty rates, the Fed could have used this dispute as a teaching opportunity, but instead it came off as defensive. The Fed's position about its activities often seems to be that the institution has no duty to help the public make sense of its voluminous (and often extremely dense and technical) disclosures, but unfortunately this plays directly into the hands of those who attack its fundamental legitimacy and portray it as a shadowy force.[75]

Accountability Mechanisms at Work

To provide a better sense of how this wide range of institutional monitors worked during the crisis, in this section I provide two case studies chosen to highlight some of the most significant confrontations with the crisis fighters: the contentious debates about whether the rescue of AIG constituted a backdoor bailout of investment banks and about the true fiscal costs of the crisis responses. In each episode, government watchdogs and media competed with the crisis fighters to supply the definitive interpretation of crisis responses and their legitimacy. In neither case was there a clear resolution, but studying the interactions between the various accountability mechanisms provides important insights into the contested determination of legitimacy.

AIG and the Backdoor Bailout

The Federal Reserve's creation of the Maiden Lane III special purpose vehicle (SPV) in November 2008 generated a huge controversy, one that to this day remains a point of serious disagreement between the Fed's defenders and its critics. After its decision to rescue AIG during the chaos of September 2008, the Fed found that the company's position continued to deteriorate. In creating the $30 billion Maiden Lane III facility, the Fed sought to neutralize some of AIG's most explosive commitments: credit default swaps (CDSs) written by its financial products division on a variety of collateralized debt obligations (CDOs). These essentially functioned as insurance for a variety of counterparties against severe drops in value in holdings of MBSs, and those with the largest contracts included Wall Street's biggest investment banks. The CDS contracts became especially dangerous to AIG because of their collateral requirements: as the underlying assets were downgraded and the chance of losses became more serious, AIG needed to post more collateral; and if AIG itself was downgraded, it would also have to post more collateral. This set up a potential death spiral for the giant insurer: even if the insured CDOs did not lose all their value, the growing likelihood that they could do so forced a liquidity crisis.[76] Through the Maiden Lane III SPV, the Federal Reserve Bank of New York (FRBNY) and AIG would purchase the underlying CDOs and therefore gain the ability to extinguish the CDS contracts, ending the collateral crunch on AIG.[77]

What made this maneuver so controversial was the identity of the sellers of these CDOs: unloading their apparently toxic CDOs were TARP-recipient banks including Goldman Sachs, Bank of America, Merrill Lynch, and Wells Fargo as well as large foreign banks including Société Générale, Deutsche Bank, and UBS.[78] AIG made numerous attempts to reach bilateral agreements to terminate the CDS contracts with these counterparties, but they resolutely refused to make any concessions, arguing that AIG had a contractual obligation to make them whole and that they were well positioned to have their claims honored if AIG were to go into bankruptcy. The Fed made further efforts to gain concessions after creating Maiden Lane III but once again failed to secure any agreements. As a result, Maiden Lane III paid the full fair-market value for the CDOs it acquired. Along with AIG's surrender of collateral already posted, these payments basically ensured that counterparties would receive full par value for their CDSs.[79] Many observers felt the banks should have been forced to make large concessions, and so was born the narrative of the AIG backdoor bailout—framed more or less, depending on the critic, as an underhanded and corrupt giveaway to Goldman Sachs, in spite of the fact

that the Treasury secretary's old firm seems to have been fully hedged against an AIG failure.[80]

Fed critics writing in mainstream media and on financial blogs were the original sources of the backdoor bailout complaint and would remain its most energetic promoters, but their concern soon transferred to Congress and thence to all of the government watchdogs. During one of the many House Oversight Committee hearings on the Bank of America purchase of Merrill Lynch, Representative John Tierney (D-Mass.) asked Bernanke, "Why was 100 percent paid on these various obligations. . . ?" As the Fed did consistently, Bernanke explained that the Fed felt it had no viable legal options to do anything other than entice sales by offering full compensation.[81] In brief coverage of the controversy in a September 2009 report, the GAO scrutinized the Maiden Lane transactions as part of a full review of support for AIG. Characteristically, that report was understated, fairly aired both sides of the controversy, and ultimately judged that the program helped to stabilize AIG.[82]

Responding to requests from twenty-seven members of Congress who asked whether the Maiden Lane III transactions were beneficial for taxpayers, SIGTARP also took up the subject for a November 2009 report. Also characteristically, the report featured commendable detail, ambivalent conclusions, and angrily adversarial rhetoric. The report fully embraces the "backdoor bailout" terminology in spite of concluding that the FRBNY had been handcuffed by AIG's legal status in trying to seek concessions. Barofsky and his team ambivalently explained that the Fed strongly resisted any suggestions that it should gain bargaining power through use of its regulatory powers and generally sought to uphold the sanctity of contract—in other words, in this case the Fed chose not to use its discretionary regulatory authority as a soft-power club.[83] While condemning the Fed's reluctance to share information about the identities of AIG's counterparties, the report conceded that the Fed's inability to bargain was mostly baked into its original September 2008 decision to save AIG. And yet SIGTARP consciously promoted the backdoor bailout slogan, which it said was appropriate because it accurately characterized the effect, if not necessarily the intent, of the support given to AIG.[84] From a logical standpoint, this criticism makes little sense; by their nature, financial bailouts of systemically important institutions are meant to provide support to counterparties, making the "backdoor" appellation rather gratuitous if it is based merely on the fact that AIG's counterparties were aided by its rescue. From a political standpoint, however, SIGTARP's support for the backdoor bailout interpretation allowed critics to keep using the trope, which they certainly did—including Barofsky himself in his 2012 book.[85]

In late 2009, Representative Darrell Issa became the next public champion of backdoor bailout claims. Issa was apparently quite unmoved by the Fed's legal necessity defense, and he presented the backdoor bailout as a persistent mystery in need of solving, asking the FRBNY "why [it] would not drive a better bargain for the American taxpayer."[86] He enthusiastically pursued his questions into the following year, issuing subpoenas, though the investigation did not result in any further actions.[87]

Perhaps the grandest of the denunciations of the rescue of AIG came from COP, which in June 2010 issued a 350-page report on the government's involvement with AIG. It is a revealing document, as much for what it says about COP's conception of its mission as for what it says about the actions to rescue AIG. First, COP did not hesitate to expand its sphere of inquiry beyond the statutorily designated subjects of TARP and the actions of the Treasury. Explaining that the Treasury's actions could only be understood in conjunction with those taken by the Fed's Board of Governors and the FRBNY, COP decided to evaluate all of these entities' actions.[88] Having adopted that wide view, COP spent much of its extensive report denouncing the actions of the Fed, which it believed improperly framed the choice about AIG as allowing failure or providing full support, greatly increased moral hazard for counterparties by ensuring they be made whole, wrongly passed up the chance to facilitate a private rescue, and showed insufficient zeal in maximizing the potential value of intervention for taxpayers.[89]

A recurring theme in the COP report, as in SIGTARP's report, was that many potential options for dealing with AIG's counterparties were effectively ruled out by the nature of the Fed's September 2008 rescue of the company, as well as by the decision to avoid bankruptcy,[90] but COP additionally saw the Fed and the Treasury as blameworthy for not having somehow transcended their legal limitations at later stages in their involvement with AIG. Regarding Maiden Lane III, the COP scolded the Fed for giving "wholly inadequate" attention to the option of using an SPV to purchase the CDS contracts themselves rather than the underlying CDOs—though it recognized that this might have meant ignoring the Fed's legal responsibility to only lend against good collateral.[91] In a similar tone, COP strenuously complained that the Fed and the Treasury had not found creative ways to lean on AIG's counterparties and thereby extract concessions. Indeed, COP felt that if private parties had failed to comply with their requests, "the names of the non-complying counterparties could have been disclosed to the public. FRBNY and Treasury had powerful non-financial tools at their disposal; they did not use them."[92] Finally, COP condemned the politically accountable Treasury secretary and president for

not somehow providing a more satisfactory resolution—"notwithstanding their lack of formal authority to intervene."[93] In sum, the COP had little reservation about righteously proclaiming that the Fed and the Treasury should have done things that were legally impossible (or at best, extremely problematic from a rule of law perspective) to drive a harder bargain for taxpayers and punish those who had relied on AIG.[94]

The GAO eventually weighed in with its own comprehensive report on the government's involvement with AIG in October 2011, offering enough sharp criticisms of the Fed's choices about Maiden Lane III to give fresh life to the backdoor bailout criticism. In tones that qualify as harsh by GAO standards, the accountability agency found that the FRBNY had given inconsistent accounts of its efforts to gain concessions from counterparties, calling into question whether it had really assured itself that receiving meaningful concessions was unlikely.[95] In addition, it argued that the decision to structure Maiden Lane III in a way that treated all counterparties equally was costly and possibly unnecessary, given the large disparities in the quality of underlying assets covered by the various CDSs, and that, although it was not legally required to do so, the FRBNY should have taken much greater pains to document and justify the bases of its decisions.[96] News coverage of the GAO reports amplified its concerns. The *New York Times* highlighted the questions raised about the FRBNY's earlier accounts of its actions; bloggers picking up on that coverage said that the FRBNY "basically refused to drive a hard bargain with the AIG counterparties and have lied about their actions."[97]

To this day, the accusation of the backdoor bailout retains its power in many circles. (Some readers are sure to resent the rather forgiving tone of the discussion offered here.) Former AIG CEO Hank Greenberg explicitly invoked the trope in his lawsuit against the New York Fed, alleging that AIG shareholders (along with taxpayers) had been given a bad deal by the FRBNY's refusal to extract concessions from counterparties. And even if courts ultimately rule against him, there is no reason to think that judicial involvement will do anything to silence the long-standing controversy. This is especially so because the nature of the complaints about the handling of aid to AIG were thoroughly disconnected from any legal concerns. Indeed, many of the sharpest critics seem to have been angered that the Treasury and the Fed allowed themselves to be constrained by existing legal limits; the legal finality of keeping AIG out of bankruptcy through provision of government support strikes these critics as a pesky detail that should have been overcome rather than treated as controlling. The Fed's claims of legal necessity have not

sufficed to quiet most observers' concerns, and as a result the central bank has simply had to weather the storm of criticism.

It would probably be foolish to imagine that controversies such as the one surrounding the backdoor bailout are ever really settled; rather, they simmer on, with the main account of history being written by the victors. In the case of the bailout, that history has yet to be written. But pressure on the Fed has largely subsided: there is little interest from the broad public or from Congress at this point and no real reason to expect new developments in the future. This is no doubt in large part because Maiden Lane III turned out to register a profit in the end: perhaps the FRBNY could have done better for the taxpayer, but in 2012 its SPV closed with a return of $6.6 billion.[98] So too, to the great surprise of many, did the government's overall involvement with AIG: as of March 2013, the government has no interest in AIG, and its official tally has it coming out $22.7 billion ahead.[99]

Accounting Accountability

The reckoning of these dollar costs is itself politically fraught, with accountability bodies again staking out adversarial positions. Throughout the crisis, one of the most straightforward ways of making the complex and often confusing mix of policy responses comprehensible to citizens was to offer simple dollar cost estimates. Especially if it combined program costs into a single number, each such accounting exercise seemed to offer an objective bottom line. But accounting in complex situations rarely yields singular, simple realities. With high enough political stakes, accounting statements inevitably become political statements, issued for political reasons. This is true of both the official estimates released by the Treasury through the Office of Management and Budget (OMB) and of the many competing estimates constructed by the institutions devoted to producing crisis accountability. The clashes between them—many of which remain unresolved to this day—reveal several interesting dynamics.

From the time of TARP's passage, both its specific cost and the likely combined cost of all government interventions were hotly contested. The program's $700 billion price tag was, of course, a shock to the American people, who often seemed to think of that sum as having been spent in the same way as a typical appropriation. Those who sought to defend TARP, or even just to calm down thinking about it, sought to clarify that $700 billion far exceeded even the maximum plausible loss, let alone the fairly expected cost.[100] On the other hand, those who questioned the wisdom of supporting the banks hoped to emphasize that the total size of taxpayers' commitments was potentially much larger even than this shocking figure. One early estimate pegged the cost

of the Federal Reserve's loan programs at $2 trillion, a number that also circulated as an estimate of what Geithner's expanded plan for TARP might cost.[101] Others projected higher totals for a full recapitalization of the banking system; Simon Johnson estimated that $3 trillion to $4 trillion would be needed, at a net cost to taxpayers of between $1 trillion and $2 trillion.[102] As noted above, SIGTARP raised things to a different order of magnitude in mid-2009 with its $23.7 trillion figure. Careful readers would see that this did not represent an estimate of any kind but was rather an accounting exercise adding up all potential commitments of any kind and disregarding any collateral received, but casual headline readers would draw the inference that taxpayers' exposure was far larger than they had previously contemplated. A later effort using similar methods declared that "total spending" was over $29 trillion.[103] Bloomberg's much publicized contribution to this debate argued that $7.77 trillion was actually committed as of March 2009. The huge discrepancies in these figures need not indicate that any of their authors made wholly unreasonable choices in constructing their calculations; rather, because they each attempted to answer a somewhat different question, their contributions were each defensible. But in the broad discourse, their primary role was undoubtedly to shape political perceptions of the bailouts, usually sharply detracting from their legitimacy by making it seem as though the crisis fighters had—somehow without the notice of the democratic process—exponentially expanded the programs' scope.

As time went by, bailout defenders largely seized the initiative in shaping the narrative with claims that TARP had been paid back or was expected to turn a profit. In a press release in June 2010, the Treasury trumpeted, "Repayments to Taxpayers Surpass TARP Funds Outstanding." At that point, $194 billion had been collected, and just $190 billion was outstanding—a "milestone" that sounded vaguely like full repayment but which actually indicated half repayment.[104] By spring 2011, the Treasury could hail real breakeven—at least in the CPP.[105] And by spring 2012, TARP cost estimates from the relatively objective Congressional Budget Office (constrained by law to make various stylized assumptions, but largely without a particular political agenda) projected that the program's net cost would be just $32 billion (compared with its March 2009 estimate of $356 billion).[106] The Treasury released a slickly designed packet of charts that countered the assertions of huge costs and instead showed that taxpayers might "realize a gain" on the government's financial stability programs.[107] In January 2013, the Treasury claimed 93 percent TARP repayment and once again heralded likely gains from the FDIC's and Fed's programs.[108]

The Treasury's critics were none too happy with these increasingly rosy assessments of TARP. In April 2012, under Christy Romero, Neil Barofsky's successor, SIGTARP denounced the "widely held misconception that TARP will make a profit," emphasizing that projected repayments were far from certain and that any reckoning of costs that failed to account for the moral hazard created would be badly incomplete.[109] Pointing out that the Treasury's own estimates still projected considerable official losses for TARP, critics denounced the government's rhetoric suggesting that the program would be a wash financially.[110]

Although these critics' rhetoric has sometimes been overblown and often politically motivated, they are certainly correct in their assertion that the Treasury has been slippery in its presentation of TARP's overall costs. This is exemplified by the Treasury's December 2013 press releases accompanying the government's sale of its last shares of General Motors. According to the release, "Treasury has recouped a total of $39 billion from the original GM investment. To date, Treasury has recovered a total of $432.7 billion on all TARP investments—including the sale of Treasury's shares in AIG—compared to $421.8 billion disbursed," and the *New York Times* repeated this language quite closely.[111] The Treasury ably avoids the question that many citizens might sensibly wonder about: How did the taxpayer fare in the government's intervention to save GM? The most straightforward answer, contrary to GM's public relations campaign's trumpeting of "full repayment of loans," is that taxpayers lost approximately $9 billion.[112] Instead, the press release gives the happy impression of a profit for the overall program with the help of two subtle subterfuges—or presentational choices, if you prefer to be more charitable. First, the Treasury lumps into TARP the acquisition of common shares of AIG, which were actually acquired through the Fed's intervention without any help from TARP. Second, it implies that expenditures are now finished—when, in fact, OMB's own budget releases project an additional expenditure (perhaps unrealistic) of tens of billions of dollars on foreclosure mitigation efforts.[113] The Treasury has, rather adroitly, figured out how to speak out of both sides of its mouth about these future expenses—not counting them when it hopes to favorably portray the program's net balance but playing up their certainty when confronting critics who say the government has done too little to help struggling homeowners.

Rather strangely, there has been little public focus on the OMB's official reckoning of TARP—which actually has legal consequences attached to it thanks to § 134 of EESA, which required the president to propose a "recoupment" of any net costs from the financial industry. The fiscally conservative

Blue Dog Democrats had successfully proposed recoupment as an accountability mechanism for TARP so that they could tell their constituents that the hefty bailout would protect taxpayers in the long run.[114]

From the Treasury's public pronouncements, one might think that there simply was no shortfall and thus no need for a legislative proposal from the president, but this is simply incorrect. By OMB's fiscal year 2015 budget, TARP's total cost is estimated to be $39.0 billion.[115] Accordingly, § 134 required the president to issue a recoupment proposal, although by the time the requirement activated in 2013, it seemed to have been nearly forgotten. The president very quietly complied in a little-noticed section of his budgets: a proposed "financial crisis responsibility fee" that, if enacted, would assess a seventeen-basis-point fee on bank assets beginning in 2016 and bring in a projected $56 billion over the following decade.[116] With no political energy or institutional actor attached to this particular TARP accountability mechanism, it failed to significantly shape later politics.

Can we get beyond any political perspective to identify the "real" cost of TARP or of the financial crisis responses more generally? If we stick simply to budgetary impact, TARP's cost seems to be somewhere between $20 billion and $50 billion, depending on how much will ultimately be spent on housing programs.[117] Including programs undertaken outside of TARP can turn the balance positive, depending on what is counted.[118] But digging into the details of these questions is a sure way to learn about the ambiguities of public accounting. A sizable portion of the budgetary gains logged by Fannie Mae and Freddie Mac, for example, comes from valuing deferred tax assets on the companies' books and then logging corresponding amounts on the Treasury's behalf. But the very nature of the deferred tax asset is that it will allow the companies to forgo paying taxes later—meaning it is a gain only from a particular accounting perspective and not in a real sense. Tax issues such as these are pervasive: the IRS treatment of banks participating in TARP was frequently very favorable, meaning that bailed-out firms avoided tax bills for several years.[119]

Others have emphasized the difficulty of determining how the government should account for risk: even if amounts were eventually paid back in full, this includes no consideration of the time value of money or the risk taken by the government, let alone the difficult-to-quantify costs arising from moral hazard.[120] (None of these discussions even begin to address the even harder question of how much the crisis itself cost the American people, which several others have attempted.)[121] As objective as cost figures may seem, the frustrating truth is that any grand total calculated for the

government's crisis responses will say as much about its author's assumptions as about the underlying facts.

Having offered that caveat entirely in earnest, we can nevertheless say with certainty that the responses cost less than most observers initially expected, so that citing the dollar costs of the bailouts became a less compelling critique of the administration as time went by. As a result, critics turned to other kinds of attacks, which ultimately proved more potent at generating mass responses questioning the bailouts' legitimacy.

7

Taking Stock and Looking Ahead

In responding to the financial crisis, officials at the Federal Reserve, the Treasury, and the Federal Deposit Insurance Corporation sought to strike a balance between what they saw as the most directly effective ways of containing the damage and what they believed would produce legitimacy for their actions. They often erred on the side of neglecting legitimacy, creating room for a significant political backlash even as the economic situation began to brighten. This reaction played out at both the mass and elite levels, and it generated important legal changes. I examine these reactions and then conclude with suggestions about how legitimacy might be better secured in responding to future financial crises.

Legitimacy Impugned

Throughout the book, most of the challenges to the legitimacy of particular crisis responses that have been discussed were driven by elites. Not every issue fits this pattern; the vehement reaction to the AIG retention bonuses in March 2009 was extremely widespread, motivated by a powerful sense that only a miscarriage of justice could have enabled the payouts. But, as chapter 1 explained, most of the crisis responses were fairly obscure to the broader public, which has a limited appetite for financial arcana, and so people relied, in large part, on professional interpreters.

Over time, however, more citizens invested their time and attention in understanding what was, quite evidently, one of the defining

Timeline for Events Discussed in Chapter 7

- February 19, 2009: CNBC host Rick Santelli's angry rant against plan to help underwater mortgage holders inspires Tea Party movement
- July 21, 2010: Dodd-Frank Wall Street Reform and Consumer Protection Act signed into law, including provisions to audit the Federal Reserve and to alter the Fed's and Federal Deposit Insurance Corporation's crisis-fighting powers
- July 21, 2011: Government Accountability Office audit of Fed governance released
- September 17, 2011: Occupy Wall Street protests begin in Zuccotti Park in New York

political-economic episodes of our time. The fights over the legitimacy of the crisis responses thus widened, drawing in hundreds of thousands or perhaps millions of active participants. Two mass movements provided the central organizing structure for the outpouring of discontent that resulted: the Tea Party and Occupy Wall Street. These loosely organized protest movements' activities in 2010–12 provided channels for ordinary citizens to register their sense that the government's responses to the crisis had been fundamentally illegitimate, and in doing so importantly shaped Congress's official responses-to-the-responses. Although both movements would soon turn their focus to other issues—making a full treatment of them well beyond the scope of this book—their crisis-specific protests provide important barometers of public discontent.

The Tea Party and the Demand for a Federal Reserve Audit

The Tea Party's beginning is usually dated to CNBC host Rick Santelli's angry rant on the floor of the Chicago Board of Trade on February 19, 2009, in which he denounced President Obama's plan to help underwater mortgage holders as promoting bad behavior.[1] His call for "another tea party" quickly became a focal point for anti-bailout discontent, with dozens of small protests held around the country on February 27 and larger events on tax day in April. By September, the movement coordinated a march on Washington that drew tens of thousands, and in February 2010 it held a National Tea Party Convention in Nashville.[2] The movement evolved into a political force to be reckoned with, culminating in a series of surprising Republican primary victories

for some of the movement's champions and a strong victory for Republicans in the 2010 midterm elections.

Both the Tea Party's adherents and its opponents struggled to pin down the nature of the movement's central concerns, but the responses to the financial crisis were at the heart of their grievances, especially early on. At meetings, some passed around novelty "trillion-dollar bills featuring the face of Ben Bernanke" to protest what they saw as the Fed's giveaways of money to the banks.[3] As one sympathetic observer at the time saw it, the decentralized Tea Party movement "emerged due to a substantial loss of government legitimacy (primarily from the mishandling of the global financial crisis) and continues to percolate as legitimacy continues to drain away from the government (health care, banking reform, unemployment, foreclosures, bankruptcy, deficit, etc.)."[4] But as this parenthetical indicates, the issues exciting members of the movement went well beyond those of the financial crisis, with the president's health care law becoming a central focus as time passed and the movement became more successfully integrated into the framework of the Republican Party, especially through the work of former Republican majority leader Dick Armey (Tex.) and his organization, FreedomWorks.[5] Perhaps more important to the movement than any particular issue was a sense of anger at the political establishment, including Republican elites who had supported the Troubled Asset Relief Program (TARP).[6] Anti-TARP challengers, most of whom explicitly embraced the Tea Party banner, far exceeded expectations in Republican primaries, including unseating longtime incumbent senator Bob Bennett (R-Utah).[7]

The Tea Party's rise intertwined with the leftovers of Representative Ron Paul's (R-Tex.) 2008 presidential campaign and its followers' long-standing, enthusiastic opposition to the Federal Reserve. For many years Paul had argued for a return to the gold standard and helped to spread Austrian economics among his many followers, and in September 2009 he published *End the Fed*, a political treatise that shot up the best-seller lists.[8] Many Tea Party activists shared this prescription without reservation, but others sought to rework it into a form more likely to gain political traction. Tea Party delegates to Maine's Republican Party Convention managed to replace the state party's platform, including in the new version a call to audit the Fed "as the first step in Ending the Fed."[9] Tea Party office seekers embraced this call, making it a central part of their campaigns.[10]

"Audit the Fed" became the primary rallying cry for those seeking greater accountability for the crisis fighters during 2009, including not only Paul's supporters or Tea Party adherents but also several left-leaning political figures

who questioned the Fed's legitimacy. Senator Bernie Sanders (I-Vt.) sponsored a (symbolic) Senate budget resolution amendment adopted in April 2009 demanding full disclosure of the identity of recipients of Fed support.[11] Ron Paul amassed 320 cosponsors for his Federal Reserve Transparency Act in the House, denouncing the idea that the central bank's "independence" should protect it from further scrutiny as well as the "technocratic terms" with which the Fed defended its secrecy.[12] The bill did not have the support of the chamber's Democratic leadership, however, and so it failed to move in 2009. Sanders and Paul relentlessly pressed for inclusion of a Fed audit provision in the huge financial reform bill being negotiated in 2010, and eventually Sanders succeeded in attaching his version of the bill as an amendment to the Senate's reform.[13] Paul's version, seen as more aggressive, was narrowly voted down in the Senate.[14] Sanders' provision eventually became § 1109 of the Dodd-Frank Act, which required one-time Government Accountability Office (GAO) audits of the Fed's crisis actions and its governance.

Champions of the audit spoke as if it would provide clear improvements in accountability at the Fed, which they perceived to be secretive and impervious to objective scrutiny, but it is best understood as a coalescence of concerns about the Fed's legitimacy rather than as a way to address particular grievances about the Fed's processes. Few Fed critics realized that the central bank had submitted to frequent GAO audits of its basic processes since 1978; that the Fed has an inspector general dedicated to ensuring the integrity of its accounts; or that most of the information requested by Sanders and Paul had already been publicly released, some of which in pursuance with parts of the Emergency Economic Stabilization Act (EESA) requiring disclosures about actions taken under § 13(3).[15] Still, it is true that the transparency demanded went further. The Sanders amendment successfully compelled the release of information about the identity of loan recipients and the terms they received, over the Fed's political objections.[16] Ironically, the Fed would later cite these forced disclosures when it was defending itself against the Bloomberg reporters' aspersions, suggesting that the releases improved its ability to defend its legitimacy in spite of its earlier resistance to such releases.[17] Although it stopped short of requiring a full GAO review of the process by which the central bank makes monetary policy decisions, as Paul's version would have, it did require a one-time GAO review of the Fed's governance, which was released in July 2011.

The audit's champions hailed this release as transformative, although in many ways it painted a sympathetic portrait of the Fed.[18] In a familiar maneuver, Fed critics led with the largest number they could derive from the report: the GAO reported $16.1 trillion in loans ("not term-adjusted"), a figure derived by

summing loans rolled over frequently. More novel at that point was the focus on the Fed's loans to foreign entities, including its swaps with foreign central banks and its loans to non-U.S. banks through several of its special facilities.[19] Others noted the GAO's recommendations to the Fed to avoid the potential appearance of conflicts of interest.[20] Few dwelled long on several of the GAO's other conclusions: that the Fed had no internal control issues, had a clean audit, and did a great deal to mitigate the risk of losses.[21] In its typical manner, the GAO offered a great many constructive suggestions to improve the Fed's processes, making it a worthwhile exercise, but it hardly served as the exposé that the audit's backers often seemed to expect.

Clearly demonstrating that the "Audit the Fed" mantra represented something other than a desire to audit the Fed, the movement was resuscitated in 2012, when Representative Paul shepherded an updated version of the Federal Reserve Transparency Act through the House by a vote of 327–98, including all but one Republican.[22] Notably, the bill's sponsors were unperturbed by testimony from the leader of the GAO's previous audit stating that the need for new audit legislation had largely passed.[23] The Democratic leadership felt that Paul's bill, the main effect of which would be to require the GAO to wade into monetary policy, would be unproductive, and it never moved in the Senate. In Barney Frank's judgment, "What we're talking about is taking some fake punches at the Federal Reserve but not doing anything serious."[24] Nevertheless, auditing the Fed has continued to serve as a call to arms for those demanding more transparency from the Fed; Paul's son, Senator Rand Paul (R-Ky.), has continued to press for further legislative action, and the House once again passed an audit bill in September 2014.[25] The continued political vitality of this message is powerful evidence of the Fed's damaged legitimacy, even if its champions' particular demands are far from a model of clarity.

Occupy Wall Street's Sprawling Challenge

Where the Tea Party served to organize discontent from the right, Occupy Wall Street provided a rallying point for critics of bailouts on the left. Inspired largely by popular uprisings against corrupt governments in the Middle East, a group of political anarchists organized a demonstration near Wall Street on September 17, 2011, purposefully sparking a nationwide series of protests. Within a month, this initial Occupy Wall Street (OWS) protest had generated dozens of protests in other cities across the country and around the world. At the original Wall Street location (the small Zuccotti Park), protesters camped and were a continuous presence until finally being forced out on November 15.[26]

From its beginnings, figuring out the precise demands of this protest movement was difficult—which, in part, was its original planners' vision. Many of the movement's adherents rejected the legitimacy of American democracy and its response to the financial crisis; nearly all offered denunciations of corporate culture, greed, and the capture of government by moneyed interests, and especially bankers. Ron Paul supporters were well represented, and contempt for the bank bailouts widespread.[27] A few protesters brandished papier-mâché squids, recalling Taibbi's scathing metaphorical denunciation of Goldman Sachs.[28] But, sharing a strong desire to operate through "horizontal" consensus rather than any "vertical" power structure, the protesters aimed to make OWS an outlet for all kinds of grievances about the nature of capitalist society, with denunciations of inequality becoming its trademark.[29]

Rather than objecting to the nature of the government's crisis interventions itself, what OWS protesters seemed most angry about was the disparity between the generosity toward large, struggling, indebted institutions and its seeming stinginess toward individual, struggling, indebted citizens. Occupy protesters frequently highlighted the burdens imposed not only by mortgage debt but also by student loan debt and consumer debt. Shaping and channeling these feelings was David Graeber, a professor of anthropology who became a central figure in OWS. Graeber sought to force a radical reconsideration of the role of debt, arguing that financial contracts should much more easily adapt to changed economic conditions and that debt should periodically be forgiven in society-wide "jubilees." These ideas won a handful of enthusiastic converts, especially among young people disillusioned with a president who they had imagined would be a far more transformative figure.[30] But for the most part, this program was too far outside the political mainstream to give the Occupy movement practical traction among economists or policymakers.[31]

The OWS movement occasionally produced far more focused efforts that attempted to work within the existing policymaking system, even if many protesters doubted that whole system's legitimacy. Most notably, Occupy the SEC formed to participate in the rulemaking process for the Volcker rule, one of the Dodd-Frank Act's signature reforms. Bringing together a variety of people with experience in the financial industry, it submitted a 325-page comment letter to the Securities and Exchange Commission in February 2012.[32] The letter drew rapturous applause from those who felt that Occupy was finally hitting its stride and adopting much-needed specificity.[33] The group went on to sue the government for unnecessary delay in promulgating the final Volcker rule, as well as submitting comments on many other rules,

and seems to have had at least a modest effect in shaping policy.[34] In this way, amorphous misgivings about a government's legitimacy were converted into specific legal influence.

Although Occupy the SEC continues its work, by most accounts the larger OWS movement has failed to gain institutional traction in the American political scene. Initial public sympathy gradually deteriorated, with the style of its critique of America's political and economic system too aggressive for most citizens (or either political party) to embrace.[35] Nevertheless, there is little doubt that the picturesque moments of mass resistance left their imprint on America's political debate, raising the profile of inequality as an issue and keeping pressure on banks.

Other Indicators of Diminished Legitimacy

Beyond the concerns of the Tea Party or OWS, both of which many observers view as marginal groups, there is no question that the crisis responders' legitimacy has been seriously impaired, perhaps so much that they would be seriously handicapped if they needed to address another financial crisis today. This is true both at the mass and elite levels. Survey data indicate that confidence in the government's economic leaders has fallen dramatically since the crisis began.[36] Recent surveys show that large majorities of Americans believe the primary beneficiaries of the responses to the crisis were wealthy people, large corporations, and large banks and financial institutions, while few believe that ordinary people benefited much at all, leading a majority to regard the crisis responses with disapproval.[37] The judgment of elites is somewhat more mixed; most prominent academic economists seem to take an overall favorable view of the government's actions,[38] but among politically active opinion makers, hostility to bailouts is widespread and unusually bipartisan.[39]

Politically, the damage to legitimacy was registered clearly when President Obama reappointed Fed chair Ben Bernanke in August 2009. As Obama chose continuity, members of both parties used Bernanke's December confirmation hearing before the Senate Banking Committee as an opportunity to vent their frustrations with the Fed, both as a financial regulator and as an architect of the crisis response. Ranking member Richard Shelby suggested that recent experience had shown that Congress had been wrong to trust the Fed, while Jeff Merkley (D-Ore.) worried that the Fed had acted "without any checks and balances and without any oversight." Persistent Fed critic Jim Bunning went considerably further, denouncing Bernanke's tenure as chair as a "failure" and accusing him of "hand[ing] out cheap money to your masters on Wall Street."[40] In spite of these misgivings, the Senate confirmed Bernanke

for a second term, 70-30 (with 18 of 40 Republicans against), but this was far and away the weakest endorsement of a Federal Reserve chair nominee in history—and quite a slide from Bernanke's 99-1 confirmation vote in 2006.[41]

Should policymakers think of this damage to legitimacy simply as a playing out of Geithner's paradox? To reprise Geithner's view: "The central paradox of financial crises is that what feels just and fair is the opposite of what's required for a just and fair outcome."[42] In other words, doing the right thing is likely to be unpopular, and doing the popular thing is likely to be wrong. The need for bank rescues can be clear in the moment for the decisionmaker, even if it is fundamentally incompatible with the average citizen-observer's sense of right and wrong, and eventually history will legitimate the policymaker's willingness to prioritize the long run over the short run. Prioritizing "seeking to increase public legitimacy" in the present moment rather than focusing all available resources on combating the crisis in the most effective way available is, in short, to be understood as an act of cowardice.

There is more than a grain of truth in this outlook. Nothing succeeds in earning legitimacy like success in securing prosperity. If the secretary of the Treasury were to happen upon a genie who could grant him the wish of ending a financial crisis and bringing widespread prosperity—but only if he were to immediately pay Bernie Madoff a billion dollars—this would be an easy choice. For the good of the country, he should just do it, in spite of the offense to cosmic justice and instantaneous hatred that the decision would entail. Once his sacrifice had been made known, he would justly become a fairy-tale hero.

But the world is not so neat, nor the path from crisis response to economic recovery so certain, as to make this flight of fancy particularly relevant. Instead, counterfactual histories are utterly obscure to us. Even the best-informed policymakers can never be entirely sure exactly how one crisis response affected the nation's economy, and normal citizens will be far less able to discern the response's effects reliably. For a democracy to allow its leaders to take actions that are deeply unpalatable in the moment, it must extend considerable trust, and when that trust is in danger of being lost leaders must take steps to shore it up through investments in process and accountability. A policymaker cannot hope to retain the legitimacy needed to act effectively without actively cultivating these forms of legitimacy.

In other words, in the messiness of the real world, and especially a real democracy, there is a simple answer to the question of whether policymakers should focus all of their energy on crisis-combat and none on "worrying about" legitimacy: no. As the example of the Public-Private Investment

Program shows, winning legitimacy for a crisis response strategy is sometimes strictly necessary to its efficacy, and as such legitimation deserves to have considerable resources devoted to it.

To be fair, occasional defensive rhetoric notwithstanding, this is obvious to Timothy Geithner and all the other crisis responders. They all sought to enhance their legitimacy in several ways even if they quite consciously chose to deprioritize that goal and limit the amount of resources it would consume. Most saliently, that prioritization meant more time and money were devoted to ensuring the health of the big banks and less to supporting households struggling with mortgage debt. This meant critics, such as Paul Krugman, could characterize Geithner's crisis philosophy as "all for bailing out banks but against bailing out families."[43] For many critics, including Neil Barofsky and Sheila Bair, the extent of this prioritization was not only unaligned with public desires but also inconsistent with what TARP had promised. Similarly, many observers felt that the crisis responders spent too much effort restoring the status quo ante and not enough reforming it.

Crisis responders offer a defense of the balance they chose: they were truly taxed to their utmost by the task of trying to contain the crisis, and so it is not metaphorical when they say that more effort devoted to legitimacy would have led to worse program design and execution—and that the worsened outcomes that would have resulted would ultimately have led to greater legitimacy problems. That argument is difficult to evaluate on its merits—but in the most consequential senses, its veracity is unimportant. If it is correct, it suggests that it would have been socially productive to have extra resources specifically dedicated to legitimation. If it is incorrect, then the crisis responders bear some blame for making bad decisions about allocating their time and energy at the margin, as a greater focus on improving their legitimacy would have served them well. In either case, constructive prescriptions for the future must offer practical strategies for improving legitimacy. Before doing so, it is necessary to take a hard look at what kinds of reforms Congress already enacted in its reform law, the Dodd-Frank Act.

Legality Amended: Dodd-Frank's Response to the Crisis Responses

The most straightforward way for America's political system to secure greater accountability in the wake of the crisis was for Congress to enact reform laws based on the lessons of recent history. To the extent that adhocracy was resented as illegitimate, Congress could seek to ensure the predictability and

nonarbitrariness demanded by the rule of law by establishing strongly binding rules for the Treasury, the FDIC, and the Fed to follow in future crises. In fact, Congress did take many steps in this direction, while at the same time making many other choices that reveal a preference for discretionary authority in crises; legislators took away some of the tools used most aggressively in 2008 but created powerful new ones that, in some ways, magnified the importance of the executive branch judgment in dealing with a crisis.

The vehicle for nearly all of the changes was a single omnibus reform law negotiated from late 2009 through mid-2010: the enormous Dodd-Frank Wall Street Reform and Consumer Protection Act.[44] President Obama hailed the law's reforms and promised they would ensure that "the American people will never again be asked to foot the bill for Wall Street's mistakes."[45] Both the bitter partisan battle to pass Dodd-Frank and the law's sweeping consequences have inspired book-length treatments by now, so I will avoid trying to offer a comprehensive assessment of the law.[46] Instead, I focus on two aspects: first, how Congress reacted to the Federal Reserve's and the FDIC's extensive crisis improvisations by limiting their powers; and, second, how Congress attempted to create the conditions for a law-like resolution of failing systemically important institutions so as to end the problem of "too big to fail" (TBTF).

Adhocracy Tamed?

Title XI of Dodd-Frank remakes the Federal Reserve's § 13(3) authority to lend to financial institutions other than banks during crises—though exactly what this renovation of the Fed's emergency powers accomplishes is still very much a subject of debate. It seems clear that, after the law's changes, the Fed cannot return to its exact 2008 playbook again: its aid to JPMorgan Chase in purchasing Bear Stearns and its rescue of AIG would both be ruled out under Dodd-Frank. Similarly, the FDIC would find its signature crisis intervention, the Temporary Liquidity Guarantee Program, impossible to replicate after Dodd-Frank. Given the pattern of creatively searching for legal powers up to the very edge of what statutory language can support, however, assessing what the Fed and FDIC will be able to do in a future crisis is much harder.

This much is certain: § 1101 of Dodd-Frank removes the Fed's ability to lend to specific firms and instead confines its emergency powers to creating facilities "with broad-based eligibility." Reflecting the widespread distaste for the Fed's perceived ability to "pick winners and losers," this change apparently would not prevent creation of programs such as the Term Auction Facility, the Term Asset-Backed Securities Loan Facility, and the Commercial Paper Funding Facility, but it would ban firm-specific rescues such as those embodied in

the loan to AIG or the creation of the Maiden Lane special purpose vehicles. Dodd-Frank attempts to constrain potentially arbitrary Fed power in two other ways as well. First, the Fed must promulgate clear procedures for granting aid under § 13(3) that will ensure only high-quality collateral is accepted as security for loans, prevent borrowing by insolvent firms, and guarantee that Congress is notified immediately of new programs' beneficiaries as well as their existence. Second, the Fed's ability to act independently of political actors in a crisis is significantly constrained: now, new § 13(3) facilities can be created only with the approval of the Treasury secretary.[47]

Some worry that these changes will hobble the Fed's ability to act effectively, others that the ever-creative Fed has emerged no less able to improvise than it was in 2008. The former camp emphasizes the Fed's lost flexibility, which it believes the central bank wielded effectively and in good faith during the crisis.[48] From this angle, restricting the Fed's power looks like punishing it for having shown much-needed boldness and foresight. Former Fed vice chair Donald Kohn has also expressed reservations about the requirement that the Fed secure the Treasury secretary's approval before acting. Although in 2008 Henry Paulson and Bernanke worked together quite closely, so that this requirement would have changed little, Kohn worries that a future Treasury secretary might bow to short-term political pressures against bailouts and prevent the Fed from acting in a moment of need.[49] Finally, Kohn and others have warned that the requirement that borrowers' identities be revealed immediately will worsen the problem of stigma—that is, that borrowers who would benefit themselves (and the safety of the financial system as a whole) by prudently borrowing from the Fed might be dissuaded from doing so because of worries about investor and public backlash upon disclosure of their borrowing.[50]

On the other side are those who contend that Dodd-Frank's changes will not restrict the Fed nearly as much as advertised. Most notably, Richmond Fed president Jeffrey Lacker has expressed concern to Congress that the Fed could devise a facility that formally meets the broad-based eligibility requirement while practically offering aid to just one firm, thereby circumventing Dodd-Frank's restriction.[51] In other words, the Fed is clever enough to legally engineer a facility open to all but only attractive to a single systemically important failing firm.[52] Alternatively, some worry that the requirement of broad-based program access might be effectively restricted to a particular kind of firm, such as primary dealers.[53] The changes made by Dodd-Frank were also frustrating for those few observers worried by the way the Fed elided the fuzzy loan-purchase distinction by using § 13(3) to essentially purchase assets.

Although § 1101 makes it clear that the Fed cannot use its emergency lending power to relieve a single institution of troubled assets, nothing in it appears to address the question of broad-based asset purchases, thus failing to address the ambiguity the Fed used to create the CPFF and other facilities.[54] In short, with Dodd-Frank, Congress seems not to have internalized the fact of Federal Reserve legal creativity as it devised constraints for future crisis responses.

Although one should always hesitate to ascribe to legislative subtlety what might instead be the result of factiousness or lack of foresight, it is possible to understand Congress's revisions in § 1101 as embodying a fairly nuanced position about the Federal Reserve's actions during the crisis. First, notwithstanding any worries about formal Fed independence, a clear lesson of the crisis was that the Fed is likely to become politically vulnerable through its support for unpopular banks. As a result, its long-run institutional performance depends on having political support for these actions. If it were to openly defy the wishes of a sitting Treasury secretary, it would put itself in a precarious position, in which its basic legitimacy might be effectively undermined. Without this legitimacy, it is unlikely that the Fed could operate effectively; formal powers alone would be insufficient to provide anything but the most fleeting support. And as chapter 3 describes, seeking political cover from the Treasury secretary was important to the Fed even when doing so was not legally obligatory. Making this cooperation mandatory is thus simply codifying a bit of crisis political wisdom.

Second, the decision to attempt to shut down single-institution rescues while preserving the option of broad-based emergency facilities was a deliberate one that closely tracks widely shared political sensibilities. As Jose Gabilondo—who generally worries that the Fed's discretion has been overly constrained—puts it, "The requirement that emergency liquidity be provided through programs rather than one-off deals largely codifies into a statutory safe harbor the best practices that the Fed discovered by experimenting."[55] Congress clearly lends its democratic legitimacy to the creation of emergency § 13(3) facilities and clearly makes it much more difficult and politically costly for the Fed to try to rescue single institutions. That it leaves the door open a crack for future Fed creativity (when approved by the Treasury secretary) may reflect a willingness to allow some flexibility in future emergencies. The Fed would undertake such actions well warned of the political wounds it would suffer if critics were able to credibly paint it as "picking winners." Perhaps the Fed would do more than it did in the chaos of 2008 to ensure that all of its processes not only achieved fairness but also gave off the clear appearance of doing so.

Finally, Congress's disregard for the Fed's worries of borrowing stigma represents a possible tradeoff of policy efficacy for political legitimacy. Whether this is a good trade is impossible to know for certain, and perhaps the champions of transparency have shrugged off the downsides of disclosure too casually. One consequence of forcing the Fed to disclose its estimates of asset values is that it (and thus the taxpayer) may lose some bargaining leverage and lose out on some value.[56] More important, when the financial system is becoming destabilized but not yet in full-blown panic, banking institutions increase the strength of the whole system when they borrow to shore up their balance sheets. If they are discouraged from doing so because they expect both market and political backlash within weeks of borrowing, this would be an extremely unfortunate consequence of reform. But this is not a certainty. The Fed's design of many crisis programs effectively mitigated stigma concerns, and there are reasons to hope that they can build on this experience.[57] Even granting that the costs of disclosure are serious, however, the potential gains in political legitimacy from quicker and more thorough lending disclosure may outweigh them. Critics of the Fed's crisis activities based a huge portion of their rhetoric on the idea that the Fed was a shadowy, secretive organization that would not allow itself to be subjected to the public's scrutiny. This is what has fueled the not-yet-dead "audit the Fed" campaign even after Dodd-Frank's audits were completed. To the extent that the Fed can credibly present itself as basically transparent, it thus stands to gain significantly in terms of its legitimacy with the public. The Fed has moved slowly toward implementing Dodd-Frank's revisions to § 13(3), sometimes fueling skepticism, but it has now proposed changed procedures and guidelines for its emergency aid, and it has much to gain from this process.[58]

It is worth briefly noting that Dodd-Frank made some less-noticed parallel changes meant to discipline the FDIC's crisis powers. The FDIC had stretched (or arguably exceeded) its statutory authorities to put into place the Temporary Liquidity Guarantee Program (TLGP), which turned out to be one of the more heavily used and useful crisis programs. Dodd-Frank curtails its ability to repeat that legal maneuver, however, by restricting the uses to which the FDIC may put its funds and punctuating the exclusivity of these uses with the unusual § 212(b), which declares that "no governmental entity may take any action to circumvent the purposes of this title."[59] Dodd-Frank also replaced the TLGP with a temporary program to provide unlimited FDIC insurance for non-interest-bearing transaction accounts, most often used to handle corporate payrolls, which expired at the end of 2012 after Congress failed to pass a bill extending it.[60]

But Dodd-Frank explicitly created a procedure by which the FDIC could create a guarantee program with better democratic legitimacy and clearer limits. Sections 1104 and 1105 of the law require the FDIC to formulate procedures by which it would create a broad-based debt guarantee program for solvent banks. That program would be limited to a prespecified dollar amount, funded by fees charged to participants, subject to the finding of the FDIC and Fed that there is a "liquidity event" threatening the financial system, and then contingent on approval of the Treasury secretary and Congress (through a joint resolution). Having created a legal framework for a debt guarantee program, § 1106(a) then explicitly strips the FDIC of the (questionable) legal authority it used to create the TLGP.

As with the changes to the Fed's § 13(3) powers, there are those who doubt that the FDIC restrictions written into Dodd-Frank will be effective; they warn that the political approval required by § 1105 would not act as an effective brake and that by clearly authorizing a debt guarantee program Dodd-Frank has effectively opened the door to an FDIC giveaway of taxpayer funds.[61] These questions, though, have been little noticed and less debated, because they are overshadowed by the huge debate centering on one of Dodd-Frank's major innovations, the FDIC's Orderly Liquidation Authority and its relationship to the phenomenon of too big to fail.

Does OLA End TBTF? How Can We Pre-Commit to the Rule of Law?

Title II of Dodd-Frank creates a new procedure for dealing with systemically important failing firms. It promises that if the government were to face another Bear Stearns, Lehman Brothers, or AIG, it could use a new, better-suited tool—the Orderly Liquidation Authority (OLA)—rather than choosing either a full rescue of creditors or an uncontrolled and disruptive bankruptcy. Once a determination of systemic importance is made, in a manner analogous to the way it handles failed banks the FDIC is given the authority to take over a firm that threatens financial stability, wipe out its shareholders and creditors, and then run its operations until they could be sold off in whole or in parts.[62] Section 214 of the law boldly promises a "prohibition on taxpayer funding," stating in several ways that no taxpayer dollars can be used to facilitate these liquidations, and the aforementioned § 212(b) makes it clear that no funding mechanism other than the one provided within the act is to be used. Title II is thus the indispensable piece of Dodd-Frank for those who claim that the reform law put an end to taxpayer bailouts. As the law's defenders see it, whereas in 2008 there was only legal ambiguity and confusion for failing financial institutions other than commercial banks, after Dodd-Frank

there is a rule-based procedure, compatible with rule of law, to deal with them effectively.[63] According to this view, TBTF is a thing of the past.

This view has received withering criticism from both the political left and right. This is not the place to work through the specifics of these arguments or the rebuttals offered by Dodd-Frank's defenders, including at the FDIC. Instead, this section shows how, collectively, the attacks on Title II go to the very heart of what the rule of law can and ought to look like during crises. From across the political spectrum, there are several main strands of OLA criticisms, some of which are mutually exclusive:

—Because Dodd-Frank does not clearly define when or how the OLA must be used, it makes the fate of struggling firms more unpredictable rather than less and thus threatens the stability of those financial institutions potentially subject to it.[64]

—Title II shreds the due process rights of firms designated as systemically important while failing to outline a clear and effective strategy for arresting crises. It places its trust in the FDIC's discretion without any compelling reason. Only a strongly rule-based system, such as the bankruptcy code, can provide order during a crisis.[65]

—In practice, the OLA will function as a tool to provide taxpayer-funded bailouts for bank creditors, notwithstanding the statute's promise to shield taxpayers.[66] Title II thus legitimates and institutionalizes the practice of bailing out banks at taxpayer expense.[67] The post–Dodd-Frank system is thus even more advantageous to the creditors of large firms than the 2008 system of ad hoc bailouts was.[68]

—The OLA is unworkable, or at least too risky for crisis fighters to want to use it when a crisis seems imminent. Because of these problems, we should expect Congress to enact new bailout legislation in a future crisis (or perhaps simply acquiesce to extralegal use of taxpayer funds), so that TBTF and its attendant moral hazard remain undiminished.[69]

Of these arguments, the first three are clearly in strong tension with the fourth. In each of the first three criticisms, the focus is on the discretion built into the OLA and how officials are likely to use their new power in ways that effectively perpetuate TBTF or worsen financial stability concerns. In the fourth, however, the concern is nearly the opposite: Title II looks to be constraining enough of potential crisis responders that they will forsake it entirely, figuring out some way of acting without explicit legal sanction or simply turning to a future Congress to amend the law.

A solution to TBTF, then, must be as rule-like as possible to avoid both destructive arbitrariness and capture, embracing the value of predictability

that is central to the rule of law. But if the device is too rigidly defined, it simply will not be used—as other critics point out, crisis fighters will find a way to circumvent it, through Congress if necessary. Build a flexible device, and it looks inconsistent with the rule of law because it leaves the door open to arbitrariness and favoritism. Build a clean, predictable rule, and it will be overtaken by events: the rule of law will look secure in normal times, but will (rather predictably) give way in a crisis.

Consequently, to prevent taxpayer-funded bailouts, a well-structured legal framework for dealing with failing firms without taxpayer support is necessary but not sufficient. To offer a credible alternative to keeping firms afloat with taxpayer funds, the mechanism must strike lawmakers contemplating its use as clearly superior in terms of preserving the social value of struggling firms and arresting financial crisis.[70] The regulators charged with readying the OLA (and their sympathizers) have certainly been mindful of this need and have worked hard to devise a strategy that is credible.[71] Nevertheless, it is probably impossible to achieve certainty on this front short of a successful utilization of the OLA in a future crisis, leading some bailout critics to insist that the only way to solve the political-economic riddle posed by TBTF is to ensure that institutions never find themselves vulnerable to failure.[72]

Just as important as workability but much less reflected on is the need for the non-bailout mechanism to have legitimacy. This may come through a combination of trust in officials, democratic support, and provision of ex post accountability. Unfortunately, this mix is not encouraging at present: in the wake of the crisis, trust is at a low ebb; the Dodd-Frank Act's democratic support was nearly exclusively Democratic, creating uncertainty for how its OLA would be regarded by Republican officials; and the OLA has few process protections or meaningful chances for ex post review.[73] As FDIC officials continue to work on their planning for OLA use, they should also be thinking about ways of improving their tool's legitimacy on all of these fronts.

Legality Impaired?

To some critics, America's identity as a nation of laws and not men has been seriously called into doubt by the crisis responses. From this perspective, it seems as though the Treasury and the Fed tried every approach to the crisis except "applying the rule of law."[74] The seeming arbitrariness of our crisis adhocracy eviscerated the thick rule of law, and the stretching of legal powers well beyond their natural meanings would seem to call into question even our commitment to the thin rule of law, which merely constrains government to

play by its own rules. There is every reason to expect executive branch overreach to spill into normal times. We may choose to struggle mightily against this trend in service to the rule of law ideal now in disrepair, but our work will be difficult. Or, following Posner and Vermeule's advice, we might instead begin to think of the rule of law as a quaint anachronism with little relevance to twenty-first-century governance.

When I began researching this book I placed myself among the potential champions of the wounded rule of law, but over the course of writing it I have come to think that position combines a lack of historical awareness, hyperbole, and an unrealistic sense of what the rule of law can and should do in a crisis. First, across oceans and centuries political leaders have found a way to stretch their legal powers to meet the exigencies of war and financial crisis, with or without legislative support. This is not necessarily a fact to be celebrated, and it comes with real hazards; the case of Weimar Germany's descent into government by decree and tyranny is invoked to the point of cliché for a reason. But granting crisis authority in the form of limited enabling acts has not proved deadly to democracy or impossible to terminate. The Troubled Asset Relief Program is no exception: while money can still flow out of it for a few limited purposes, at this point there is no possibility that the time-limited law will be used to support new large-scale programs of any kind.

Second, it is simply untrue to say that America's crisis responders were untroubled by the legal constraints they faced. Indeed, at many points in the crisis, legal constraints were decisive: when the Treasury refrained from backstopping the Fed before TARP because of the Anti-Deficiency Act; when the government took only 79.9 percent ownership of AIG and of the GSEs because of the formal legal budgetary consequences of taking more; and when the Fed refrained from making outright purchases of assets.[75] Or, more controversially, when the government decided it was without legal options to save Lehman Brothers or to forcibly reverse the bonus payments at AIG. In none of these cases did law align neatly with well-established political demands, and yet in none of these cases did it prove a mere paper barrier. When legal limitations are specified explicitly and unambiguously enough, they matter profoundly.

Third, it is conceptually sloppy to consider it a defeat for the rule of law whenever the government wields discretionary power aggressively. As defenders of the thick rule of law used to acknowledge—including both Lon Fuller and F. A. Hayek—it is unreasonable to imagine that every kind of government action ought to be law-like, neutral, and predictable. Nobody expects a general or a diplomat to behave like a rule-governed civil servant (or at least they ought

not), and central bankers acting as lenders of last resort ought to be thought of as more akin to these actors than to regular bureaucrats. Of course, that does not mean they should be thought of as above the law, but their primary actions must of necessity be guided by expediency and opportunity, so that layering on legalistic controls is likely to significantly diminish their ability to operate creatively and effectively. We should have no false sense that we can eliminate instances of soft power—as it flows naturally from the existence of power itself.

All that said, we should hope for crisis adhocracy to expire with the crisis; during normal times, we should not have to greet government officials' actions with a sense of awe at their innovativeness, and that includes the actions of central bankers. What was novel should be regularized and subjected to discipline; the kind of legislative involvement that was impossible under the time pressure of a worsening crisis should, without question, sort out competing priorities for the future.

Dodd-Frank answers this need in part. Title XI of the law renders a series of defensible judgments about the acceptability of the Fed's and the FDIC's various crisis responses and alters some of their powers accordingly while also taking steps to ensure that future emergency actions have political legitimacy. Title II also works toward making the failure of systemically important non-bank financial companies as routine and unspectacular as the FDIC's handling of failed depository institutions, though it is entirely fair to question whether it did enough to pin down the practical details of resolution and to propose changes that might offer greater clarity and predictability.

But Dodd-Frank missed several opportunities to provide legal clarity. First and most contentious, the body charged with making decisions about systemic risk—the Financial Stability Oversight Council (FSOC)—is famously underinstructed by the law. Its procedures are minimally defined, and it is given enormous discretion to fashion policies regulating systemically important financial institutions and to deal with their failures. Although FSOC might use its discretionary power productively, it is unfortunate that the law did not help it achieve legitimacy by providing a better-defined process, clear accountability mechanisms, and a clear statement of the outer limits of its authorities.

Second and probably more important, Dodd-Frank did not really tackle the huge changes in the Fed's operating model as the lender of last resort. The economist Perry Mehrling, whose work has helped illuminate the logic of the Fed's disparate crisis actions, offers an optimistic assessment: "The various facilities that the Fed has launched have been cobbled together in order to fit under existing legislative authority; in the longer run, legislation can be

expected to adapt to the new reality."[76] In other words, Congress must ensure that legal realities catch up to modern practice, lest the Fed be forced to repeat its stretching and bending of its statutory powers in a future crisis. Dodd-Frank did not do this updating. Expecting action to this end to naturally bubble up in the longer run may sound comforting enough for some, but it is easy to imagine this legislation failing to materialize without a precipitating event. If there is no such event in the coming years (as we may certainly hope will be the case), the Fed's powers may recede from the agenda without this need for amendment having been fulfilled.

As of now, there is still simmering a strong desire to restrict the Fed in one way or another; mostly, this is channeled into unproductive symbolic measures. That pattern may fit well into the zeitgeist of our political moment, but it ill serves the country by failing to tailor the Fed's powers to the shape of current financial markets. Our political system must figure out a way to transmute the energy of those suspicious of the Fed's actions during the crisis into a force for regularizing and disciplining those kinds of actions rather than simply declaring them illicit. This will require some legislative ingenuity. One possible vessel might be the Centennial Monetary Commission proposed by Representative Kevin Brady (R-Tex.), which would consist of six members of Congress and six appointed members (as well as nonvoting representatives from the Treasury and the Fed) and would be charged with a comprehensive review of the Federal Reserve's role in the economy.[77] While this commission has primarily been envisioned as a vessel for promoting a wholesale restructuring of the Fed and the restoration of the gold standard, it might offer the possibility for detailed learning about the Fed's crisis operations. It is at least imaginable that the fruit of such deliberation could be a well-tailored Federal Reserve Modernization Act that would update the Fed's legal powers (and limitations) based on the lessons of the Fed's recent experience. Whether through this mechanism or some other one, modernization of the Fed's statutory lender-of-last-resort powers should be a priority, for Fed critics and sympathizers alike.

Looking beyond the Fed we confront a broader question about legality: what could we do to make legal constraints more effectively limit the options available to executive branch crisis responders acting independent of Congress? The truth is that if limitation alone were the goal, it would be easy to achieve. Hard dollar caps could be set on the Fed's balance sheet; a blanket prohibition on guarantees not specifically provided for could be written into law. These two changes, and perhaps a few others like them, could have effectively prevented most of the actions taken outside of TARP.

And yet, Congress chose not to pursue this path and instead added to existing powers by following the time-honored legislative preference for an enabling act that confers tremendous discretion on executive branch officials. Compared with many moments of crisis, the political embrace of TARP was distinctly limp, but it was chosen nonetheless. It came with a clearly defined maximum price tag and a host of accountability mechanisms but was otherwise written to confer extraordinary discretionary power on the Treasury secretary to combat the crisis—indeed, even more than he originally asked for on some dimensions. As much as his use of that flexibility frustrated critics, it probably served the country's and the taxpayers' interests fairly well.

Those who cherish legally limited government for its own sake therefore bear the onus of explaining how a more restrictive set of rules could have served the needs of the crisis; and all such proposals must be realistic about political resources that we have. That is, wishing that we had a legislature nimble enough to devise statutes responsive to every new crisis development will not do, because it fails to take into account the basic dilemma of crisis responders. Faced with the need for quick action, executive branch officials are likely to stretch authorities already available to them rather than make a risky overture to the legislature that might be rejected or at least fatefully delayed. For their part, legislators are wary of putting in place the kinds of restrictions that might produce the next Lehman Brothers, and they bear a much more modest political cost by tolerating legal gray areas.

A Jeffersonian Extralegal Alternative?

There is, of course, another way for officials to address crisis situations in which their legal tools prove poorly matched to exigent challenges: they could embrace the Jeffersonian approach to crisis response, which is to forthrightly act outside of the law and subject themselves to judgment for their actions after the fact. A Treasury secretary or Fed chair could decide to publicly explain that acting on behalf of the public good requires breaking the law, and then (like Andrew Jackson in New Orleans) stand trial before a jury of his or her peers or (like Lincoln in the beginning of his presidency) seek retroactive indemnification from Congress. If such departures from the law were within the realm of serious possibilities, they would provide a kind of safety valve for overly restrictive laws, by offering a possibility of clear accountability and legitimacy determined outside of the law.

Some academics are enthusiastic about this prerogative-like tradition and believe it has immediate relevance for tomorrow's crisis responders—but, for

better or worse, it has the feeling of anachronism in today's lawyer-saturated world. As Jack Goldsmith argues, the institutionalization of legalism in our culture is extremely advanced compared to the days of Jefferson, Jackson, or Lincoln, and today's crisis decisionmakers show little interest in forthrightly departing from the law.[78] Law is imperial and ascendant, not least because of the reservoirs of discretionary power it offers to the executive branch. By now there is a long tradition of awkwardly stretching statutes to provide dubious legal justifications of official actions; government lawyers' winking acceptance of such maneuvers (at least those with some facial plausibility) is a built-in feature of the system. This pattern is unlikely to change merely because some legal scholars worry about its unfortunate consequences for law's integrity.

Prescriptions: Legal Tools and Legitimation Strategies for Future Financial Crises

Rather than lament this state of affairs, we should focus on the message of this book, which is that legality claimed is not always legitimacy produced. But while it is not a panacea for legitimation, law is nevertheless a resource that can be deployed to improve legitimacy, and crisis responders should think hard about how it can be best used in that capacity. To that end, I conclude by offering several prescriptions: for a more active dialogue between crisis responders in the executive branch and legislators; for additional investments in bureaucratic processes and in the cultivation of broad-based public trust; for explicit proscriptions of certain uses of legal powers and public resources; and, finally, for an acceptance and clear delineation of a zone in which crisis responders can act without any legal guidance at all.

Democratic Legitimacy through a More Active Legislature

In spite of the availability of crisis-fighting powers from old enabling acts, throughout the crisis both the Treasury and Fed sought cover from elected officials for their actions in the form of informal assurances from congressional leaders. As adhocracy took shape over the course of 2008, it was with the blessing of these representatives of the people, even if not a public one. And eventually, in spite of the awesome powers they managed to find already existing, the crisis fighters decided that a more formal, dedicated authorization from Congress in the form of a new enabling act was indispensable. In other words, for all the talk of Congress having been marginalized or subordinated, in some ways it maintained its central role in performing democratic legitimation.

That said, the relationship between the crisis fighters and Congress was anemic in many ways and could have been greatly improved. First, reluctance about enduring a wide-ranging debate about proper crisis responses led Bernanke and Paulson to refrain from seeking new legislation before the calamitous autumn of 2008—in part because Harry Reid and others encouraged them to figure things out on their own. With the benefit of hindsight, it is easy to see how this delay proved costly and would have better been avoided. Then again, given the initial rejection of TARP, it is hard to blame the crisis fighters for having worried about making the situation worse by seeking democratic legitimacy. Both sides of this relationship deserve some blame and could benefit from a different approach whenever the next financial crisis threatens. Lines of communication should be far more open, including those with nonleadership members, and neither side should imagine that issues of immense public import can be effectively kept out of the public eye simply by delaying congressional involvement. Congress should not need to be made to feel that an ultimatum is being delivered at the last moment, especially when a problem evolves over the course of many months.

Second, Congress as a whole should be more zealously protective of its legitimating function, rather than sitting by as the executive circumvents its judgments. In other words, when the Treasury came looking for money for auto loans and left empty handed, more legislators should have taken umbrage at the Treasury's subsequent decision to accomplish the same thing through the use of TARP funds clearly intended for other purposes. Although this Bush administration action ended up having the legitimating effect of putting both parties' fingerprints on the auto bailouts, it also was potentially costly in terms of legitimacy: rather than having a well-tailored, democratically ratified apparatus specifically devoted to the auto rescues, we got an improvised and legally messy use of TARP. While difficult questions about legislative function and dysfunction in the current hyperpartisan era undoubtedly complicate things, as a matter of deeper institutional principle the legislature should aspire to more robustly embrace its role of legitimator—which it cannot do if legal sanction will either be accepted or assumed no matter the outcome of legislative proceedings.

The two-tranche structure of TARP deserves some credit in this respect. By forcing Congress to vote on the release of the second half of the $700 billion, the law mitigated the sense that the bill could only pass in conditions of near panic. Building requirements of continued congressional assent into targeted enabling acts is a useful way to ensure continuing democratic legitimacy. That principle might be extended to support a kind of financial War Powers Act,

under which the Fed or the Treasury is explicitly granted the power to take action within a certain window of time but must renew its crisis-fighting mandate with Congress at regular intervals.[79]

Legitimacy through Legal Process

Crisis responders can increase the legitimacy of their actions by reducing both arbitrariness and appearances of arbitrariness. The crucial point to understand here is that this objective can be served in ways other than complying with constraints or procedures imposed by statutes. Just because deliberate or transparent decisionmaking is not required does not mean it is prohibited, and indeed, one of the enduring lessons from the recent crisis is that relatively low-cost investments in these dimensions of decisionmaking offer large returns. Crisis fighters who devote most of their time and energy to working on behalf of (their conception of) the public good (and for a salary that is likely lower than would be available in another pursuit for far less effort) might reasonably take offense when their motives or impartiality are questioned. But it is counterproductive to assume that one's goodwill is automatically transparent to others—and probably unduly prideful to believe that one's decisionmaking could not benefit from being subjected to some deliberately chosen control processes to ensure fairness.

Bureaucratic process has a very bad name, but it is at its most socially valuable when new programs are being constructed and the public is worried about abuse. Crisis fighters initiating new programs should rush to embrace the GAO and draw on its process expertise. They should seek to produce transparent records of their decisionmaking that could serve as reasoned defenses of their actions for skeptical observers. They should probably also warmly greet whatever adversarial investigator Congress assigns to oversee their operations, as getting early input from these watchdogs can help them avoid damaging missteps later. Where capacity constraints make following this advice difficult, they should consider turning to Congress for additional resources dedicated to improving process.

In attempting to cultivate process-based legitimacy, the Fed in particular should consider whether it would be well served by becoming more legally transparent. The law governing the central bank is extremely obscure—it is the rare area of legal scholarship that has cost the lives of just a few slender trees rather than large forests. No doubt the Fed is quite happy not to be bound by an extensive body of case law, but shrouding the logic behind its key invocations of §13(3) in mystery leaves the impression that the institution will ultimately reach whatever legal conclusions serve it best. I suspect that

impression is unfair, but there is little way for even an interested scholar to be sure since the Fed refuses to release its legal rationales, even at the urging of a FOIA request.[80] Publishing the legal guidelines for its own internal decision processes would serve both to discipline the institution's thinking and allow it to substantiate its claims to be making objective judgments about such crucial matters as collateral quality and institutional solvency.

Trust and Accountability

Crisis fighters will undoubtedly be more effective when they begin with the public's trust, but in any case, that trust must be nurtured and tended to throughout the crisis. This requires a greater investment in what might easily be mistaken for mere public relations. Perhaps somewhat unfairly (and then, perhaps not), PR professionals, and especially those in the political realm, are thought of as trafficking largely in bullshit—which I use here in its scholarly form, where the essence of the art is an indifference to the truth.[81] Because of this suspicion, efforts to cultivate trust must proceed very carefully, lest they backfire when people interpret them as smokescreens.

What is necessary looks more like an educational campaign than a traditional public relations effort. It was difficult for ordinary citizens to understand the actions of 2008 and beyond, and the crisis fighters often seemed to convey the message that it was people's own fault. Especially in the early going, both the Treasury and the Fed often relied on their assertions that the truly interested citizen could find a wealth of information about their various programs from their respective websites. Availability of information that people are unprepared to use is of little value, though. All of the institutions involved should have been far more assertive in helping people decode the sea of acronyms and financial jargon that supplied the idiom of the crisis. This requires not only a wide-ranging effort to present actions to the attentive public but also a willingness to correct specific misunderstandings—even (or perhaps especially) those that seem to unfairly impugn the integrity of dedicated public servants. Because institutional legitimacy is often necessary for programmatic efficacy, such efforts should not be thought of as mere distractions from the institutions' core missions.

The Fed as an institution has become far more aware of a duty of public explanation, as well as disclosure, and several of its efforts represent clear improvements. Bernanke's appearances on *60 Minutes,* first in March 2009 and then again in December 2010, were watershed moments.[82] In these interviews, Bernanke was at his professorial best, explaining the Fed's origin and funding source and why taking steps that seemed so unfair was necessary to

save the broader economy. Bernanke would also become the first Fed chair to routinely field journalists' questions at press conferences, which helped demystify the institution. On the other hand, the Fed's reaction to Bloomberg's "secret loans" story provides an instructive example of what not to do. The institution came off as dismissive of critics, unwilling to descend to specifics, and suspiciously vague in some of its claims. For better or worse, it is deeply counterproductive in the current media environment for the Fed to give the impression that it feels it is beyond needing to justify itself to those who would paint it as a shadowy ally of the banks. Because the Fed *has* done a great deal to promote transparency, it should take every opportunity to increase its legibility to the public—not just insist that it is an open book. By engaging more substantively with critics, it can help illuminate to the broader public just how many of its opponents are actually dead set against the very idea of central banking rather than any particular institutional characteristics or decisions of the Fed.

Where trust does not already prevail, accountability mechanisms can sometimes provide partial substitutes. These mechanisms can dispel any sense that programs are issuing blank checks with no scrutiny and thus produce a kind of backhanded legitimacy when they focus on the shortcomings of crisis responses: if harsh critics lack any truly scandalous accusations and stop short of denying the basic good faith of crisis fighters, this may serve as a sign of trustworthiness. Many times, ordinary citizens' most strongly held priority is that insiders not be enriching themselves at the public's expense.[83] To the extent they can be reassured by strong investigations that officials are not simply enriching their cronies through corrupt diversion of funds, they may be far more willing to trust decisions whose substance remains somewhat obscure.

Finally, it is worth noting that there is an interesting kind of informal accountability now playing out through the principal participants' attempts to account for their own actions in their respective (and sometimes dueling) crisis memoirs. In a sense, shaping the historical narrative to either accept or reject the crisis responses will determine those actions' legitimacy as guides for future action. If history is written by the victors, it is as yet unclear which interpretation will be triumphant in this debate, and so the public responses to these crisis narratives are of great importance.

What Clear Law Can Do: The Neglected Promise of "Thou Shalt Not's"

Although this book has often focused on the limitations of law's ability to constrain crisis responses, it has also sought to show that laws continue to matter

in important ways, contrary to the claims of some recent arguments that the executive is, for all practical purposes, "unbound" to pursue whatever policies it prefers in a crisis.

The most prominent, and controversial, instance of legal constraint was the Fed's insistence that it had no legal tools available to save Lehman Brothers after its attempt to broker a purchase by Barclays fell apart in September 2008. Many observers feel the after-the-fact insistence on legal limitations in this instance is disingenuous, exposed as such when compared with the actions taken to rescue Bear Stearns in March 2008 and AIG just a day after Lehman's demise. Those who think the Fed was equipped to save the embattled investment bank are conspicuously silent about what legal mechanism would have been appropriate to use; perhaps they think it is self-evident that the Fed could have ginned up a huge loan with the firm's equity value taken as collateral, as it soon after did with AIG. After new revelations about the New York Fed's own assessments of Lehman's solvency, some are belatedly prepared to argue that Lehman would have remained a solvent institution with the Fed's support.[84] But note that this suggestion does not imply the law's irrelevancy. Rather, it argues that in exercising its discretionary judgment about the quality of collateral Lehman had to offer, as required by § 13(3) of the Federal Reserve Act, the Fed may have erred in its assessment. Law stays in the picture.

If law's role in Lehman's demise remains hotly contested, its role in shaping the overall contours of the crisis responses is much less remarked on and, ultimately, far more consequential. As Bear Stearns deteriorated in March 2008, Treasury secretary Hank Paulson wanted to guarantee the Fed's loans to facilitate its purchase. But his lawyers told him in no uncertain terms that this was simply impossible because of the Anti-Deficiency Act, which flatly bars agents of the federal government from making expenditures or incurring obligations without explicit congressional appropriations. Through enactments in 1870 and 1884, Congress enacted these proscriptions to stop an abusive pattern in which agencies effectively spent money that they did not have and then told legislators they needed to fund these commitments or risk the good name of the U.S. government.[85] The Anti-Deficiency Act is thus quite unlike laws that attempt to limit their own affirmative grants of authority through definitions of their purposes or through discretionary requirements (such as the Fed's requirement to only lend against good collateral). It is a proscription of certain conduct—one with criminal penalties attached to it. Although there are a host of technical issues around the definition of what entails a government commitment to which the act is applicable,

for many potential expenditures and commitments there is no doubt; where this is the case, few public officials dare to cross the bright line that Congress has drawn. Congress appropriated $700 billion for TARP—certainly a mind-boggling figure, but limited all the same, and it would have been quite unthinkable for the Treasury secretary to countenance making expenditures beyond this clearly defined outer bound.

To be sure, the letter of the law can command obedience while the spirit is subverted through other channels. The Housing and Economic Recovery Act sought to limit commitments supporting Fannie Mae and Freddie Mac to a period of two years, but the Treasury found ways to effectively go beyond this period by establishing ongoing supports before the deadline. The Treasury looked to increase the effective reach of its $700 billion in TARP funding by essentially leveraging it, using support from the Federal Reserve in the arcane designs of the Term Asset-Backed Securities Loan Facility and Public-Private Investment Program. And some may wonder if the reservoirs of power embodied in the Federal Reserve's enabling statutes are essentially so deep as to allow it to act as a backup fiscal actor when spending limits (such as TARP's) would otherwise bind.

These are serious concerns that alert us to the importance of precision in legal drafting, but they should not blind us to the basic efficacy of proscriptive laws that clearly define what crisis fighters should not do. When Congress confronts executive branch actors with clear "thou shalt not" statements, these are almost always respected. If it feels that adhocracy has run amock, Congress ought to make more use of this style of law. Doing so requires some foresight about the shape of future crisis responses, and achieving perfect control through negative definition is clearly impossible; perhaps more vexingly to legislators, there is also a strong sense that they should not have to proscribe conduct that is not authorized by (their interpretation of) any existing law. But the perfect should not be the enemy of the good, and Congress should not be naïve in its understanding of executive branch powers. Executive branch officials creatively make use of apparently unrelated authorities to combat crises, and this is not a new phenomenon. To the extent that certain kinds of actions are offensive to legislators' sensibilities, they ought to assert that executive actors are not to produce those actions through any legal channels. If legislators refuse to spend some serious time and energy thinking explicitly about how existing enabling acts may be misused, and attach prohibitive clauses accordingly, they may be justly accused of sloppiness.

Dodd-Frank's unusual prohibition against using any taxpayer funds to support uses of the Orderly Liquidation Authority is noteworthy in this context. Mindful of concerns that the law would somehow entrench taxpayer-funded bailouts, the law's drafters included the proscriptive § 212(b), prohibiting any circumvention of Title II's bank-funded strategy for handling failures. Only time will tell what becomes of this clause, but it would be a mistake to treat it as an irrelevancy. It unambiguously enshrines congressional intent as to what kinds of crisis responses toward failing financial institutions are acceptable, and it would be quite surprising if a future crisis responder were simply to shrug it off.

Having sung the praises of proscriptions, I now quickly turn to their limitations—about which Congress should also be realistic and act accordingly.

Accommodating the Limits of Law: The Case for an Accountable Slush Fund

Thinking about prescriptions for legal change, in the typical ending for a policy-oriented book, can surely be constructive—or so I earnestly hope. But one of this book's central aims is to explore the divergence between legality and legitimacy. As Carl Schmitt foretold, in meeting the demands of crises, legitimacy can often trump legality, marginalizing it in ways that are uncomfortable for our normal conception of liberal, rule-of-law-cherishing republican government. Throughout the crisis, the Fed, the Treasury, and the FDIC all showed remarkable flexibility and creativity in devising ways to confront worsening financial conditions, often in ways that went to the very edge of their legal powers and beyond. In spite of the tension of their actions with the requirements of the law, many of these actions were undoubtedly regarded as legitimate responses undertaken on behalf of the country's best interests.

Perhaps the most striking exemplar of this pattern is the rescue of the money market funds recounted at the end of chapter 3. To briefly recap: Following Lehman's failure, the oldest of the money market funds broke the buck, meaning that its shares' value fell below their face value. A whole class of financial instruments that investors had relied on as risk free was suddenly exposed as distinctly risky, and a rush for the exits by institutional investors ensued. Consequently, a crucial source of funding for the commercial paper markets that provided day-to-day financing for America's blue chip companies looked set to evaporate, and the alarming possibility that Fortune 500 companies could miss their payroll loomed on the horizon. In other words, the crisis

threatened to escalate in a way that could have had catastrophic consequences for millions of ordinary Americans.

Paulson's Treasury Department arrested this ominous possibility by making use of the Exchange Stabilization Fund (ESF)—a pot of money meant to be used to smooth out fluctuation in foreign exchange, which had previously only been used to make loans. Pledging $50 billion to guarantee the redemption of money market shares at par (eventually by way of a program that would charge participating firms a fee) proved almost instantly effective in quelling the panic in this market. In the end, no money was paid out of the program, which must be regarded as a resounding success.

Strangely, Congress was offended enough by this maneuver to specifically outlaw its repeat in the EESA, but its means of doing so is extremely telling. Rather than clearly restricting the conditions in which the ESF could be used—which would seem to be the natural response if their chief concern really was the preservation of the fund for its intended uses—legislators merely declared that the Treasury secretary needed to reimburse the ESF for any funds used and in the future would be barred from using the ESF to guarantee money market funds.

This seems like a peculiarly narrow and misguided reaction to what may have been the most successful intervention of the crisis. It is true that twisting the ESF in this way strained the law to its utmost, but why not simply conclude that the Treasury secretary should be given a dedicated pot of money to be used in combating crises that would not need to be distorted and could be used in unstrained compliance with the law and with full transparency?

Indeed, the lesson I draw from the use of the ESF is that the Treasury Department should have a financial crisis emergency fund available that is strictly dollar limited but otherwise leaves the Treasury secretary with nearly unlimited discretion upon publicly declaring the existence of a financial crisis. Perhaps this would be $50 or $100 billion, and perhaps it would also be wise to stipulate that the president must give his approval and that the money is not to be leveraged in any way. This would be, to put it crudely, a discretionary slush fund.

The history of that now-pejorative phrase is somewhat instructive. "Slush fund" has a maritime origin: ships would fry salt pork and collect its drippings on their voyage, selling off this "slush" to candle- or soap-makers at the end, generating a small fund that could be used to purchase various items for the crew. This was a benign function; only later did the term acquire the connotation of public funds that could be spent unaccountably.[86] If the shipmaster can be trusted to use the money for the good of the crew—or if there is some

utterly reliable way to ensure that the money is spent well—then the slush fund can be rendered a useful tool for maintaining morale.

Implementing a financial crisis emergency fund would require some combination of trust and strict accountability. The former being in short supply, it would probably need to rely heavily on the latter. But as a feat of legislative drafting, this does not seem particularly difficult to accomplish. We could require near-instantaneous reporting on the use of the funds, so as to be able to clearly render judgment about the legitimacy of the usage; and then put in place procedures for immediately disciplining a secretary who was judged to have misused them. Those could feature fast-track votes to stop outflows of money, impeachment and levying fines against the Treasury secretary, or even imposing criminal liability for any uses judged to be in bad faith.

Such a system squarely faces up to the idea that the Treasury secretary is a powerful official likely to find resources in a crisis, by hook or by crook, and institutionalizes a societal preference for putting emergency scrambling above board and out in the open, rather than having it surreptitiously justified through scavenged legal authorities. By choosing a form of political accountability instead of the fiction that legal constraints make executive branch improvisation impossible, the law makes crisis response more honest, clarifies responsibility, and improves the accountability of the overall system.

Choosing this kind of realism is not tantamount to admitting that government will get its way no matter what the law says. Instead, it uses law to create political conditions that discipline government actors better than static verbal rules could. It saves the tool of legal control for tasks it is better suited for and does not try to hide the inadequacy of normal law for the early stages of responding to a fast-moving crisis.

One of the features originally proposed as a part of Dodd-Frank was a pre-funded pot of money to facilitate OLA resolution of failing institutions. This money—$150 billion in the version passed by the House and $50 billion in preliminary Senate bills—would have been derived from a special assessment on financial institutions and its use would have been limited to winding down firms declared to pose a serious danger to the overall health of the financial system. Several prominent academics had proposed systemic emergency insurance funds of various sorts. They argued that forcing the financial industry to pre-fund its own insurance system would effectively force internalization of costs otherwise shouldered by the broader taxpaying public in the event of a crisis.[87] These arguments failed to persuade critics of

a pre-funded "bailout fund" on the right, however, and whether there should be any pre-funded mechanism at all became a sticking point in negotiations in the Senate. Eventually backers of pre-funding relented, removing it from the bill to help send the huge package of reforms toward passage.[88] Title II instead contains a means to levy an after-the-fact assessment on financial firms if necessary.

Two points of contention doomed the pre-funded resolution authority in Dodd-Frank. The first was the question of who should pay—which would require figuring out what kinds of institutions would be subject to the assessment, as well as figuring how individual firms' responsibility would be determined. Those are hard questions, and with billions of dollars at stake they naturally created fearsome lobbying.[89] The second cause of opposition, which was much more important, was the prediction—confidently and gloomily delivered by people from across the political spectrum, including Secretary Geithner—that the mere existence of such a fund would greatly exacerbate moral hazard for potential creditors, who would feel sure of being made whole by the bailout fund and thus fail to exercise sufficient caution in choosing their counterparties.[90]

What I propose here is quite distinct from the proposals debated as a part of Dodd-Frank, but the same worries are clearly applicable: who would pay, and how would we prevent the fund's existence from incentivizing bad behavior?

On the first count, I propose to use public funding rather than industry funding. What this loses in stick-it-to-'em appeal it gains in clarifying the fund's purpose, which is to provide a social resource available to fight financial crises. This is more akin to targeted national savings than it is industry self-insurance, and it should be seen as a vessel of opportunistic crisis defense on the public's behalf rather than as a sure way to handle any particular segment of the financial industry's problems (especially given the existence of Dodd-Frank's post-funded OLA). The motivation is not to guarantee fairness but to acknowledge that resources will be found somewhere and ensure that strong back-end accountability and process requirements discipline their use. Refusing to accept this overwhelming likelihood is thus best seen as a missed opportunity to say where crisis-fighting money should come from, how long it should be available without further congressional involvement, and what kind of control processes should be attached to it.

Moral hazard concerns might be mitigated by not specifying the way the fund would be used. Since its actions would be difficult to anticipate, it would be less likely to incentivize particular kinds of investors to bank on government backstopping. Moreover, the Treasury secretary, nakedly responsible for

the way the fund was used, would be loath to use it unless doing so were really of grave national importance. Since investors would have a hard time knowing whether their own peril of losing their money would rise to this level of importance, they would have a hard time gaming the system. Finally, it is worth saying what is often forgotten, which is that moral hazard concerns can be taken too far. Making government funds available to guarantee certain assets before a catastrophic failure—as in the case of the money market fund rescue—can be much, much cheaper and more efficient than trying to mop up liquidated firms.

In recommending that the Treasury secretary have full discretion in when to use the financial crisis emergency fund, I am going against time-honored wisdom, offered by Machiavelli and Rossiter alike, that any extraordinary crisis powers should be activated by some institution other than the one that will have the power to wield them, thereby lessening the potential for self-serving abuse.[91] I make this choice advisedly because of the particular features of our contemporary political scene. We live in a polity in which the ability of ambition to check ambition is the dominant feature; stalemate seems to be the greater danger than abuses from an unchecked actor, especially in facing crises. An excess of veto points and a dearth of clearly designated responsibility enhances the case for a clearly delimited grant of emergency power.

Nor does my proposal create open-ended exposure or the likelihood of an executive run amock. By ensuring that political judgment is rendered immediately after usage, it would avoid opening an exception that would swallow the rule. Indeed, by emphasizing just how extraordinary the fund is, I hope to partake of at least a little of the Jeffersonian spirit of crisis response; although the fund's presence would mean that the Treasury could access emergency cash without doing anything illegal or extralegal, the burden of immediate justification would fall squarely on the secretary's shoulders.

The financial crisis emergency fund as I have proposed it would not offer a viable strategy for single-handedly addressing a large financial crisis, if only because its size is too small. But this should be seen as a feature rather than a bug. To access additional resources, the executive crisis fighters would still need to turn to Congress. But the slush-fund cushion would allow them to act simultaneously. By potentially giving Congress more time to deliberate and the executive less ability to insist on new powers lest the sky fall, this insulation might actually increase the ability to fashion effective legal constraints and accountability mechanisms for the main source of crisis-fighting funds.

Needless to say, attempting to create legal bounds on a space of unrestricted executive branch action can be a difficult and dangerous game. Weimar's constitution sought to enable emergency decrees, only to have this exceptional power utterly swallow the normal order. Such historical lessons must weigh heavily on us as we try to devise a means for combating financial crises that is largely unconstrained by legal specifics. But if we are right to fear abuses, we are wrong to let our fear blind us to the ways in which legitimacy displaces normal legality in a crisis. Planning for this eventuality can ultimately make our system more honest and more resilient.

Glossary of Crisis Laws and Programs

§ 11(r)(2) of the Federal Reserve Act. Allows the Board of Governors of the Federal Reserve to approve an action with a unanimous vote of fewer than five members if the action is deemed necessary for economic health or financial stability.

§ 13(3) of the Federal Reserve Act. Originating in amendments to the Federal Reserve Act in 1932, this section became the foundation for most of the Federal Reserve's crisis actions in 2008 and beyond. It was amended by the Dodd-Frank Act.

§ 23A of the Federal Reserve Act. Prohibits certain transactions between a member bank and its affiliates.

ABCP. Asset-backed commercial paper; short-term bonds backed by physical assets.

AIFP. Automobile Industry Financing Program; added as a TARP program to direct funding to GM, Chrysler, and eventually GMAC.

AIG. American International Group, the giant insurer that received substantial aid from the Fed and the Treasury beginning in September 2008.

AMLF. Asset-Backed Commercial Paper Money Market Fund Liquidity Facility; lending program created by the Federal Reserve Board in September 2008 to support firms' purchases of commercial paper from money markets.

BHC. Bank holding company; a company that owns a bank; regulated by the Fed.

BofA. Bank of America.

CDO. Collateralized debt obligation; structured financial instrument that pools assets, often repackaging them into discrete tranches to be sold to investors.

CDS. Credit default swap; an agreement wherein the seller will compensate the purchaser in the event of a default and, in exchange, the buyer pays the seller a fee.

COP. Congressional Oversight Panel; bipartisan congressional panel created by EESA to oversee TARP and associated programs; dissolved in 2011.

CPFF. Commercial Paper Funding Facility; institution created by the Federal Reserve Bank of New York in October 2008 to provide liquidity to registered issuers of commercial paper.

CPP. Capital Purchase Program; central program created under TARP to inject capital into banks.

DIP financing. Debtor-in-possession financing; financing arranged by a company while under chapter 11 bankruptcy.

EESA. Emergency Economic Stabilization Act; the major $700 billion enabling act passed by Congress in October 2008; often simply referred to as TARP.

ESF. Exchange Stabilization Fund; an emergency reserve fund of the Treasury that was used in a legally dubious manner to guarantee money market funds.

FCIC. Financial Crisis Inquiry Commission; bipartisan congressional commission created in May 2009 to investigate the causes of the financial crisis; issued final report in January 2011.

FDIC. Federal Deposit Insurance Corporation; government insurance corporation established in 1933 that guarantees depositors' bank holdings.

FDICIA. FDIC Improvement Act of 1991; amended § 13(3) of the Federal Reserve Act to expand the types of loans that could be made.

FHA. Federal Housing Administration; a government agency created in 1934 that provides mortgage insurance to qualified lenders.

FHFA. Federal Housing Finance Agency; regulator of Fannie Mae and Freddie Mac created by HERA of 2008.

FOIA. Freedom of Information Act; federal statute giving citizens the right to access information from federal agencies.

FRBNY. Federal Reserve Bank of New York; the most important of the twelve Federal Reserve Banks of the United States, often responsible for executing the Fed's crisis responses.

FSA. Financial Services Authority; United Kingdom's consolidated regulator of financial institutions in 2008; subsequently dissolved.

GAO. Government Accountability Office; independent agency that monitors and audits government spending on behalf of Congress.

GM. General Motors.

GMAC. General Motors Acceptance Corporation; finance company for GM that received extensive assistance under TARP; eventually renamed Ally Financial.

GSE. Government-sponsored enterprise; privately held corporation with public purposes created by Congress to reduce the cost of capital for certain borrowing sectors of the economy. Often used to refer specifically to Fannie Mae and Freddie Mac.

HAMP. Home Affordable Modification Program; loan modification program under TARP.

HERA. Housing and Economic Recovery Act of 2008; legislation passed in July 2008 to address the subprime mortgage crisis and restore confidence in Fannie Mae and Freddie Mac; created and empowered the agencies' new regulator, the FHFA.

HUD. U.S. Department of Housing and Urban Development.

LIBOR. London interbank offered rate; interest rate index based on interest rates for short-term loans between banks.

LTCM. Long-Term Capital Management; hedge fund that in 1998 received a privately funded bailout orchestrated by the Federal Reserve.

MAC clause. Material adverse change clause; clause often included in contracts for mergers and acquisitions that allows the acquirer to back out of a transaction if the other party announces a significant event that may negatively affect its stock price or operations.

MBS. Mortgage-backed security; an asset-backed security secured by a mortgage; central to the financial crisis because many banks overvalued their holdings.

MMIFF. Money Market Investor Funding Facility. Facility created by the Fed using § 13(3) authority in October 2008 to provide liquidity to money market investors. Closed in October 2009 without ever having made any loans.

MMF. Money market mutual fund; low-risk and low-return investment wherein each share has its value pegged at $1 and pays a fluctuating dividend based on performance.

OMB. Office of Management and Budget; White House budgetary office.

PDCF. Primary Dealer Credit Facility; institution created by the Federal Reserve in March 2008 to provide funding to primary dealers in exchange for a specified range of eligible collateral.

PPIP. Public-Private Investment Program; federal plan under TARP created in March 2009 through joint efforts by the FDIC, the Fed, and the Treasury to facilitate partially government-financed purchases of hard-to-value securities.

SEC. Securities and Exchange Commission; regulator of capital market participants, including investment banks.

SIGTARP. Special Inspector General for TARP; position created by EESA to provide added oversight and antifraud enforcement.

SPV. Special purpose vehicle; a corporate structure used to carry out a predesignated business function; often used to isolate certain assets from a larger firm, which retains an equity interest in the SPV's holdings.

TAF. Term Auction Facility; a monetary policy program initiated by the Fed in December 2007 in which Federal Reserve credit is put up for auction.

TALF. Term Asset-Backed Securities Loan Facility; created in March 2009 to provide nonrecourse loans against various kinds of non-mortgage-backed assets.

TARP. Troubled Asset Relief Program; name generally used for the programs operated under EESA of 2008, passed by Congress in October 2008.

TGPMMF. Temporary Guarantee Program for Money Market Funds; temporary program established by the Treasury Department in September 2008 using funding from the ESF that successfully stopped a run on money market funds.

TLGP. Temporary Liquidity Guarantee Program; FDIC program created in October 2008 to guarantee senior bank debt and extend deposit insurance to larger accounts.

TSLF. Term Securities Lending Facility; Federal Reserve program created in March 2008 under § 13(3) to expand the types of collateral that the central bank would accept, which effectively made broker-dealers, including securities firms, eligible for some forms of Fed lending.

UAW. United Automobile Workers.

WaMu. Washington Mutual Bank.

Notes

Chapter One

1. Eric A. Posner and Adrian Vermeule, *The Executive Unbound: After the Madisonian Republic* (Oxford University Press, 2010).

2. Max Rheinstein, ed., *Max Weber on Law in Economy and Society*, translated by Edward Shils (New York: Clarion, 1967), pp. 11–12.

3. One could argue that power dynamics make this untrue; possibly, achieving legitimacy in the eyes of the powerful is more important, at least in terms of social stability.

4. Put somewhat more precisely, I argue that partaking more of qualities X, Y, and Z is likely to make action A more legitimate, but I stop short of offering any formula that says that action A can achieve legitimacy if and only if it achieves levels X, Y, and Z of the various characteristics.

5. For the classic treatment of how "mass opinion" is a rather more protean quality than is usually acknowledged, see John R. Zaller, *The Nature and Origins of Mass Opinion* (Cambridge University Press, 1992).

6. The most glaring omission is the Federal Reserve's central bank liquidity swaps, through which it effectively extended hundreds of billions of dollars to foreign central banks that had need of them to deal with dollar-denominated assets causing problems in their own countries. These swap lines have largely remained outside of political discussion in spite of their huge size and importance, much to the Fed's relief. See Perry Mehrling, "Understanding the Fed's Swap Line," *Financial Times,* November 18, 2008 (http://blogs.ft.com/economistsforum/2008/11/254/); Michael J. Fleming and Nicholas J. Klagge, "The Federal Reserve's Foreign Exchange Swap Lines," *FRBNY Current Issues in Economics and Finance* 16 (April 2010)

(http://www.newyorkfed.org/research/current_issues/ci16-4.pdf); Neil Irwin, "Fed's Aid in 2008 Crisis Stretched Worldwide," *New York Times,* February 23, 2014 (http://www.nytimes.com/2014/02/24/business/feds-aid-in-2008-crisis-stretched-worldwide.html).

7. David Easton, "A Re-Assessment of the Concept of Political Support," *British Journal of Political Science* 5 (1975): 437. Easton differentiates specific support for particular actions from the more stable "diffuse support" that attaches to offices, rather than officeholders (pp. 444–45).

8. Without naming names, it is worth pointing out that others who make judgments about government legitimacy often have incentives to distort things. Since saying how things are necessarily has implications for how things should be, those committed to yet unenacted policy reforms have a great incentive to exaggerate feelings of illegitimacy. Conversely, those who wish to stand pat will have reason to dismiss legitimacy concerns as marginal. In short, there is every reason for the normative to spill over into the positive. I doubt that I am immune from this tendency, though I try to guard against it.

9. See especially H. L. A. Hart, *The Concept of Law,* 2nd ed. (Oxford University Press, 1994).

10. See Philip Wallach, "Contested Constraints: Regulatory Statutes in America's Modern Administrative State," Ph.D. diss., Princeton University, 2012.

11. See Philip Wallach, "When Can You Teach an Old Law New Tricks?," *NYU Journal of Legislation and Public Policy* 16 (2013): 689–755; David J. Barron and Martin S. Lederman, "The Commander in Chief at the Lowest Ebb: A Constitutional History," *Harvard Law Review* 121 (2008): 960.

12. This was highlighted in the famous debate between Lon Fuller and H. L. A. Hart, in which Fuller persuasively argued that one of the most serious failings of the legal system in Nazi Germany was the abandonment of meaningful legal process. Not only had many Nazi laws sought evil ends, but in order to turn the legal system toward those ends the Nazis had been forced to completely shred the normal legal procedures of German law, including resorting to such process monstrosities as "secret laws" that did nothing more than nonpublicly legalize the decisions of high government officials. Lon L. Fuller, "Positivism and Fidelity to Law: A Reply to Professor Hart," *Harvard Law Review* 71 (1958): 649–57. See also John E. Finn, *Constitutions in Crisis: Political Violence and the Rule of Law* (Oxford University Press, 1991), pp. 29–37.

13. Democratic legitimacy can also erode if there is a sense that the alternatives available to voters do not present a genuine choice. E. E. Schattschneider, *The Semi-Sovereign People* (New York: Holt, Rinehart, and Winston, 1960), p. 141. Some theorists argue that to successfully perform their legitimating functions, legislators must achieve a very high level of discourse that grapples with the values of society. For example, the Weimar theorist Hermann Heller, discussed in David Dyzenhaus, *Legality and Legitimacy: Carl Schmitt, Hans Kelsen, and Hermann Heller in Weimar* (Oxford University Press, 1997), pp. 164–67, 181, 187–88; and Jürgen Habermas, *The Inclusion of the Other: Studies in Political Theory*, edited by Ciarin Cronin and Pablo De Greiff (MIT Press, 1998), pp. 249–50.

14. Many such arguments are instead framed exclusively in terms of legality (or, in the United States, constitutionality) rather than democracy: the claim is that the action is actually illegal, whatever the scribes of the legislature might claim.

15. See, for example, *Jacobson* v. *Massachusetts*, 197 U.S. 11 (1905).

16. Rheinstein, *Max Weber on Law in Economy and Society*, pp. 336–37.

17. Madison, *Federalist No. 51,* in *The Federalist Papers,* edited by Clinton Rossiter (New York: Signet Classic), p. 319.

18. Clement Fatovic, *Outside the Law: Emergency and Executive Power* (Johns Hopkins University Press, 2009), especially pp. 11–25.

19. John Locke, *Second Treatise of Government* (Indianapolis: Hackett Publishing, 1980), chap. 14, § 161 (quoted in full). See also § 165.

20. Madison, *Federalist No. 40,* in Rossiter, *Federalist Papers,* p. 249.

21. Hamilton, *Federalist No. 70,* in Rossiter, *Federalist Papers,* p. 422.

22. Fatovic, *Outside the Law*, pp. 195–200, 210–11.

23. I considered breaking out "positivist legitimacy" closely corresponding to Albert Venn Dicey's vision of the thin rule of law, as well as making "process legitimacy" a distinct category, but ultimately decided for the sake of economy to roll these factors into other ones.

24. Ira Katznelson, *Fear Itself: The New Deal and the Origins of Our Time* (New York: W. W. Norton, 2013).

25. In contrast to Posner and Vermeule, who are remarkably unconcerned with the lessons of the 1930s and confidently assert that government tyranny is impossible in America and should never preoccupy citizens or their political leaders (*The Executive Unbound,* chap. 6).

26. Cited in Tom R. Tyler, "Psychological Perspectives on Legitimacy and Legitimation," *Annual Review of Psychology* 57 (2006): 381. The article is an excellent literature review of recent writing about legitimacy.

27. Robert F. Bruner and Sean D. Carr, *The Panic of 1907: Lessons Learned from the Market's Perfect Storm* (New York: Wiley, 2008), pp. 90–91, 100–03, 125, 132–36.

28. Roger Lowenstein, *When Genius Failed: The Rise and Fall of Long-Term Capital Management* (New York: Random House, 2000), especially chap. 10.

29. Roosevelt totally refused to cooperate with Hoover during the intolerably long lame-duck session running into March 1933—a decision many have attributed to ego or misplaced contempt for his predecessor. But given the relationship between legitimacy and efficacy, Roosevelt's distancing of himself from the then-illegitimate Hoover should be understood as a canny means of protecting his own legitimacy.

30. Franklin D. Roosevelt, "Inaugural Address," March 4, 1933, American Presidency Project (http://www.presidency.ucsb.edu/ws/?pid=14473).

31. Franklin D. Roosevelt, "Proclamation 2039, Declaring Bank Holiday," March 6, 1933, American Presidency Project (http://www.presidency.ucsb.edu/ws/?pid=14661). He based his authority on a creative application of the Trading with the Enemy Act of 1917, which empowered the president to "investigate, regulate, or prohibit . . . any transactions in foreign exchange and the export, hoarding, melting, or earmarkings of

gold or silver coin or bullion or currency." The legal dubiousness of this action, which required taking the analogy to war in Roosevelt's inaugural address at face value, was quite apparent, but the banks did shut down. When it convened on March 9, Congress retroactively sanctioned this act in the Emergency Banking Act of 1933, which passed after just eight hours of debate.

32. Franklin D. Roosevelt, "Executive Order 6102, Requiring Gold Coin, Gold Bullion, and Gold Certificates to Be Delivered to the Government," April 5, 1933, American Presidency Project (http://www.presidency.ucsb.edu/ws/?pid=14611); Elmus Wicker, "Roosevelt's 1933 Monetary Experiment," *Journal of American History* 57 (1971): 867; Liaquat Ahamed, *Lords of Finance: The Bankers Who Broke the World* (New York: Penguin Press, 2009), Kindle edition, loc. 7204–30.

33. Clinton L. Rossiter, *Constitutional Dictatorship: Crisis Government in The Modern Democracies* (Princeton University Press, 1948), Kindle edition, chap. 17.

34. The word is not my own neologism, and it actually has a positive connotation in the context of business, where it is contrasted with stodgy bureaucracy. It even has its own book: Robert H. Waterman Jr., *Adhocracy: The Power to Change* (Knoxville, Tenn.: Whittle Direct Books, 1990).

Chapter Two

1. The language is from Sanford Levinson and Jack M. Balkin, "Constitutional Dictatorship: Its Dangers and Its Design," *Minnesota Law Review* (2010): 1800–01, citing Niccolo Machiavelli, *Discourses on Livy*, translated by Harvey C. Mansfield and Nathan Tarcov (University of Chicago Press, 1996), p. 95.

2. *Emergency* can take on something of a tautological definition in this context, meaning "things that the normal operation of the state is unequal to handling" rather than "really bad things that happen in the world." This clearly runs counter to familiar usage in modern America, in which natural disasters frequently lead to the declaration of a state of emergency. This legal protocol, designed to streamline government's response to the problem, is in fact highly normalized, and so while there is an emergency for the people suffering, there is no emergency in the state of the law.

3. Carl Schmitt, *Legality and Legitimacy*, edited and translated by Jeffrey Seitzer (Duke University Press, 2004), p. 5.

4. Ibid., pp. 19–22, 87–92.

5. Ibid., pp. 4–7, 67–82.

6. Toward the end of his life, as Germany fell into disorder in 1918–20, Max Weber also thought that the emergence of a charismatic leader, balanced against formally rational legal authority, might be the only way to secure legitimacy for a modern state. David Dyzenhaus, *Legality and Legitimacy: Carl Schmitt, Hans Kelsen, and Hermann Heller in Weimar* (Oxford University Press, 1997), pp. 11–12, 40–45.

7. Carl Schmitt, *Political Theology*, translated by George Schwab (MIT Press, 1985), p. 5.

8. At the very start of his scholarly career, Schmitt himself accepted the viability of a "commissarial" dictatorship devoted to a narrow goal, but he later came to believe

it would be impossible to effectively prevent a limited dictatorship from becoming a full "sovereign" dictatorship. See Oren Gross, "The Normless and Exceptionless Exception: Carl Schmitt's Theory of Emergency Powers and the 'Norm-Exception' Dichotomy," *Cardozo Law Review* 21 (2000): 1825–68, 1834.

9. William E. Scheuerman, "Survey Article: Emergency Powers and the Rule of Law after 9/11," *Journal of Political Philosophy* 14 (2006): 61–84.

10. Clinton L. Rossiter, *Constitutional Dictatorship: Crisis Government in the Modern Democracies* (Princeton University Press, 1948), Kindle edition, chap. 4; Oren Gross and Fionnuala Ni Aolain, *Law in Times of Crisis: Emergency Powers in Theory and Practice* (New York: Cambridge University Press, 2006), pp. 83–85; Kim L. Scheppele, "Law in a Time of Emergency: States of Exception and the Temptations of 9/11," *University of Pennsylvania Journal of Constitutional Law* 6 (2004): 1008.

11. RealClearPolitics, "President Bush Job Approval" (http://www.realclearpolitics.com/epolls/other/president_bush_job_approval-904.html).

12. Gallup, "Trust in Government" (http://www.gallup.com/poll/5392/trust-government.aspx), sixth question.

13. For example, Anthony Faiola, "The End of American Capitalism?," *Washington Post,* October 10, 2008 (http://www.washingtonpost.com/wp-dyn/content/article/2008/10/09/AR2008100903425.html); Lawrence Jacobs and Desmond King, "America's Political Crisis: The Unsustainable State in a Time of Unraveling," *PS: Political Science and Politics* 42 (April 2009): 277–85; Joseph Stiglitz, "Why We Have to Save Capitalism," *The Telegraph,* January 23, 2010 (http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/7061058/Joseph-Stiglitz-Why-we-have-to-change-capitalism.html).

14. "Some one may say that it is bad in any case for a man, subject as he is to all the accidents of human passion, to have the supreme power, rather than the law." Aristotle, *Politics* 3.8 (http://classics.mit.edu//politics.3.three.html).

15. Thomas Bingham, Baron Bingham of Cornhill, "The Rule of Law," lecture at the Centre for Public Law, Cambridge University, November 16, 2006 (http://www.cpl.law.cam.ac.uk/past_activities/the_rule_of_law_text_transcript.php).

16. Ronald Cass, *The Rule of Law in America* (Johns Hopkins University Press, 2001), chap. 1.

17. Rachel Kleinfeld, "Competing Definitions of the Rule of Law," in *Promoting the Rule of Law Abroad: In Search of Knowledge*, edited by Thomas Carothers (Washington: Carnegie Endowment for International Peace, 2006), p. 37; David Dyzenhaus, "The Logic of the Rule of Law: Lessons from Willis," *University of Toronto Law Journal* 55 (2005): 691–714.

18. There are of course many variations. Emphasizing generality, F. A. Hayek, *The Road to Serfdom: Text and Documents, The Definitive Edition,* edited by Bruce Caldwell (University of Chicago Press, 2007), pp. 112, 152–54; Michael Oakeshott, *On History and Other Essays* (Indianapolis: Liberty Fund, 1999), pp. 140, 148. Emphasizing "principled predictability," Cass, *The Rule of Law in America*, pp. 8–9. Emphasizing legal process and reason-giving, Richard H. Fallon Jr., "'The Rule of Law' as a

Concept in Constitutional Discourse," *Columbia Law Review* 97 (1997): 18–20; Jeremy Waldron, "The Concept and the Rule of Law," *Georgia Law Review* 43 (2008): 7–9, 20–23, 32–36, 54–57. Relating the rule of law to separation of powers, Montesquieu, *The Spirit of the Laws* (Online Library of Liberty) (http://oll.libertyfund.org/titles/837), book 11, chap. 6; Paul R. Verkuil, "Separation of Powers, the Rule of Law, and the Idea of Independence," *William and Mary Law Review* 30 (1989): 301–41. And emphasizing the substantive characteristics laws must have to succeed, Lon Fuller, *The Morality of Law,* rev. ed. (Yale University Press, 1969), pp. 38–82. See also *Federalist* No. 62: "It will be of little avail to the people, that the laws are made by men of their own choice, if the laws be so voluminous that they cannot be read, or so incoherent that they cannot be understood; if they be repealed or revised before they are promulgated, or undergo such incessant changes that no man, who knows what the law is to-day, can guess what it will be to-morrow. Law is defined to be a rule of action; but how can that be a rule, which is little known, and less fixed?" James Madison, *Federalist* No. 62, in *The Federalist Papers,* edited by Charles R. Kesler (New York: Signet Classic, 2003), p. 379.

19. Arguably this might be true in normal times as well as in emergencies. There are some who argue that a full realization of the thick rule of law is not desirable even in theory, as the justifiable fear of arbitrary power may become an irrational distrust of all discretion and thus an inability to cope with the fact that "so much governmental activity—especially as it relates to the executive—is fundamentally irreducible to law." Clement Fatovic, *Outside the Law: Emergency and Executive Power* (Johns Hopkins University Press, 2009), p. 32.

20. The thin rule of law's most revered theorist is Albert Venn Dicey, who argues that the two fundamental facts of the English Constitution (which he took to exemplify the rule of law) were absolute parliamentary sovereignty and the jurisdiction of normal courts (rather than ad hoc or temporary bodies unconstrained by precedent). He argues that these are essentially two sides of the same coin: because only law made by the sovereign, Parliament, could ultimately dictate government action, that body is unambiguously made responsible for exercising its sovereignty to address whatever problems may arise. As noted later, subscribing to some "thicker" and more substantive version of the rule of law necessarily creates tensions with democratic sovereignty. Albert Venn Dicey, *Introduction to the Study of the Law of the Constitution,* 8th ed. (London: Macmillan, 1920), pp. 37–40, 183–95, chap 13. See also See David Dyzenhaus, "*Schmitt* v. *Dicey*: Are States of Emergency Inside or Outside the Liberal Order?," *Cardozo Law Review* 27 (2006): 2005–39.

21. Alexander Hamilton, *Federalist* No. 72, in Kesler, *Federalist Papers*, p. 434. Important for this book, Hamilton's view about financial operations has long been realized in the unique legal status of the Treasury Department, which has been treated by courts quite differently from other administrative agencies throughout American history. In short, the Treasury's policy decisions are treated as matters subject to political oversight rather than legal control. See David Zaring, "Administration by Treasury," *Minnesota Law Review* 95 (2010): 187–243.

22. *Max Weber on Law in Economy and Society*, edited by Max Rheinstein, translated by Edward Shils (New York: Clarion, 1967), p. 45.

23. Hayek, *The Road to Serfdom*, pp. 155–56, 207, 211, 215. He would require full generality only for those laws that enable coercion of citizens by the state. For his part, Fuller calls attention to the limits of his "morality" of law and warns that such areas as taxation, control of the military, and "tasks of economic allocation" are fundamentally unsuited to the forms of law, which if applied would "result in inefficiency, hypocrisy, moral confusion, and frustration." Fuller, *The Morality of Law*, pp. 169, 168–74. Oakeshott, too, thought that the rule of law could never provide for "the care for the interests of a state in relation to other states," that is, for national security, since "necessity knows no law." *On History and Other Essays,* p. 176.

24. Cited in Rossiter, *Constitutional Dictatorship*, pp. 11–12.

25. See David Dyzenhaus, "Emergency, Liberalism, and the State," *Perspectives on Politics* 9 (March 2011): 69–78; William E. Scheuerman, "Emergencies, Executive Power, and the Uncertain Future of U.S. Presidential Democracy," *Law and Social Inquiry* 37 (Summer 2012): 743–67.

26. Levinson and Balkin, "Constitutional Dictatorship," p. 1857.

27. Gary Gorton, *Misunderstanding Financial Crises: Why We Don't See Them Coming* (Oxford University Press, 2012), Kindle edition, chap. 8, especially loc. 1820–50. See also John A. Fliter and Derek S. Hoff, *Fighting Foreclosure: The* Blaisdell *Case, the Contract Clause, and the Great Depression* (University Press of Kansas, 2012).

28. William Graham Sumner, *A History of Banking in the United States* (New York: Journal of Commerce and Commercial Bulletin, 1896), cited in Gorton, *Misunderstanding Financial Crises,* loc. 1852.

29. Alexander Hamilton, *Federalist* No. 23, in Kesler, *Federalist Papers*, p. 149. Emphasis in original.

30. David J. Barron and Martin S. Lederman, "The Commander in Chief at the Lowest Ebb: Framing the Problem, Doctrine, and Original Understanding," *Harvard Law Review* 121 (2008): 1035.

31. Theodore Roosevelt, *An Autobiography* (New York: Macmillan, 1913), pp. 388–89. A brief but helpful discussion can be found in Harold C. Relyea, "National Emergency Powers," Congressional Research Service Report, September 18, 2001 (http://fpc.state.gov/documents/organization/6216.pdf).

32. Franklin D. Roosevelt, "Message to Congress on Stabilizing the Economy," September 7, 1942, American Presidency Project (http://www.presidency.ucsb.edu/ws/?pid=16302). See Mitchell Franklin, "War Power of the President: An Historical Justification of Mr. Roosevelt's Message of September 7, 1942," *Tulane Law Review* 17 (1942): 217–55.

33. Eric A. Posner and Adrian Vermeule, *The Executive Unbound: After the Madisonian Republic* (Oxford University Press, 2010). See also Adrian Vermeule, "Our Schmittian Administrative Law," *Harvard Law Review* 122 (2009): 1095–149.

34. Posner and Vermeule, *The Executive Unbound*, p. 85.

35. Ibid., p. 103. Frustratingly, Posner and Vermeule advance two different forms of their argument at different points in the book. Often they seem to advance a strong form, which is that all attempts to constrain the executive through law are basically delusional. If true, this dubious thesis would clearly expose the rule of law as a useless theoretical construct. Other times, however, they advance a weaker thesis: that it is impossible for all executive branch actions to be brought under the control of "normal" legal control and judicial review (for example, p. 92). But if only this far more defensible thesis is correct, the implications about legality are quite unclear. If a system can be more or less governed by law—even if preventing all exceptions is impossible—that would imply that it is quite important to think about how and in what contexts legal constraints can be made more effective, but the authors are curiously indifferent to this question.

36. Schmitt, *Legality and Legitimacy*, p. 5.

37. See also Dyzenhaus, *Legality and Legitimacy*, pp. 95–98.

38. Posner and Vermeule, *The Executive Unbound,* pp. 32–33. They mention Hitler only in passing, and the history of Weimar Germany (where the exception clearly did swallow the norm) not at all. Instead, they devote a chapter to denouncing "tyrannophobia" as an unhelpful American fixation, likely to reduce possibilities for helpful discretion without compensating benefits. This attitude makes their refusal to seriously consider the case of Weimar and the rise of Hitler particularly galling. It is as if the twentieth century failed to leave much of an impression on them. This is a very unusual intellectual fault—indeed, so rare as to be rather beguiling. But while being wrong in interesting ways is often a real intellectual public service, it is still a variety of being wrong.

39. Jack Goldsmith, *The Terror Presidency: Law and Judgment inside the Bush Administration* (New York: W. W. Norton, 2007), pp. 75–100; Barron and Lederman, "The Commander in Chief at the Lowest Ebb," pp. 704–10.

40. Goldsmith, *The Terror Presidency*, pp. 80–82, 102.

41. Stephen I. Vladeck, "The Laws of War as a Constitutional Limit on Military Jurisdiction," *National Security Law and Policy* 4 (2010): 295.

42. The most important justification was the memorandum from Jay S. Bybee, assistant attorney general, Office of Legal Counsel, to Alberto R. Gonzales, counsel to the president, "Standards of Conduct for Interrogation under 18 USC §§2340–2340A," August 1, 2002 (http://www.lawfareblog.com/wp-content/uploads/2013/05/Memorandum-from-Jay-S.-Bybee-Assistant-Attorney-General-Office-of-Legal-Counsel-to-Alberto-R.-Gonzales-Counsel-to-the-President-%E2%80%9CStandards-of-Conduct-for-Interrogation-Under-18-USC-%C2%A7%C2%A72340-2340A%E2%80%9D-Aug-1-2002.pdf) (hereafter cited as "Torture Memorandum"). For a complete index, see http://www.nytimes.com/ref/international/24MEMO-GUIDE.html.

43. Three issues stand out: the military's ability to hold and try those captured separate from the civilian court, the appropriate parameters of interrogation, and the appropriate procedures for electronic surveillance.

Courts dealt a number of setbacks to the military tribunals, see *Hamdi* v. *Rumsfeld*, 243 F.Supp. 2d 527 (E.D. Va. 2002); *Hamdi* v. *Rumsfeld*, 542 U.S. 507 (2004); *Padilla* v. *Rumsfeld*, 352 F.3d 695 (2nd Cir. 2003); *Rumsfeld* v. *Padilla*, 542 U.S. 426 (2004); *Padilla* v. *Hanft*, 423 F.3d 386 (4th Cir. 2005); cert denied, 547 U.S. 1062 (2006); *Rasul* v. *Bush*, 542 U.S. 466 (2004); *Hamdan* v. *Rumsfeld*, 548 U.S. 557 (2006); *Boumediene* v. *Bush*, 553 U.S. 723 (2008).

The issue of detainee treatment, that is, torture, famously became a source of distrust in the Bush administration and required extensive cooperation with Congress to correct, if only partially; even today, it is clear that the process by which these decisions were made, in addition to the substance, remains harmful to legitimacy. See Jeffrey Rosen, "Conscience of a Conservative," *New York Times,* September 9, 2007 (http://www.nytimes.com/2007/09/09/magazine/09rosen.html?pagewanted=print); Benjamin Wittes, *Law and the Long War* (New York: Penguin Press, 2008), pp. 203–14.

In the realm of surveillance of electronic communications, the Bush administration ran up against an extensive preexisting legal structure, causing a number of run-ins with the judiciary. See Wittes, *Law and the Long War*, pp. 233–35. There have always been lingering suspicions that other activities have been conducted outside of this system without an adequate process of legal scrutiny—fears that were substantiated by leaked documents released with great fanfare in 2013. The pervasive shroud of secrecy over the National Security Agency effectively invites people to question its legitimacy: If its activities are acceptable, why must they be so thoroughly protected from scrutiny?

44. Clement Fatovic, "Constitutionalism and Presidential Prerogative: Jeffersonian and Hamiltonian Perspectives," *American Journal of Political Science* 48 (2004): 429–44.

45. Jeremy David Bailey, "Executive Prerogative and the 'Good Officer' in Thomas Jefferson's Letter to John B. Colvin," *Presidential Studies Quarterly* 34 (2004): 732–54, 734–35. Bailey argues that the caveats Jefferson offers are crucial to correctly understanding Jefferson's message: Jefferson conceded that while the principle was quite easy, it was "sometimes embarrassing in practice." Jefferson emphasized that those sitting in judgment of a leader's decision to act extralegally should put themselves in the position of the leader at the moment of decision and decide if the choice was an appropriate exercise of civic duty, notwithstanding any evidence obtained with the benefit of hindsight suggesting that the decision may have been ultimately unnecessary or unwise.

46. Abraham Sofaer, "Emergency Power and the Hero of New Orleans," *Cardozo Law Review* 2 (1981): 233–53, 233–34, n. 5.

47. Barry J. Balleck, "When the Ends Justify the Means: Thomas Jefferson and the Louisiana Purchase," *Presidential Studies Quarterly* 22 (1992): 679–96, 691–92. See also Stephen Skowronek, *The Politics Presidents Make* (Cambridge, Mass.: Belknap Press, 1997), pp. 78–79.

48. Arthur M. Schlesinger Jr., *The Imperial Presidency* (Boston: Houghton Mifflin Company, 1973), pp. 24–25.

49. Thomas Jefferson, “Seventh Annual Message,” October 27, 1807, American Presidency Project (http://www.presidency.ucsb.edu/ws/?pid=29449).

50. Arguably, Jefferson may not have violated any statute: he incurred an obligation without prior statutory authorization rather than actually expending funds, which was not explicitly prohibited by Congress until 1820. Barron and Lederman, “The Commander in Chief at the Lowest Ebb,” pp. 975–77.

51. Sofaer, “Emergency Power and the Hero of New Orleans,” pp. 241–48, 250–53.

52. Rossiter, *Constitutional Dictatorship*, chap. 15.

53. Abraham Lincoln, “Special Session Message,” July 4, 1861, American Presidency Project (http://www.presidency.ucsb.edu/ws/?pid=69802).

54. 12 Stat. 326 (1861). Rossiter, *Constitutional Dictatorship*, chap. 15, p. 230. For its part, a 5-4 Supreme Court majority upheld the naval blockade’s legality in the Prize Cases, which found that Lincoln’s actions were authorized by Militia acts, accepted Lincoln’s claims of power to defend the nation’s integrity emanating from his constitutional responsibility, and suggested that his judgment of necessity was not reviewable by courts. *Prize Cases*, 67 U.S. 635 (1863).

55. See Sofaer, “Emergency Power and the Hero of New Orleans,” p. 253.

56. See Clement Fatovic and Benjamin A. Kleinerman, eds., *Extra-Legal Power and Legitimacy: Perspectives on Prerogative* (Oxford University Press, 2013), p. 14; within that volume, see Jeremy D. Bailey, “The Jeffersonian Executive: More Energetic, More Responsible, and Less Stable,” p. 123; and Clement Fatovic, “Filling the Void: Democratic Deliberation and the Legitimization of Extra-Legal Action,” pp. 171, 193.

57. Jack Goldsmith, “The Irrelevance of Prerogative Power and the Evils of Secret Legal Interpretation,” in Fatovic and Kleinerman, *Extra-Legal Power and Legitimacy,* pp. 220–21.

58. Rossiter, *Constitutional Dictatorship,* chap. 2.

59. A notable exception is Britain’s Defence of the Realm Act of 1914, which allowed the executive branch to wield nearly all of the power of the British state without any more specific legislative support as the nation entered the Great War. To compensate for the lack of democratic process and lack of accountability mechanisms, all of Britain’s major parties combined to form its first grand coalition, allowing the government to plausibly claim to represent every part of the British community as it wielded this awesome power; trust could then supplant process. Rossiter, *Constitutional Dictatorship,* chap. 11.

60. The two cases that struck down laws are *Panama Refining Co.* v. *Ryan*, 293 U.S. 388 (1935), and *Schechter Poultry Corp.* v. *United States*, 295 U.S. 495, 551, 553 (1935), from which two quotations from Justice Cardozo’s concurrence are taken. Important decisions respecting delegation through enabling acts include *U.S.* v. *Curtiss-Wright Export Corp.*, 299 U.S. 304 (1936) (emphasizing greater scope for discretion in foreign policy matters); *American Power & Light Co.* v. *SEC*, 329 U.S. 90 (1946) and *Fahey* v. *Mallonee*, 332 U.S. 245 (1947) (sustaining seemingly vague regu-

latory standards because they drew on a history of established and regularized expectations); *Ind. Union Dep't, AFL-CIO* v. *Am. Petroleum Inst.*, 448 U.S. 607 (1980) (Benzene Case), *International Union, UAW* v. *OSHA*, 938 F.2d 1310 (D.C. Cir., 1991) and *International Union, UAW* v. *OSHA*, 37 F.3d 665 (D.C. Cir., 1994) (Lockout/Tagout I and II, respectively), and *Whitman* v. *American Trucking Associations*, 531 U.S. 457 (2001) (all developing a practice of construing statutes so as to avoid potential nondelegation concerns rather than invalidating them).

61. For example, during World War I, the National Defense Act of 1916, the Army Appropriations Act of 1916, the Lever Act of 1917, and the Overman Act of 1918; see Rossiter, *Constitutional Dictatorship,* chap. 16, and Robert Higgs, *Crisis and Leviathan: Critical Episodes in the Growth of American Government* (New York: Oxford University Press, 1987), chap. 7. During World War II, the First and Second War Powers Acts and the Economic Stabilization Act of 1942, Higgs, chap. 9, and Rossiter, chap. 18. Various acts collectively known as the Renegotiation Act also allowed the government to recoup "excessive profits" from government contractors, as determined by the undersecretary of war or a newly created War Contracts Price Adjustment Board. *Lichter* v. *United States*, 334 U.S. 742 (1948).

62. Many enabling acts could be activated by the declaration of emergency; President Truman's proclamation of national emergency at the outset of the Korean War lingered for a quarter century and provided the basis for continued use of many statutes.

63. *Yakus* v. *United States*, 321 U.S. 414 (1944); *Bowles* v. *Willingham*, 321 U.S. 503 (1944); *Lichter* v. *United States*, 334 U.S. 742 (1948).

64. Jack Goldsmith, *Power and Constraint: The Accountable Presidency after 9/11* (New York: W. W. Norton, 2012). To be sure, not everyone is convinced by Goldsmith's portrait of our current accountability system as effective: some see his analysis as "Panglossian," marred by "is-ought" difficulties; Baher Azmy, "An Insufficiently Accountable Presidency: Some Reflections on Jack Goldsmith's *Power and Constraint*," *Case Western Reserve Journal of International Law* 45 (2012): 24–25; others suggest that accountability is highly politicized in partisan terms, Jeremy Rabkin, "War without End? Legal Wrangling without End," *Case Western Reserve Journal of International Law* 45 (2012): 82–84; yet others that it is haphazard or even largely illusory, Neal Katyal, "Stochastic Constraint," *Harvard Law Review* 126 (2013): 991.

65. Rossiter, *Constitutional Dictatorship,* chap. 11. For similar concerns about Woodrow Wilson's orientation toward Congress during World War I, see Rossiter, *Constitutional Dictatorship,* chap. 16.

66. U.S. Senate, Committee on Government Operations and the Special Committee on National Emergencies and Delegated Emergency Powers, *Source Book: Legislative History, Texts, and Other Documents Relating to the National Emergencies Act,* 94th Congress, 2d. Session (1976), p. 5.

67. The sequencing of the termination of World War II powers and creation of Korean War powers is somewhat confusing, because the declarations of war against Germany and Japan were not formally terminated until 1951 and 1952. See U.S.

Senate, *Source Book*, p. 2. See also Jules Lobel, "Emergency Power and the Decline of Liberalism," *Yale Law Journal* 98 (1989): 1400–02.

68. Lobel, "Emergency Power and the Decline of Liberalism," p. 1410; *Sardino* v. *Federal Reserve Bank of New York*, 361 F.2d 106, 109 (1966).

69. Lyndon B. Johnson, "Executive Order 11,387, Governing Certain Capital Transfers Abroad," January 1, 1968, American Presidency Project (http://www.presidency.ucsb.edu/ws/?pid=106173); see also Lyndon B. Johnson, "Statement by the President Outlining a Program of Action to Deal with the Balance of Payments Problem," January 1, 1968, American Presidency Project (http://www.presidency.ucsb.edu/ws/?pid=28804).

70. 90 Stat. 1255; 50 U.S.C. 1601–51; Relyea, "National Emergency Powers," p. 12.

71. Lobel, "Emergency Power and the Decline of Liberalism," pp. 1413–16, noting that because presidents have never begun the War Power Resolution's sixty-day clock, courts have found the statute nonjusticiable, and the procedural requirements of the National Emergencies Act and International Emergency Economic Powers Act have been generally ignored; John Hart Ely, "Suppose Congress Wanted a War Powers Act That Worked," *Columbia Law Review* 88 (1988): 1384, summarized as follows: "Very simply, . . . the President has refused to obey the law, and Congress has not had the fortitude to call him on it"; Richard F. Grimmett, "War Powers Resolution: Presidential Compliance," Congressional Research Service, September 25, 2012 (http://www.fas.org/sgp/crs/natsec/RL33532.pdf).

72. See Philip Wallach, "Contested Constraints: Regulatory Statutes in America's Modern Administrative State," Ph.D. diss., Princeton University, 2012.

73. *Ex parte Merryman*, 17 F. Cas. 144, at 153 (C.C.D. Md. 1861). See Michael Stokes Paulsen, "The *Merryman* Power and the Dilemma of Autonomous Executive Branch Interpretation," *Cardozo Law Review* 15 (1993): 81–111.

74. *Ex parte Quirin*, 317 U.S. 1 (1942).

75. Especially notable are those cases in which the Supreme Court allowed the policy of Japanese internment (initiated by the executive branch but also approved by Congress), *Hirabayashi* v. *United States*, 320 U.S. 81, 102 (1943), and *Korematsu* v. *United States*, 323 U.S. 214 (1944). Notably, in his dissent from the court's majority opinion in the latter case, Justice Robert Jackson espoused judicial avoidance of such cases, arguing that "a judicial construction of the due process clause that will sustain this order is a far more subtle blow to liberty than the promulgation of the order itself" (pp. 245–46). Regarding passive virtues, see Alexander Bickel, "Foreword: The Passive Virtues," *Harvard Law Review* 75 (1961): 40.

76. 71 U.S. 2, 127 (1866).

77. For example, Gross and Ni Aolain, *Law in Times of Crisis*, 89–90. In its immediate aftermath, *Milligan* was bitterly contested on largely partisan terms. See Samuel Issacharoff and Richard H. Pildes, "Institutional Process Approach to Rights during Wartime," *Theoretical Inquiries in Law* 5 (2004): 13–15.

78. Edward S. Corwin, *The President: Office and Powers; History and Analysis of Practice and Opinion* (New York University Press, 1940), p. 166.

79. *Ex parte Endo*, 323 U.S. 283 (1944); *Duncan* v. *Kahanamoku*, 327 U.S. 304 (1946). Decades later, in the 1980s, lower courts would repudiate the findings of the military that were the legal foundation for Japanese internment; *Korematsu* v. *U.S.*, 598 F.Supp. 1406 (N.D. Cal. 1984) and *Hirabayashi* v. *U.S.*, 828 F.2d 591 (9th Cir. 1987).

80. *Youngstown Sheet & Tube Co.* v. *Sawyer*, 343 U.S. 579 (1952).

81. Ibid., 587–89.

82. Ibid., 636–38.

83. Ibid., 654.

Chapter Three

1. St. Louis Federal Reserve, FRED Economic Data, "Real Gross Domestic Product" (http://research.stlouisfed.org/fred2/series/GDPC1); Bureau of the Census, "Census Data, Housing Vacancies, and Homeownership (CPS/HVS)," Historical Table 16 (http://www.census.gov/housing/hvs/data/histtabs.html).

2. Neil Irwin, *The Alchemists: Three Central Bankers and a World on Fire* (New York: Penguin, 2013), pp. 93–103.

3. St. Louis Federal Reserve, FRED Economic Data, "S&P/Case-Shiller National Composite Home Price Index" (http://research.stlouisfed.org/fred2/series/USCSCOMHPISA).

4. David Wessel, *In Fed We Trust: Ben Bernanke's War on the Great Panic* (New York: Crown Business, 2009), pp. 100–01; Gary Gorton, *Misunderstanding Financial Crises* (Oxford University Press, 2012), chap. 13.

5. Irwin, *The Alchemists*, pp. 126–28.

6. For one collection of essays on the variety of responses, though one that does not focus on legal issues, see Nancy Bermeo and Jonas Pontusson, eds., *Coping with Crisis: Government Reactions to the Great Recession* (New York: Russell Sage Foundation, 2012).

7. Marc Labonte, "Financial Turmoil: Federal Reserve Policy Responses," Congressional Research Service, July 15, 2010 (http://assets.opencrs.com/rpts/RL34427_20100715.pdf), pp. 5–6; Thomas C. Baxter, "The Legal Position of the Central Bank: The Case of the Federal Reserve Bank of New York," paper prepared for the Regulatory Response to the Financial Crisis Conference, London School of Economics, January 19, 2009 (http://www.lse.ac.uk/fmg/documents/events/conferences/2009/regulatoryResponse/1160_Baxter.pdf), pp. 2–3.

8. Bryan Burrough, "Bringing Down Bear Stearns," *Vanity Fair,* August 2008 (http://www.vanityfair.com/politics/features/2008/08/bear_stearns200808-2).

9. The Fed would accept as collateral "federal agency debt, federal agency residential-mortgage-backed securities (MBS), and nonagency AAA/Aaa-rated private-label

residential MBS." Federal Reserve Board of Governors, press release, March 11, 2008 (http://www.federalreserve.gov/newsevents/press/monetary/20080311 .htm).

10. For example, James Hamilton, "TSLF," *Econbrowser* (blog), March 15, 2008 (http://www.econbrowser.com/archives/2008/03/tslf.html).

11. Wessel, *In Fed We Trust*, pp. 161–62.

12. Baxter, "The Legal Position of the Central Bank," p. 7; Alexander Mehra, "Legal Authority in Unusual and Exigent Circumstances: The Federal Reserve and the Financial Crisis," *University of Pennsylvania Journal of Business Law* 13 (2010): 227.

13. David H. Small and James A. Clouse, "The Scope of Monetary Policy Actions Authorized under the Federal Reserve Act," Federal Reserve System, Finance and Economics Discussion Series, Paper 2004–40, pp. 8–9, 15.

14. David Fettig, "The History of a Powerful Paragraph," *The Region* (Federal Reserve Bank of Minneapolis), June 2008.

15. Walker Todd, "FDICIA's Emergency Liquidity Provisions," *Federal Reserve Bank of Cleveland Review* (Third Quarter 1993) (http://www.clevelandfed.org/Research/Review/1993/1993-q3.pdf), pp. 19–22; Simon Johnson and James Kwak, *13 Bankers: The Wall Street Takeover and the Next Financial Meltdown* (New York: Vintage, 2011), Kindle edition, loc. 2922–34.

16. The seminal case is *Raichle* v. *Federal Reserve Bank*, 34 F.2d 910, 915 (2d. Cir. 1929), which concludes that "correction of discount rates by judicial decree seems almost grotesque, when we remember that conditions in the money market often change from hour to hour, and the disease would ordinarily be over long before a judicial diagnosis could be made."

17. Thomas O. Porter, "The Federal Reserve's Catch-22: A Legal Analysis of the Federal Reserve's Emergency Powers," *North Carolina Banking Institute Journal* 13 (2009): 509.

18. Small and Clouse, "The Scope of Monetary Policy Actions Authorized under the Federal Reserve Act," p. 16, citing Howard H. Hackley, *Lending Functions of the Federal Reserve Banks: A History* (Washington: Board of Governors of the Federal Reserve System, May 1973).

19. Baxter, "The Legal Position of the Central Bank," p. 6.

20. Wessel, *In Fed We Trust*, p. 147.

21. William D. Cohan, *House of Cards: A Tale of Hubris and Wretched Excess on Wall Street* (New York: Anchor Books, 2009), pp. 29, 74–75.

22. Porter, "The Federal Reserve's Catch-22," p. 506.

23. Randall D. Guynn, Annette L. Nazareth, and Margaret E. Tahyar, "Federal Reserve Emergency Intervention Authority: Old Tools Used in New Ways," in *Davis Polk Financial Crisis Manual* (New York: Davis, Polk and Wardwell, LLC, 2009), pp. 24–25; Minutes of the Board of Governors of the Federal Reserve System, March 14, 2008 (http://www.federalreserve.gov/newsevents/press/other/other20080627a1.pdf).

24. Henry Paulson, *On the Brink: Inside the Race to Stop the Collapse of the Global Financial Crisis* (New York: Hachette Book Group, 2010), Kindle edition, loc. 1676. News coverage of the Fed's "extraordinary step" noted Paulson's involvement, for example, Neil Irwin and Tomoeh Murakami Tse, "Fed Comes to Rescue as Wall St. Giant Slips," *Washington Post,* March 15, 2008 (http://articles.washington post.com/2008-03-15/business/36841262_1_bear-stearns-alan-d-schwartz -discount-window).

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26. It was repaid in full on Monday, March 17, including interest of approximately $4 million. Federal Reserve Board, "Bear Stearns, JP Morgan Chase, and Maiden Lane LLC" (http://www.federalreserve.gov/newsevents/reform_bearstearns.htm).

27. Cohan, *House of Cards*, pp. 95–97, 97.

28. Roger Lowenstein, *The End of Wall Street* (New York: Penguin, 2010), p. 128.

29. Cohan, *House of Cards*, p. 112. The details of the March 16 arrangement were not made public immediately, and they remain somewhat hazy. See also Labonte, "Financial Turmoil," p. 19.

30. For the original deal between the two firms, see "Agreement and Plan of Merger by and between the Bear Stearns Companies Inc. and JPMorgan Chase & CO," *Wall Street Journal* (http://online.wsj.com/public/resources/documents/bearJPMdeal .pdf).

31. Federal Reserve Board Governors, press release, March 16, 2008 (http://www .federalreserve.gov/newsevents/press/monetary/20080316a.htm).

32. Cohan, *House of Cards*, pp. 133–35.

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34. Phillip Swagel, "The Financial Crisis: An Inside View," *BPEA,* no. 1 (2009): 32.

35. Paulson, *On the Brink,* loc. 1878–1900; Wessel, *In Fed We Trust*, p. 169; Greg Robb, "Treasury Details Key Role in Bear Stearns Bailout," *MarketWatch,* April 1, 2008 (http://www.marketwatch.com/story/correct-treasury-details-extensive-role -in-bear-stearns-bailout).

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37. Paulson, *On the Brink*, loc. 1842.

38. Federal Reserve Board, "Comprehensive Review of Regulation W and Overview of § 23A" (http://www.federalreserve.gov/boarddocs/SRLetters/2003/SR0302a1.pdf).

39. Minutes of the Board of Governors of the Federal Reserve System, March 16, 2008 (http://www.federalreserve.gov/newsevents/press/other/other20080627a2.pdf); Bryan J. Orticelli, "Crisis Compounded by Constraint: How Regulatory Inadequacies Impaired the Fed's Bailout of Bear Stearns," *Connecticut Law Review* 42 (2009): 669–71; Saule T. Omarova, "From Gramm-Leach-Bliley to Dodd-Frank: The Unfulfilled Promise of Section 23A of the Federal Reserve Act," *North Carolina Law Review* 89 (2010–11): 1683–1776.

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41. Greg Ip, "More on Those Fed 23A Exemptions to Banks," *Real Time Economics* (blog), *Wall Street Journal,* August 28, 2007 (http://blogs.wsj.com/economics/2007/08/28/more-on-those-fed-23a-exemptions-to-banks/).

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53. Baxter, "The Legal Position of the Central Bank," pp. 11–13, 13.

54. Chad Emerson, "The Illegal Actions of the Federal Reserve: An Analysis of How the Nation's Central Bank Has Acted Outside the Law in Responding to the Current Financial Crisis," *William and Mary Business Law Review* 1 (2010): 128, 129.

55. Mehra, "Legal Authority in Unusual and Exigent Circumstances," pp. 238–41. Other legal scholars have defended the legality of the Fed's actions; see, for example, Jose Gabilondo, "Financial Hospitals: Defending the Fed's Role as Lender of Last Resort," *Seattle University Law Review* 36 (2013): 765.

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59. For a full video of the hearing, see "U.S. Economic Outlook," C-Span, April 2, 2008 (http://www.c-spanvideo.org/videoLibrary/transcript/transcript.php?programid=188348), especially around 50:00, 1:04:00.

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63. Federal Reserve Bank of New York, "Maiden Lane Transactions" (http://www.newyorkfed.org/markets/maidenlane.html).

64. See Davidoff and Zaring, "Regulation by Deal."

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66. Cohan, *House of Cards*, p. 116.

67. Federal Reserve Board of Governors, press releases: May 2, 2008 (http://www.federalreserve.gov/newsevents/press/monetary/20080502a.htm); July 30, 2008 (http://www.federalreserve.gov/newsevents/press/monetary/20080730a.htm); June 5, 2008 (http://www.federalreserve.gov/newsevents/press/orders/20080605a.htm).

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2011), p. 17; GAO, "Fannie Mae and Freddie Mac: Analysis of Options for Revising the Housing Enterprises' Long-Term Structures," p. 13.

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(yeas included 44 Democrats, 26 Republicans, 2 Independents) (http://www.govtrack.us/congress/bills/110/hr3221).

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112. Stewart, "Eight Days."

113. Davidoff and Zaring, "Regulation by Deal," pp. 474, 493–94; see also FCIC, "Final Report," pp. 332–34; Stewart, "Eight Days."

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116. Stewart, "Eight Days."

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118. For a defense of this explanation, see William R. Cline and Joseph E. Gagnon, "Lehman Died, Bagehot Lives: Why Did the Fed and Treasury Let a Major Wall Street Bank Fail?," Peterson Institute for International Economics, Policy Brief PB13-21 (2013) (http://www.piie.com/publications/pb/pb13-21.pdf), p. 3: "Our results . . . suggest that saving Lehman would have required an outright deception on the part of the Fed that was not required for the other emergency loans." Critics generally say that the government's choice merely reflected a shortage of "the political capital necessary to bail out another bank in the face of congressional and public criticism." Johnson and Kwak, *13 Bankers*, loc. 3141–42.

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128. European banking regulators, who quickly began to feel the shock waves of Lehman's collapse, were furious at the unexpected decision, having no time for any legalistic rationalizations. Gillian Tett, *Fool's Gold* (New York: Free Press, 2009), p. 239.

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133. Webel, "Government Assistance for AIG," p. 1, n. 3.

134. Sorkin, *Too Big to Fail*, loc. 4082.

135. FCIC, "Final Report," p. 346.

136. Webel, "Government Assistance for AIG," pp. 1–2; COP, "The AIG Rescue," pp. 36–40.

137. COP, "The AIG Rescue," pp. 60–61, 239; Sorkin, *Too Big to Fail*, loc. 4603.

138. Sorkin, *Too Big to Fail*, loc. 6418; COP, "The AIG Rescue," 245. The agreement was to allow AIG to borrow from its subsidiaries, posting less-liquid assets as collateral.

139. Webel, "Government Assistance for AIG," p. 2.

140. COP, "The AIG Rescue," pp. 64–65; FCIC, "Final Report," p. 348.

141. Stewart, "Eight Days"; Sorkin, *Too Big to Fail*, locs. 7435, 7530; COP, "The AIG Rescue," p. 245.

142. Sorkin, *Too Big to Fail*, loc. 7525.

143. Swagel, "The Financial Crisis: An Inside View," p. 41; Stewart, "Eight Days."

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146. More precisely, the rate was set at the three-month LIBOR rate (then around 4 percent) plus 850 basis points. Federal Reserve, press release, September 16, 2008 (http://www.federalreserve.gov/newsevents/press/other/20080916a.htm). (The full agreement, finalized a week later, is available at http://www.sec.gov/Archives/edgar/data/5272/000095012308011496/y71452exv99w1.htm). Strangely, the shares were issued not to the FRBNY but to a trust operated for the benefit of the Treasury, perhaps to put some distance between the government and AIG. Davidoff and Zaring, "Regulation by Deal," pp. 496–97; Sjostrom, "AIG Bailout," pp. 965–68.

147. Sjostrom, "AIG Bailout," p. 967.

148. Sorkin, *Too Big to Fail*, loc. 7813, 7879; Lowenstein, *The End of Wall Street*, pp. 213–14.

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Chapter Four

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11. Ibid., p. 6.

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13. 154 Cong. Rec. H9949.

14. Senator Bunning took several opportunities to decry the "un-American" program's "financial socialism." *Turmoil in U.S. Credit Markets,* p. 13. Representative Virginia Foxx (R-N.C.) touted her belief in "the principles that undergird this country . . . the rule of law, our Judeo-Christian heritage, and capitalism. . . . And it is not appropriate to turn our economic system to the government." 154 Cong. Rec. H9950.

15. Senator Sherrod Brown's comments in the Senate Banking Committee hearing are a good example, *Turmoil in U.S. Credit Markets,* p. 16.

16. 154 Cong. Rec. S9264.

17. Discussion between Senator Schumer and Secretary Paulson, *Turmoil in U.S. Credit Markets,* p. 50; remarks of Senator Herbert Kohl (D-Wisc.), 154 Cong. Rec. S9469.

18. Senator Johnny Isakson (R-Ga.), 154 Cong. Rec. S9613. Senator Norm Coleman (R-Minn.) notably quoted Abraham Lincoln in arguing for the propriety of transparency measures: "I am a firm believer in the people. If given the truth, they can be depended upon to meet any national crisis. The great point is to bring them the real facts." 154 Cong. Rec. S9622.

19. Remarks of Representative John Tanner (D-Tenn.), 154 Cong. Rec. H10,759.

20. *Turmoil in U.S. Credit Markets,* p. 21.

21. 154 Cong. Rec. S9362. Paulson was an investment banker from 1974 until he became Treasury secretary in 2006, but apparently his geographic location in Chicago (until becoming CEO of Goldman Sachs in 1999) was enough to reassure the senator about the content of his character. For more praise of Bernanke, see Representative John Spratt (D-S.C.), 154 Cong. Rec. H10,383.

22. 154 Cong. Rec. H10,360.

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26. 154 Cong. Rec. H10,367.

27. 154 Cong. Rec. H10,364.

28. 154 Cong. Rec. H10,712. Admittedly, this quotation is out of chronological order here.

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34. George W. Bush, "Address to the Nation on the National Economy," September 24, 2008, American Presidency Project (http://www.presidency.ucsb.edu/ws/?pid=84355).

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39. Representative Burgess (R-Tex.), 154 Cong. Rec. H10,303. See also remarks of Doggett, 154 Cong. Rev. H10,364.

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47. Senate vote on H.R. 1424 (amended to include EESA) (October 1, 2008), votes 212 and 213 (http://www.opencongress.org/vote/2008/s/213); my count of Democrats includes Senator Joseph Lieberman of Connecticut, who was technically an Independent Democrat at that point.

48. "Congress Clears $700 Billion Bailout of Financial Services Industry," p. 7–6.

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89. Tobias Adrian, Karin Kimbrough, and Dina Marchioni, “The Federal Reserve’s Commercial Paper Funding Facility,” *FRBNY Economic Policy Review,* May 2011 (http://www.newyorkfed.org/research/epr/11v17n1/1105adri.pdf), pp. 25, 33.

90. Meg Marco, “What Is Commercial Paper and Why Is the Federal Reserve Suddenly Buying It?,” Consumerist, October 7, 2008 (http://consumerist.com/2008/10/07/what-is-commercial-paper-and-why-is-the-federal-reserve-suddenly-buying-it/).

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92. Marc Labonte, “Financial Turmoil: Federal Reserve Policy Responses,” Congressional Research Service, July 15, 2010 (http://assets.opencrs.com/rpts/RL34427_20100715.pdf), 14.

93. Jose Gabilondo, “Financial Hospitals: Defending the Fed’s Role as Lender of Last Resort,” *Seattle University Law Review* 36 (2013): 783.

94. Ibid., pp. 769–71.

95. Memorandum from Federal Reserve Legal Division, “Authority of the Federal Reserve to Provide Extensions of Credit in Connection with a Commercial Paper Funding Facility (CPFF),” March 9, 2009 (http://cybercemetery.unt.edu/archive/fcic/20110310193436/http://c0181567.cdn1.cloudfiles.rackspacecloud.com/2009-03-09_Federal_Reserve_Bank_Letter_from_Legal_Division_to_Files_Re_Authority_of_the_Federal_Reserve_to_provide_extensions_of_credit_in_connection_with_a_commercial_paper_funding_facility_CPFF.pdf).

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98. Mark Felsenthal and Glenn Somerville, "Fed Creates Facility to Buy Commercial Paper," Reuters, October 7, 2008 (http://www.reuters.com/article/2008/10/07/us-financial-fed-paper-idUSTRE4964S420081007).

99. Labonte, "Financial Turmoil," p. 14; Adrian, Kimbrough, and Marchioni, "The Federal Reserve's Commercial Paper Funding Facility," pp. 35–36; Marcin Kacperczyk and Philipp Schnabl, "When Safe Proved Risky: Commercial Paper during the Financial Crisis of 2007–09," *Journal of Economic Perspectives* 24 (2010): 29–50.

100. FCIC, "Final Report," pp. 372–73; Dawn Kawamoto, "The Fed's Commercial Paper Buying Knew No National Boundaries," DailyFinance, December 8, 2010 (http://www.dailyfinance.com/2010/12/08/the-feds-commercial-paper-buying-knew-no-national-boundaries/).

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102. Baird Webel, "Government Assistance for AIG: Summary and Cost," Congressional Research Service, March 11, 2013 (http://www.fas.org/sgp/crs/misc/R42953.pdf), p. 9.

103. Federal Reserve Bank of New York, "Actions Related to AIG" (http://www.newyorkfed.org/aboutthefed/aig/index.html).

104. For instance, the Congressional Oversight Panel's extensive and very critical report on the government's AIG programs found nothing worth noticing about the program. Congressional Oversight Panel (COP), "The AIG Rescue, Its Impact on Markets, and the Government's Exit Strategy," June 10, 2010 (http://cybercemetery.unt.edu/archive/cop/20110401232818/http://cop.senate.gov/documents/cop-061010-report.pdf), pp. 84, 165. For the most skeptical take I could find, see Yves Smith, "Fed Lending Another $38 Billion to AIG," Naked Capitalism, October 8, 2008 (http://www.nakedcapitalism.com/2008/10/fed-lending-another-38-billion-to-aig.html). Commenter "bidrec" has useful thoughts.

105. Bair, *Bull by the Horns,* p. 118.

106. 12 U.S.C. 1823(c)(1).

107. 12 U.S.C. 1823(c)(4), especially (G).

108. FDIC, "Chairman's Statement on the Temporary Liquidity Guarantee Program," October 23, 2008 (http://www.fdic.gov/regulations/resources/TLGP/chairman_statement.html); Bair, *Bull by the Horns,* p. 301. Bair memorably calls the prospect of unlimited insurance, which she says Geithner favored, a "draconian giveaway."

109. John Poirier, "FDIC Seeking Temporary Unlimited Treasury Loans," Reuters, October 1, 2008 (http://www.reuters.com/article/2008/10/01/us-financial-bailout-fdic-idUSTRE48T7F920081001).

110. Alan S. Blinder and R. Glenn Hubbard, "Blanket Deposit Insurance Is a Bad Idea," *Wall Street Journal,* October 15, 2008 (http://online.wsj.com/news/articles/SB122403056396434697).

111. Jeff Gerth and Brady Dennis, "Loophole Helps GE Benefit from Bank Rescue Program," *Washington Post,* June 29, 2009 (http://www.washingtonpost.com/wp-dyn/content/article/2009/06/28/AR2009062802955.html).

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113. Luigi L. De Ghenghi, John L. Douglas, and Reena Agrawal Sahni, "The FDIC's Temporary Liquidity Guarantee Program," chap. 5 in *Davis Polk Financial Crisis Manual* (New York: Davis, Polk, and Wardwell, 2009), pp. 116–19.

114. Gerth and Dennis, "Loophole Helps GE."

115. De Ghenghi, Douglas, and Sahni, "The FDIC's Temporary Liquidity Guarantee Program," p. 120.

116. Gerth and Dennis, "Loophole Helps GE." On GE's competitors, see "Private Capital to the Rescue," *Wall Street Journal,* July 20, 2009 (http://online.wsj.com/article/SB10001424052970203946904574300221028710590.html).

117. FDIC, "Temporary Liquidity Guarantee Program" (http://www.fdic.gov/regulations/resources/TLGP/index.html).

118. Andrew Ross Sorkin, *Too Big to Fail* (New York: Viking, 2009), Kindle edition, loc. 9900; FCIC, "Final Report," p. 374.

119. The New York Fed determined which banks fit into this category. Paulson, *On the Brink*, loc. 5534.

120. The banks were Bank of America, Bank of New York Mellon, Citigroup, Goldman Sachs, JPMorgan Chase, Merrill Lynch (not yet absorbed into Bank of America), Morgan Stanley, State Street, and Wells Fargo. John M. Brandow and others, "The Capital Twist," chap. 3 in *Davis Polk Financial Crisis Manual*, p. 69.

121. Sorkin, *Too Big to Fail,* loc. 10088.

122. Brandow and others, "The Capital Twist," p. 72.

123. Sorkin, *Too Big to Fail,* loc. 10104. John Allison, former CEO of BB&T Bank (and now president of the Cato Institute), reports a similar experience, with his regulators making a barely veiled threat against the bank if it refused to accept TARP capital. John Allison, *The Financial Crisis and the Free Market Cure* (New York: McGraw Hill, 2013), pp. 170–72.

124. Brandow and others, "The Capital Twist," pp. 73–74.

125. For example, Edward Harrison, "Paulson Abandons TARP Asset Purchase and Risky Assets Plummets," *EconMonitor* (blog), Roubini Global Economics, November 21, 2008 (http://www.economonitor.com/blog/2008/11/paulson-abandons-tarp-asset-purchase-and-risky-assets-plummets/).

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127. Matt Taibbi, "Secrets and Lies of the Bailout," *Rolling Stone*, January 4, 2013 (http://www.rollingstone.com/politics/news/secret-and-lies-of-the-bailout-20130104).

128. *Oversight of Implementation of the Emergency Economic Stabilization Act of 2008 and of Government Lending and Insurance Facilities: Impact on the Economy and Credit Availability*: *Hearings Before the House Financial Services Committee,* 110th Congress (November 18, 2008) (http://www.gpo.gov/fdsys/pkg/CHRG-110hhrg46593/pdf/CHRG-110hhrg46593.pdf), p. 66.

129. *Oversight of Implementation of the Emergency Economic Stabilization Act,* p. 39.

130. For example, remarks of Representative Jeb Hensarling (R-Tex.), *Oversight of Implementation of the Emergency Economic Stabilization Act,* p. 6.

131. Paulson, *On the Brink,* loc. 5655; *Oversight of Implementation of the Emergency Economic Stabilization Act,* p. 3.

132. Paulson, *On the Brink,* loc. 5924. See also *Oversight of Implementation of the Emergency Economic Stabilization Act,* pp. 7, 39–40; *Bank of America and Merrill Lynch: How Did a Private Deal Turn into a Federal Bailout? Part III: Hearing Before the House Committee on Oversight and Government Reform,* 111th Congress (July 16, 2009) (http://www.gpo.gov/fdsys/pkg/CHRG-111hhrg55765/pdf/CHRG-111hhrg55765.pdf), pp. 34–35.

133. Katalina Bianco, "A Retrospective of the Troubled Asset Relief Program," Wolters Kluwer, March 11, 2011 (http://business.cch.com/bankingFinance/focus/News/TARPwhitepaper.pdf), p. 7, quoting Paulson's remarks on November 12, 2008; "Remarks by Secretary Henry M. Paulson, Jr. on Financial Rescue Package and Economic Update," November 12, 2008, U.S. Treasury Department (http://www.treasury.gov/press-center/press-releases/Pages/hp1265.aspx).

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135. COP, "Foreclosure Crisis: Working toward a Solution," March 6, 2009 (http://cybercemetery.unt.edu/archive/cop/20110402010739/http:/cop.senate.gov/documents/cop-030609-report.pdf), p. 31; Lea Christie, "Hope Now's Numbers Don't Add Up to Much Help," *CNN Money*, April 2008 (http://money.cnn.com/2008/04/10/real_estate/Hope_Now_Feb_stats/?postversion=2008041016).

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139. *Oversight of Implementation of the Emergency Economic Stabilization Act,* p. 21. See also comments of Representative Mel Watt (D-N.C.), pp. 36–37.

140. See Bair, *Bull by the Horns,* p. 131.

141. *Oversight of Implementation of the Emergency Economic Stabilization Act*, pp. 8, 14–15.

142. *Oversight of the Emergency Economic Stabilization Act: Examining Financial Institution Use of Funding under the Capital Purchase Program: Hearing Before the Senate Committee on Banking, Housing, and Urban Affairs,* 110th Congress (November 13, 2008) (http://www.gpo.gov/fdsys/pkg/CHRG-110shrg50417/pdf/CHRG-110shrg50417.pdf) (remarks of Senator Dodd, p. 3; remarks of Senator Schumer, p. 11).

143. Mike McIntire, "Bailout Is a Windfall to Banks, If Not to Borrowers," *New York Times*, January 17, 2009 (http://www.nytimes.com/2009/01/18/business/18bank.html?pagewanted=all).

144. Joseph E. Stiglitz, "A $1 Trillion Answer," *New York Times,* November 29, 2008 (http://www.nytimes.com/2008/11/30/opinion/30stiglitz.html?pagewanted=all).

145. Cleveland-area representatives Sarah LaTourette (R) and Dennis Kucinich (D) and Senator Sherrod Brown (D) each angrily denounced the role that TARP had played in facilitating PNC's purchase of National City, which had been deemed too unhealthy to qualify for funds by its primary regulator, the Office of the Comptroller of the Currency. *Oversight of Implementation of the Emergency Economic Stabilization Act,* pp. 32–35; *Oversight of the Emergency Economic Stabilization Act,* p. 9. See Sabrina Eaton, "National City's Bailout Application Never Seriously Considered," *Cleveland.com* (blog), *Cleveland Plain Dealer*, November 14, 2008 (http://blog.cleveland.com/business/2008/11/national_citys_bailout_applica.html); Teresa Dixon Murray, "Questions Remain on PNC–National City Deal," *Cleveland Plain Dealer,* December 29, 2008 (http://www.cleveland.com/plaindealer/stories/index.ssf?/base/business-11/1230543069185071.xml&coll=2). More broadly, critics wondered whether admission into TARP would ultimately hinge on a bank's political connectedness rather than its creditworthiness and would point to some troubling episodes; Damian Paletta and David Enrich, "Barney Frank Goes to Bat for Lender, and It Gets an Infusion," *Wall Street Journal,* January 22, 2009 (http://online.wsj.com/article/SB123258284337504295.html); David Cho and Lori Montgomery, "Delays in Bank Aid Spur Frustration," *Washington Post*, January 23, 2009 (http://www.washingtonpost.com/wp-dyn/content/article/2009/01/22/AR2009012203930.html).

146. Neil Barofsky, *Bailout* (New York: Free Press, 2012), Kindle edition, p. 77.

147. See Swagel, "The Financial Crisis: An Inside View," p. 2.

148. Paulson makes it clear that he found the lack-of-tracking criticisms basically vacuous in the interview presented in Joe Berlinger, "Hank: 5 Years from the Brink," film produced by Bloomberg Businessweek, released on Netflix in September 2013.

149. Andrew Ross Sorkin, "A.I.G. May Get More in Bailout," *New York Times*, November 9, 2008 (http://www.nytimes.com/2008/11/10/business/economy/10aig.html).

150. U.S. Treasury, "Treasury to Invest in AIG Restructuring under the Emergency Economic Stabilization Act," press release, November 10, 2008 (http://www.treasury.gov/press-center/press-releases/Pages/hp1261.aspx).

151. More precisely, the rate for loaned funds was changed to 300 basis points above the three-month LIBOR rate (then just over 2 percent). Board of Governors of the Federal Reserve System, press release, November 10, 2008 (http://www.federalreserve.gov/newsevents/press/other/20081110a.htm).

152. See Hester Peirce, "Securities Lending and the Untold Story in the Collapse of AIG," Working Paper 14-12, Mercatus Center, May 2014 (http://mercatus.org/sites/default/files/Peirce_SecuritiesLendingAIG_v2.pdf), pp. 41–42.

153. Board of Governors of the Federal Reserve System, press release, November 10, 2008.

154. Federal Reserve Bank of New York, "AIG CDO LLC Facility: Terms and Conditions," effective December 3, 2008 (http://www.newyorkfed.org/markets/aclf_terms.html). See also Webel, "Government Assistance for AIG," pp. 4, 10–11.

155. Mehra, "Legal Authority in Unusual and Exigent Circumstances," p. 249.

156. Chad Emerson, "The Illegal Actions of the Federal Reserve: An Analysis of How the Nation's Central Bank Has Acted Outside the Law in Responding to the Current Financial Crisis," *William and Mary Business Law Review* (2010): 129.

157. Reported in COP, "The AIG Rescue, Its Impact on Markets, and the Government's Exit Strategy," June 10, 2010 (http://cybercemetery.unt.edu/archive/cop/20110401232818/http://cop.senate.gov/documents/cop-061010-report.pdf), p. 268. See also Gabilondo, "Financial Hospitals," pp. 783–84.

158. For criticisms, see David Henry and Matthew Goldstein, "The Fed's Risky Backdoor Bailouts," *Businessweek*, December 16, 2008 (http://www.businessweek.com/stories/2008-12-16/the-feds-risky-backdoor-bailouts). For final accounting, see Federal Reserve Bank of New York (FRBNY), "Maiden Lane Transactions," press releases of February 28, 2012, and August 23, 2012 (http://www.newyorkfed.org/markets/maidenlane.html).

159. FCIC, "Final Report," pp. 379–80.

160. Special Inspector General for TARP (SIGTARP), "Extraordinary Financial Assistance Provided to Citigroup, Inc.," January 13, 2011 (http://www.sigtarp.gov/Audit%20Reports/Extraordinary%20Financial%20Assistance%20Provided%20to%20Citigroup,%20Inc.pdf), pp. 8–12.

161. Ibid., pp. 13–15; GAO, "Regulators' Use of Systemic Risk Exception Raises Moral Hazard Concerns and Opportunities Exist to Clarify the Provision," p. 24. For Bair's position, see *Bull by the Horns*, p. 123.

162. Nemo, "How Big Is Citigroup, Again?," *Self-evident,* November 22, 2008 (https://self-evident.org/?p=359).

163. Robert Reich, "Why CitiGroup Is About to Be Bailed Out and Not General Motors," *Robert Reich's blog,* November 21, 2008 (http://web.archive.org/web/20081216032600/http://robertreich.blogspot.com/2008/11/why-citigroup-is-about-to-be-bailed-out.html).

164. SIGTARP, "Extraordinary Financial Assistance Provided to Citigroup, Inc.," pp. i, 42–43. Also critical was the head of the (now defunct) Office of Thrift Supervision, John Reich, who told the Financial Crisis Inquiry Commission that he worried that systemic risk determinations reflected "some selective creativity"; FCIC, "Final Report," p. 382.

165. The capital injection would be formalized as the Targeted Investment Program and was executed on December 31, 2008. The ring-fencing arrangement would be formalized as the Asset Guarantee Program and was executed on January 2, 2009, though the final selection of the assets in the pool would drag on for nearly a year. "Joint Statement by Treasury, Federal Reserve, and the FDIC on Citigroup," press release, November 23, 2008 (http://www.federalreserve.gov/newsevents/press/bcreg/20081123a.htm); Steven M. Davidoff and David Zaring, "Regulation by Deal: The Government's Response to the Financial Crisis," *Administrative Law Review* 61 (2009): 529; SIGTARP, "Extraordinary Financial Assistance Provided to Citigroup, Inc.," pp. 6, 17, 19–20, 24, 42.

166. Mara Der Hovanesian, "Citigroup's Uneasy Victory," *Businessweek*, November 24, 2008 (http://www.businessweek.com/stories/2008-11-24/citigroups-uneasy-victorybusinessweek-business-news-stock-market-and-financial-advice); SIGTARP, "Extraordinary Financial Assistance Provided to Citigroup, Inc.," p. 22.

167. Paul Krugman, "Citigroup," *The Conscience of a Liberal* (blog), *New York Times,* November 24, 2008 (http://krugman.blogs.nytimes.com/2008/11/24/citigroup/); Barry Ritholtz, "Citi Bailout," *The Big Picture* (blog), November 24, 2008 (http://www.ritholtz.com/blog/2008/11/citi-bailout/); Andrew Samwick, "The Feds Double Down on Citigroup," *Capital Gains and Games* (blog), November 24, 2008 (http://capitalgainsandgames.com/blog/andrew-samwick/650/feds-double-down-citigroup).

168. Bair, *Bull by the Horns*, pp. 6, 125.

169. James Kwak, "Citigroup Bailout: Weak, Arbitrary, Incomprehensible," *Baseline Scenario* (blog), November 24, 2008 (http://baselinescenario.com/2008/11/24/citigroup-bailout-weak-arbitrary-incomprehensible/).

170. Federal Reserve Board of Governors, Order Approving Acquisition of Merrill Lynch by Bank of America, November 28, 2008 (http://www.federalreserve.gov/newsevents/press/orders/orders20081126a1.pdf). The Fed noted that the Riegle-Neal Act's prohibition on bank mergers that led to more than 10 percent of the nation's assets being held in one bank did not apply, since Merrill Lynch's bank was chartered under the Home Owners' Loan Act rather than the National Banking Act (p. 2, n. 6).

171. FCIC, "Final Report," p. 383. The question of whether Lewis and Bank of America made proper disclosures of available information about Merrill Lynch before the shareholder vote on December 5 would become the subject of three lawsuits: the first, brought by the SEC, settled for $150 million in 2010; the second, brought by the New York attorney general under the Martin Act, was eventually superseded by the third, which was a shareholder class action that ended in 2012 with a $2.43 billion settlement. Michael J. de la Merced, "BofA Sued by Cuomo, but Strikes Deal with S.E.C.," DealBook, *New York Times*, February 4, 2010 (http://dealbook.nytimes.com/2010/02/04/bofa-agrees-to-150-million-settlement-in-sec-case/); Jessica Silver-Greenberg and Susanne Craig, "Bank of America Settles Suit over Merrill for $2.43 Billion," DealBook, *New York Times*, September 28, 2012 (http://dealbook.nytimes.com/2012/09/28/bank-of-america-to-pay-2-43-billion-to-settle-class-action-over-merrill-deal/).

172. William D. Cohan, "The Final Days of Merrill Lynch," *The Atlantic,* September 2009 (http://www.theatlantic.com/magazine/archive/2009/09/the-final-days-of-merrill-lynch/307621/

173. Alvarez, the Fed's top lawyer, was by all accounts one of the central architects of the crisis responses and is a major power player at the Fed. He also has a remarkable talent for staying out of the public eye, and so the precise nature of his contributions is difficult for an outsider to discern. For some sharply critical speculation, see Jesse Eisinger, "The Power behind the Throne at the Federal Reserve," DealBook, *New York Times,* July 31, 2013 (http://dealbook.nytimes.com/2013/07/31/the-power-behind-the-throne-at-the-federal-reserve/).

174. *Bank of America and Merrill Lynch, Part II,* June 25, 2009 (http://www.gpo.gov/fdsys/pkg/CHRG-111hhrg55102/pdf/CHRG-111hhrg55102.pdf), p. 17.

175. Paulson, *On the Brink*, loc. 6533–78.

176. FCIC, "Final Report," p. 384.

177. Federal Reserve, FDIC, and U.S. Treasury, "Treasury, Federal Reserve, and the FDIC provide assistance to Bank of America," joint press release, January 16, 2009 (http://www.federalreserve.gov/newsevents/press/bcreg/20090116a.htm); Federal Reserve, "Report Pursuant to Section 129 of the Emergency Economic Stabilization Act of 2008: Authorization to Provide Residual Financing to Bank of America Corporation Relating to a Designated Asset Pool" (http://www.federalreserve.gov/monetarypolicy/files/129bofa.pdf). The ring-fenced assets would have BofA taking the first loss position ($10 billion), the Treasury ($7.5 billion), FDIC ($2.5 billion), and BofA ($1.1) splitting the second loss position, and the Federal Reserve providing a § 13(3) loan to cover any additional losses. Bank of America would issue an additional $4 billion in preferred shares as a fee for the program.

178. Baird Webel, "Troubled Asset Relief Program (TARP): Implementation and Status," Congressional Research Service, Report R41427, June 27, 2013 (http://www.fas.org/sgp/crs/misc/R41427.pdf), p. 16.

179. "Mugging Bank of America," *Wall Street Journal,* January 17, 2009 (http://online.wsj.com/news/articles/SB123215299934192217).

180. Ken Lewis deposition, "In Re: Executive Compensation Investigation, Bank of America–Merrill Lynch," February 26, 2009 (http://online.wsj.com/public/resources/documents/ExhibitA-cuomo04232009.pdf), pp. 52–56.

181. *Bank of America and Merrill Lynch: How Did a Private Deal Turn into a Federal Bailout? House Committee on Oversight and Government Reform,* 111th Congress (June 11, 2009) (http://www.gpo.gov/fdsys/pkg/CHRG-111hhrg54877/pdf/CHRG-111hhrg54877.pdf) (comment of Representative Jim Jordan (R-Ohio), p. 15).

182. *Bank of America and Merrill Lynch,* June 11, 2009, Lewis testimony, pp. 18, 24–25, 59, 61, 99. Nevertheless, journalists continued to fret about "the sanctity of legal contracts in post-crash America" in relation to the deal. See Cohan, "The Final Days of Merrill Lynch."

183. *Bank of America and Merrill Lynch,* June 11, 2009, Lewis testimony, pp. 56, 66.

184. John Crawley, "Congress Weighs Loans for Automakers," Reuters, September 9, 2008 (http://www.reuters.com/assets/print?aid=USWBT00966320080909).

185. "Loans Keep Automakers Afloat," *CQ Almanac* 64 (2008): 7–20. The funding provision was attached to H.R. 2638, a bill that funded America's troops and various disaster relief efforts, which passed 370–58 in the House on September 24, 2008 (https://www.govtrack.us/congress/votes/110-2008/h632) and 78–12 in the Senate on September 27, 2008 (https://www.govtrack.us/congress/votes/110-2008/s208). President Bush signed the bill into law on September 30; see David Kiley, "Bush Approves Automaker Loan Program: But Will It Arrive in Time?," *AutoBeat* (blog), *Businessweek,* October 1, 2008 (http://www.businessweek.com/autos/autobeat/archives/2008/10/bush_approves_a.html).

186. Steven Rattner, *Overhaul: An Insider's Account of the Obama Administration's Emergency Rescue of the Auto Industry* (New York: Mariner Books, 2010), pp. 20–23.

187. *Oversight of Implementation of the Emergency Economic Stabilization Act*, p. 19. Paulson apparently also conveyed this message during a speech at the Reagan Library on November 20, 2008; see Paulson, *On the Brink*, loc. 6258.

188. Rattner, *Overhaul,* p. 24.

189. Bill Vlasic and David Herszenhorn, "Auto Chiefs Fail to Get Bailout Aid," *New York Times,* November 19, 2008 (http://www.nytimes.com/2008/11/20/business/20auto.html).

190. Karlyn Bowman, "TARP, the Auto Bailout, and the Stimulus: Attitudes about the Economic Crisis," *AEI Public Opinion Studies,* American Enterprise Institute, May 2010 (http://www.aei.org/files/2010/04/22/EconomicCrisis-2010.pdf), p. 24.

191. "A Message to Washington: Invest in America," editorial, *Detroit Free Press,* December 5, 2008, p. 1.

192. *Examining the State of the Domestic Automobile Industry, Part II: Hearing Before the Senate Committee on Banking, Housing, and Urban Affairs,* 110th Congress (December 4, 2008) (http://www.gpo.gov/fdsys/pkg/CHRG-110shrg50420/pdf/CHRG-110shrg50420.pdf) (remarks of Senator Dodd, pp. 3–4).

193. H.R. 7321, Auto Industry Financing and Restructuring Act, House vote 690, 237 ayes, 205 noes (Democrats: 205 ayes, 20 noes; Republicans: 32 ayes, 150 noes) (https://www.govtrack.us/congress/votes/110-2008/h690).

194. Rattner, *Overhaul,* pp. 36–38; "Congress Clears $700 Billion Bailout of Financial Services Industry," pp. 7–21.

195. David M. Herszenhorn and David E. Sanger, "Senate Abandons Automaker Bailout Bid," *New York Times,* December 11, 2008 (http://www.nytimes.com/2008/12/12/business/12auto.html?pagewanted=all&_r=0); "The Use of TARP Funds in Support and Reorganization of the Domestic Automotive Industry," September 9, 2009 (http://cybercemetery.unt.edu/archive/cop/20110402043042/http://cop.senate.gov/documents/cop-090909-report.pdf), p. 78; Rattner, *Overhaul,* pp. 31, 34.

196. Rattner, *Overhaul,* p. 41; Paulson, *On the Brink*, loc. 6508; Stephen Labaton and David M. Herszenhorn, "White House Ready to Aid Auto Industry," *New York Times,* December 12, 2008 (http://www.nytimes.com/2008/12/13/business/13auto.html?pagewanted=all).

197. Christopher DeMuth and George W. Bush, "A Conversation with President Bush," American Enterprise Institute, Washington, December 18, 2008 (http://aei.org/speech/society-and-culture/free-enterprise/a-conversation-with-president-bush/).

198. George W. Bush, "Remarks on the American Auto Industry," December 19, 2008, American Presidency Project (http://www.presidency.ucsb.edu/ws/?pid=85276).

199. Rattner, *Overhaul*, p. 41.

200. More specifically, GM signed a term sheet on December 31, 2008, that allowed it to draw $4 billion immediately, $5.4 billion on January 16, and $4 billion on February 17 contingent on the release of the last half of the TARP funds. Chrysler signed on January 2, 2009, immediately drawing its $4 billion. COP, "The Use of TARP Funds in Support and Reorganization of the Domestic Automotive Industry," September 9, 2009 (http://cybercemetery.unt.edu/archive/cop/20110402043042/http://cop.senate.gov/documents/cop-090909-report.pdf), pp. 8–9.

201. *Examining the State of the Domestic Automobile Industry*, pp. 9–10, 15. Acting Comptroller General Gene Dodaro also asserted that the Federal Reserve could help the companies by using § 13(3), assuming certain conditions were satisfied.

202. More ambitious constitutional arguments can be and have been made against the general structure of the EESA, as discussed above, but these are not generally auto specific.

203. EESA § 101(a)(1).

204. EESA § 3(9).

205. EESA § 3(5).

206. Lawson, "Burying the Constitution," p. 70.

207. Ibid., 70–71; Todd Zywicki, "The Auto Bailout and the Rule of Law," *National Affairs* 7 (Spring 2011): 72 (http://www.nationalaffairs.com/publications/detail/the-auto-bailout-and-the-rule-of-law); Brent J. Horton, "The TARP Bailout of GM: A Legal, Historical, and Literary Critique," *Texas Review of Law and Politics* 14 (2010): 244–45; Ilya Shapiro and Carl G. DeNigris, "Occupy Pennsylvania Avenue: How the Government's Unconstitutional Actions Hurt the 99%," *Drake Law Review* 60 (2012): 1100.

208. Shah, "Emergency Economic Stabilization Act of 2008," p. 583; Samples, "Lawless Policy," p. 11. See also COP, "The Use of TARP Funds in Support and Reorganization of the Domestic Automotive Industry," pp. 71–73.

209. Vicki Needham, "White House Not Yet Ready to Back Auto Aid," *Roll Call,* December 16, 2008.

210. EESA § 115(a)(2) and (3).

211. Paulson, *On the Brink*, loc. 6102, 6476.

212. Ibid., loc. 6602.

213. Lawrence H. Summers, letter to congressional leaders, January 15, 2009 (http://change.gov/newsroom/entry/letter_from_lawrence_h._summers_to_congressional_leaders/).

214. Neil Irwin and David Cho, "Fed Backs Obama's Bailout Request," *Washington Post,* January 14, 2009 (http://www.washingtonpost.com/wp-dyn/content/article/2009/01/13/AR2009011300861.html).

215. U.S. Senate, "U.S. Senate Roll Call Votes, 111th Congress," Senate Roll Call 5, on S.J.Res. 5, January 15, 2009 (http://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=111&session=1&vote=00005).

Chapter Five

1. This continuity was clearly realized with the Fed's § 13(3) programs, all of which continued without disruption across administrations and many of which were extended as economic conditions remained difficult in 2009. The CPFF was extended in June 2009 and stopped making new loans on February 1, 2010; the AMLF was extended three times and closed on February 1, 2010; the Money Market Investor Funding Facility (MMIFF) was expanded and then extended but nevertheless closed without any activity on October 30, 2009; the PDCF was extended four times and closed February 1, 2010; and the TSLF was expanded and extended four times and closed on February 1, 2010. Federal Reserve, "Credit and Liquidity Programs and Balance Sheet" (http://www.federalreserve.gov/monetarypolicy/bst_lendingother.htm); St. Louis Fed Financial Crisis Timeline (http://timeline.stlouisfed.org/pdf/CrisisTimeline.pdf).

2. Steven Rattner, *Overhaul: An Insider's Account of the Obama Administration's Emergency Rescue of the Auto Industry* (New York: Mariner Books, 2010), pp. 43–44.

3. Ibid., pp. 59–61.

4. Mitt Romney, "Let Detroit Go Bankrupt," *New York Times*, November 18, 2008 (http://www.nytimes.com/2008/11/19/opinion/19romney.html).

5. Chrysler asked for an additional $5 billion and GM for $16.6 billion. Government Accountability Office (GAO), "Summary of Government Efforts and Automakers' Restructuring to Date," GAO-09-553, April 23, 2009 (http://www.gao.gov/assets/290/288835.pdf), p. 12.

6. Rattner, *Overhaul,* pp. 120–24; Ryan Lizza, "Inside the Crisis," *New Yorker,* October 12, 2009 (http://www.newyorker.com/reporting/2009/10/12/091012fa_fact_lizza).

7. Barack Obama, "Remarks on the United States Automobile Industry," March 30, 2009, American Presidency Project (http://www.presidency.ucsb.edu/ws/?pid=85927).

8. GAO, "Summary of Government Efforts and Automakers' Restructuring to Date," p. 13.

9. Obama, "Remarks on the United States Automobile Industry," March 30, 2009. The Warranty Commitment Program, as it was officially known, would work through a special-purpose company funded by contributions from GM, Chrysler, and the AIFP; see GAO, "Summary of Government Efforts and Automakers' Restructuring to Date," p. 14.

10. U.S. Department of the Treasury, "Treasury Announces Auto Supplier Support Program," press release, March 19, 2009 (http://www.treasury.gov/press-center/press-releases/Pages/tg64.aspx). Only $413 million would ever be loaned out, and little fuss was made over the program, with the lone exception of Senator Bob Corker, who felt that the funding broke a promise made to him that no additional funds would go out without restructuring. Rattner, *Overhaul,* pp. 126–27.

11. According to Rattner, the administration briefly considered the possibility of seeking new speed-bankruptcy legislation that would have smoothed out the legal process, but ultimately it decided not to bother because of the certainty of delay in Congress, the possibility of defeat, and the constitutional challenges on Fifth Amendment grounds that the new process might have to work through. Rattner, *Overhaul,* p. 107.

12. Barack Obama, "Remarks on the United States Automobile Industry," April 30, 2009, American Presidency Project (http://www.presidency.ucsb.edu/ws/?pid=86081).

13. Barack Obama, "Remarks on General Motors Restructuring," June 1, 2009 (http://www.whitehouse.gov/the_press_office/Remarks-by-the-President-on-General-Motors-Restructuring/).

14. Congressional Oversight Panel (COP), "The Use of TARP Funds in Support and Reorganization of the Domestic Automotive Industry," September 9, 2009 (http://cybercemetery.unt.edu/archive/cop/20110402043042/http://cop.senate.gov/documents/cop-090909-report.pdf), summary chart for Chrysler, pp. 27–28; summary chart for GM, p. 31.

15. Rattner, *Overhaul,* p. 125.

16. Ibid., p. 60.

17. Neil King Jr. and Jeffrey McCracken, "U.S. Forced Chrysler's Creditors to Blink," *Wall Street Journal*, May 11, 2009 (http://online.wsj.com/news/articles/SB124199948894005017).

18. Obama, "Remarks on the United States Automobile Industry," April 30, 2009.

19. COP, "The Use of TARP Funds in Support and Reorganization of the Domestic Automotive Industry," pp. 24–25.

20. In the unlikely event that the retiree health trust's equity turned out to be more than sufficient to repay the original debt, the overage would go to the Treasury, but this did ultimately not occur. Rattner, *Overhaul,* p. 154.

21. Ibid., p. 159.

22. King and McCracken, "U.S. Forced Chrysler's Creditors to Blink." Rattner, *Overhaul,* p. 149–50, renders this quotation, which he attributes to Ron Bloom, as "I need workers to make cars, but I don't need lenders."

23. Stephen Lubben, "Chrysler & Credit Bidding," *Credit Slips* (blog), May 7, 2009 (http://www.creditslips.org/creditslips/2009/05/chrysler-credit-bidding.html); Todd Zywicki, "The Auto Bailout and the Rule of Law," *National Affairs* 7 (Spring 2011): 75 (http://www.nationalaffairs.com/publications/detail/the-auto-bailout-and-the-rule-of-law).

24. Richard A. Epstein, "The Deadly Sins of the Chrysler Bankruptcy," *Forbes*, May 12, 2009 (http://www.forbes.com/2009/05/11/chrysler-bankruptcy-mortgage-opinions-columnists-epstein.html).

25. Todd Zywicki, "Chrysler and the Rule of Law," *Wall Street Journal*, May 13, 2009 (http://online.wsj.com/news/articles/SB124217356836613091?mg=reno64-wsj&url=http%3A%2F%2Fonline.wsj.com%2Farticle%2FSB124217356836613091.html).

26. Mark J. Roe, "Stress-Testing Washington's Chrysler Bankruptcy Plan," *Forbes*, May 13, 2009 (http://www.forbes.com/2009/05/12/buffett-treasury-bankruptcy-opinions-contributors-chrysler.html).

27. Key articles in this debate include Mark J. Roe and David A. Skeel, "Assessing the Chrysler Bankruptcy," *Michigan Law Review* 108 (2010): 727–72; Barry E. Adler, "A Reassessment of Bankruptcy Reorganization after Chrysler and General Motors," *American Bankruptcy Institute Law Review* 18 (2010): 305–18; and Stephen J. Lubben, "No Big Deal: The GM and Chrysler Cases in Context," *American Bankruptcy Law Journal* 83 (2009): 531–48.

28. Eric Bradner, "Inside Mourdock's Chrysler Battle," *Evansville Courier and Press,* October 7, 2012 (http://www.courierpress.com/news/2012/oct/07/inside-mourdocks-chrysler-battle/).

29. *In re Chrysler LLC, et al., Debtor*, 405 B.R. 84, 96–99, 101–02 (2009).

30. *In re Chrysler LLC, et al., Debtor*, 576 F.3d 108, 121–23 (2d. Cir. 2009). The court found that the Indiana pensioners suffered no injury in fact from the Treasury's involvement.

31. *Indiana State Police Pension Trust* v. *Chrysler LLC*, 129 S.Ct. 2275 (2009).

32. Michael de la Merced and Micheline Maynard, "Fiat Deal with Chrysler Seals Swift 42-Day Overhaul," *New York Times*, June 10, 2009 (http://www.nytimes.com/2009/06/11/business/global/11chrysler.html).

33. *Indiana State Police Pension Trust* v. *Chrysler LLC*, 130 S.Ct. 1015 (2009).

34. Fred N. David, "Interpreting the Supreme Court's Treatment of the Chrysler Bankruptcy and Its Impact on Future Business Reorganization," *Emory Bankruptcy Developments Journal* 27 (2011): 25–70. This article is the source of the "short, cryptic" quotation in the preceding sentence, at p. 39.

35. Zywicki, "The Auto Bailout and the Rule of Law," p. 76.

36. COP, "The Use of TARP Funds in Support and Reorganization of the Domestic Automotive Industry," p. 28–31.

37. Ralph Nader and Robert Weissman, "Obama's GM Plan Looks Like a Raw Deal," *Wall Street Journal*, May 29, 2009 (http://online.wsj.com/news/articles/SB124355327992064463).

38. Alex Nishimoto, "Rattner Says UAW Wages Should Have Been Cut during Bailouts," *Motor Trend*, December 16, 2011 (http://wot.motortrend.com/rattner-says-uaw-wages-should-have-been-cut-during-bailouts-147425.html).

39. Delphi was spun off from GM in 1999, at which time GM agreed with three unions to guarantee certain pension levels for Delphi retirees in the event of Delphi's failure. Delphi filed for bankruptcy in 2005; the PBGC assumed trusteeship of its pension plans in 2009 and then decided that promised payments would be cut. At that point, New GM chose to honor the agreements with the unions that Old GM had made with no resistance from the Auto Task Force—once again angering those who felt that union workers' claims were effectively being wrongly prioritized over other creditors at the new incarnation of the firm. GAO, "Delphi Pension Plans: GM Agreements with Unions Give Rise to Unique Differences in Participant Benefits," GAO-12-168 (http://www.gao.gov/assets/590/587045.pdf), pp. 28–32; *Testimony Before the Subcommittee on Government Operations: Delphi Pensions: Key Events Leading to Plan Terminations,* House Committee on Oversight and Government Reform, GAO-13-854T, September 11, 2013 (http://www.gao.gov/assets/660/657739.pdf); Special Inspector General for TARP (SIGTARP), "Treasury's Role in the Decision for GM To Provide Pension Payments to Delphi Employees," SIGTARP 13-003, August 15, 2013 (http://www.sigtarp.gov/Audit%20Reports/SIGTARP_Delphi_Report.pdf), pp. 22–26.

40. *In re General Motors Corp.*, 407 B.R. 463, 475 (Bankr. S.D.N.Y. 2009).

41. Joseph Checkler, "Creditor Lawsuit Could Undo Elements of 2009 GM Bailout," *Wall Street Journal*, September 27, 2012 (http://blogs.wsj.com/deals/2012/09/27/creditor-lawsuit-could-undo-elements-of-2009-gm-bailout/).

42. James Sherk and Todd Zywicki, "Auto Bailout or UAW Bailout? Taxpayer Losses Came from Subsidizing Union Compensation," *Heritage Foundation Backgrounder,* no. 2700, June 13, 2012 (http://www.heritage.org/research/reports/2012/06/auto-bailout-or-uaw-bailout-taxpayer-losses-came-from-subsidizing-union-compensation).

43. Karlyn Bowman, "TARP, the Auto Bailout, and the Stimulus: Attitudes about the Economic Crisis," AEI Public Opinion Studies, May 2010, American Enterprise Institute (http://www.aei.org/files/2010/04/22/EconomicCrisis-2010.pdf), pp. 24–27; Dennis Jacobe, "Republicans, Democrats Differ over U.S. Automaker Bailout," Gallup Economy, February 23, 2012 (http://www.gallup.com/poll/152936/Republicans-Democrats-Differ-Automaker-Bailout.aspx).

44. COP, "The Use of TARP Funds in Support and Reorganization of the Domestic Automotive Industry," pp. 51–52. Far less charitably, one observer has characterized the outmaneuvered senior creditors' complaints as "whinging and apocalyptic fear-mongering": "More of a Kickin' Sitcheyation," *Epicurean Dealmaker* (blog), May 11, 2009 (http://epicureandealmaker.blogspot.com/2009/05/more-of-kickin-sitcheyation.html).

45. Mark J. Roe, "Stress-Testing Washington's Chrysler Bankruptcy Plan." On UAW worker compensation, see David Leonhardt, "$73 an Hour: Adding It Up," *New York Times*, December 9, 2008 (http://www.nytimes.com/2008/12/10/business/economy/10leonhardt.html).

46. Roe and Skeel, "Assessing the Chrysler Bankruptcy," pp. 758–59.

47. Lubben, "No Big Deal," pp. 546–47.

48. Rattner, *Overhaul,* p. 230.

49. Brent J. Horton, "The TARP Bailout of GM: A Legal, Historical, and Literary Critique," *Texas Review of Law and Politics* 14 (2010): 246. The citation Horton offers establishes nothing of the sort.

50. Barack Obama, "Remarks to the United Auto Workers Convention," February 28, 2012, American Presidency Project (http://www.presidency.ucsb.edu/ws/?pid=99722).

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52. Obama, "Remarks on the United States Automobile Industry," March 30, 2009.

53. Rattner, *Overhaul,* pp. 134–39.

54. Sheryl Gay Stolberg and Bill Vlasic, "U.S. Lays Down Terms for Auto Bailout," *New York Times*, March 30, 2009 (http://www.nytimes.com/2009/03/30/business/30auto.html?pagewanted=all).

55. For example, Malcolm Gladwell, "Overdrive," *New Yorker*, November 1, 2010 (http://www.newyorker.com/arts/critics/books/2010/11/01/101101crbo_books_gladwell).

56. Rattner, *Overhaul,* pp. 91, 111, 184–85, 252–53; Jonathan Alter, *The Promise: President Obama, Year One* (New York: Simon and Schuster, 2010), p. 176.

57. Alter, *The Promise,* p. 183.

58. Ibid., p. 184; Rattner, *Overhaul,* pp. 219–20.

59. Tomoeh Murakami Tse and Peter Whoriskey, "U.S. Involvement in GM Won't End with Bankruptcy," *Washington Post,* May 28, 2009 (http://www.washingtonpost.com/wp-dyn/content/article/2009/05/27/AR2009052701275.html).

60. "Kicking the Tires on the General Motors Deal," *Washington Post*, June 3, 2009 (http://articles.washingtonpost.com/2009-06-03/news/36809244_1_uaw-workers-uaw-fund-gm-cars).

61. Rattner, *Overhaul,* pp. 237–39.

62. Ibid., pp. 246–47.

63. "Barney Frank, Car Czar," *Wall Street Journal*, June 5, 2009 (http://online.wsj.com/news/articles/SB124416281882387463); Sharon Silke Carty, "National Summit: Government's GM help comes with strings," *USA Today*, June 17, 2009 (http://abcnews.go.com/Business/story?id=7867867).

64. For example, Montana's senators and representative apparently dissuaded GM from importing its palladium, convincing the firm to keep using a more expensive supplier in their state. Neil King Jr., "Politicians Butt In at Bailed-Out GM," *Wall Street Journal,* October 30, 2009 (http://online.wsj.com/news/articles/SB125677552001414699).

65. Horton, "The TARP Bailout of GM," p. 248.

66. Jonathan Alter very sloppily attributed the fuel efficiency standards' timing to Obama "ha[ving] his foot on [the auto companies'] necks" and in a footnote claims it is ludicrous to imagine that the Auto Team was not somehow responsible for their release. But this (admiring, rather than critical) implication of a power play is totally unsupported. Alter, *The Promise,* p. 182.

67. King, "Politicians Butt In."

68. Rattner, *Overhaul,* pp. 247–48; SIGTARP, "Factors Affecting the Decisions of General Motors and Chrysler to Reduce Their Dealership Networks," SIGTARP 10-008, July 19, 2010 (http://www.sigtarp.gov/Audit%20Reports/Factors%20Affecting%20the%20Decisions%20of%20General%20Motors%20and%20Chrysler%20to%20Reduce%20Their%20Dealership%20Networks%207_19_2010.pdf), pp. 6–15.

69. SIGTARP, "Factors Affecting the Decisions of General Motors and Chrysler to Reduce Their Dealership Networks," pp. 25–33.

70. Rattner, *Overhaul,* p. 291. The legislation was included as a part of a Consolidated Appropriations Act including Transportation, H.R. 3266, 111th Congress (enrolled December 13, 2009), which passed fairly comfortably 256-168 in the House and 73-25 in the Senate, with the vast majority of Democrats supporting (http://www.cq.com/doc/billtext-3267038?wr=Nng4dW84NzhVdzB5TE9iSUVoayozQQ; http://clerk.house.gov/evs/2009/roll637.xml; http://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=111&session=1&vote=00287#position).

71. George F. Will, "Obama's State Capitalism," *Washington Post,* August 23, 2009 (http://articles.washingtonpost.com/2009-08-23/opinions/36930254_1_state-capitalism-energy-costs-legislation). For a more recent example, see Todd Zywicki, "The Corporatist Legacy of the Auto Bailouts," *Liberty Law Blog*, January 13, 2014 (http://www.libertylawsite.org/2014/01/13/the-corporatist-legacy-of-the-auto-bailouts).

72. Rattner, *Overhaul,* pp. 241, 278, 292–93; Bill Vlasic and Anne Lowrey, “U.S. Ends Bailout of G.M., Selling Last Shares of Stock,” DealBook, *New York Times*, December 9, 2013 (http://dealbook.nytimes.com/2013/12/09/u-s-sells-remaining-stake-in-gm/?smid=tw-share&_r=0).

73. William K. Sjostrom Jr., “The AIG Bailout,” *Washington and Lee Law Review* 66 (2009): 972.

74. Ibid., pp. 973–74; COP, “The AIG Rescue, Its Impact on Markets, and the Government’s Exit Strategy,” June 10, 2010 (http://cybercemetery.unt.edu/archive/cop/20110401232818/http://cop.senate.gov/documents/cop-061010-report.pdf), pp. 94–97.

75. Henry Paulson, *On the Brink: Inside the Race to Stop the Collapse of the Global Financial Crisis* (New York: Hachette Book Group, 2010), Kindle edition, locs. 4255, 4365.

76. Amit Paley, “Executive Pay Limits May Prove Toothless,” *Washington Post*, December 15, 2008 (http://articles.washingtonpost.com/2008-12-15/politics/36889501_1_executive-compensation-executive-compensation-top-executives).

77. American Recovery and Reinvestment Act of 2009, Public Law 111-5 (http://www.gpo.gov/fdsys/pkg/BILLS-111hr1enr/pdf/BILLS-111hr1enr.pdf), Title VII.

78. Section 111(b)(3)(D) of amended TARP; for a detailed analysis, see Joseph E. Bachelder III, “Executive Compensation under TARP,” *Forum on Corporate Governance and Financial Regulation* (blog), Harvard Law School, April 28, 2009 (http://blogs.law.harvard.edu/corpgov/2009/04/28/executive-compensation-under-tarp/); Sarah H. Burghart, “Overcompensating Much? The Impact of Preemption on Emerging Federal and State Efforts to Limit Executive Compensation,” *Columbia Business Law Review* 2009 (2009): 681–90.

79. Section 111(g) of amended TARP; see also McDermott, Will, and Emery, “American Recovery and Reinvestment Act of 2009 Expands Executive Compensation Restrictions for TARP Recipients,” February 18, 2009 (http://www.mwe.com/info/news/wp0209c.pdf).

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