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Governmental Intervention in an Economic Crisis

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Abstract

This paper articulates a framework both for assessing the various government bailouts that took place at the onset of Great Recession and for guiding future rescue efforts when they become necessary. The goals for those engineering a bailout should be to be as transparent as possible, to articulate clearly the reason for the intervention, to respect existing priorities among investors, to exercise control only at the top level where such efforts can be seen by the public, and to exit as soon as possible. By these metrics, some of the recent bailouts should be applauded, while others fell short. We also explore the related question of what level of judicial scrutiny is appropriate for government actions taken during a bailout. We eschew the extremes of no judicial review on the one hand and full recourse to the courts on the other. Courts need to avoid interfering in a time of crisis, yet, when normalcy has returned, they should measure the actions taken against applicable legislative and constitutional requirements.

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Robert K. Rasmussen‡ & David A. Skeel, Jr.‡

Introduction

Optimists about the efficacy of the 2010 financial reforms, known as the Dodd-Frank Act, sometimes claim that the reforms have permanently ended bailouts.[1] Pessimists retort that the Dodd-Frank Act didn't end bailouts at all — some insisting it actually enshrines them in law — and that bailouts could truly be ended if lawmakers rolled back the legislation and enacted a different set of reforms.[2] The two camps find common ground in the belief that, with the right set of government policies, bailouts will be a thing of the past.

We reject such aspirations as both fanciful and destructive. We count ourselves among the bailout realists who believe that bailouts could never be eliminated unless lawmakers banned debt finance and required banks and other firms to finance themselves entirely with equity.[3] In this country, at least, debt will always be with us and so too will the prospect of bailouts. It may be possible to make bailouts less likely, but we cannot make them disappear altogether.

Despite the unrealistic claims made by both sides, the debate between Dodd-Frank optimists and pessimists has raised two important questions that are relevant not just to financial institutions, but also to government intervention in an economic crisis generally. First, and most basic, what exactly is a bailout? The term seems intuitive, but it is used in very different ways in both the public press and the academic literature. For example, the recent attempt to tar the

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[1] For instance, when he signed the Dodd-Frank Act into law, President Obama proclaimed that the reforms had ended taxpayer-funded bailouts forever. President Barack Obama, Remarks by the President at Signing of Dodd-Frank Wall Street Reform and Consumer Protection Act (July 21, 2010) (transcript available at https://www.whitehouse.gov/the-press-office/remarks-president-signing-dodd-frank-wall-street-reform-and-consumer-protection-act). A former Federal Reserve governor recently made a similar claim. Alan Blinder, Why Trump, the 'King of Debt,' Hates Dodd-Frank, **Wall St. J.** (June 6, 2016), http://www.wsj.com/articles/why-trump-the-king-of-debt-hates-dodd-frank-1465254435.

[2] See, e.g., Peter J. Wallison, Letter to the Editor, Dodd-Frank Hasn't Eliminated TBTF Banks, **Wall St. J.** (June 14, 2016), http://www.wsj.com/articles/dodd-frank-hasnt-eliminated-tbtf-banks-1465937932 ("[T]he only recourse [when faced with a failing trillion-dollar bank] under Dodd-Frank is a taxpayer bailout."); Representative Jeb Hensarling, Remarks of Chairman Jeb Hensarling to the Economic Club of New York As Prepared for Delivery (June 7, 2016) (transcript available at http://financialservices.house.gov/uploadedfiles/hensarling_ny_econ_club_speech_june_7_2016.pdf)("Dodd-Frank codified into law Too Big to Fail and taxpayer-funded bailouts").

[3] Such a ban would have to extend to all promises to pay money in the future, and this would sweep defined benefit pension plans within its orbit, at least where such plans are not fully funded in advance. Indeed, the financial distress that afflicts many cities and states today has been caused in large part by unfunded promises to pay retirement benefits. See, e.g., Robert Novy-Max & Joshua D. Rauh, The Liabilities and Risks of State-Sponsored Pension Plans, 23 **J. Econ. Persp.** 191, 204 (2009)(estimating underfunded pension obligations at $3 trillion).

Puerto Rico debt adjustment scheme as a bailout attempted to label legislation one group of investors did not like as a bailout, regardless of whether there is a plausible case to invoke that term.[4] Second, if bailouts have not been eliminated, how should they be managed? When should the government intervene, what are the ground rules for effective intervention, and when should the government exit the scene? Rather than engaging in the snipe hunt of eliminating all possibility of a bailout, we should work to reduce bailouts to the lowest level practical and embrace principles to guide the inevitable bailouts that will occur.

The first question, what-is-a-bailout, turns out to be a key point of contention in the Dodd-Frank debate, although the debate usually is not framed in these terms. Title II, the Dodd-Frank Act's resolution provisions, gives regulators a vast source of U.S. Treasury funding to finance the resolution of troubled, systemically important financial institutions.[5] For many Dodd-Frank pessimists, this automatic (or nearly automatic) governmental funding is a bailout, plain and simple. Not so fast, say the optimists. If the resolution works as intended, the troubled institution will repay the government in full and American taxpayers will be entirely unharmed. And if the institution cannot repay what it owes, the Dodd-Frank Act requires that the difference be collected through an assessment on other large financial institutions, thus sparing the general fisc.[6]

These two perspectives reflect different conceptions of what constitutes a bailout.[7] The Dodd-Frank pessimists tend to assume that, any time the government steps in with funding and does not let the market run its course, it has provided a bailout. The optimists assume that, if the government is acting solely as a lender of last resort and honors traditional lender of last resort principles, its funding does not constitute a bailout. According to the classic test, which is associated with nineteenth century economic journalist Walter Bagehot, the lender of last resort should lend money if the institution is illiquid, but not if it is insolvent.[8] To solve a liquidity crisis, Bagehot argued, the lender of last resort should provide large amounts of funding, but should obtain enough collateral to fully secure the loan and should charge a high interest rate to ensure the institution has an incentive to repay the loan promptly.[9] If things go as planned, the lender eliminates the crisis at no long-term cost to the taxpayer.

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[4] See Jonathan Mahler & Nicholas Confessore, Inside the Billion-Dollar Battle for Puerto Rico's Future, **N.Y. Times** (Dec. 19, 2015), http://www.nytimes.com/2015/12/20/us/politics/puerto-rico-money-debt.html (noting that hedge funds had mobilized opposition to Puerto Rico's debt restructuring plan by casting it as a taxpayer-funded bailout).

[5] See Dodd-Frank Wall Street Reform and Consumer Protection Act § 210(n), 12 U.S.C. § 5390(n) (2016) (effective Oct. 8, 2016) (permitting the FDIC to borrow 10% of the pre-resolution value of a financial institution placed in receivership under Title II, and ninety percent of its post-intervention value).

[6] Dodd-Frank Act § 210(o).

[7] The arguments of a more sophisticated version of bailout pessimism reflect a conception of bailouts that is closer to the optimists' view. Sophisticated pessimists argue that regulators may fail to recoup losses from the other firms in the industry, and that even if they do, the assessments are an indirect tax.

[8] Anthony J. Casey & Eric A. Posner, A Framework for Bailout Regulation, 91 **Notre Dame L. Rev.** 479, 522 (2015) (citing **Walter Bagehot**, **Lombard Street: A Description of the Money Market** 188-89 (Hartley Withers ed., E. P. Dutton & Co. 1920)).

[9] Id.

Although we find the Bagehot test persuasive, it is notoriously difficult to distinguish between insolvency and illiquidity in the heat of the moment, and pure liquidity crises are uncommon. We will therefore use a somewhat broader definition of bailout, a conception that is closer to pessimists' view in practice. If the government provides funding, and this funding protects creditors or shareholders from losses that they would otherwise suffer, we will call the intervention a bailout, regardless of whether the government actually loses any money in the effort.[10] This definition is much easier to apply than the liquidity/insolvency distinction and focuses more directly on the principal concern with bailouts: the risk that investors will lend too cheaply and will fail to monitor the institution if they expect to be bailed out in a crisis.[11]

Under our definition of what constitutes a bailout, most of the government's interventions in 2008 and 2009 were bailouts. Some were good bailouts and others were bad,[12] but nearly all were bailouts of one flavor or another. The government stepped in, put money on the table, and prevented losses to some, if not all, of the investors of the bailed out entity.

By contrast, and contrary to the vehement claims of hedge funds that hold Puerto Rico debt, enacting a bankruptcy-like restructuring framework for Puerto Rico and its municipalities was not a bailout. If the framework (or the voluntary debt adjustment provisions in the legislation) is used, Puerto Rico's creditors will bear losses. The restructuring framework is in some respects precisely the opposite of a bailout, since it may reduce the pressure for Congress to provide a genuine bailout. Indeed, failing to give Puerto Rico a debt restructuring option would have made it more likely that the federal government would have had to inject funds into the Commonwealth to prevent a complete collapse.[13] The desire for a true bailout appears to have been the principal reason some bondholders tried to thwart the restructuring law by calling it a bailout.

If future bailouts are inevitable, as we and many others believe, the second question raised by the recent debate — how best to manage bailouts — becomes critically important. A bailout is like a military or rescue operation. When a crisis looms, the government needs to determine whether to intervene, how to structure its bailout investment, how to manage the investment, and when to exit. Things are likely to go better if there is agreement on broad

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[10] For a similar definition, see id. at 481, stating that a "bailout occurs when the government makes payments (including loans, loan guarantees, cash, and other types of consideration) to a liquidity-constrained private agent in order to enable that agent to pay its creditors and counterparties, when the agent is not entitled to those payments under a statutory scheme."

[11] From this perspective, it remains debatable whether the Title II resolution will lead to bailouts. Under the single point of entry approach, which the Federal Deposit Insurance Corporation has signaled that it intends to use, derivatives and other short-term debt will be protected, whereas bond debt will be restructured. Federal Deposit Insurance Corporation, The Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 **Fed. Reg.** 76614 (Dec. 18, 2013). In a sense, the short-term debt will be bailed out. But if the FDIC fully commits to this treatment in advance, the approach gives a pre-defined priority to short term debt and is not necessarily a bailout.

[12] A view we will define later. See infra Part II(A).

[13] One of us has argued that restructuring debt, standing alone, is probably not sufficient to solve the territory's woes. See Robert K. Rasmussen, Puerto Rico: Of Capital Structures, Control Rights and Liquidity, 11 **Cap. Mkts. L.J.** 228, 243 (2016) (suggesting that structural changes such as the development and enforcement of pro-growth policies are necessary as well).

principles in advance rather than an assiduous effort to deny the risks of future bailouts until they are actually upon us.

In this article, we focus on the management question and consider the full range of bailout management issues. Quite surprisingly in our view, this Article seems to be one of the first to do so. The debate between Dodd-Frank optimists and pessimists considers many of these issues in the context of resolution under the Dodd-Frank Act's resolution rules, but it has less to say about bailouts outside of that context. Scholars have addressed particular features of governmental intervention, such as the potential distortions introduced by government control, more extensively.[14] But they have not offered a full account of government intervention.[15]

In our effort to fill this gap, we divide the bailout process into three general stages: the decision to intervene, the implementation of the bailout, and the exit. With the initial bailout decision, we argue that political accountability is the key feature, which requires that the bailout be transparent and that the government articulate the reasons for intervening. By this yardstick, the $700 billion TARP legislation in 2008 was successful, and the car company bailouts less so. At the implementation stage, we argue that the government should honor investors' priorities to the extent possible, and we propose a simple, transparency-based standard for distinguishing between legitimate and illegitimate exercise of governmental control. Although forcing an executive to step down may seem heavy-handed, it is transparent and consistent with the power wielded by private lenders in other contexts, and therefore should be in the government toolbox. Intervention in a company's operations, by contrast, is far less transparent and therefore should be viewed as illegitimate. With exit, we argue that the government should begin easing out of its investment as soon as conditions stabilize, since the primary objective of a bailout is containment.

Given the extraordinary nature of bailouts, it is of course always possible that regulators will intervene in problematic ways, even if the bailout is otherwise defensible. On multiple occasions, the 2008 and 2009 bailouts seemed to take liberties with existing law. This raises the question of whether government intervention should be subject to judicial review. We argue that it should, but that the scope of review should be considerably narrower than it is for transactions between private parties in order to minimize interference with emergency interventions.[16] It is

[14] See generally, e.g., Marcel Kahan & Edward Rock, When the Government is the Controlling Shareholder: Implications for Delaware, 35 **Del. J. Corp. L.** 409 (2010) (discussing the implications of sovereign immunity on Delaware law); Matthew R. Shahabian, Note, The Government as Shareholder and Political Risk: Procedural Protections in the Bailout, 86 **N.Y.U. L. Rev.** 351 (2011) (discussing the political risks for shareholders emanating from the government's status as a major shareholder of firms); J.W. Verret, The Bailout Through a Public Choice Lens: Government-Controlled Corporations as a Mechanism for Rent Transfer, 40 **Seton Hall L. Rev.** 1521 (2010)[hereinafter Verret, Government-Controlled Corporations] (arguing that the government, in its capacity as a shareholder, will be able to put political pressure on firms to cater to political constituencies); J.W. Verret, Treasury Inc.: How the Bailout Reshapes Corporate Theory and Practice, 27 **Yale J. Reg.** 283 (2010)[hereinafter Verret, Treasury Inc.] (arguing that the Troubled Asset Relief Program (TARP) bailout and government shareholding will reshape many facets of the practice of corporate law).

[15] But see Casey & Posner, supra note 8 at 481 (offering a relatively complete account, though focusing primarily on the threshold decision whether to effect a bailout and less on its implementation).

[16] David Zaring recently reached a similar conclusion about the need for review. See David Zaring, Litigating the Financial Crisis, 100 **Va. L. Rev.** 1405, 1431-32 (2014) (advocating for judicial review of government emergency actions in light of standing issues and emergency limitations not equally applicable in private litigation).

essential that courts identify deviations from existing law, however, even if they ultimately conclude that liability is not appropriate. Judicial candor can reduce the risk that extraordinary governmental interventions will distort the legal framework that applies to similar transactions in more ordinary circumstances. By this yardstick, courts' performance during and after the crisis has been quite mixed.

This article proceeds as follows. In Part I, we briefly review the major governmental interventions in 2008 and 2009, and identify some of the apparent departures from ordinary law in the transactions that the government arranged. In Part II, we develop our framework for well-designed governmental intervention. In Part III, we consider the appropriate scope of judicial review of bailouts. We briefly sum up in the conclusion.

I. The Government's Role in 2008 and 2009

Nearly a decade after the 2008 crisis, the government's intervention remains almost as contested and controversial as it was at the time. Much of the debate centers on the question of when, if ever, it is appropriate for the government to provide rescue financing to major institutions during a financial crisis, and we too will devote considerable attention to this issue. But there is another, closely-related issue as well: to what extent should government intervention be constrained by existing law? Several of the biggest bailouts of 2008 and 2009 seemed to take liberties with the laws that applied to the transactions in question. Is this simply inevitable, or should the government's actions be subject to challenge during or after a crisis?

We begin this part by briefly describing the debate over the 2008 and 2009 bailouts. We then note the questionable features of several of the key interventions, and the efforts by interested parties to challenge the transactions. Our objective at this point is primarily descriptive. We will offer a normative perspective on the issues in the parts that follow.

A. The Bailout Debate

A little less than a year after the first tremors of the financial crisis began, bank regulators bailed out the investment bank Bear Stearns in March 2008, providing a $29 billion guarantee to facilitate Bear's sale to JPMorgan Chase.[17] In August 2008, the U.S. Treasury took over Fannie Mae and Freddie Mac, eventually giving them $187.5 billion of rescue financing and putting them in conservatorship pursuant to legislation that had been enacted several weeks earlier.[18] Several days after letting Lehman Brothers file for bankruptcy on September 15, 2008, the Federal Reserve bailed out AIG.[19] In October 2008, Congress passed the TARP legislation,

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[17] For a brief case study of the Bear Stearns bailout, see David A. Skeel, Jr., Governance in the Ruins, 122 **Harv. L. Rev.** 696, 733-42 (2008) (reviewing **Curtis J. Milhaupt & Katharina Pistor**, **Law and Capitalism** (2008)). This and the other governmental interventions are chronicled in the many books that came out of the crisis, the best known of which is **Andrew Ross Sorkin, Too Big to Fail: The Inside Story of How Wall Street and Washington Fought to Save the Financial System—and Themselves** (2009).

[18] Housing and Economic Recovery Act of 2008 (HERA), Pub. L. No. 110-289, 122 Stat. 2654 (codified as amended in scattered sections of 12 U.S.C.A.).

[19] For more information, see generally William K. Sjostrom, Jr., Afterward to the AIG Bailout, 72 **Wash. & Lee L. Rev.** 795 (2015) (describing the United States Federal Government's bailout of AIG, further recapitalization restructuring, and the government's shareholder role and return on the AIG Bailout).

which provided $700 billion of rescue funding, more than $200 billion of which was later injected into the largest banks.[20] The U.S. Treasury also used TARP money for the General Motors and Chrysler bailouts, lending more than $64 billion to them ($49.5 billion to GM and $14.9 billion to Chrysler) before and during the carmakers' bankruptcy cases.[21] As a result of these interventions, the government acquired major equity stakes in Fannie Mae, Freddy Mac, AIG, General Motors, Chrysler, and Citigroup, as well as smaller preferred stock stakes in the other banks that took TARP money.[22] Although Fannie Mae and Freddy Mac are still under government control, the government has sold its stakes in AIG, General Motors, Chrysler and Citigroup, and the TARP banks have repaid the government.[23]

Since the crisis, two broad narratives about the government's interventions have emerged. The first excoriates the bailouts, insisting that the Bush and Obama administrations propped up giant financial institutions that did not deserve to be rescued. Many of these critics, especially those on the left, point out that home owners whose mortgages were underwater wanted help too, but for the most part did not get it.[24] The second narrative applauds the government response to the crisis. According to this narrative, bailouts are sometimes necessary, and in this case, they saved America's economy from a far greater collapse — possibly even a second Great Depression.[25]

Most Americans do not hold to either narrative in its pure form. For populists on the left, the bank bailouts were indefensible, but the bailouts of General Motors and Chrysler enlightened policymaking. During the recent presidential campaign, Senator Sanders was at pains to make this distinction when he was criticized for opposing the TARP legislation, which provided the funds used in the car bailouts.[26] Sanders insisted that he favored the car bailouts, but that he opposed TARP because it would be used to rescue the largest banks.[27]

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20 See Verret, Government-Controlled Corporations, supra note 14, at 1523-24 (describing the allocation of TARP funds).

21 See Verret, Treasury Inc., supra note 14, at 295 (2010) (citing **Office of the Special Inspector Gen. for the Troubled Asset Relief Program**, **Quarterly Report to Congress** 94 (July 21, 2009)). The Treasury also provided $13.4 billion to GMAC, which was GM's auto loan business prior to being spun off, and $1.5 billion to Chrysler Financial. Id.

22 See, e.g., Steven M. Davidoff, Uncomfortable Embrace: Federal Corporate Ownership in the Midst of the Financial Crisis, 95 **Minn. L. Rev.** 1733, 1755 (2011) (noting that the government ultimately invested in seven hundred and seven financial institutions, acquiring nonconvertible preferred securities).

23 See Jeffrey Spartshott and Erik Holm, End of a Bailout: U.S. Sells Last AIG Shares, Wall Str. J. (Dec. 11, 2012), available at http://www.wsj.com/articles/SB10001424127887323339704578172960483282372; Jim Henry, U.S. Treasury Sells Ally Financial Stake; No More Government Motors, Forbes (Dec. 31, 2014), available at http://www.forbes.com/sites/jimhenry/2014/12/31/u-s-treasury-sells-ally-financial-stake-no-more-government-motors/#f8ddd6d50c0c; Nick Bunkly, Government Sells Stake in Chrysler, NY Times (July 21, 2011), available at http://www.nytimes.com/2011/07/22/business/us-sheds-its-stake-in-chrysler.html?_r=0; Randall Smith, et al., U.S. Unloads Citi Stake for a $12 Billion Profit, Wall Str. J. (Dec. 7, 2010), available at http://www.wsj.com/articles/SB10001424052748704156304576003884177348202; Pro Publica, Bailout Tracker; Bailout Recipients, available at https://projects.propublica.org/bailout/list.

24 See, e.g., Thomas Frank, Interview of Elizabeth Warren, **Salon**(Oct. 12, 2014)("They protected Wall Street. Not families who were losing their homes.").

25 This narrative is the central theme of **David Wessel**, **In Fed We Trust: Ben Bernanke's War on the Great Panic** (2009).

26 See George Zornick, Democrats Who Voted Against TARP Funds Say it Wasn't About the Auto Bailouts, **The Nation** (March 8, 2016), https://www.thenation.com/article/democrats-who-voted-against-tarp-funds-say-it-wasnt-about-the-auto-bailouts/(describing Sanders as insisting that "his vote against releasing the TARP funds was based

Although defenders of the government's interventions tend to praise both the bank and the car bailouts, they often acknowledge that the government made a substantial mistake or two along the way. The most common criticism is that the government should have rescued Lehman rather than forcing it to file for bankruptcy.[28] If asked to identify when bailouts are appropriate, the government's defenders tend to say they are appropriate if the failure of an entity or a market is likely to cause market-wide harm.

Critics of the government's interventions worry that the prospect of government rescues creates moral hazard because creditors of a major bank expect the bank to be bailed out in a crisis. This incentivizes the creditors to lend more aggressively and monitor less diligently. Bailouts, according to this reasoning, reward the profligate. Defenders acknowledge the risk of moral hazard, but contend that the government intervention is both appropriate and inevitable if the alternative is a market-wide collapse.

The framework we will develop in the next Part is in some respects an intermediate view: we are generally skeptical of government intervention, but believe it is sometimes necessary and that regulators can minimize the potential distortions by managing a bailout effectively.

B. Bending the Law in the Crisis

Although government intervention is debated in the abstract, it takes place against a backdrop of extant laws and regulations. At each stage of the crisis, regulators included provisions in their rescue transactions that seemed to stretch and perhaps exceed the relevant legal constraints.

The Bear Stearns rescue was structured as a merger with J.P. Morgan Chase & Co., in which J.P. Morgan acquired all of Bear's stock and the Federal Reserve used its emergency lending powers to guarantee $29 billion of the assets.[29] Although the basic transaction and the guarantee were legitimate, the merger included a lockup provision that authorized J.P. Morgan to acquire thirty-nine percent of Bear's stock even if Bear's stockholders voted to reject the merger.[30] J.P. Morgan was to receive these shares in advance of the shareholder vote,[31] thereby allowing them to be voted in favor of the merger. Moreover, the merger agreement did not limit

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on opposition to the Wall Street bailout and how it was conducted, and pointed to an earlier vote in December 2008 in which he supported direct help for the automotive industry").

27 Id.

28 This may be one reason that the three principal decision makers have each claimed that legal constraints made it impossible for them to bail out Lehman. See **Ben S. Bernanke**, **The Courage to Act** 287-91 (W.W. Norton & Company 2015) (concluding that Lehman could not be saved by government action because the methods of rescue used on Bear Stearns and AIG were not available); **Timothy F. Geithner**, **Stress Test** 207 (Crown Publishers 2014) (arguing that, contrary to popular opinion, the federal government could not have saved Lehman without violating legal constraints or damaging the government's ability to deal credibly and effectively with the upcoming financial challenges); **Henry M. Paulson**, **JR.**, **On the Brink** ___ (2010). Given the creativity that showed at other points during the crisis, the claimed incapacity is implausible.

29 Skeel,, supra note 17, at 735; See also Marcel Kahan & Edward B. Rock, How to Prevent Hard Cases from Making Bad Law: Bear Stearns, Delaware and the Strategic Use of Comity, 58 **Emory L.J.** 713, 716-721 (2009)(explaining the background and setting forth the details of the Bear Stearns-J.P Morgan merger agreement).

30 Skeel, , supra note 17, at 736 n. 149; Kahan & Rock, supra note 29, at 719.

31 Kahan & Rock, supra note 29, at 719.

J.P. Morgan's right to purchase additional stock, and J.P. Morgan eventually increased its stake to over forty-nine percent before the shareholder vote.[32] The lockup and additional stock purchases made it impossible for pre-existing Bear shareholders to reject the favored transaction, even if they believed it to be inadequate. Under ordinary Delaware law, this arrangement would have been struck down as illegal.[33]

With the AIG bailout, the Federal Reserve once again used its emergency lending powers, supplying AIG with an immediate infusion of $85 billion initially and nearly $100 billion more thereafter.[34] Although the emergency lending powers were a legitimate source of funding, the structure of the transaction was problematic. Rather than lending the funds to AIG or guaranteeing some of AIG's obligations, the Federal Reserve acquired nearly eighty percent of the voting power of AIG through a trust arrangement set up for the transaction.[35] Because the Federal Reserve is required to make loans under its emergency lending power and is prohibited from acquiring an ownership interest, the bailout appeared to be designed in a manner to evade this limit of its emergency lending provision.[36]

Funding for the Chrysler and General Motors bailouts came from the Treasury, which drew on the funds provided by the TARP legislation, rather than the Federal Reserve. In each case, the government arranged a transaction in which the carmaker filed for bankruptcy, then "sold" its assets to a newly created entity roughly a month later.[37] The principal problem with the car bailouts was that they made it essentially impossible for a competing bidder to challenge the government — orchestrated bid. The auction rules required competing bidders to agree to the same terms as the government transaction — which in the case of Chrysler meant promising to pay $4.6 billion to Chrysler retirees and to give them fifty-five percent ownership of the company, as well as paying $5.3 billion in trade debt in full.[38] Although the bidding rules were more draconian in the General Motors case,[39] the effect was less problematic because the government provided enough funding to pay GM's senior creditors in full, and other creditors arguably were not harmed by the transaction. The effect of the Chrysler transaction was quite different. Chrysler's senior lenders only received twenty-nine percent of their claims — significantly less than their collateral appears to have been worth.[40]

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32 Id. at 720.

33 See Id. at 721 (concluding that "under existing statutory and case law, the SEA [merger agreement] was invalid and should have been enjoined")(emphasis removed).

34 See William K. Sjostrom, Jr., The AIG Bailout, 66 **Wash. & Lee L. Rev.** 943, 944-45 (2009) (noting that the infusion ultimately grew to $182.5 billion).

35 Eric A. Posner & Adrian Vermeule, Crisis Governance in the Administrative State: 9/11 and the Financial Meltdown of 2008, **76 U. Chi. L. Rev.** 1613, 1629 (2009).

36 See Id. at 1630 (explaining that the transaction was "a loan in form" but a "purchase in substance").

37 Although TARP was designed to bail out financial institutions, rather than car companies, the definition of "financial institution" was capacious enough to include car companies. See In re Motors Liquidation Co., 430 B.R. 65, 95 (S.D.N.Y. 2010) ("EESA's broad definition of 'financial institution' is flexible enough to encompass automobile companies, and the legislation grants the Treasury Secretary the discretion to respond to a monumental financial crisis.").

38 See Mark J. Roe & David Skeel, Assessing the Chrysler Bankruptcy, 108 **Mich. L. Rev.** 727, 733 (2010)(summarizing the deal structure in the Chrysler Bankruptcy).

39 The GM bidding rules completely foreclosed consideration of a nonconforming bid, whereas the Chrysler rules allowed the debtor to decide whether to consider such a bid.

40 See Roe & Skeel, supra note 38, at 733-34 (explaining that secured creditors received only $2 billion of their $6.9 billion claim).

The most recent of the government's legally suspect maneuvers involved its takeover of Fannie Mae and Freddie Mac. The government first took over Fannie and Freddie in August 2008, shortly after Congress enacted legislation-giving regulators the necessary power to do so.[41] The initial takeover was not problematic. Fannie and Freddie appear to have been deeply insolvent. This condition could have justified a decision to liquidate the two entities; however, the regulators decided to put Fannie and Freddie in conservatorships instead. Taking this route meant that the shareholders, though deeply underwater, were not wiped out. The potentially problematic move came nearly four years later. In early 2012, the government changed the terms of the preferred stock it acquired in return for the $187.5 billion rescue financing it had provided to the two entities.[42] Regulators removed the original ten percent dividend requirement, and replaced it with a "sweep" that required that all profits go to the Treasury.[43] The effect of the sweep was to eliminate any interest Fannie's and Freddie's private common and preferred stockholders had in its future profits. Although some have defended the "sweep,"[44] it was hard to reconcile with FHFA's responsibilities as a conservator, and it appeared to effect a taking of the private investors' investment property.

With each of the government's interventions, investors filed lawsuits alleging that the transactions violated the law. The lawsuits have been largely unsuccessful, though for somewhat different reasons. In the discussion that follows, we briefly describe each, shifting the order to reflect the timing of the judicial rulings.

With the Bear Stearns transaction, Bear shareholders filed a lawsuit alleging that the lockup provision violated Delaware corporate law.[45] Although the challenge seemed extremely strong on the merits, the Delaware chancery court sidestepped the case, abstaining from hearing it so that related litigation could be pursued in New York[46]. The New York court eventually dismissed the lawsuit.[47] Some commentators have speculated that the Delaware judges were reluctant to interfere with a transaction involving the U.S. government and would have invalidated the lockup were it an ordinary merger.[48]

In the Chrysler and General Motors cases, the bankruptcy judges rejected the challenges to the sale transactions, insisting that the government was acting no differently than an ordinary debtor-in-possession financer when it insisted on a prompt sale of the companies' assets, and that the sales were fully consistent with existing law.[49] The value of the companies threatened to

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[41] See Adam Badawi & Anthony Casey, The Fannie and Freddie Bailouts Through the Corporate Lens, 10 **N.Y.U. J.L. & Bus.** 443, 444-448 (2014)(describing and defending the interventions).

[42] See, e.g., Gretchen Morgenson, Fannie, Freddie and the Secrets of a Bailout with No Exit, **N.Y. Times**, May 22, 2016, at BU1 (describing the potential for Fannie and Freddie to never return to private investors).

[43] Id.

[44] See Badawi & Casey, supra note 41 at 445 (arguing against critics of the "sweep," and stating that it "did not substantively violate the norms of corporate law and finance that would apply to private companies in the same position").

[45] In re Bear Stearns Companies, Inc. S'holder Litig., No. CIV.A. 3643-VCP, 2008 WL 959992, at *6 (Del. Ch. Apr. 9, 2008).

[46] See id. at *8 (granting a stay in the Delaware lawsuit in favor the New York lawsuit).

[47] In re Bear Stearns Litig., 23 Misc.3d 447 (Sup. Ct. 2008).

[48] Kahan & Rock, supra note 29 at 744.

[49] See In re Chrysler LLC, 405 B.R. 84, 104 (Bankr. S.D.N.Y. 2009) (approving the transaction over objections and noting that "A court's role is to either grant or deny the relief sought based upon the record before it, not to interject itself into the business judgment of the entity funding the transaction, even if that lender is the government"), aff'd, 576 F.3d 108 (2d Cir. 2009), cert. granted, judgment vacated sub nom. Indiana State Police

deteriorate rapidly, the judges concluded, justifying an immediate sale; and because the sales did not dictate the terms of a potential reorganization, they did not violate the prohibition against "sub rosa" reorganizations.[50] When Indiana's public pension fund, which had purchased some of Chrysler's senior debt, appealed directly to the Second Circuit, the Second Circuit was even more dismissive. The Second Circuit gave enthusiastic approval to the bankruptcy court's reasoning and conclusion.[51] The Supreme Court responded quite differently, however. The Court accepted the Indiana pension fund's request for certiorari and vacated the Second Circuit opinion but dismissed the case as moot, without explaining its reasoning.[52]

The AIG bailout was challenged in two major lawsuits raising parallel though distinct objections to the dilution of AIG's shareholders' stake in the company when the U.S. government acquired eighty percent ownership. The first lawsuit, which alleged that the government's controlling stake imposed on the government fiduciary duties that it violated, was quickly dismissed.[53] A district court judge in the Southern District of New York concluded that the government did not actually own the stock (since it was held by trusts set up for the purposes of the transaction), so it was not a controlling lender, and that any state law fiduciary duty obligations were preempted by the Federal Reserve's federal statutory obligations.[54]

The second lawsuit fared somewhat better. Represented by superlawyer David Boies, AIG shareholders alleged that the bailout effected a taking of most of the value of their stock and thus violated the Takings Clause of the Constitution.[55] After a lengthy bench trial in the Federal Court of Claims, which included testimony by former Treasury Secretary Timothy Geithner and former Federal Reserve Chair Ben Bernanke,[56] the judge ruled that the government had indeed violated the Takings Clause.[57] He held that the shareholders were not entitled to damages, however, because AIG probably would have collapsed and its shareholders would have been wiped out altogether if it were not for the bailout.[58]

Shareholders of Fannie Mae and Freddie Mac filed a number of lawsuits attacking the 2012 "sweep" as, among other things, breaching the conservator's responsibility to preserve and

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Pension Trust v. Chrysler LLC, 558 U.S. 1087 (2009) and vacated sub nom. In re Chrysler, LLC, 592 F.3d 370 (2d Cir. 2010); In re Gen. Motors Corp., 407 B.R. 463, 520 (Bankr. S.D.N.Y. 2009) (approving the transaction over objections), aff'd sub nom. In re Motors Liquidation Co ., 428 B.R. 43 (S.D.N.Y. 2010) and aff'd sub nom. In re Motors Liquidation Co., 430 B.R. 65 (S.D.N.Y. 2010); See also Douglas G. Baird & Robert K. Rasmussen, The End of Bankruptcy, 55 **Stan. L. Rev.** 751, 784-88 (2002) [hereinafter Baird & Rasmussen, The End of Bankruptcy] (describing the rise of senior lenders using Chapter 11 to sell firms as going concerns); Douglas G. Baird & Robert K. Rasmussen, Chapter 11 at Twilight, 56 **Stan. L. Rev.** 673, 675-685 (2003) [hereinafter Baird & Rasmussen, Chapter 11 at Twilight] (confirming the claim in The End of Bankruptcy, that going-concern sales have replaced traditional reorganizations).

50 In re Chrysler LLC, 405 B.R. at 113; In re Gen. Motors Corp., 407 B.R. at 495-98.

51 In re Chrysler LLC, 576 F.3d 108, 127 (2d Cir. 2009), cert. granted, judgment vacated sub nom. Indiana State Police Pension Trust v. Chrysler LLC, 558 U.S. 1087 (2009) and vacated sub nom. In re Chrysler, LLC, 592 F.3d 370 (2d Cir. 2010).

52 Indiana State Police Pension Trust v. Chrysler LLC, 558 U.S. 1087, 1087 (2009).

53 Starr Int'l Co. v. Fed. Reserve Bank of N.Y., 906 F. Supp. 2d 202, 205 (S.D.N.Y. 2012), aff'd sub nom. Starr Int'l Co. v. Fed. Reserve Bank of N.Y., 742 F.3d 37 (2d Cir. 2014), cert. denied 134 S. Ct. 2884 (2014).

54 Id. at 215, 229-30.

55 Starr Int'l Co. v. United States, 121 Fed. Cl. 428, 430-31 (2015).

56 Id. at 431.

57 Id. at 475.

58 Id.

restore the companies, violating the Administrative Procedure Act, and effecting a taking of investors' property. In 2014, a federal trial court judge rejected one of the main challenges to the 2012 transaction.[59] The court ruled that the legislation that authorized the conservatorship barred injunctive relief, and precluded shareholders from bringing shareholders' derivative litigation.[60] Although investors could pursue contract or tort claims for damages and could allege constitutional violations, the court rejected these claims.[61] In dismissing the investors' takings claim, the court held that any property interest the investors may have had disappeared when Fannie and Freddie were placed in receivership.[62]

Having described the judicial challenges and the basis for each, we offer three tentative comments on the judicial response. First, the most obvious pattern in the cases is that none has produced tangible relief thus far. Investors won symbolic victories in the Chrysler and AIG actions, but could not persuade a court to assess damages or in any way undo the bailouts. Second, the outcomes in some of the cases were quite unusual. It is not often that the Supreme Court resolves a case on equitable mootness grounds,[63] or that Delaware courts abstain from ruling in a major case involving a Delaware corporation.[64] These odd rulings strongly suggest that courts are struggling with their role in the cases. Finally, the courts seem to be less dismissive of challenges to the government intervention in the more recent cases than in the earlier cases. In the Chrysler, GM, and initial AIG cases, courts treated the challenges as misguided and the transactions as beyond reproach. The current cases seem to be taking the challenges more seriously. The further we get from the Great Recession and its immediate aftermath, the more willing courts are to take a hard look at the government's actions. We will revisit the cases and these observations in Part III when we offer our own normative perspective on scrutinizing governmental interventions.

II. Rules of Thumb for Intervention

The previous Part detailed some of our country's recent experiences with bailouts necessitated by the Great Recession.[65] The variety of the situations, their unexpectedness, and their novelty highlight an uncomfortable truth: bailouts are inevitable. Before the financial turmoil brought the corporations to their knees, few would have imagined that the likes of GM, AIG, and Citicorp would become wards of the federal government. In hindsight, one can always assess where things went awry and created a situation in which a bailout was needed. Similarly, hindsight can reveal ways in which the bailout could have been handled better. It is easy to operate retrospectively. To be sure, we can and should learn from the past. A government should be able to plan how to better respond should the exact same or similar crisis reappear. There is

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59 Perry Capital LLC v. Lew, 70 F. Supp. 3d 208, 214 (D.D.C. 2014) (order granting defendants' motion to dismiss and denying individual plaintiffs' cross-motions for summary judgment).

60 Id. at 219-29.

61 Id. at 233-45.

62 Id. at 244-45.

63 Indeed, the Supreme Court has never formally endorsed the principle that a court reviewing a confirmation order has the power to dismiss the action on the grounds of equitable mootness. Justice Alito, while he was a member of the Third Circuit, labeled the practice of dismissing bankruptcy appeals on the grounds of equitable mootness a "curious doctrine." In re Continental Airlines, 91 F.3d 553, 567 (3d Cir. 1996) (en banc) (Alito, J., dissenting).

64 It also is fairly uncommon for a court to conclude that the plaintiff has been wronged but it not entitled to any damages, as in the second AIG case.

65 There have of course been other bailouts as well, such as that of New York City, Washington, D.C., and the earlier Chrysler bailout, to name a few. For additional examples, see Casey & Posner, supra note 8, at 495.

little excuse for making the same mistake twice. But we should not harbor the belief that the fixing the flaws of the past ensures a placid future. Life is not that simple. Bailouts are not Groundhog Day.

There are often complaints, after a crisis, that regulators had too much flexibility, and that, going forward, they should be more constrained. In the case of banks, for example, one of the rallying cries is "no more bailouts."[66] This was much of the impetus behind Dodd-Frank,[67] and it is reflected in two key features of the law: a provision prohibiting the Federal Reserve from making emergency loans to individual financial institutions,[68] and a requirement that regulators "liquidate" rather than restore any financial institution they place in resolution under the new Orderly Liquidation Authority.[69]

These anti-bailout concerns stem from multiple sources. As noted earlier, one of the most common is the concern with moral hazard. Should there be a bailout today and/or a promise of a bailout in the future, the reasoning goes, those in charge of the institutions will not fear the downside when making investment decisions. We need to tie ourselves to the mast so that the feckless do not take advantage of our impulses to run in to help when a crisis hits.

Of course, it would be irresponsible not to put in place a system that would have addressed the problems that we faced in the Great Recession. We have made some efforts on the banking front with the passage of the Dodd-Frank legislation and its provisions aimed at more orderly resolution of financial distress. Industrial policy, on the other hand, remains as it was prior to the crisis. No mechanisms have been put in place to either lessen the probability that a major sector like the domestic automobile industry will suffer existential threat or to deal with such a crisis once it strikes. Yet, humility is in order. We can retrofit the system to respond to the past crisis; we can even attempt to address crises that we can foresee. But we need to recognize the limit of human foresight.

When a crisis hits, the government needs to be predictable. The fact that the government cannot specify in advance precisely what it will do in a crisis should not be a license for ad hoc decision making. It should apply the same principles across bailouts. To see the mischief that can be created when this does not happen, we do not have to look back far. When the government ensured that Bear Stearns did not collapse by engineering a merger with J.P. Morgan, it created an expectation in the market that the government would not let a major investment firm file for bankruptcy.[70] These expectations were dashed when Lehman filed for

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[66] For example, the Tea Party Express lists "No more bailouts" as the first of its six principles. Mission Statement, **Tea Party Express**, http://teapartyexpress.org/mission (last visited Oct. 10, 2016).

[67] Whether it succeeded on this score, of course, is another matter. **H.R. Rep. No.** 111-4173, at 278 (2010) (Conf. Rep.).

[68] This provision amends section 13(3) of the Federal Reserve Act to permit only industry-wide loan programs. Dodd-Frank Act, Pub. L. No. 111-203, § 1101(a) (2010).

[69] Dodd-Frank Act § 214. See also **Paul H. Schultz, Perspectives on Dodd-Frank and Finance** 97 (2014) ("Senator Barbara Boxer added a 'Thou shalt liquidate' provision to Title II late in the legislative process to make sure that the message was received."); see also **David Skeel, The New Financial Deal: Understanding the Dodd-Frank Act and Its (Unintended) Consequences** 149 (2011)

[70] See, e.g., Id. at 31-33 (offering analysis of the Bear Stearns counterfactual). Conventional accounts of the Lehman bankruptcy filing often neglect the perverse effects of the expectations the government created when it bailed out Bear Stearns.

bankruptcy.[71] The uncertainty that this created—not knowing what the criteria were for being rescued—wreaked havoc in the financial markets.

While they are inevitable, bailouts and how they are effectuated are also consequential. How our government responds when confronted with a crisis has impact on the polity. In this section, we reflect on what lessons we can learn from the nation's past experience with bailouts and suggest the principles that should guide future rescue efforts. We look at how the government should operate when deciding to launch a bailout effort, how it operates during the bailout, and how it exits the bailout.

A. The Initial Decision to Engineer a Bailout

The first, and we think the most important, lesson that we draw from recent experience is that government officials should act in a way that promotes the political accountability of the elected branches of government.[72] Bailouts tend to change the rules of the game. The extant playing field has led to an unacceptable outcome, and the government is going to alter that outcome. In such a situation, there inevitably will be winners and losers. We take it that, as a first principle, citizens should be able to assess and hold accountable the government officials charged with making these decisions. By their nature, bailouts are drastic remedies with the potential for wide-ranging effects. Indeed, in recent years, few decisions that our government have made loom as large as TARP, both as applied to its original target — the banking sector — and its later beneficiaries — the auto industry. As such, citizens should be able to hold the government accountable. By accountability, we mean that the public can ascertain, at a high level of generality, what actions were taken, by whom, and for what reasons.

There are two necessary conditions for political accountability. The first is transparency. If actions from the various branches of government are opaque, it necessarily means that the citizens are unaware of them and thus cannot assess the action of their elected leaders, for good or for ill. To be sure, the size and complexity of the modern administrative state make it infeasible for every action to be subject to widespread scrutiny. We also recognize that decision making in a crisis is inherently more free-wheeling than decision making under ordinary circumstances. Yet, for major decisions such as saving the country's banking system or rescuing its auto industry or assisting an insolvent territory, citizens should be able to ascertain what actions were taken and by whom.

The second condition promoting accountability is articulation of the reason for the intervention. Articulating why the government is altering the rules of the game serves twin purposes. The first is that it sets a benchmark against which their actions can be measured. Citizens should be justly concerned when there is a gap between the actions their government

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71 Id.

72 All constitutional theorists embrace accountability as a feature of our political system, though they diverge as to whether accountability is the primary goal of our constitutional system or a means to achieve other ends. See, e.g., **Alexander M. Bickel**, **The Least Dangerous Branch** 37 (2d ed. 1986) (noting that the starting point of analysis is "democratic faith" in the principle of majoritarian lawmaking); Rebecca L. Brown, Accountability, Liberty and the Constitution, 98 **Colum. L. Rev.** 531, 535 (1998) (arguing that accountability is necessary to protect a system of individual rights); Lawrence Lessig & Cass R. Sunstein, The President and the Administration, 94 **Colum. L. Rev.** 1, 94 (1994) (asserting that accountability is one of the two "central values of the framers' original executive").

takes and the reasons put forward for them. The second is that it provides a limiting principle for the intervention. The articulated reasons give a sense of the appropriate level of intervention and shape the government's exit strategy.

It is important in this regard to emphasize that many enterprises, and indeed sectors, of the economy encounter financial distress, and little thought at all is given to a bailout. WorldCom, by some measures, was a larger company than General Motors when it filed for Chapter 11 bankruptcy.[73] While many employees, suppliers, and communities would be affected by the collapse of the company, there were not any calls to bail out the enterprise.[74] The recent collapse in oil prices has led to substantial financial losses in the domestic oil industry.[75] Arthur Andersen was one of the world's most venerable accounting firms.[76] Yet in none of these cases was there even a whisper that the government should intervene. Against this backdrop, bailouts are an anomaly. They depart from our general expectations. A fully articulated bailout decision would explain why the car companies were different and warranted rescue financing.

Although the rollout was far from flawless, TARP was a model, in our mind, in terms of the process that leads to its enactment and implementation, at least as it concerns the banking sector. Congress, at the urging of the President, enacted legislation designed to halt the meltdown of the banking system.[77] By any reasonable measure, the effort was a success. First and foremost, the banking system did not collapse. It is difficult to overstate the impact on a country when its banks fail. When a banking system collapses, the economy grinds to a halt. Recession could easily become depression. Instead, the Treasury Department deployed the funds in ways that prevented the deterioration of our financial system. Indeed, in the end, the Treasury made money.[78] While one can quibble on the margins[79] – one always can – this was a significant choice made by the branches of government charged with acting.

The branches charged with enacting and implementing government policy – Congress and the President – both stood behind the bailout. Moreover, their efforts were public, and the

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[73] See **New Generation Research, The 2015 Bankruptcy Yearbook & Almanac** 53 (Kerry A. Mastroianni ed., 25th ed. 2015) (listing WorldCom as the third largest American public company bankruptcy and GM as number four).

[74] Some even questioned whether WorldCom should have been allowed to emerge from bankruptcy (as MCI). See Joseph L. Bower & Stuart Gilson, The Social Cost of Fraud and Bankruptcy, **Harvard Business Review**, Dec. 2003.

[75] See Ernest Scheyder & Terry Wade, U.S. Oil Industry Bankruptcy Wave Nears Size of Telecom Bust, **Reuters** (May 4, 2016), http://www.reuters.com/article/us-usa-shale-telecoms-idUSKCN0XV07V (describing the large decline in crude oil prices since 2014, leading to decreased valuations and increased bankruptcy rates among US energy companies).

[76] See **Barbara Ley Toffler**, **Final Accounting: Ambition, Greed and the Fall of Arthur Andersen** 7 (2003) ("[Arthur Andersen] was a great and venerable American brand that had, over the course of the twentieth century, become a global symbol of strength and solidarity.").

[77] Andrew Glass, Bush Signs Bank Bailout, Oct. 3, 2008, **Politico** (Oct. 3, 2013), http://www.politico.com/story/2013/10/bush-signs-tarp-legislation-oct-3-2008-097742.

[78] Jonathan Weisman, U.S. Declares Bank and Auto Bailouts Over, and Profitable, **N.Y. Times** (Dec. 19, 2014), http://www.nytimes.com/2014/12/20/business/us-signals-end-of-bailouts-of-automakers-and-wall-street.html.

[79] For example, the price of agreement was that regional banks would receive TARP funds along with the systemically crucial money center banks. While the government recouped the funds that it lent to the money center banks, and more, it ended up with losses on the funds that it lent to the regional banks. See, e.g., Colin Barr, Treasury's Citi Sale: TARP's Last Hurrah?, **Fortune** (March 30, 2010), http://archive.fortune.com/2010/03/30/news/companies/banks.tarp.fortune/index.htm.

implementation was public as well. Indeed, we view it as something of a tragedy that a process that was successful both procedurally and on the merits has become a public cause for vilification rather than celebration.

In contrast, we find fault with the process by which the auto bailouts were initiated. The original sin here was using the TARP money to bail out the car companies.[80] It may be wise policy to support a crucial domestic industry when it is threatened with an existential crisis. Just as the banking system has systematic effects, in that the failure of a major bank can destabilize other banks, the failure of a key player in an industry can cripple the entire industry. The economy could still function when Enron went bankrupt. It will continue to move forward despite the current troubles roiling the domestic oil and gas industry. Arguably, the failure of General Motors and Chrysler could have been different. The ordinary bankruptcy process might not have worked and could have led to the collapse of the entire domestic auto industry.[81] Indeed, given the success of rescuing the two car companies, one can make the argument that the bailout here, at least in terms of its ultimate outcome, was a success.[82] We take issue with the process, not so much the overall result.

The failure can be laid at the feet of Congress. Confronted with the question of whether GM and Chrysler should receive rescue financing from the government, Congress ducked. At the time Congress was considering a bailout for the auto industry, public sentiment was turning against both bailouts in general and the auto industry in particular.[83] The leaders of the car companies did little to endear themselves to the public.[84] Whatever shortcomings they may have had, however, there was the pressing issue of whether GM and Chrysler should be allowed to fail. There was, if press reports are to be believed, widespread support in Congress for not letting the companies fail, though there were disagreements over the terms on which the bailout should take place.[85] Congress, however, was confident that the Administration would use TARP

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80 The U.S. Treasury's use of TARP funds to bail out General Motors and Chrysler came after Treasury Secretary Henry Paulson had assured Congress that he did not intend to use TARP for this purpose. See Wendy Jones, Paulson, Bernanke Testify, Get Grilled, **NBC News: First Read** (Nov. 18, 2008), http://firstread.msnbc.msn.com/_news/2008/11/18/4425489-paulson-bernanke-testify-get-grilled (quoting Paulson testimony stating that using TARP money for car bailouts "would not be a good thing").

81 See Douglas G. Baird, Lessons from the Automobile Reorganizations, 4 **J. Legal Analysis** 271, 271 (2012) (stating the need for the U.S. to inject money into the failing auto industry); James B. Stewart, When Debating the Auto Bailout, Consider Lehman's Fate, **N.Y. Times** (Mar. 9, 2012), http://www.nytimes.com/2012/03/10/business/when-debating-the-auto-bailout-consider-lehmans-fate.html?_r=0 (illustrating the necessity of the government's intervention).

82 See Robert J. Samuelson, Celebrating the Auto Bailout's Success, **Wash. Post: Opinions** (Apr. 1, 2015), https://www.washingtonpost.com/opinions/celebrating-the-auto-bailouts-success/2015/04/01/67f3f208-d881-11e4-8103-fa84725dbf9d_story.html (arguing that the overall outcome of the auto industry bailout was successful).

83 Compare Lydia Saad, Americans Divided on Aid to Big Three Automakers, **Gallup** (November 18, 2008), http://www.gallup.com/poll/111943/Americans-Divided-Aid-Big-Three-Automakers.aspx (showing that forty-nine percent of Americans surveyed opposed government assistance to the automakers compared to the forty-seven percent that supported one), with Lydia Saad, Americans Continue to Oppose GM, Chrysler Loans, **Gallup** (March 31, 2009), http://www.gallup.com/poll/116107/Americans-Reject-Sequel-Auto-Bailout.aspx (describing how fifty-nine percent of Americans disapproved of the loans made to GM and Chrysler).

84 See, e.g., Josh Levs, Big Three Auto CEOs Flew Private Jets to Ask for Taxpayer Money, **CNN** (Nov. 19, 2008), http://www.cnn.com/2008/US/11/19/autos.ceo.jets/ (describing criticisms of the CEOs' decision to take private jets).

85 See Micheline Maynard, U.A.W. at Center of Dispute Over Bailout, N.Y. Times (Dec. 12, 2008), available at http://www.nytimes.com/2008/12/13/business/13uaw.html.

funds to rescue GM and Chrysler. Knowing this, it refused to go on record and support what it actually wanted to happen.[86]

From our point of view, the decision lacked transparency. Saving the car industry is a big deal. It is the type of decision that will shape our polity for years to come. At the time of the intervention, it was unclear whether the car companies could be saved at anything close to a reasonable price. GM and Chrysler had not been making the best business decisions over the prior years, and the rescue effort could well have been a case of throwing good money after bad.[87] It seems, however, that the basic decision to bail out both companies was supported by a majority of those in both the House and Senate. Those individuals should have gone on record. Voters should be able to observe when the government makes decisions such as these.

The lack of Congressional accountability here leads to even more questionable outcomes. Even if one supports the bailout of GM, it is easy to find fault with how the value of the company was distributed. The government, for all intents and purposes, owned GM after it made the bailout loan.[88] The amount that the government was owed exceeded the reasonable valuation of the company. In exercising its rights as the holder of the fulcrum security, the government engineered a Chapter 11 case that favored union retirees over those holding claims with the same priority in at least two respects. First, in 2007, GM had transferred its promises for health care for retires to an independent trust. As part of the transfer, GM promised to pay over $20 billion, though no collateral was given to back up this promise. In GM's bankruptcy, this unsecured claim received a greater rate of recovery than other unsecured obligations.[89]

The second way in which GM favored union retirees had to do with its former subsidiary, Delphi.[90] At the time that GM spun off Delphi, it agreed to backstop the claims of the union retirees. Should the monies that had been put aside for these retirees prove insufficient to pay the benefits that had been promised, GM would fund the difference.[91] This promise, like the one to the health care trust, was an unsecured obligation. Delphi turned over its pensions to the Pension Benefit Guaranty Corporation, which cut some of the payments to the retirees. In GM's

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[86] See Pete Davis, Senate Auto Bailout Vote Was Not What It Seemed, **Capital Gains and Games: Pete Davis's Blog** (Dec. 14, 2008), http://capitalgainsandgames.com/blog/pete-davis/681/senate-auto-bailout-vote-was-not-what-it-seemed (explaining that the Senate vote to defeat the auto bailout was not an indication of its desire to see the auto industry rescued).

[87] For the history of Chrysler and GM leading up to the financial crisis, see Baird, supra note 81, at 273.

[88] See Baird, supra note 81, at 288.

[89] See James Sherk, Auto Bailout or UAW Bailout? Taxpayer Losses Came from Subsidizing Union Compensation, Testimony before Committee on Oversight and Government Reform, available at http://www.heritage.org/research/testimony/2013/08/auto-bailout-or-uaw-bailout-taxpayer-losses-came-from-subsidizing-union-compensation.

[90] The general history behind GM's decision regarding the Delphi pension plans can be found at **U.S. Gov't Accountability Office**, **GAO-12-168, Delphi Pension Plans** (Dec. 2011), http://www.gao.gov/assets/590/587045.pdf. While the GAO initially concluded that it was GM that decided to adhere to the prior agreement to top-up the pensions of Delphi's union workers, a later report by the Special Inspector General for TARP concluded that, in fact, it was the Treasury Department that commanded GM to take such action. **Special Inspector Gen. for the Troubled Asset Relief Program**, **SIGTARP-13-003**, **Treasury's Role in the Decision for GM to Provide Pension Payments to Delphi Employees** (Aug. 15, 2013), https://www.sigtarp.gov/Audit%20Reports/SIGTARP_Delphi_Report.pdf.

[91] GAO-12-168, *supra* note 90, at 3-4.

bankruptcy, it promised to top off the claims of the union, but not the non-union retirees, at a cost of over $1 billion.[92]

This was a significant policy decision: the use of government funds to bail out insolvent union pension plans, while not providing similar support to either other unsecured creditors or to employees covered by non-union plans. We do not question that the government is free to make tradeoffs such as this. There is nothing illegitimate about it. Workers who were promised pensions and find out only when they retire that the promises are not going to be fulfilled are a sympathetic claimant to many eyes. The problem in the GM case is that Congress decided to abandon the field. Congress, in effect, gave a blank check to the administration, and the administration was able to implement its policy choice in the fog of war of GM's Chapter 11 case.[93]

One may object that we are asking too much of elected officials. The argument, in a nutshell, is that politicians are craven.[94] They know that they have to act, but they will shy away from doing so if it risks their political careers. Bailouts became toxic. After TARP, no one wanted to be seen as providing a bailout. Indeed, Congress balked at a package to bailout the auto industry. At some level, however, this was cheap talk, in that the recalcitrant legislators knew that if they did not act, the President would. The President would take the political heat, and they could play dog in the manger and decry executive overreach.

We should resist, or at the very least condemn, this tendency. Our system of government depends in large measure on accountability, which requires transparency and accountability. In both respects, the bank bailouts were much more defensible than the car bailouts. Everyone knows that the government bailed out the banks and can applaud or jeer as he or she sees fit. The government was quite transparent about its intent. It is much harder to trace what occurred with the car companies. Similarly, the government explained the purpose of the bank bailouts, thus inviting accountability, while the car bailouts were opaque and indirect. When the government articulates its reasons for intervening, citizens can assess whether the government's actions fit its justification, and can sense when something else is going on. Articulating reasons also puts a limit on the intervention. Saying why you are going in gives a blueprint of what to do, and, equally important, when to get out.

B. Implementing the Bailout

Once the government decides to make an intervention, the next question that arises is how should that intervention be effectuated. A key principle in crafting a bailout is that the government should respect the existing priority levels. This does not mean that the government

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[92] See Mary Williams Walsh, For Delphi Pensioners, the Union Label Helps, N.Y. Times. (Oct. 26, 2009), available at http://www.nytimes.com/2009/10/27/business/27delphi.html.

[93] Indeed, the full extent to which officials from the Department of Treasury were the ones making the policy decisions here became public knowledge more than four years after the fact. See id.

[94] Posner and Vermeule offer a slightly more sanguine explanation of legislators' failure to act, arguing that the deliberative structure of legislative decision-making makes it harder for the legislative branch than for the executive branch to act quickly. Eric A. Posner & Adrian Vermeule, Crisis Governance in the Administrative State: 9/11 and the Financial Meltdown of 2008, 76 **U. Chi. L. Rev.** 1613, 1643 (2009)(stating that "before a crisis, they lack the motivation and information to provide for it in advance, while after the crisis has occurred, they have no capacity to manage it themselves.").

has to pay everyone off in full if it wants to intervene. Rather, it means that, as part of the intervention, the government should not transfer value that otherwise would have gone to one set of investors to another. Our system of finance depends on investors being able to know where they stand in the pecking order. To the extent that the government needs to provide rescue financing, it is unclear why this would include rejiggering the relative priority of the various investments. Indeed, to the extent that priorities are reordered, it raises the question of whether the bailout was done exclusively for the reasons stated or whether part of the motivation was to assist the group that received value that it otherwise would not.

The way in which the bailout of Chrysler was handled was problematic on this score.[95] First, it was unclear initially that Chrysler posed the same systemic risk as did GM. It may well have been that a rescue of GM – by far the larger of the two companies – would have been sufficient to save the auto sector from collapse. Indeed, the Chrysler bailout can be viewed as a liquidation in which its assets were transferred to Fiat.[96] The government arguably could have allowed a true liquidation of the company without inviting serious systemic harm.

Even if we assume that Chrysler should have been bailed out, problems remain. There, the secured lenders were owed far more than the bid from Fiat. There was some speculation that a breakup of the company could fetch more than the Fiat bid. Certainly some of the senior lenders made noises that they wanted to explore this possibility. The government's loan was junior to that of the secured lenders; the government had no way to prime the existing secured loans. The holders of these loans were owed more than the assets were plausibly worth, in either a reorganization or a liquidation. Normally, a secured lender in this position could protect its interest by credit bidding its claim at the auction.[97]

The bidding procedures that the government drafted, however, precluded the secured lenders from taking such action. The procedures provided that bidders had to agree to the deal worked out by the government for Fiat to acquire the Chrysler assets, maintain the existing collective bargaining agreements and pay off the trade creditors.[98] Of course, the lenders had standing to object to the terms of the auction. They initially expressed an intention to make such a claim. As time went on, however, most of the lenders stayed silent. What explains this docile reaction? This is not a group that tends to hesitate in pursuing its financial interests. It turns out that the Department of the Treasury, through its TARP lending, was a major investor in the banks that held the lion's share of the secured loans. There have been rumblings that the Treasury used its position as lender to the banks to force them to stand down and not object to

[95] See Roe & Skeel, supra note 38 (describing the Chrysler bailout and how the bailout structure did not fit with the ordinary bankruptcy structure).

[96] See Baird, supra note 81 (articulating how the government played a key role in preserving the automobile industry during the bailout).

[97] See 11 U.S.C. § 363k (2005)(explaining that the holder of the claim may bid at the sale). To be sure, at the time of the Chrysler case, it was uncertain whether the secured creditor's right to credit bid extended to a sale conducted as part of a plan of reorganization. See In re Philadelphia Newspapers, LLC, 599 F.3d 298 (3d Cir. 2010) (holding that the right to credit bid did not apply in the context of a plan of reorganization). While the Supreme Court eventually held that the right to credit bid does apply in a sale conducted via a plan, see RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 132 S. Ct. 2065 (2012)(holding that secured creditors must be permitted to credit bid if the property that is subject to their lien will be sold in connection with a chapter 11 plan),)no one questioned the ability of the secured creditor to exercise this right in a sale under Section 363. see also.

[98] See Zachary Chapman, Bankruptcy Court Enters Order on Chrysler Bidding Procedures, May 8, 2009, available at http://www.lexology.com/library/detail.aspx?g=c6cf7e95-7bc8-4e96-947a-a1850d0c875f.

the sale of Chrysler to Fiat.[99] Regardless of the reason, the end result of the Chrysler bailout – in addition to saving the company – was that the senior lenders were not paid in full, and junior interests were allowed to receive a return.[100] It is this type of violation of priority that we suggest be avoided in future bailouts.

Chrysler is not the only example of this tendency coming from the bailouts that were made in the wake of the Great Recession. Consider in this regard the bailout/takeover of Fannie Mae and Freddie Mac. One could articulate a reason as to why the shareholders of these entities should have been wiped out. One could argue that the companies were insolvent, and that the price for the rescue financing was that the old equity would be eliminated. The problem is that it appears that the government changed the terms of the deal. At the initial stage, the equity holders were not wiped out. Rather, they retained twenty percent of the equity. In 2012, however, the government revised the transaction to ensure that all profits would go to the Treasury.[101] The government in effect inserted itself as the residual claimant to the company, at the expense of the shareholders who otherwise would have received these funds.

The failure to respect priorities is problematic both for the investors, who lose as a result, and for the financial markets generally. If priorities are not respected, investors will be more reluctant to lend during a crisis to companies that may later be subject to governmental intervention. In effect, political risk must be factored into the price of the investment.

Respecting priority is not the only issue to worry about when a bailout occurs. Once the government intervenes, the question arises as to what level of control it should be allowed to exercise over the entity or entities that it bailed out. The past two decades have witnessed the rise of creditor control of companies that are in financial distress.[102] Lenders have innovated to devise ways in which they can influence the debtor's conduct. Senior lenders today can exercise power that few could have imagined two decades ago. They can force a sale, they can nudge out the CEO, they can put in a trusted lieutenant to restructure the debtor's operations. In essence, they can affect almost every aspect of the debtor's business. To what extent should the government be allowed similar latitude?

The possibility for mischief here is patent. When the government has control over an entity, there is always the concern that it will not act in a way to maximize either the value of that entity or the value of its interest. The fear is that the government will make decisions for political rather than economic reasons. It will make decisions to reward its supporters rather than solely focus on fixing the causes of the company's financial distress. To be sure, one could allay these fears by requiring that the government take no action at all; that it hold only cash flow rights and not control rights in its investments in the private sector. In such a regime, the government would be a passive investor.

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[99] See Neil King, Jr. & Jeffrey McCracken, <u>U.S. Forced Chrysler's Creditors to Blink,</u> Wall Str. J. (May 11, 2009); available at http://www.wsj.com/articles/SB124199948894005017.
[100] See Roe & Skeel, <u>supra, note 36 at 733.</u>
[101] Morgenson, <u>supra</u> note 42, at BU1.
[102] <u>See</u> Baird & Rasmussen, <u>The End of Bankruptcy</u>, <u>supra</u> note 49; <u>see also</u> Douglas G. Baird & Robert K. Rasmussen, <u>Private Debt and the Missing Lever of Corporate Governance,</u> **154 U. Pa. L. Rev.** 1209, 1236-42 (2006) [hereinafter Baird & Rasmussen, <u>Private Debt</u>] (explaining how senior creditors continue their involvement in corporate governance even post Chapter 11); <u>see also</u> David A. Skeel, Jr., <u>Creditors' Ball: The "New" New Corporate Governance in Chapter 11</u>, 152 **U. Pa. L. Rev.** 917, 918 (2003)(documenting the changes in Chapter 11, which now has its focus on the creditor, rather than the debtor and its managers).

We do not believe that the government should be toothless here. While the government may have mixed motives in acting, not changing the operations of a failing entity for fear of overreach seems a bit drastic. After all, government intervention is necessary precisely because the operations are failing, and it is likely that drastic steps are necessary to return the entity to financial health. We prefer a categorical approach, where the government would be able to take some types of actions but not others.

Perhaps the most pressing question in any case of financial distress centers on the leadership of the company. Any time an enterprise runs into difficulty, it is fair to question the ability and vision of those in charge. We start with the CEO. In the private sector, it is often the case that when a company runs into financial distress, the CEO is terminated.[103] The intuition here is straightforward – the person who ran the enterprise as its fortunes worsened may not be the best person to right the ship. Barring the government from exercising its power to make a similar change could leave in place management that is not up to the task of turning around the business. Indeed, we saw such a situation in the GM bankruptcy. The government basically fired the CEO and brought in new management.[104] Prior to his ousting by the Auto Task Force, the CEO had even refused to consider the possibility that GM might need to reorganize in bankruptcy.[105]

We are not troubled by the government's decision to remove the CEO. This type of action may be both necessary and transparent. The alternative — not allowing the government to consider changing the leadership team of an entity that it has bailed out — seems foolhardy. Moreover, cashiering the CEO is a public act. To the extent that one of our goals is that the government should act in a way that promotes accountability, this is the type of action that is transparent and readily understandable by those with even a passing familiarity with the situation.

In addition to sacking the CEO, it is quite common for investors to end up with control of or at least to have representation on the company's board of directors. Directors are vested with the ultimate authority over the company, though they do not have day-to-day control of the operations. Appointing directors is less visible than appointing a CEO, though they have enormous influence on the major decisions that the company makes.[106] It is easy to imagine that the government would populate the board with directors eager to carry out the political goals of those making the appointment. On the other hand, having a board whose allegiances lie with someone other than the major shareholder is a recipe for a less engaged board. On balance, we would allow the government to appoint the directors, though we would forbid any government official from serving as a director.

We have greater reservations about having the government use its influence to adjust operations of a company in which it holds a controlling interest. In many businesses that

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[103] See Baird & Rasmussen, Private Debt, supra note 102, at 1225-26 (providing an example of the termination of Warnaco's CEO after the business incurred a substantial amount of debt).

[104] See Neil King, Jr. & John Stoll, Government Forces Out Wagoner at GM, **Wall St. J.** (Mar. 30, 2009), http://www.wsj.com/articles/SB123836090755767077 (detailing GM's CEO stepping aside when asked by a government official).

[105] See, e.g., Michael E. Levine, Why Bankruptcy is the Best Option for GM, **Wall St. J.** (Nov. 17, 2008), http://www.wsj.com/articles/SB122688631448632421 (quoting Wagoner as saying "bankruptcy is not an option").

[106] Under Delaware law, the formal control over the corporation rests with the Board of Directors. **Del. Code Ann. tit.** 8, § 141 (2016).

encounter financial distress, cuts have to be made, plants have to be closed, and work forces need to be trimmed. Given that the government is not solely a financial creditor, it is easy to imagine that politics could infect such decisions.[107] To be sure, wielding its power to replace managers or directors could enable the government to shape the troubled firm's operations. But the influence is much less direct.

By and large, these were the stated policies of the government during the most recent round of bailouts. The Treasury stated that its four goals were to act as a reluctant shareholder, not interfere with the day-to-day running of the company, ensure a strong board of directors, and exercise its voting rights only on core governance issues.[108] It is not clear that these principles were respected at every turn, especially the early days of the bailout. For example, the Special Inspector General for TARP found that Treasury officials exercised great control over GM, including decisions regarding the treatment of pension obligations. Still, we hope that the statement of intentions becomes a firm precedent for future bailouts.

C. Getting Out

One of the most notable developments in the treatment of financially distressed companies has been the rise of the "loan- to-own" strategy.[109] Here, an investor takes a position in the company with the goal of using that position, often in a Chapter 11 proceeding, to gain control of the business. It is not unusual to see a pre-bankruptcy lender end up owing the company when it emerges from bankruptcy. The lender buys its stake looking to be involved in the company for the long haul.

The government could easily structure a bailout that effectively did the same thing, even if the government insisted that it had no intent to nationalize the bailout recipient.[110] The investment would allow the government to become the de facto owner of the company. Once the government does intervene, the pressure to get out is not nearly as great as the pressure to get in. It is not difficult to imagine the government enjoying having its hands on the levers of control. Running a multi-billion dollar entity is heady stuff. Even if one did not want to attribute to those in charge a desire to use the power to reward political allies, it does not take much to imagine that those wielding power could quickly develop a taste for it.

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[107] Our vision of governmental control is thus narrower than the approach outlined by Matthew Shahabian. Shahabian proposes that the government promote short-term stability, protect the taxpayer and maximize long-term value. Shahabian, supra note 14, at 378-79. In our view, the government should not seek to shape a bailout recipient's operations either to dampen a crisis in the short-run or to maximize the bailout recipient's long-term value. See also Verret, Government-Controlled Corporations, supra note 14, at 1532 (arguing that the government may use its control to effect indirect rent transfers).

[108] See **U.S. Gov't Accountability Off.**, **GAO-10-325T**, **Troubled Asset Relief Program: The U.S. Government Role as Shareholder in AIG, Citigroup, Chrysler, and General Motors and Preliminary Views on its Investment Management Activities** 3 (2009), http://www.gao.gov/assets/130/123926.pdf (summarizing core principles of government bailouts).

[109] See David A. Skeel, Jr. From Chrysler and General Motors to Detroit, 24 **Widener L. J**. 121, 134 (2015) (discussing the effect that information asymmetry has on bidding).

[110] In other countries, direct nationalization has sometimes been the response to a crisis involving systemically important institutions. Some commentators advocated this step for large U.S. banks in 2008-2009. See, e.g., Paul Krugman, Banking on the Brink, **N.Y. Times**, Feb. 22, 2009, at A27 (arguing for temporary nationalization of banks). The government, however, consistently resisted this.

Sensible bailout policy should be alert to this tendency, and an overriding goal should be to minimize the distortions of government ownership by getting out as quick as possible. Smoothly exiting the company is preferable to holding onto an investment in the hopes of getting a larger return. The government intervened to stabilize the situation — not to play the market. Obviously, the government cannot set a specific time limit as to when it will sell its share. Setting a hard and fast deadline robs the government of flexibility. The goal should be to begin exiting as soon as the immediate crisis has been contained.[111]

This is a metric on which the government performed well during the recent financial crisis. It exited the banks fairly quickly. Part of the impetus here was how the government's intervention was structured. In the case of banks, part of the terms of the loan was a restriction on banker pay while the loan was outstanding.[112] This created a great incentive on the part of the bankers to raise sufficient capital to pay off the loans.

The government also terminated its relationship with the car companies in relatively expeditious fashion. Fiat took control of Chrysler as part of the bankruptcy sale. As to GM, after the company's bankruptcy, much of the debt that the government held was converted to equity. Indeed, the government held sixty percent of General Motors after the bankruptcy case, enough that some quipped that the company should be called "Government Motors." Yet the government did not dawdle in shedding this interest. The government began selling its shares in 2010, and by the end of 2013, it had sold its entire interest.[113]

In short, the lessons that urge on future bailout architects are these: be clear in what you are doing, articulate the reasons for your actions, do not alter existing priorities, intervene in operations only at the top level, and get out as soon as practical. Hewing to these principles would limit the distortionary effects of future bailouts.

III. Ex Post Oversight of Bailouts and Other Crisis Intervention

Having considered the question of how the government should structure its intervention during a financial crisis, we ask in this part what should be done when regulators go awry. Should regulators' efforts to staunch a crisis be subject to judicial review, and if so, what should that review look like? We consider these issues from three angles. We first ask whether regulatory overreach during a crisis should be insulated from review while the crisis lasts. We then ask the related but distinct question of whether it is appropriate for Congress to restrict review of actions taken under regulations it enacts in a crisis. We conclude by considering what crisis review should look like.

Before considering the appropriate scope of ex post judicial review, we pause to note that the friction between bailouts and other crisis intervention, on the one hand, and the background legal rules, on the other, can be reduced on the margins if lawmakers provide escape hatches from ordinary regulation for emergencies. The Federal Reserve's emergency lending powers are

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111 For a discussion of containment as the central rationale for governmental intervention, see Anna Gelpern, Financial Crisis Containment, 41 **Conn. L. Rev.** 1051, 1076 (2009).
112 See 11 U.S.C. 5221.
113 See Bill Vlasic & Annie Lowrey, U.S. Ends Bailout of G.M., Selling Law Shares of Stock, N.Y. Times Dealbook (Dec. 9, 2013), available at http://dealbook.nytimes.com/2013/12/09/u-s-sells-remaining-stake-in-gm/.

precisely this kind of escape hatch.[114] While we believe the Federal Reserve pushed the boundaries of its emergency lending powers during the crisis, we worry that post-crisis restrictions on the power will create unnecessary frictions in the future.[115] The Federal Reserve can no doubt evade the limitations, but only by violating their purported intention.

A. Should Crisis Intervention be Subject to Review?

In the wake of the 2008 crisis, Eric Posner and Adrian Vermeule argued that the government functions are radically different during a crisis than at other times.[116] According to Posner and Vermeule, the executive branch and its agencies inevitably dictate the response, while Congress and the courts slide into the background.[117] The key factors are speed and legitimacy, each of which the executive has and the other branches of government do not. "The basic dilemma for legislatures," Posner and Vermeule say, "is that before a crisis, they lack the motivation and information to provide for it in advance, while after the crisis has occurred, they have no capacity to manage it themselves."[118] The problem with courts is that they "come too late to the crisis to make a real difference in many cases, and . . . courts have pragmatic and political incentives to defer to the executive . . . ."[119] The executive therefore can step in without any real constraint from legal rules or from Congress or the courts. The only serious constraints are political — with popular opinion being the main limiting factor.[120]

In our view, executive branch dominance in a crisis is not quite as pervasive as Posner and Vermeule suggest.[121] Treasury Secretary Henry Paulson and the Bush administration did turn to Congress at several key junctures during the crisis, asking for formal authority to take over Fannie Mae and Freddie Mac in the summer of 2008, and for the $700 billion TARP program several months later. Although Posner and Vermeule attribute these requests to the

[114] Federal Reserve Act, Pub. L. No. 114-219, § 13(3), 124 Stat. 2113 (providing for emergency powers of the legislature) (codified as amended at 12 U.S.C.S. § 343 (2016)).
[115] The Dodd-Frank Act amended Section 13(3) to forbid bailouts of individual institutions, requiring that any program be industry-wide. The Federal Reserve could easily evade this stricture by devising a program that purports to be industry-wide but is designed to rescue a particular institution.
[116] Posner & Vermeule, supra note 89..
[117] Id. at 1614.
[118] Id. at 1643 (emphasis omitted) (describing the paralyzing behavior of Congress).
[119] Id. at 1654 (explaining the ineffectiveness of the judicial branch in this case).
[120] "[T]he executive does need to play politics; politics, rather than law, will place limits on its actions. The executive will have an interest in enlisting congressional support, which can enhance the credibility of the executive's policies." Id. at 1679 (citing Eric A. Posner & Adrian Vermeule, The Credible Executive, 74 **U. Chi. L. Rev.** 865, 868, 894-913 (2007) (suggesting that the limiting factor, public opinion, is reflected in Congress)).
[121] See David A. Skeel, Jr., Institutional Choice in an Economic Crisis, 2013 **Wis. L. Rev.** 629 (2013) (describing constraints on the executive's authority during a crisis). Others have made similar points. See, e.g., Richard H. Pildes, Law and the President, 125 **Harv. L. Rev.** 1381, 1407 (2012) (reviewing **Eric A. Posner and Adrian Vermeule, The Executive Unbound: After the Madisonian Republic** (2010)(noting rational choice reasons for executive to comply with law)); Aziz Z. Huq, Binding the Executive (by Law or by Politics), 79 **U. Chi. L. Rev.** 777, 795-99 (2012) (reviewing **Eric A. Posner and Adrian Vermeule, The Executive Unbound: After the Madisonian Republic** (2010) (giving examples of constraining effects of framework statutes in the national security context); Saikrishna B. Prakash & Michael D. Ramsey, The Goldilocks Executive, 90 **Tex. L. Rev.** 973, 985-95 (2012) (reviewing **Eric A. Posner and Adrian Vermeule, The Executive Unbound: After the Madisonian Republic** (2010) (cataloguing Congressional, judicial and other constraints on the executive)).

weakened state of the Bush administration,[122] which was deeply unpopular by this point, the administration's actions during the crisis seem better explained as consistent with a pattern of recognizing that the executive cannot ignore the limits of the law altogether.

Even if the executive branch is not entirely unbound, the executive and its regulators clearly do enjoy much broader discretion during a crisis than at other times. Courts seem reluctant to interfere with decisions made when the markets are under extraordinary stress. As we saw earlier, none of the litigants challenging the governmental interventions since 2008 has obtained meaningful relief thus far. Is this deference desirable, or should there be limits to the deference?

As a presumptive stance, courts' tendency to defer to other branches of government during a crisis is appropriate in our view. Regulators are able to act much more quickly, and ordinary judicial review could significantly interfere with the response to a crisis. But judicial review can serve at least two purposes even under circumstances that call for courts generally to stay in the background. First, courts can police egregious actions taken in the name of an emergency. If regulators sought to take over a systemically important financial institution that was not in genuine danger of default, for instance, a court could limit the potential harm by enjoining the threatened takeover. Second, courts can seek to limit the risk that the extraordinary actions regulators take during a crisis will permanently distort the law. We will elaborate on these points below. For the moment, the key point is that courts still have an important role to play even under conditions that call for deference to the decisions made by the other branches of government.[123]

B. Congressional Limits on Judicial Review

In discussing the question of whether courts should give more deference to bailouts during a time of crisis than at other times, we have assumed that the legal framework itself does not limit the scope of judicial review. In this section, we remove that assumption and consider three major laws Congress enacted during the crisis and its immediate aftermath, each of which significantly constrains ex post review: the Housing and Economic Recovery Act of 2008 ("HERA"), which gave regulators new authority over Fannie Mae and Freddie Mac in the event of financial distress; the $700 billion TARP legislation; and the Dodd-Frank Act of 2010. After describing the restrictions imposed by the three laws, we offer an initial assessment and a proposed approach to judicial review of future bailouts.

HERA restricts challenges to regulatory oversight of Fannie Mae and Freddie Mac in two major respects. First, when the Federal Housing Finance Agency ("FHFA"), the government sponsored entities' new regulator, placed Fannie and Freddie in receivership, FHFA was treated

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122 Posner & Vermeule, supra note 116, at 1674-77 (outlining the credibility and popularity issues that faced the Bush administration).

123 We doubt that Posner and Vermeule would disagree with this general point. Their analysis is primarily descriptive. Although they suggest that executive preeminence in a crisis is desirable, their principal argument is that it is inevitable, and they do not rule out the possibility of judicial review. Indeed, Posner worked as an expert witness in the second AIG case, arguing that the government violated the law in the AIG bailout. See Casey & Posner, supra note 7, at 479 n.* (disclosing Posner's involvement).

as assuming all of the powers of the shareholders and directors of the GSE.[124] At least as construed by the first court to address the issue, this provision removed shareholders' right to bring shareholder actions against those acting in the name of the GSE.[125] Second, HERA prohibits most actions for injunctive relief. Only if the aggrieved party has an action for damages can she bring the action. Together, these provisions significantly limit the scope of potential challenges to actions taken by regulators of the GSEs. Only contractual, tort, and constitutional claims for damages are permitted.

The TARP legislation imposed very similar limitations on challenges to regulatory action. It prohibited courts from enjoining any purchases or other actions taken by Treasury under the legislation, "other than to remedy a violation of the Constitution."[126] In addition, the legislation sharply restricted the possibility of pursuing a damages action, stating that "no action or claims may be brought against the Secretary by any person that divests its assets with respect to its participation in a program . . . other than as expressly provided in a written contract with the Secretary."[127]

Unlike the two earlier laws, which were designed to help extinguish the crisis, the Dodd-Frank Act of 2010 was enacted in its aftermath. But the Dodd-Frank Act too deals in part with financial distress. Title II, the Orderly Liquidation Authority, authorizes regulators to take over a financial institution whose failure could cause systemic harm, and to liquidate the institution. If regulators decide to intervene, it is almost impossible for the financial institution or other interested parties to undo the intervention, no matter how ill-founded it may be. The institution is given only twenty-four hours to challenge the regulators' takeover.[128] Although regulators ostensibly cannot intervene unless a default could cause systemic harm to the economy, the institution is not permitted to challenge the systemic harm determination. To stop the intervention, the institution must show either that it is not a financial institution, or that it is not in default or in danger of default.[129] This is essentially no review at all, since regulators are not likely to try to take over a non-financial institution and even if the institution were healthy, the regulators' decision to take it over would itself raise the specter of default.[130]

In addition to the explicit constraints on review in each of the statutes, interested parties cannot challenge regulators' intervention unless they satisfy the formal standing requirements. This has been a significant obstacle in several of the cases thus far. In the Chrysler case, the bankruptcy court ruled that the principal objector did not have standing to question whether Chrysler was a proper recipient of TARP funds, concluding that the objector and other creditors

[124] 12 U.S.C. § 4617(b)(2)(A)(i)(2012).
[125] Perry Capital LLC v. Lew, 70 F. Supp. 3d 208, 230-32 (D.D.C. 2014).
[126] Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, §119(a)(2)(A) (codified at 12 U.S.C. § 5229(a)(2)(A) (2012)).
[127] 12 U.S.C. § 5229(3) (2012).
[128] Dodd-Frank Act § 202(a)(1)(A)(v).
[129] Dodd-Frank Act § 202 a)(1)(A)(iii).
[130] In a critique of the FDIC's single-point-of-entry strategy for resolving troubled financial institutions under Title II, Paul Kupiec and Peter Wallison argue that the "danger of default" requirement will be difficult to satisfy. Paul Kupiec & Peter Wallison, Can the "Single Point of Entry" Strategy be used to Recapitalize a Failing Bank? (Am. Enter. Inst., Working Paper No. 2014-08, 2014), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2519229. As the text reflects, we differ with them on this point.

benefitted from the government's TARP loans to Chrysler.[131] Standing issues also have complicated efforts to preemptively challenge Title II and other parts of the Dodd-Frank Act.

It is important to note that several of the restrictions that we have just described were not dreamed up for the first time during the crisis. The ordinary bank resolution laws prohibit injunctive relief, just as HERA and TARP do, and significantly limit the possibility of bringing a successful ex-post challenge. The principal justification for the restrictions is that, because the value of a financial institution may immediately evaporate on default, regulators need to be able to act quickly and decisively. The standard bank resolution takes place over a single weekend, with regulators closing the failed bank on Friday, then immediately transferring some or all of its assets and liabilities to a purchaser that has been identified in advance.[132] Restrictions on challenges are thus endemic to the resolution of financial institutions, even in the absence of a broader financial crisis.

We also should note that most of these restrictions are perfectly permissible. Because the U.S. government has sovereign immunity, Congress is not required to subject regulatory intervention to the same scope of review as actions by private parties.[133] Although Congress cannot insulate regulators from Constitutional challenges, it can leave the shield of sovereign immunity in place for other claims if it wishes to do so. Thus, the question we will ask in the next section is not whether judicial review of regulatory intervention in a crisis can be restricted; it is whether review should be restricted.

C. What Should Judges Do in a Crisis?

We have suggested that courts inevitably will not — and in our view should not — police regulators' decision — making as closely in the midst of a crisis as at other times. Since courts do not have a comparative advantage in responding to a crisis, their first responsibility is simply to avoid unnecessarily disrupting the crisis response. If regulators intervened in a crisis, and did so based on a defensible interpretation of existing law, a judicial decision halting the intervention would unnecessarily interfere. In a fast-moving crisis, the delay imposed by a formal legal proceeding might itself impede the crisis response, even if the court later upheld the regulators' actions.

Yet judicial review continues to be important during a crisis. While courts should avoid tripping up regulators where possible — the first principle of judicial review of a bailout — they also should seek to protect the integrity of the operative legal framework. If courts ignore this second principle, and uphold interventions that violate existing law, they may invite further violations or distortions by other parties after the crisis passes.

[131] In re Chrysler LLC, 405 B.R. 84, 103 (Bankr. S.D.N.Y. 2009) (holding that Indiana Funds did not have standing under EESA because the party would receive pro-rata distribution of the value of the collateral and thus had no apparent injury), aff'd, 576 F.3d 108 (2d Cir. 2009), cert. granted, judgment vacated sub nom. Indiana State Police Pension Trust v. Chrysler LLC, 558 U.S. 1087 (2009) and vacated sub nom. In re Chrysler, LLC, 592 F.3d 370 (2d Cir. 2010).

[132] See, e.g., Skeel, supra 68, at 122-23 (describing the bank resolution process.

[133] See, e.g., Verret, supra 14, at 1536 (discussing the U.S. government's sovereignty protections).

Finally, if the legal violation is egregious, courts should provide a remedy. In an extreme case, this may mean enjoining the problematic action. If the transaction is not or cannot be enjoined, the appropriate remedy may be damages or other ex-post relief.

Drawing on these three simple principles, we first will assess courts' performance during the crisis and the aftermath. We then will offer a simple normative perspective on the appropriate scope of judicial review in future crises.

1. Judicial Challenges to the Government's Interventions

In the 2008 crisis, courts were most attentive to the first consideration: doing no harm to regulators' crisis intervention. Their handling of the second and third concerns was less consistent, as will become clear as we briefly revisit the major governmental interventions of the crisis.

Delaware's treatment of shareholders' challenge to the Bear Stearns bailout was unusual but largely effective. The court's abstention permitted the transaction to go through, without giving Delaware's imprimatur to the dubious lockup provision that made it impossible for other bidders to challenge the favored bid.[134] Although the abstention did not provide any explicit guidance for future parties, it strongly suggested that lockup provisions, like the Bear Stearns lockup, are not permissible- if the provision had been permissible, the Chancery Court would have decided the case rather than abstaining.[135] The principal limitations of this strategy are that it was less than fully transparent and could leave an aggrieved party without relief in a case where the party has suffered tangible harm.[136]

The Chrysler decision, by contrast, was problematic from the perspective we are considering. The bankruptcy court and Second Circuit insisted that the Chrysler sale was entirely consistent with existing law. In reality, the sale was highly unusual. If an investor wished to challenge the government-arranged transaction by offering a competing bid, her bid would not be treated as a "qualifying bid" unless the investor promised to give the same favored treatment to retirees and trade creditors as the government-approved bid did.[137] This made it essentially impossible for anyone else to make a bid. In many sales in bankruptcy court, the senior lenders are able to credit bid their holdings, and use their existing investment to purchase the debtor. Such action was taken off the table. The absence of a real auction ensured the success of a transaction that appears to have given Chrysler's senior lenders considerably less

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[134] See In re Bear Stearns Litig., 23 Misc.3d 447 (Sup. Ct. 2008) (holding that motion for summary judgment is dismissed based on the business judgment rule).

[135] The abstention was, in this sense, somewhat similar to a company's announcement that it has no comment when rumors circulate about a potential transaction or event. The corporation's failure to comment suggests that the rumor is probably accurate, much as Delaware's abstention implied that the Bear stockholders' allegations of illegality were accurate. Id. at 471.

[136] The Treasury and Fed initially pressured Bear and JPMorgan Chase to give Bear shareholders only $2/share in the merger, but JPMorgan was forced to up its bid to $10 in return for removal of a provision that mistakenly committed JPMorgan to guarantying Bear's obligations. Andrew R. Sorkin, JPMorgan Raises Bid for Bear Stearns to $10 a Share, **N.Y. Times: Business Day** (Mar. 24, 2008), http://www.nytimes.com/2008/03/24/business/24deal-web.html. As a result, Bear's shareholders appear to have fared relatively well in the end.

[137] See, e.g., Roe & Skeel, supra note 38, at 733 (noting that the terms accepted by the court promised retirees payment and decided which creditors would get paid).

than the value of their collateral. By insisting that the transaction was entirely legitimate, and thus suggesting that it is not necessary to require a meaningful auction in connection with a proposed sale, the courts sowed the seeds for future mischief. In theory, other parties could arrange artificial sales that protected some creditors while leaving others behind, without regard to the parties' priorities.[138]

Like the Chrysler ruling, the district court in the first AIG case suggested that its decision upholding the Federal Reserve's acquisition of nearly eighty percent of AIG's voting power was entirely appropriate under existing law.[139] While the court's decision to dismiss the shareholders' claims was probably the right ruling, it strikes us as a much closer case than the court's analysis suggests. By claiming otherwise, the court implies that future regulators need not pay attention to legal constraints in a crisis. The second AIG case was more commendable in this regard. The court ruled that regulators effected a taking of the shareholders' property, but concluded that the shareholders were not entitled to damages because their shares would have been worthless if the government had not intervened and bailed AIG out.[140]

The first major ruling on the Fannie Mae and Freddie Mac litigation — the District Court's dismissal of shareholders' claims — relied heavily on the restrictions on judicial review included in HERA.[141] The court rejected claims that the conservator acted outside its authority by agreeing to the 2012 sweep, and held that actions the conservator took were barred by the restriction on injunctive relief.[142] Almost the only claim that remained was the shareholders' claim that the dilution of their interests constituted a Taking.[143] On this claim, the court held that any property interest the shareholders might have had disappeared when regulators took over Fannie and Freddie. The court held:

> Whether the defendants executed the . . . [2012 sweep] to generate profits for taxpayers or to escape a "downward spiral" of the GSEs seeking funding in order to pay owed dividends back to Treasury, it does not change the fact that it was executed during a period of conservatorship and, thus, after the plaintiffs' property interests—whatever they may have been prior to the . . . [2012 sweep]—were extinguished.[144]

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[138] The sale of Detroit's art to a newly created trust and the distribution of the proceeds solely to pension beneficiaries was analogous to the Chrysler transaction in some respects. See David A. Skeel, Jr. From Chrysler and General Motors to Detroit, 24 **Widener L. J**. 121, 136 (2015)(stating that the proceeds of the Detroit bankruptcy were used to increase the payout of Detroit's pension beneficiaries).

[139] See Starr Int'l Co. v. Fed. Reserve Bank of N.Y., 906 F. Supp. 2d 202, 237 (S.D.N.Y. 2012) (finding that Delaware fiduciary duty law is preempted and does not apply to a federal instrument, such as a Federal Reserve Bank), aff'd, 742 F.3d 37, 38 (2d Cir. 2014).

[140] Starr Int'l Co. v. United States, 121 Fed. Cl. 428, 474 (2015).

[141] Perry Capital LLC v. Lew, 70 F. Supp. 3d 208, 219-20 (D.D.C. 2014). For a critical assessment of the Perry Capital decision, see Ally C. Steele, Note, Fannie, Freddie, and Fairness: Judicial Review of Federal Conservators, 53 **Harv. J. Legis.** 417 (2016).

[142] Perry Capital LLC, 70 F. Supp. 3d at 222.

[143] *Id.* at 242. The district court only had jurisdiction over takings claims under $10,000. Larger takings claims must be brought — and are currently pending — in the Federal Court of Claims.

[144] Id. at 242. It is not entirely clear whether the court is stating that any Taking claim was permanently cut off when the conservatorship was commenced, or whether it might reemerge if at any point the basis for conservatorship no longer existed.

The Fannie Mae decision, which is currently on appeal to the D.C. Circuit, is debatable though arguably defensible. Even if it is correct as a matter of law, it raises two very significant concerns. First, as construed by the district court, the statute leaves almost no room for judicial oversight of regulators' actions, regardless of how far removed the actions are from the concerns that justify limits on judicial review. The prohibition on injunctive relief ensures that regulators can act promptly in a crisis, for instance, and need not worry that a court will interfere. But it seems much less necessary to preclude judicial challenges that are not likely to interfere with regulators' discretion. The excessive stinginess of the restrictions is particularly apparent in this context, given that investors are trying to challenge actions that took place four years after FHFA put Fannie and Freddie in conservatorship, at a time when speed and flexibility were no longer a concern.

Second, the Fannie Mae case underscores the importance of providing a remedy for egregious regulatory actions. The district court concluded that, so long as the conservatorship itself was proper, investors have no remedy for any actions taken by the conservator.[145] In this case, the conservator has funneled all of the GSE's profits to the government, and precluded the GSEs from ever repaying the government.[146] In addition to disrupting investors' expectations, the 2012 sweep created dangerously perverse incentives for Congress. Because any profits go to Treasury, and the GSEs can continue to operate in the meantime, there has been very little incentive for Congress to restructure the GSEs.[147] They have simply remained in limbo. If investors were found to have a remedy for the government's punitive 2012 reconfiguration of its treatment of the GSEs, by contrast, pressure to reform the GSEs would quickly mount.

1. Lessons for Judicial Review of Crisis Interventions

How might judicial review be improved, to better achieve the objectives we described at the outset of this section? We have several simple suggestions.

Our first suggestion is simply that it is important to leave at least some scope for judicial review. Although Congress is not required to permit meaningful judicial review, it would be a mistake to insulate regulators' actions from review altogether — even in a crisis. The Fannie Mae decision underscores the costs of excessively constrained review. For the same reasons, courts should construe restrictions on judicial review narrowly, in the interest of ensuring that at least limited judicial review is available. Courts also can further facilitate review by construing standing doctrine expansively in this context.[148]

It is important to emphasize that the opportunity for judicial review can have beneficial effects even in cases that do not ultimately provide relief. By assessing the legality of regulators'

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145 Id. at 227-28.
146 Id. at 227.
147 Note that the capital is being wound down to zero in 2018. See Third Amendment to Amended and Restated Senior Preferred Stock Purchase Agreement Sec. 3, August 17, 2012, available at http://www.fhfa.gov/Conservatorship/Documents/Senior-Preferred-Stock-Agree/2012-8-17_SPSPA_FannieMae_Amendment3_508.pdf. Theoretically, this could create pressure to act, but it also could create pressure for an additional bailout if the GSEs run into trouble.
148 See Zaring, supra note 14, at 1407 (emphasizing the potential for looser standing restrictions to facilitate judicial review).

intervention, courts can minimize the distortions that crisis-period decision making might otherwise cause in existing law.

Recent corporate law provides a useful analogy in this regard. As construed by the Delaware courts, the business judgment rule review has evolved to pursue two, somewhat different roles, serving, as one scholar puts it, both as a rule of conduct and as a rule of liability.[149] The rule of conduct is quite strict. In addressing an alleged violation of directors' fiduciary duties, Delaware courts carefully scrutinize the directors' behavior, and assess the quality of the directors' performance of their responsibilities. When it comes to liability, by contrast, the courts are much more forgiving. Even if the directors failed to follow best practices, the courts often conclude that they should not be held liable, lest directors be unduly chilled by the threat of liability.[150]

In our view, judicial review of crisis interventions should function somewhat similarly. Courts should give more deference to regulators' actions during a crisis than they would at other times, and they should be more hesitant to invalidate a regulatory intervention. But courts should not ignore obvious distortions of existing law. Even if a court ultimately concludes that investors are not entitled to a remedy, a judge can use her opinion to point out actions that are legally problematic. Indeed, to the extent that a court of law rules on the legality of action after the fact, this can promote accountability by signaling to the public that the relevant actors overstepped their bounds. The AIG decision seems to us a model in this regard, criticizing some of the government's actions, despite finding that the investors ultimately were not harmed.

We are not offering solely a pyrrhic victory here to the investors. When a court rules that conduct is out of bounds, even if there is no ultimate relief, it articulates the rule of conduct going forward. There will be other bailouts. To the extent that the government is called to task, even belatedly in the prior bailout, this will cast a shadow on future efforts. Clearly articulating the legal boundaries on government action will, at the margin, make it more likely that the boundaries will be respected the next time we are in a crisis situation. To be sure, the boundary may prove to be porous, but it is better to have the regulator to consider the boundary, even though it may be rejected in the extreme, than to pretend that it does not exist.

Conclusion

Bailouts are a feature, not a bug, of our financial system. The ever-evolving world of finance has provided great benefits for our country. But the very innovation that has created wealth for the nation creates the inevitability that something unforeseen is going to happen. Creating new financial products can enhance overall welfare. Yet no one has the foresight to predict with precision how things may go awry. It would be foolhardy to ban innovation for fear that we cannot predict all of the consequences. Rather, part of the architecture of our society is

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[149] See Melvin A. Eisenberg, The Divergence of Standards of Conduct and Standards of Review in Corporate Law, 62 **Fordham L. Rev.** 437, 467-68 (1993)(concluding that the standards of review governing liability are not themselves standards of conduct).

[150] Delaware's handling of Disney shareholders' challenge to Disney's decision to terminate Michael Ovitz without cause is the best known recent illustration of this bifurcated approach to review. See In re The Walt Disney Co. Derivative Litig., 907 A.2d 693, 697 (Del. Ch. 2005), aff'd, 906 A.2d 27, 35-6 (Del. 2006)(criticizing CEO's and directors' handling of their responsibilities, but concluding that none was liable).

to have a government that, on the back end, intervenes to tamp down the crisis. Government as a backstop allows us to plunge ahead.

That we need a government backstop does not mean that the government has carte blanche to do as it pleases in the time of financial crisis. As with most things, the government can perform well in this area or it can perform poorly. To maximize the chances that it performs well, there should be an articulation of the principles that guide future bailouts. We here have argued for accountability (which requires both transparency and articulation of the reasons for intervention), minimizing the disruption of settled interest, and prompt exit. Moreover, in addition to articulating such principles in advance, there should be modest judicial review after the fact, both to convey to the country how well our government complied with its obligations and to bolster compliance in the next go-around. Uncertain the future is, but that is no reason to avoid setting out our expectations for how our government should respond.