

INSTITUTIONAL CHOICE IN AN ECONOMIC CRISIS

DAVID A. SKEEL, JR.*

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INTRODUCTION

With the publication of his classic book *Imperfect Alternatives*¹ two decades ago, and even earlier in the articles that preceded it, Neil Komesar identified a ubiquitous weakness in debates over whether a particular issue is best handled by courts, markets, or legislation. Scholars nearly always considered the institutions in isolation, engaging in what Komesar called “single institution” analysis.² Focusing on the capabilities of a single institution can be deeply misleading. Even if courts are not well positioned to resolve some kinds of issues, such as product market flaws that cause relatively small harms to many victims, they may be more effective than markets or legislatures. Similarly, issues that play to courts’ strengths might be handled even better by other institutions.

As this Symposium attests, Komesar’s work transformed our understanding of how institutional analysis should be done. To make matters worse, he not only explained in theoretical terms the importance of taking multiple institutions into account, but he also showed how it should be done. In *Imperfect Alternatives*, his more recent book *Law’s*

* S. Samuel Arsht Professor of Corporate Law, University of Pennsylvania Law School. My thanks to Andy Coan, Victoria Nourse, and the editors of the *Wisconsin Law Review* for inviting me to participate in this Symposium; to Greg Shaffer, Alan Weisbard, and the participants at the conference for helpful comments; and to Neil Komesar for providing the occasion. I have omitted from this Article the personal reminiscences with which I began the conference remarks on which this Article is based. I note here only that Neil had a profound influence on me early in my career, both through his pathbreaking scholarship and through his personal encouragement.

1. NEIL K. KOMESAR, *IMPERFECT ALTERNATIVES: CHOOSING INSTITUTIONS IN LAW, ECONOMICS, AND PUBLIC POLICY* (1994).

2. *Id.* at 6 (defining “single institutionalism”).

Limits,³ and elsewhere, Komesar has applied his insights to everything from nuisance law⁴ to the *United States v. Carolene Products Co.* footnote⁵ and the business judgment rule in corporate law.⁶

There is one very surprising omission from the breathtaking range of Komesar's oeuvre, however: he has never directly applied his framework to crises. The institutional dynamics of crises are extraordinarily important. Nearly all of America's major federal corporate and financial regulation has been enacted in the wake of, and as a result of, crises. To understand American business regulation, we therefore need to consider how institutions function during, and immediately after, a crisis.⁷

In important recent work, two prominent scholars—Eric Posner and Adrian Vermeule—have partially filled the gap, arguing that the executive branch has sweeping authority during a crisis, checked only by popular will.⁸ Although Posner and Vermeule's theory is compelling in many respects, they miss several key dimensions of institutions' interactions in a crisis, in part because they do not directly apply the Komesarian framework. They overstate the scope of executive control, for instance, and do not fully consider some of the endogenous features of the institutional environment, such as the possibility that Congress will respond to executive overreaching during a crisis by enacting legislation that ties the executive's hands in its wake.

My aim in this Article is to advance, at least in a small way, our understanding of institutional choice during and after an economic crisis. Part I very briefly revisits the recent crisis, emphasizing its institutional dimensions. Part II identifies three puzzles posed by a crisis for standard Komesarian analysis. Part III then shows how Posner and Vermeule's executive-centered theory partially but not completely addresses these puzzles. Part IV offers an expanded institutional analysis of a crisis. In addition to exploring the endogenous interactions between the executive branch and Congress, this Part also argues the courts' choice set is

3. NEIL K. KOMESAR, *LAW'S LIMITS: THE RULE OF LAW AND THE SUPPLY AND DEMAND OF RIGHTS* (2001).

4. *Id.* at 11–16.

5. *Id.* at 61 (referencing *United States v. Carolene Prods. Co.*, 304 U.S. 144, 153 n.4 (1938)).

6. *Id.* at 178.

7. A fine new article by Jonathan Lipson explores other aspects of the recent crisis—in particular, the choice between administrative resolution and bankruptcy—in comparative institutional terms. See Jonathan C. Lipson, *Epic Fail: An Institutional Analysis of Financial Distress* 74–77 (Univ. of Wis. Law Sch. Legal Studies Research Paper Series, Paper No. 1201, 2012).

8. See ERIC A. POSNER & ADRIAN VERMEULE, *THE EXECUTIVE UNBOUND: AFTER THE MADISONIAN REPUBLIC* (2010).

broader and more significant than is sometimes recognized. Even if courts accede to the executive's wishes, as they did in the most recent crisis, the way a court characterizes its ruling can have a significant effect on the subsequent development of the law.

I. THE CRISIS

To provide a context for the discussion that follows, I begin with a very brief refresher on the recent economic crisis—just enough to highlight some of the key institutional features of the crisis and lawmakers' regulatory response.

In March 2008, Bear Stearns, one of the nation's largest investment banks, suddenly collapsed.⁹ Bear Stearns's demise began when questions about its liquidity arose,¹⁰ triggered in part by a rumor that Goldman Sachs had refused to renew the daily repo loans it was making to Bear.¹¹ As hedge funds and other clients withdrew their money, Bear's CEO Alan Schwartz called superlawyer Rodgin Cohen, the chairman of Sullivan & Cromwell, who quickly alerted Timothy Geithner, then-president of the Federal Reserve Bank of New York.¹² After failing to line up new financing, Schwartz contacted the head of JPMorgan Chase and proposed a deal.¹³ With heavy involvement from Geithner and United States Department of the Treasury ("the Treasury") Secretary Henry Paulson, including a \$29 billion loan guarantee by the New York Federal Reserve,¹⁴ the parties hastily agreed to a purchase of Bear by JPMorgan.¹⁵

This was no ordinary arm's-length business transaction. As the two banks gravitated toward a price of \$4 to \$5 per share, Secretary Paulson insisted that they lower the price so that Bear Stearns would not benefit from the bailout.¹⁶ The Federal Reserve ("the Fed") and the Treasury

9. *Id.* at 4.

10. *See, e.g.*, Kate Kelly, *Fear, Rumors Touched Off Fatal Run on Bear Stearns*, WALL ST. J. (May 28, 2008), <http://online.wsj.com/article/SB121193290927324603.html>.

11. *See, e.g.*, Roddy Boyd, *The Last Days of Bear Stearns*, CNNMONEY (Mar. 31, 2008), http://money.cnn.com/2008/03/28/magazines/fortune/boyd_bear.fortune/.

12. Kelly, *supra* note 10.

13. *Id.*

14. David Lawder, *NY Fed to Provide \$29 Billion in Bear Stearns Financing*, REUTERS, Mar. 24, 2008, *available at* <http://www.reuters.com/article/2008/03/24/us-bearstearns-fed-idUSWAT00917720080324>.

15. Kelly, *supra* note 10; Kate Kelly, *Bears Stearns Nearing Collapse Twice in Frenzied Final Week*, WALL ST. J. (May 29, 2008), <http://online.wsj.com/article/SB121202057232127889.html>.

16. Kelly, *supra* note 15. The price was later renegotiated upward to \$10 per share after the parties discovered a glitch in the terms of the merger agreement, which

also played an active role in structuring the transaction, which took the form of a merger in which JPMorgan acquired Bear's stock from Bear's shareholders.¹⁷ To ensure that the government-endorsed transaction could not be disrupted, the parties added lockup provisions that clearly violated Delaware merger law.¹⁸ The key provision promised JPMorgan forty-nine percent of stock even if its acquisition fell through, thus making it impossible for a competing bidder to obtain control.¹⁹

Although the Fed and the Treasury were the key institutional players throughout Bear's fall, the judicial system had a cameo role. A group of Bear shareholders filed litigation in the Delaware Chancery Court, challenging the proposed merger.²⁰ Faced with the thorny question whether to strike down the transaction as a violation of Delaware law and thus thumb its nose at the federal government, or to uphold the transaction and thus do violence to Delaware law, the judge did neither.²¹ He abstained from deciding the case, ruling that it should be decided in New York instead.²²

Congress was almost entirely absent as Bear's fate was decided. Its first major involvement in the crisis came several months later, as fears grew about the stability of Fannie Mae and Freddie Mac, the two government-sponsored corporations that buy or guarantee most home mortgages.²³ In July 2008, the Treasury asked Congress to enact legislation giving it the power to take over Fannie Mae and Freddie Mac if their financial stability deteriorated.²⁴ Secretary Paulson assured lawmakers that, while it was important that he have the powers, he did not intend to use them.²⁵ A little over a month after Congress passed the legislation with large majorities, Secretary Paulson used them, seizing control of both institutions in early September 2010 and putting each in conservatorship.²⁶

could be read as an open-ended commitment by JPMorgan to guarantee Bear Stearns's obligations. *Id.*

17. *Id.*

18. Marcel Kahan & Edward Rock, *How to Prevent Hard Cases from Making Bad Law: Bear Stearns, Delaware, and the Strategic Use of Comity*, 58 EMORY L.J. 713 (2009) (analyzing provisions of the deal in detail).

19. *Id.* at 723 n.68, 724–25.

20. *Id.* at 720.

21. *Id.* at 756.

22. *Id.* The best account of this episode is a postmortem by Marcel Kahan and Edward Rock, who praise the Delaware judge for sidestepping the issue, since there were serious downsides to either upholding the transaction or striking it down. *Id.*

23. *See generally* DAVID WESSEL, IN FED WE TRUST: BEN BERNANKE'S WAR ON THE GREAT PANIC 176–87 (2009) (describing the episode in great detail).

24. *Id.* at 178–80.

25. *Id.* at 183.

26. *Id.* at 186–87.

Next up was Lehman Brothers, another of the largest investment banks. Although Lehman was four times as large as Bear Stearns, the Fed and the Treasury refused to bail it out, pushing Lehman into bankruptcy as last-ditch negotiations to sell most of the bank's assets to Barclays fell through.²⁷ Lehman's bankruptcy caused the Reserve Primary Fund, a large money market fund that held a substantial amount of the short-term debt issued by Lehman, to "break the buck"—that is, to acknowledge that it could no longer assure its clients that they would get back at least \$1 for every \$1 they had invested.²⁸ The Treasury responded to the ensuing panic by putting rescue funding in place for all money market funds.²⁹

Two days after Lehman's bankruptcy filing, AIG, the giant insurance and financial services company, threatened to collapse.³⁰ The Fed and the Treasury put together an \$85 billion bailout package (later expanded to \$182.5 billion) to avert a default.³¹ The rescue financing had a number of unusual features. Most important for present purposes, it appeared to give the New York Federal Reserve control of nearly eighty percent of AIG's stock, through trusts set up to facilitate the rescue.³² The stock feature was noteworthy because the Fed's emergency lending powers permit it to make loans, but not to buy or sell stock.³³

In late September, Secretary Paulson asked Congress to enact legislation giving the Treasury \$700 billion to purchase troubled assets held by the banking industry.³⁴ The direness of Secretary Paulson's warnings and the paucity of details about the Treasury's specific plans terrified the markets.³⁵ After the House of Representatives initially

27. See *Too Big to Fail: The Role for Bankruptcy and Antitrust Law in Financial Regulation Reform (Part I): Hearing Before the Subcomm. on Commercial & Admin. Law of the H. Comm. on the Judiciary*, 111th Cong. 69–73 (2009) (statement of Harvey R. Miller, Bankruptcy Counsel for Lehman Brothers).

28. WESSEL, *supra* note 23, at 206–07.

29. See *id.* at 208. During the same period the Fed provided support for banks to buy commercial paper in order to prop up the price of the commercial paper held by money market funds. See *id.*

30. See William K. Sjostrom, Jr., *The AIG Bailout*, 66 WASH. & LEE L. REV. 943 (2009) (an extensive scholarly analysis of the AIG collapse and bailout).

31. *Id.* at 944–45.

32. See *id.* at 966.

33. See, e.g., 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, 1629–30 (2009).

34. See ANDREW ROSS SORKIN, *TOO BIG TO FAIL: THE INSIDE STORY OF HOW WALL STREET AND WASHINGTON FOUGHT TO SAVE THE FINANCIAL SYSTEM—AND THEMSELVES* 490–97 (2009).

35. See JOHN B. TAYLOR, *GETTING OFF TRACK: HOW GOVERNMENT ACTIONS AND INTERVENTIONS CAUSED, PROLONGED, AND WORSENERED THE FINANCIAL CRISIS* 28 (2009).

rejected the proposed legislation, jolting the markets once again, both houses approved it, and President George W. Bush signed the \$700 billion Troubled Asset Relief Program (TARP) into law on October 3, 2008.³⁶ For the second time in the crisis, Congress had stepped in, each time acceding to urgent prodding by the executive branch. Although the Treasury originally planned to purchase banks' mortgage-related assets, it used the funds to provide capital to each of the largest banks.³⁷

Secretary Paulson insisted that none of the TARP funds would be used to bail out the auto industry. "The TARP is aimed at the financial system," he assured Congress a few weeks after its enactment.³⁸ "[I]n terms of autos, I have said it would not be a good thing."³⁹ After an auto bailout proposal was swatted away by Congress, Secretary Paulson and the Bush administration changed their minds. They made \$17 billion in loans to Chrysler and General Motors, enough to ensure that neither company ran out of cash before the end of the Bush administration and the transition to a new administration.⁴⁰

At the outset of his administration, President Barack Obama set up an Auto Task Force to deal with Chrysler and General Motors.⁴¹ After reviewing the companies' own proposals for rejuvenation, the administration ushered each through a "quick rinse" bankruptcy.⁴² Rather than using the ordinary restructuring process, which requires a creditor vote and a variety of other protections, each company "sold" its most important assets to a new company set up for this purpose.⁴³ To finance the process, the Treasury lent additional TARP funds to each company.⁴⁴ Chrysler served to some extent as a guinea pig for the much larger General Motors bankruptcy. In each case, the bankruptcy judge approved the sale transaction roughly a month after the initial filing.⁴⁵

36. WESSEL, *supra* note 23, at 226–27.

37. *Id.* at 227.

38. See Wendy Jones, *Paulson, Bernanke Testify, Get Grilled*, NBC NEWS (Nov. 18, 2008, 7:25 PM), http://firstread.msnbc.msn.com/_news/2008/11/18/4425489-paulson-bernanke-testify-get-grilled (quoting Paulson testimony).

39. *Id.*

40. See Michael Giusti, *Automakers Receive \$17 Billion in Bush Bailout*, BANKRATE.COM, <http://www.bankrate.com/finance/auto/automakers-receive-17-billion-in-bush-bailout-1.aspx> (last visited Feb. 25, 2013).

41. Steven Rattner, *The Auto Bailout: How We Did It*, CNNMONEY (Oct. 21, 2009, 9:30 AM), http://money.cnn.com/2009/10/21/autos/auto_bailout_rattner.fortune/ (a somewhat self-serving inside account of the Auto Task Force's work).

42. *Id.*

43. Mark J. Roe & David Skeel, *Assessing the Chrysler Bankruptcy*, 108 MICH. L. REV. 727, 733–34 (2010) (describing and criticizing the Chrysler transaction in considerable detail, and the General Motors deal more briefly).

44. *Id.* at 733.

45. *Id.* at 728.

Although the automaker transactions are sometimes described as having been blessed by every court that considered them,⁴⁶ this is not quite accurate.⁴⁷ After the Second Circuit affirmed the bankruptcy court's approval of the Chrysler sale, the case was appealed to the Supreme Court.⁴⁸ The Supreme Court vacated the Second Circuit opinion and dismissed the case but declined on equitable mootness grounds to rule on the underlying transaction.⁴⁹

Also in early 2009, the Fed and the Treasury conducted "stress tests" of the nineteen largest bank holding companies. They concluded that ten were undercapitalized, and committed additional TARP funds to improve the banks' capital.⁵⁰

The legislative branch assumed a much more central role in the next major phase of the crisis, which led to the enactment in July 2010 of the financial reforms known as the Dodd-Frank Act.⁵¹ The reforms gave a great deal of power to the financial regulators. The legislation gave a new regulatory council comprised of the heads of the major financial regulators authority to designate systemically important financial institutions for special oversight, it gave the FDIC the power to take over a financial institution whose default might otherwise jeopardize the financial system, and it created a new consumer regulator.⁵² The legislation also sought to constrain regulators' ability to bail out troubled financial institutions in the future, however. Most importantly, it limited the special lending authority that the Fed used for much of the rescue financing in 2008 by prohibiting the Fed from using the authority to bail out particular institutions.⁵³

46. See, e.g., Steven Rattner, *Delusions about the Detroit Bailout*, N.Y. TIMES, Feb. 24, 2012, at A27 ("[T]he president's plan was litigated throughout the federal court system—all the way to the Supreme Court, in the case of Chrysler—without so much as a nod to the opponents from a single judge.").

47. The misstatement appears to have originated with Steven Rattner, the head of the Auto Task Force. See *id.*

48. *Ind. State Police Pension Trust v. Chrysler LLC*, 130 S. Ct. 1015 (2009).

49. *Id.* at 1015.

50. David Ellis, *Stress Tests: Banks Need \$75 Billion*, CNNMONEY (May 8, 2009, 7:47 AM), http://money.cnn.com/2009/05/07/news/companies/stress_test_announcement/index.htm.

51. The Dodd-Frank Act and the effects described in the discussion that follows are analyzed in detail in DAVID SKEEL, *THE NEW FINANCIAL DEAL: UNDERSTANDING THE DODD-FRANK ACT AND ITS (UNINTENDED) CONSEQUENCES* (2011).

52. *Id.* at 130–32 (FDIC's resolution powers); *id.* at 106–09 (the new consumer bureau).

53. *Id.* at 136 (describing new restrictions on the Fed's use of its emergency lending powers in § 13(3) of the Federal Reserve Act, as introduced by Dodd-Frank Act § 1101).

The Dodd-Frank Act was also noteworthy for the extent to which it delegated final decisions about the shape of the regulation to regulators. According to one count, the legislation instructed regulators to make 243 new rules and conduct sixty-seven studies.⁵⁴

The crisis has thus had three major phases: the first was the steps taken to contain it in 2008 and 2009, which involved primarily the executive and agencies, whose response included a number of measures of questionable legality; the second was the enactment of major new financial legislation in 2010, which centered on Congress and the executive; and the third is the agency implementation that is currently taking place and will likely continue for some time.

II. PUZZLES FOR COMPARATIVE INSTITUTIONAL ANALYSIS

For decades (forty years, by his count), Neil Komesar has urged scholars and decision makers to take institutional choice seriously, paying heed to each of three main institutions—markets, courts, and legislatures—rather than just one.⁵⁵ Even if an institution is flawed, it may still be the best choice to handle an issue if the alternative institutions are even more flawed in the relevant context.⁵⁶ Similarly, the fact that an institution can handle an issue well should not end the analysis.⁵⁷ Another institution may be even better.⁵⁸

Komesar's own approach is "participation centered," placing particular emphasis on the likelihood that the affected parties will make their interests known to the relevant institutional decision maker.⁵⁹ Here, he draws heavily on Mancur Olson's writings on collective action but with a twist: whereas most legal scholars who write in this tradition have emphasized the risk of "minoritarian" bias—that is, that concentrated interest groups will have more influence than diffuse groups—Komesar insists on a "two-force" model that also considers the potential for

54. Davis Polk & Wardwell LLP, *Summary of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Enacted into Law on July 21, 2010*, i (July 21, 2010), http://www.davispolk.com/files/Publication/7084f9fe-6580-413b-b870-b7c025ed2ecf/Presentation/PublicationAttachment/1d4495c7-0be0-4e9a-ba77-f786fb90464a/070910_Financial_Reform_Summary.pdf.

55. See Neil K. Komesar, *The Logic of the Law and the Essence of Economics: Reflections on Forty Years in the Wilderness*, 2013 WIS. L. REV. 265, 288.

56. *Id.* at 301.

57. *Id.* at 302.

58. See KOMESAR, *supra* note 1, at 6.

59. *Id.* at 7–8.

“majoritarian bias,” in which the majority uses its numerical superiority to shortchange the interests of the minority.⁶⁰

Although Komesar generally assumes that the parties’ interests and roles are stable, he considers several ways in which they may shift. Prior to a products liability injury, potential injurers have high stakes (such as the costs a manufacturer will bear if the government imposes new safety regulations), while the stakes of potential victims are highly diffuse.⁶¹ Once a harm occurs, by contrast, the actual victims have very high stakes, thus making their participation more likely.⁶² Somewhat similarly, a party that loses at one point in time may reassert itself at another.⁶³ If a legislative majority enacts legislation that imposes costs on a concentrated interest group, and implementation of the legislation is delegated to an agency, the interest group may be able to capture the agency and undo some or all of the costs of the majoritarian legislation.⁶⁴

As we shall see, each of these insights is highly relevant to a comparative institutional analysis of economic crisis. So far so good. But economic crises also pose at least three puzzles for Komesarian comparative institutional analysis.

The first is that majoritarian preferences seem to function very differently during a crisis than at other times. Large numbers of Americans were sharply opposed to the bailouts of Bear Stearns and AIG, and they acted as if they had high stakes.⁶⁵ This suggests that the crisis transformed their stakes. But the significance of the transformation was not altogether clear. For many, it seems to have been a shift in their perceived stakes rather than a shift in actual stakes.⁶⁶ The majoritarian hostility to bailouts also seems to have been less efficacious than strong

60. *Id.* at 65–81 (proposing and defending the two-force approach). The term “shortchange” is of course loaded. The influence of either a majority or a minority can be either good or bad, depending on what our goal is. *See* KOMESAR, *supra* note 3, at 64–65; Thomas W. Merrill, *Institutional Choice and Political Faith*, 22 *LAW & SOC. INQUIRY* 959, 982–87 (1997) (reviewing Komesar’s *Imperfect Alternatives*).

61. KOMESAR, *supra* note 1, at 167–68.

62. *Id.*

63. *Id.* at 161–77 (analyzing shifts in stakes and their implications).

64. *See id.* at 95–96 (increased influence of concentrated groups in administrative setting).

65. *See* Conor Friedersdorf, *Why the Tea Party and Occupy Wall Street Should Cooperate*, *ATLANTIC* (Oct. 11, 2011, 11:00 AM), <http://www.theatlantic.com/politics/archive/2011/10/why-the-tea-party-and-occupy-wall-street-should-cooperate/246413/>.

Hostility to the bailouts was (along with opposition to the healthcare legislation) one cause of the emergence of the Tea Party Movement and also figured in the subsequent rise of the Occupy Wall Street Movement. *Id.*

66. Even those who did not lose their jobs or suffer other direct financial repercussions from the 2008 crisis may have worried about the cost of the bailouts to them as taxpayers, but the direct cost to an individual taxpayer is likely to have been relatively small.

majoritarian preferences ordinarily are, because it did not prevent either of these companies from being bailed out.

The second puzzle is the prominence of the executive branch during an economic crisis. The executive is almost completely invisible in Komesarian comparative institutional analysis, which treats markets, courts, and the legislature as the principal institutions.⁶⁷ Yet the executive—both directly and through its agencies—was by far the most visible institution during the height of the crisis. Secretary Paulson was the key player throughout much of 2008, and his successor, Timothy Geithner, was similarly central, both before and after the Obama administration came in.

The third puzzle is the role of the judicial system. Komesarian comparative institutional analysis nearly always begins with the courts.⁶⁸ Although some issues are best decided by Congress, others by markets, and others by courts, Komesar assumes that courts are the key gatekeeper—the ones who are actually making the institutional choice. Komesar does not make Herculean assumptions about courts. Quite to the contrary, he repeatedly emphasizes that courts' capacity is quite limited, and that the costs of participation in the judicial process are high.⁶⁹ But he focuses primarily on “court-made law,”⁷⁰ and usually assumes that judges will decide whether to defer to the markets or legislature.⁷¹ Yet the crisis does not seem to have been court centered at all. In a sense they performed a gatekeeping function, but the courts seemed to be playing a distinctively secondary role throughout the crisis. The question I propose to pursue for the remainder of the Article is this: What can comparative institutional analysis tell us about these three puzzles and about responding to an economic crisis?

III. THE EXECUTIVE UNBOUND

Two prominent legal scholars—Eric Posner and Adrian Vermeule—have offered comparative institutional analysis answers to each of the puzzles.⁷² Whereas Komesar focuses primarily on courts, the star of Posner and Vermeule's recent work is the executive branch.⁷³ Particularly but not exclusively in a crisis, they argue, the executive calls

67. See KOMESAR, *supra* note 1, at 53–97 (outlining a model of legislative influence in his chapter addressing “the political process”). Komesar nearly always talks about legislators when he speaks of the political process.

68. See KOMESAR, *supra* note 3, at 9 (noting his focus on “court-made law”).

69. See, e.g., *id.* (noting constraints on size and judicial capacity).

70. *Id.*

71. See, e.g., *id.* at 11.

72. See POSNER & VERMEULE, *supra* note 8; Posner & Vermeule, *supra* note 33.

73. See POSNER & VERMEULE, *supra* note 8.

the shots.⁷⁴ The key issues are speed and legitimacy, each of which the executive has and the other branches of government do not.⁷⁵ “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.”⁷⁶ 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.”⁷⁷ The executive therefore can step in without any real constraint from legal rules or from Congress or the courts. The only real checks are political—with popular opinion being the main limiting factor.⁷⁸

The first thing to note is how easily the Posner-Vermeule account can be translated into Komesarian terms. Like Komesar, Posner and Vermeule highlight the limitations of courts’ institutional capacity. For Posner and Vermeule, the issues are speed and legitimacy, whereas Komesar emphasizes questions of competence and scale. The terms Posner and Vermeule use to explain the executive’s dominance also are not far removed from those one might expect Komesar to use. Posner and Vermeule’s claim that the principal constraint on the executive is popular opinion suggests, for instance, that majoritarian preferences figure more prominently in a crisis than the preferences of concentrated interests such as the financial services industry.

How persuasively does this account answer the comparative institutional puzzles? The strength of the Posner-Vermeule account, in my view, is that it provides a plausible explanation for the prominence of the executive branch during a crisis. In addition, their claim that the executive has considerable leeway to ignore existing law—a concept they first explored in the national security context—is clearly accurate, at least as a description of the recent crisis. As noted earlier, the government-orchestrated bailout of Bear Stearns flouted ordinary merger law, the AIG bailout arguably violated the Fed’s lending powers, and the car bailouts stretched the rules on bankruptcy sales well past the breaking point.⁷⁹

But the account also seems to me to have several limitations. The first is that Posner and Vermeule exaggerate the executive’s ability to

74. *See id.* at 34–61.

75. *See id.*

76. Posner & Vermeule, *supra* note 33, at 1643 (emphasis omitted).

77. *Id.* at 1654.

78. *See id.* at 1679 (“The 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.”).

79. *See supra* notes 18-19, 30-33, 43, and accompanying text.

ignore law and the other branches during an economic crisis.⁸⁰ As already discussed, Treasury Secretary Henry Paulson and the Bush administration turned 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.⁸¹ Although Posner and Vermeule attribute these requests to the weakened state of the Bush administration,⁸² which was deeply unpopular by this point, this explanation does not seem especially compelling. Although President Franklin D. Roosevelt hinted that he might circumvent Congress if it resisted his proposals for addressing the Great Depression,⁸³ as Posner and Vermeule note, he consistently turned to Congress for implementation.⁸⁴ Similarly, President Roosevelt's court-packing plan triggered a backlash because it was widely viewed as flouting the law.⁸⁵

The Bush 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. Similarly, the Obama administration went to great lengths to package the auto bailouts as if they were ordinary bankruptcy sales. In each case, legality operated as a constraint. And this, in my view, was a good thing. There were substantial costs to abandoning rule of law principles. The car bailouts seem to have distorted credit markets, for instance, by creating uncertainty as to whether creditors' entitlements would be honored.⁸⁶

80. Others have made similar points. See, e.g., Aziz Z. Huq, *Binding the Executive (by Law or by Politics)*, 79 U. CHI. L. REV. 777, 795–99 (2012) (giving examples of constraining effects of framework statutes in the national security context); Richard H. Pildes, *Law and the President*, 125 HARV. L. REV. 1381, 1407 (2012) (noting rational-choice reasons for the executive to comply with the law); Saikrishna B. Prakash & Michael D. Ramsey, *The Goldilocks Executive*, 90 TEX. L. REV. 973, 985–95 (2012) (cataloguing congressional, judicial, and other constraints on the executive).

81. See *supra* notes 24–26, 34, and accompanying text.

82. Posner & Vermeule, *supra* note 33, at 1674–77.

83. See Franklin D. Roosevelt, *Inaugural Address. March 4, 1933*, in 2 THE PUBLIC PAPERS AND ADDRESSES OF FRANKLIN D. ROOSEVELT 15 (Random House 1938).

84. Posner & Vermeule, *supra* note 33, at 1669–70.

85. See JONATHAN ALTER, *THE DEFINING MOMENT: FDR'S HUNDRED DAYS AND THE TRIUMPH OF HOPE* 322–23 (2006).

86. BRADLEY BLAYLOCK ET AL., *THE MARKET-WIDE CONSEQUENCES OF GOVERNMENT INTERVENTION* 32–33 (2011), available at <http://home.business.utah.edu/finmh/GovIntervention.pdf> (finding an increase in the cost of credit in politically sensitive industries after auto bailouts). Another study found that the cost of issuing bonds in favored industries went down due to the prospect that these firms may benefit from a bailout. DENIZ ANGINER & A. JOSEPH WARBURTON, *THE CHRYSLER EFFECT: THE IMPACT OF THE CHRYSLER BAILOUT ON BORROWING COSTS* 31–32 (2011), available at http://www.clevelandfed.org/research/conferences/2011/4-14-2011/Anginer_Warburton.pdf.

The consequences might well have been even worse if there had been less attention to legal constraints.

The second limitation of the Posner-Vermeule account is that they do not fully consider the importance of endogenous factors as a crisis develops. They treat courts and other institutions as largely helpless to resist the actions of the executive branch at the height of a crisis.⁸⁷ Yet the likelihood that a court will defer to the executive may depend in important respects on how the issue in question is framed. Moreover, even if it accedes to the executive's wishes, a court can do so in a way that minimizes the violence done to ordinary principles of legality.⁸⁸

There is a similar endogeneity in Congress's interactions with the executive. Even if the executive can sidestep Congress at the height of the crisis, Congress may punish the executive for bending the law too far by imposing harsher constraints at the next stage, as Congress enacts legislation in response to the crisis. I will give specific illustrations of endogeneity in the recent crisis in the next Part.

Finally, Posner and Vermeule are quite vague about how popular opinion functions as a constraint. They say very little about just how it influences the executive and other branches. Although I translated their references to popular opinion into Komesarian terms earlier, Posner and Vermeule do not explore the nature of ordinary citizens' stakes and participation in any detail.⁸⁹ They also seem to assume that popular opinion constrains the executive in desirable ways. But it is not clear that this is necessarily accurate—at the very least, the case has not been made.⁹⁰

87. The qualifiers “largely” in the sentence in the text and “fully” in the preceding sentence are important. Posner and Vermeule do consider institutional interactions on multiple occasions. *See, e.g.*, Posner & Vermeule, *supra* note 33, at 1677 (noting that despite the Bush administration's weakness at the time of the 2008 crisis, “Congress did not take up the slack”). My point is that Posner and Vermeule understate the extent to which particular strategic decisions by each branch shaped the financial crisis and its aftermath.

88. For specific illustrations of this point, see *infra* Part IV.

89. For a brief consideration of the role of public opinion, see Posner & Vermeule, *supra* note 33, at 1677–79 (considering the possibility that public opinion constrained the executive less after 9/11, which involved an issue on which the interests of most Americans were aligned, whereas the financial crisis affected citizens in more diverse ways).

90. For skeptical accounts of legislation enacted after a financial crisis, see, for example, Larry E. Ribstein, *Bubble Laws*, 40 Hous. L. Rev. 77 (2003); and Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1591–94 (2005).

IV. REVISITING THE PUZZLES

How might a more complete account of the dynamics of institutional interaction and of the role of popular opinion shape our analysis? Answering these questions takes us back to the three puzzles one last time.

Start with the influence of majoritarian preferences during an economic crisis. Outside of a crisis, ordinary citizens pay little attention to the details of financial regulation; it is too complex, and the relevance of particular rules is not sufficiently clear.⁹¹ But a crisis has the same effect as a fire alarm in a soporific classroom. Everyone snaps to attention. Ordinary citizens are galvanized, and they have a much more direct influence on policy.⁹²

In Komesarian terms, we might call this a shift in stakes, parallel to a potential tort victim's shift from low to high stakes when she becomes an actual tort victim.⁹³ But the shift caused by an economic crisis is more nebulous. Whereas the costs of a tort injury can be quantified fairly precisely, ordinary citizens' stake in a financial crisis is often less clear. Some are devastated by a crisis—such as the homeowners whose houses were suddenly worth less than they owed, or the employees who lost their pensions when Enron and WorldCom failed—but many initially are not. For this latter group, the effect of the crisis depends on how it develops and how it is handled. Their stake is thus probabilistic rather than fixed; it is a stake with a wide range of variation.

This shift in stakes makes the politics of a crisis more majoritarian than politics at other times. It is no accident that nearly all of America's major federal corporate and financial regulation has been enacted in the wake of financial crises.⁹⁴ This does not mean that crisis-inspired legislation is optimal. The precise stakes of the newly aroused majority are often uncertain, and the majority may not be acting on full or even good information. During the recent crisis, for instance, the deep hostility to bailouts spurred Congress to add a "thou shalt liquidate" requirement to the provisions in the Dodd-Frank Act that give regulators the power to take over a systemically important financial institution that is in danger of failing.⁹⁵ This provision purports to forbid regulators from preserving

91. This tendency and the shift that occurs in a crisis is the central theme of DAVID SKEEL, *ICARUS IN THE BOARDROOM: THE FUNDAMENTAL FLAWS IN CORPORATE AMERICA AND WHERE THEY CAME FROM* (2005).

92. *Id.* at 9.

93. *See supra* note 61 and accompanying text.

94. *See SKEEL, supra* note 91, at 9.

95. For discussion and criticism of this provision, see Thomas H. Jackson & David A. Skeel, Jr., *Dynamic Resolution of Large Financial Institutions*, 2 HARV. BUS. L. REV. 435, 441 (2012).

or restructuring a troubled financial institution, even if liquidation would be disastrous.⁹⁶ Interest groups also may continue to have some influence, even in a crisis. This was perhaps most evident in the failure to take effective steps to deal with underwater mortgages during the early years of the crisis. On several occasions, lawmakers debated an amendment to the bankruptcy laws that would have permitted homeowners to restructure their mortgages in bankruptcy, but the major banks managed to fend off the reform, even at the height of the crisis.⁹⁷ But financial regulation is far more majoritarian during a crisis than under ordinary circumstances.

Because majoritarian influence is temporary, it may be undercut if the implementation of crisis-inspired legislation is delegated to agencies rather than dictated in the original legislation. As has often been noted, the recent financial legislation delegates an unusually large portion of its content to agency rulemaking.⁹⁸ As a result, large financial institutions and other interest groups are likely to have much more influence on its content than would have been the case with more fully specified legislation.⁹⁹

With the second puzzle, the prominence of the executive branch at the height of an economic crisis, Posner and Vermeule rightly emphasize both the executive's preeminence at the outset of a crisis and the importance of the executive's legitimacy. But they do not follow the legitimacy issue as far as they might. The executive's legitimacy is important when the executive reacts not just to the initial crisis, but also to the legislative process that follows. At the second, legislative stage, there may be real costs to having stretched or flouted the rules earlier. In the recent crisis, the most obvious cost of the Fed's and the Treasury's legally dubious bailouts was the sharp restriction of the Fed's emergency lending authority.¹⁰⁰ As noted earlier, the Dodd-Frank Act amended the emergency lending authority to prohibit Fed loans to particular institutions, thus precluding the kind of support that was used to rescue

96. See *id.* at 453 (discussing the new approach). The FDIC has subsequently devised a "single point of entry" resolution strategy that is designed to quickly recapitalize and preserve a systemically important financial institution. *Id.* The strategy is clearly at odds with the "thou shalt liquidate" requirement, but the FDIC plans to claim it is a liquidation because assets technically would be transferred to a new bridge institution.

97. Editorial, *What about the Rest of Us?*, N.Y. TIMES (Sept. 25, 2008), http://www.nytimes.com/2008/09/26/opinion/26fri1.html?_r=0.

98. See, e.g., *supra* note 54 and accompanying text.

99. KOMESAR, *supra* note 1, at 90–97.

100. See *supra* note 53 and accompanying text (discussing curtailing of Fed authority under § 13(3) of the Federal Reserve Act).

Bear Stearns and AIG.¹⁰¹ Under the Treasury white paper proposing reform, the Fed's lending authority would have been increased.¹⁰² Despite the fact that the proposal came from a new administration, Congress insisted that the reins on the Fed be tightened, rather than relaxed.

Finally, what are we to make of the generally hands-off approach of the courts? To some extent, this surely reflects the institutional limitations of courts, as hinted at in traditional comparative institutional analysis and emphasized in the crisis context by Posner and Vermeule. But here, too, endogenous factors may play a role—and do seem to have done so in the recent crisis. The disgruntled shareholders who sued to enjoin the Bear Stearns merger sued in Delaware Chancery Court rather than in a federal court.¹⁰³ This is standard practice, but it may have affected the course of the litigation, at least a little. The Delaware Chancery Court was in an institutionally vulnerable position in handling a dispute in which the executive branch of the federal government had a direct stake, since Delaware faces an ongoing risk that federal legislation will erode the value of Delaware's status as the preeminent state of incorporation and principal regulator for the largest corporations.¹⁰⁴ It was highly unlikely that a Delaware court would interfere even with the most egregious violation of corporate law under these circumstances. To be sure, even if the case had been brought in federal district court, only the most sturdy-spined judge would have dared to interfere with the government-midwifed merger. But it would have been imaginable, whereas it was not with a Delaware judge.

A second example of judicial endogeneity arose from direct interactions between the executive and judicial branches and is for this reason far more revealing. When the Obama administration steered Chrysler and General Motors into bankruptcy, the ordinary reorganization process would have given each class of creditors and shareholders an opportunity to vote on the proposed restructuring and would have included a variety of other procedural protections.¹⁰⁵ As a result, a large number of decision makers would have contributed to the decision. The administration sidestepped this process by structuring both

101. *Id.*

102. See DEP'T OF THE TREASURY, FINANCIAL REGULATORY REFORM: A NEW FOUNDATION 76–79 (2009) [hereinafter FINANCIAL REGULATORY REFORM], available at http://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf.

103. See *supra* note 20 and accompanying text.

104. Mark Roe has written at length about Delaware's vulnerability to federal intrusion and its efforts to head off federal intervention. See, e.g., Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 592 (2003).

105. See Roe & Skeel, *supra* note 43, at 734–36 (comparing the safeguards of sales and of ordinary reorganizations).

cases as “sales” of the car companies’ assets. As a result, the decision rested entirely on the shoulders of a single bankruptcy judge. It was highly improbable that a single Article I bankruptcy judge would interfere with a transaction that the executive branch insisted was necessary to save millions of jobs in the Midwest, no matter how problematic the transaction might be under existing bankruptcy law.

In each of these cases, it would have been very difficult for any court to cast cold water on transactions arranged by the executive branch during a crisis. But the likelihood of second-guessing would have been considerably greater if the cases had come before different judges (in Bear Stearns) or had been structured differently (Chrysler and General Motors). The particular posture of the cases, and the decisions that produced this posture, seem to me an important part of the institutional story.

It is also important to consider the courts’ role in the overall sequence of interactions that begins with the crisis but also includes both the post-crisis legislation and reverberations in future case law and practice. Even if a court does not strike down the executive branch’s response to a crisis, it can protect rule of law principles by signaling its concern with executive branch transactions that appear to violate existing law. At the least, this can reduce the risk that legally problematic responses to a crisis will cause lasting distortions to the law.

The record of the judicial branch has been quite mixed in this regard during the recent crisis. Although the Chrysler and General Motors transactions were highly unusual, both judges treated them as if they were simply ordinary transactions, different only in scale from transactions that bankruptcy courts handle every day. This stance is in one sense quite understandable. A trial judge who voices concerns in the course of approving an executive branch transaction is inviting closer scrutiny on appeal—and is inviting the losing litigants to pursue that appeal. But failing to speak up increases the risk that distortions of existing law will permanently reshape the law rather than being treated as one-off efforts to contain a crisis. Following the lead of Chrysler and General Motors, for instance, future corporate debtors might structure their bankruptcies as sham sales that favor the interests of some claimants over others, as Chrysler appears to have done.¹⁰⁶

A more recent crisis-related decision is even more disappointing in this regard. In dismissing litigation by AIG shareholders against the New York Federal Reserve, a district court judge described the AIG bailout not only as necessary under the circumstances, but also as entirely

106. *See id.* at 761–63 (illustrating potential abuse).

consistent with existing law.¹⁰⁷ Because the AIG stock acquired in the bailout was held by a trust and not directly by the Fed, the court concluded the Fed did not control the AIG stock. Although the decision came more than four years after the bailout, at a time when the worst period of the crisis appears to have passed, the judge did not offer even a wisp of a suggestion that the Fed's intervention pushed the boundaries of existing law. The court's form-over-substance analysis can be seen as an invitation to the Fed to circumvent any legal constraints on its emergency lending powers whenever it wishes to do so.

Much more promising were the judicial responses on two other occasions. When the bankruptcy judge in the Lehman bankruptcy approved a sale (which the executive branch endorsed) of Lehman's brokerage operations to Barclays four days after Lehman filed for bankruptcy in 2008, he emphasized that the sale was highly unusual, and that four days was not nearly enough time to make a fully informed decision.¹⁰⁸ Although he permitted the sale to go through, he underscored the crisis conditions that shaped his decision and warned the parties not to treat the decision as precedential in any future case.

Although the posture was quite different, the Supreme Court's ruling on appeal in the Chrysler case sent a similarly valuable signal.¹⁰⁹ The Court did not interfere with the Chrysler restructuring, but it accepted certiorari, reversed, and vacated the appellate court opinion before dismissing the case as moot.¹¹⁰ This made quite clear that the Chrysler transaction was legally problematic, and may have reduced the likelihood that the lower courts' failure to point this out will distort reorganization practice after the crisis.

As these cases make clear, even when courts accede to the executive's wishes during a crisis, the manner in which they do so is profoundly important. My claim is that the different responses will shape institutional interactions in the post-containment phase of a crisis in divergent ways.

CONCLUSION

The response to an economic crisis seems far removed from the concerns of Komesarian comparative institutional analysis. Unlike in the

107. *Starr Int'l Co. v. Fed. Reserve Bank of N.Y.*, No. 11-CV-8422-PAE, 2012 WL 5834852 (S.D.N.Y. Nov. 16, 2012).

108. See Michael J. de la Merced, *Lehman Sale to Barclays Was Proper, Judge Rules*, N.Y. TIMES DEALBOOK (Feb. 22, 2011, 7:55 PM), <http://dealbook.nytimes.com/2011/02/22/lehman-sale-to-barclays-was-proper-judge-rules/>.

109. See *Ind. State Police Pension Trust v. Chrysler LLC*, 130 S. Ct. 1015 (2009).

110. *Id.* at 1015.

typical Komesarian context, courts play a distinctively secondary role; they are not the most visible gatekeeper. Yet this Article suggests that by adapting Komesar's insights and by building on important, complementary work by Posner and Vermeule on the role of the executive, we can begin to sketch out an institutional analysis of the economic crisis—an analysis that accounts both for the fluidity of the stakes of ordinary citizens and for the shifting roles of the relevant institutions.