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## YALE LAW & POLICY REVIEW

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### Administering Crisis: The Success of Alternative Accountability Mechanisms in the Capital Purchase Program

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## INTRODUCTION

The recent financial crisis is the worst the United States has faced since the Great Depression.<sup>1</sup> As the crisis gradually evolved from a mere housing bubble into a severe recession, the government's response evolved as well, culminating in the well-known Troubled Asset Relief Program (TARP). Established by the Emergency Economic Stabilization Act (EESA),<sup>2</sup> this unprecedented program authorized the Secretary of the Treasury to purchase up to \$700 billion in assets and securities from financial institutions in order to stabilize the nation's financial markets. But however necessary it may have been to avert a crisis, EESA's extremely broad delegation of authority, vague statutory commands, and weak provisions on judicial review raised the possibility of unaccountable administrative governance on a massive scale.

That possibility has helped to make TARP deeply unpopular. The public debate has generally characterized TARP as a \$700 billion blank check, which the Treasury Department then essentially signed over to the banking industry.<sup>3</sup> Even worse, the program's very purpose was to rescue banks from a crisis that they themselves had created in the first place. Popular antipathy toward TARP was most palpable in March 2009 during the popular uproar over the large bonuses paid to employees at American Insurance Group (AIG), which received billions of dollars in taxpayer aid even as unemployment climbed into the double digits. But the underlying sentiment predated that incident and has long outlasted it. The AIG bonus scandal simply crystallized a larger narrative in which the Treasury administered TARP so as to save the banks while allowing ordinary citizens to continue to suffer. This narrative has some basis in fact, since, as a mechanism to save failing banks from their own mistakes using public funds, TARP necessarily involved a level of raw unfairness. Popular consciousness has blamed that unfairness on Congress for delegating such an enormous amount of power to the Treasury, and on the Treasury for allegedly using that power to the exclusive benefit of banks.

The legal literature on TARP is remarkably small, but to the extent that legal scholars have written about TARP, they have taken a similarly dim view of the program.<sup>4</sup> Gary Lawson, for example, argues that EESA delegated such un-

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1. CONG. OVERSIGHT PANEL, SPECIAL REPORT ON REGULATORY REFORM 2 (2009), available at <http://cop.senate.gov/documents/cop-012909-report-regulatoryreform.pdf>.
  2. See Emergency Economic Stabilization Act, Pub. L. No. 110-343, 122 Stat. 3765 (2008).
  3. See *infra* notes 21-27 and accompanying text.
  4. Aside from the few pieces of scholarship described, see *infra* notes 5-12, the legal literature on TARP has focused narrowly on the executive compensation regulations that EESA imposes on financial firms that take certain forms of TARP money. See, e.g., Lucian A. Bebchuck & Holger Spamann, *Regulating Bankers' Pay*, 98 GEO. L.J. 247 (2010) (advancing a conceptual framework for executive compensa-

fettered power to the Treasury that it exceeded Congress's enumerated powers and runs afoul of the non-delegation doctrine,<sup>5</sup> the rarely invoked legal mechanism by which the Supreme Court prevents Congress from surrendering its lawmaking powers to executive agencies.<sup>6</sup> Lawson also claims that EESA so drastically altered the Treasury Secretary's official responsibilities that it also violates the Appointments Clause.<sup>7</sup> A number of student notes also argue that EESA and TARP violate the non-delegation doctrine or are otherwise repugnant to the Constitution.<sup>8</sup>

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tion regulation); Miriam A. Cherry & Jarrod Wong, *Clawbacks: Prospective Contract Measures in an Era of Excessive Executive Compensation and Ponzi Schemes*, 94 MINN. L. REV. 368 (2009) (examining one type of restriction on executive compensation contained in EESA); Michael B. Dorff, *Confident Uncertainty, Excessive Compensation, and the Obama Plan*, 85 IND. L.J. 491 (2010) (assessing the likely impact of the amendments to EESA pertaining to executive compensation in the stimulus bill); Janice Kay McClendon, *The Perfect Storm: How Mortgage-Backed Securities, Federal Deregulation, and Corporate Greed Provide a Wake-Up Call for Reforming Executive Compensation*, 12 U. PA. J. BUS. L. 131 (2009) (arguing that the executive compensation reforms in EESA and the stimulus bill are welcome but inadequate); Michael diFilipo, Note, *Regulating Executive Compensation in the Wake of the Financial Crisis*, 2 DREXEL L. REV. 258 (2009) (arguing that the executive compensation reforms in EESA and the stimulus bill will not reduce compensation or fix the skewed incentives that contributed to the crisis). One additional article has focused not on executive compensation, but on the Capital Purchase Program's (CPP) potential to further fragment and complicate federal banking regulation. See Jackie Prester, *When the Government Becomes a Stockholder: Impact of the Capital Purchase Program on Bank Regulation*, 39 U. MEM. L. REV. 931 (2009).

5. Gary Lawson, *Burying the Constitution Under a TARP*, 33 HARV. J.L. & PUB. POL'Y 55 (2010).
6. See *Pan. Ref. Co. v. Ryan*, 293 U.S. 388 (1935) (striking down a provision of the National Industrial Recovery Act that empowers the president to bar certain oil products from being imported into the United States as an improper delegation of legislative power to the executive branch); *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935) (striking down a provision of the National Industrial Recovery Act empowering the president to give industry codes of fair competition the force of law as an impermissible delegation of legislative authority); see also *The Benzene Case*, 448 U.S. 607, 685-86 (1980) (Rehnquist, J., concurring in the judgment) (explaining the non-delegation doctrine).
7. Lawson, *supra* note 5, at 67-69.
8. See, e.g., Steven Pearce, Note, *Accounting for the Lack of Accountability: The Great Depression Meets the Great Recession*, 37 HASTINGS CONST. L.Q. 409, 421-22 (2010) (arguing that EESA violates the non-delegation doctrine); David T. Riley, Note, *Roll Up the Constitution and Unfurl the TARP: How Spending Conditions in the Troubled Asset Relief Program Violate the Constitution*, 98 KY. L.J. 595, 616-20 (2010) (arguing that EESA's limitations on judicial review are unconstitutional).

Most notably, however, scholars Eric Posner and Adrian Vermeule have argued that EESA is emblematic of a larger pattern in the modern administrative state—namely, that unchecked executive power is an all but inevitable feature of crisis governance.<sup>9</sup> Drawing on the work of German political theorist Carl Schmitt, Posner and Vermeule maintain that Congress, because of its limited expertise and access to information,<sup>10</sup> and the courts, because of their limited political legitimacy,<sup>11</sup> are institutionally incapable of constraining the Executive in a crisis. These scholars conclude, therefore, that raw politics will represent the only real restraint on executive power under such circumstances.<sup>12</sup> According to this view, Congress through EESA not only essentially empowered the Treasury to do whatever it took to end the financial crisis, limited primarily by its judgment as to what was the best policy and what might provoke a political backlash, but no reasonable observer should have expected Congress to do otherwise. Posner and Vermeule present their argument as a purely descriptive thesis rather than a critique of TARP, but their vision of a program administered by unchecked executive power is not normatively attractive in a legal culture that prizes the separation of powers.

In order to assess the validity of this popular and scholarly consensus that TARP represents a paradigmatic case of the modern administrative state run amuck, this Note analyzes how the Treasury Department and other administrative agencies have actually administered the first and largest sub-program established under TARP, the Capital Purchase Program (CPP).<sup>13</sup> Through the CPP, the Treasury made \$204.9 billion in capital injections into 707 banks and financial institutions between October of 2008 and December of 2009.<sup>14</sup> The structure of the CPP involved voluntary transactions between the government and banks, thus representing a variation on the theme of “regulation by deal” that dominated the first few years of the government’s response to the financial cri-

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9. 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, 1636 (2009). (“[W]e argue that the conditions of the administrative state make it practically inevitable that the executive and the agencies will be the main crisis managers, with legislatures and courts reduced to adjusting the government’s response at the margins and carping from the sidelines.”).

10. *Id.* at 1643.

11. *Id.* at 1654.

12. *Id.* at 1679.

13. As of this writing, TARP encompasses thirteen separate sub-programs. OFFICE OF THE SPECIAL INSPECTOR GEN. FOR THE TROUBLED ASSET RELIEF PROGRAM [hereinafter SIGTARP], QUARTERLY REPORT TO CONGRESS: JULY 21, 2010, at 8 (2010) [hereinafter SIGTARP, JULY 2010 REPORT], available at [http://www.sigtar.gov/reports/congress/2010/July2010\\_Quarterly\\_Report\\_to\\_Congress.pdf](http://www.sigtar.gov/reports/congress/2010/July2010_Quarterly_Report_to_Congress.pdf).

14. *Id.* at 39.

sis.<sup>15</sup> In contrast to the ad hoc succession of government bailouts that preceded TARP, however, the CPP reflected an effort to structure a comprehensive and systematic set of transactions to deal with the crisis.

The administration of the CPP has not been without its flaws, but its critics' worst fears of captured bureaucrats constrained only by brute political expediency have not come to pass.<sup>16</sup> The constraints the program has imposed on banks are consistent with basic rule-of-law requirements—they are stable, consistent, general in application, and have been announced in advance of enforcement. Moreover, the CPP has succeeded in injecting capital into the banking system quickly, and the Congressional Budget Office projects that by the time the program is fully unwound it will actually *make* taxpayers \$2 billion in profits.<sup>17</sup> The program has done this while maintaining transparent operations that enable political oversight by elected officials and the public. The CPP has thus generally operated in a manner consistent with the three basic goals of any administrative regime: effective administration, protection of the legal rights of regulated entities, and facilitation of democratic control.<sup>18</sup>

Administrative law scholars and practitioners generally assume that statutory specificity and judicial review are the primary mechanisms through which administrators are held to account, but both of these features were largely absent from the CPP.<sup>19</sup> I therefore explain the CPP's success as the result of two alternative mechanisms of administrative accountability—managerial accountability mechanisms and market-based accountability mechanisms. In the face of a nearly standardless statute and non-existent judicial review, these alternative accountability mechanisms sufficed to deliver responsible, public-regarding

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15. See Steven M. Davidoff & David Zaring, *Regulation by Deal: The Government's Response to the Financial Crisis*, 61 ADMIN. L. REV. 463, 466 (2009).
  16. The arguments in this Note are limited to the CPP; I make no claims about other TARP sub-programs, which are structured and administered differently than the CPP. For other TARP programs, particularly the Home Affordable Modification Program, critics' charges of captured administration may be more accurate. See SIGTARP, JULY 2010 REPORT, *supra* note 13, at 6 (“[The Home Affordable Modification Program] continues to struggle to achieve its original stated objective, to help millions of homeowners avoid foreclosure . . .”).
  17. CONG. BUDGET OFFICE, REPORT ON THE TROUBLED ASSET RELIEF PROGRAM—MARCH 2010, at 2 (2010), available at <http://www.cbo.gov/ftpdocs/112xx/doc11227/03-17-TARP.pdf>.
  18. See Jerry L. Mashaw, *Recovering American Administrative Law: Federalist Foundations, 1787-1801*, 115 YALE L.J. 1256, 1263-64 (2006) (describing the aspiration of administrative law as the search for “institutional designs that appropriately balance the simultaneous demands of political responsiveness, efficient administration, and respect for legal rights”).
  19. See *id.* at 1258 (describing as one of the two “governing myths” of administrative law that “administrative law is the law of judicial review of administrative action. On this view, to the extent that law holds administration accountable, it is law in courts that counts.”).

administrative governance beyond what politics alone could produce, even in the midst of crisis. Indeed, contrary to the arguments of Posner and Vermeule, to the extent that politics dictated any of the administrative details, it made the program worse rather than better. Alternative accountability mechanisms made the CPP an administrative success primarily because the structure of the program and the surrounding political environment aligned the administrative goals of efficiency, rights protection, and democratic oversight. For that reason, managerial and market-based accountability mechanisms—usually implemented to promote administrative effectiveness—in practice operated to promote rights protection and democratic oversight as well. This explanation for the CPP’s successful implementation has immediate relevance for ongoing policy debates regarding the Treasury’s newly created Community Development Capital Initiative and the recently enacted Small Business Lending Fund, programs that are both modeled on the CPP.<sup>20</sup> More broadly, the CPP illustrates the power of alternative mechanisms of administrative accountability and the importance of the degree of alignment among different administrative goals, which have implications for crisis governance and the study of administrative law in general.

This Note proceeds as follows. Part I outlines the popular and scholarly critiques of TARP and provides a theoretical framework for understanding the role that managerial and market-based accountability mechanisms play in administrative governance. Part II lays out the background of the crisis and the haphazard and improvisational nature of the government’s initial response. Part III chronicles the passage of EESA and the establishment of the CPP. Part IV analyzes how the Treasury Department has managed each of the various decisions it must make in the life of a bank’s participation in the CPP. Part V assesses the manner in which the Treasury and other agencies have administered the CPP.

## I. THEORETICAL FRAMEWORK: ALTERNATIVE MECHANISMS OF ADMINISTRATIVE ACCOUNTABILITY

### A. *Popular and Scholarly Critiques of TARP*

TARP has been an extremely unpopular program, in large part because the public believes that it has been administered irresponsibly. In the words of a report by the Special Inspector General for TARP (SIGTARP),

Notwithstanding TARP’s role in bringing the financial system back from the brink of collapse, it has been widely reported that the American people view TARP with anger, cynicism, and distrust . . . [Many Americans believe] that TARP funds went into a “black hole”; that TARP was created in secrecy to transfer wealth from taxpayers to Wall

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20. Small Business Jobs and Credit Act of 2010, Pub. L. No. 111-240, §§ 4101-4113 (2010); SIGTARP, *JULY 2010 REPORT*, *supra* note 13, at 85-86.

Street insiders (exacerbated by the announcement of billions of dollars of profits and record-setting bonus pools at TARP recipients while unemployment and foreclosures continue to rise); or that Treasury is just too closely aligned with the interests of Wall Street . . . .<sup>21</sup>

The program was born in a quintessential crisis atmosphere, with the Treasury Department requesting enormous resources and nearly unfettered discretion while insisting that there was no time for congressional hearings or extended debate. One Congressman described the legislative debate as a hostage-taking, analogizing Treasury Secretary Hank Paulson's initial legislative proposal to a "ransom note" for "\$700 billion in unmarked bills."<sup>22</sup> When the program was up and running, the Congressional Oversight Panel sharply criticized the Treasury's refusal to require banks receiving TARP funds to keep track of what they did with the money, which fed into a widespread claim that the government does not even know where the public funds spent through TARP have gone.<sup>23</sup>

The public's resentment and frustration with the Treasury's allegedly lax management of taxpayer funds was perhaps most evident in the controversy surrounding the bonuses paid at insurance giant AIG. In March 2009, AIG, recipient of \$170 billion in emergency taxpayer aid, announced that it would pay \$165 million in extra compensation to employees in its financial services division, the division responsible for the transactions that had nearly brought down the company.<sup>24</sup> The announcement prompted an outpouring of populist outrage directed at both AIG and TARP, and politicians outdid each other in denouncing the bonuses. Treasury Secretary Timothy Geithner,<sup>25</sup> despite quickly

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21. SIGTARP, QUARTERLY REPORT TO CONGRESS: OCTOBER 21, 2009, at 4 (2009), available at [http://www.sig tarp.gov/reports/congress/2009/October2009\\_Quarterly\\_Report\\_to\\_Congress.pdf](http://www.sig tarp.gov/reports/congress/2009/October2009_Quarterly_Report_to_Congress.pdf).
  22. Kathy Kiely & Sue Kirchhoff, *Leaders Back Historic Bailout; "Now We Have To Get the Votes"*, USA TODAY, Sept. 28, 2008, at A1.
  23. See CONG. OVERSIGHT PANEL, ACCOUNTABILITY FOR THE TROUBLED ASSET RELIEF PROGRAM 3 (2009), available at <http://cop.senate.gov/documents/cop-010909-report.pdf> ("The Panel still does not know what the banks are doing with taxpayer money . . . . The recent refusal of certain private financial institutions to provide any accounting of how they are using taxpayer money undermines public confidence."). In a widely distributed clip from his movie "Capitalism: A Love Story," Michael Moore interviewed Elizabeth Warren, Chair of the Congressional Oversight Panel, and asked her the following question: "Where is the \$700 billion of bailout money which Congress gave to the big banks and Wall Street investment companies?" Warren replied simply, "I don't know." CAPITALISM: A LOVE STORY (Overture Films 2009).
  24. Edmund L. Andrews & Peter Baker, *At AIG, Huge Bonuses After \$170 Billion Bailout*, N.Y. TIMES, Mar. 14, 2009, at A1, available at <http://www.nytimes.com/2009/03/15/business/15AIG.html>.
  25. Geithner succeeded Paulson as Treasury Secretary after Obama's inauguration as president. See Jackie Calmes, *Geithner Wins Confirmation*, N.Y. TIMES,

condemning the bonuses and taking steps to recoup them, received withering criticism,<sup>26</sup> and Senator Chris Dodd, who had inserted the critical language in EESA, suffered a huge political backlash and eventually decided not to seek reelection.<sup>27</sup> The political uproar eventually subsided, but the unfavorable perception of the government's handling of TARP funds has persisted.

To the extent that they have commented on the program, legal scholars have also taken a negative view of TARP's conformity with the basic requirements of democracy and the rule of law. Several observers have suggested that the program runs afoul of the non-delegation doctrine and other constitutional constraints,<sup>28</sup> but the most influential scholarly critique thus far has been that of Eric Posner and Adrian Vermeule.<sup>29</sup> These scholars argue not only that EESA delegated an enormous amount of nearly unfettered authority to the Treasury Secretary, but more generally that unchecked executive power is an all but inevitable result of the institutional and political dynamics of crisis governance. The dynamic they describe proceeds as follows. First, an externally precipitated crisis creates strong political demand for government action. Accordingly, the Executive seeks new statutory authority from Congress.<sup>30</sup> Congress, however, knows relatively little about the true nature and extent of the crisis, since relevant expertise and accurate information rest with executive branch administrators and the private actors they regulate.<sup>31</sup> Moreover, the ongoing emergency raises the opportunity cost of continued deliberation, leading Congress ultimately to enact a statute with few constraints on the Executive.<sup>32</sup> This enables the Executive to act and insulates members of Congress from any charge that they left the government shackled in a crisis.<sup>33</sup> The courts, meanwhile, to the extent they even have authority to exercise review, generally can only do so after the fact. Moreover, they generally have even less information and expertise than

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Jan. 27, 2009, at A20, available at <http://query.nytimes.com/gst/fullpage.html?res=9906E5DC1238F934A15752CoA96F9C8B63>.

26. See Ryan J. Donmoyer & Laura Litvan, *Geithner Vows To Recoup AIG Bonuses as Lawmakers Express Fury*, BLOOMBERG, Mar. 18, 2009, [http://www.bloomberg.com/apps/news?sid=a\\_TbsRunotbQ&pid=20601087](http://www.bloomberg.com/apps/news?sid=a_TbsRunotbQ&pid=20601087).
27. Adam Nagourney, *Dodd is Said To Decide Against Re-Election Bid*, N.Y. TIMES, Jan. 6, 2010, at A1, available at <http://www.nytimes.com/2010/01/06/us/politics/06dodd.html>.
28. See *supra* notes 5-8 and accompanying text.
29. Posner & Vermeule, *supra* note 9.
30. *Id.* at 1638-39.
31. *Id.* at 1643-45.
32. *Id.* at 1646-47.
33. *Id.* at 1650.



Congress, and rarely possess the political legitimacy to second-guess the Executive's response to the crisis.<sup>34</sup>

The result of this dynamic, according to Posner and Vermeule, is that in a crisis, "politics, rather than law, will place limits on [the Executive's] actions."<sup>35</sup> They claim that this result accords with the Weimar political theorist Carl Schmitt's view that "liberal lawmaking institutions, such as legislatures and courts, 'come too late' to crises in the modern state," and therefore are simply incapable of contributing much to contemporary crisis governance.<sup>36</sup> Posner and Vermeule frame their analysis as a mere empirical description of the governing capacities of the three branches of government rather than any kind of normative endorsement or critique.<sup>37</sup> But the implications of their vision are quite unsettling. An executive branch unchecked by the legislature or the judiciary and constrained only by its own political calculations is at odds with basic assumptions of administrative law, fundamental principles of the separation of powers, and, ultimately, the rule of law.

### B. *Alternative Accountability Mechanisms*

Posner and Vermeule's analysis, non-delegation-based constitutional critiques of EESA, and, to a large extent, the more inchoate popular frustration at the Treasury's management of TARP, share an assumption that accountable administrative governance based on the rule of law flows from two basic sources: statutory specificity and judicial review. Where there are no detailed statutory provisions by which courts can hold agencies to the rule of law, what is left, in Posner and Vermeule's view, is the rule of politics, or, in the general popular view, the rule of irresponsible, captured bureaucrats. This assumption accords with the widespread belief among administrative lawyers that "to the extent that law holds administration accountable, it is law in courts that counts."<sup>38</sup> But if Posner and Vermeule are right about the institutional constraints that Congress and the courts face during crises, then this widely shared assumption implies that accountable crisis governance is basically infeasible. If politics provides the only reliable constraint on executive discretion in a crisis, there will be wide room for arbitrary, capricious, inconsistent, and otherwise lawless administrative action.

Fortunately, however, there are other sources of administrative accountability beyond statutory specificity and judicial review. Of particular importance

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34. *Id.* at 1654-59.

35. *Id.* at 1679.

36. *Id.* at 1640-41.

37. *Id.* at 1636 ("Ought implies can: before asking what authority institutions ought to have to manage crises, we must ask what their capacities are, and what allocations of authority are feasible given those capacities.").

38. Mashaw, *supra* note 18, at 1258.

to this study of the CPP are managerial accountability mechanisms and market-based accountability mechanisms. The first of these—managerial accountability mechanisms—is a long-recognized but often forgotten element of administrative law. As early as 1905, Professor Frank Goodnow highlighted the important role that the internal structure and hierarchy of government agencies play in promoting administrative efficiency.<sup>39</sup> More recently, Professor Jerry Mashaw has explained that these mechanisms can also promote the goals of protecting individual legal rights and facilitating democratic oversight.<sup>40</sup>

The critical insight underlying managerial accountability mechanisms is that administrative agencies are not monolithic, unitary actors, but rather collective organizations composed of superior and inferior agencies and officials. Superior officials transmit directions to subordinates as to how they should exercise their discretion and then hold those subordinates to account through hiring and firing, performance reviews, control over the allocation of privileges and duties, and other managerial techniques. This is not to claim that agency heads have dictatorial power—inferior officers can of course resist some orders from above, and in the end, lines of authority are negotiated rather than imposed. The point, rather, is that in asserting and maintaining what hierarchical control they do have, superior officials limit the discretion of individual inferior officers and push them to make decisions in accord with the agency's overall policies and guidelines. This managerial imperative, even under conditions of crisis, can help to produce administration governed by consistent, general, impersonal norms—that is, administration consistent with the basic requirements of the rule of law. That is a feat that politics alone often cannot achieve.

Market-based accountability mechanisms—the second important type of alternative accountability mechanism in this Note—are not a pervasive feature of administrative law, but where an administrative regime involves numerous voluntary transactions, they become quite relevant. In market-based accountability mechanisms, producers and consumers attempt to satisfy each others' preferences through consensual exchanges, and they hold each other accountable by negotiating new terms for those exchanges, or, at the extreme, by refusing to make any exchanges at all. Thus, when a government agency undertakes a market transaction, the agency can be held to account by the counterparty's ability (1) simply to walk away, and (2) to bargain for more favorable terms by threatening to walk away. When the agency undertakes a *series* of transactions, the agency is also constrained by (3) the effect that its current conduct will have on potential future counterparties' perceptions, creating an incentive for honesty and fair dealing. Where relevant, these forces can produce a measure of responsible administration beyond what politics alone can produce.<sup>41</sup>

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39. FRANK J. GOODNOW, *THE PRINCIPLES OF THE ADMINISTRATIVE LAW OF THE UNITED STATES* 371-72 (1905).

40. Mashaw, *supra* note 18, at 1264-65.

41. A third source of accountability is that produced through social networks; members of social networks reciprocally sanction and reward each other based on their

The central claim of this Note is that, in the absence of any significant statutory constraints or meaningful judicial review, the success of the CPP demonstrates that alternative accountability mechanisms can produce responsible, public-regarding administration even in the midst of a crisis. To be sure, managerial and market-based mechanisms will not always be enough to deliver accountable administrative governance on their own. Statutory specificity and judicial review also matter; in fact, they are likely to be critical in programs that are under less public scrutiny than the CPP and where the values of effectiveness, rights protection, and democratic oversight are not so closely aligned as they were in the CPP. The CPP is a unique program administered under unique circumstances, but at the very least, its success shows that where a politically important and closely watched program is structured to align the basic goals of administrative governance, alternative accountability mechanisms can make all the difference.

At a more general level, this Note is a reminder that statutory specificity and judicial review co-exist with other accountability mechanisms. What that means is that the absence of any one mechanism does not necessarily imply that the administrative state will run rampant. Contrary to the assumption of Posner and Vermeule, non-delegation critics, and the general public, the administration of the CPP shows that the rule of law in the modern administrative state does not depend solely on detailed statutes and attentive courts but also on the structure of the programs and the agencies in question.

## II. CHRONOLOGY OF THE CRISIS AND THE INITIAL GOVERNMENT RESPONSE

TARP and the CPP were established at a turning point in the U.S. government's response to the financial crisis. That crisis began as a bubble in the U.S. housing market. Between the beginning of 2001 and the middle of 2006, housing prices grew at an unsustainable rate of nearly twelve percent per year,<sup>42</sup> and consumers, home-builders, mortgage underwriters, and, most importantly, large financial institutions, came to assume that home prices would continue to rise forever. When the bubble finally burst in May of 2006, prices initially fell

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adherence to internally generated norms. Social accountability mechanisms can be quite important in administrative governance, see Jerry L. Mashaw, *Structuring a "Dense Complexity": Accountability and the Project of Administrative Law*, ISSUES IN LEGAL SCHOLARSHIP, 2005, at 24-26, 36, <http://www.bepress.com/ils/iss6/art4>, but their effects on a given administrative regime are difficult to discern without a level of close anthropological study that is beyond the scope of this Note.

42. See Standard & Poor's, *S&P/Case-Shiller Home Price Indices—Instrument: Seasonally Adjusted Composite 20 Index*, [www2.standardandpoors.com/spf/pdf/index/SA\\_CSHomePrice\\_History\\_092955.xls](http://www2.standardandpoors.com/spf/pdf/index/SA_CSHomePrice_History_092955.xls), cited in CONG. OVERSIGHT PANEL, DECEMBER OVERSIGHT REPORT: TAKING STOCK: WHAT HAS THE TROUBLED ASSET RELIEF PROGRAM ACHIEVED? 8 n.1 (2009), available at <http://cop.senate.gov/documents/cop-120909-report.pdf>.

only slightly, dropping just three percent in the next year,<sup>43</sup> but that was enough to send the vulnerable subprime mortgage market into panic. By 2007, major subprime lenders were battling rising default rates, and by June of that year, ratings agencies were furiously downgrading their evaluations of securities backed by subprime mortgages.<sup>44</sup> Ratings downgrades caused the crisis to spread from the housing market into the broader credit and equity markets, prompting a government response.<sup>45</sup> The government stepped in with classic macroeconomic remedies: the Federal Reserve steadily lowered interest rates,<sup>46</sup> and Congress provided \$100 billion in fiscal stimulus in the form of tax cuts.<sup>47</sup> By the fall of 2007, the stock market had recovered, and credit markets had calmed.<sup>48</sup>

Housing prices, however, continued to decline, forcing financial institutions exposed to the housing market to take large write-downs and undertake massive recapitalization efforts. But new equity could not neutralize the huge quantities of non-performing securities backed by the mortgage market on banks' balance sheets. By March of 2008, non-performing assets caused Bear Stearns, then one of the five largest Wall Street investment banks, to totter towards insolvency, leading to a run on the bank.<sup>49</sup> Massive write-downs caused Bear Stearns's investors to lose confidence and pull their money out, which in turn led the bank's counterparties to demand the posting of collateral. Collateral calls raised the bank's borrowing costs and weakened it further, causing even more investors to lose confidence, resulting in a vicious cycle.<sup>50</sup>

Unwilling to watch a systemically important firm<sup>51</sup> fail and go through a chaotic bankruptcy, the Treasury and the Federal Reserve kicked off the next

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43. *Id.*

44. See CONG. OVERSIGHT PANEL, DECEMBER OVERSIGHT REPORT: TAKING STOCK: WHAT HAS THE TROUBLED ASSET RELIEF PROGRAM ACHIEVED? 9 (2009) [hereinafter CONG. OVERSIGHT PANEL, DECEMBER 2009 REPORT], available at <http://cop.senate.gov/documents/cop-120909-report.pdf>.

45. Davidoff & Zaring, *supra* note 15, at 471.

46. See FED. RESERVE BD., OPEN MARKET OPERATIONS (2008), <http://www.federalreserve.gov/fomc/fundsrate.htm>; FED. RESERVE DISCOUNT WINDOW, HISTORICAL DISCOUNT RATES: PRIMARY AND SECONDARY CREDIT (2008), <http://www.frbdiscountwindow.org/primarysecondary.xls>.

47. Economic Stimulus Act of 2008, Pub. L. No. 110-185, 122 Stat. 613 (2008).

48. Davidoff & Zaring, *supra* note 15, at 472.

49. See Roddy Boyd, *The Last Days of Bear Stearns*, FORTUNE, Apr. 14, 2008, at 86, available at [http://money.cnn.com/2008/03/28/magazines/fortune/boyd\\_bear.fortune/](http://money.cnn.com/2008/03/28/magazines/fortune/boyd_bear.fortune/).

50. See *id.*

51. Though it was the smallest of the top five Wall Street investment banks, Bear Stearns was extremely interconnected to the rest of the financial system. See Hyoung-Tie Kim, *Systemically Important Financial Institutions and Policy Implica-*

phase of the government's response to the crisis by crafting an ad hoc bailout. These agencies stretched their statutory powers—and likely broke Delaware corporations law—by arranging for JP Morgan to acquire Bear Stearns.<sup>52</sup> The Federal Reserve then lowered interest rates even further<sup>53</sup> and increased its lending.<sup>54</sup> Congress, for its part, passed a bill extending aid to subprime borrowers and increasing the Treasury's powers over Fannie Mae and Freddie Mac in case they should become insolvent.<sup>55</sup> The relatively small scale of this response, however, indicates that the relevant government actors basically hoped that this first bailout would be enough to solve the problem.

But important financial institutions continued to fail. July 2008 saw the second-largest bank failure in U.S. history,<sup>56</sup> and in early September, the Treasury took both Fannie Mae and Freddie Mac into conservatorship. Despite these additional bailouts, credit markets continued to seize up, and by mid-September, Lehman Brothers and Merrill Lynch were entering the same vicious cycle that had brought down Bear Stearns. Merrill managed to negotiate a private bailout by Bank of America, but Lehman's attempt to reach a similar deal with Barclay's fell through when Barclay's U.K. regulator balked.<sup>57</sup> That left no one to turn to but the U.S. government. In this case, however, the government refused to intervene, forcing Lehman to file for bankruptcy. Secretary Paulson has maintained that the reason for this decision was that the Treasury and the Federal Reserve "didn't have the powers" to act.<sup>58</sup> But given that the Treasury and the Federal Reserve had previously engineered a bailout of the similarly situated Bear Stearns, this explanation is not credible. The more plausible explanation is that Paulson and Federal Reserve Chairman Ben Bernanke, alarmed by the growing list of government bailouts, wanted to fight the problem of moral

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tions, 1 CAP. MRKT. PERSP. 2 (2009), available at [http://www.ksri.org/publish/down\\_nomember.asp?idx=416](http://www.ksri.org/publish/down_nomember.asp?idx=416).

52. See *id.* at 476-83 (arguing that several deal-protection devices in JP Morgan's take-over of Bear Stearns violated a number of Delaware doctrines governing mergers and acquisitions).
53. See *supra* sources cited in note 46.
54. The Federal Reserve opened its discount window beyond the banks it oversees to all seventeen institutions that are "primary dealers" in federal government securities. Press Release, Fed. Reserve Bank of N.Y., Primary Dealer Credit Facility: Frequently Asked Questions (June 25, 2009), [http://www.newyorkfed.org/markets/pdcf\\_faq.html](http://www.newyorkfed.org/markets/pdcf_faq.html).
55. Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654 (2008).
56. Davidoff & Zaring, *supra* note 15, at 485.
57. *Id.* at 491-92.
58. Joe Nocera & Edmund L. Andrews, *Running a Step Behind as a Crisis Raged*, N.Y. TIMES, Oct. 23, 2008, at A1, available at <http://www.nytimes.com/2008/10/23/business/economy/23paulson.html>.

hazard with a dose of austerity. Bailouts are, after all, a form of taxpayer-funded insurance, which encourages banks to take on excessive risks. The Treasury and the Federal Reserve thus acted to show banks that they could not simply assume that the government would always come to the rescue, forcing banks to self-insure.<sup>59</sup>

But as more systemically important institutions continued to fail, this tough-love policy quickly became untenable. Just one day after Lehman filed for bankruptcy, the Federal Reserve extended an emergency loan to AIG, which had become insolvent the day before.<sup>60</sup> Even so, credit markets remained panicked, and the interbank lending rate—a key indicator of banks' confidence in one another—spiked.<sup>61</sup> The panic began to reach even traditionally safe and staid corners of the financial world when a venerable money-market fund “broke the buck,” setting off the beginnings of a run on the money-market industry.<sup>62</sup> Since U.S. corporations rely on money-market funds for working capital, including funding for making payroll, this was a particularly grim development. The Treasury stepped in yet again, this time relying on obscure language from an old Depression-era statute that had been enacted for the entirely obsolete purpose of stabilizing exchange rates through gold market transactions.<sup>63</sup> Further bailouts continued even while Congress debated a more comprehensive approach to the crisis; the Federal Deposit Insurance Corporation (FDIC) seized and resold the deposits of one large consumer bank, Washington Mutual, and forced the sale of another, Wachovia.<sup>64</sup> With the list of failing firms saved by ad hoc government bailouts continuing to mount, it became clear that financial markets would not fix themselves and that a more holistic plan would be necessary.

### III. THE PASSAGE OF EESA AND THE ESTABLISHMENT OF THE CPP

#### A. *The Passage and Structure of EESA*

By the fall of 2008, the government's initial response to the financial crisis had proven ineffectual. An improvisational approach had required the Treasury and the Federal Reserve to chase the panic as it ran through the financial system and to stretch their statutory powers at each stage in order to craft an ad hoc

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59. See Davidoff & Zaring, *supra* note 15, at 493-94.

60. *Id.* at 495.

61. LIBOR Rates: Historical Charts, [http://www.wsjprimerate.us/libor/libor\\_rates\\_history-chart-graph.htm](http://www.wsjprimerate.us/libor/libor_rates_history-chart-graph.htm) (last visited Oct. 17, 2010).

62. Davidoff & Zaring, *supra* note 15, at 505-06.

63. Press Release, U.S. Dep't of the Treasury, Treasury Announces Guaranty Program for Money Market Funds (Sept. 19, 2008), <http://www.treasury.gov/press/releases/hp1147.htm>.

64. Davidoff & Zaring, *supra* note 15, at 508-10.

bailout. Moreover, no discernible *ex ante* standards governed what firms, like Bear Stearns, the government would rescue, and what firms, like Lehman Brothers, it would allow to fail. A comprehensive approach authorized by Congress, on the other hand, held the potential to enable a systematic response that could calm markets generally and legitimate the government's extraordinary interventions. So, on September 20, 2008, Secretary Paulson proposed the enactment of a very brief—three-page, 849-word—bill that would have given the Treasury Secretary the unreviewable authority to purchase up to \$700 billion in mortgage-related assets with taxpayer money.<sup>65</sup> The bill would also have authorized the Secretary “to take such actions as the Secretary deems necessary to carry out the authorities in this Act, including, *without limitation*,” hiring employees and financial agents, entering into contracts, setting up vehicles, and issuing regulations and guidance.<sup>66</sup> This “without limitation” language seemed to indicate that the only constraints the bill placed on the Secretary's authority were (1) the \$700 billion cap on the amount of obligations that could be outstanding at one time, (2) a two-year sunset provision, (3) a requirement that the Secretary report back to Congress, and (4) a vague exhortation that the Secretary use his or her authority to “provid[e] stability or prevent[] disruption to the financial markets” and “protect[] the taxpayer.”<sup>67</sup> The plan explicitly precluded all judicial review.<sup>68</sup>

Congress at first balked at this enormous proposed delegation of authority, but as legislators haggled over what to do, the final product actually gave the Secretary even *more* power than the initial Paulson proposal. Senator Dodd, Chairman of the Senate Banking Committee, proposed an amended bill that retained the Paulson plan's basic elements while creating an oversight board, requiring audits by the Government Accountability Office (GAO), placing restrictions on executive compensation at firms participating in the program, and offering a smattering of aid to homeowners. Most importantly, the Dodd proposal authorized the Secretary not only to buy mortgage-related assets, but also to take equity stakes in financial firms.<sup>69</sup> The House of Representatives rejected

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65. See Jeanne Sahadi, *Bush Wants OK To Spend \$700B*, CNNMONEY.COM, Sept. 20, 2008, [http://money.cnn.com/2008/09/20/news/economy/bailout\\_proposal/index.htm?postversion=2008092009](http://money.cnn.com/2008/09/20/news/economy/bailout_proposal/index.htm?postversion=2008092009); *Treasury's Bailout Proposal*, CNNMONEY.COM, Sept. 20, 2008, [http://money.cnn.com/2008/09/20/news/economy/treasury\\_proposal/index.htm?postversion=2008092011](http://money.cnn.com/2008/09/20/news/economy/treasury_proposal/index.htm?postversion=2008092011) (reporting the text of the proposed bill sent to lawmakers by the White House).

66. *Treasury's Bailout Proposal*, *supra* note 65 (emphasis added).

67. *Id.* Sec. 3.

68. *Id.* Sec. 8 (“Decisions by the Secretary pursuant to the authority of this Act are non-reviewable and committed to agency discretion, and may not be reviewed by any court of law or any administrative agency.”).

69. Summary: Dodd Legislative Changes to Treasury Proposal (Sept. 22, 2008), <http://www.dodd.senate.gov/index.php?q=node/4567>.

the amended plan.<sup>70</sup> Three days later, however, the House returned to the bill, which now included additional oversight mechanisms and a host of tax-breaks and other pork barrel provisions to secure passage. The bill passed both chambers of Congress and was signed into law as the Emergency Economic Stabilization Act (EESA) on October 3, 2008.<sup>71</sup>

As ultimately enacted, EESA differs very little in substance from the Paulson and Dodd proposals. The central authorizing provision empowers the Treasury Secretary “to establish the Troubled Asset Relief Program (or ‘TARP’) to purchase, and to make and fund commitments to purchase, troubled assets from any financial institution . . . .”<sup>72</sup> This authorization is broader than the initial Paulson proposal, since the Act defines “troubled assets” to include not only “residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages,” but also “any other financial instrument that the Secretary, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability . . . .”<sup>73</sup> Moreover, “financial institution” is defined broadly as “any institution, including but not limited to” a list of various kinds of banks, dealers, and firms.<sup>74</sup> In a very important provision, EESA also bars the Treasury Secretary from making purchases of greater than \$100 million without receiving warrants from the financial institution that give the Treasury an option to receive non-voting common stock in the institution.<sup>75</sup> This provision was designed to enable the government to participate in any increase in the bank’s value resulting from TARP transactions

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70. Carl Hulse & David M. Herszenhorn, *Defiant House Rejects Huge Bailout; Stocks Plunge; Next Step Is Uncertain*, N.Y. TIMES, Sept. 30, 2008, at A1, available at <http://www.nytimes.com/2008/09/30/business/30cong.html>.

71. Emergency Economic Stabilization Act, Pub. L. No. 110-343, 122 Stat. 3765 (2008).

72. *Id.* § 101(a)(1), 122 Stat. 3767. In addition to this primary authorization provision, the Act also contains another provision mandating that the Secretary establish a program to insure troubled assets. Added to secure the votes of conservative Republicans uncomfortable with more aggressive government interventions into financial markets, this provision has had little impact on the actual operation of TARP. See DEP’T OF TREASURY, REPORT TO CONGRESS PURSUANT TO SECTION 102 OF THE EMERGENCY ECONOMIC STABILIZATION ACT 1 (2008), <http://www.financialstability.gov/docs/AGP/sec102ReportToCongress.pdf> (“It is not anticipated that the [Asset Guarantee Program] will be made widely available.”); SIGTARP, JULY 2010 REPORT, *supra* note 13, at 90 (describing the Asset Guarantee Program).

73. Emergency Economic Stabilization Act § 3(9).

74. *Id.* § 3(5). This definition is so broad that the Treasury Department has used it to bail out two major automakers, Chrysler and General Motors. See SIGTARP, JULY 2010 REPORT, *supra* note 13, at 107-10 (describing the automotive industry support programs through TARP).

75. Emergency Economic Stabilization Act § 113.



while limiting the government's downside exposure.<sup>76</sup> EESA additionally requires the Treasury Secretary to consult with various other government agencies,<sup>77</sup> to "take such steps as may be necessary to prevent 'unjust enrichment,'"<sup>78</sup> and to promulgate conflict-of-interest regulations.<sup>79</sup>

EESA also contains provisions regulating the compensation of executives at firms that sell assets directly to the Treasury. Section 111 of the Act requires the Secretary to promulgate regulations (1) limiting compensation schemes that incentivize excessive risk-taking, (2) requiring the recovery of bonuses based on performance criteria that are later proven inaccurate, and (3) barring so-called "golden parachute" payments. While the restriction on golden parachute payments is a flat prohibition, the other two restrictions essentially leave all of the details of implementation up to the Secretary. This regulatory flexibility led most observers to predict that the substance of these restrictions would be quite mild. Yet executive compensation regulation proved politically potent, and in the American Recovery and Reinvestment Act (ARRA), also known as the stimulus package, Congress retroactively imposed further compensation restrictions on the most senior officers of firms receiving \$500 million or more in TARP funds.<sup>80</sup>

EESA also has several important oversight provisions. Beyond a requirement of periodic reports to Congress,<sup>81</sup> the Act creates a Financial Stability Oversight Board composed of the Chairman of the Federal Reserve, the Treasury Secretary, the Director of the Federal Housing Authority, the Chairman of the Securities and Exchange Commission (SEC), and the Secretary of Housing and Urban Development.<sup>82</sup> This body is tasked with reviewing the Treasury Secretary's use of his or her authority under EESA, making recommendations, and reporting malfeasance.<sup>83</sup> The Act also requires audits by the GAO,<sup>84</sup> establishes

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76. By diluting the bank's common stock, however, the warrant provision also had the perverse effect of discouraging the bank from raising additional capital by issuing new stock. See *Principles that Should Have Guided TARP: Hearing Before the Cong. Oversight Panel*, 111th Cong. 12 (2009) (statement of Charles Calomiris), available at <http://cop.senate.gov/documents/testimony-111909-calomiris.pdf>.

77. Emergency Economic Stabilization Act § 101(b).

78. *Id.* § 101(e).

79. *Id.* § 108.

80. American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, § 7001, 123 Stat. 115, 516-20 (2009).

81. Emergency Economic Stabilization Act § 105.

82. *Id.* § 104.

83. *Id.*

84. *Id.* § 116.

SIGTARP,<sup>85</sup> and creates the Congressional Oversight Panel to aid Congress in its supervision of the program.<sup>86</sup>

The Act's provisions on judicial review are minimal and are drafted in a curiously contradictory manner. On the one hand, section 119(a)(1) provides that "[a]ctions by the Secretary pursuant to the authority of this Act shall be subject to [the judicial review provisions of the Administrative Procedure Act (APA)] . . . including that such final actions shall be held unlawful and set aside if found to be arbitrary, capricious, an abuse of discretion, or not in accordance with law." This strong judicial review provision is then immediately undercut by section 119(a)(2)(A), which provides that "[n]o injunction or other form of equitable relief shall be issued against the Secretary for actions pursuant to [the power-granting provisions of the Act] . . . other than to remedy a violation of the Constitution." Because, as the Supreme Court has recognized, the APA's judicial review provisions are equitable in nature,<sup>87</sup> the second provision effectively eliminates all judicial review conferred by the first provision, with the exception of review of constitutional claims. The end result of these provisions is consistent with case law strongly disfavoring the preclusion of judicial review of constitutional claims,<sup>88</sup> but the circuitous drafting suggests that it is probably the product of congressional haste rather than considered respect for judicial precedent.<sup>89</sup> In any case, firms participating in TARP have not turned to the courts for protection, and judicial involvement in TARP has been non-existent.<sup>90</sup>

### B. Establishment of the CPP

As the Treasury Department considered how it would use its newly acquired authority in the weeks following EESA's enactment, credit markets remained frozen and the stock market remained pessimistic. When the Treasury finally made a decision, it chose to establish an equity purchase program rather

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85. *Id.* § 121, 122.

86. *Id.*

87. *See Doe v. Chao*, 540 U.S. 614, 619 n.1 (2004) (referring to "the general provisions for equitable relief within the Administrative Procedure Act").

88. *See, e.g., Webster v. Doe*, 486 U.S. 592, 603-05 (1988); *Johnson v. Robison*, 415 U.S. 361, 366-74 (1974).

89. *See Davidoff & Zaring*, *supra* note 15, at 519-20 (suggesting that EESA's judicial review provisions may be the result of hasty drafting); *Posner & Vermeule*, *supra* note 9, at 1634 (same).

90. It should be noted that these provisions cover the Secretary's decisions as to what transactions to enter into and on what terms. Once the Secretary has signed a contract with a bank, either party may enforce that contract through regular contract remedies. *See* Emergency Economic Stabilization Act § 119(d)(3).

than an asset purchase program.<sup>91</sup> This was a surprising change of course. Although EESA clearly authorizes an equity purchase program,<sup>92</sup> that power was only added as part of the Dodd plan, and equity purchases did not figure prominently in the public debates over EESA. Moreover, asset and equity purchase plans rest on fundamentally different assumptions about the nature of the financial crisis. An asset purchase plan essentially diagnoses the crisis as a liquidity problem, assuming that the banks are basically healthy but that market panic is preventing them from selling the mortgage-backed assets on their balance sheets for their full true value. An equity purchase plan, on the other hand, diagnoses the crisis as an insolvency problem, assuming that the banks are in fact unable to cover their obligations and that the market is accurately pricing mortgage-backed assets at a fraction of their face value. The Treasury's decision thus represented a major shift.

Two primary factors account for the Treasury Department's about-face. The first is that a number of European nations had coalesced around a strategy of recapitalizing the banking system through equity injections. The United Kingdom took the lead in adopting this approach, and after a special economic summit, the major economies of continental Europe quickly followed suit.<sup>93</sup> This international consensus was echoed by a scholarly consensus among economists across the ideological spectrum that partial nationalization through capital injections was the most efficient way to get credit flowing again.<sup>94</sup>

Second, fairly and responsibly running a \$700 billion asset purchase program would have represented an administrative task of gargantuan proportions. The "troubled" mortgage-backed assets at the heart of the crisis were immensely complicated securities, the value of each of which depended on the performance of different pools of mortgages all across the country. Moreover, these

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91. See Press Release, U.S. Dep't of the Treasury, Statement by Secretary Henry M. Paulson, Jr. on Actions To Protect the U.S. Economy (Oct. 14, 2008), <http://www.treas.gov/press/releases/hp1205.htm> (announcing that \$250 billion in TARP funds would be used to "purchase equity stakes in a wide array of banks and thrifts").

92. Equity shares clearly fall within EESA's broad definition of "troubled asset." See Emergency Economic Stabilization Act § 3(9). Moreover, the legislative history specifically references authorizing equity purchases. In a colloquy with Representative Barney Frank, Chairman of the House Financial Services Committee, Representative Jim Moran stated: "I do want to clarify that the intent of this legislation is to authorize the Treasury Department to strengthen credit markets by infusing capital into weak institutions in two ways: by buying their stock, debt, or other capital instruments; and, two, by purchasing bad assets from the institutions." Representative Frank replied: "I can affirm that." 154 CONG. REC. H1424 (daily ed. Oct. 3, 2008).

93. See CONG. OVERSIGHT PANEL, DECEMBER 2009 REPORT, *supra* note 44, at 17; Paul Krugman, Op-Ed., *Gordon Does Good*, N.Y. TIMES, Oct. 13, 2008, at A29, available at <http://www.nytimes.com/2008/10/13/opinion/13krugman.html>.

94. See Davidoff & Zaring, *supra* note 15, at 526.

assets were not standardized and were not being traded in any kind of liquid market—in fact, that was precisely the problem. The Treasury, therefore, would have had to create guidelines for what categories of assets it would be willing to purchase and evaluate each individual proffered asset's adherence to those guidelines. Then, most importantly, the Treasury would have to set a price on the very same assets the private market had proven itself unable to value. Many commentators worried that banks and asset managers could easily manipulate these prices to benefit insiders and politically connected firms.<sup>95</sup> Equity shares, by contrast, are standardized securities traded by and large in liquid markets; moreover, an equity purchase program would require far fewer transactions to achieve a similar systemic effect. As Interim Assistant Treasury Secretary Neel Kashkari later explained: “[P]urchasing equity in healthy banks would be the fastest way to inject much-needed capital into the financial system and restore confidence,” adding, rather understatedly, that “[i]lliquid asset purchases . . . would take longer to implement . . . .”<sup>96</sup>

The Treasury's equity purchase program was born on October 14, 2008, when the heads of the nine largest U.S. banks were invited to a meeting with Secretary Paulson, Chairman Bernanke, and the heads of the New York Federal Reserve, the FDIC, and the Office of the Comptroller of the Currency (OCC). According to reports and to the regulators' talking points memorandum, these bankers were told—not asked—that their institutions would be accepting \$125 billion in TARP capital injections.<sup>97</sup> Later that day, the Treasury announced that it would be making up to \$250 billion available to eligible U.S. banks in the

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95. See, e.g., Simon Johnson & James Kwak, *A Hedge Fund Like No Other: A Key Task for Congress: Matching Managers' and Taxpayers' Interests*, WASH. POST, Sept. 23, 2008, at A21, available at <http://www.washingtonpost.com/wp-dyn/content/article/2008/09/22/AR2008092202584.html>.

96. Press Release, U.S. Dep't of the Treasury, Interim Assistant Secretary Neel Kashkari Remarks on Implementation of the Emergency Economic Stabilization Act (Nov. 19, 2008), <http://www.ustreas.gov/press/releases/hp1281.htm>. The Treasury Department later set up an asset purchase program through TARP known as the Public-Private Investment Program. The administrative complexity of that program and the amount of run-up time required to get it moving appear to vindicate Treasury's judgment that an equity purchase would be easier and faster to implement. See SIGTARP, *JULY 2010 REPORT*, *supra* note 13, at 100-05.

97. Mark Landler, *U.S. Investing \$250 Billion To Bolster Banks; Dow Surges 936 Points: Stock Markets Rally Worldwide-Biggest Intervention Since '30s*, N.Y. TIMES, Oct. 14, 2008, at A1, A14, available at <http://query.nytimes.com/gst/fullpage.html?res=9D06E2DE173DF937A25753C1A96E9C8B63> (reporting that Secretary Paulson “essentially told the participants that they would have to accept government investment for the good of the American financial system”); *CEO Talking Points*, JUDICIAL WATCH (Oct. 13, 2008), <http://www.judicialwatch.org/files/documents/2009/Treasury-CEO-TalkingPoints.pdf> (quoting Secretary of the Treasury Henry M. Paulson, Jr.: “If a capital infusion is not appealing, you should be aware that your regulator will require it in any circumstance.”).

form of purchases of preferred stock.<sup>98</sup> That program was later dubbed the Capital Purchase Program (CPP).

#### IV. ADMINISTERING THE CPP

Although the Treasury Department created the CPP in part because it would be easier to administer than an asset purchase program, the program by no means ran itself. To get a sense of the administrative tasks involved in the program, consider a hypothetical bank that wants to participate in the CPP. Once the bank's management applies to the program, the Treasury must decide whether to allow it to participate or not. If accepted, the bank and the Treasury then have to execute a Securities Purchase Agreement (SPA) to effectuate the transaction. Then the Treasury must monitor the bank's compliance with the terms of the SPA, EESA, and any applicable regulations for the duration of the time the Treasury holds the bank's securities. If the bank runs into trouble after receiving the Treasury's capital injection, it might approach the Treasury about restructuring its investment—after all, if the bank were to fail, the securities the Treasury purchased would be worthless. The Treasury would then have to decide whether or not to allow the restructuring. If the bank remains healthy, it will eventually want to repurchase the securities it sold to the Treasury, forcing the Treasury to decide when the bank is healthy enough to exit the program. Finally, the Treasury must also decide how to dispose of the warrants EESA requires it to receive from the bank.

This Part examines in detail how the Treasury dealt with each of these elements of the program—application processing, SPA execution, compliance monitoring, consideration of restructuring requests, consideration of repurchasing requests, and disposition of warrants. This examination will show that, in the absence of specific statutory commands enforced by judicial review, the market-based structure of the program and the internal processes set up to manage its implementation enabled the CPP to operate in accordance with stable, consistent rules that facilitated efficient administration, democratic oversight, and protection of banks' legal rights.

##### A. *Application Processing*

The process that the Treasury established to sift through banks' applications to participate in the CPP clearly shows the importance of managerial accountability mechanisms in the program's successful administration. Rather than analyzing each applicant institution itself, the Treasury delegated the lion's share of responsibility for application processing to the four federal banking agencies (FBAs)—the Federal Reserve, the FDIC, the OCC, and the Office of Thrift Supervision (OTS). In order to ensure that the FBAs exercised this dele-

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98. Press Release, U.S. Dep't of the Treasury, Treasury Announces TARP Capital Purchase Program Description (Oct. 14, 2008), <http://www.treas.gov/press/releases/hp1207.htm>.

gated authority in line with the Treasury's priorities, the Treasury issued guidelines detailing the grounds on which applications should be accepted or rejected.<sup>99</sup> Senior officials in the FBAs in turn developed their own guidelines and processes to control the discretion of line employees within that FBA.<sup>100</sup> A hierarchical administrative structure thus necessitated steps to ensure that each bank's application was evaluated according to articulated standards of general applicability. In the only cases in which the Treasury deviated from these steps—the first nine applications to the program—it did so only because it was necessary to overcome a collective action problem and get the CPP up and running.<sup>101</sup>

Since the purpose of the CPP was to inject capital into the banking system quickly, it is not surprising that the application process the Treasury established was quite streamlined. When the program was announced, the Treasury and the FBAs each posted a six-page CPP application on their respective websites.<sup>102</sup> The first four pages of this application consisted entirely of information about the program, and the fifth asked only for contact information. Only the final page of the application required any substantive information about the applicant institution.<sup>103</sup> The Treasury was able to use this pared-down application by leveraging the pre-existing knowledge, expertise, and administrative infrastructure of the FBAs. Treasury officials instructed banks to consult with the appropriate FBA in the first instance and to submit their application to that FBA rather than to the Treasury.<sup>104</sup> The FBAs then evaluated each application and forwarded a recommendation on to the Treasury.

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99. See OFFICE OF THE INSPECTOR GEN. OF THE BD. OF GOVERNORS OF THE FED. RESERVE SYSTEM, AUDIT OF THE BOARD'S PROCESSING OF APPLICATIONS FOR THE CAPITAL PURCHASE PROGRAM UNDER THE TROUBLED ASSET RELIEF PROGRAM 14 (2009) [hereinafter FEDERAL RESERVE OIG REPORT], available at [http://www.federalreserve.gov/oig/files/CPP\\_Final\\_Report\\_9.30.09\\_for-web.pdf](http://www.federalreserve.gov/oig/files/CPP_Final_Report_9.30.09_for-web.pdf).
100. See *id.* at 14-16 (describing the Federal Reserve's internal procedures for processing CPP applications); OFFICE OF THE INSPECTOR GEN. OF THE FED. DEPOSIT INS. CORP., CONTROLS OVER THE FDIC'S PROCESSING OF CAPITAL PURCHASE PROGRAM APPLICATIONS FROM FDIC-SUPERVISED INSTITUTIONS 2-7 (2009) [hereinafter FDIC OIG REPORT], available at <http://www.fdicig.gov/reports09/09-004EV.pdf> (describing the FDIC's internal procedures for processing CPP applications).
101. See *infra* notes 124-127 and accompanying text.
102. Press Release, U.S. Dep't of the Treasury, Statement by Secretary Henry M. Paulson, Jr. on Capital Purchase Program (Oct. 20, 2008), <http://www.treas.gov/press/releases/hp1223.htm>.
103. See U.S. DEP'T OF THE TREASURY, APPLICATION GUIDELINES FOR TARP CAPITAL PURCHASE PROGRAM, <http://www.financialstability.gov/docs/CPP/application-guidelines.pdf> (last accessed Nov. 20, 2010).
104. See Press Release, U.S. Dep't of the Treasury, *supra* note 98; U.S. DEP'T OF THE TREASURY, PROCESS-RELATED FAQs FOR CAPITAL PURCHASE PROGRAM,

The guidance document the Treasury issued to circumscribe the FBAs' discretion, entitled *Process for Evaluation of QFI [Qualified Financial Institutions] Participation in the TARP Capital Purchase Program*, has not been publicly released.<sup>105</sup> But other Treasury guidance, congressional testimony by Treasury officials, and reports by SIGTARP, the Inspector General of the Federal Reserve, and the Inspector General of the FDIC have revealed the program's basic eligibility standards.<sup>106</sup> The Treasury has insisted from the beginning that CPP capital injections were intended to shore up banks that were "healthy" and "viable," not to bail out failing banks.<sup>107</sup> The FBAs, therefore, were instructed to evaluate applicant institutions' viability based on standard bank examination ratings<sup>108</sup>

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<http://www.ustreas.gov/press/releases/reports/faqcpp.pdf> (last accessed Nov. 20, 2010).

105. See FEDERAL RESERVE OIG REPORT, *supra* note 99, at 14 (stating the name of the guidance document).
106. See FDIC OIG REPORT, *supra* note 100; FEDERAL RESERVE OIG REPORT, *supra* note 99; SIGTARP, INITIAL REPORT TO THE CONGRESS: FEBRUARY 8, 2008, at 50-52 (2008) [hereinafter SIGTARP, INITIAL REPORT]; U.S. Dep't of the Treasury, *Factsheet on Capital Purchase Program*, FINANCIALSTABILITY.GOV (Oct. 3, 2010), <http://www.financialstability.gov/roadtostability/CPPfactsheet.htm>. The Federal Reserve's Inspector General has described the Treasury's initial guidance on CPP applications as "limited." FEDERAL RESERVE OIG REPORT, *supra* note 99, at 14.
107. See, e.g., Press Release, U.S. Dep't of the Treasury, *supra* note 102 (describing the CPP as "designed to attract broad participation from healthy institutions"); Press Release, U.S. Dep't of the Treasury, *Treasury Provides Funding To Bolster Healthy, Local Banks* (Jan. 27, 2009), <http://www.ustreas.gov/press/releases/tg03.htm> (describing the CPP as "a means to directly infuse capital into healthy, viable banks").
108. Treasury has relied upon three different kinds of ratings: the CAMELS rating, the Community Reinvestment Act (CRA) rating, and, for bank holding companies, the C/RFI rating. SIGTARP, OPPORTUNITIES TO STRENGTHEN CONTROLS TO AVOID UNDUE EXTERNAL INFLUENCE OVER CAPITAL PURCHASE PROGRAM DECISION-MAKING 26 (2009) [hereinafter SIGTARP, OPPORTUNITIES TO STRENGTHEN CONTROLS], available at [http://www.sig tarp.gov/reports/audit/2009/Opportunities\\_to\\_Strengthen\\_Controls.pdf](http://www.sig tarp.gov/reports/audit/2009/Opportunities_to_Strengthen_Controls.pdf). A bank's CAMELS rating is a score on a scale of one to five based on capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk. See SIGTARP, INITIAL REPORT, *supra* note 106, at 52. A bank's CRA rating rates the bank's performance in the context of its business strategy, community, and competitors. See SIGTARP, OPPORTUNITIES TO STRENGTHEN CONTROLS, *supra* note 108, at 5-6 n.4. A C/RFI rating rates a bank holding company's financial condition and the potential risk it poses to its subsidiary depository institution(s). See Letter from Richard Spillenkothen, Dir. of the Div. of Banking Supervision and Regulation for the Bd. of Governors of the Fed. Reserve Sys., to the Officer in Charge of Supervision and Appropriate Supervisory and Examination Staff at Each Fed. Reserve

and specified performance measures,<sup>109</sup> as well as certain “mitigating factors” the FBAs could consider if an applicant institution failed to meet one or more of the performance measures.<sup>110</sup>

In addition to application criteria, the Treasury also established a multi-level application review process. For each applicant bank, the FBAs were to prepare a “case decision memo” providing a brief narrative about the bank and classifying it in one of three categories.<sup>111</sup> Applications in the first category, for banks with the highest examination ratings, were forwarded directly to the TARP Investment Council at the Treasury, which could grant preliminary approval subject to the final decision of the Assistant Secretary for Financial Stability. Applications in the second category, for banks with lower examination ratings, were forwarded to an intermediate body called the CPP Council. Consisting of representatives from the four FBAs, the CPP Council could ask for additional information, recommend withdrawal of the application, or recommend approval, in which case the application would be forwarded up to the TARP Investment Council. Banks with applications in the third category, for banks with weak examination ratings, were asked for additional information or advised to withdraw their applications.<sup>112</sup>

The description of this complex interagency process is somewhat misleading, however, because the Treasury Department was extremely deferential to the recommendations made by the FBAs. Indeed, for at least the first eleven months of the program, the Treasury did not reject a single CPP application that an FBA had recommended for approval.<sup>113</sup> Accordingly, while as a formal matter, all application decisions rested with the Treasury Secretary as required by EESA, in practice the actual decision making took place inside the FBAs, where bank examinations were conducted and performance measures and mitigating factors were analyzed. Each FBA developed its own internal review process, composed of preliminary recommendations by regional offices and multiple levels

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Bank and All Bank Holding Companies (Dec. 6, 2004), available at <http://www.federalreserve.gov/boarddocs/srletters/2004/sr0418.htm>.

109. The performance measures “relate to acceptable percentages for classified assets, non-performing loans, other real estate owned, and construction and development loans.” See FEDERAL RESERVE OIG REPORT, *supra* note 99, at 14.
110. FDIC OIG REPORT, *supra* note 100, at 8.
111. See SIGTARP, OPPORTUNITIES TO STRENGTHEN CONTROLS, *supra* note 108, at 26-27.
112. See SIGTARP, INITIAL REPORT, *supra* note 106, at 52-53.
113. See Donald L. Barlett & James B. Steele, *Good Billions After Bad*, VANITY FAIR, Oct. 2009, at 204.



of review at the headquarters in Washington, D.C.<sup>114</sup> Indeed, there is evidence that at least one FBA, the FDIC, actually tweaked the review process on its own initiative, forwarding applications that only barely met the criteria for the first category to the intermediate CPP Council instead of the TARP Investment Council.<sup>115</sup> The Treasury thus set out the standards for acceptance to the program, while the FBAs made all of the actual decisions.

The Treasury's reliance on the FBAs represented a sensible administrative structure for the CPP along several dimensions: it leveraged the FBAs' pre-existing knowledge, expertise, and administrative infrastructure; it enabled the CPP to get up and running in a matter of weeks; it minimized the possibility of conflict with the larger structure of federal banking regulation; and it protected the FBAs' bureaucratic turf. At the same time, the basis for this critical cooperation between the Treasury and the FBAs, like many aspects of the administration of the CPP, was remarkably informal. The CPP's administrative structure was announced by press release,<sup>116</sup> and no memoranda of understanding or other interagency agreements have come to light, indicating that these relationships were based entirely on informal agreements among the relevant agency officials. The Treasury informally consulted with the FBAs in the design of the CPP application process,<sup>117</sup> and the FBAs sought additional guidance from Treasury officials by email when questions arose.<sup>118</sup> This informality is somewhat less surprising for the OCC and OTS, which are bureaus of the Treasury Department and therefore subject to the Treasury Secretary's hierarchical control, but it is quite surprising for the Federal Reserve and the FDIC, both of which are independent agencies. Still, informality does not appear to have hindered the CPP's operation. A preliminary scholarly study has shown that the actual distribution of CPP funds was consistent with the Treasury's announced policy of only providing aid to healthy, viable banks.<sup>119</sup>

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114. See SIGTARP, *OPPORTUNITIES TO STRENGTHEN CONTROLS*, *supra* note 108, at 4-9; see also FDIC OIG REPORT, *supra* note 100, at 2-7 (describing the FDIC's internal review process); FEDERAL RESERVE OIG REPORT, *supra* note 99, at 14-16 (describing the Federal Reserve Board's internal review process).

115. FDIC OIG REPORT, *supra* note 100, at 9.

116. See U.S. Dep't of the Treasury, *supra* note 98.

117. U.S. Dep't of the Treasury, *supra* note 102.

118. See FDIC OIG REPORT, *supra* note 100, at 6.

119. Dinara Bayazitova & Anil Shivdasani, *Assessing TARP* (Aug. 29, 2009) (unpublished manuscript) (manuscript at 12), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1461884](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1461884) (finding that banks receiving CPP funds had stronger loan portfolios than banks that did not participate, leading to the conclusion that "approval appears to have been provided to promote the financial stability of healthy banks rather than the bailout of economically unhealthy banks"). Another recent study has suggested that the extent of banks' political ties to the Federal Reserve and to the relevant congressional committees significantly affected how much funding they received through CPP, with the effect being par-

It is worth mentioning at this point that several CPP-participating banks have claimed that their federal regulator leaned on them to apply to the program when they otherwise would not have done so.<sup>120</sup> It is impossible to determine from the public record exactly what transpired between these banks and their regulators, but the claims are widespread enough to be credible, raising questions about the manner in which the FBAs exercised the authority the Treasury de facto delegated to them. Part of the problem was clearly that many banks felt hamstrung by the perception that the CPP was just another bailout program<sup>121</sup> and were reluctant to participate for fear of being stigmatized by investors and customers.<sup>122</sup> The deeper problem, however, lies in the tension between the CPP's pressing macroeconomic goal of recapitalizing the banking system as quickly as possible and the fact that EESA did not authorize coercive regulation, only voluntary transactions. To mediate this tension, the FBAs apparently at times implicitly threatened to use their pre-existing coercive regulatory powers to convince reluctant banks to "get with the program," so to speak.

But it is hard to imagine how the Treasury could have designed the CPP to avoid this dynamic. The risk of implied threats was built into the structure not only of the CPP, but of EESA itself; indeed, this type of risk is inherent in any scheme in which the government proposes to enter into a voluntary transaction with a pervasively regulated entity like a bank. Even if the FBAs had not been the agencies receiving and initially processing CPP applications, the FBAs still would have been aware of the program's existence and would have had their pre-existing regulatory authority, creating the possibility of implicit threats. Moreover, in the midst of an extreme crisis in which banks played a key role, it is not surprising that bank regulators were emboldened to push the limits of their powers. Indeed, SIGTARP has actually faulted the Treasury and the Federal Reserve for not leveraging their coercive regulatory powers more aggressively

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ticularly strong for weaker banks. See Ran Duchin & Denis Sosyura, TARP Investments: Financials and Politics (Feb. 24, 2010) (unpublished manuscript), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1426219](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1426219). However, this study did not bracket out the first nine banks to participate in the CPP, which the government essentially forced to participate due to concerns about the "too-big-to-fail" phenomenon and collective action problems. See *infra* notes 125-127 and accompanying text.

120. See, e.g., Edmund L. Andrews, *Some Banks Tell U.S. To Keep Bailout Cash*, N.Y. TIMES, Oct. 30, 2008, at B6, available at <http://www.nytimes.com/2008/10/31/business/31plan.html>; Loren Steffy, *Here, Banks, Take This Money Whether You Need it or Not*, HOUSTON CHRON., Oct. 31, 2008, <http://www.chron.com/dispatch/story.mpl/business/steffy/6087315.html>. For the special case of the first nine banks to participate in the CPP, see *infra* notes 124-127 and accompanying text.
121. Given (1) the long string of government bailouts that preceded the passage of EESA, see *supra* Part II, and (2) that the first \$125 billion of CPP was given to the nation's nine largest banks, many of which were generally regarded as insolvent, this perception was not entirely unreasonable.
122. See Andrews, *supra* note 120, at B6.

in their dealings with AIG and its counterparties.<sup>123</sup> Thus, while banks' claims of regulatory pressure raise questions, what is most remarkable about these claims is not that they are being made, but rather that they are not more serious and widespread.

The one instance in which regulators clearly did pressure banks—forcefully—was in the October 14, 2008 meeting in which the country's nine largest banks were first convinced to participate. While these initial nine transactions<sup>124</sup> were part of the CPP, they did not go through the CPP application process that the Treasury later established and are *sui generis*. These initial participating institutions faced a collective action problem stemming from the fact that TARP was still perceived as a bailout program. If the Treasury simply let these institutions apply individually, any institution that chose to participate would be seen as ailing and in need of help. This perception would have destroyed the bank's ability to raise capital in the private market and possibly started a run on the bank. Consequently, no institution would apply, despite the fact that many of them desperately needed additional capital.<sup>125</sup> Moreover, there was no point in restricting the program to a subset of these banks that the Treasury deemed "viable," due to the "too-big-to-fail" problem. If an institution were excluded from the program and labeled "non-viable," investors would immediately pull their money out and a bank run would ensue. Then, because all of these large institutions were incredibly systemically important, the government would just have to intervene to forestall further panic. Accordingly, Treasury opted simply to have all nine institutions join the program simultaneously, with the Treasury Secretary declaring all of them to be "healthy,"<sup>126</sup> even though some of them almost certainly were not.<sup>127</sup> The regulatory pressure exerted against these banks thus had a clear public purpose, since it was the only way to get the program off the ground.

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123. SIGTARP, QUARTERLY REPORT TO CONGRESS: JANUARY 2010, at 20 (2010) [hereinafter SIGTARP, JANUARY 2010 REPORT], available at [http://www.sig tarp.gov/reports/congress/2010/January2010\\_Quarterly\\_Report\\_to\\_Congress.pdf](http://www.sig tarp.gov/reports/congress/2010/January2010_Quarterly_Report_to_Congress.pdf).

124. This count of nine treats Merrill Lynch and Bank of America as separate institutions, although at the time, the latter was in the process of buying the former.

125. See Jane Sasseen & Theo Francis, *Paulson's \$250 Billion Bank Buy*, BLOOMBERG BUSINESSWEEK, Oct. 14, 2008, [http://www.businessweek.com/bwdaily/dnflash/content/oct2008/db20081013\\_441566\\_page\\_2.htm](http://www.businessweek.com/bwdaily/dnflash/content/oct2008/db20081013_441566_page_2.htm).

126. See Press Release, U.S. Dep't of the Treasury, *supra* note 91 ("These are healthy institutions, and they have taken this step for the good of the U.S. economy.").

127. See SIGTARP, EMERGENCY CAPITAL INJECTIONS PROVIDED TO SUPPORT THE VIABILITY OF BANK OF AMERICA, OTHER MAJOR BANKS, AND THE U.S. FINANCIAL SYSTEM 14 (2009), available at [http://sig tarp.gov/reports/audit/2009/Emergency\\_Capital\\_Injections\\_Provided\\_to\\_Support\\_the\\_Viability\\_of\\_Bank\\_of\\_America...\\_100509.pdf](http://sig tarp.gov/reports/audit/2009/Emergency_Capital_Injections_Provided_to_Support_the_Viability_of_Bank_of_America..._100509.pdf) (determining that several of the initial nine banks to participate in the CPP were not "healthy" at the time they entered the program).

### B. Securities Purchase Agreements

Once the Treasury accepted a bank's application to the program, the next step in the process was for the Treasury and the applicant bank to sign a Securities Purchase Agreement (SPA) to effect the transaction. After the first nine transactions, the Treasury developed standardized SPAs for the various types of banks eligible to participate in the CPP, as well as term sheets explaining the contract terms, which it posted on its website.<sup>128</sup> The decision to use standardized contracts flowed directly from hierarchical managerial concerns, since they enabled senior officials at the Treasury to maintain control over the hundreds of transactions the CPP eventually entailed. The market structure of the CPP, however, constrained the Treasury's discretion over the terms of the standard SPAs, since they had to be generous enough to draw banks to apply. In the words of the Assistant Secretary of the Treasury for Financial Stability, the SPAs were "designed . . . to be attractive to encourage broad participation, while also including important taxpayer protections."<sup>129</sup>

The standardized SPA terms allow the Treasury to purchase senior preferred shares totaling between one and three percent of the bank's risk-weighted assets, up to \$25 billion. The shares accrue dividends at a rate of five percent annually for the first five years, and, in order to encourage prompt repayment, at a rate of nine percent thereafter. The Treasury also received warrants for common shares totaling fifteen percent of the dollar amount of the senior preferred shares purchased. The exercise price of the warrants is the common share price at the time the senior preferred shares are purchased. The preferred shares carry no voting rights except on decisions to issue securities senior to the preferred shares, unless the bank should fail to pay the required dividends, in which case the Treasury gains certain voting rights. While the warrant common shares carry voting rights, the SPA specifies that the Treasury will not exercise them. The

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128. The only differences among the terms for different types of banks are designed to account for different ownership structures and tax treatments. See U.S. Dep't of the Treasury, TARP Capital Purchase Program (Mutual Banks and Savings Associations), <http://www.financialstability.gov/docs/PPP/PPP%20Term%20Sheet%20-%20Mutual%20Banks.pdf> (last visited Dec. 10, 2010); U.S. Dep't of the Treasury, TARP Capital Purchase Program (Non-Public QFIs, excluding Mutual Banks and Savings Associations), <http://www.financialstability.gov/docs/PPP/Term%20Sheet%20%20Private%20C%20Corporations.pdf> (last visited Dec. 10, 2010); U.S. Dep't of the Treasury, TARP Capital Purchase Program, Senior Preferred Stocks and Warrants, Summary of Senior Preferred Terms, <http://www.treas.gov/press/releases/reports/termsheet.pdf> (last visited Dec. 10, 2010) [hereinafter U.S. Dep't of the Treasury, Senior Preferred Stocks]; U.S. Dep't of the Treasury, TARP Capital Purchase Program, (Subchapter S Corporations) (Jan. 14, 2009), <http://www.financialstability.gov/docs/PPP/scorp-term-sheet.pdf>.

129. Press Release, U.S. Dep't of the Treasury, Interim Assistant Secretary for Financial Stability Neel Kashkari Remarks at the SIFMA Summit on the TARP (Nov. 10, 2008), <http://www.ustreas.gov/press/releases/hp1262.htm>.

preferred shares, the warrants, and the warrant common shares are all, with a very limited exception, freely transferable by the Treasury.<sup>130</sup>

The Congressional Oversight Panel has criticized the Treasury Department for not getting a good enough deal for taxpayers in the SPAs, claiming that for each dollar the Treasury spent, it only received securities worth sixty-six cents.<sup>131</sup> But the Treasury left the application window open for over a year and still did not spend all of the \$250 billion it initially allocated to the program. Harsher terms would have led to even smaller subscriptions. Moreover, the Treasury was prevented from taking idiosyncratic, bank-specific risks into account in its pricing decisions, since it did not negotiate each transaction individually, but rather, in order to enable the program to run more smoothly and consistently, made these deals through standardized SPAs. Finally, unlike in transactions with other private actors, banks dealing with the Treasury had to price in the risk that Congress might later retroactively impose additional restrictions on CPP-participating banks, as Congress in fact did through ARRA.<sup>132</sup> In any case, the very question as to whether the standard SPA terms were too generous highlights the tension between the Treasury's macroeconomic regulatory mission to recapitalize the banking system and its fiscal mission to protect taxpayers. The Treasury's efforts to streamline the CPP, systematize its transactions, and encourage broad participation thus may have prevented it from seeking the best possible deal in every transaction. Such is the price of a consistently and effectively administered recapitalization program premised upon voluntary market transactions.

### C. Compliance Monitoring

Once an SPA was finalized, the terms of the SPA, EESA, and ARRA all placed restrictions on the bank's activities for the period of time that the Treasury was to be a shareholder. The SPA, for example, by transacting a sale of preferred shares, inherently limits the bank's ability to pay dividends on its common stock. In order to encourage the bank to remain adequately capitalized, the SPA also restricts the bank's ability to repurchase certain types of its own

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130. U.S. Dep't of the Treasury, TARP Capital Purchase Program, Senior Preferred Stocks and Warrants, Summary of Senior Preferred Terms, <http://www.treas.gov/press/releases/reports/termsheet.pdf>. The text of this termsheet describes the SPA terms for a public bank. The terms for other types of banks are slightly different, but are structured to be economically identical. See sources cited in *supra* note 128.

131. CONG. OVERSIGHT PANEL, FEBRUARY OVERSIGHT REPORT: VALUING TREASURY'S ACQUISITIONS 4 (2009), available at <http://cop.senate.gov/documents/cop-020609-report.pdf>.

132. See John Faust, *TARP's 66-Cent Myth*, REAL TIME ECONOMICS (Apr. 24, 2009, 6:00 AM), <http://blogs.wsj.com/economics/2009/04/24/guest-contribution-tarps-66-cent-myth/> (arguing that these types of considerations show that Treasury did not in fact overpay for the securities it received).

securities from third parties.<sup>133</sup> The most important restrictions, however, are EESA's executive compensation provisions, which ARRA expanded and strengthened. ARRA also contains a provision restricting banks' ability to hire non-immigrant foreign workers.<sup>134</sup>

As with application processing, the Treasury delegated responsibility for monitoring banks' compliance with these requirements to the FBAs. Unlike application processing, however, the Treasury has played a more limited role in defining how the FBAs conduct compliance monitoring. In a December 2008 report, the GAO noted that the Treasury had not yet set up compliance monitoring mechanisms and that FBAs disagreed among themselves as to their monitoring responsibilities.<sup>135</sup> Over time, however, the FBAs coordinated among themselves and developed mechanisms to assess an institution's adherence to CPP and other TARP requirements. These mechanisms were later integrated into the FBAs' other bank examination functions.<sup>136</sup> Indeed, the FBAs have at times even gone further than the Treasury has asked in monitoring CPP-participating banks. Shortly after the CPP was established, SIGTARP and the Congressional Oversight Panel began pushing the Treasury to require institutions receiving TARP funds to track and disclose what they did with the taxpayers' money.<sup>137</sup> The Treasury initially refused, arguing that the fungibility of money rendered such an exercise pointless; only in December of 2009 did it finally agree to implement this recommendation.<sup>138</sup> At least three of the four FBAs, however, had already been monitoring participating banks' use of CPP funds for some time at that point.<sup>139</sup>

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133. See Prester, *supra* note 4, at 947-48.

134. American Recovery and Reinvestment Act, Pub. L. No. 111-5, § 1611, 123 Stat. 115, 304 (2009).

135. U.S. GOV'T ACCOUNTABILITY OFFICE [hereinafter GAO], TROUBLED ASSET RELIEF PROGRAM: ADDITIONAL ACTIONS NEEDED TO BETTER ENSURE INTEGRITY, ACCOUNTABILITY, AND TRANSPARENCY 27 (2008), available at <http://www.gao.gov/new.items/d09161.pdf>.

136. GAO, TROUBLED ASSET RELIEF PROGRAM: ONE YEAR LATER, ACTIONS ARE NEEDED TO ADDRESS REMAINING TRANSPARENCY AND ACCOUNTABILITY CHALLENGES 18-19 (2009), available at <http://www.gao.gov/new.items/d1016.pdf>.

137. See CONG. OVERSIGHT PANEL, QUESTIONS ABOUT THE \$700 BILLION EMERGENCY ECONOMIC STABILIZATION FUNDS 11-12 (2008), available at <http://cop.senate.gov/documents/cop-121008.pdf>; SIGTARP, INITIAL REPORT, *supra* note 106, at 8.

138. See SIGTARP, JANUARY 2010 REPORT, *supra* note 123, at 139-40. For more on the back and forth between Treasury and the oversight bodies on this issue, see James E. Kelly, *Transparency and Bank Supervision*, 73 ALB. L. REV. 421, 429-36 (2010).

139. OFFICE OF THE COMPTROLLER OF THE CURRENCY, ANNUAL REPORT: FISCAL YEAR 2009 11 (2009), available at <http://www.occ.treas.gov/annrpt/1-2009AnnualReportSectionOne.pdf>; OFFICE OF THRIFT SUPERVISION, TROUBLED

The most interesting aspect of the CPP's compliance monitoring system is the unique structure established to evaluate banks' adherence to EESA's restrictions on executive compensation. The Treasury's executive compensation regulations promulgated under EESA and ARRA require *non-public* banks to submit certifications of compliance to both the Treasury and to the appropriate FBA, but require *public* banks to submit their executive compensation certifications to the Treasury and the SEC instead.<sup>140</sup> The Treasury thus shifted responsibility over public banks in this area from the FBAs to the SEC, an enforcement agency that played a relatively minor role in the government's response to the financial crisis.<sup>141</sup> This unique delegation to the SEC suggests that the Treasury Department did not view the executive compensation regulations as part and parcel of the CPP, but rather as a distinct regulatory scheme with a separate purpose. That conclusion is bolstered by the fact that the Treasury opposed the stringent retroactive executive compensation provisions in ARRA<sup>142</sup> and supported the recent statute creating the new Small Business Lending Fund,<sup>143</sup> which will operate much like the CPP but without any executive compensation restrictions.<sup>144</sup>

Executive compensation regulation is one of the elements of TARP that has received the most detailed attention from Congress. At the same time, the Treasury's apparent view that the executive compensation restrictions distract from TARP's central purpose has merit. The restrictions have served as a flashpoint for banks' disillusionment with the CPP, and there is considerable evidence that many banks withdrew their CPP applications after the more restrictive provisions in ARRA went into effect. The restrictions are also a major reason why many banks have sought to exit the CPP early.<sup>145</sup> The intervention of elected

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ASSET RELIEF PROGRAM: CAPITAL PURCHASE PROGRAM: PRELIMINARY EXAMINATION RESPONSE KIT 2 (2009), available at <http://files.ots.treas.gov/4830002.pdf>.

140. See 31 C.F.R. § 30.7(c) (2008).
141. See Davidoff & Zaring, *supra* note 15, at 500-01 (“[T]he SEC rarely played an important role at any stage of the crisis.”).
142. See Edmund L. Andrews & Eric Dash, *Stimulus Plan Tightens Reins on Wall St. Pay*, N.Y. TIMES, Feb. 14, 2009, at A1, available at <http://www.nytimes.com/2009/02/14/business/economy/14pay.html>.
143. SIGTARP, JULY 2010 REPORT, *supra* note 13, at 86.
144. See Small Business Jobs and Credit Act of 2010, Pub. L. No. 111-240, §§ 4101-4113, 124 Stat. 2504, 2582 (2010). It is also worth noting that in the recently enacted financial regulatory reform statute, Congress assigned the enforcement of new executive compensation restrictions almost entirely to the SEC rather than the FBAs. See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 951-960, 124 Stat. 1376, 1899-1907 (2010).
145. See Jane K. Storer & Lawrence R. Wiseman, *To Redeem or Not To Redeem?: Considerations in Determining Whether To Exit the TARP Capital Purchase Program*, 126 BANKING L.J. 625 (2009); Brian Cadman, Mary Ellen Carter & Luann J. Lynch, *Executive Pay Restrictions: Do They Restrict Firms' Willingness To*

representatives responding to political forces created a statutory anomaly—a coercive regulatory provision mixed into a voluntary transactional program—which the Treasury has attempted to blunt through a countervailing anomaly in the CPP’s administrative structure. The CPP’s *compliance monitoring* system thus shows that while political realities have clearly impacted how the Treasury has run the CPP, they have detracted from, rather than contributed to, the program’s structural and administrative coherence.

*D. Restructuring CPP Investments*

Once the Treasury has invested in a CPP-participating bank, it must not only monitor the bank’s compliance with its obligations, but, if the bank runs into financial trouble, it may also have to decide whether to restructure its investment through a securities exchange. Although a restructured investment will typically leave the Treasury holding securities with greater risk or a lower rate of return than the CPP-preferred shares it originally received, a securities exchange will often still be beneficial if it decreases the likelihood that the bank will fail altogether, in which case the Treasury’s investment would lose all of its value.

In keeping with its fiscal obligation to taxpayers, the Treasury treats decisions on restructuring its CPP investments very much as a private investor or creditor would. The Treasury only considers a securities exchange if a bank comes forward with a restructuring proposal, in which case it directs the proposal to an outside asset manager for study and to conduct due diligence on the bank’s health.<sup>146</sup> As of June 30, 2010, the Treasury had conducted securities exchanges with only eight CPP-participating banks.<sup>147</sup> However, the Treasury has stated that institutions that participate in the recently announced Community Development Capital Initiative and the Small Business Lending Fund program may convert their CPP-preferred shares into the new standardized securities created in these programs.<sup>148</sup> These two programs are designed to encourage smaller community banks and financial institutions to increase lending to small businesses, the dearth of which the Treasury views as a significant drag on the economic recovery.<sup>149</sup> Now that the banking industry has been pulled back from the brink of collapse, the Treasury appears to be using securities exchanges to fine-tune the incentives that its investments give to participating banks. The market structure of the CPP, however, constrains the Treasury’s ability to

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Participate in TARP? (Aug. 2010) (unpublished manuscript), available at [http://management.bu.edu/academics/departments/documents/CCL\\_120709.pdf](http://management.bu.edu/academics/departments/documents/CCL_120709.pdf).

146. SIGTARP, July 2010 REPORT, *supra* note 13, at 80.

147. *Id.* at 81 (listing CPP securities exchanges).

148. *Id.* at 85-86.

149. See, e.g., Press Release, U.S. Dep’t of the Treasury, Unlocking Credit for Small Business Fact Sheet (Mar. 16, 2009), <http://www.ustreas.gov/press/releases/tg58.htm>.



change banks' obligations midstream in response to shifting policy imperatives; in order to obtain a bank's consent to a securities exchange, the Treasury must make it attractive enough to be worthwhile.

#### E. Repurchasing CPP-Preferred Shares

The penultimate administrative element of the CPP program concerns banks' ability to exit the program by buying back their CPP-preferred shares from the Treasury.<sup>150</sup> Permitting a bank to exit the program is an extremely important regulatory decision, since when a bank repurchases its shares, the bank's capital base decreases by the dollar amount of those shares, and the bank is no longer subject to the restrictions described above. The guidelines the Treasury has announced on repayment for most banks are quite vague, although the rules announced for the nation's largest banks, whose shares represent the lion's share of CPP outlays, are somewhat more specific.<sup>151</sup> Overall, however, the Treasury has allowed banks that want to exit the program to do so in order to enable the government to end its ownership of private financial firms sooner rather than later.<sup>152</sup> As of June 30, 2010, eighty-two banks had repurchased some or all of their CPP-preferred shares, totaling \$146.9 billion in repayments.<sup>153</sup>

Repayment and exit from the CPP are governed by a combination of statutory provisions, SPA terms, and Treasury policy. As initially enacted, EESA was silent on repayment, which accords with Congress's belief at the time that it was authorizing an asset purchase program rather than an equity purchase program like the CPP. When the Treasury launched the CPP, it included a clause in the

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150. In addition to deciding if and when to allow repayment, Treasury must of course also decide at what price to allow the bank to repurchase the preferred shares. The decision on price, however, is controlled by the SPA, which provides that the bank must simply pay back whatever Treasury initially paid for the shares, plus the value of any unpaid dividends. See U.S. Dep't of the Treasury, Senior Preferred Stocks, *supra* note 128.

151. CONG. OVERSIGHT PANEL, JULY OVERSIGHT REPORT: TARP REPAYMENTS, INCLUDING THE REPURCHASE OF STOCK WARRANTS 10-11, 17-18 (2009) [hereinafter CONG. OVERSIGHT PANEL, JULY 2009 OVERSIGHT REPORT], available at <http://cop.senate.gov/documents/cop-071009-report.pdf>.

152. Indeed, critics have charged that the Treasury has at times allowed banks eager to get out from under restrictions on executive compensation to exit the program too early. See, e.g., Stephen Gandel, *Citi's TARP Repayment: The Downside for a Troubled Bank*, TIME, Dec. 15, 2009, <http://www.time.com/time/business/article/0,8599,1947625,00.html>.

153. SIGTARP, JULY 2010 REPORT, *supra* note 13, at 71. Three smaller CPP-participating banks have declared bankruptcy and therefore will never pay back taxpayers' investments. SIGTARP, JANUARY 2010 REPORT, *supra* note 123, at 53. Treasury has also received \$9.4 billion in dividend and interest payments, with 105 CPP-participating banks having missed a dividend or interest payment. SIGTARP, JULY 2010 REPORT, *supra* note 13, at 72.

standard SPA under which banks were not permitted to repurchase their shares for three years unless they raised an equivalent amount of capital from private investors.<sup>154</sup> Given that a large part of the reason that the CPP was necessary in the first place is that private capital was hard to come by, this clause made repurchasing CPP shares quite difficult for banks. In early 2009, however, the clause was superseded by a provision of ARRA that made repayment easier for banks. Section 111(g) of EESA as amended now provides that “subject to consultation with the appropriate federal banking agency, [the Treasury] shall permit a TARP recipient to repay [CPP-preferred shares] without regard to whether the financial institution has replaced such funds from any other source or to any waiting period . . . .”<sup>155</sup>

As a result of this statutory change, the Treasury had to develop a policy on when it and the FBAs will allow banks to exit the CPP through repayment. The Treasury has explained that three principles guide its decisions on CPP repayment: “maintaining systemic stability,” “[p]reserving the stability of individual institutions,” and “maximizing return on investment” for the taxpayer.<sup>156</sup> But as the Congressional Oversight Panel has noted, these principles will often point in different directions, and are broad enough to justify any decision that the Treasury ultimately makes.<sup>157</sup> Treasury Secretary Timothy Geithner has stated that the “ultimate test” for repurchase decisions is the effect that repayment would have on the overall availability of credit in the economy.<sup>158</sup> Yet even this single criterion is ambiguous enough to be quite malleable.

For most CPP-participating banks, the Treasury and the FBAs have not publicly provided any guidance beyond these broad principles.<sup>159</sup> But for the sixteen largest CPP-participating banks that also participated in the Supervisory Capital Assessment Program (SCAP), the Treasury and the Federal Reserve announced more detailed rules that accord with the requirements of that program. SCAP, popularly known as the “stress test,” was a TARP program

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154. CONG. OVERSIGHT PANEL, JULY 2009 OVERSIGHT REPORT, *supra* note 151, at 10.

155. American Recovery and Reinvestment Act, Pub. L. No. 111-5, § 7001, 123 Stat. 115, 516 (2009). Note that this provision gives implicit congressional ratification to the Treasury’s decision to delegate significant amounts of administrative authority over the CPP to the FBAs.

156. CONG. OVERSIGHT PANEL, JANUARY OVERSIGHT REPORT: EXITING TARP AND UNWINDING ITS IMPACT ON THE FINANCIAL MARKETS 29-30 (2010), available at <http://cop.senate.gov/documents/cop-011410-report.pdf>.

157. *Id.*

158. *Hearing before the Cong. Oversight Panel*, 111th Cong. (Apr. 21, 2009) (statement of Timothy Geithner, Treasury Secretary), available at <http://cop.senate.gov/hearings/library/hearing-042109-geithner.cfm>.

159. See U.S. Dep’t of the Treasury, FAQs on Capital Purchase Program Repayment and the Capital Assistance Program, [http://www.financialstability.gov/docs/FAQ\\_CPP-CAP.pdf](http://www.financialstability.gov/docs/FAQ_CPP-CAP.pdf) (last visited Dec. 10, 2010) (providing only very general guidance on repayment).

through which the Treasury and the FBAs analyzed the capital structure of the nation's largest banks to determine if they needed additional capital to remain healthy, and if so, how much.<sup>160</sup> In a joint press release, the heads of the Treasury Department, the Federal Reserve, the FDIC, and the OCC stated that if SCAP banks desire to repurchase their CPP shares, they must first show that upon repayment they would still have enough capital to cover the capital "buffer" mandated by SCAP.<sup>161</sup> The Federal Reserve later added that SCAP banks would also have to raise a sizeable amount of equity from private investors and issue long-term debt without the help of FDIC aid.<sup>162</sup> As of July 1, 2010, thirteen of the sixteen SCAP banks that participated in the CPP had fully exited the program.<sup>163</sup>

#### F. Warrant Disposition

The final element of the administration of the CPP pertains to the disposition of the warrants that EESA requires the Treasury to acquire from any firm receiving more than \$100 million in TARP funds. A warrant is simply "a security that permits the holder to buy a specified number of common shares (the 'underlying' shares) at a specified price (the 'strike price') on or before a specified date (the 'expiration')." <sup>164</sup> In financial terms, it is a type of call option. The warrants issued through the CPP give the Treasury Department the option to buy common shares in the CPP-participating bank at a price equal to the share price at the time the SPA is signed, in an amount totaling fifteen percent of the dollar amount of the CPP-preferred shares purchased at any time within ten years. Because the strike price is equal to the price at the time the SPA is signed, these warrants give the U.S. taxpayer the ability to participate in the upside from a rise in the bank's stock price without carrying any risk if the stock price falls. Half of a bank's TARP warrants are freely transferable at any time; the oth-

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160. SIGTARP, JANUARY 2010 REPORT, *supra* note 123, at 51.

161. Press Release, Joint Statement by Sec'y of the Treasury Timothy F. Geithner, Chairman of the Bd. of Governors of the Fed. Reserve Sys. Ben S. Bernanke, Chairman of the Fed. Deposit Ins. Corp. Sheila Bair, and Comptroller of the Currency John C. Dugan, *The Treasury Capital Assistance Program and the Supervisory Capital Assessment Program* (May 6, 2009), <http://www.federalreserve.gov/newsevents/press/bcreg/20090506a.htm>.

162. Press Release, The Bd. of Governors of the Fed. Reserve Sys. (June 1, 2009), <http://www.federalreserve.gov/newsevents/press/bcreg/20090601b.htm>.

163. See *List of 19 Banks Undergoing Stress Tests*, REAL TIME ECONOMICS (Apr. 24, 2009, 2:46 PM), <http://blogs.wsj.com/economics/2009/04/24/list-of-19-banks-undergoing-stress-tests/>; U.S. Dep't of the Treasury, *Troubled Asset Relief Program Transactions Report*, FINANCIALSTABILITY.GOV, <http://www.financialstability.gov/docs/transaction-reports/7-1-10%20Transactions%20Report%20as%20of%206-30-10.pdf> (last visited Dec. 10, 2010).

164. CONG. OVERSIGHT PANEL, JULY 2009 OVERSIGHT REPORT, *supra* note 151, at 7.

er half can be exercised or transferred only if the bank elects not to raise an equivalent amount of capital from the private market.<sup>165</sup>

Like decisions on repayment, the Treasury's decisions on warrant disposition are governed by a combination of statute, contract, and policy. EESA as originally enacted simply required the Treasury to exercise or sell the warrants when "the Secretary determines that the market is optimal for selling such assets, in order to maximize the value for taxpayers . . ."<sup>166</sup> An amendment to EESA then mandated that the Treasury "liquidate" the warrants when banks repurchase their CPP-preferred shares.<sup>167</sup> A further amendment restored the Treasury's discretion over warrant disposition, providing that it "may liquidate warrants associated with [TARP] assistance."<sup>168</sup> Ultimately, however, these statutory amendments were ineffectual, since the Treasury had limited its own statutory discretion over warrant disposition through the standard SPA. Under the SPA, once CPP-participating banks have repurchased their preferred shares, they can also buy back their warrants upon notice to the Treasury.<sup>169</sup> Aside from this contractual obligation, the Treasury has also stated that its policy is to dispose of warrants as soon as possible in order to disengage the government from private markets and minimize any long-tail risk.<sup>170</sup>

Unlike repayment, for which any issues concerning the price of the transaction were resolved by the SPA, the Treasury and the banks must negotiate a price for the warrants. EESA's provisions on warrant pricing are very open-ended, requiring only that the terms and conditions of the warrants be written "at a minimum . . . to provide for reasonable participation by the Secretary, for the benefit of taxpayers, in equity appreciation . . ."<sup>171</sup> The SPA for public banks follows that mandate by establishing an elaborate negotiating process through which the Treasury and the bank can agree on the warrants' "fair mar-

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165. U.S. Dep't of the Treasury, Form of Warrant To Purchase Common Stock, § 13(H), <http://www.financialstability.gov/docs/PPP/warrant.pdf>.

166. Emergency Economic Stabilization Act, Pub. L. No. 110-343, § 113(a)(2)(A), 122 Stat. 3765, 3778 (2008).

167. American Recovery and Reinvestment Act, Pub. L. No. 111-5, § 7001, 123 Stat. 115, 520 (2009).

168. Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, § 403, 123 Stat. 1632, 1658 (2009).

169. See U.S. Dep't of the Treasury, Senior Preferred Stocks, *supra* note 128, at 2.

170. See Press Release, U.S. Dep't of the Treasury, Treasury Announces Warrant Repurchase and Disposition Process for the Capital Purchase Program (June 26, 2009), [http://www.financialstability.gov/latest/tg\\_06262009.html](http://www.financialstability.gov/latest/tg_06262009.html) ("The President has clearly stated that his objective is to dispose of the government's investments in individual companies as quickly as is practicable.")

171. Emergency Economic Stabilization Act, Pub. L. No. 110-343, § 113 (d)(2), 122 Stat. 3765, 3777 (2008).

ket value.”<sup>172</sup> This scrupulously balanced process at least in part reflects the CPP’s market structure, which gave the Treasury powerful incentives to devise a process that banks would regard as reasonable and fair.

The process proceeds as follows. First, the bank must propose a price based on the opinion of an independent investment firm. The Treasury then has ten days to accept or reject, which it does by performing its own modeling and consulting with outside investment advisors. If the Treasury rejects the bank’s offer, the parties then have ten days to reach an agreement, at which point either party can invoke an Appraisal Procedure. If either party invokes this procedure, each party chooses an independent appraiser, and the two appraisers have thirty days to agree on a fair market price. If they are unable to agree, the parties by mutual consent appoint a third appraiser, and the average of the three appraisals is then binding on both the Treasury and the bank. The bank, however, is not bound to repurchase the warrants and can walk away at any time. The bank can then restart the process at any time, assuming that the Treasury has not sold the warrants to a third party in the meantime.<sup>173</sup>

Because the underlying shares of the warrants for private banks are not publicly traded, the standard SPA treats them somewhat differently. The SPA prices private bank warrants at \$0.01 per share and prices the underlying shares such that, when exercised, they total five percent of the Treasury’s non-warrant investment in the bank. The Treasury has a policy of exercising these private bank warrants immediately upon receiving them. Thus, if a private bank wishes to redeem its warrants, it must simply buy back the shares.<sup>174</sup>

If a bank elects not to repurchase its warrants, the Treasury remains free to exercise them or to sell them to a third party.<sup>175</sup> Treasury officials have stated that, in accordance with its policy of disposing of the warrants as soon as possible, the Treasury will auction off any warrants that a bank does not redeem within six months after the bank repurchases its CPP-preferred shares.<sup>176</sup> As of June 30, 2010, thirty-seven public institutions had repurchased their warrants for a total of \$2.9 billion, and eleven private banks had repurchased the shares

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172. U.S. Dep’t of the Treasury, Securities Purchase Agreement: Standard Terms, § 4.9(c)(ii), <http://www.financialstability.gov/docs/Cpp/spa.pdf> (last visited Dec. 10, 2010).

173. See CONG. OVERSIGHT PANEL, JULY 2009 OVERSIGHT REPORT, *supra* note 151, at 15-16.

174. *Id.* at 16-17.

175. *Id.* at 17.

176. This willingness to resort to an auction has led some observers to question why Treasury bothered to use an elaborate negotiation process with public banks—that is, why it does not simply use auctions to dispose of all of its warrants. See Simon Johnson, *No Way Out: Treasury and the Price of TARP Warrants*, THE BASELINE SCENARIO (June 29, 2009 6:58 AM), <http://baselinescenario.com/2009/06/29/no-way-out-treasury-and-the-price-of-tarp-warrants/>.

underlying their warrants for a total of \$3.8 million.<sup>177</sup> The Treasury had also auctioned off the warrants of thirteen institutions that had chosen not to repurchase their warrants directly, raising a total of \$1.4 billion.<sup>178</sup>

#### V. ASSESSING THE ADMINISTRATION OF THE CPP

The aspiration of administrative law has been described as the search for “institutional designs that appropriately balance the simultaneous demands of political responsiveness, efficient administration, and respect for legal rights.”<sup>179</sup> These competing values may be served by a variety of accountability mechanisms, including judicial review, congressional specification of statutory mandates, presidential control over administrative bureaucracies, internal managerial techniques, and market-based mechanisms. A given accountability mechanism may be primarily oriented towards only one of the competing values, but accountability mechanisms often promote more than one value simultaneously. Judicial review, for example, is primarily concerned with the protection of legal rights, but it can also operate to serve efficiency and democratic oversight as well. In the case of the CPP, as the foregoing description of the actual operation of the program makes clear, some of these types of accountability mechanisms—judicial review and statutory specificity—were almost entirely absent, while others—managerial and market-based mechanisms—played a crucial role in the program’s administration. The administrative success of the CPP can be traced to the fact that the program’s structure and the surrounding political environment were such that the values of efficiency, rights protection, and democratic control were generally aligned. Measures designed to get the program up and running quickly and to send a clear, consistent, calming message to the banking industry also tended to protect the legal rights of applicant and participating banks, as well as to facilitate democratic oversight and control. It is for this reason that managerial and market-based accountability mechanisms—techniques that are usually oriented primarily towards administrative efficiency—proved adequate to deliver crisis governance comporting with the basic requirements of the rule of law.

Managerial accountability mechanisms played an especially critical role in the administration of the CPP. In fact, the initial decision to make the CPP an equity purchase program rather than an asset purchase program was essentially an internal bureaucratic decision based primarily on concerns about administrative efficiency. As Interim Assistant Treasury Secretary Neel Kashkari explained to Congress, an asset purchase program would simply have taken too

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177. SIGTARP, JULY 2010 REPORT, *supra* note 13, at 76.

178. *Id.* at 78-79.

179. Mashaw, *supra* note 18, at 1263-64.

long to implement.<sup>180</sup> That choice also had the effect, however, of serving democratic control, as it would have been nearly impossible for elected representatives to keep tabs on thousands of separate asset purchase transactions.

Beyond this initial design choice, moreover, the internal structures the Treasury established to run the equity purchase program also served multiple administrative values. The CPP was a large program, involving thousands of applications and more than \$200 billion distributed through more than seven hundred transactions in less than fifteen months.<sup>181</sup> Delegation was an operational necessity, and in order to control the discretion that the Treasury delegated to FBAs, and that senior FBA officials delegated to their subordinates, consistent policies and guidelines reflecting stable, impersonal norms had to be developed. Senior officials then enforced these guidelines through hierarchical review procedures and assessments by the agencies' inspectors general.<sup>182</sup> But these written guidelines did more than promote efficient administration. They also facilitated democratic control by enabling oversight bodies like the Congressional Oversight Panel and SIGTARP to analyze and publicize the Treasury's policies, and they promoted the protection of legal rights by forcing officials to treat all applicant banks according to the same articulated standards. Similar managerial concerns also underlay the Treasury's decision not to negotiate individually with each participating bank, but rather to use standardized SPAs that banks could either take or leave.<sup>183</sup> Standardized public SPAs simultaneously avoided the administrative headache of negotiating hundreds of separate deals, sent a clear signal to banks, apprised them of their legal rights, and informed elected officials and the public of exactly what the Treasury was doing.

The market-based structure of the CPP was also instrumental in ensuring accountability and adherence to the basic requirements of the rule of law. With the exception of the first nine transactions, the Treasury had to obtain each bank's consent for purchasing an equity stake, thereby protecting banks' rights.<sup>184</sup> Written contracts gave banks notice of their obligations and severely limited the Treasury's ability to come back later and change the terms of the deal. In order to impose new obligations not contained in the original contract, as the Treasury appears to want to do through the new Community Develop-

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180. See Press Release, U.S. Dep't of the Treasury, Interim Assistant Secretary Neel Kashkari Remarks on Implementation of the Emergency Economic Stabilization Act (Nov. 19, 2008), <http://www.ustreas.gov/press/releases/hp1281.htm>.

181. SIGTARP, JULY 2010 REPORT, *supra* note 13, at 39.

182. See *supra* notes 99-119 and accompanying text (discussing the delegation structure for application processing); *supra* notes 135-139 and accompanying text (discussing the delegation structure for compliance monitoring); *supra* notes 155-163 and accompanying text (discussing the delegation structure for allowing repayment).

183. See *supra* Section IV.B.

184. See *supra* Sections IV.A-B.

ment Funding Initiative and Small Business Lending Fund, the Treasury must negotiate a new contract, which banks may refuse to sign.<sup>185</sup> The market structure of the CPP also had the effect of promoting efficient administration, as it encouraged the banks that most needed capital injections to come forward and apply first. A preliminary academic study indicates that earlier rounds of CPP funding did in fact go to the banks that needed it most—early participating banks suffered the largest capital shocks and, once they received CPP funding, experienced the largest excess returns.<sup>186</sup>

This is not to deny that politics also played an important role in the administration of the CPP. Given TARP's notoriety as a public program and the high priority that both the Bush and Obama Administrations attached to rehabilitating the banking sector, the agencies implementing the CPP had strong political reasons to ensure that the program ran efficiently and effectively. Congress also created three new bodies to help provide oversight over the Treasury's implementation of TARP, and while the Financial Stability Oversight Board has been largely missing-in-action, the Congressional Oversight Panel and SIGTARP have established themselves as important public agencies.<sup>187</sup> Much of the research for this Note has come from reports prepared by these bodies,<sup>188</sup> and they have often played the role of political entrepreneurs, publicizing perceived weaknesses and flaws in TARP and drawing on public sentiments to build their institutional legitimacy and gain leverage over the Treasury.

Contra Posner and Vermeule, however, politics have not been the primary driving force behind accountable crisis governance in the CPP. Indeed, when Congress has responded to the political winds and tinkered with the administration of the CPP, it has meddled with banks' rights and harmed the program's effectiveness. Most notably, after the program was up and running and many banks had already signed contracts with the Treasury, Congress through ARRA imposed significant retroactive restrictions on how banks receiving TARP funds may compensate their senior executives. Whatever one believes about the propriety of tighter regulation of executive compensation in general, this statutory restriction made little sense for the CPP. In fact, since the CPP was specifically designed to attract healthy banks, the statutory restrictions had the effect of punishing many executives who had run their institutions responsibly. By mixing coercive and arguably punitive restrictions into a voluntary program designed to recapitalize the banking system, the ARRA executive compensation provisions decreased participation in the CPP and pushed firms to exit the program before they were financially ready. The Treasury has faithfully implemented

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185. See SIGTARP, JULY 2010 REPORT, *supra* note 13, at 85-86.

186. Bayazitova & Shivdasani, *supra* note 119, at 3.

187. Joshua Ruby, Note, *Sound and Fury, Confused Alarms and Oversight: Congress Delegation, and Effective Responses to Financial Crises*, 47 HARV. J. ON LEGIS. 209, 227-29 (2010).

188. E.g., CONG. OVERSIGHT PANEL, JULY 2009 OVERSIGHT REPORT, *supra* note 151; SIGTARP, JULY 2010 REPORT, *supra* note 13.



these provisions, but its assignment of enforcement responsibility to the SEC and its support for ditching executive compensation restrictions in the Small Business Lending Fund indicates that the Treasury realizes that these restrictions are in tension with the CPP's larger goals. Politics' effect on the administration of the CPP has been far more ambiguous than that of other accountability mechanisms.

Alternative accountability mechanisms are thus primarily responsible for the CPP's administrative success. The atmosphere of crisis eviscerated the power of the traditional mechanisms of statutory specificity and judicial review, and politics' ability to promote consistent governance in accordance with the rule of law has been mixed at best. Where the values of administrative efficiency, rights protection, and democratic oversight are aligned, the CPP demonstrates that alternative accountability mechanisms can be powerful indeed.

## CONCLUSION

The CPP is a very large and important public program, but it has been under-analyzed in the legal academic literature. The foregoing analysis of the inner administrative workings of the program shows that what little has been written thus far may be misplaced in its focus. While the executive compensation regulations have received much public attention, they are in many ways anomalous and separate from the program's central thrust. Moreover, while the authority Congress delegated to the Treasury through EESA is quite broad and the provisions on judicial review quite weak, the Treasury has nevertheless exercised its discretion in a manner that has promoted all of the basic goals of administrative governance.

The pivotal role that managerial and market-based accountability played in the CPP underlines the importance of alternative accountability mechanisms in administrative governance in general, especially when the dynamics of crisis render traditional techniques like statutory specificity and judicial review ineffective. The Treasury, Congress, and other oversight bodies would do well to bear these alternative mechanisms in mind as they consider the institutional design of the new Small Business Lending Fund and any other future programs modeled on the CPP. More broadly, the lessons of the CPP suggest that scholars and practitioners of administrative law should pay careful attention to how the various goals of administrative governance—efficiency, rights protection, and political responsiveness—do or do not align in any particular administrative scheme. The extent of such alignment will often determine which accountability mechanisms will actually add value. Where these values run orthogonal to one another, all of the traditional mechanisms—statutory specificity, judicial review, presidential supervision, etc.—may be necessary to secure responsible, public-regarding administration. But where, as in the case of the CPP, these values run parallel to one another, alternative accountability mechanisms may suffice, and the addition of further mechanisms may simply serve to gum up the works. One can also imagine a spectrum of intermediate cases of partial align-

ment in which alternative mechanisms could compensate for weaknesses in, rather than the absence of, traditional accountability techniques.

In the case of the CPP, near-perfect alignment enabled a vague statute and weak judicial review to serve the cause of successful crisis administration. If Congress had made EESA's provisions more specific and subjected the Treasury's actions to intensive judicial review, the Treasury might have been forced to implement TARP as an asset purchase program and might never have been able to create a much-needed capital injection program like the CPP. Statutory specificity and effective judicial review would also almost certainly have delayed the Treasury's actions for weeks if not months. In the absence of such measures, internal managerial controls and the market-based structure of the program permitted the Treasury—still subject to effective democratic control and respectful of banks' rights—to implement the CPP quickly and effectively.