INCREASING PUBLIC ACCOUNTABILITY UNDER THE EMERGENCY ECONOMIC STABILIZATION ACT

Recommendations from a Conference Held at the Washington College of Law, American University, on November 21, 2008

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Available at: wcl.american.edu/go/bailout

On October 3, 2008 Congress passed, and the President signed, the Emergency Economic Stabilization Act of 2008, Public Law 110-343, designed to rescue the U.S. financial system. It authorizes the Secretary of the Treasury to spend up to $700 billion to purchase distressed assets, especially mortgage-backed securities, and make capital investments in financial institutions. This program became known as the Troubled Assets Relief Program (TARP). The legislation was enacted with uncommon speed—having been proposed as a three-page, 849-word draft on September 20, 2008, and enacted 13 days later as a 451-page bill.

Section 2 of the Act provides that the primary purpose of the bill is to "restore liquidity and stability to the financial system of the United States." Other purposes include protecting home values, preserving homeownership, promoting jobs and economic growth, as well as "maximiz[ing] overall returns to the taxpayer" in a manner that "provides accountability for the exercise of such authority."

The Program of Law and Government at American University's Washington College of Law convened a "participatory roundtable" to examine the public accountability mechanisms in the Act.[1] The roundtable focused on four aspects of this issue:

(a) public participation in Treasury policymaking,
(b) transparency of government decisions and required reports,
(c) judicial review, and
(d) oversight mechanisms established by the Act.

The discussion revealed some clear shortcomings in each area. The leaders of the roundtable (faculty members at Washington College of Law) have now attempted to distill some of the conclusions that appeared to attract a consensus from the participants assembled. However, only the undersigned members of the roundtable have agreed with this specific set of recommendations.

The group did not seek to address the wisdom or legality of the Secretary's substantive decisions in allocating the TARP funds. We note, however, that the original legislation

[1] "The Bailout Bill and the Rule of Law: A Public Participatory Roundtable on Plugging the Bill's Procedural Leaks," Washington College of Law, American University, Nov. 21, 2008. The podcast is linked to the Conference website, *available at* wcl.american.edu/go/bailout.

was intended primarily to authorize and fund the government's purchase of "troubled" mortgage-related assets which are in the portfolios of banks and other financial institutions, but that this plan was rather quickly jettisoned in favor of a plan to use the fund for direct injections of capital into banks in return for preferred stock and warrants to acquire common stock. It also seems likely that the program will be extended to non-bank financial institutions. Other changes in direction are possible in the future, given the extremely broad authority given to the Secretary in the Act.

Subsequent to the Conference, the Government Accountability Office issued the first of its required reports under the Act.[2] Nothing in these recommendations is inconsistent with the recommendations in that report, and some of the recommendations are similar. That report covers many areas not covered by these recommendations, and these recommendations cover areas not discussed in the GAO report.

The following recommendations are made in an attempt to improve accountability and balance the other relevant purposes identified by Congress in the Act as the TARP goes forward—either in implementing the current statute, or in providing guidance to Congress if and when it is amended. We suggest general principles for reform in each of the four areas, rather than specific statutory language, although we are available to assist in the drafting if that would be helpful.

RECOMMENDATIONS

A. Public Participation

The EESA is not very clear about what type of procedures should be used by the Treasury Department in developing its policies, or to what extent the public will have an opportunity to provide input. Of course the administrators of the TARP are free to consult outside experts, and have been doing so. But broader public participation in agency policymaking also has its virtues. It can educate the agency about public concerns as well as elicit overlooked ideas, and it can also provide interested and knowledgeable members of the public with an opportunity to take part in the development of policy that affects them and others around the world. On the other hand, as the Administrative Procedure Act (APA) recognizes, in emergency situations where time is truly of the essence, the agency may dispense with notice-and-comment procedures for "good cause," or it may shorten the time for public comments. Similarly, when an agency is simply issuing non-binding policy guidance, it may be issued without public participation. Even in such cases, however, there is a possibility of using post-promulgation opportunities for comment. A standard technique for doing this is "interim-final" rulemaking.

[2] U.S. GOVERNMENT ACCOUNTABILITY OFFICE, TROUBLED ASSET RELIEF PROGRAM: STATUS OF EFFORTS TO ADDRESS DEFAULTS AND FORECLOSURES ON HOME MORTGAGES, GAO-09-231T, December 4, 2008, *available at* http://www.gao.gov/new.items/d09231t.pdf.

One example of the absence of public input relates to the conditions that the Treasury Department adopted when it announced that it would accept applications from major banks to sell preferred stock and warrants to the Treasury. Although the actual terms chosen looked very much like a set of rules that Treasury would follow in purchasing the preferred stock, the decision to promulgate them in final form, as conditions of purchase, eliminated any opportunity for interested persons—ranging from banks to taxpayers to investment advisers to other financial institutions—to suggest that the terms were either too strict or too lenient. In particular, several participants at the roundtable noted the apparent absence of any affirmative requirement that the banks use the funds to make additional loans, nor any negative covenants that would forbid the use of the funds to acquire other banks or pay dividends.

1. Congress should take care to specify the policymaking tools to be used by the agencies implementing the EESA. Specifically Congress should clarify when the Treasury Department should issue regulations as opposed to non-binding guidance. Moreover, where Congress intends that the Department issue a regulation, Congress should also make clear whether such regulations are exempted from the rulemaking provisions of the Administrative Procedure Act and direct the Treasury Department to use notice-and-comment procedures to the maximum extent reasonable when making policy.
2. When it is not reasonably possible to have public input prior to a decision, either because of time constraints or because public deliberations leading to a major policy decision would be counterproductive, the Treasury Department should explain the rationales for its decisions fully and promptly after they are made so that the public and the oversight bodies understand what the agency did and why.
3. Where the Department issues a final regulation or significant guidance without prior opportunity for public comment, it should, to the extent practicable, offer an opportunity for post-promulgation comment, *i.e.*, in the case of a regulation, issuing it as an interim-final rule.
4. When issuing an interim-final rule, the Department should (a) include a statement in the Federal Register notice that, although the rule is final, the agency will, if it receives significant adverse comments, consider those comments and publish a response along with necessary modifications to the rule, if any, and (b) consider whether to include in the Federal Register notice a commitment to act on any significant adverse comments within a fixed period of time.
5. The Department should enhance the EESA website by (a) adding clear links to the *Regulations.gov* page that contains the public comments on those Department rules and notices for which the public is given an opportunity to comment, and (b) providing an up-to-date rulemaking agenda that contains a list of all the aspects of the TARP plan on which the Department plans to issue rules or guidance, with projected dates and contact persons.

B. Transparency

The EESA provides for eighteen different reports submitted by eleven different entities to six different recipients. Only one of these reports is explicitly required to be made public.

On the other hand, the Act also only appears to require confidentiality with respect to a single report. Although to date the reports have been public, it is unclear whether that practice will continue.

Most of the reports envisioned by the Act relate to the anticipated purchase of troubled assets. With the TARP's revised emphasis on direct investment of capital into troubled entities, different types of reports may be necessary. More significantly, there appears to be a lack of a mandate in the Act for the Treasury Department to require the recipients of the TARP funds to report to the Department and to the public about the expenditure of these funds. The term sheets issued by Treasury for these transactions do not contain such a requirement, and because Treasury has not made public the final documents on which its purchases were based, it is not possible to determine whether such a requirement is contained in them.

Furthermore, perhaps there should be different transparency standards for the government as regulator versus the government as investor. Just as private investors in equities are entitled to a complete "prospectus" concerning the companies they are investing in, so should the government and the taxpayers be entitled to similar information about the troubled companies that are receiving the TARP funds—especially as to how they are using these funds.

Among the most important decisions being made by Treasury is the choice as to which banks should be approved for purchases of preferred stock. The process required the banks to file applications, and the federal agency that regulates the bank was then asked to comment on the application. Since the first round of preferred stock purchases on October 28th, one of the banks—Citigroup, which received $25 billion—has encountered subsequent difficulties and is now receiving substantial additional funding. Doubtless, the public would be very interested to see what Citigroup's regulator had to say about its initial application. It seems almost certain that such information would not be made public, but it surely should be made available to the congressional and other oversight entities under the Act.

Exemption 8 of the Freedom of Information Act (FOIA), 5 U.S.C. § 552(b)(8), permits agencies responsible for the regulation or supervision of financial institutions to protect from disclosure matters contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of the agency. This exemption has been interpreted to cover a wide range of documents, primarily operating reports, condition reports, and examination reports of financial institutions.

Exemption 8's protection of operating, condition and examination reports is generally seen as serving three primary purposes: (1) It protects banks—including both the examined bank and those that have relationships with it—from substantial harm that might be caused by disclosure of information and opinions about their condition; (2) It facilitates the free exchange of information between bank personnel and examiners and encourages bank examiners to be candid and, as necessary, immediately responsive, in their assessments of a bank's financial position and operation; and (3) It protects the privacy of bank customers (*e.g.*, depositors and borrowers).[3] These are important purposes, but Exemption 8 should not be used, without other showings of harm, to withhold reports made to Congress nor to withhold documents relating to the Department's preferred stock investments in banks made with taxpayer money

1. Congress should make clear that any reports required to be made to Congress under the EESA should also be made public, unless specifically made confidential in the Act or some portion is specifically designated by the reporting entity as being exempt from disclosure under FOIA.
2. Congress should also require the Treasury Department to make public the hourly rates for law firms and other contractors, and the specific terms it imposes regarding conflicts of interest.
3. The Treasury Department should require the recipients of federal funds to report to them and to the public on how they are using those funds.
4. The Treasury Department and the other financial regulatory agencies should work with the Department of Justice to ensure that the maximum amount of public and congressional disclosure about TARP activities occurs under the FOIA, consonant with the purposes of the relevant exemptions. In particular, all of the documents exchanged between the Department and the banks in which it has made preferred stock investments should be made public since the nearly $300 billion invested is taxpayer money that the Treasury is supposed to recover at some point.

<u>C. Judicial Review</u>

Congress wisely rejected Treasury's original proposal to bar all judicial review, but it does not appear to have thought through what types of decisions under this Act should be subject to judicial review and by whom. The latter question involves the doctrine of standing and other threshold defenses to suits against the government that are regularly asserted by the Department of Justice. Most significantly, the Supreme Court has emphatically ruled that, except in a narrow category of cases involving the Establishment Clause of the First Amendment, taxpayers do not have standing to challenge executive actions, even when the claim is that the spending violates the Constitution, let alone a federal statute.[4] Thus, it is essential that Congress review TARP as it is actually operating (and as it is likely to operate under a new Administration) and decide first what kinds of adverse rulings should be subject to judicial review. Once that determination is made, then Congress should re-evaluate the provisions for judicial review now in the Act.

The Judicial Review section of the Act (§ 119) appears on the one hand to provide for the normal type of judicial review under the Administrative Procedure Act, but on the other hand provides a series of restrictions on injunctive or other forms of equitable relief that can be granted by the reviewing courts (other than to remedy a violation of the

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[3] This description is from Administrative Conference of the United States Recommendation 95-1, "Application and Modification of Exemption 8 of The Freedom of Information Act," 60 Fed. Reg. 13, 692 (Mar. 14, 1995), *available at* http://www.law.fsu.edu/library/admin/acus/305951.html.

[4] See *Hein v. Freedom From Religion Foundation, Inc*., 127 S. Ct. 2553 (2007).

Constitution). This may be understandable as an attempt to prevent an individual district court judge from shutting down an aspect of the TARP program. But it is an overbroad restriction, especially since (1) courts have ample tools for denying such broad relief, and (2) the Act also contains a provision that automatically stays any injunction that is granted, for a period that allows the Secretary to seek a further stay from the court of appeals.

It is also unclear whether Congress intended to imply by denying injunctive relief that it wants to allow claims for money damages for persons somehow aggrieved by the actions of TARP.

1. Congress should re-consider the judicial review provisions in light of the evolving operations of TARP and determine which types of decisions should and should not be brought to court. Specifically Congress should be clear as to whether it intends to allow or preclude claims for money damages.
2. Subject to Congress's determination about the reviewability of certain specific actions under paragraph 1, it should amend the Act's judicial review provision to simply provide that the Secretary's actions under the Act are reviewable "subject to chapter 7 of title 5, United States Code." It is unnecessary and potentially confusing to also specifically refer to some, but not all, of the scope of review provisions of that chapter. Moreover the anti-injunction provisions should be removed, and replaced by a provision that automatically stays any equitable relief against any rule issued under authority of the Act, or to enjoin the implementation of a program (in contrast to a specific decision under a program), pending review of the stay by the appropriate appellate court. Congress should also consider channeling all cases under the Act to a single district court and/or a single court of appeals, such as the District of Columbia Circuit or the Second Circuit.
3. Congress should clarify that declaratory judgments are permitted and are not barred as "Other equitable remedies" comparable to injunctions.

D. Oversight

Numerous oversight mechanisms are established by the bill, beyond the normal congressional committee oversight. The Act creates a Financial Stability Oversight Board, made up of five financial service regulatory agency heads to review and make recommendations regarding the Treasury's actions, even though several of its members are participants in the very decisions being reviewed by the Board.[5] A Congressional Oversight Panel is created by the bill to review the state of the markets, current regulatory system and the Treasury Department's management of TARP. The Comptroller General (director of the Government Accountability Office) is required to monitor the performance of the program, and report findings to Congress every 60 days, and to audit the program annually. In addition, the Act creates a new Office of the Special Inspector

[5] Three of these—the Federal Reserve Board, the Securities & Exchange Commission, and the Federal Housing Finance Agency—are independent agencies, and their heads are thus only removable by the President for cause.

General for TARP whose job it is to monitor, audit, and investigate the activities of the Treasury in the administration of the program, and report findings to Congress every quarter.

1. Congress should make sure that the oversight responsibilities of the four oversight entities mesh properly. Special attention should be paid to the reporting requirements to make sure that they are not redundant, overly frequent, or needlessly overlapping.[6]
2. Congress should also consider whether the resources and responsibilities of these oversight entities are allocated properly in view of the shifting nature of the TARP program. For example, a program of purchasing troubled assets would seem to be more in need of a very active Inspector General, than the current program for injecting capital, which may be better evaluated by another entity.
3. Under section 115(a)(3) of the Act, before Treasury can spend the remaining TARP monies, it must inform Congress of how it plans to use the money, and Congress may prevent the use of those funds only if it passes a law to that effect within 15 calendar days of receipt of the Secretary's plan. Presumably, Treasury would not forward such a plan without the approval of the President, which means that Congress would need two-thirds votes in both Houses to override the President's veto.[7] Given the limited ability of Congress, the courts, and the oversight bodies to control decisions of the Treasury, Congress should consider changing the law to require affirmative congressional approval before spending the next $350 billion (as well as any additional funds that Congress may subsequently appropriate).

This Recommendation was approved by the following Conference participants (affiliation noted for informational purposes only):

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[6] One example will illustrate the problem: the Congressional Oversight Panel created by the Act is required to make recommendations on overhauling the financial regulatory system by January 20, 2009, and Treasury Department is required to make its own recommendations on the same subject by April 20, 2009.

[7] The original recommendation D.3 stated that the override would have to take place within 15 calendar days, but that failed to take into account section 114(f)(4) that tolls the 15 days while the President is considering the joint resolution of disapproval.