Dodd-Frank and The Constitution

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In *Federalist* 51, Madison identifies the fundamental challenge of constitutional architecture:

> But what is government itself, but the greatest of all reflections on human nature? If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controls on government would be necessary. In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed; and in the next place oblige it to control itself. A dependence on the people is, no doubt, the primary control on the government; but experience has taught mankind the necessity of auxiliary precautions.

Madison thus identifies the tradeoff at the heart of government: you "must first enable the government to control the governed; and in the next place oblige it to control itself." And to this end, the Constitution erected a system of "auxiliary precautions" to bring that result about.

What exactly then is the "the great difficulty" that Madison sought to address? In the first place, the government must be able "to control the governed." What does Madison mean by this? Recall that the primary problem that the Framers in erecting the Constitution was to confront the problem of "factions"—what we today call "interest groups"—that capture the government and pervert its functions to do the bidding of the interest group's bidding at the expense of the general public. To reduce the threat of factions (whether majoritarian or minority special interest groups), government officials should be made independent from political processes and pressures. In theory, independent government officials (such as federal judges) will be more likely to resist public passions or special interest influence than would public officials immediately responsive to the public will.

But providing governmental officials with sufficient independence to resist public pressure raises the offsetting difficulty: we must, in the second instance "oblige [the government] to control itself." In other words, independence is a double-edged sword: in providing government officials with independence to resist interest-group pressures to subordinate the public interest to their demands, we run the risk that the government officials will use this power to pursue their own personal agendas, rather than the public interest. Thus, despite the fact that a king could be largely resistant to interest-group pressures (shy of revolution) monarchy is not the ideal form of government because of the tendency for the monarch to pursue his own interest rather than the nation's interest (what an economist would call agency costs). This tendency of highly independent government officials to pursue their own interest rather than the public's will surely come as no surprise to the follower's of Justice Anthony Kennedy's jurisprudence, for example.

Madison's wisdom was to see that this tension—between independence and accountability—is an unsolvable dilemma. It cannot be solved: only balanced, controlled, and mitigated. The instrumentalities for trying to bring that balance into play are the various "auxiliary precautions" created by the Constitution, notably federalism and the separation of powers. The Framers believed that the clash brought about by these auxiliary precautions would be most likely to frustrate fractions while also restraining overreach by governmental officers themselves.

The Dodd-Frank financial reform act, passed in response to the most recent financial crisis, implicitly assumes a model of government radically opposed to Madison's vision. The architects of Dodd-Frank implicitly assumed that the primary cause of the financial crisis was the undue influence of Wall Street and other financial interests and the only justifiable response is to empower governmental officials with a combination of power and unaccountability unprecedented in American history—indeed, perhaps too powerful and unaccountable to withstand constitutional scrutiny. Yet at the same time that Dodd-Frank purports to be a response to the problem of special interest influence that allegedly caused the financial crisis, the statute itself embodies an orgy of special interest rules that ironically will almost uniformly favor the nation's largest banks, by making the too-big-to-fail banks still larger, smothering smaller banks in a mountain of regulation, and entrenching the too-big-to-fail subsidy for the largest banks. Chris Dodd and Barney Frank would have done well to heed James Madison's cautionary advice about the tradeoff between independence and accountability.

This essay will examine the novel regulatory structures created by Dodd-Frank through the lens of the Madisonian constitutional dilemma. In particular, this essay will describe the unprecedented combination of power and unaccountability established by Dodd-Frank and the dangers that combination potentially entails. The Financial Consumer Protection Bureau, established by Dodd-Frank, will provide a central case study, but other major provisions of Dodd-Frank, such as the so-called "orderly liquidation authority" and the system for dealing with supposedly "systemically risky" financial institutions will be reviewed as well.

One theme will run throughout: while special interests are a ubiquitous danger to democratic government, excessive independence vested in the hands of unelected government officials is dangerous as well. By erecting a massive new law run by a new set of institutions insulated from oversight, Dodd-Frank comes down on the side of unaccountable government, ignoring the risks that accompany such unaccountable power. And, ironically, in so doing, Dodd-Frank entrenches the power of the nation's largest banks, providing them with new competitive advantages that will promote consolidation of the banking industry and eliminate many smaller rivals.

Dodd-Frank's Narrative of the Financial Crisis

Dodd-Frank is premised on a particular narrative of the financial crisis, which goes something like this. During the 18th century in America, banking was essentially a *laissez*

faire system. The absence of regulation led to frequent bank runs and panics, resulting in economic disruption and the recurrent destruction of family savings in failing banks. This chaotic system reached its apotheosis in the Great Depression, when the system broke down in a cataclysm of failed banks, financial ruin, and economic disaster.

Washington responded by ushering in a system of wise regulation, the centerpieces being deposit insurance (to protect consumers), the Glass-Steagal Act (to protect the public from excessive risk-taking by depository institutions), and paternalistic consumer regulation (primarily by state governments) that would protect consumers from high interest rates and unscrupulous lenders. The result, so the story goes, was decades of blissful stability in the American banking system and happy consumers who "lived within their means" and were protected by the temptations of crafty lenders preying on their ignorance and weakness to lure them into financial ruin.

Alas, this happy state of affairs was shattered by the deregulatory ravages of the Reagan and Clinton eras, as one after another these regulatory barriers were swept away. First, banks unleashed credit cards on unsuspecting American consumers, then by virtue of the Supreme Court's ruling in *Marquette National Bank v. First of Omaha Corp.* (1978), which held that credit card contracts for national banks would be governed by the regulatory regime of the state in which the bank was based, rather than the consumer. This, so the narrative goes, prompted a "race to the bottom" in consumer protection, as credit card lenders relocated to light regulation states such as South Dakota and Delaware, effectively deregulating credit card interest rates and other terms as credit card terms would be set by private contracts rather than caring legislators and regulators. Other deregulatory efforts arose apace: from the growth of payday lending to innovative mortgage products and methods of financing (i.e., mortgage-backed securities) that were left to proliferate without proper government oversight. Mortgage lenders, in particular, developed products that were designed to dupe hapless consumers with terms such as "teaser" rates and negative-amortization mortgages that preyed on consumer biases. But not only were federal bank regulators asleep at the switch—they were active participants in this train wreck, as they used the power of federal preemption to interfere with the legions of mini-Eliot Spitzers in state legislatures and attorneys general offices around America who sought to rein in these predations.

Then, in what should have been an early warning signal for the forces of deregulation, came the savings and loan crisis of the 1980s, allegedly caused by deregulation that allowed formerly-prudent savings and loans to engage in an orgy of wild speculation, crashing that once-staid backbone of the American housing finance system. Rather than learning its lesson, the forces of deregulation pushed on until the Clinton administration put the final stake in the heart of the New Deal era banking regime in 1999 with Gramm-Leach-Bliley's repeal of Glass-Steagall. Once Wall Street got into a consumer banking market denuded of the kindly hand of consumer protections and prudent safety and soundness rules, it was just a matter of time until the next financial crisis. Dodd-Frank, then, was a first step on the road to return us to the golden age of banking that existed in the post-Depression era, and whose lessons we forgot over the corresponding decades. Yet, some insist, still more must be done, such as Senator Warren's call for a "new"

Glass-Steagall Act (despite her admission during her Senate campaign that Glass-Steagall probably wouldn't have prevented the crisis).

But this led those on the left to ponder—given the Edenic nature of the New Deal financial regulation structure, why would Washington abandon this system? As they scanned the horizon their eyes fell on an age-old culprit: greedy bankers. Deep pocketed special interests, they insisted, had essentially corrupted the political process for decades, buying their way out of regulatory oversight so that they could reap ever-larger profits from the misery of the new wage slavery of overpriced mortgages, exploitive credit card issuers, and, perhaps worst of all, the reviled payday lenders.

Leave aside for the moment that virtually every element of the Dodd-Frank narrative is wrong. What matters for current purposes is that the narrative is believed (in its generalities at least) by a large swath of the population, including leading Democratic pols and their soft-headed lackeys in the establishment media. In this worldview, the entire crisis could be traced back to a fundamental problem—the excessive influence of special interests in politics, especially Wall Street and other "bankers." If so, then the solution appears to be equally obvious—to insulate our kindly regulators from direct or indirect influence of special interests. Congress and the people will cede to President Obama and our nonpartisan, professional regulators the authority to do the "right" thing, even in the face of special interest wailing. Moreover, not only must the bureaucrats be given this power, they must not have their hands tied by well-specified rules, but must be given the ability to respond on the fly to nip crises in the bud and to catch predatory lenders looking for loopholes to exploit. Regulators must be given the flexibility to respond to emerging problems, not hamstrung in their efforts by rules and oversight. In this view, regulators are largely incorruptible and wise when left to their own devices—it is only necessary to eliminate the pernicious influence of special interests ("the governed") to create good government.

Dodd-Frank's Embodiment of the Narrative

Hence, Dodd-Frank's 2400 pages consists not so much of well-specified mandates, but delegation of huge authority and discretion to bureaucrats of one stripe or another to give the law its final shape. Consider three areas: The Consumer Financial Protection Bureau, the proposals to control "systemic risk," and the so-called "Orderly Liquidation Authority" for financial troubled institutions.

Title X of the act, establishing the Consumer Financial Protection Bureau, is the clearest exemplar of the Progressive mindset. The brainchild of former Harvard law professor and now-Senator Elizabeth Warren, the CFPB was crafted as a centerpiece of Dodd-Frank, to rein in nefarious banks and other financial institutions (such as payday lenders) that had been wantonly abusing consumers and ravaging the economy.

The institutional design of the CFPB illustrates this mindset. The CFPB is highly insulated by any oversight from the Executive, Legislative, or Judicial branches. The Director of the CFPB is appointed by the President subject to confirmation by the Senate,

but once confirmed serves a five year term and is removable only for cause, such as egregious misconduct or dereliction of duty. Nor, despite CFPB's official status as a "bureau" of the Federal Reserve, are its actions subject to review by the Fed, in contrast (for example) to the Bureau of Consumer Protection of the Federal Trade Commission, whose actions must be approved by the Commissioners. CFPB is also insulated from Congressional oversight through it use of the "power of the purse"—CFPB draws its budget on a direct allocation from the Federal Reserve, amounting to 12% of the operating expenditures of the Fed. To give a sense of its size, CFPB's appropriation from the Fed was $597 million in 2013—roughly double that of the FTC, which is the federal government's primary consumer protection regulator as well as one of the two antitrust agencies. Finally, judicial oversight is limited by a provision in Dodd-Frank that requires the judiciary to grant *Chevron* deference to any interpretation of any statue within CFPB's jurisdiction. Indeed, this provision limits the ability of even other agencies to control the CFPB by stating that CFPB's interpretation shall trump that of any other agency. Indeed, the only substantive check on the CFPB is that its actions can be set aside only upon a two-thirds vote of the Financial Stability Oversight Commission (FSOC) and only then if the action would threaten the safety and soundness or stability of the entire U.S. financial system. CFPB regulations are exempt from review by the Office of Information and Regulatory Affairs in the Office of Management and Budget.

In addition, Dodd-Frank creates huge grants of broadly defined powers, most notably the authority of the CFPB to regulate any consumer product or term that it considers to be "unfair, deceptive, or abusive." And while unfair and deceptive inherit their previous definitions from the Federal Trade Commission (although the CFPB is expressly empowered to modify that definition over time) "abusive" is an entirely new term with no determinate definition. Section 5531(d) of Dodd-Frank defines "abusive" as a product or service that:

> (1) materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
>
> (2) takes unreasonable advantage of—
>
> > (A) a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;
> >
> > (B) the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or
> >
> > (C) the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.

It is not clear what exactly "abusive" means—moreover, there is no legislative history that explains the term and no identifiable forerunner in state or federal law. But then again, for purposes of Dodd-Frank, that's the point—to define the term would be hamstring the CFPB from stopping "abuse" wherever it finds it. And, indeed, CFPB

Director Richard Cordray has stated that despite the vagueness of the term and the uncertainty that sows, he does not intend to issue regulations to define it, but will rather define it through enforcement actions. In other words, lenders will find out after the fact whether their actions are deemed "abusive," rather than knowing when they make the loan.

In short, in light of the combination of vast, vaguely-defined powers on one hand and the lack of any effective institutional control over the agency on the other, CFPB may be the most most-powerful and least-accountable agency in American history.

Other controversial provisions of Dodd-Frank reflect this extraordinary delegation of unchecked discretion to agencies. The power to designate financial institutions—even non-bank financial institutions—rests with the Financial Stability Oversight Council ("FSOC", a body chaired by the Secretary of the Treasury, and also including the heads of the Securities Exchange Commission, Commodities Futures Trading Commission, Federal Housing Finance Agency, Office of the Comptroller of the Currency, CFPB, the Federal Reserve Board, the National Credit Union Administration Board, and another member with insurance expertise. Among other powers, the FSOC has the authority to force the Federal Reserve Board to begin supervising entities that the FSOC believes to be systemically risky—although that term is not defined in any meaningful sense in the statute. According to Dodd-Frank, this includes any financial institution whose "nature, scope, size, scale concentration, interconnectedness, or mix of the activities" are such that the institution "could pose a threat to the financial stability of the United States." Entities so classified may try to protest this designation, but must request a hearing with the FSOC within thirty days—except that the FSOC has the authority to "waive or modify" the notice and hearing requirements if it thinks that it is important to do so. Finally, while the affected institution can challenge the designation in court, it must also do that within 30 days and a court can reverse the determination only if the FSOC's determination is deemed arbitrary and capricious—notably, the court may not hear *any* statutory or constitutional challenges. The FSOC may also impose a number of highly discretionary limits on the operations of any bank holding company with more than $50 billion in assets or any non-bank under Fed supervision if it thinks necessary to control systemic risk.

The regulators also have broad power to declare a financial institution to be insolvent and put it into FDIC receivership. The process is somewhat complicated, but requires the cooperation of the FDIC, Federal Reserve, and Secretary of the Treasury. While that might seem to provide checks against arbitrary decision-making, consider this: once a bank is declared to be appropriate for receivership, this determination can be reversed by a bank only through requesting a confidential hearing with a U.S. district court and the court must *make a determination* within 24 hours of receiving the petition that the government's actions were "arbitrary and capricious," again without regard to whether the determination violated the statute or the Constitution. If the court doesn't reverse the determination within 24 hours it is deemed granted. Meanwhile, anyone who "recklessly discloses" information about the challenge faces potential felony criminal penalties of five years in prison, a fine up to $250,000 or both. Moreover, appellate review is

limited—for example, judges are specifically prohibited from revisiting the government's determination whether default would have "serious adverse effects" on the country's financial stability.

Dodd-Frank in the Scope of Regulatory History

Federalist 51 also notes that in securing the balance of powers and resist the accumulation of power in the hands of one branch, the Framers were aware that the members of each branch must be given "consists in giving to those who administer each department the necessary constitutional means and personal motives to resist encroachments of the others." As such, Madison insisted that "The provision for defense must in this, as in all other cases, *be made commensurate to the danger of attack*."

The architects of Dodd-Frank take this admonition and turn it on their head. Rather than dividing powers and making each branch strong enough to resist the encroachments of the other, Dodd-Frank sees the problem as being "special interests" against the "the government." Fragmentation of power is seen as weakness because it allows special interests to pick off their targets one at a time. Instead, a unified opposition of a small, insulated elite is necessary to resist those powerful interests.

To be sure, the threat of rent-seeking by big banks is a very real and important concern. Indeed, the political power of large banks may be the most important economic issue of the modern era—as illustrated by their ability to extract some $700 billion from taxpayers to save them from their own foolishness and corruption. And, as will be discussed, despite all its saber-rattling to the contrary, the consensus view is that Dodd-Frank does not solve, but rather entrenches the too-big-to-fail problem (and the accompanying too-big-to-fail capital subsidy and competitive advantage), and Dodd-Frank's accumulated regulatory weight falls harder on small banks than large, adding a still further layer of competitive advantages for the nation's largest banks. The ironic legacy of Dodd-Frank will be to accelerate the consolidation of the banking industry, making too-big-to-fail banks still larger and potentially systemically risky, and further entangling banks and politicians in a scheme of what my colleague Michael Greve dubs "adversarial corporatism" but for which the old label "corporatism" will do just fine.

But implicit in this vision is an assumption: that contra Madison we need only worry about the ability of the government to control the governed, and we need not worry whether the government can be made to control itself. Instead, vest power in a group of incorruptible elites—preferably wherever possible former Harvard law professors—and relieve them of the burden of political accountability. Notably, the cluster of special interests that define the modern Democratic Party—trial lawyers, bureaucrats, university professors, handout recipients, and members of the large NGO sector—are merely defined not to be interest groups in this mindset.

This story of Dodd-Frank will sound familiar to students of American history. At the beginning of the Twentieth Century, the progressives (led by Woodrow Wilson) envisioned exactly the sort of regulatory state we see today. Frustrated by what they saw

as the outmoded checks and balances of the Constitution, they railed against the supposedly improper influence of interest groups, big business that obstructed the well-meaning economic reforms of the age. The solution that they saw was much like that of today's progressives—to end-run the archaic structures of checks and balances and replace it with a more modern form of government that could counterweight the influence of big business and bring them to saddle. The famous statue outside of the Federal Trade Commission—one of the first great independent regulatory agencies—of a man restraining the wild horses of commerce stands as the eternal symbol of the age.

The True History of Progressive Regulatory Agencies

But this progressive fable ignores a major part of the story—the crashing of the first progressive/New Deal revolution on the shoals of economic realities of the 1970s. Indeed, the collapse of the first progressive revolution was not the result of special interest activity, but the reality that the administrative architecture that had been erected during the first progressive era suffered from precisely the defects predicted by Madison—we were "unable to oblige the government to control itself."

The dismal historical record of regulation that resulted in the deregulatory movement of the 1970s and 1980s will be familiar to those in this room, even if those events have been forgotten or obliterated by the champions of Dodd-Frank. The Progressive Era and New Deal erected the pillars of the regulatory state, "expert" agencies insulated from political and economic pressures were left to pursue their own visions of the public good. The results for the economy were disastrous as poor regulation choked off economic growth. A decade of stagflation, high unemployment, and slow economic growth, combined with rising competition from Germany, Japan, and other countries, prompted bipartisan efforts to reform the American regulatory system. The result was the abolition of several dysfunctional agencies (such as the Interstate Commerce Commission, Civil Aeronautics Board, and others) and the reform of others (such as the Federal Trade Commission).

In addition, scholars of regulation came to identify the structural pathologies that bureaucracies tend to manifest when left to their own devices without engaged oversight. For example, bureaucracies tend to exhibit a sense of "tunnel vision" in the sense of believing that their particular agency mission is more important than others. Because they are insulated from effective feedback, they tend to lack any reliable "rudder" to help set regulatory priorities or to ensure that the marginal benefits of their regulations exceed the costs, and thus tend to regulate in response to political pressure, media headlines, or mere whim. As result, without adequate supervision, bureaucracies succumb to certain predictable problems. In short, while unaccountable bureaucracies have the power to resist public pressures through their independence, they also lack the information and responsiveness to control their own biases. In addition, regulators can become captured by various interest groups they regulate—early on, this was thought to be primarily the industries which the agencies were set up to regulate. But eventually, it has been broadened to recognize that any interest groups, including NGOs and other non-industry interest groups that thrive in a symbiotic relationship with the government.

Lessons in Agency Design

The collapse of the New Deal regulatory state in the 1970s re-taught the lessons of the Framers. In Madisonian terms, regulators should be subject to checks and balances that will "oblige" them to control themselves as well as trying to insulate them from improper political influence. Over time, two basic regulatory models have emerged that have passed Constitutional muster: executive departments and independent agencies. Significantly, CFPB is neither.

One option for bringing regulatory agencies within the Constitution is the model of the executive agency. Under this model, the head of the agency is accountable to and serves at the pleasure of the President, and once appointed and confirmed, can be fired at any time by the President. For executive agencies, accountability is secured through the President's direct line of control over his appointees, who are expected to carry out the President's policy initiatives. Final accountability runs to the people through their ability to elect or not elect the President, in theory based on the President's performance.

Beginning in the late 19th and early 20th century, a second model emerged, perhaps best exemplified by the Federal Trade Commission. This is the model of the "independent" agency, for which one of its defining characteristics is that it is presided over by a bipartisan multi-member panel of commissioners who serve for a term of years and are removable only for cause. Independent agencies typically are also subject to the congressional appropriations process (as are executive agencies as well, of course). In *Humphrey's Executor v. United States* (1935), the Supreme Court upheld this essential structure of the Federal Trade Commission, holding that the President could not remove an FTC Commissioner before the expiration of his term.

Independent agencies lack the direct political accountability that the President receives for the actions of executive agencies, thus the constitutional status of independent agencies has always been subject to some degree of controversy. I have argued that the logic of independent agencies that arguably justifies their status as being constitutional is that the multi-member collegial decision-making process of the agency itself provides some degree of accountability in Madisonian terms. The logic of a bipartisan agency structure is that through the internal deliberative, and occasionally adversary, process of decision-making, bureaucratic tendencies toward biased, irrational, or other problematic decision-making features may be tempered. Collegial processes increase the quality and variety of information considered and the aggregation of information through the deliberative process can improve accuracy and output quality. Multi-member decision-making can also temper idiosyncratic or extreme outlying views that might otherwise be held by a single person. Collegial processes can also make use of and encourage specialization among commission members, thereby encouraging a division of labor and the improvement of overall decision-making. In addition, collegial processes can discipline decision-making by forcing proponents of particular actions to articulate a coherent rationale to support their decisions thereby reducing the threat of biased, ill-considered, or politically-motivated decisions.

Thus, although the decisions of independent agencies are not directly accountable to the voters (as is the case with executive agencies) there is a sense in which the members of the commission are accountable to one another. Minority commission members can serve as "whistleblowers" to point out decisions that are ill-considered or tainted with bias. Moreover, the opportunity for members to publicly dissent from the commission's decision can provide valuable information for any subsequent review by a judge subject to a legal challenge. And, of course, Congress can also provide oversight through its control over the budget process, which provides a stick to ensure the responsiveness of the agency.

CFPB, however, is neither: neither an executive agency nor an independent agency. Although presided over by a single head, the director is not accountable to the President. Although named for a term of years and removable only for cause, the director is not merely one of several commissioners. Moreover, as noted, the agency is not subject to congressional appropriations nor is it subject to the control of the Federal Reserve.

In short, the CFPB is a truly novel and unprecedented agency in light of its combination of power and lack of accountability. Other agencies are headed by single members—but these are typically executive agencies with the heads removable by the President. Those who can be removed only for cause have the internal checks and balances of a commission structure. And almost all agencies with this degree of power and discretion are subject to oversight by Congress through the appropriations structure. In short, the CFPB really is a new super-agency with a combination of features unprecedented in American history.

Unfortunately, in its short time in existence, the CFPB has already begun to manifest the pathologies associated with unconstrained bureaucratic behavior. I have written about this extensively elsewhere, but the agency itself has demonstrated many of the features that scholars of regulation have come to identify as characteristic of bureaucracies lacking proper oversight: agency expansionism, tunnel vision, and haphazard and questionable rule-making decisions.

What Can Be Done?

But is Dodd-Frank itself unconstitutional? But there is also a second question—even if Dodd-Frank is unconstitutional, will courts actually have the institutional guts to declare it? At least two lawsuits have been filed raising that objection.

But first an important digression. One of the more peculiar aspects of constitutional law for those who are not trained as lawyers is the doctrine of "standing." Standing requires a variety of formal elements to be satisfied, the most important of which is that someone must show that they are personally injured by the governmental action. The bottom line is that even if some law that is passed is unconstitutional, it may be the case that no one is in a position to challenge it. In short, the doctrine of standing means that there are laws that are unconstitutional, or decisions of lower courts that are incorrectly decided, but for which no one has standing to be able to challenge it.

Many of the most noxious elements of Dodd-Frank, and actions taken during the financial crisis itself, have escaped judicial review because of a lack of standing. Consider one important example: the diversion of funds from the Troubled Asset Relief Program (TARP) by President Bush to bail out Chrysler and General Motors during Fall 2008. According to its own terms, the TARP was to be used to buy troubled assets from financial firms. One will search in vain for any authorization to give TARP funds to manufacturers of crummy cars that no one wants to buy, and even less authorization for redirecting TARP funds to the United Auto Workers (which, believe it or not, is the actual reason that the bankruptcy courts upheld the bailout plans in those cases). Indeed, when GM first asked Hank Paulson for TARP money, he explicitly told them that the TARP could not be used for that purpose and that they must seek a congressional appropriation. Which they did—only to be denied by the Senate. At which point Bush and Paulson turned around and gave them billions of dollars anyway.

The diversion of TARP funds was in fact raised in the Chrysler bankruptcy case by the Indiana state pension funds for state police and teachers, who were among the secured creditors who were robbed in the Chrysler case, only to have their claims dismissed for a lack of standing. But is there anyone who might have standing to say that they were directly harmed by this blatant violation of the law? Not that I can see or that anyone else has identified. And note this isn't even to say that the diversion of funds was legal or not, it is just to say that no one can even raise a claim in court that the government's actions broke the law because they don't have standing.

This has proven to be a problem for early challenges to the constitutional of Dodd-Frank. One lawsuit that took aim at the CFPB, FSOC's systemic risk designation, and OLA was thrown out this fall for a lack of standing. The party bringing the case was a small bank in Texas, who claimed that it was injured by Dodd-Frank. Yet the court held that they could not challenge it. For example, the Texas bank claimed that it was injured by the ability of the FSOC to essentially formally designate certain financial institutions at "too big to fail," thereby essentially creating a *de facto* government guarantee for creditors of those institutions. This, in turn, would entrench the so-called "too big to fail subsidy," which because of the reduced risk of lending to these firms would enable them to gain access to capital markets less expensively than smaller banks. This wasn't good enough. So who could challenge it? Apparently only those firms that were classified as too big to fail—but if they are on net benefited by the designation, why would they have any incentive to challenge it? Thus, only those benefited can challenge it, but they have no incentive to do so.

But there is an additional layer—the past few years has brought out more than ever before the true risk to regulated industries of challenging their regulators. Whether the issue is Dodd-Frank or Obamacare, this administration has constantly reminded regulated entities that their ability to function rests on the pleasure of their regulators. There is inherently a lot of discretion in the regulation of banks and there is much informal pressure that never reaches the public eye: "Nice bank ya got there; hate for something to happen to it." As Jamie Dimon has recently been reminded, the Washington overlords

seem to keep track of who plays ball and who doesn't. So even among those who could have standing, there is a great chilling effect to being willing to bring a lawsuit challenging the regulators.

But there is one ongoing lawsuit challenging the CFPB. This is a case involving a lawyer and a company named Morgan Drexen that assists lawyers and they have brought me in to consult on the case. They are in the CFPB's cross-hairs and they are fighting back, in what amounts to a bet the company litigation in order to avoid the CFPB putting them out of business. The case is early on and was just filed in August of this year.

But there is a second difficulty to challenging Dodd-Frank: the apparent reluctance of judges to challenge the government's overreach in these areas. During the financial crisis courts essentially abdicated any role in checking the excesses and overreach of the government. For example, when the Chrysler case initially came to the Supreme Court it did so on the request for a stay from the Indiana pensioners of the bogus "sale" of the company. The Supreme Court stayed the case for a day or two, during which the Obama administration waged an all-out PR offensive to get the court to back down. Which it eventually did, allowing the case to proceed. Yet when the case later came back around to the Supreme Court, it took cert on the case and then dismissed it as moot—having no effect but to vacate the original precedent approving the sale, a hollow victory if there ever was one.

And, of course, whether justified or not, many observers have interpreted Chief Justice Roberts opinion in the Obamacare case as a cave to political pressure rather than a principled judicial opinion.

Why does this matter? Because even if certain major features of Dodd-Frank are unconstitutional, it is a separate question whether the courts will be willing to do anything about it.

And this may be the greatest legacy of the financial crisis. During the financial crisis, politicians on both sides of the aisle shredded the rule of law, only to entrench that discretion in Dodd-Frank. The legacy of the financial crisis and Dodd-Frank has been to entrench crony capitalism, promote further consolidation of the banking industry, and transfer extraordinary powers to unelected bureaucrats. And yet, to date, virtually all of this took place outside of the Constitution.

The courts are the last line of defense to stand up for the Constitution and the rule of law. It would be nice if the American populace would also demand adherence to the rule of law from our political leaders, but as the last two presidential administrations have shown, the public seems quite willing to surrender constitutional government to the exigencies of the moment if they agree with the political results.

It is fitting that the lawlessness of the diversion of TARP funds was undertaken by the Bush-Paulson Administration, which laid the foundation for a new era of executive authority. And it is even more fitting that Barack Obama took the modest diversion of

TARP funds directed by Bush and Paulson and blew it up into even a larger diversion and did so expressly to reward his political supporters, a symbol of the current Administration's doubling-down on the extreme assertions of executive authority first laid down by President Bush.

If Dodd-Frank is allowed to stand, the long term consequences for the American economy are grim. It will stifle economic growth and further entangle banking and the political sector in America. As the regulatory cost of Dodd-Frank chokes off small banks and the entrenchment of the too-big-to-fail subsidy for large banks codifies their competitive advantage, there will be an accelerating consolidation of the banking industry. Largest banks will increasingly become like public utilities, subject to the whims of a largely unaccountable bureaucracy. And as David Skeel shows in his book *The New Financial Deal*, this entanglement of government with banking creates new opportunities for essentially off-budget policy-making, as government uses its informal persuasive powers to "encourage" banks to advance politicians' political and social goals.

Madison saw this threat over two centuries ago and explained the tradeoff. Now is a good time to remind ourselves that the Constitution exists to protect us from our governors as much as ourselves before we rediscover this lesson the hard way.