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NATIONALIZATION AND NECESSITY: TAKINGS AND A DOCTRINE OF ECONOMIC EMERGENCY

NESTOR M. DAVIDSON*

Serious economic crises have recurred with regularity throughout our history. So too have government takeovers of failing private companies in response, and the downturn of the last decade was no exception. At the height of the crisis, the federal government nationalized several of the country's largest private enterprises. Recently, shareholders in these firms have sued the federal government, arguing that the takeovers constituted a taking of their property without just compensation in violation of the Fifth Amendment.

This Essay argues that for the owners of companies whose failure would raise acute economic spillovers, nationalization without the obligation to pay just compensation should be recognized as a natural extension of the doctrine of emergency in takings. Public officials must be able to respond quickly to serious economic threats, no less than when facing the kinds of imminent physical or public health crises—such as wildfires and contagion—that have been a staple of traditional takings jurisprudence. Far from an affront to the rule of law, this reflection of necessity through an extension of emergency doctrine would reaffirm the flexibility inherent in property law in times of crisis.

INTRODUCTION

On the morning of Thursday, September 4, 2008, with the global economy teetering on the edge of collapse, Treasury Secretary Henry Paulson came to the Oval Office to brief President Bush on the challenges facing Fannie Mae and Freddie Mac, two troubled private companies at the heart of the U.S. mortgage finance system. “For the good of the country,” Paulson would later write in his memoir of the crisis, “I had proposed that we seize control of the companies,” and that the Administration do so swiftly, without warning. As Paulson said to the President that morning, the “first sound they’ll hear is

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their heads hitting the floor.”¹ The next day, Paulson summoned top executives from Fannie Mae and Freddie Mac to the White House and dropped the ax, nationalizing companies that held over \$5 trillion worth of mortgage-related assets.²

Although there was a widely held, if erroneous, belief at the time that Fannie Mae and Freddie Mac were governmental entities, the companies in fact were publicly traded, with hundreds of millions of privately held shares outstanding on the eve of their takeover. Given this, the privatization of these companies may have seemed a remarkable intervention in the market and a *sui generis* infringement on the property rights of shareholders and other economic stakeholders in these companies. But these were by no means the only instances of the government taking control of significant private enterprises during the recent economic crisis (or, for that matter, in past economic crises). The technical mechanisms varied in each instance, but the practical results were the same for General Motors (“GM”), the American International Group (“AIG”), and other companies nationalized during the chaotic early days of the Great Recession.³

Shareholders and others who claim an economic stake in these firms have recently filed several suits raising, among other claims, Takings Clause challenges to the takeovers.⁴ These claims squarely raise the question whether public officials have the authority and necessary latitude to respond to overriding threats to the national economy without compensating those whose economic interests have been harmed as a consequence.⁵ These cases thus have the potential

1. HENRY PAULSON, ON THE BRINK: INSIDE THE RACE TO STOP THE COLLAPSE OF THE GLOBAL FINANCIAL SYSTEM 1 (2010).

2. I use the term nationalization intentionally to describe instances of the government—and it is usually the federal government—taking control of private enterprises, recognizing that the term has traditionally carried negative connotations. Doing so, however, recognizes the reality of this particular economic intervention in our constitutional discourse.

3. See generally Steven M. Davidoff & David Zaring, *Regulation by Deal: The Government's Response to the Financial Crisis*, 61 ADMIN. L. REV. 463 (2009).

4. See *infra* Part II. Shareholders who held Fannie Mae and Freddie Mac stock at the time of their nationalization are seeking just compensation on the order of \$41 billion. See Complaint at 63, Wash. Fed. v. United States, No. 1:13-cv-00385-MMS (Fed. Cl. June 10, 2013) [hereinafter Complaint, Washington Federal]. Similarly, one of AIG's largest shareholders—and former CEO—is asserting takings claims through both direct and shareholder derivative claims on behalf of the company, seeking just compensation across these claims of at least \$55 billion. See *Starr Int'l Co. v. United States*, 106 Fed. Cl. 50, *recons. denied*, 107 Fed. Cl. 374 (Fed. Cl. 2012).

5. It can be argued that the nationalization of Fannie Mae and Freddie Mac fell into a different category because they were originally congressionally chartered (hence the descriptor

to shape the policy landscape for future economic crises, as well as important aspects of our understanding of takings law.

This Essay's core claim is that the nationalization of private enterprises whose failure would pose particularly significant systemic risks can be justified in times of economic crisis without a mandate to provide the owners of those firms just compensation.⁶ Overriding necessity has always placed an important limitation on the absolutism of common-law property rights, and there is likewise a well-established doctrine of emergency in the constitutional law of property. This strain in the jurisprudence has traditionally been invoked in contexts such as disasters and public health crises, giving public officials the ability to create firebreaks in the face of wildfires or stop the spread of contagion without compensating those whose property interests are harmed as a result.⁷

Although the constitutional doctrine of emergency in takings law has not historically included economic exigencies, its logic of imminent necessity clearly applies to firms whose failure pose systemic risks in our increasingly interconnected economy. The underlying rationale has always been that officials must be free to act quickly and decisively to forestall great harm and that property injured as a consequence is a reasonable burden for owners to bear. The same can be said for nationalization as it has been practiced in times of economic crisis. "Too big to fail" does not *always* mean too important to require compensation for those harmed when the failure of such firms is prevented, but under the right circumstances, that is precisely the constitutional latitude that public officials require.

"government-sponsored enterprise," or GSE). However, these particular GSEs had clearly been privatized (even if they remained heavily regulated).

6. Nationalization potentially implicates other constitutional provisions, most notably the Due Process and Equal Protection clauses, as well as statutory and regulatory issues, many of which have been raised in the recently filed cases.

7. See *infra* text accompanying notes 58–67. There are two related doctrines that have some relevance to the constitutional landscape of takings and nationalization. The first is the version of the emergency doctrine in constitutional property that has arisen in the military context. See *infra* note 61. The second is a contested doctrine of incompatible economic imperatives exemplified by the cedar rust tree destruction blessed by the Supreme Court in *Miller v. Schoene*, 276 U.S. 272 (1928). See *infra* text accompanying notes 82–83. For reasons elaborated below, this Essay does not rely primarily on either of these traditions to craft a doctrine of economic emergency in takings, although each sheds some light on the boundaries of necessity in constitutional property.

An extension of the emergency doctrine to such economic actors hardly means that all property rights are casually defeasible in times of crisis, as some critics of nationalization suggest.⁸ Nor would it undermine the rule of law to acknowledge that the nature of the harms at issue in emergencies can evolve. But it does mean that the legal boundaries of property in crisis are—and should be—more flexible than such critiques suggest.

Let me address two conceptual objections at the outset about the nature of the doctrinal claims at issue, as an initial instinct may be that there is no actual takings issue in nationalization. Consistent with our general historical approach, every instance of nationalization in the most recent economic crisis was accompanied by the investment of significant public resources in companies that were understood at the time to be failing. And, in each instance, the relevant firm at least nominally authorized the takeover.⁹

This might suggest categorically that no takings liability could attach, but these conditions do not necessarily obviate that potential for takings liability. This is because shareholders would not necessarily have fared as poorly as they did had these companies gone through bankruptcy proceedings (or had the firms somehow found buyers), and also because the public investments seem not to have actually compensated shareholders. Moreover, shareholders are vigorously contesting the voluntary nature of the takeovers, and board consent is not necessarily a bar to shareholder claims.¹⁰

There is more to be said about these and related doctrinal issues, but given that takings challenges to nationalization are quite active and likely to be a factor in any future crisis, I am advancing a less technical, more foundational argument in this Essay.¹¹ Property is a constitutive project that, despite the claims of some theorists for universal norms, develops over time through the accretion of legal and

8. See *infra* text accompanying notes 85–89.

9. See *infra* note 30.

10. See *infra* text accompanying note 57.

11. The technical merits of the takings claims that have been raised recently are important, and I will review them briefly in Part II. But this Essay will not attempt to weigh definitively the many substantive and procedural nuances these claims raise, many of which require substantial additional factual development to resolve. Moreover, even if the specific suits now pending from the wave of nationalization during the Great Recession do not succeed, the issues they raise are live, and likely to recur in future economic crises, so understanding the dimensions of takings liability in nationalization is important regardless.

cultural responses to particular challenges. Nationalization raises not only important questions about the intersection of corporate law and constitutional property, but also provides a telling window through which to observe the boundary between individual rights and community obligation instantiated in that evolving property law.

I. NATIONALIZATION IN TIMES OF ECONOMIC CRISIS

Financial crises are a seemingly inevitable feature of our economic system and have recurred with distressing regularity throughout American history. Amidst the tremendous variety of public policy responses throughout those cycles, one regulatory tool that public officials have repeatedly deployed has been the takeover of private companies, particularly where the potential collapse of those companies has posed larger economic threats.

In the Great Depression, for example, the Federal Reconstruction Finance Corporation took ownership interests in thousands of banks to prevent their failure.¹² The Resolution Trust Corporation similarly took over and restructured the assets of many failing thrifts during the savings and loan crisis of the late 1980s.

Nationalization was a particularly prominent—if narrowly focused—tool during the recent Great Recession.¹³ As to Fannie Mae

12. See Steve Lohr, *U.S. Not Always Averse to Nationalization, Despite Its Free-Market Image*, N.Y. TIMES (Oct. 13, 2008), <http://www.nytimes.com/2008/10/13/business/worldbusiness/13iht-nationalize.4.16915416.html> (noting that the Resolution Finance Corporation made investments in banks in the 1930s equivalent to between \$400 and \$500 billion in current dollars). One of the more direct precursors of nationalization during the recent Great Recession was the takeover of Continental Illinois National Bank and Trust. In 1984, the bank was one of the ten largest in the country, and the federal government, fearing that a failure would cause a financial panic, took an eighty percent ownership stake, which was held until the bank was sold a decade later to Bank of America. *Id.*

13. See Marcel Kahan & Edward B. Rock, *When the Government Is the Controlling Shareholder*, 89 TEX. L. REV. 1293, 1299–300 (2011) (noting that the federal government became the controlling shareholder in companies such as GMAC and owned as much as 34% of outstanding Citigroup common stock); see also Deborah Solomon et al., *U.S. to Buy Stakes in Nation's Largest Banks—Recipients Include Citi, Bank of America, Goldman; Government Pressures All to Accept Money as Part of Broadened Rescue Effort*, WALL ST. J., Oct. 14, 2008, at A1 (discussing federal bank investments); Damian Paletta, Lingling Wei & Ruth Simon, *IndyMac Reopens, Halts Foreclosures on Its Loans*, WALL ST. J., July 15, 2008, at C1 (describing the takeover of IndyMac). All told, the companies that the federal government nationalized had a collective economic footprint in the trillions of dollars—yes, with a t—and hundreds of millions of publicly traded shares. That said, nationalization was a relatively small part of a set of much

and Freddie Mac, the Housing and Economic Recovery Act of 2008 (“HERA”),¹⁴ authorized the Federal Housing Finance Agency (“FHFA”) to place the companies in conservatorship.¹⁵ Facing mounting evidence of potential threat to the national economy from the instability of the housing enterprises, FHFA acted on this authority in September 2008, placing both companies in conservatorship.¹⁶

AIG followed a slightly different pattern, although the end result was similarly federal control. At the moment the economic crisis was reaching its most precarious point, AIG stood at the center of a significant system of risk associated with housing finance.¹⁷ AIG had sold a high volume of credit default swaps, a form of insurance used by investors in collateralized debt obligations (“CDOs”) such as mortgage-backed securities.¹⁸ However, the housing crisis caused counterparties to start to make claims and collateral calls against this insurance, causing a liquidity crisis for the company. In September 2008, the Federal Reserve Bank of New York agreed to provide AIG with a two-year revolving line of credit of up to \$85 billion, and obtained control of the company in exchange.

GM was a third variation on nationalization arising from Great Recession, albeit one that has not generated shareholder takings litigation primarily because it resulted in bankruptcy. Although still

broader interventions early in the crisis that primarily consisted of subsidies to shore up various market sectors without any material change in ownership structure.

14. Pub. L. No. 110-289, 122 Stat. 2654 (2008) (codified as amended in scattered sections of 12 U.S.C. (Supp. II 2008)).

15. See 12 U.S.C. § 4617 (2012).

16. The technical means through which the companies were nationalized involved votes by Fannie Mae and Freddie Mac’s Boards of Directors to consent to the conservatorships, one of the grounds provided under § 4617, although there were arguably other grounds under the statute available for an involuntary imposition. The conservatorship came as part of a broad-based assumption of the GSEs’ risks and the taking of equity by the federal government in Fannie Mae and Freddie Mac. Specifically, Treasury received \$1 billion in senior preferred stock and warrants to obtain 79.9 percent ownership of Fannie Mae and Freddie Mac’s common stock. In exchange, Treasury provided the companies with a line of credit (originally up to \$100 billion, later increased) and began purchasing Fannie and Freddie-issued securities to forestall a collapse in the pricing of such securities. See Cynthia M. Hajost, *From Oversight to Conservatorship: What Does the Housing and Economic Recovery Act of 2008 Hold For GSEs Fannie Mae and Freddie Mac?*, 18 J. AFFORDABLE HOUS. & CMTY. DEV. L. 3, 7 (2008).

17. William K. Sjostrom, Jr., *The AIG Bailout*, 66 WASH. & LEE L. REV. 943, 946 (2009); see generally MAURICE R. GREENBERG & LAWRENCE A. CUNNINGHAM, *THE AIG STORY* (2013).

18. Credit default swaps are contracts that provide, in exchange for ongoing payments by counterparty, “that the party writing the CDS is obligated to pay the counterparty the par value of the debt instrument in the event the instrument defaults.” *Starr Int’l Co. v. United States*, 106 Fed. Cl. 50, 55, *recons. denied*, 107 Fed. Cl. 374 (Fed. Cl. 2012).

the world's largest automaker at the time, by the peak of the crisis in 2008 GM faced serious liquidity challenges from a combination of the general economic slowdown and a rise in fuel costs.¹⁹ From late 2008 through the spring of 2009, the federal government provided GM with a series of loans in what would eventually become a \$50 billion rescue plan.²⁰ Through a structured bankruptcy, the federal government eventually came to hold a nearly 60 percent stake in the company.²¹

Common to each of these instances of nationalization—and many other examples in the past—is that the company involved posed systemic economic risk, which is to say that if they were to fail, the consequences would likely have induced larger market failures. The demise of any firm costs jobs, risks undermining confidence in some sector of the economy, or otherwise redounds beyond the boundaries of the company at issue. But in the modern economy, certain firms raise the risk of particularly acute spillover effects. Scholars have debated the bounds of what constitutes an institution that is, in the words of the Treasury Department, “systemically important,”²² but the primary focus in the context of nationalization has been on threats of rapidly escalating market failures of great significance.²³

For financial firms, this can relate to liquidity for related firms and collateral cascades with counterparties.²⁴ For non-financial firms,

19. See generally STEVEN RATTNER, *OVERHAUL: AN INSIDER'S ACCOUNT OF THE OBAMA ADMINISTRATION'S EMERGENCY RESCUE OF THE AUTO INDUSTRY* (2010).

20. See Brent J. Horton, *The TARP Bailout of GM: A Legal, Historical, and Literary Critique*, 14 TEX. REV. L. & POL. 217, 275 (2010).

21. See Neil King Jr. & Sharon Terlep, *GM Collapses into Government's Arms*, WALL ST. J. (June 2, 2009, 12:01 AM), <http://online.wsj.com/article/SB124385428627671889.html>.

22. In the early days after the crisis, the Treasury Department focused in particular on firms “whose combination of size, leverage, and interconnectedness could pose a threat to financial stability if [they] failed.” U.S. DEPT OF THE TREASURY, FINANCIAL REGULATORY REFORM—A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION 21 (2009), available at http://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf. See also Maziar Peihani, *Systemically Important Financial Institutions (SIFIs): An Analysis of Current Regulatory Development*, 29 BANKING & FIN. L. REV. 129, 131–32 (2013) (arguing for a definition of systemic risk at the institutional level that focuses on the size of an institution, its interconnectedness, its complexity, and the concentration or dominance of a given firm in a market).

23. See generally Iman Anabtawi & Steven L. Schwarcz, *Regulating Systemic Risk: Towards an Analytical Framework*, 86 NOTRE DAME L. REV. 1349 (2011). Adam Levitin argues that systemic risk cannot be understood solely in terms of the economic impact of a given firm's failure, but rather must be approached as a question of the limits of socially acceptable harm. See Adam Levitin, *In Defense of Bailouts*, 99 GEO. L.J. 435 (2011).

24. Edward Morrison, for example, notes three sources of systemic risk for financial firms. First, when a firm stops payment on its debt and similar obligations, there can be a cascading

the size of an enterprise can embed its influence not only on investors and creditors, but also on employees, franchisees, suppliers, and other economic actors in the orbit of that firm. These significant macro-scale spillover effects may impact financial markets, as with AIG, or housing markets, as with Fannie Mae and Freddie Mac, or even broad consumer and labor markets, as with GM.²⁵ In each arena, the failure of a subset of truly significant and interconnected economic entities can have macroeconomic consequences that are every bit as tangibly harmful as the physical and public health threats encompassed in traditional emergency doctrine.

The critical defining characteristic of systemic risk in this context is not simply external harm rippling out from collapse—that is necessary, but hardly sufficient—but rather that a particular firm's failure is likely to cascade and threaten large sectors of the economy, if not the economy *in toto*. Financial markets and the firms that operate in them are increasingly entwined, a phenomenon that the financial reporter Andrew Sorkin describes as the “new ultra-interconnectedness.”²⁶ Just as ordinary nuisance involves harm to the use and enjoyment of one owner's property arising from activities on another owner's property—spillovers that cross physical property lines—so too can economic contagion leap from firm to firm, and market to market almost instantaneously. By whatever definition is used to identify such firms, it seems clear that each of the major companies nationalized in the most recent crisis qualifies.

Given this risk, it is hardly surprising that another common element of each instance of nationalization in the recent crisis was that

effect throughout markets that depend on steady payment streams, including derivative and insurance markets. Second, the threat of liquidation incentivizes contractual counterparties to terminate existing contracts. Finally, a failing financial institution will cause counterparties that have hedge risks through liquid securities to liquidate that margin, which will reduce the value of that collateral for all market participants. See Edward R. Morrison, *Is the Bankruptcy Code an Adequate Mechanism for Resolving the Distress of Systemically Important Institutions?*, 82 TEMP. L. REV. 449, 451–52 (2009).

25. The reaction to the failure of Lehman Brothers exemplifies the risks involved. When Lehman filed for bankruptcy on September 15, 2008, the Dow Jones Industrial Average dropped more than 500 points, wiping out roughly \$700 billion in value from a broad range of investment portfolios. The Lehman Brothers' bankruptcy involved “8,000 subsidiaries and affiliates, \$600 billion in assets and liabilities and more than 100,000 creditors.” Peihani, *supra* note 22, at 130.

26. ANDREW ROSS SORKIN, *TOO BIG TO FAIL: THE INSIDE STORY OF HOW WALL STREET AND WASHINGTON FOUGHT TO SAVE THE FINANCIAL SYSTEM FROM CRISIS—AND THEMSELVES* 5 (2009).

federal control came with significant public subsidies.²⁷ These included, most prominently, direct subsidies, lines of credit and other financing, assumptions of liability, debt guarantees and similar loan backstops.²⁸ This might seem to take nationalization immediately out of the realm of takings and into the realm of “givings.”²⁹ But there is a difference between a grant of public funds to an entity, even a subsidy that carries significant strings, and one that accompanies the transfer of functional or actual ownership or control, even if the ultimate net financial result for the entity involved is positive (or even significantly positive). Moreover, a government takeover can result in a significant or even complete elimination of the economic value of pre-existing ownership rights in the entity, despite the subsidy. Indeed, it is arguable that in many instances public funds provided to failing companies during the Great Recession did not compensate those with ownership interests prior to the takeover but rather were used to keep the entities operating and prioritize the claims of other stakeholders.

The Fannie Mae, Freddie Mac, and AIG nationalizations, moreover, each resulted from an agreement with, or at least acquiescence by, the company’s Board of Directors.³⁰ Shareholders challenging these takeovers have made the obvious counterarguments about duress, asserting in essence that any acquiescence was illusory, and it is not implausible that the courts will credit these arguments.

Finally, with some notable exceptions—Fannie Mae and Freddie Mac in particular—nationalization in times of economic crisis tends to be short-lived and targeted at immediate market-failure cascades, rather than some long-term governmental self-interest.³¹ The

27. In the case of GM, for example, the total public investment reached roughly \$50 billion. See Horton, *supra* note 20, at 275. AIG’s line of credit eventually reached over \$182 billion. Pam Selvarajah, *The AIG Bailout and AIG’s Prospects for Repaying Government Loans*, 29 REV. BANKING & FIN. L. 363, 365 (2010).

28. See Jeffrey Manns, *Building Better Bailouts: The Case for a Long-Term Investment Approach*, 63 FLA. L. REV. 1349, 1359, 1358–65 (2011); see generally Levitin, *supra* note 23.

29. Cf. Abraham Bell & Gideon Parchomovsky, *Givings*, 111 YALE L.J. 547 (2001).

30. See Winston Sale, *Effect of the Conservatorship of Fannie Mae and Freddie Mac on Affordable Housing*, 18-SPG J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 287, 299 (2009); Sjoström, *supra* note 17, at 976–77. In the GM case, again, the Board of Directors approved the financing structure that placed the federal government effectively in control of the company. See Sheryl Gay Stolberg & Bill Vlasic, *U.S. Lays Down Terms for Auto Bailout*, N.Y. TIMES (Mar. 30, 2009), <http://www.nytimes.com/2009/03/30/business/30auto.html?pagewanted=all>.

31. Another historical example of nationalization of a significant failing company that can be put in the long-term column of the ledger is Amtrak, which was created under the Rail

prevailing ethos behind this short-term orientation was expressed by then-Treasury Secretary Paulson early in the crisis, when he said that “[g]overnment owning a stake in any private U.S. company is objectionable to most Americans—me included.”³² Accordingly, the federal government entirely divested its ownership stake in AIG by December 2010 (making a profit of slightly under \$23 billion).³³ GM was similarly reprivatized by December 2012.³⁴ The fact that governmental control was temporary does not necessarily change the takings calculus at the time of each takeover³⁵ but does shape how one might evaluate the purpose and legitimacy of the intervention.

All of this underscores a pattern of nationalization in which state intervention is focused on the potential macroeconomic consequences of the failure to act in times of crisis, with a primary purpose to reinforce faltering markets and limit the large-scale consequences of the potential collapse of firms that are particularly important from a systemic-risk perspective. The question remains, however, whether this type of intervention requires compensation for those whose

Passenger Service Act of 1970. See Laurence E. Tobey, *Costs, Benefits, and the Future of Amtrak*, 15 TRANSP. L.J. 245, 253 (1987). The statute led to the public ownership of much of the nation's private intercity passenger rail service. *Id.* at 255. By contrast, although the Consolidated Railway Corporation, or Conrail, was created in the early 1970s to nationalize certain freight lines of six bankrupt carriers, it was privatized in 1987 and its assets are now owned by CSX Transportation and Norfolk Southern Railway. See Agis Salpukas, *Conrail Chugs Off into the Sunset; CSX and Norfolk Southern Take Over*, N.Y. TIMES (June 1, 1999), <http://www.nytimes.com/1999/06/01/business/conrail-chugs-off-into-the-sunset-csx-and-norfolk-southern-take-over.html>.

32. Press Release, U.S. Dep't of Treasury, Statement by Secretary Henry M. Paulson, Jr. on Actions To Protect the U.S. Economy (Oct. 14, 2008), available at <http://www.treasury.gov/press-center/press-releases/Pages/hp1205.aspx>.

33. See Jeffrey Sparshott & Erik Holm, *End of a Bailout: U.S. Sells Last AIG Shares*, WALL ST. J. (Dec. 11, 2012, 11:08 AM), available at <http://online.wsj.com/news/articles/SB10001424127887323339704578172960483282372>.

34. Steven Rattner, *The Liberation of General Motors*, N.Y. TIMES OPINIONATOR BLOG (Dec. 19, 2012, 7:41 PM), <http://opinionator.blogs.nytimes.com/2012/12/19/the-liberation-of-general-motors/>.

35. There is a basic doctrinal divide in the law of takings when it comes to temporary takings. For traditional exercises of the power of eminent domain, temporary takings generally require compensation and the primary question is valuation. For regulatory takings, however, the question of the duration of a governmental action is itself an aspect of the predicate question of whether a taking has occurred. See *Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency*, 535 U.S. 302, 331 (2002). As will be discussed below, the appropriate way to think about nationalization in the recent crisis is as potential regulatory takings, so the temporal dimension can be important in evaluating the expectations of those whose ownership interest in entities has been harmed by nationalization.

property rights are harmed in the name of larger public benefits—the quintessential question at the heart of every takings claim. Understanding that the answer, in general, should be “no” requires an exploration of the particular takings claims at issue in nationalization.

II. POTENTIAL TAKINGS LIABILITY IN NATIONALIZATION

As I noted at the outset, this wave of nationalization has recently begun generating significant litigation raising takings challenges on behalf of shareholders and the companies themselves, through derivative suits. The theory of economic emergency that this Essay advances does not ultimately turn on whether the current claims necessarily succeed, given that the issue of economic nationalization will continue to recur, just as economic crises continue inevitably to recur. But it is useful, nonetheless, to outline the basic nature of the claims at issue and acknowledge that, despite their early stages, it is quite plausible that one or more could succeed.

A. *Fannie Mae and Freddie Mac*

In June 2013, a group of individual and institutional Fannie Mae and Freddie Mac shareholders filed a class-action suit, alleging that the federal government’s conservatorship of Fannie Mae and Freddie Mac constituted an illegal exaction and/or taking of their property without just compensation.³⁶ The complaint, which seeks roughly \$41 billion in compensation, raises two primary claims. The first is that the conservatorships were illegally imposed under the terms of HERA.³⁷ The second, broader set of charges argue that the conservatorship was designed to channel funds from Fannie Mae and Freddie Mac to other companies (providing the government with a vehicle to purchase troubled mortgage debt), and ultimately back to the Treasury.³⁸

36. Complaint, Washington Federal, *supra* note 4, at 50.

37. 12 U.S.C. § 4617. Specifically, they allege that the conservatorship was imposed not in response to concerns about Fannie Mae and Freddie Mac’s financial condition, but rather because of concerns about the broader health of the financial system. They further allege that the consent of Fannie Mae and Freddie Mac’s Boards under § 4617 was coerced. These claims go to the threshold question of the authority of the government to act and the validity of the action, not whether the conservatorship constituted a taking of the plaintiffs’ property without just compensation.

38. Complaint, Washington Federal, *supra* note 4, at 56.

Specifically, the shareholders assert that they were harmed by FHFA's order to the companies to cease paying dividends (other than to the Treasury), the subsequent delisting of the companies' common and preferred shares from the New York Stock Exchange in June 2010, and by agreements to sweep net profits from the government-sponsored enterprises ("GSEs") for the Treasury when they returned to economic stability.³⁹ The complaint states that the government's imposition and subsequent administration of conservatorships (where the government purchased roughly 80% of the companies' stock) rendered the common and preferred shares of the companies virtually worthless.

The plaintiffs further assert that Treasury did not seek or obtain the companies' consent to sign stock agreements, and, in drafting the stock agreements, the Treasury did not take into consideration factors required by the companies' charters. Though HERA contemplated conservatorships to return Fannie Mae and Freddie Mac to their previous financial health, the shareholders argue that the takeovers went beyond helping the companies and were instead designed to promote overall growth of the economy by providing increased liquidity to the mortgage market.⁴⁰ According to the plaintiffs, none of the conditions required by statute to impose conservatorships existed because Fannie Mae and Freddie Mac were adequately capitalized at the time of the conservatorships.⁴¹

B. American International Group

On November 21, 2011, Starr International Company, Inc., one of AIG's largest shareholders (headed by Maurice "Hank" Greenberg, the former chairman of AIG in the years before the economic crisis), filed suit challenging the federal takeover. Starr argued that the government illegitimately forced AIG to issue over 562 million shares for

39. *Id.*

40. *Id.* at 55.

41. *Id.* Not all of the challenges to the Fannie Mae and Freddie Mac conservatorships and the issuance of the net worth sweep are framed as takings claims. Shareholders are also raising issues such as breach of contract and violations of the Administrative Procedure Act. *See, e.g.*, *Cane v. FHFA*, No. 1:13-cv-01184 (D.D.C. Aug. 1, 2013); *Dennis v. FHFA*, No. 1:13-cv-01208 (D.D.C. Aug. 1, 2013); *Am. European Ins. Co. v. Fed. Nat'l Mortgage Ass'n*, No. 1:13-cv-01169 (D.D.C. July 30, 2013); *Cacciapelle v. Fed. Nat'l Mortgage Ass'n*, No. 1:13-cv-01149 (D.D.C. July 29, 2013); *Liao v. Lew*, No. 1:13-cv-01094 (D.D.C. July 16, 2013); *Fairholme Funds, Inc. v. FHFA*, No. 1:13-cv-01053 (D.D.C. July 10, 2013); *Perry Capital, LLC v. Lew*, No. 1:13-cv-01025 (D.D.C. July 7, 2013).

which the government paid only \$500,000,⁴² and that the government then forced the company to purchase over \$62 billion worth of CDO assets from AIG counterparties, which, Starr alleged, led to the direct taking of cash collateral from AIG.⁴³ Starr's direct takings claims are based on the argument that the dilution of shares by the government undermined both the economic value and the voting power of Starr's holdings.⁴⁴ Amid anger from Congress and voters who expressed disbelief that AIG would sue the same entity that rescued it from financial collapse, AIG decided not to join the Starr lawsuit.

C. Assessing the Viability of These Claims

Were there no plausible takings claims in arising from the practice of nationalization, then it might be unnecessary to evaluate rationales for justifying the practice, although the issue of economic nationalization is likely to recur in future crises. Certainly, if the government directly seized control of the companies at issue, as it has done at times in the past,⁴⁵ or similarly directly expropriated the shares of the owners of those companies, it seems hard to argue that there would be no threshold issue of takings liability. In those cases, the government could certainly be challenged on the scope of its authority to act,⁴⁶ on whether such action met the public use test, or even on the measure of just compensation.⁴⁷ But there would be little doubt

42. In June, 2009, AIG undertook a reverse stock split that reduced its outstanding shares from 3 billion to 150 million, which allowed the conversion of the government's preferred to common stock in January 2011. *Starr Int'l Co. v. United States*, 106 Fed. Cl. 50, 58 (Fed. Cl. 2012).

43. *Id.* at 59. In June 2013, the Court of Federal Claims ruled that Starr's shareholder derivative claims were barred by application of the business judgment rule because AIG's Board had considered and rejected them. *Starr Int'l Co. v. United States*, 111 Fed. Cl. 459, 471 (Fed. Cl. 2013).

44. *Id.* at 482.

45. See *Youngstown Sheet & Tube Co. v. Sawyer*, 343 U.S. 579, 615–28 (1952) (Frankfurter, J., concurring) (recounting history of industrial seizures).

46. It is well settled, although not without controversy, that the federal government has the power of eminent domain. See generally William Baude, *Rethinking the Federal Eminent Domain Power*, 122 YALE L.J. 1738 (2013). Nationalization—whether through direct eminent domain, or more often through other means, as was universally the case during the Great Recession—does not rely on some reserve of federal power implied in other sources but instead on specific grants of authority by Congress. As noted, the Fannie Mae, Freddie Mac, and AIG litigation all assert statutory arguments challenging the basic validity of the federal government's authority to act.

47. Even with direct expropriation, compensation to shareholders and other stakeholders

that a *taking* would have occurred and the questions raised in this Essay squarely presented.

Nationalization as it unfolded in the Great Recession, however, presents more of a doctrinal puzzle. The preferred tool to take over companies during the Great Recession, as noted, was through board consent. Shareholders are thus arguing that governmental control had the effect of diluting the value and voting rights of extant shares, which is essentially a regulatory takings claim.⁴⁸ As such, the claims might be resolved under the familiar ad-hoc framework the Supreme Court laid out in *Penn Central Transportation Co. v. New York City*⁴⁹ or through the total-deprivation-of-economic-value analysis the Supreme Court set out in *Lucas v. South Carolina Coastal Council*.⁵⁰

As to *Lucas*, it is conceivable that a shareholder could prevail on the argument that the relevant intervention had the direct effect of destroying the value of their shares. The Court in *Lucas* suggested that personal property—particularly in regulated industries—falls outside the categorical rule that applies to land,⁵¹ but lower courts have been mixed on this question.⁵² Were a court to apply *Lucas*—and not find a background principle of state property law applicable to forego compensation—then the primary question would be a factual one of whether there was a total deprivation.

Under *Penn Central*, by contrast, the inquiry would likely focus primarily on the reasonable expectations of owners in light of the

with property interests at issue might be nominal, depending on whether the shares or other property rights actually had any value in the context of a failing company.

48. Claims that are being made on behalf of the nationalized firms themselves that their property was siphoned off for public purposes while the government was in control might be seen as closer to a direct taking.

49. 438 U.S. 104, 123 (1978) (“In engaging in these essentially ad hoc, factual inquiries [for regulatory takings], the Court’s decisions have identified several factors that have particular significance. The economic impact of the regulation on the claimant and, particularly, the extent to which the regulation has interfered with distinct investment-backed expectations are, of course, relevant considerations. So, too, is the character of the governmental action.” (internal citations omitted)).

50. 505 U.S. 1003 (1992).

51. *Id.* at 1027–28 (noting that “in the case of personal property, by reason of the State’s traditionally high degree of control over commercial dealings, [an owner] ought to be aware of the possibility that new regulation might even render his property economically worthless (at least if the property’s only economically productive use is sale or manufacture for sale)”).

52. See Eduardo Moisés Peñalver, *Is Land Special? The Unjustified Preference for Landownership in Regulatory Takings Law*, 31 *ECOLOGY L.Q.* 227 (2004) (discussing lower court decisions that have rejected the *Lucas* distinction between real and personal property for purposes of applying a per se test).

relevant type of firm and the nature of economic ownership in large, publicly traded companies.⁵³ Certainly, most shareholders should expect that regulation can change the economic landscape in which companies operate, even for companies that are not as heavily regulated as Fannie Mae and Freddie Mac have been (or banks and similar financial institutions generally are).⁵⁴ But it is a closer question with respect to an actual government takeover, even under the extraordinary circumstances of an economic crisis that are present when companies face not only failure, but failure that threatens wider economic harm. It is reasonable for shareholders to expect that the government will not directly appropriate their ownership stake for its own purposes, and that would seem to apply to the collateral consequences of public investments to rescue firms whose failure threatens significant, imminent macroeconomic harm.⁵⁵

In the background for shareholder claims is the possibility of bankruptcy, even for companies that had not actually failed at the time of nationalization.⁵⁶ If shareholders would have been wiped out in the absence of public intervention, it is hard to see how they should be able to recover in a takings claim. But it is not entirely clear that such demise was inevitable or that shareholders would necessarily have been lost all economic value even in a collapse. Even if a company is likely to end up in bankruptcy, it is not necessarily the case that all shareholder value would be subordinate to claims of creditors. Where there is insufficient residual value, shareholders are unlikely to retain any value in bankruptcy. In some ways, this is a question of the certainty of the impending demise. A short-term crisis is not the same thing as an actual collapse and an early intervention may

53. Questions under the *Penn Central* analysis regarding economic impact, as with the issue of total deprivation or not, require factual development that remains contested in those suits that have actually been filed.

54. Cf. Christopher T. Curtis, *The Takings Clause and Regulatory Takeovers of Banks and Thrifts*, 27 HARV. J. ON LEGIS. 367, 373–74 (1990) (discussing the role of expectation in heavily regulated financial industries). The federal government has raised a version of this argument in the Fannie Mae and Freddie Mac suits. See Defendant's Motion to Dismiss at 30, Wash. Fed. v. United States, No. 1:13-cv-00385-MMS (D.D.C. Nov. 7, 2013) (analogizing Fannie and Freddie to banks subject to resolution authority).

55. A non-trivial argument can be made that for many shareholders, any loss from the nationalization of one firm may be compensated implicitly in offsetting gains to the larger economy. That is because shareholders, as a general matter, should not bear firm-specific risk given how easy diversification is to achieve and the fact that no premium should be paid for bearing overly concentrated investments.

56. Cf. Morrison, *supra* note 24.

have left shareholders in a worse position than it might have seemed at the time.

Moreover, as noted, there is a serious question of whether the acquiescence of boards of directors to a takeover renders any takings challenges by shareholders moot. Shareholders are contesting the voluntary nature of those approvals, but even if that argument fails, it does not necessarily follow that such board action precludes claims by those harmed by an agreement between the board (on behalf of the corporate entity) and the government. A claim based on collateral damage to shareholders would not be outside the mainstream of takings claims in other contexts.⁵⁷

In sum, there is a plausible argument that at least some of the claims currently being asserted in challenging nationalization in the Great Recession are viable as a threshold matter under the Takings Clause, and the suits are proceeding apace. Even if not all of the claims being raised succeed, the issue of takings liability will inevitably shadow future economic crises. How, then, to understand the fundamental nature of what the government does in this situation—as an aberration or as an extension of the fabric of takings doctrine? It is to that question we now turn.

III. A DOCTRINE OF ECONOMIC EMERGENCY

Shifting our focus, then, nationalization—even without compensating shareholders—for firms whose failure would significantly threaten our interconnected economy can be justified for the same reasons that certain acute emergencies have historically fallen outside the scope of the Takings Clause. I recognize that such an exercise in analogical reasoning requires significant caveats, which I will explore below. But the parallels between traditional overriding necessity and the kind of emergency presented by the potential failure of firms that pose particularly significant systemic risks in the midst of economic crisis are surprisingly apt.

A. From Physical Threats to Systemic Economic Risk

In the law of takings, there is a well-recognized tradition of constitutional latitude granted to officials to respond to imminent threats

57. *E.g.*, *Armstrong v. United States*, 364 U.S. 40, 48 (1960) (taking arising from the exercise of governmental contract right that rendered liens unenforceable).

to the public through the appropriation or even destruction of private property without compensation.⁵⁸ As the Supreme Court noted in *Lucas v. South Carolina Coastal Council*, officials have long had the authority to harm or even destroy “‘real and personal property, in cases of actual necessity, to prevent the spreading of a fire’ or to forestall other grave threats to the lives and property of others.”⁵⁹ This constitutional doctrine of emergency parallels a tort doctrine of public necessity that provides a limited, but clear, exemption from liability to avert imminent harm.⁶⁰

There are two primary areas where constitutional immunity for emergency has traditionally arisen. The first has involved military necessity, primarily in times of war.⁶¹ Cases have arisen, for example, involving the destruction of privately owned assets—bridges and refineries, for example⁶²—tracing all the way back to claims made

58. There is a related, although not entirely parallel, doctrine of private necessity that provides a privilege against trespass. One primary difference between public necessity and private necessity is that in the latter context, although a private actor is not liable for the act of trespass, the actor is generally liable for any harm that results from the privileged entry. See RESTATEMENT (SECOND) OF TORTS § 197 (1965). For private necessity, courts tend to require that an action be taken to preserve life or property. Moreover, any individual who invokes the defense must be reasonable in their actions and cannot exploit the privilege beyond what is required under the circumstances. Generally, then, courts will look for evidence indicating a strong relationship between the action taken and the harm averted, and the stronger the relationship, the more likely the doctrine of private necessity will be found to apply to the situation.

59. 505 U.S. 1003, 1029 n.16 (1992) (quoting *Bowditch v. City of Boston*, 101 U.S. 16, 18 (1880)).

60. See RESTATEMENT (SECOND) OF TORTS § 196 (“One is privileged to enter land in the possession of another if it is, or if the actor reasonably believes it to be, necessary for the purpose of averting an imminent public disaster.”); *id.* § 262 (“One is privileged to commit an act which would otherwise be a trespass to a chattel or a conversion if the act is or is reasonably believed to be necessary for the purpose of avoiding a public disaster.”). Public officials have historically faced both tort suits and constitutional actions, hence the intertwined nature of the takings emergency jurisprudence and the tort doctrine of public necessity.

61. During World War I, for example, the federal government temporarily nationalized critical infrastructure, such as railroads and telegraphs (and including even the Smith & Wesson Company). Again in World War II, the federal government nationalized transportation and energy companies important to the war effort. Perhaps the apogee of the rationale—and functionally likely the reason it is no longer deployed with any regularity—involved the events that gave rise to *Youngstown Sheet & Tube Co. v. Sawyer*, 343 U.S. 579 (1952). In this case, not often discussed by property theorists, although exceedingly familiar to scholars of the separation of powers as the *Steel Seizure* case, the Supreme Court rejected President Truman’s attempt to nationalize the steel industry during the Korean War pursuant to nothing more than an Executive Order.

62. See, e.g., *United States v. Caltex (Phil.), Inc.*, 344 U.S. 149 (1952) (holding that destruction of oil facilities in the Philippines during battle in World War II did not constitute

during the American Revolution.⁶³ In this context, emergency doctrine has been drawn somewhat narrowly, perhaps recognizing the potentially all-encompassing nature of military need. There are also national security considerations at play that make the tradition of military necessity a somewhat uncomfortable basis to find grounding for a doctrine of economic emergency in takings.

However, a second, more immediately relevant, context in which state action in times of crisis is excused from takings liability involves steps taken to prevent disasters in the face of imminent physical threats such as spreading wildfires, flooding, and contagious disease.⁶⁴ To pick one of any number of historical examples by way of illustration, in *American Print Works v. Lawrence*, the Mayor of New York City and two Alderman were found not liable in trespass, and no takings were held to have occurred, following their decision to use gun powder to blow up the buildings at 44 and 46 Exchange Place—and in the process destroy “800 cases prints; 70,000 pieces prints; 50 cases drillings; 1000 pieces drillings, and a large quantity of prints, drillings, and other dry goods, wares, and merchandizes of great value, to wit, of the value of two hundred thousand dollars.”⁶⁵ The officials made the decision to destroy the storehouse in the face of what was then “one of the most extensive fires ever known in this country, and property, both real and personal, to the value of many millions of dollars was destroyed, much the larger portion being

a compensable taking under the Fifth Amendment); *Juragua Iron Co. v. United States*, 212 U.S. 297 (1909) (finding no recovery for owners of a factory destroyed by soldiers fighting in Cuba to prevent the spread of disease); *United States v. Pac. R.R.*, 120 U.S. 227, 239 (1887) (recognizing “the exemption of government from liability for private property injured or destroyed during war, by the operations of armies in the field, or by measures necessary for their safety and efficiency” in a case involving federal government destruction of private property during the Civil War).

63. See *Respublica v. Sparhawk*, 1 U.S. (1 Dall.) 357, 1 L.Ed. 174 (Pa. 1788) (holding that there was no recovery for destruction of property where the British were on the verge of taking Philadelphia).

64. See John Alan Cohan, *Private and Public Necessity and the Violation of Property Rights*, 83 N.D. L. REV. 651, 719, 728 (2007); see also Susan S. Kuo, *Disaster Tradeoffs: The Doubtful Case for Public Necessity*, 54 B.C. L. REV. 127, 131 (2013). There is a similar doctrine of immunity from compensation for property harmed in the course of police actions (in the sense of law enforcement, not in sense of the general police power). See Derek T. Muller, “As Much upon Tradition as upon Principle”: A Critique of the Privilege of Necessity Destruction Under the Fifth Amendment, 82 NOTRE DAME L. REV. 481, 497 (2006).

65. 21 N.J.L. 248 (1847).

consumed by the flames.”⁶⁶ Similar cases have been a staple of takings (and tort) jurisprudence since the time of the Founding—and before.⁶⁷

The logic of uncompensated taking in the emergency context seems to rest on a number of foundations. First, in many instances the property at issue would have been destroyed regardless of the actions of public officials, so if, for example, a house is destroyed to stop a wild-fire that would have destroyed that house regardless, the owner can hardly complain.⁶⁸ But not all instances of emergency action fall into this category. An alternative explanation might be that invoking necessity in situations of crisis represents a particularly acute collective action problem that justifies swift action even without compensation.⁶⁹ There is much to this, but a final rationale, and the one that seems most clearly to explain the doctrine, is that vulnerability to this kind of exigency is inherent in the obligations of ownership and membership in a community.⁷⁰

66. *Id.* at 261 (Randolph, J., concurring).

67. See, e.g., *Field v. City of Des Moines*, 39 Iowa 575 (1874). *Bowditch v. City of Boston*, 101 U.S. 16 (1880), is probably the best known of these early emergency cases, by virtue of Justice Scalia’s invocation of the case in *Lucas*. See *supra* text accompanying note 59. The facts of *Bowditch* echo so many of the urban firebreak cases in the crowded cities of the nineteenth century. In the face of “great fire [that] occurred in the city of Boston on the night of the 9th and 10th of November, 1872,” fire engineers decided to demolish a building that was in the path of the fire; the building was blown up (destroying “fixtures, merchandise, and tools belonging to [the plaintiff] . . . of the value of \$60,000” as well as the value of the plaintiff’s leasehold estate), which “stopped the progress of the fire.” *Id.*

68. As applied to economic emergencies, the analogy could be that if a company is nationalized but would have gone under in the absence of public intervention, that is no different from a house being destroyed that would have been burnt regardless. However, as noted, it can be quite contestable whether a company would have failed and even if so, whether shareholders would necessarily have lost the share value or control rights they did.

69. Richard Epstein has argued that common-law necessity doctrine can be justified as a limited intrusion on otherwise absolute property rights where transaction costs prevent gains from trade. Richard Epstein, *Property and Necessity*, 13 HARV. J.L. & PUB. POL’Y 2,7 (1990) (“Under certain localized circumstances, however, conferring . . . absolute rights to exclude does not advance competition in ordinary markets, but rather it creates bilateral monopoly, holdout problems, and transaction-cost obstacles of one sort or another. At common law it is just these various situations in which there is a systematic, intuitive willingness to back off the comprehensive ideal of property in favor of a system that is a little bit frayed at the edges.”). If one translates that logic from common-law judges to other legal actors, and from private to public actors, the basic rationale remains. This rationale can then translate fairly directly to the emergency exception for just compensation.

70. Cf. Andrea L. Peterson, *The Takings Clause: In Search of Underlying Principles—Part II—Takings as Intentional Deprivations of Property Without Moral Justification*, 78 CALIF. L. REV. 55, 85–93 (1990).

This emergency exception has not generally been applied to the kinds of “grave threats,” to quote the Court in *Lucas*, that arise out of economic crises, but the logic of doing so is compelling. As the above discussion of systemic risk illustrates, there are certain firms whose potential demise threatens not only localized economic harm, but a kind of ripple effect that can injure broad swaths of the economy, and in some cases the economy as a whole. The increasingly interconnected nature of economic activity places certain firms at a nexus point where the consequences of failure can induce economic panic and damage every bit as fast-moving as a wildfire. Public officials have many policy tools available when such an economic wildfire starts, including, of course, doing nothing and letting markets react, which is what happens when most firms fail. But creating financial firebreaks through nationalization is a response that echoes a long tradition of legitimate necessity in constitutional property, whatever one might think of the merits or wisdom of any given choice to apply the policy.⁷¹

The merits of drawing on a well-established doctrinal tradition, in the best (constitutional) common-law tradition, is that this kind of analogical exercise can suggest several important limiting principles to cabin an exercise of authority legitimately open to concern about abuse. The analogy thus suggests, as an important constraint, that any doctrine of economic emergency would require a genuine threat (defined here in terms of the harms arising from the systemic risk posed by the potential failure of a firm) as well as imminence—that

71. To be clear, the gravamen of the argument here is that the traditional jurisprudence of emergency in the law of takings supplies a foundation for a similar doctrine in the context of economic crises, but the argument is not that emergency creates executive authority where there is none. The Supreme Court has been skeptical of invocations of economic emergency since at least *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495, 528 (1935) (“Undoubtedly, the conditions to which power is addressed are always to be considered when the exercise of power is challenged. Extraordinary conditions may call for extraordinary remedies. But the argument necessarily stops short of an attempt to justify action which lies outside the sphere of constitutional authority. Extraordinary conditions do not create or enlarge constitutional power.”). Nonetheless, emergency is clearly a legitimate basis for understanding the contours of constitutional authority that already exists. See, e.g., *Block v. Hirsh*, 256 U.S. 135 (1921) (noting that “a public exigency will justify the legislature in restricting property rights in land to a certain extent without compensation” in upholding emergency rent control during World War I); see also *Home Bldg. & Loan Ass’n v. Blaisdell*, 290 U.S. 398, 426 (1934) (“While emergency does not create power, emergency may furnish the occasion for the exercise of power. . . . The constitutional question presented in the light of an emergency is whether the power possessed embraces the particular exercise of it in response to particular conditions.”).

officials must act quickly to forestall that grave harm. Moreover, inherent in all emergency rationales is the constraint that officials must be acting reasonably in the face of such threats.⁷²

Although military necessity jurisprudence is less directly relevant than the disaster and public health cases, one distinction the Supreme Court has drawn in the former context can supply another important limiting principle for economic emergencies. In cases of military necessity, the Court has long distinguished between immediate threats and military actions that seem designed to satisfy a public need that could otherwise be met through the market, such as where property is “taken for the service of our armies, such as vessels, steam-boats, and the like, for the transport of troops and munitions of war, or buildings to be used as store-house and places of deposit of war material, or to house soldiers or take care of the sick, or claims for supplies seized and appropriated.”⁷³

In other words, if a public actor is appropriating or destroying property to respond to an immediate crisis, that necessity is more likely to be recognized as an exigency that can obviate compensation, but if the motivation (or consequence) is to supply the government with a benefit that the government could have procured, then claims of necessity will be met with greater skepticism.⁷⁴ This echoes the general argument that Joseph Sax made that takings liability is appropriate where the government seeks to benefit itself, but there should be no liability where the government is merely adjusting economic relations.⁷⁵ Given legitimate concerns about the risk of aggrandizement

72. As the Texas Supreme Court emphasized in a case rejecting the application of the emergency doctrine in a case under the Texas Constitution,

one who dynamites a house to stop the spread of a conflagration that threatens a town, or shoots a mad dog in the street, or burns clothing infected with small-pox germs, or, in time of war, destroys property which should not be allowed to fall into the hands of the enemy, is not liable to the owner, *so long as the emergency is great enough, and he has acted reasonably under the circumstances.*

Steele v. City of Houston, 603 S.W.2d 786, 792 (Tex. 1980) (citing WILLIAM L. PROSSER, *THE LAW OF TORTS* § 24 (4th ed. 1971)) (emphasis added).

73. *United States v. Pacific R.R.*, 120 U.S. 227, 239 (1887).

74. The analysis may not be the same for actions taken by authorities *after* the initial takeovers, when the entities involved had been returned to positions of financial stability. However, the initial compensability of the takeovers is a distinct question from the validity of subsequent actions once the firms were nationalized.

75. See Joseph L. Sax, *Takings and the Police Power*, 74 YALE L.J. 36, 63 (1964) (“[W]hen economic loss is incurred as a result of government enhancement of its resource position in its enterprise capacity, then compensation is constitutionally required; it is that result which is to be characterized as a taking. But losses, however severe, incurred as a consequence of

in economic nationalization, this strain of the necessity rationale can be a vital constraint.⁷⁶

There are reasonable arguments to be made, of course, against the analogy between physical and financial threats. Perhaps the most salient is the question of imminence.⁷⁷ After all, the GM bankruptcy process played out over the course of months and even AIG and the GSEs arguably might have bought some time had other policy interventions been tried. However, the immediacy of the relevant threat should be measured in terms of public and market reaction to failure to act, rather than the time it takes for a policy to reach fruition. Properly viewed this way, economic emergencies are not significantly different for businesses whose failure poses systemic risks than when a wildfire is raging, even if it may take time for officials to align the necessary institutions to allow action.⁷⁸ Markets today can react almost instantaneously to signals from public officials and even the possibility that certain firms might fail in the absence of public action can cause significant public harm.⁷⁹

government acting merely in its arbitral capacity are to be viewed as a non-compensable exercise of the police power.”).

76. In the Fannie Mae, Freddie Mac, and AIG suits, one set of arguments that the claimants are making is that the takeovers in each case were not designed to forestall financial panic or even stabilize critical aspects of the economy but rather to directly benefit the federal government itself. For example, in the GSE suits, the allegations relating to the sweep of profits to the federal government are essentially arguments that the conservatorships were thinly disguised ways of pumping money into the federal treasury. *See* Complaint, Washington Federal, *supra* note 4, at 65. Considering the amount of public subsidy—and the genuine uncertainty about the outcome of the interventions in each case—this argument is hard to credit on its face. Nationalization that represents a surgical intervention, and particularly one that is temporary, is better understood as a move (wise or not) to stabilize markets, rather than expropriation to benefit the government itself. There are legitimate reasons why some members of a polarized public may question this logic. *See* Levitin, *supra* note 23. But I think the better understanding of the governmental actions at issue—at least in the initial nationalization—is that they were not aggrandizing.

77. As noted, emergency doctrine generally requires imminent danger and an actual emergency that establishes the necessity. *See, e.g.,* TrinCo Inv. Co. v. United States, 722 F.3d 1375, 1378 (Fed. Cir. 2013) (doctrine not appropriate to be invoked when the Forest Service was undertaking prophylactic, rather than emergency, wildfire prevention).

78. The Great Recession demonstrated, however, that public institutions can sometimes move extremely quickly in the face of true looming public disaster. In the midst of the recent crisis, particularly in its early days, federal officials often had to act more like private deal-makers, forcing them, as Steven Davidoff and David Zaring have argued, to “decide quickly, negotiate hard, consider transaction and other costs to the best they can, and then call it a day.” Davidoff & Zaring, *supra* note 3, at 467.

79. Arguments about the comparative *significance* of the relevant types of threat—that fire or disease are of a different order of magnitude than economic harm—or even some

Moreover, the context of economic emergency no doubt presents significantly greater complexity than a fast-moving fire or a rapidly spreading disease. An official may be able to watch a fire approaching and reasonably conclude with relatively little information that the destruction of property is an appropriate precautionary measure to lessen the risk of a larger conflagration. An economic crisis sufficiently grave to threaten larger macroeconomic harm, on the other hand, may be hard to define. We have suffered many significant downturns, such as the stock market crash in 1987 and the end of the tech bubble, all without significant takeovers. Even if the threshold condition of a sufficient emergency can be discerned, delineating between appropriate “firebreaks” and other firms that should be left to the market, regardless of the consequences, is exceedingly difficult.⁸⁰

For all of these reasons, some takings theorists have been troubled by the concept of emergency or necessity as a justification for vitiating a compensation mandate.⁸¹ The argument for applying emergency to economic crisis is admittedly novel, and the Court has been reluctant to expand immunity from takings liability beyond categories traditionally recognized in common law. But many lower courts understand

formalist taxonomical objection, make little sense. In the kind of shock that the failure of the most interconnected and economically significant firms might bring, there are very real and extremely wide-spread harms that result, and such harms can last far longer than the aftermath of a wildfire.

80. Because nationalization so often involves action at the federal, rather than state (or local) level, it does present a paradigm of takings that inverts the traditional locus of eminent domain at the state level. Simply by dint of the docket, most foundational questions of takings law involve challenges to state and local regulation or eminent domain, and any doctrine developed in the context of federal law must be sensitive to the consequences for states and localities. That said, traditional emergency doctrine in takings jurisprudence much more often involved such state and local entities, so the extension of the doctrine to the economic sphere would not be entirely orthogonal to past experience. Nonetheless, if an economic emergency doctrine is grounded in the nature of extraordinary systemic risk, that fact might suggest caution in states and local governments invoking the rationale, given the risks of inconsistency across states and the limits of a national perspective for such sub-federal governments.

81. See, e.g., John J. Costonis, *Presumptive and Per Se Takings: A Decisional Model for the Takings Issue*, 58 N.Y.U. L. REV. 465, 487 n.94 (1983) (describing the “necessity” and “emergency” cases as “among the Court’s most troublesome takings precedents because they lack a basis in principle”). Peter Byrne has noted that emergency and related doctrines have “stood on the fringes of regulatory takings doctrine because giving them full effect would come close to abolishing any normative foundation for regulatory takings generally.” J. Peter Byrne, *The Cathedral Engulfed: Sea-Level Rise, Property Rights, and Time*, 73 LA. L. REV. 69, 93 (2012). But this anxiety ignores the pedigree of the privilege and the not-insignificant boundaries that courts have historically placed around the doctrine. Whether that is more or less normatively destabilizing than the many other ambiguities in takings doctrine is hard to say.

that definitions of harm and public exigencies can evolve over time, and these complexities are ultimately judicially manageable.

In short, while the traditional law of emergency in takings would import significant constraints on the invocation of the rationale to support nationalization of systemically important firms in economic emergencies, the extension of the doctrine in this way makes eminent sense. It is important doctrinally to give reasonable latitude to the judgment of officials in the thick of crisis, even if, in the calm after the storm, other avenues might seem to have been preferable. All of this, then, gives us the rough outlines of a doctrine of economic emergency in takings that bears directly on the practice of nationalization.

B. Economic Externalities and Irreconcilable Choices?

To this point, the argument has sought to ground a takings doctrine for nationalization that reflects, and extends, traditional emergency rationales. There is a closely related jurisprudential vein in constitutional property, however, that might supply an even broader doctrinal grounding for nationalization. Public officials are sometimes faced with the choice of irreconcilable economic conflicts reflecting the harm that one owner's property threatens to cause another owner. In a situation posing this kind of irreconcilable choice, officials may legitimately choose one set of economic interests over another.

This logic is familiar from the cedar rust tree disease case, *Miller v. Schoene*,⁸² where the Court articulated the dilemma as follows:

[T]he state was under the necessity of making a choice between the preservation of one class of property and that of the other wherever both existed in dangerous proximity. It would have been none the less a choice if, instead of enacting the present statute, the state, by doing nothing, had permitted serious injury to the apple orchards within its borders to go on unchecked. When forced to such a choice the state does not exceed its constitutional powers by deciding upon the destruction of one class of property in order to save another which, in the judgment of the legislature, is of greater value to the public.⁸³

82. 276 U.S. 272 (1928).

83. *Id.* at 279.

This recognition of the harm principal can apply as well to modern economic harms caused by private entities in companies whose failure poses systemic risks. *Miller* was a due process, not a takings case, and the Court appeared to distance itself from the case in *Lucas*.⁸⁴ But the proposition has not been explicitly disavowed and, even transformed, can be seen in the *Lucas* understanding of background principles of state law as a limitation on *per se* takings liability.

As with other necessity-based rationales, the *Miller* doctrine is not unlimited and must be grounded in the reasonable exercise of authority, however deferentially construed. The reason for relying on the emergency doctrine as a basis for justifying nationalization in times of economic crisis is that a *Miller*-esque economic nuisance argument is harder to cabin and harder, perhaps ironically, to operationalize. Relying on the tradition of imminent necessity, rather than a broader conception of harm and incompatibility, is thus a sounder foundation for what might be understood as a novel extension of economic authority.

IV. NATIONALIZATION, NECESSITY, AND THE RULE OF LAW

Even if one were to accept the argument that the emergency doctrine should logically be extended to contemporary economic dangers, one might still object more fundamentally to the idea of invoking crisis and systemic risk to affect the landscape of takings law, regardless of the nature of the emergency. Nationalization is a term that for many people invokes visions of unconstrained dictatorial authority—think banana republic⁸⁵—and all the more so if there are grounds for taking control of companies without compensating those harmed by that action.

Indeed, some commentators have argued that it is precisely in times of crisis that protection for property rights—taken somewhat narrowly to mean constraint on public authority to adjust economic benefits and burdens—should be at its highest level. Todd Zywicki,

84. See *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1022–23 (1992) (“The ‘harmful or noxious uses’ principle was the Court’s early attempt to describe in theoretical terms why government may, consistent with the Takings Clause, affect property values by regulation without incurring an obligation to compensate—a reality we nowadays acknowledge explicitly with respect to the full scope of the State’s police power.”).

85. Cf. Ashton B. Inniss, *Rethinking Political Risk Insurance: Incentives for Investor Risk Mitigation*, 16 SW. J. INT’L L. 477 (2010).

for example, argues that the purpose of property rights (and the rule of law more generally) is to provide “as much stability as possible” to facilitate the “economic coordination” that economic activity requires, and in emergencies more than ever.⁸⁶ Zywicki gives the following example:

Consider the milk in your refrigerator or cafeteria. Think of the chain of coordination required to get it there: Farmers must decide to use their land to graze dairy cows; determine how many cows to graze; and employ people and use machinery to milk the cows, pasteurize the milk, and deliver it into the stream of commerce. All the coordination in that relatively simple chain of production must then align with millions of consumers deciding whether to buy milk or Coke and ensuring that they can buy both milk and Cheerio's. The extent to which these systems are coordinated is remarkable.⁸⁷

Zywicki, drawing on Friedrich Hayek, argues that complex economic activity not only requires this kind of coordination but involves constant informational feedbacks to adjust.⁸⁸ State intervention to respond to market failures short-circuits this feedback mechanism and the resulting uncertainty, so the argument goes, undermines incentives for private investment.⁸⁹

However, these kinds of arguments about the necessity of stability and the rule of law in constitutional property ignore another side to the ledger of expectations about property. Zywicki's milk may require Herculean market coordination to get from the cow to the consumer's cup, but such complex markets are apt not only to be much less efficient in the absence of a baseline of regulatory protection in the ordinary course,⁹⁰ but reveal their greatest weaknesses in times of

86. See Todd Zywicki, *Economic Uncertainty, the Courts, and the Rule of Law*, 35 HARV. J.L. & PUB. POL'Y 195 (2012).

87. *Id.* at 197 (footnote omitted).

88. *Id.*

89. *Id.* at 199. Zywicki makes some leaps in causation that are hard to support. For example, Zywicki argues that the reason credit markets have been slow to return after the crisis is because “political response to the financial crisis (or perhaps more accurately rationalized as a response to the financial crisis) created a huge amount of instability that makes it hard to price a loan.” *Id.* at 198. The real reason banks were slow to extend credit in the aftermath of the housing crisis, however, is most likely not policy-induced “instability” but much more likely the very inability of the Hayekian information chain to allow lenders to accurately assess (and price) risk in the face of market failure.

90. See Joseph W. Singer, *Things That We Would Like to Take for Granted: Minimum*

economic crisis. For markets to work, property rights must be appropriately calibrated and all the more so during times of emergency.

Hanoch Dagan has mounted a broader challenge to expropriation without compensation as an affront to the rule of law that has relevance here as well.⁹¹ Dagan asserts that any constitutional doctrine that offers less than fair market value for takings offends two aspects of the rule of law. First, drawing on Joseph Raz, Dagan argues that judicial validation of non-compensatory takings fails to provide the guidance necessary for people to form clear expectations about how authorities will exercise their coercive power, which in turn is critical to the value of autonomy.⁹² Second, the case-by-case method through which compensation practices are determined threatens the rule of law value, Dagan continues, that seeks to constrain the arbitrary exercise of power.⁹³

These are important concerns—and Dagan acknowledges that takings without full compensation can be justified on the grounds of the reciprocal obligations that owners have as members of a community, which I think best explains traditional emergency doctrine in takings⁹⁴—but his concern with guidance and arbitrary exercise of power risks a kind of circularity. In practice, the kinds of standards that tend to dominate takings law actually provide a significant amount of notice to owners and the broad sweep of litigation on takings tends to generate rule-like categories that are quite intelligible.⁹⁵ As Joseph Singer has noted, “while the ad hoc test looks vague on paper, it is highly predictable in practice. The courts entertain a strong presumption that regulations of property are legitimate if passed by legislatures to promote public ends.”⁹⁶ Indeed, Singer rightly notes, “the *Penn Central* test is more predictable than a seemingly rigid rule that would prevent changes in ‘established property rights’ given

Standards for the Legal Framework of a Free and Democratic Society, 2 HARV. L. & POL'Y REV. 139 (2008).

91. See Hanoch Dagan, *Expropriatory Compensation, Distributive Justice, and the Rule of Law*, in RETHINKING PUBLIC INTEREST IN EXPROPRIATION LAW (H. Mostert & LCA Verstappen eds., forthcoming 2014), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2345115.

92. See *id.* at 6 (citing Joseph Raz, *The Rule of Law and Its Virtues*, in THE AUTHORITY OF LAW: ESSAYS ON LAW AND MORALITY 210, 213, 218 (1979)).

93. *Id.* at 6–7.

94. See *supra* text accompanying notes 68–70.

95. See Joseph William Singer, *The Rule of Reason in Property Law*, 46 U.C. DAVIS L. REV. 1369, 1402–05 (2013).

96. *Id.* at 1405.

the need to interpret what those rights are before they can be defined as immune from change without compensation.”⁹⁷

Moreover, whether the judicial validation of expropriatory practices that do not provide compensation represent the arbitrary exercise of power depends heavily on one’s view of the discretion being deployed. If a policy of intervention to solve a potentially devastating market collapse—as one example of a reason why compensation might not be granted—seems like an excuse for officials to advance some more nefarious goal, then such steps will seem arbitrary regardless of the legality of the process through which such power has been exercised. This is partly a cultural question, and it was evident in much of the popular reaction to nationalization during the Great Recession. Ultimately, though, it requires some external metric of arbitrariness to say that an exercise of the power to interfere with property rights, including compensationless expropriation, necessarily violates this aspect of the rule of law.

It is reasonable to raise questions about the arbitrariness of the exercise of power the longer the government remains in control of an entity. Economic nationalization that involves forestalling market failure and restoring the health of a systematically important firm may take on a different cast—and raise increasing risks—if that control continues longer than necessary to respond to an emergency. Fannie Mae and Freddie Mac remain under conservatorship, while AIG and GM and others have been re-privatized, and it is not surprising that the conservatorships have generated ongoing questions about the purpose and role of federal control.⁹⁸ This does not change the calculus in moments of crisis, but is worth reflecting on for the ultimate legitimacy of any instance of nationalization.

In short, while it is fair to argue that extraordinary departures from what property law demands in the name of emergency may undermine the rule of law, nationalization—so present throughout our history, as much as we tend to forget the fact—is not such a departure. The critical point about the rule of law here is that, as uncomfortable as this reality might be, a doctrine that acknowledges the kind of limited intervention represented in our tradition of nationalization would

97. *Id.*

98. See, e.g., Nick Timiraos, *Fannie-Freddie Fate Rests in Courts: Shareholder Suits Challenge U.S.’s Profit-Taking Structure*, WALL ST. J. (Feb. 11, 2014, 9:24 AM), <http://stream.wsj.com/story/latest-headlines/SS-2-63399/SS-2-451130/>.

not be outside the bounds of law but deeply consonant with the oldest pathways of the takings clause.

CONCLUSION

One might question the wisdom or the foresight of any of the instances of nationalization that occurred in responding to the Great Recession and there is no doubt that, in the heat of the moment, officials likely made mistakes. In the early months of the crisis, a great deal of debate swirled around which companies should be saved or left to their fate—why Bear Stearns and not Lehman?—and it was difficult for officials to anticipate how events would play out given that all indications pointed toward a rapidly spreading global economic meltdown.

There is a difference, however, between policy concerns about nationalization and constitutional arguments for barring the practice without compensation, which would likely forestall the practice altogether. How one views the wisdom of nationalization in any given instance is inherently complicated, and my own perspective is that this is a valuable policy tool if used carefully, recognizing the risk of abuse, as with all public authority. But that debate is one that is better carried out in a political, rather than judicial, arena.

It does no violence to norms of ownership—or the rule of law—to acknowledge that overriding necessity in times of crisis can be as relevant to economic emergency as it has always been to more prosaic threats. The doctrine of economic emergency that this Essay has proposed accords with the deepest traditions of our system of property, and rightly should be so recognized.

