Self-Regulation for Safety and Security: 
Final Minutes or Finest Hour?

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ABSTRACT

The terrorist attacks of September 11, 2001, and the accounting 
and auditing crisis later caused by the Enron and Worldcom scandals 
of that same year, created a great sense of insecurity in many Ameri-
cans. In this Article, I analyze the federal government’s response to 
crisis. I first define what a crisis is: a sudden, existential threat to 
which the entity has insufficient resources to respond. I then explain 
how regulation for safety and security is unique in two aspects: per-
ceptions matter, and the assistance of the regulated entities is essen-
tial. I proceed by describing and analyzing the regulatory history and 
crisis responses to these two instances from 2001, then compare them 
to two notable instances from the early twentieth century: the crises 
in banking and in meatpacking. From these four examples, I extract 
a paradigm of crisis response. The government’s initial response to a 
crisis is to provide a massive new federal presence, which is expected 
and accepted if for nothing more than its calming effect. Shortly 
thereafter, however, the government is expected to deliver results 
that both work and appear to work. In most instances where safety 
and security is the goal of the regulation, the public relies on the 
regulated entities to provide much of the guidance. I seek to apply 
this paradigm to our newest policy arena: homeland security. I con-
clude that the government has followed the paradigm I have identi-
ified and that, although there are significant differences in homeland 
security from other regulation, these four lessons from the past have 
a lot to teach us about the future.

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INTRODUCTION

Regulation is a political process, where perception can matter as much as reality.1 Two recent events—the September 11, 2001 attacks and the spate of accounting and audit failures beginning later that same year with the Enron and Worldcom scandals—have left many Americans doubtful that those in charge of at least two industries can self-regulate in matters of safety or security. At first consideration, terrorist attacks and corporate scandals may seem to have nothing in common but coincidence. President Bush, in signing major corporate reform legislation, clearly linked the two events:

Terrorists attacked the center and symbol of our prosperity. A recession cost many American workers their jobs. And now corporate corruption has struck at investor confidence, offending the conscience of our nation. Yet, in the aftermath of September the

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1 See James Q. Wilson, The Politics of Regulation, in THE POLITICS OF REGULATION 357, 384 (James Q. Wilson ed., 1980) (“By far the largest number of regulatory issues discussed in this book arose not because of a fundamental shift in technology or prices, but because perceptions about what constituted a problem changed.”).
11th, we refuse to allow fear to undermine our economy. And we
will not allow fraud to undermine it either.2 Former Securities and Exchange Commission Chairman Harvey L.
Pitt, referring to both the financial collapse of Enron and the Sep-
tember 11 attacks, noted that “[c]rises like these require us to reas-
sess how our system functions for us; they also require us to assess
how we function in our system.”3 Although 2001 is beginning to seem
like a more distant tragedy, these events will surely frame the next few
years’ thinking about the proper role of the government in supervis-
ing those who assure us that regulatory systems are functioning prop-
erly, and as we seek to provide safety and security in the post-
September 11 world.

A major question still unresolved is: Will government rely to any
significant degree on the regulated entities themselves? The popular
sentiment, for the moment, is “no.” Many private regulations have
recently been removed from private hands. Airport security has been
taken over in part by the federal government.4 A new board under
federal supervision has been created to regulate the accounting pro-

ession.5

Nonetheless, regulatory theory suggests that continued deep in-
volution of the players in the regulated industries will be critical in
these areas. Safety and security regulation has unique aspects that
make reliance on regulated entities particularly useful in designing
systems that are safe and that appear safe.

I submit in this Article that self-regulation, properly imple-
mented and supervised, is a key part of any successful solution. This
may be especially important as we move toward vast new frontiers of
homeland security regulation with a new federal department whose
mission is not only physical safety but peace of mind.

In Part I, I review principles of crisis and response, and explain
why the recent regulatory developments in “process regulation” are
uniquely suited to the task of safety and security regulation. Part II
reviews the two recent crises which together have increased Ameri-
cans’ insecurities: the airplane hijackings of September 11, 2001, and

Corporate Corruption Bill (July 30, 2002), available at http://www.whitehouse.gov/
news/releases/2002/07/20020730.html. The bill of which President Bush spoke is
the Sarbanes-Oxley Act of 2002, discussed in detail infra in Part II.B.
3 Harvey L. Pitt, Chairman, U.S. Securities and Exchange Commission, Remarks
news/speech/spch540.htm.
4 See infra notes 83–99 and accompanying text.
5 See infra notes 134–41 and accompanying text.
the crisis in accounting and auditing of our public companies which followed shortly thereafter, beginning only a month later with Enron’s initial announcement of accounting irregularities. In Part III, I discuss two very close historical parallels to these crises: the meatpacking crisis of 1906 and the banking crisis of 1933 with its reprise in 1989. From these histories, both recent and distant, we can draw lessons in crisis response and regulation. In Part IV, I apply these lessons to the emerging and puzzling task of providing homeland security for America. I conclude that we can profitably apply these regulatory theories, with the aid of four demonstrations from history, to provide regulation which allows Americans to both be and feel safe and secure.

I. SELF-REGULATORY THEORIES IN AN INSECURE WORLD

Most policy analysts have recognized the general utility of private actors in programs of government regulation. The conditions and criteria for success, and the likelihood of success, vary according to the uses to which the private actors and the government powers are put, of course. This is also true with security self-regulation. There are two basic unique facets of safety and security regulation to keep in mind in order to create effective programs. First, perceptions matter. That is, an important part of the success of a safety and security program is whether it feels safe. Second, self-regulation by its nature does not admit to traditional “command and control” regulation or “end of the pipe” assessment. There is no good measure of success nor permitted amount of failures. Terrorism is not a known disease nor a hazard capable of measurement. Thus, we will generally not know when we have been successful. Failure, unfortunately, will be tragically obvious. With each facet, there are different implications for the government-private mix of responsibility.

A. Perceptions Matter

People’s beliefs are an important subject of safety and security regulation. Regulatory systems must not only be effective, but they
must appear to be effective in order to restore and maintain confidence. If people perceive a crisis, they expect immediate and forceful action at the highest levels.

A crisis can be defined as an existential threat to a system with little time, structure or resources available for an immediate effective response. The lack of resources available to meet the threat is probably the most critical element. In order to trust the governmental response, the public must perceive it to be “(a) competent, (b) open, (c) concerned, and (d) reliable.” Ordinarily, this means “retreat” by the public to a familiar trusted circle of advisers. Perceptions are important at this juncture, because fear makes impossible the rational analysis that can form the basis for trust, thus, more heuristic approaches are substituted. “When you’re living in fear, it’s easy to let others make security decisions for you. You might passively accept any security offered to you. This isn’t because you’re somehow incapable of making security trade-offs, but because you don’t understand the rules of the game.” Thus, “trust” in government in a crisis situation does not mean the same as “trust” in government.

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8 Posner, supra note 7, at 682–83. Posner makes the distinction as one between using regulation to minimize risks that people fear, and using regulation to reduce fear. Both are difficult, but the latter is more ambitious and offers the most hope for undermining the use of terror to achieve political objectives. Id. See also Schneier, supra note 6, at 9 (“Security is both a feeling and reality. We’re secure when we feel protected from harm . . . . In this way, security is merely a state of mind.”).

9 See Sunstein, supra note 7, at 98 (discussing “The Demand for Law” in crisis situations). The irrationality of such expectations is apparent, but the expectations persist nonetheless. See Eric A. Posner, Law and the Emotions, 89 GEO. L.J. 1977, 2002-06 (2001) (discussing how the correct regulatory response depends upon the nature of the fear or panic).

10 Aneil K. Mishra, Organizational Responses to Crisis: The Centrality of Trust, in TRUST IN ORGANIZATIONS 261, 262 (Roderick M. Kramer & Tom R. Tyler eds., 1996).

11 See Eugene J. Webb, Trust and Crisis, in TRUST IN ORGANIZATIONS, supra note 10, at 288, 290.

12 Mishra, supra note 10, at 265 (citations omitted).

13 Webb, supra note 11, at 292; see also Mishra, supra note 10, at 270–71 (noting also increased reliance on decentralized decisionmaking).


15 SCHNEIER, supra note 6, at 8.
ernment in normal situations, where the government is charged with the promotion of legal compliance, long-term stability, and reliability of commercial relations. Indeed it is more like the trust placed in others in more social situations, where the trust is not based on rational calculations of probable advantage, but on social cues, and personal relationships. This type of personal trust begins to resemble the law’s fiduciary relationship. One writer goes further to suggest that reliance on government exists perhaps out of resignation “because [such institutions] are virtually necessary, or at least very helpful, to us and because we begin to have a fairly high degree of confidence that they will perform better for us than any extant alternative.”

However, the assurance provided by the initial governmental response is often short-lived. Professor Robert Hahn’s words about air security in normal situations, where the government is charged with the promotion of legal compliance, long-term stability, and reliability of commercial relations. Indeed it is more like the trust placed in others in more social situations, where the trust is not based on rational calculations of probable advantage, but on social cues, and personal relationships. This type of personal trust begins to resemble the law’s fiduciary relationship. One writer goes further to suggest that reliance on government exists perhaps out of resignation “because [such institutions] are virtually necessary, or at least very helpful, to us and because we begin to have a fairly high degree of confidence that they will perform better for us than any extant alternative.”

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16 See, e.g., Avner Ben-Ner & Louis Putterman, Trusting and Trustworthiness, 81 B.U. L. Rev. 523, 527–32 (2001) (evaluating elements of trust as displayed between parties to a commercial transaction); Dan M. Kahan, Trust, Collective Action, and Law, 81 B.U. L. Rev. 333, 340–46 (2001) (analyzing individuals’ trust in each other to comply with the tax laws versus individuals’ apprehension of likely penalties for non-compliance). Further distinct still is the trust that individuals place in others within the same group or organization. See, e.g., Walter W. Powell, Trust-Based Forms of Governance, in TRUST IN ORGANIZATIONS, supra note 10, at 51, 51 (analyzing trust within and among commercial firms); Tom R. Tyler & Peter Degoey, Trust in Organizational Authorities: The Influence of Motive Attributions on Willingness to Accept Decisions, in TRUST IN ORGANIZATIONS, supra note 10, at 331, 331 (analyzing trust within hierarchical organizations generally).


18 Compare United States v. Chestman, 947 F.2d 551, 568 (2d Cir. 1991) (defining a fiduciary relationship in the securities fraud context as one involving “reliance” or “confidence” on the one side and “control,” “dominance,” or “superior influence” on the other), with Mark A. Hall, Law, Medicine, and Trust, 55 Stan. L. Rev. 463, 474 (2002) (generally defining personal trust as “the optimistic acceptance of a vulnerable situation in which the trustee believes the trustor will care for the trustor’s interests”).

19 Russell Hardin, Distrust, 81 B.U. L. Rev. 495, 520 (2001); see also Lawrence A. Cunningham, The Appeal and Limits of Internal Controls to Fight Fraud, Terrorism, Other Ills, 29 J. Corp. L. 267, 280 (2004) (noting that laws passed in response to terrorist and accounting crises were “based far less on a calculated cost-benefit assessment of the likelihood of their effectiveness than a populist need to exhibit taking control”).

20 See Posner, supra note 7, at 688 (noting that fear decreases over time); Mark C. Niles, On the Hijacking of Agencies (and Airplanes): The Federal Aviation Administration, “Agency Capture,” and Airline Security, 10 Am. U. J. Gender Soc. Pol’y & L. 381, 437 (2002) (“An obvious and extensive federal presence could alleviate some . . . fears, and consequently bring [air] passengers back . . . . Presumably, security fears will diminish over time, and as the public’s confidence in air travel increases, the benefit provided by federal involvement in screening will diminish in comparison to the additional costs that such involvement produces.”).
safety regulation could be extended to apply generally to our post-September 11 world.

Politicians of all stripes have a strong tendency to overreact in the face of a crisis. Their overreaction is desirable to the extent that their rhetoric has a calming effect. But when their rhetoric yields hastily assembled policies, the results are often less than benign. Policy proposals offered in the heat of the moment, therefore, should be received with a healthy dose of skepticism.²¹

Whether wise from a policy standpoint, the immediate and forceful federal response to terrorist threats and stock market meltdowns should not be surprising from a political standpoint. When appearances matter, visible, central, immediate, and comprehensive regulation is needed. These features respond directly to what created the crisis in the first place: an existential threat coupled with inadequate resources to deal with it. The unabashed rush to direct federal regulation following these human and financial catastrophes, although predictable in theory, was nonetheless remarkable in its speed and unanimity. The robustness of this observation is even greater given that the prevailing political mantra of the late twentieth century was that the federal government should be smaller and better, but at least smaller in any event.²²

Thus, perceptions matter because, in a crisis, people do not have the luxury of rational choice. A crisis may also create fear, and an immediate response is expected—indeed, required—by those normally perceived to be in control. This response is intended to reassure the public, as by definition the nature and scope of the threat is unknown, and to provide credibility to the response by placing it in the familiar hands of experts.²³ When the problem is national in scope, that normally implies a federal government response.²⁴

²¹ Robert W. Hahn, The Economics of Airline Safety and Security: An Analysis of the White House Commission’s Recommendations, 20 Harv. J.L. & Pub. Pol’y. 791, 812 (1997); see also Cunningham, supra note 19, at 320 & n.207 (describing how crisis response is usually an inadequate and improper overreaction because “[t]he pressure to respond quickly is too great”).

²² See Thomas O. McGarity, The Expanded Debate over the Future of the Regulatory State, 63 U. Chi. L. Rev. 1463, 1468–83 (1996) (comprehensive history of twentieth century regulation in the United States). McGarity observes that “for those who feel unduly constrained by regulation, these are heady times; and for those who have depended upon the federal government to protect them from the unconstrained exercise of private economic power, these are dangerous times.” Id. at 1483–84.

²³ See Posner, supra note 7, at 691–93 (discussing how “signaling” (visible governmental action) is a regulatory instrument of reassurance and credibility).

²⁴ One analyst notes that in dealing with terrorism, “[a]t least in one respect, the role of the government is clear. The public expects the Federal government to protect citizens from external threats.” Brent K. Marshall et al., Terrorism as Disaster: Se-
B. Innovative Regulatory Approaches are Required

We can expect the importance of this federal presence, standing alone, to diminish slightly over time. In the long run, the fact that the regulation is credible and effective will be more important in diminishing fear. This is because, given the luxury of time, the trust relationship evolves from the initial personal, heuristic, or emotional trust into one which is more rational and calculating.\textsuperscript{25} The initial reassurances must be backed up with reaction, and the initial credibility signaled by government involvement and confidence must be backed up with results. This challenge can be exacerbated by passage of time which, among other things, changes people’s recollection of the magnitude of the crisis.\textsuperscript{26}

The results, however, may be difficult to deliver. Safety and security is impossible to assure, and regulation of it is difficult to supervise because it does not admit to traditional “end of the pipe” inspection.\textsuperscript{27} We cannot say that a flight had an “acceptable risk” of a terrorist attack, or that a company’s financial statements were ninety-seven percent free of fraud. In many cases, of course, we will not know that our prevention and deterrence measures have been suc-

\textsuperscript{25} Trust and game theorists would posit that this is due to the existence of many iterations in the game, allowing for repeated observations of the other’s conduct and the ability to determine if trust was well- or foolishly-placed. See supra note 16 and accompanying text.

\textsuperscript{26} See W. Kip Viscusi & Richard J. Zeckhauser, Recollection Bias and the Combat of Terrorism, 34 J. LEGAL STUD. 27 (2005). Viscusi and Zeckhauser describe this bias as the tendency of individuals to understate the risk when viewed after the fact. They discuss surveys given to students at three different professional schools: Quite remarkably given the magnitude and surprise of the September 11 attack, 57 percent of respondents exhibited recollection bias: they stated that the risks were no greater post- than preattack. The current risk estimates of those exhibiting recollection bias were no lower than the estimates of those who did not exhibit such bias; the bias was not due to a failure to perceive the risks after September 11 as others do. Rather, it was a failure to recognize that they had updated their risk beliefs, just as others had. Id. at 51.

\textsuperscript{27} See Cary Coglianese et al., Performance-Based Regulation: Prospects and Limitations in Health, Safety, and Environmental Protection, 55 ADMIN. L. REV. 705, 712 (2003) (“[W]hen direct and continuous monitoring of smokestack emissions is possible, performance can be clearly verified. In contrast, performance cannot be directly measured for rare and catastrophic events, and instead must be predicted, making implementation more difficult.”).
cessful.\textsuperscript{28} As the effort moves from assurance to achievement, however, there is a clear incentive to rely on the regulated industries. They alone have the expertise and incentive to innovate and succeed where government regulation cannot, and they can use that advantage to produce more effective regulation.\textsuperscript{29} This was noted by a former securities industry regulator and now a leading member of private industry, in a speech shortly after the September 11 attacks, about the “new normal” of a post-September 11 world and how the largely self-regulated securities industry will respond:

> I am not enough of a sage to be certain whether this new normal will be better or worse than the old. Certainly in a number of ways it will be less convenient and more costly, at least in the short run. . . .

> One of the key factors in our markets’ success and resiliency throughout this period has been the strength of our regulatory system. . . . Self-regulation brings to bear a keen practical understanding of the industry. It taps resources and perspectives that are not as readily available to governments. . . .

> That is why self-regulation is so well suited to help usher in the new normal in the securities industry. Because no one has a stronger incentive than [the industry] to ensure that their disaster recovery and business continuity plans—to take just one big example—are fully adequate . . . . And no one can bring greater resources or expertise to bear than our industry, acting collectively, to see that such plans are not only formulated, but followed.\textsuperscript{30}

How can the regulated industries’ expertise be employed? There is, fortunately, an answer in modern regulatory theory.

\textsuperscript{28} See id. at 721 (noting that in the case of the combination of complex systems and low-probability events, “meaningful performance measures or indicators may be difficult to define”).


Regulatory theory has, in recent years and in many areas, developed along the lines of “process” regulation. In process regulation, the end result is not inspected and found compliant or in violation; rather, the regulatory process is developed and measured against criteria of efficacy and reliability. Risks are identified and measures are put in place to control those risks. Process regulation is especially well-suited to areas such as safety and security regulation because performance-based detection and enforcement is not as much of a challenge as design-based or process-based prevention. Prevention of failures is what process regulation is designed to do.

Process regulation necessarily enlists the help of the regulated entities. Indeed, it may go further and vest them with primary responsibility for development of an effective prevention program. It is clear that those involved in each industry may be best-suited to identify the greatest security risks and develop the initial set of preventative measures. Recent initiatives in the area of computer systems defense and protection indicate a preference for industry participation. In addition, safety and security experts routinely employ

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31 For a full discussion of one most robust example, see infra Part IIA (developments in meat and poultry processing). See also Jody Freeman, Collaborative Governance in the Administrative State, 45 UCLA L. REV. 1 (1997) (environmental regulation); McGarity, supra note 22 (general review of regulatory reforms).

32 See, e.g., Neal D. Fortin, The Hang-Up with HACCP: The Resistance to Translating Science Into Food Safety Law, 58 FOOD & DRUG L.J. 565, 567 (2003) (“Although the traditional inspection works well at accomplishing what it was designed to achieve—cleaner food produced under more sanitary conditions—, it is inadequate in preventing many foodborne illnesses. Whereas traditional food safety assurance programs rely on general sanitation inspections and end-product testing, HACCP [process regulation] identifies the risks and then applies preventative control measures.” (footnotes omitted)).

33 See, e.g., id.

34 In theory, regulation likely is not solely “performance-based” or “design-based,” but lies on a spectrum between those two endpoints. Coglianese et al., supra note 27, at 712.

35 See id. at 721 (“[P]erformance-based regulation may often require the application of performance indicators so that agencies can intervene before an undesirable event occurs.”).

36 See id. at 709–10 (listing different types of performance-based standards, ranging from those with loose specifications to those that more closely resemble traditional “command and control” regulation).

37 See Richard Clarke, National Coordinator for Security Infrastructure Protection and Counter-terrorism, National Security Counsel, Keynote Address for the Terrorism and Business Conference Dinner Reception: Threats to U.S. National Security: Proposed Partnership Initiatives Towards Preventing Cyber Terrorist Attacks (Oct. 14, 1999), in 12 DEPAUL BUS. L.J. 33, 41 (2000) (“We think that these computer defense centers in the various sectors; transportation, electricity, banks, can create best practices, establish benchmarks and work with the insurance industry and with the audit industry so that there is a benefit to a company that is living up to the best
so-called “red teams”: insiders given the job of acting as outsiders to defeat the existing protective mechanisms. Industry has already responded to the need for emergency preparedness with proposed national standards for the private sector.

Such involvement of private industry—those most knowledgeable about their systems and their vulnerabilities—is critical in establishing safety and security in the context of surprise attacks. “It is impossible to be strong everywhere, or to respond to every alarm with costly defensive measures (such as grounding all civil aviation, as in the wake of September 11), or to eavesdrop on every plotter.” Even rudimentary cost-benefit analysis will yield a large number of potential threats against which no defensive measures can or should be taken. Determining which avenues are best traveled and which are best left alone is difficult in any event, but the additional information supplied by the entities involved will make the decision easier.
II. THE CRISIS OF 2001–02

This Part reviews the self-regulatory developments in safety and security related to the infamous airline and accounting crises of 2001 and 2002.

A. Airplane and Airport Security

The four hijackings of September 11, 2001, were, first and foremost, a crisis in aviation safety and security. Although the terrorist attack aspect of the event has assumed equal or greater significance, this part deals solely with the aviation regulation aspects of the disasters that day.

The basic arrangement in the United States’ aviation safety regulatory system was for many years that the Federal Aviation Administration (“FAA”) retained general oversight and enforcement authority, but the first-line responsibility was delegated. Air carriers bore the primary responsibility for applying security measures to passengers, service and flight crews, baggage and cargo. Airports, run by State or local government authorities, were responsible for maintaining a secure ground environment and for providing law enforcement support for implementation of airline and airport security measures. Terrorism, and its human, psychological, and economic costs, has often changed this power-sharing arrangement.

Modern aviation terrorism is widely recognized as having begun with the bombing of Pan Am Flight 103 over Lockerbie, Scotland, on December 21, 1988. With the explosion that day, it was clear that the major objective of the terrorists was no longer notoriety or asylum, but rather death and destruction for its own destabilizing sake, and on a scale previously unknown.

In its wake, President Bush chartered a Commission on Aviation Security and Terrorism. On July 4, 1990, the President issued Executive Order No. 12,686, 54 Fed. Reg. 32,629 (Aug. 9, 1989), which established the Commission.

42 See generally Niles, supra note 20, 425–33.
44 See Phillip A. Karber, Re-Constructing Global Aviation in an Era of the Civil Aircraft as a Weapon of Destruction, 25 Harv. J.L. & Pub. Pol’y 781, 787 (2002). Although there had been numerous explosions aboard aircraft, only one had been on the scale of the Lockerbie disaster until that time: a 1985 explosion of an Air India plane off the coast of Ireland, in which 329 people were killed. Report of the President’s Commission on Aviation Security and Terrorism 166 (1990) [hereinafter 1990 Commission Report].
17, 1996, following the crash of TWA Flight 800, initially suspected of being a terrorist act, President Clinton chartered a Commission on Aviation Security and Safety. These are not the only such studies, of course, but they are important in determining public reaction and public assurances in airline safety and security. In each instance, reports with recommendations were issued covering similar areas: reform of baggage and passenger screening and matching of baggage with passengers, improved and standardized training for security officials, and broad-based reform of management of the industry by the FAA, and even of the FAA itself.

In addition, Congress ventured into the arena. The Federal Aviation Reauthorization Act of 1996 ("the 1996 Act") began as a bill "primarily directed toward improvements in airport and airway infrastructure," but soon became an important piece of safety and security legislation, as it was amended to include many of the recommendations of the Commission on Aviation Security and Safety, as well as a mandate for a comprehensive study on aviation security responsibilities and funding.

The study required by the 1996 Act was issued by the FAA in December 1998. Important for our purposes is the FAA’s reexamination of this public-private distribution of the responsibility for air safety and security. The study noted that both Presidential commis-

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48 1990 COMMISSION REPORT, supra note 44, at 49 (Recommendations 2–3); 1997 COMMISSION REPORT, supra note 46, at 36 (Recommendation 3.20).
49 The 1990 Report was especially critical of the FAA. See, e.g., 1990 COMMISSION REPORT, supra note 44, at 53 (labeling the FAA’s regulation as “largely dictated by incidents and reaction to those incidents” and concluding that the FAA “has not risen to the challenge” of adequately addressing security problems); see also 1997 COMMISSION REPORT, supra note 46, at 9–15 (Recommendations 1.2–1.4, 1.10).
53 Federal Aviation Reauthorization Act of 1996 § 301.
54 See FAA 1998 STUDY, supra note 43.
sions had recommended a greater federal role in this area, but that the industry remained resolute in defense of the status quo. An acceptable compromise appeared to be to heighten the federal role in the area of standard setting, particularly in relation to passenger screening, but to leave the carriers in charge of implementation. There were many criticisms of the FAA’s explosives detection plans, most of them grounded in the lack of good science or technology.

In 1997, the FAA independently proposed comprehensive revisions to its security rules for airports and air carriers. These rules

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55 Id. at 31–34. See also id. at 34 (quoting 1997 COMMISSION REPORT, supra note 46, at 53 (“There are few areas in which the public so uniformly believes that government should play a strong role as in aviation safety and security. . . . Problems in these areas contribute to an erosion of public faith in aviation, and in government itself.”)).

56 Id. at 35–36.

57 Id. at 41.

There is broad, although not universal, agreement that the regime of shared responsibilities should stay the same. However, it could be argued that the Federal Government should increase its involvement by setting training standards, thereby adding to its other responsibilities for capital equipment purchases, R[esearch], E[ngineering] & D[esign], intelligence assessments, testing countermeasures, standard setting, and compliance and enforcement of regulations. Air carriers would still be responsible for screening, but their employees, the screeners and their supervisors, would be trained to standards set by the FAA . . . .

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58 See Hahn, supra note 21, at 797–98 (summarizing reviews of classified studies by the General Accounting Office, concluding “their findings do not inspire confidence”); 1997 COMMISSION REPORT, supra note 46, at 51 (“The Commission has reviewed numerous machines designed to detect explosives in cargo, checked baggage, carry-on bags, and on passengers. There is no silver bullet. No single machine offers a solution to the challenges we face. Each machine has its own advantages and its own limitations. Even machines that work fairly well in the laboratory need to be tested in actual use at busy airports.”); Shephard W. Melzer, Report on Aviation Safety Committee on Aeronautics of the Association of the Bar of the City of New York, 64 J. AIR L. & COM. 771, 821–22 (1999) (reviewing current technologies, concluding that “[a] foolproof or ‘complete detection’ system simply does not exist”). Lack of sound science continues to be a problem. Congress in the Aviation and Transportation Security Act has attempted to address this problem by increased funding, requiring adoption of new technology, and mandating further agency research. See Aviation and Transportation Security Act, Pub. L. No. 107-71, §§ 137, 120, 112, 115 Stat. 597, at 637, 629, 620 (2001) (codified as amended primarily in scattered sections of 49 U.S.C.) [hereinafter ATSA].

were finalized shortly before the September 11 attacks. In both instances, the FAA adopted a decentralized approach to security program management. Both aircraft operators and airport operators are required to file a security “plan” and designate a security coordinator. And although the regulations state specific requirements which each security plan must meet, most of the details are left to each individual plan. This is because each plan will be different for each airport or airline in important respects, and each will include information which should remain confidential.

A special focus on the regulation of screeners was mandated by the 1996 Act, with proposed rules ultimately forthcoming several
years later. In 2000, Congress passed the Airport Security Improvement Act, directing specific additions to the rules governing training, security, and background checks. The FAA had just finished the final rules when the attacks came on September 11, 2001.

The September 11 attacks were a double challenge for the airlines: they created a safety crisis and exacerbated the existing financial crisis. As for airline safety, just as Pan Am Flight 103 changed the face of air terrorism, September 11 changed it again. The use of the airplane as a weapon against others was as new as bombing for its own sake was in 1988. Air travel security assumed unquestioned primacy, as the risk of failure increased by orders of magnitude not previously imagined. As for the financial problems, the resulting costs and precipitous drop in passenger traffic were nearly fatal to an industry already on the verge of financial collapse before the attacks.

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69 See id. §§ 2–4, 114 Stat. at 2517–21. In particular, Congress mandated adoption of the proposed rule, see supra note 67, as a final rule, with additions and responses to comments, by May 31, 2001. Id. § 3(a), 114 Stat. at 2519.
71 See Keith Sealing, Thirty Years Later: Still Playing Catch-Up with the Terrorists, 30 Syracuse J. Int’l L. & Com. 339, 342–49 (2003) (describing the four phases of aircraft-based terrorism: the first prior to Lockerbie, the second between Lockerbie and September 11, the third after September 11, and the fourth beginning in November 2002 with the use of shoulder-launched missiles fired at commercial aircraft).
72 See Karber, supra note 44, at 791 (demonstrating how the September 11 attacks are literally “off the charts” of past experience with commercial aviation terrorist attacks). There is, of course, serious debate about whether such events should have been or were “imagined” before. See id. at 789 (discussing the “only known prequel to September 11,” a 1994 attempt to hijack an aircraft to be flown into the Eiffel Tower).

The irony of this “war” [on terrorism] is that it is unintentionally exacerbating the financial dilemma of an industry already squeezed with exorbitant losses. These losses are the result of first, declining revenues cause[d] by a global macroeconomic slowdown, decreasing passenger traffic, and lower airline pricing power; and second,
Congress tackled the financial problem first, as it was the more critical of the two.\textsuperscript{74} The Air Transportation Safety and System Stabilization Act ("ATSSSA") was passed only eleven days after the attacks.\textsuperscript{75} Its main purpose was to provide immediate financial stability,\textsuperscript{76} with $5 billion in direct compensation and $10 billion in credit for the airlines.\textsuperscript{77} A key additional component to assuring the industry’s survival was a limitation on liability for injuries and damage suffered in the attacks.\textsuperscript{78} At this point, an important last-minute\textsuperscript{79} addition was made in the law.

It was here that the plaintiffs’ trial lawyers and Congressional Democrats stepped in, arguing that Congress could not limit the rights of the victims without providing an alternative remedy. Congressional staffers therefore conceived of the Victim Compensation Fund, which would provide compensation to September 11th victims from the United States Treasury on a no-fault basis.\textsuperscript{80}

Although this might be considered simply a legislative "quid pro quo" for the liability limitation on the airlines’ part, another motivation of Congress in establishing the Victim Compensation Fund was to provide “rapid closure” for the victims of the attacks.\textsuperscript{81}

\textsuperscript{74} See James P. Kreindler & Brian J. Alexander, September 11 Aftermath: A Perspective on the VCF and Litigation, AIR & SPACE LAW., Winter 2004, at 1, 18 (Winter 2004) (citing 147 CONG. REC. S9589 (daily ed., Sept. 21, 2001) (statement of Sen. Leahy) ("If Congress does not pass this legislation today, it is likely that all of our Nation’s air carriers would cease service next Wednesday.")).


\textsuperscript{76} See Kreindler & Alexander, supra note 74, at 18 ("Disregarding the airlines’ dire financial plight before September 11, the aviation lobbyists were singularly focused on leveraging this event [the September 11 attacks] to create a federally funded bailout of the entire aviation industry.").

\textsuperscript{77} ATSSSA § 101(a) (2001).

\textsuperscript{78} Id. § 408(a); see Robert M. Ackerman, The September 11th Victim Compensation Fund: An Effective Administrative Response to National Tragedy, 10 HARV. NEGOT. L. REV. 135, 143 (2005) (discussing legislative background).

\textsuperscript{79} See Kreindler & Alexander, supra note 74, at 18 ("Notably, the [Victim Compensation Fund] portion of the legislation was hastily drawn up just two days before the Act became law.").

\textsuperscript{80} Ackerman, supra note 78, at 143 (footnotes omitted). The legislation is Title IV of the ATSSSA, which is separately titled the "September 11th Victim Compensation Fund of 2001." See ATSSSA §§ 401-09.

\textsuperscript{81} See Robert L. Rabin, The Quest for Fairness in Compensating Victims of September 11, 49 CLEV. ST. L. REV. 573, 575-78 (2001) (describing the fund as not just a quid pro quo for limited liability, but reflecting the “love-hate relationship the American pub-
Next came the problem of restoring confidence in the safety and security of the air transport system. It was clear that fundamental changes were required. Congress made many of those changes in the Aviation and Transportation Security Act ("ATSA"), creating a new Transportation Security Administration ("TSA") in the Department of Transportation, and writing new rules for aircraft security, mandating screening of all checked bags and cargo, and reassigning the authority for screening passengers and property.

lic has with its tort system," in this instance allowing injured parties to bypass the traditional tort system in favor of quick, certain compensation). Much of this is conjecture, as is often the case with emergency legislation of this sort. "[A]t the time of passage, few people were inclined to question the philosophy or mechanics of the Fund. The Fund reflected the national outpouring of grief and sympathy in the wake of the unprecedented attacks of September 11th. The terrorist missions were attacks on the nation, and Congress and the public regarded it as altogether fitting that the nation as a whole should provide relief to the most directly affected victims." Ackerman, supra note 78, at 144. An interesting question is whether there is any social consensus about the appropriate national response to victims of terrorist attacks, which may unfortunately become an important question in the twenty-first century. See Rabin, supra, at 587–89 (discussing whether the September 11th Victim Compensation Fund is a model for the future).

"For the first time, terrorists don’t want only to make a political statement with the hijacking of one of our airplanes or the destruction of an airplane. They have actually taken our airplane and used it as a guided bomb—a 400,000-pound bomb." Scott McCartney, Airline Pro’s Altered Perspective—To Restore Public Confidence, Continental’s CEO Urges U.S. to Take Over Security, WALL ST. J., Sept. 21, 2001, at B1 (quoting Continental Airlines chief executive officer Gordon M. Bethune); see also U.S. DEP’T OF TRANSPORTATION, REPORT OF THE SECRETARY’S RAPID RESPONSE TEAM ON AIRPORT SECURITY 1 (2001), available at http://www.dot.gov/affairs/airportsec.htm ("Extraordinary challenges require extraordinary measures. The terrorist attacks on America of September 11, 2001 require that we reform our Nation’s aviation security system in fundamental ways.").


ATSA § 110(c), (f), 115 Stat. at 615. The TSA’s new regulations reflect those changes. See Civil Aviation Security Rules, 67 Fed. Reg. 8340, 8345 (Feb. 22, 2002) (to be codified at 49 C.F.R. pt. 1544) (detailing the new requirements of the ATSA). Compare 49 C.F.R. §§ 1544.203(c), 1544.205(b) (2005), 67 Fed. Reg. at 8367 (mandating screening of checked baggage and cargo), with 14 C.F.R. §§ 108.203, 108.205 (repealed) (no such language). The scanning of checked baggage was, of course, a major focus after the bombing of Pan Am Flight 103. As to cargo, see Security Programs for Aircraft 12,500 Pounds or More, 67 Fed. Reg. 8205, 8206 (Feb. 22, 2002) (to be codified at 49 C.F.R. pts. 1540, 1544) ("[T]he events on September 11, 2001, demonstrate the ability to use aircraft to endanger persons on the ground. An aircraft so used is just as dangerous whether it holds cargo or passengers.").
One of the major questions before Congress was whether the responsibility for screening would remain with aircraft operators or become the direct responsibility of the federal government. The compromise reached in the ATSA was to make screening initially a job done directly by federal employees, provided that private companies could apply to take over the screening after two years. In the interim, TSA has operated a pilot program of supervised private screening at five airports, dubbed the “PP5” program. A fifteen-month study commissioned by TSA concluded (though based on limited data) that the screening at the five airports was not significantly different in terms of cost or effectiveness from the federal program. TSA now plans to expand privatization with the successor to PP5, the “Screening Partnership Program.” Although the impact on passen-

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92 See GUIDANCE ON SCREENING PARTNERSHIP PROGRAM, supra note 89, at 6.
gers and operators was an important factor in the initial study, TSA officials sought to provide assurance that the program’s main focus continues to be security assurance.

[S]ecurity has been and will remain our top priority. The utilization of private contractors in the PP5 program did not lead to a rollback of security or to a reversion to the type of screening operations that were conducted prior to the September 11, 2001 attacks. We managed the PP5 program with security first and foremost on our minds and in keeping with the requirements of ATSA, and security will remain our most important consideration as we move forward on implementing the Screening Partnership Program.

Despite this assurance, TSA’s own guidance for private contractors continues to stress customer service and management efficiency equally with security as criteria for selection, although the ATSA mandates only “the level of screening services and protection” as the sole standard for private companies. This result is in accord with regulatory theories suggesting that, where efficiency is not the sole goal, government intervention may be permanently necessary.

The failure of the pre-September 11 approach was that the delegation to the airlines did not adequately account for safety as a regulatory goal, either because the airlines did not recognize safety as a factor that should be fully internalized or devoted insufficient care to protecting safety. In retrospect, this lack of recognition is not completely surprising: although efficiency in a broad sense includes safety, matters such as health and safety are sometimes viewed from a regulatory standpoint as going beyond efficiency.

The Screening Partnership Program seeks to maintain just such a strong federal presence while permitting private control. It allows airports to apply to have screening done by private companies, but it must be done only by a list of TSA-approved “Qualified Vendors” who

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95 See 49 U.S.C. § 44920(d)(1) (Supp. II 2002) (as amended by ATSA § 108(a)).

96 Schwarcz, supra note 29, at 348.
operate under contract with TSA directly. In addition, there remains at each airport a Federal Security Manager with overall responsibility for screening. This suggests that Congress was unwilling to surrender very much control to the private screeners. This sentiment is echoed for the moment by the airports, as the response to the Screening Partnership Program has been lukewarm.

The response to the September 11 hijackings shows that Congress, motivated to act quickly and decisively, responded by a complete, though perhaps temporary retreat to federal control. Although the hijackings themselves did not create a systemic crisis, the nearly palpable public fear of flying on a commercial airliner in the United States, exacerbating the airlines critical financial conditions, did create such a crisis.

The September 11 attacks introduced a unique characteristic through the fear factor that directly impacts the future development of air transport. As a result, the grim task of restoring passenger confidence stands in the way of the economic revival of the air transport industry.

To deal with the “fear factor,” direct federal control was required over the problem areas of passenger and baggage screening. The
need for clear federal control, however, has been balanced by congressional mandate with reliance on private industry, although that reliance outside of official public statements remains hesitant at best in the light of its perceived continuing failures. Furthermore, it appears that the post-September 11 emphasis in the airline industry is a return to customer satisfaction, which involves less of a focus on safety than on service. It is likely that continued public constraint of the private industry approach may be necessary for the foreseeable future.

B. Public Accounting Quality Assurance

It is difficult to determine exactly why there was a crisis in public accounting. It is easy to determine when; its epicenter can be placed precisely with the decline and fall of Enron in November and December of 2001 and WorldCom in June of 2002. There were other revelations of accounting frauds at various other companies before and after these cataclysmic events, but it is these two that spurred the type of public action characteristic of a crisis response.

The meteoric collapse of Enron from its first announcement of problems in October 2001 to its bankruptcy in December revealed problems with the management, to be sure, but the focus quickly moved to the complicity of others, particularly Arthur Andersen LLP, Enron’s auditors. Other similar frauds disclosed at the same time began to create a climate demanding change. The crowning blow came

Donald J. Carty, former Chairman and CEO of AMR Corporation) (commenting on how the federal government’s role should be “[t]aking responsibility for security and safety oversight . . . and freeing up the market as much as [possible].”).

See supra text accompanying note 93 (statement of TSA official).

Niles, supra note 20, at 413.

Abeyratne, supra note 73, notes that before September 11, the industry “was already affected by unsustainable slot congestion, ineffective management, and unconscionable flight delays, all of which inevitably resulted in some airlines going out of business.” Id. at 4. The section of the article entitled “Restoring Passenger Confidence” is about service-based competition rather than safety concerns. Id. at 4–26.

See Schwartz, supra note 29, at 337 (indicating that government safeguarding of non-efficiency-based goals will be necessary when relying on private regulation).
with WorldCom’s “confession” on June 25, 2002 of a $3.8 billion fraud which, unlike Enron’s, was an astonishingly simple and old ruse, again over the unqualified opinion of its auditor, Arthur Andersen. Adding fuel to the flames was the agonizing sell-off in the stock markets which began in March 2000 and would ultimately drain over $8 trillion of wealth from the nation’s investors. The decline was attributed in part to the management and auditing failures.

Corporations have imploded in fraud and stock market bubbles have burst many times before without creating a crisis. However, the unprecedented speed and magnitude of the declines led many to conclude broadly that the financial information which fueled the country’s stock markets and investments was or was becoming completely unreliable. Consider the following contemporary account of reaction to the events:

BLOOMENTHAL, supra note 107, § 6, at 12 (“The [WorldCom] announcement staggered the financial world because of the size of the overstatement and the simplicity of the fraud classifying apparent operating expenses as capital expenditures.”).


See, e.g., Richard A. Oppel, Jr., Negotiators Agree on Broad Changes in Business Laws, N.Y. TIMES, July 25, 2002, at A1 (observing that “the scandals at Tyco, Adelphia and WorldCom, and the perception that the fall in the stock market stemmed from a loss of investor confidence, made it increasingly risky for any politician to object” to proposed reforms). See also Brian Kim, Recent Development, The Sarbanes-Oxley Act, 40 HARV. J. ON LEGIS. 235, 235 (2003) (citing congressional testimony from, among others, former Federal Reserve Chairman Alan Greenspan and the observation that “[t]he disclosures [by Enron and others] shook the public’s confidence and contributed to a sharp decline in the stock market”). Consider, however, the following reporter’s “confession”:

I was occasionally assigned to write the daily dollar or stock market stories . . . to find out where the dollar finished against other major currencies, or to ascertain why the Dow Jones Industrial Average moved up or down. I was always amazed that whichever way the markets moved, whether the dollar fell or rose, some analyst always had a pithy one-liner explaining why $1.2 trillion in transactions on six different continents across twenty-four different time zones resulted in the dollar falling or rising against the Japanese yen by half a penny. And we all believed this explanation.


See Cunningham, supra note 107, at 927 (“The upshot was the wholesale questioning of the quality of financial reporting throughout corporate America.”); Bratton, supra note 108, at 1023 (“The stock market awakened in 2002 to discover that it no longer had numbers it could trust.”); Aronson, supra note 110, at 127 (“Shaken to the core [by the September 11 terrorist attacks and the series of accounting scandals], many American investors, who had enjoyed one of the great bull markets of all times, came to a number of numbing conclusions. First, internal and external audit-
[T]he country is beginning to reappraise the celebration of free-market forces that marked the 1990s. And early political tremors of public opinion hint at greater fallout to come.

. . . .

Political momentum to restrain government regulation is waning. As they await the government’s response to a wave of business scandals, six in 10 Americans say they are worried regulators won’t go far enough. Thus a global, existential, unprecedented threat, or “crisis,” was born. Uncertainty and risk change the calculus in the financial markets. Perceptions matter because “[t]he foreboding could become self-fulfilling, if it paralyzes people and companies. . . . [G]enuine risk is an unsettling concept.” Risk is not normally expected from audits, as audits are intended to reduce risk and increase uniformity—“the potential loss of confidence in our accounting firms and the audit process is a burden our capital markets cannot and should not bear.”

Although the crisis was new, the subject was not. The state of public company financial accounting regulation in the United States in early 2002 was similar to that of aviation safety as previously described, namely, federal oversight with private entity first-line responsibility. Upon passage of the federal securities laws in 1933 and 1934, the idea of having government employees audit public company financial statements was discussed, but dismissed as impractical.
Penn Central crisis in 1972 brought unsuccessful calls for federal regulation of auditors. There were reforms a few years later, prompted by the investigations of illegal foreign payments by U.S. companies. And the idea of federal regulation surfaced again in the late 1980s, as the Securities and Exchange Commission (“SEC”) considered requiring “peer reviews” of auditors of public companies. The SEC settled instead for a supervised private arrangement. Every auditor of public companies was required to become a member of an industry trade group with peer reviews by accounting firms of each others’ audits. A separate independent group, the Public Oversight Board (“POB”), was given the task of evaluating the peer review process itself. In the 1990s, other reform efforts focused on improving the independence of auditors from their clients with the creation of the Independence Standards Board, whose work was later assumed by the SEC.

With the crisis of 2001–02, however, came a new and very visible federal response. Upon the announcement of the WorldCom fraud, the SEC ordered nearly one thousand public companies to immediate hearings that preceded the Securities Act of 1933, and the resulting decision to rely on the private sector has not been challenged seriously in the intervening seven decades.”)

118 See Weismann, supra note 108, at 110.
122 That trade group is the SEC Practice Section (“SECPS”) of the American Institute of Certified Public Accountants. Nearly all firms auditing public companies are members of the SECPS. See Michael, supra note 120, at 215 n. 281.
ately certify the accuracy of their financial reports.\textsuperscript{124} The Commission noted:

In light of recent reports of accounting irregularities at public companies, including some large and seemingly well-regarded companies, the purpose of the Commission’s investigation is to provide greater assurance to the Commission and to investors that persons have not violated, or are not currently violating, the provisions of the federal securities laws governing corporate issuers’ financial reporting and accounting practices . . . .\textsuperscript{125}

It seems that the Commission, “so much taken aback”\textsuperscript{126} by the stunning frauds culminating with WorldCom, acted in a manner analogous to the FAA’s grounding of airplanes on September 11, to provide a baseline of assurance and to calm investors. The relatively strong and immediate federal presence is consistent with the kinds of reaction necessary to assuage fear and create the appearance of control and confidence.

In a further effort to strengthen federal oversight of public auditing, the Commission proposed a new independent board to oversee peer reviews.\textsuperscript{127} Faced with this lack of support and having earlier been stripped of major funding, the POB voted to dissolve.\textsuperscript{128} The SEC’s proposal, in turn, is widely considered to have been intended to create an incentive for Congress to act, as an accounting reform bill had passed the House but was appearing to stall in the Senate.\textsuperscript{129} The WorldCom revelations supplied additional pressure,\textsuperscript{130} and the

\textsuperscript{125} Id.
\textsuperscript{126} BLOOMENTHAL, supra note 107, § 7, at 15.
\textsuperscript{127} See generally SEC Auditor Oversight Proposal, supra note 119.

The drive for an overhaul of the industry seemed to lose steam after public outrage peaked over Enron earlier this year. The House in April passed an industry-backed bill that punted the most difficult decisions about how tough to be to the SEC . . . .

. . . The SEC plan prompted Senate Republicans to cave in to Democratic demands for a tough measure, reviving a bill that had been written off as dead.

\textsuperscript{130} Id.
\textsuperscript{130} BLOOMENTHAL, supra note 107, § 9, at 20 (explaining that the WorldCom revelation “sealed the Congressional fate of financial fraud reform legislation”); Kim, supra note 111, at 240–41 (“The political climate changed dramatically when the succession of scandals burst into the media coverage.”). See generally Larry E. Ribstein,

Although the Sarbanes-Oxley Act made wide-ranging changes,\footnote{Press Release, White House Office of the Press Sec., President Bush Signs Corporate Corruption Bill, (July 30, 2002), http://www.whitehouse.gov/news/releases/2002/07/20020730.html.} most were codifications of current practice or modest changes in corporate law. Truly dramatic changes, however, were made to the auditing and accounting standard setters and regulators.\footnote{Bloomenthal calls it “a securities regulation smorgasboard.” \textsc{Bloomenthal, supra} note 107, § 10, at 21.} The Act created a new Public Company Accounting Oversight Board (“PCAOB”) and requires it to inspect the firms auditing public corporations.\footnote{Sarbanes-Oxley Act of 2002 §§ 101–05, 15 U.S.C. §§ 7211–16 (Supp. II 2002).} In addition, the Act mandates that the PCAOB set auditing standards.\footnote{Id. § 103, 15 U.S.C. § 7213. The PCAOB has the authority to adopt existing standards as “initial and transitional” standards. \textit{Id.} § 103(a)(3)(B), 15 U.S.C. § 7213(a)(3)(B).} The Act also moves the funding of the current accounting standard-setter, the Financial Accounting Standards Board (“FASB”), from a private industry group endowment to a fee levied on public companies.\footnote{Id. § 109(e), 15 U.S.C. § 7219(e). The FASB is not mentioned by name as the standard setting body, but this was clearly Congress’ intent. \textsc{Senate Comm. on Banking, Hous., and Urban Affairs, Public Company Accounting Reform and Investor Protection Act of 2002, S. Rep. No. 107-205, at 13 (2002)} (“The bill seeks to formalize the SEC’s reliance on the FASB . . . .”). The SEC has in fact so recognized the FASB. \textit{Commission Statement of Policy Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter, Securities Act Release No. 8221, Exchange Act Release No. 47,743, Investment Company Act Release No. 28,028, 68 Fed. Reg. 28,333 (May 1, 2003).}} The PCAOB was given the discretion by the Act to continue the present arrangement regarding auditing standards, that is, reliance on the American Institute of Certified Public
Accountants’ Auditing Standards Board.\textsuperscript{138} The PCAOB declined this invitation,\textsuperscript{139} and although the pre-Act standards have been adopted on a transitional basis,\textsuperscript{140} the PCAOB has made clear its intent to review every existing standard and change them where necessary.\textsuperscript{141}

None of the reforms proposed in the wake of the Enron/WorldCom revelations had suggested replacing the private accounting profession with a federal staff, as was done with the airline baggage inspectors.\textsuperscript{142} Nonetheless, the private arrangement consisting of the private board was replaced, not with a government agency,\textsuperscript{143} but one nonetheless under tight government control.\textsuperscript{144} And, importantly, the PCAOB was not a preexisting private sector arrangement blessed by Congress, but a private entity created for solely

\begin{footnotes}
\item[141] PCAOB Release No. 2003-005, supra note 139, at 10 (“[T]he Board will establish a schedule for the review of all Interim Professional Auditing Standards. The Board intends to commence this review as soon as possible. The objective of the review will be to determine, on a standard-by-standard basis, whether the Interim Professional Auditing Standards should become permanent standards of the Board, be repealed, or be modified.”); see also Nagy, supra note 134, at 992 & n.79.
\item[142] One proposed amendment to the House version of the bill would have created a “Federal Bureau of Audits” within the SEC to perform the audits of financial statements required under the securities laws. 148 Cong. Rec. H1537, 1567 (daily ed., Apr. 24, 2002). The sponsors of this amendment likened the federal audit corps to the FBI, \textit{id}. at H1571 (remarks of Rep. Kucinich), and the federal bank examiners, \textit{id}. at H1573 (remarks of Rep. LaFalce). The amendment failed by a vote of thirty-nine to 381. \textit{Id}. at H1573–74.
\end{footnotes}
public purposes. The combination of the SEC’s initial immediate certification of financial statements and Congress’s creation of a new board with centralized control and authority shows a paradigmatic crisis response. Will there be a return to reliance on private groups? As stated above, the PCAOB’s initial indication is that it does not intend to return auditing standards to private control. However, the prognosis for the PCAOB’s exercise of active, vigorous control remains mixed.

III. CRISIS PAST

This Part discusses historical comparisons to the events of 2001–02 from two very different places and times. First, I discuss the meat and poultry industry and the crisis faced approximately a century ago. Then, I discuss the bank and thrift industry during crises in the Great Depression and in the late 1980s.

A. Meat and Poultry Processing

It is widely recognized that the publication of Upton Sinclair’s novel, *The Jungle*, in February 1906 precipitated a crisis of sorts in the American meat packing industry.

Millions of Americans were sickened by Sinclair’s vivid descriptions of the abominably filthy conditions in American meat processing.

... [T]he novel galvanized public support behind the idea for pure food and drug and meat inspection legislation. ... [T]he federal government, prodded by Sinclair’s exposé, assumed the responsibility for ensuring sanitary production of food products.

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145 It is in this respect that the PCAOB differs markedly from any self-regulatory organization or government corporation which came before it. Nagy, supra note 134, at 1022–29.

146 Compare Bratton, supra note 108, at 1026–27, 1032 (contending that supervised self-regulation will be an efficient model so long as the supervisor—here, the PCAOB—avoids “capture” by the industry), with Weismann, supra note 108, at 126–27 (criticizing the continued reliance on private advisory groups, concluding that “the PCAOB emerges as a weak rule-making authority rather than a proactive supervisory agent of the SEC” and that the PCAOB “believes it can regulate standards but not morality, which is considered to be the key to infusing investor confidence in the marketplace”).

Although the campaign for pure food and drug laws had been building since the 1880s,\textsuperscript{148} the stark revelation of the conditions in the packing houses had an immediate, paralyzing impact on the beef processing industry in the United States. Demand for meat dropped by half or more following the publication of Sinclair’s book: \textsuperscript{149} Meat outlets felt immediate effects. Trade in lard, sausage, and canned goods came almost to a standstill. Hundreds of consumers who usually bought steaks and chops contented themselves with fresh fruits and vegetables. Restaurants reported a vast decline in business.\textsuperscript{150} It was largely Sinclair’s work that created the atmosphere necessary for the ultimate success of the movement.\textsuperscript{151} His book was read carefully by President Roosevelt, who ordered his own separate inspection of the packing houses.\textsuperscript{152} He threatened to release the results of this study to the public unless Congress acted swiftly and forcefully on the question,\textsuperscript{153} and he actively helped broker a compromise.\textsuperscript{154} The re-

\textsuperscript{148} Richard A. Merrill & Jeffrey K. Francer, Organizing Federal Food Safety Regulation, 31 SETON HALL L. REV. 61, 79 (2000) (“Congress prohibited food adulteration in the District of Columbia in 1879, but it took nearly thirty more years and the defeat of 190 bills before legislation was passed to prohibit the marketing of adulterated food in interstate commerce.”). For a history of food and drug reforms in the decade preceding Sinclair’s novel, see OSCAR E. ANDERSON, JR., THE HEALTH OF A NATION: HARVEY W. WILEY AND THE FIGHT FOR PURE FOOD 120–96 (1958).

\textsuperscript{149} See JAMES HARVEY YOUNG, PURE FOOD: SECURING THE FEDERAL FOOD AND DRUGS ACT OF 1906, at 231 (1989); STEPHEN WILSON, FOOD & DRUG REGULATION 37 (1942).


\textsuperscript{151} See JIMMY M. SKAGGS, PRIME CUT: LIVESTOCK RAISING AND MEATPACKING IN THE UNITED STATES 1607–1983, at 123 (1986) (“While it has become fashionable among some revisionist historians to denigrate and superciliously dismiss ‘the twelfth-hour impact of . . . The Jungle,’ the sensational book unquestionably riveted public attention on the appalling conditions in meatpacking.”).

\textsuperscript{152} See GOODWIN, supra note 150, at 250–51, YOUNG, supra note 149, at 231–35, WILSON, supra note 149, at 36–37.

\textsuperscript{153} See GOODWIN, supra note 150, at 251; YOUNG, supra note 149, at 235–36 (“[Roosevelt] had begun to consider the threat of announcing to the nation the . . . discoveries as a valuable club to hold over the heads of packers to get them to acquiesce in a remedial law.”). Ultimately, the President had to make good on his threat. The assessment of the impact of the release of the report is mixed. Compare GOODWIN, supra note 150, at 250 (“The [release of the] report touched off a meat scandal of unprecedented proportions.”), with YOUNG, supra note 149, at 241 (“The . . . report struck both public and Congress as somewhat déjà vu. It made no new revelations and cited no incidents of dead workers contaminating the food supply [as a famous passage from The Jungle had done]. Nevertheless, the report’s straightforward prose, describing what the two social workers had seen, even after frantic efforts by packing companies to clean up, had a sobering impact.”).

\textsuperscript{154} YOUNG, supra note 149, at 246 (“[T]he president stood at the center of the compromising efforts to fashion a meat-inspection bill that both Senate and House
resulting legislation was the predecessor to the Federal Meat Inspection Act,\(^{155}\) and was passed only four months after publication of Sinclair’s work.\(^{156}\)

A largely voluntary inspection system was replaced with pervasive direct federal control. Federal inspection was considered a key part of restoring consumer confidence.\(^{157}\) The first act required, and the law still requires,\(^{158}\) a federal employee to inspect and approve, by a label or stamp, each animal and meat or poultry product sold in interstate commerce.\(^{159}\)

Would accept. His Cuban experiences [with tainted meat served to armed forces in the Spanish-American War], his continuing legal involvements with the beef trust, his moral judgments, the degree of public agitation, all impelled Roosevelt to desire prompt enactment of such a law.


\(^{156}\) \textit{Young, supra} note 149, at 229–51; \textit{Anderson, supra} note 148, at 188–94 (chronicling events from The Jungle’s publication in February to the passage of the Department of Agriculture appropriation act and the Pure Food and Drug Act on June 30, 1906). Sinclair’s book also indirectly spurred rapid consideration and passage of the Pure Food and Drug Act; \textit{see Peter Temin, Taking Your Medicine: Drug Regulation in the United States 29} (1980) ("Public outrage over The Jungle was used by advocates of general legislation on adulteration to secure passage of their act, even though it did not refer to and was separate from a bill on the inspection of meat packing.").

\(^{157}\) \textit{Wilson, supra} note 149, at 37 ("[T]he packers favored government inspection as the only means of restoring public confidence."). The only real question was whether the inspectors would be paid by the packers or by the taxpayers (the latter were ultimately tagged with the costs). \textit{Young, supra} note 149, at 248–50.

\(^{158}\) \textit{See Merrill & Francer, supra} note 148, at 79 ("The [Meat Inspection Act of 1906] established the program of continuous examination by resident federal inspectors in meat processing facilities that persists to this day.").

As the industry and government regulation developed, the worst abuses were curbed, to be sure, but federal meat inspectors remained at the focal point of the federal quality assurance program.

In the late 1980s and early 1990s, the Department of Agriculture’s Food Safety and Inspection Service (“FSIS”) experimented with supervised self-regulation in both meat packing and meat processing, but with limited success. In addition, the focus of meat and poultry processing problems was being drawn more to microscopic pathogens, against which the traditional visual inspections were a poor safeguard. In 1996, FSIS directed meat and poultry processors to supplement the federal inspection with a type of process regulation known as Hazard Analysis and Critical Control Point (“HACCP”) regulation. HACCP represents a shift from traditional “command-and-control” regulation to process regulation through performance standards, rather than product regulation through traditional organoleptic inspection.

The modern impact of the inspection stamp is unclear. Compare James A. Albert, A History of Attempts by the Department of Agriculture to Reduce Federal Inspection of Poultry Processing Plants—A Return to the Jungle, 51 LA. L. REV. 1183, 1191 (1991) (“Consumer confidence is absolutely essential to the food processing industry. . . . The USDA label on poultry products signifies to the public that the food has been prepared in a sanitary plant under federal government inspection, that it meets government standards for wholesomeness, and that it is safe to eat.”), with id. at 1228 (noting criticism of reliability of poultry inspections), Roger Roots, A Muckracker’s Aftermath: The Jungle of Meat-Packing Regulation After a Century, 27 WM. MITCHELL L. REV. 2413, 2426 (2001) (“The sad reality is that federal meat inspection laws have never been seriously designed to do anything other than placate the public’s post-Jungle fears of meat contamination.”), and Dion Casey, Student Article, Agency Capture: The USDA’s Struggle to Pass Food Safety Regulations, KAN. J.L. & PUB. POL’Y, Spring 1998, at 142, 148 (noting current unreliability of USDA stamp of approval because of inspectors’ failure to detect microbial pathogens).

See, e.g., SKAGGS, supra note 151, at 215 (noting U.S. and foreign meat packing standards); Merrill & Francer, supra note 148, at 68 (“Government officials regularly claim that the U.S. food supply is the safest in the world, a claim we have no basis for disputing.” (footnote omitted)).

See SKAGGS, supra note 151, at 210–11 (noting that inspectors are overworked and pressured to approve diseased or spoiled meat).

See generally Michael, supra note 29, at 562–70 (meat processing reforms); Albert, supra note 159, at 1186–93 (poultry processing regulation reforms).


Under the command-and-control-based system, the inspector assumed responsibility for “approving” production-associated decisions. Under the new system, industry assumes full responsibility for production decisions and execution. FSIS, having set food safety standards, monitors establishments’ compliance with those standards and related requirements and under HACCP, verifies process control and pathogen reduction and control.\(^{165}\)

The conceptual shift is important. Rather than focusing on the products, “HACCP provides process control to prevent food safety problems before they happen.”\(^{166}\) HACCP was developed in response to scientific advances in the understanding of food safety and, in some cases, the industry’s increases in capacity.\(^{168}\) This dramatic change\(^{169}\) developed over several years, but like the original 1906 act, was precipitated by crisis. In this case, the crisis was a 1993 outbreak of \textit{E. coli} poisoning in the northwest United States traced to hamburgers eaten at Jack-in-the-Box restaurants.\(^{170}\) HACCP has been recognized as beneficial for food processing generally, and has been adopted by the Food and Drug Administration (“FDA”) for processing in several specific food industries,\(^{171}\) with a pilot program investigating the utility of the HACCP approach for regulation of food supply safety generally.

Reviews since HACCP’s implementation for meat and poultry, animals, and products have been mixed. HACCP has not prevented

\(^{165}\) \textit{Id.}, 61 Fed. Reg. at 38,808.

\(^{166}\) Fortin, \textit{supra} note 32, at 566.

\(^{167}\) See id. at 566–67 (noting that HACCP’s origins were in preparing food for the space program, where any sicknesses could be catastrophic).

\(^{168}\) See Albert, \textit{supra} note 159, at 1186.

\(^{169}\) \textit{Margaret O’K. Glavin, HACCP: We’ve Only Just Begun, 56 FOOD & DRUG L.J. 137, 137 (2001) (favorably comparing the publication of \textit{The Jungle} and the 1906 Act with “another such revolution,” namely, the mandating of HACCP by the FSIS).}


major outbreaks; indeed, the largest single beef recall ever occurred in 1997 at a plant with full HACCP controls. In order to be successful, experience has taught that the regulated entities must be faithful and complete in their record keeping, which forms the basis for the government’s approval of the packer’s process controls. They must be motivated to fully embrace the HACCP concept. The motivation is supplied in the main by having a HACCP program based in “sound science,” that is, one that results in a safer end product. There remains a further need for retraining at the agency, which must “reinvent” itself from a product regulator to a process regulator. And most importantly, there needs to be a mechanism to deal with the inevitable failure that will result even in the best systems, and to verify that the HACCP plan is “scientifically valid, complies with FSIS regulations, and is being fully implemented.” Indeed, one of the main conceptual problems with the extension of HACCP is that it is moving from areas where sound programs will result in no failures, to raw meat and poultry products, where there will be some acceptable level of contamination.

HACCP regulations have faced some difficulties in the courts. HACCP procedures have been held to be inconsistent with the statutory command for actual direct federal inspection of each animal and product. In addition, courts have found no statutory basis for HACCP’s fundamental scheme of product quality assurance, holding that the government in an enforcement action must still show that the food product has been adulterated or that the processing is un-

173 Casey, supra note 159, at 154–55.
175 DeWaal, supra note 170, at 332 (concluding that “[w]ithout this motivation, HACCP would be little more than a paperwork exercise without significant public health impact”).
176 Glavin, supra note 169, at 138 (noting that workforce expertise and training continue to be problems).
177 Id. at 139.
178 See DeWaal, supra note 170, at 333 (“Measuring the effectiveness of HACCP on raw products is problematic, because it is expected that some pathogenic bacteria still will exist on the product.”). This has been a problem discussed in a recent enforcement case, where the packer argued successfully that the meat was contaminated prior to entering the plant. See infra note 180 and accompanying text.
These problems are only statutory, but Congress may be reluctant to change the century-old requirement for individual physical inspection of each animal and product. Nor is Congress likely to require that meat and poultry processors assure the cleanliness of each product no matter what its condition on entry to the plant.

In sum, HACCP is a revolutionary program with revolutionary problems. It is designed to have the regulated entities as partners, when to date they have embraced the strong public assurances given by direct federal inspection. It is designed to use science that tells us what will work to eradicate the problem, so that critical control points and processes may be designed to eliminate the problem. It is not designed to deal with failures, although they will generate significant public attention, and hence political attention.

Although we are now one hundred years after the crisis of *The Jungle*, it appears that regulation of meat and poultry processing can be characterized by an immediate and strong direct federal regulatory presence at the outset, in order to restore public confidence. This is done in an industry where confidence is essential to the product, and one processor’s errors can affect the entire demand for the product. Later, as the immediate crisis passed, the federal government turned to the industry for assistance, in some failed self-regulatory efforts and now with HACCP, recognizing that involvement by the regulated entities will be necessary for a successful program.

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180 Supreme Beef Processors, Inc. v. USDA, 275 F.3d 432, 440 (5th Cir. 2001) (finding that the mere presence of salmonella does not violate statute which requires meat to be “rendered” adulterated by the processor in order to result in liability), discussed in Blake B. Johnson, Student Article, *The Supreme Beef Case: An Opportunity to Rethink Federal Food Safety Regulation*, 16 LOY. CONSUMER L. REV. 159 (2004), and LEVENSON, supra note 179, at 26–28.

181 Albert, supra note 159, at 1221 (quoting an official of the American Meat Institute: “Our members’ businesses depend on maintaining consumer confidence in the nation’s meat supply”); id. at 1222 (noting industry’s opposition to relaxation of poultry inspection standards, as the processors “realiz[ed] that the perception of tough federal inspection was essential to maintaining consumer confidence”).

182 See generally DeWaal, supra note 170, at 332–34 (describing the difficulty implementing HACCP where science has not developed to provide for risk eradication but only risk reduction).

183 Some critics have alleged that the involvement of the regulated entities is due to “agency capture” rather than a demonstrated reliance on the abilities of the regulated entities to understand and comply. See Fortin, supra note 32, at 582–84 (describing a “subtle capture” theory as well as the agency’s perspective of its resources and roles as reasons for the lack of full and vigorous implementation of HACCP).
B. Financial Institutions

The nation’s financial institutions faced two crises of confidence: first, the bank failures in the 1930s and then the savings and loan failures in the 1980s. In addition, the nation’s securities brokers and dealers faced a similar problem in the 1960s. The situations and federal responses are analyzed below.\[184\]

1. The Banking Crisis of 1933

The Great Depression resulted in a series of bank failures and panics beginning in 1931, resulting ultimately in the collapse of the United States banking system by March 1933. President Hoover’s initial response to the first bank failures was the creation of the National Credit Corporation in 1931, which was broadened and reorganized as the Reconstruction Finance Corporation (“RFC”) in 1932.\[185\] Hoover regarded the problem as one of confidence in the banking system and relied primarily on the bankers themselves to voluntarily stem the tide of bank runs and failures.\[186\] Fundamentally unresponsive, the banking system’s series of failures and panics continued until the spring of 1933.

\[184\] I have not included the New Deal reforms of the securities markets in this discussion. It is true that the stock market crash of 1929 and the ensuing depression also resulted in a crisis of investor confidence. It is different from the banking crisis because there was no immediate, severe, and disabling reaction. The resulting immediate federal regulation—the Securities Act of 1933, followed by the Securities Exchange Act of 1934—came when it did not because of a disabling crisis, but because of the enormous political opportunity created by the banking crisis. See Joel Seligman, The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance 52 (1982) (discussing “the unique opportunity rapidly to enact (securities) legislation created by the favorable public and congressional response to his handling of the bank crisis just after his inauguration on March 4.”).


\[186\] See Wicker, supra note 185, at 66 (“The contribution of Hoover’s announcement [of the creation of the NCC] to the restoration of confidence in the banking system and to the ending of the panic [in the fall of 1931] has largely been ignored.”); Kennedy, supra note 185, at 43 (“Hoover and the conservative traditionalists believed that if government was to act at all, it had to operate indirectly through established institutions to reinvigorate the credit structure.”); Steven A. Ramirez, The Law and Macroeconomics of the New Deal at 70, 62 Md. L. Rev. 515, 529 (2003) (“Hoover’s approach was largely psychological; his aim was to enhance business confidence. Hoover’s view was that ‘[g]overnment should not coerce, but it could and should cajole.’” (footnote omitted)) (quoting William J. Barber, From New Era to New Deal: Herbert Hoover, The Economists, and American Economic Policy, 1921–1933, at 82 (1985)).

\[187\] The history is fully chronicled in Kennedy, supra note 185, at 22–151; see also Wicker, supra note 185, at 24–32 (events of 1930), 66–78 (events of 1931), and 116–
By March 4, 1933, nearly all of the nation’s banks had been closed because of bank “runs.” In a bank run, depositors who believe that the bank lacks sufficient liquid assets to pay deposits upon demand seek immediate payment. As a result, the fear becomes self-fulfilling as the bank must liquidate assets at “fire sale” prices to meet the increasing demand for withdrawals. Ultimately, a bank facing an unrestrained immediate demand for deposit withdrawals will fail, as many did. The outgoing Hoover administration remained firm in its belief that the industry could and should right itself, and there was nothing done until President-elect Roosevelt took office.

The Hoover administration came late to the support of essential banking reform. As a matter of conviction, the president and his advisers clung to the idea that the banking system remained fundamentally sound and could cure itself. . . . [H]e waited so long to espouse consequential change that the opportunities for passing an effective law had narrowed hopelessly. In the closing days of his term, Herbert Hoover faced a daily worsening of the banking crisis, armed only with the weapons which had failed him in the past.

. . .

By March 1 [1933], therefore, the old and the new administrations had reached a standstill. Hoover feared repudiation too much to take the risk that his last official act would blot what he regarded as an otherwise upright record. Roosevelt, on the other hand, saw no reason to rescue either Hoover or the bankers; their salvation would not improve his position and their fall could offer him some interesting opportunities. In the last analysis, however, no one—neither Hoover, nor Roosevelt, nor the bankers—produced a concrete program to correct either the banking or the gold panic until it was too late to put such measures into effect.

As President, Roosevelt’s first action was to declare a federal “bank holiday,” which was largely moot, as banks had already been
closed by the governors and legislatures in most states. The new president took several immediate steps to assume control and provide security in the midst of the panic. His inaugural address on March 4, 1933, contained the famous “nothing to fear but fear itself” language. On March 6th, Roosevelt declared the bank holiday; on March 9th, Roosevelt called Congress into session to consider emergency banking legislation, which it passed that same day. On March 12th, in the first of what would become his famous “fireside chats,” Roosevelt spoke to an estimated sixty million listeners in plain language about the banking crisis and how it would be resolved. These immediate moves by the federal government served to restore confidence in the banking system.

Banks began to reopen under federal supervision and, in many cases, with federal assistance through the RFC. The scope of this federal investment is often overlooked. The RFC owned nearly a quarter of all bank equity capital by June 30, 1934.

This first step toward stability was followed by the Banking Act of 1933, which made many fundamental reforms, including the creation of the Federal Deposit Insurance Corporation (“FDIC”). Initially,
Roosevelt was opposed to the idea of deposit insurance but eventually accepted it as a compromise. The legislation provided for temporary insurance effective January 1, 1934 and permanent insurance for all banks on July 1, 1934. Only banks certified as solvent by a federal regulator would be eligible for insurance. Additional RFC investment was needed to allow all banks to be certified and insured. This recapitalization of banks averted a second crisis in confidence in the banking system; without it, many banks would have been unable to remain open with FDIC insurance.

Although federal deposit insurance has been viewed as the seminal reform of banking in the United States in 1933, it was, as shown above, a reluctant addition to the package of banking reforms adopted. In fact, given the size and success of the government recapitalization and reorganization of banks, some have questioned why deposit insurance was needed at all. Again, the answer is likely the maintenance of public confidence in the banking system.

Why was deposit insurance . . . considered necessary at all, especially since Congress had already approved public recapitalization as a means of restoring bank stability?[?] One possible explanation is that deposit insurance, through its psychological effect on depositors, would help to guarantee the success of RFC recapitalizations. Confident that they would always have immediate access to their funds even if their bank failed, depositors would not participate in destabilizing runs. This in turn would prevent the renewed drain of deposits from banks newly recapitalized by the RFC.

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198 See KENNEDY, supra note 185, at 222 (discussing compromise and noting that when the bill was ultimately passed, “[f]or all of its provisions, the president claimed full credit, to the amusement or outrage of contemporary and hindsight observers.”); see also Garten, supra note 196, at 445–46 (discussing Roosevelt’s initial opposition to deposit insurance).


200 See Garten, supra note 196, at 460–61.

201 Id.

202 Id.; KENNEDY, supra note 185, at 202 (“To be sure, [Federal] Reserve rediscount and RFC stock purchases had rescued many shaky institutions because federal authorities felt an obligation to keep licensed banks open.”).

203 See, e.g., FRIEDMAN & SCHWARTZ, supra note 187, at 434 (“Federal insurance of bank deposits was the most important structural change in the banking system to result from the 1933 panic, and, indeed in our view, the structural change most conducive to monetary stability since . . . the Civil War.”).

204 Garten, supra note 196, at 447.
Indeed, because of the severity of the banking crisis of 1933, the issue of deposit insurance had caught the public’s attention and was therefore closely connected to the need to build public confidence. Every FDIC-insured institution places the government’s seal to be seen where deposits are taken. Although the insurance is ubiquitous today, it is noteworthy that the government and the industry felt that emphasizing federal inspection was important to restoring confidence in the nation’s financial institutions.

Also noteworthy about the response to the banking crisis of 1933 is the locus of reform. There was immediate, coordinated federal action to bolster public confidence.

The New Deal . . . revolutionized relations between the states and the federal government. It tilted the balance of power away from the states; that power and responsibility flowed into Washington; it was as if a war was under way. And indeed, there was a war: a war against a silent, invisible enemy, but a deadly one. Relatively speaking, then, the states lost some of their authority. Washington was now the center of gravity.

The declaration of a banking holiday and the promise to open sound banks under government certification worked to calm the panic that had spread nationwide. There was no assurance, in fact, that many or most banks would be opened, and many were in fact liquidated.

205 See Calomiris & White, supra note 199, at 194–95 (describing how the debate about deposit insurance moved from "smoke-filled rooms" to "the hearts and minds of the public").


207 See Patricia A. McCoy, Banking Law Manual: Federal Regulation of Financial Holding Companies, Banks and Thrifts § 3.03[3], at 3-33 (2d ed. 2003) ("Today, virtually every chartered depository institution has federal deposit insurance, either because it is required to by law . . . or because it is a market necessity for the institution to survive."); 1 Michael P. Malloy, Banking Law and Regulation § 2.2.6, at 2.64 (2000) ("While deposit insurance is generally not required as a matter of federal law for commercial banks that are not members of the Federal Reserve System, as a practical matter, federal deposit insurance is virtually a necessity." (footnote omitted)).

208 Raymond Moley with Elliot A. Rosen, The First New Deal 171 (1966) ("We knew how much of banking depended upon make-believe or, stated more conservatively, the vital part that public confidence had in assuring solvency.").


Indeed, it was uncertain exactly how the banks would be rescued. Other more drastic alternatives were considered, with the political conditions in 1933 encouraging experimentation. But in the end, the immediate response—control taken by the federal government—was largely followed by a return to the decentralized pattern that had characterized banking in the United States prior to 1933.

Federal insurance as a device to restore confidence was used again forty years later, although it is unlikely in retrospect that confidence was actually lacking. A crisis of sorts fell not upon the banks but upon the brokerage industry beginning in 1967. An increasing volume of stock trades coupled with outdated settlement and clearing processes, followed by a significant market slump from 1969 to 1970, resulted in the so-called “back office crisis.” Far from being an unimportant clerical problem, the volume of back orders resulted in a large number of failed transactions, which, coupled with the stock market slump of 1969 and 1970, resulted in an unprecedented number of brokerage firm failures.

In response, Congress enacted the Securities Investor Protection Act of 1970 (“SIPA”). SIPA was intended in large part to restore in-

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211 See generally Garten, supra note 196, at 440–45 (discussing the choices of deposit insurance and recapitalization with federal investment).

212 See Ramirez, supra note 186, at 530 (“FDR distinguished himself from Hoover not by his depth of economic understanding, but rather by his willingness to take action, to deviate from laissez-faire economics as a matter of federal policy, and to experiment. Much of the vigor that distinguished FDR from Hoover was only possible in the wake of almost four years of unrelenting economic meltdown. Before this calamity, no leader of the federal government could have mustered the political wherewithal to support massive government involvement in the economy.” (footnotes omitted)).

213 See KENNEDY, supra note 194, at 366 (The New Deal banking reforms “left the astonishingly plural and localized American banking system in place . . . .”). Looking beyond the banking reforms, it is clear that the New Deal was more revolutionary in other areas. See Ramirez, supra note 186, at 569 (“The New Deal macroeconomic legacy is ultimately quite profound. It shows that legislation and executive power can be used to secure a more powerful political economy . . . .”).


vestor confidence by creating an “insurance fund” managed by the Securities Investor Protection Corporation (“SIPC”). 217  SIPC was intended to be, and was perceived as, the FDIC insurance program for financial institutions. 218

Despite these similarities, most analysts agree that the back office crisis of 1967–70 was fundamentally different from the banking crisis of 1933. There was no comparable panic, loss of investor confidence, or industry-wide “run” on securities firms in 1967–70. Indeed, it is generally accepted that loss of investor confidence was a result of the failure of securities firms, not the cause of it. 219 This in turn suggests

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218 H.R. Rep. No. 91-1613, supra note 217, at 5255 (“The need is similar, in many respects, to that which prompted the establishment of the Federal Deposit Insurance Corporation . . . .”); Joo, supra note 214, at 1074 (“SIPC administers a fund to protect the accounts of securities investors somewhat analogous to the protection the [FDIC] provides for the accounts of bank depositors.”); Seligman, supra note 184, at 465 (characterizing SIPA as “creating the equivalent to a Federal Deposit Insurance Corporation for the securities industry”). One result of this perceived similarity is some confusion on the part of investors, who may tend to equate the FDIC and SIPC programs and erroneously believe that SIPC protects them from a decline in the value of their stocks as the FDIC protects them from a decline in the value of their deposit accounts. See GAO SIPC Report, supra note 215, at 63 (citing anecdotal evidence of confusion from SEC and FDIC officials); id. at 69 (noting SIPC agreement with this evidence). The GAO Report notes that this confusion may only intensify as a result of the Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified as amended in scattered sections of 12 and 15 U.S.C.), which allows increased intermingling of activities of financial institutions and securities firms. See GAO SIPC Report, supra note 215, at 67–69. The Gramm-Leach-Bliley Act contains provisions intended to mitigate such confusion. See Gramm-Leach-Bliley Act § 214 (codified as amended at 15 U.S.C. § 80a-34 (2000)) (making it unlawful to represent investment products as federally insured); § 305 (codified as amended at 12 U.S.C. § 1831x (2000)) (disclosure and physical segregation requirements intended to prevent confusion between insurance products and insured deposits).

219 See Joo, supra note 214, at 1082 (“[N]either Congress nor later commentators attributed the failures of brokerage firms to a loss of investor confidence in broker-dealers’ financial stability.”); id. at 1111 & n.209 (postulating the very limited effect of “runs” on brokerages houses compared to runs on banks, noting that the primary effect of a “run” on securities firms would be a decline in stock prices); Seligman, supra note 184, at 466 (attributing decline in individual investor participation in the
that one of SIPA’s main goals—investor protection—may have been an inappropriate response to a “consumer panic” widely perceived by many but now recognized as largely non-existent.²²⁰

2. The Savings and Loan Crisis of the 1980s

By 1989, the savings and loan, or “thrift” industry,²²¹ was in what could fairly be termed a state of crisis.²²²

The scope of the crisis and the losses caused by the crisis are staggering. During the period from 1980 to 1988, over 500 savings associations failed—more than three-and-a-half times as many as in the previous forty-five years combined. In meeting its obligations to depositors of failed savings and loan associations, the Federal Savings and Loan Insurance Corporation (“FSLIC”), which insured the deposits held by savings associations, became insolvent. Consequently, the Federal Home Loan Bank Board . . . , which was responsible for administering the FSLIC, lacked the funds to close hundreds of insolvent and marginally capitalized savings associations. As a result, . . . [they] continued to operate, incurring losses that were estimated to be over $20 million per day . . . .²²³

This crisis had as many causes as there are analysts. However, there are two main causes generally agreed upon. First, the high interest rates of the late 1970s made it difficult for institutions such as

²²⁰ See Joo, supra note 214, at 1075 (“There is no indication that [instilling public confidence in brokerage firms and the securities markets] is still [a goal] worthy of concern, if indeed it ever was.”).

²²¹ Paul T. Clark et al., Regulation of Savings Associations Under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, 45 BUS. LAW. 1013, 1013 n.2 (1990) (“The thrift industry is generally regarded as consisting of three types of financial intermediaries: savings and loan associations, savings banks, and credit unions. Savings and loan associations make up the largest segment of the thrift industry.” (citation omitted)). The term distinguishes these institutions primarily from those known as “banks” or “commercial banks,” but the functions of each type have begun to overlap significantly. See Malloy, supra note 207, § 1.2.2, at 1.14–15 (defining “commercial bank” in this context); Clark et al., supra, at 1099–1100 (describing increasing similarities between commercial banks and thrifts).

²²² See Michael P. Malloy, Foreword: . . . and Backward: Death and Transfiguration Among the Savings Associations, 59 FORDHAM L. REV. S1, S1 (1991) (characterizing the events as a “crisis,” “debacle,” “disaster” and “a slow, suffocating death”).

²²³ Clark et al., supra note 221, at 1013–14 (footnotes omitted); see also Carl Fel森feld, The Savings and Loan Crisis, 59 FORDHAM L. REV. S7, S40 (1991) (“[T]he S&Ls lost some two-thirds of their number. Their industry is virtually depleted; exhaustion of the thrift insurance fund is hardly their problem. . . . [T]heir problems might have to be absorbed by the commercial banking industry for their own protection . . . .”).
thrifts with long-term, low-interest assets to remain profitable.\textsuperscript{224} Second, various "rescue" legislation was passed by Congress during the 1980s giving thrifts new powers, which only postponed the day of reckoning and made the situation worse.\textsuperscript{225}

In any event, by 1989, a full-blown crisis, replete with thrift failures and thrift runs in the 1930s style, confronted the incoming Bush administration. The response in February 1989 was twofold. First, the federal government immediately took over the failing thrifts to promote order and restore confidence.\textsuperscript{226} Second, legislative changes were proposed which by August of that year were enacted as the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA").\textsuperscript{227} Although FIRREA made significant changes in the industry’s regulation,\textsuperscript{228} it left intact the major institutions of banking in the United States.

\textsuperscript{224} See Felsenfeld, \textit{supra} note 223, at S19 ("The roots of the S&L crisis are interest mismatches between what the S&Ls must pay for their money and what they may earn on that money."); Clark et al., \textit{supra} note 221, at 1020 (noting that "negative spread in interest rates resulted in significant losses for many savings associations," and the decline in value of mortgage assets "further erod[ed] the capital bases of many associations").

\textsuperscript{225} See Felsenfeld, \textit{supra} note 223, at S20–S27 (reviewing the legislative reforms of the 1980s); id. at 24 ("[T]heir general objective was to support the S&L system through what the S&L regulators hoped would be a relatively brief troubled period. . . . That all could go wrong and that the industry could self-destruct was implicitly deemed inconceivable."); Clark et al., \textit{supra} note 221, at 1020–22 (reviewing legislative reforms and the negative results); Daniel B. Gail & Joseph J. Norton, \textit{A Decade's Journey from "Deregulation" to "Supervisory Reregulation": The Financial Institutions Reform, Recovery, and Enforcement Act of 1989}, 45 BUS. LAW. 1103, 1103 (1990) (observing that in the early 1980s "there was a cautious optimism that Congress and the federal regulators could 'pull the ox from the ditch' by instituting an era of 'deregulation'"). To say these causes are "generally agreed upon" does not mean to suggest universal acquiescence. See, e.g., EDWARD J. KANE, THE S & L INSURANCE MESS: HOW DID IT HAPPEN? 70–71, 72 (1989) (contending that identifying these two changes as the causes of the thrift industry’s problems is “dangerously simplistic” and noting that the real cause of the problems was the inability to recognize and deal with losses of the books that created insolvent thrifts and the perverse incentives that insolvency creates for thrift managers and regulators).

\textsuperscript{226} See MALLOY, \textit{supra} note 207, § 1.4.3, at 1.120–21 (describing the objectives of the administrative actions, including "to establish control and oversight of each troubled institution, [and] to promote confidence and maintain customer services . . . ."); Gail & Norton, \textit{supra} note 225, at 1106 ("It was clearly the Administration’s number one domestic priority following President Bush’s inauguration in January [1989] and the pressure on Congress to act swiftly was immense.").


\textsuperscript{228} For a summary, see generally Michael P. Malloy, \textit{Nothing to Fear but FIRREA Itself: Revising and Reshaping the Enforcement Process of Federal Bank Regulation}, 50 OHIO ST. L.J., 1117 (1989) and Gail & Norton, \textit{supra} note 225.
Although much of the structure of banking regulatory law that was put in place in the 1930s still is standing, albeit in a weakened condition, the framework of the 1930s no longer commands a consensus that it best serves the national interest . . . . There has been substantial debate over what should be the business of banking and what relationships should exist between commercial banks and commercial enterprises that are not banks. There also has been significant debate over the ultimate size and shape of the entities that make up the U.S. banking market. . . . Although these concerns and others like them have thus eroded confidence in the regulatory framework of the 1930s, there has yet to develop an intellectual and political consensus on what must be constructed to replace the former structure.\textsuperscript{229}

The structure set in place in 1934 has not remained unchanged.\textsuperscript{230} However, the thrift crisis of the 1980s demonstrated the same type of federal response as was seen in the 1930s. There was swift federal action, followed by hastily-prepared legislation, to deal with the immediate crisis, in order to restore public confidence. Only later was there a return in large part to pre-crisis conditions.

3. Evaluation of Responses to the Bank and Thrift Crises

Deposit insurance has proved to be an enduring confidence-building mechanism. The banking crises of 1933 and 1989 both relied upon it. Federal account insurance was also used in the “back office” crisis of 1969–70; although there was no apparent lack of investor confidence, the insurance model was chosen as the regulatory alternative. The fact that the crisis of 1989 was not as widespread as the crisis of 1933 was due to a number of economic factors, of course, but also in large part to the public’s continued belief in the government as deposit insurer of last resort.\textsuperscript{231} Federal deposit insurance has

\textsuperscript{229} Milton R. Schroeder, The Law and Regulation of Financial Institutions ¶ 1.02[7], at 1-19 (1995) (footnote omitted).

\textsuperscript{230} See Malloy, supra note 207, §§ 1.4.5 to 1.4.8, at 1.127 to 1.136-30 (surmising that many of the problems discussed in the quoted language in the text accompanying note 229 have been addressed in significant banking reform legislation in 1991, 1994 and 1999). These are significant reforms with major regulatory issues, but they did not arise in times of a generally recognized crisis in confidence, and as such are beyond the scope of this Article.

\textsuperscript{231} See Fed. Deposit Ins. Corp., Confidence for the Future: An FDIC Symposium 54–55 (1998), available at http://www.fdic.gov/deposit/insurance/symposium/fdic15.pdf [hereinafter Confidence for the Future] ("It is generally agreed that federal deposit insurance was successful in maintaining stability in the financial system throughout the banking crisis of the 1980s, at least in part because insured depositors knew that ample capacity existed and was available to make full payment on their claims.").
two overarching features that make it a credible source of confidence. First, it is “transparent,” that is, the public understands how it works. Second, it is, or appears to be, up to the task. It has the federal backing that neither state funds nor private deposit insurance can duplicate.

In addition, once deposit insurance provided the assurance needed to calm depositor panic, the federal “cleanup” of banks in 1933–34 and thrifts in 1989 provided the second step of crisis response: delivering results. One analyst notes, in providing international guidance for bank crisis regulation, that “[e]vidence that triage is being handled efficiently should help to curtail panicky audience runs, but [regulators] must take up the task of helping those who want to take deposits out of their banks to do so in a reasoned and orderly manner.”

Finally, in both cases, the reforms left intact the multi-regulator, multi-level structure of bank regulation in the United States, one which is not inherently logical or stable. Analysts suggest that further reforms of deposit insurance are likely necessary to properly ad-
just to industry changes. This demonstrates that a crisis response is measured by the crisis itself, and is not necessarily a springboard for broader reforms.

IV. THE EMERGING REGULATORY PARADIGM AND HOMELAND SECURITY

These four stories together suggest a regulatory paradigm of crisis response. The crisis is in each case an existential new threat to the entity or industry—initially appearing to be beyond the capability of existing regulators. This initial reaction to the jarring and new information is a retreat and an attempt at composure, as is perhaps natural. In any event, such a reaction is necessary in order to provide the public with assurance that the crisis has been contained, at least for the moment. Thereafter, emergency measures are quickly replaced with a new federal regulator, as was the case for each crisis discussed above, the airlines, the accountants, the meatpackers, and the banks. By this method, and through the federal assurance of inspection and approval, the regulators seek to restore the public’s confidence. In each instance, there are prominent displays of the federal presence: the TSA inspectors at each airport, the PCAOB inspections of public company accounting firms, the USDA stamp of approval on each package of meat and poultry products, and the FDIC seal at the teller’s window of each financial institution. But completing the second step of an effective crisis response—moving from assurance to results—requires the involvement and expertise of the regulated industries themselves. For example, the government intends to return airline passenger and cargo inspection to private entities; there is an initial reliance by the federal standard-setting body on private industry auditing standards; and there have been experiments with self-certification of inspection by meat and poultry processors and with a system of process regulation. There is no clear analogy in the banking industry, which has relied on self-regulation in a meaningful way, but there has been a federal reliance on the fundamental existing regulatory structures. In each instance, the reliance on the private sector entities is an uneasy relationship—one recognizing that the public’s confidence in safety and security can be fragile.

These lessons can be and are being productively applied as we move to the broader challenge of protecting the nation’s entire productive infrastructure. This Part reviews how this paradigm has been

played out and how it will likely continue to evolve in the area of homeland security.

A. The Crisis and Response

The attacks of September 11 focused the public on terrorism as much or more than on air travel security. But apart from the carnage of the attacks, how does a terrorist attack create a crisis? The goal of the terrorist is not simply to cause physical damage, but to thereby force governmental change, to “simply . . . make a statement,” or to “endanger our values, way of life, and the personal security of our citizens.” Or more broadly, “[a] terrorist is someone who employs physical or psychological violence against noncombatants in an attempt to coerce, control, or simply change a political situation by causing terror in the general populace. The desire to influence an audience is an essential component of terrorism.” The immediate crisis, therefore, beyond the physical one, is a psychological one, and it is this threat to which the government’s homeland security reforms responded.

President Bush created the Office of Homeland Security less than a month after the terrorist attacks on September 11, 2001, providing a federal presence to coordinate security efforts. The Office was intended to have five broad functions: detection (intelligence gathering); preparedness (first responders); prevention (primarily border security and domestic investigation); protection (related to infrastructure); and response and recovery (longer term, relating to infrastructure, as distinguished from the emergency activities of first re-

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237 Recall that a crisis is defined as an existential threat with insufficient time or resources for an effective response. See supra note 10 and accompanying text.


Overall, the Office’s mission was stated as “to develop and coordinate the implementation of a comprehensive national strategy to secure the United States from terrorist threats or attacks.” This strategy is the immediate and overwhelmingly federal response, consistent with the crisis and response paradigm I have described here.

Once the Office of Homeland Security was established, detailed attention could be given to exactly how those functions were to be performed. The government had at hand several recent comprehensive studies providing templates for broader reform. It was clear, for example, that legislation would be required to provide budget and policy authority for the Office. Through a bipartisan effort, the Homeland Security Act of 2002 was passed, creating a new Department of Homeland Security (“DHS” or “Department”) which transferred and consolidated the work of dozens of agencies formerly in at least seven other departments, and created new functions primarily in intelligence and information gathering.

In addition to this massive consolidation and coordination, a main purpose of the new Department was to continue and solidify the federal presence first established by the Office of Homeland Security. In proposing the Department of Homeland Security legislation, the President noted that “America needs a single, unified homeland security structure that will improve protection against today’s threats and be flexible enough to help meet the unknown threats of the future.” The DHS was intended to provide a “federal govern-

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241 See id. at § 3(b)–(f), 66 Fed. Reg. at 51,812–14. There are other functions listed in § 3, but they are for the most part auxiliary policy and administrative functions related to these operational functions.

242 Id. § 2, 66 Fed. Reg. at 51,812.


244 See 2002 Senate Report, supra note 243, at 8 (discussing political motivations, such as making the chief homeland security officer subject to Senate confirmation and Congressional oversight).


246 See Thessin, supra note 243, at 520 & n.50 (cataloging transferred and new programs).

B. Moving from Assurance to Results

The Department, as thus initially constituted, was a massive conglomeration of agencies, cobbled together in part for its psychological impact, in order to show that the federal government was doing something. Setting down to work is another matter. There was no physical crisis which demanded immediate attention. The mission of DHS—to detect, prevent, and minimize the effects of terrorism—potentially encompasses a nationwide set of limitless assets. The attacks could come from anyone, anywhere, anytime. As was shown in Part I, for a brief amount of time, people will trust the government merely because it is the government, but demonstrated competence is necessary for trust to be maintained in the long run. This is the main difficulty the new Department faces.

1. Effective Reorganization

A reorganization, such as the creation of DHS, can be an effective psychological tool as we have seen, but its uses are otherwise limited.

A reorganization is a questionable response to a problem that is not a problem of organization. This banal point tends to be overlooked because organizational changes are often easier and cheaper to make than other reforms, as they may amount to little more than changing job titles and redrawing a table of organization. At the same time they are highly visible—even dramatic—measures and thus convey the impression, however misleading, of a vigorous response to an organization’s failure, even if it is not an organizational failure.

Although DHS is young, the gloss seems already to have worn away, and detractors abound. What one security analyst said about the

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249 See supra note 19 and accompanying text.

250 See supra note 20 and accompanying text.


252 See id. at 128–29 (citing studies by the GAO and the Center for Strategic and International Studies).
liberty-security tradeoffs made after September 11, would apply equally to homeland security.

The most politically expedient option was to slap highly invasive and expensive countermeasures on top of existing systems. At the same time, people wanted to be reassured, responding more to the feeling of security than to the reality; and because they were driven by fear, they accepted countermeasures that required extreme trade-offs. People felt that they must be getting something because they were giving up so much.

That was two years ago, though, and it’s about time we replaced these invasive systems with good security that mitigates the real threats . . . .

Others concur that the time is already ripe for reorganization of the new Department.

The Department responded with a proposed reorganization plan in July 2005. The two most far-reaching changes are the establishment of a Directorate of Policy to coordinate planning that was previously scattered in different places, a similar arrangement for domestic intelligence under a Chief Intelligence Officer, and the establishment of a Directorate for Preparedness to oversee “first responder training, citizen awareness, public health, infrastructure and

253 SCHNEIER, supra note 6, at 251.
254 See JAMES JAY CARAFANO & PAUL ROSENZWEIG, WINNING THE LONG WAR: LESSONS FROM THE COLD WAR FOR DEFEATING TERRORISM AND PRESERVING FREEDOM 67 (2005) (“There is a sweet spot on the curve of experience when an organization has been up and running long enough to separate the good from the bad; this is when it is worth changing things before they get any further along. The Department of Homeland Security is rapidly reaching that point.”).
cyber security, and ensure proper steps are taken to protect high-risk targets. 257

2. Centralization and Decentralization

The proposed reorganization can, if implemented effectively, use the Department’s great size to its full advantage. On the one hand, a larger organization can be more effective than several smaller ones in providing consistency and coordination of policies and information exchange. 258 On the other hand, the Department deals with simply too many different operations for them to be controlled in a traditional hierarchical fashion.

Terrorism can’t be defended against with a single countermeasure that works all the time. Terrorism can be defended against only when every countermeasure works in its own way and together with others provides an immune system for our society.

The Department of Homeland Security needs to coordinate but not subsume. 259

In short, a large organization must decentralize its operations (as opposed to information and policy) in order to be effective. 260 Decen-

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257 DHS Press Release, supra note 255. The Directorate for Preparedness replaces one for Information Analysis and Infrastructure Protection, which “originally was set up to map intelligence about terrorist threats against the nation’s most vulnerable facilities to help set priorities for federal attention and resources” but which “made little headway.” Block, supra note 256.

258 See SCHNEIER, supra note 6, at 252 (concluding that “all these organizations have to communicate with each other, and that’s the primary value of a Department of Homeland Security”); CARAFANO & ROSENZWEIG, supra note 254, at 69 (noting that the consolidation of intelligence and information analysis “has been long overdue and contributes to the Department of Homeland Security’s ability to see the ‘big picture.’”).

259 SCHNEIER, supra note 6, at 252.

260 See id. at 251 (“Security works better if it is centrally coordinated but implemented in a distributed manner.”); POSNER, supra note 40, at 133–34 (“[K]nowledge is costly to transfer, especially knowledge that is based on intuition or, what is closely related, involves knowing how to do something rather than knowing facts or procedures . . . . Because of the cost, the manager of a complex system is unlikely to have all the information he needs in order to be able to exercise control intelligently. Hence, the importance of decentralized methods of coordination . . . .” (footnote omitted)). See generally MICHAEL E. O’HANLON ET AL., PROTECTING THE AMERICAN HOMELAND: ONE YEAR ON 101–15 (Michael E. O’Hanlon ed., 2003) (noting the need for both centralized coordination and decentralized operations in the new DHS). However, the ability to use such an approach may be limited by the nature of the organizations themselves. One analyst suggests that the hierarchical, command-and-control approach will be inherent in the new DHS because “[s]ystems for managing emerging threats are increasingly becoming the domain of government agencies and other organizations that can claim expertise in the fields of military and national security intelligence, information technology, and law enforcement,” and they will have “increasing influence over the activities and missions of state and local emergency
talized operation means reliance on state and local governmental units and private sector entities.261

Another focus of the Department’s new strategy is to answer the fundamental problem, mentioned earlier, of being unable to be strong and vigilant everywhere at once.262 The paradigm for security effectiveness is “risk analysis” or “risk management.” The General Accounting Office has long advocated the use of risk management as a policy tool throughout the federal government.263 DHS has now adopted it as the guiding principle for preparedness operations.264

Risk management is a systematic and analytical process to consider the likelihood that a threat will endanger an asset . . . and to identify actions that reduce the risk and mitigate the consequences of an attack. An effective risk management approach includes a threat assessment, a vulnerability assessment, and a criticality assessment.265

Risk management is essentially a type of process regulation uniquely suited to the mission of DHS.266 As it would be impossible to inspect any sort of “product” at completion and judge it as compliant or de-

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261 The mission of DHS requires it to rely on state and local governments in addition to private entities. The role of state and local governments is primarily as first responders, and the policy and legal issues involved in the relationship of the federal government with other levels of government are starkly different than those involved in the relationship with nongovernmental entities; I do not discuss them here.

262 See supra note 40 and accompanying text.

263 See Homeland Security: A Risk Management Approach Can Guide Preparedness Efforts Testimony Before the S. Comm. on Governmental Affairs, 107th Cong. 2 (Oct. 31, 2001) (statement of Raymond J. Decker, Director, Defense Capabilities and Management, U.S. General Accounting Office) [hereinafter Decker Testimony], available at http://www.gao.gov/new.items/d02208t.pdf (“Since 1996, we have produced more than 60 reports and testimonies on the federal government’s efforts to combat terrorism. Several of these reports have recommended that the federal government use risk management as an important element in developing a national strategy.”).

264 Chertoff Testimony, supra note 255, at 4 (“W]e as a nation must make tough choices about how to invest finite human and financial capital to attain the optimal state of preparedness. To do this we will focus preparedness on objective measures of risk and performance.”).

265 Decker Testimony, supra note 263, at 3; accord Chertoff Testimony, supra note 255, at 4 (“Our risk analysis is based on these three variables: (1) threat; (2) vulnerability; and (3) consequences.”).

266 See O’HANLON ET AL., supra note 260, at 86 ([A] regulatory approach, especially one that consists of “commands and controls” rather than market-like incentives, can be an unnecessarily expensive mechanism for achieving a given level of security. . . . These costs can be reduced, although not eliminated, through careful attention to the design of the regulations. In particular, the more that they focus on processes and performance, rather than specific inputs, the better.”).
effective, DHS must of necessity focus on the process of security and preparedness: the process of protection. Of the three steps in risk management, the first—threat assessment—is primarily an intelligence problem and beyond the scope of study here. Moreover, when the threat is broadly described as “terrorism,” the scope of potential threats is virtually unlimited, leaving threat assessment with limited utility in this context. Therefore, analyses under the other two parts of risk management—vulnerability and criticality (or consequences)—are the key policy questions. In assessing vulnerability, private-sector help is essential. Indeed, vulnerability assessment must be primarily a private sector effort, as most of the critical infrastructure in the United States is privately owned. Therefore, the federal effort must rely on information developed in the private sector, and both Congress in the Homeland Security Act and the Department in its rules “recognize[] the importance of receiving information from those with direct knowledge on the security of . . . critical infra-

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268 A widely-circulated “statistic” is that approximately 85% of the nation’s critical infrastructure is privately owned. See, e.g., The 9/11 COMMISSION REPORT, supra note 39, at 398 (noting without reference that “the private sector controls 85 percent of the critical infrastructure in the nation”). The source of the 85% number is apparently a DHS estimate. See Press Release, Dep’t of Homeland Sec., DHS Launches Protected Critical Infrastructure Information Program to Enhance Homeland Security, Facilitate Information Sharing (Feb. 18, 2004), http://www.dhs.gov/dhspublic/display?theme=43&content=3250 (“[T]he Department of Homeland Security estimates that more than 85 percent [of critical infrastructure] falls within the private sector.”). This has now changed to the slightly different and anonymous: “It is estimated that over 85% of the critical infrastructure is owned and operated by the private sector.” Department of Homeland Security, Protected Critical Infrastructure Information (PCII) Program: Program Overview, http://www.dhs.gov/dhspublic/display?theme=92&content=3763 (last visited Apr. 26, 2006).

structure in order to reduce the vulnerability of this critical infrastructure to acts of terrorism."

3. Establishing Trust

The federal government has been encouraging private sector initiatives in infrastructure protection for many years. In 1998, President Clinton issued Presidential Decision Directive 63 ("PDD 63") on critical infrastructure protection. As to preventative measures, PDD 63 states:

[P]rivate sector owners and operators should be encouraged to provide maximum feasible security for the infrastructures they control and to provide the government necessary information to assist them in that task. In order to engage the private sector fully, it is preferred that participation by owners and operators in a national infrastructure protection system be voluntary.

The directive requires the federal government to “strongly encourage” private sector development of an information sharing and analysis center (“ISAC”), whose design and functions would be determined by the private sector. The directive also organizes the federal efforts around sectors of the economy, with responsibility parceled out among various departments and agencies. Thus, what ultimately developed was not one but a series of ISACs, each focused in an economic sector. The Financial Services ISAC was the first to be organized in 1999; the most recent tally is fifteen ISACs in various sectors.

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272 Id. at 3.
273 Id. at 10 (Annex A: “Information Sharing and Analysis Center”).
274 Id. at 8 (Annex A: “Lead Agencies”).
276 Id. at 1 (listing ISACs in the following sectors: banking and finance, chemical and hazardous materials, emergency services, electric, energy, food, multi-state government, information technology, telecommunications, research and education, public transit, surface transportation, highway, water, and real estate). The Information Sharing and Analysis Centers Council, an organization of thirteen ISACs, notes in a White Paper that the first such entity, predating Presidential Decision Directive 63, was the national Coordinating Center for Telecommunications, established in 1984. See INFO. SHARING & ANALYSIS CTRS. COUNCIL., A FUNCTIONAL MODEL FOR CRITICAL INFRASTRUCTURE INFORMATION SHARING AND ANALYSIS MATURING AND
Although PDD 63 was superseded by President Bush’s Homeland Security Presidential Directive No. 7 in 2004, the new directive continues the same emphasis on sector-by-sector organization of both the private entities and the federal government. This system of private sector ISACs is a beginning structure on which to create a robust government-private sector initiative for infrastructure protection. The ISAC system possesses the characteristics necessary for effective security: it is decentralized, it includes specific individuals with sector-specific expertise, and it provides for cross-sector information and coordination. What is needed now is a way to establish a trusted relationship between the ISACs and the federal government agencies responsible for each sector.

Establishing a trusted relationship with the federal government and collaborating groups of private industry has several important but not fatal problems. Private entities are understandably reluctant to share information with the federal government for five broad reasons. First, disclosure to the government is risky where the information could be used by another agency for a collateral regulatory purpose. For example, information disclosed by a company to DHS might be useable in an investigation or enforcement action by the government or a private litigant. Second, sharing of proprietary in-
formation among industry competitors can result in economic injury if it is exploited by a competitor, but if the information is not so exploited, the conduct of the industry group may be considered anti-competitive under antitrust laws. Third, information, once given to the government, is subject to the Freedom of Information Act ("FOIA") and may have to be disclosed. Fourth, the information "sharing" with the federal government is viewed by the private sector to be more of a one-way flow, since the government’s ability to disclose information to the private sector may be limited by privacy laws and the government’s interest in using the information for law enforcement or national security purposes. Fifth, even if there were none of these perceived disadvantages, the production and distribution of information is costly for a business, and no rational business, however patriotic, will undertake the effort without a perceived benefit that exceeds the cost.

Some of these concerns have been addressed. For example, Congress addressed the FOIA problem with the Critical Infrastructure Information Act of 2002, part of the Homeland Security Act of 2002. DHS implemented these requirements by inaugurating the Protected Critical Infrastructure Information ("PCII") Program on February 18, 2004. The law and regulations provide that PCII is not subject to disclosure under FOIA or any similar law.

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283 See Dacey Testimony, supra note 275, at 32 ("As we reported last year, much of the reluctance by [private groups] to share information has focused on concerns over potential government release of that information under the Freedom of Information Act, antitrust issues resulting from information sharing within an industry, and liability for the entity that discloses the information."); Block, supra note 256 (noting that the DHS unit charged with collecting infrastructure information "made little headway" and that “[f]ew businesses in pivotal sectors of the economy wanted to share information about vulnerabilities with Homeland Security, fearing it could be used against them by regulators or leaked to competitors").

284 See Kochems, supra note 281, at 6 ("DHS needs to present sound economic and business reasons for the private sector to assist in protecting the nation.").


286 6 C.F.R. pt. 29 (2006) (regulations under the PCII Program); see also supra note 268 and accompanying text.

there has been significant federal funding for some ISACs which work in tandem with federal agencies regulating their sectors.\footnote{See Dacey Testimony, supra note 275, at 18–22 (noting at least five ISACs which are partially or fully funded by the federal government).}

However, much work remains to be done. Both the ISAC trade group and the GAO emphasize the immediate need for increased federal funding and for the development of standards which will allow the private entities to trust the information sharing arrangements both within each ISAC and between the ISAC and the government.\footnote{See id. at 31–33 (building trusted relationships); id. at 35 (government funding); ISAC Council White Paper, supra note 276, at 7 (noting the need for government financial support and establishment of a “TRUSTED information sharing and analysis process”).}

There remains a stubbornly enduring hesitancy to share information.\footnote{See Walker Testimony, supra note 267, at 13 (noting “the need for the completion of comprehensive national threat and risk assessments,” and that “stakeholder involvement [in this process] was limited”); White House, The National Strategy for the Physical Protection of Critical Infrastructures and Key Assets 20 (2003) (“[T]here are barriers impeding the public and private sectors from achieving a relationship of [trust]. Many current attitudes and institutional relationships, processes, and structures are products of a bygone era. Safeguarding our critical infrastructures . . . requires a new, more cooperative set of institutional relationships and attitudes.”).}

The arrangement between DHS and the private entities who are encouraged to share information on critical infrastructure is unlike the previous models of crisis and regulatory response. It was not borne of any one particular crisis, and it is a campaign that is voluntary in nature and involves as yet no substantive regulation. It is unstated what DHS is to do with information which may suggest that a particular critical infrastructure is not adequately protected. The government therefore lacks the ability to offer a significant incentive to the private entities to comply, which is a key factor in any cooperative program.\footnote{See Michael, supra note 29, at 545 (“Cooperative implementation should transform existing rules from negative commands into conditions for a government reward, such as a license, permit, grant, or a lighter burden of direct regulation.”). Presumably, DHS expects that access to the collected base of critical infrastructure information will eventually become a sufficient incentive.}

By contrast, other homeland security initiatives, such as the use of private entities in passenger screening,\footnote{See supra notes 87–92 and accompanying text.} and the new
program of approving products and technologies in exchange for reduced liability\textsuperscript{293} have an incentive built in to encourage private entity participation.\textsuperscript{294}

CONCLUSION

It is perhaps unsettling, though not surprising, that humankind continues to generate crises which threaten the existence of its major institutions and industries. It is therefore perhaps as comforting that there is a demonstrated pattern of crisis response that has proved effective and enduring through the years. It is a useful pattern as we seek to address the larger problem of homeland security.

The key features of self-regulation make it an especially useful tool in dealing with the challenges that global terrorism brings to the domestic front. The potential dangers are boundless. To provide safety and security, control must be coalesced at the top, but the responsibility must be spread to the regulated entities. It is they who know the dangers best, and they who also have the greatest incentive to have their industries perceived as safe and secure. Furthermore, the focus with respect to terrorism must be on regulating the process rather than the product; this is an area especially well-suited for carefully supervised process regulation by the regulated entities.

This is a pattern, not a simple formula. There is no “one size fits all” pattern for crisis response, for three main reasons. First, the problem is partly if not largely psychological, and the response must be tailored to the public’s fear. Second, each regulated industry is unique in its composition of firms and associations and the degree to which sound science will yield solutions that work. Finally, the politi-
cal system ultimately controls, in the unsure fashion of coalition and consensus building, the degree and direction of reform.

However, in the final analysis, the pattern provides a useful direction for public policy in regulating for safety and security. Properly used, it can assure that the next crisis, wherever it appears and however tragic the consequences, can be met with a response that is swift and effective to assure the public’s need to be and feel safe and secure, in large part because we already know what to do.