Corporate governance case study: AIG and the business judgment rule

Thomson Reuters
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April 08, 2013

Ever heard of a corporation hiring two noted law school professors to opine whether it should join a shareholder derivative lawsuit? Or inviting in the shareholder's lawyer for a presentation to the board, including a rebuttal after arguments against involvement? In a dismissal motion filed Friday, AIG details the consideration its board members and their hired advisors gave to claims brought on AIG's behalf against the United States Treasury by Starr International, the vehicle of former AIG chief Hank Greenberg. It's a pretty impressive show of corporate governance best practices. Starr may yet be able to demonstrate that AIG's process was fatally flawed but it's not going to be easy.

Let's stipulate up front that most boards don't take shareholder derivative demands for litigation very seriously at all. In the face of a real threat - when, say, shareholders are calling for board accountability after a criminal fine - you might see independent directors appointed to a special litigation committee, which might even hire a law firm to advise it. Those are exceptional cases, though. Usually you don't see much deliberation of any sort from corporate boards when shareholders agitate for derivative litigation. Delaware corporations, after all, are insulated by business judgment rule, which presumes that boards are faithfully fulfilling their fiduciary duties, absent compelling evidence that they're behaving with no rational business purpose. Shareholder derivative suits are usually brought against directors and officers who can almost always divine a rational business reason for opting not to sue themselves. So instead of banging their heads against the business judgment wall - er, rule - shareholders generally choose instead to argue that they didn't even bother to demand action from the board because it would have been futile.

In the context of your typical derivative suit, Starr International's case has always been unusual. Starr's lawyers at **Boies, Schiller & Flexner** and **Skadden, Arps, Slate, Meagher & Flom** didn't bring claims against AIG's board members, but against the U.S. government on behalf of AIG. And when the United States moved to dismiss the suit on the grounds that Starr hadn't served a demand on the AIG board and hadn't otherwise satisfied the demand futility requirement, AIG's board sat out the argument. It turned out that Starr and AIG had aside deal, under which AIG said it wouldn't join the government in asserting demand futility and Starr said it would give AIG extra time to answer the derivative complaint.

If the government had prevailed, AIG's board would never have had to deal with Starr's claims that shareholders were victimized by the federal bailout of the company in 2008. That didn't happen. Judge **Thomas Wheeler** of the U.S. Court of Federal Claims ruled that Starr could proceed with both direct and derivative claims under the Taking Clause of the Fifth Amendment. Last month, Wheeler certified a class of AIG shareholders, led by Starr, to move forward with their direct claims that the government illegally stripped them of $55 billion in AIG equity.

But the derivative claims were a bit more complicated. You probably remember the furor in January, when Dealbook first reported that the AIG board was meeting to discuss the possibility

that the company would join Starr's suit or assume the lead in the case. Shock and outrage ensued, with much talk of the company's ingratitude for even considering claims against its federal saviors. After two board meetings in January, AIG voted to side with the government (and popular opinion) and oppose Starr's suit. Starr, as I've reported, subsequently argued in an amended complaint filed last month that AIG's board had been coerced and intimidated into bowing to the government - that it was futile, in other words, to have expected board members to bring the derivative claims.

AIG's motion to dismiss Starr's derivative suit argues to the contrary that this board's actions are a textbook example of directors responsibly exercising their business judgment. "Whatever Starr may think, it was not irrational for AIG's board to conclude that the claims Starr seeks to bring in AIG's name are not the 'slam dunk' 'easy winners' Starr portrays," wrote AIG's lawyers at **Weil, Gotshal & Manges**. "To the contrary, AIG's board was advised by its counsel (and experts on constitutional law and financial regulation) that Starr's likelihood of success is in fact low. AIG's directors also recognized that AIG would face incalculable harm to AIG's corporate brand and image and relationships with shareholders, customers, regulators and elected officials if AIG pursued litigation against the government." If there was any doubt that the decision whether to join Starr's suit called for the board's business judgment, the brief said, it should have been resolved by the torrent of opprobrium directed at the company after the board's meeting was disclosed.

In an appendix to the motion, AIG included an unredacted version of the letter sent to Starr after the board's vote in January by the directors' outside law firms, **Seitz Ross Aronstam & Moritz** and **Simpson Thacher & Bartlett**. The letter detailed the board's four-month process for considering Starr's claims, which included obtaining expert opinions from Harvard Law professor **John Coates** and University of Califronia Irvine Law School Dean **Erwin Chemerinsky**. Both academics, according to AIG, expressed serious doubts about the ultimate viability of Starr's claims. The board also brought in the economic consulting firm Cornerstone to evaluate Starr's damages model, which Cornerstone said significantly overvalued AIG shares as the company stood on the brink of bankruptcy. And those independent reports were in addition to hours-long board presentations by lawyers from all of the parties.

AIG evened turned Starr's argument about the government's threats and coercion into another justification of the board's exercise of business judgment. It's true, AIG said, that Treasury's counsel said during the board presentation that if AIG backed Starr, "the government will be your adversary," and AIG could face another round of embarrassing congressional hearings. But that amounted to another factor for the board to weigh. "Starr may characterize these statements as 'threats,' but they are simply facts that AIG's board had a fiduciary duty to consider in determining whether a suit by AIG against the Government would serve the best interests of AIG and its shareholders," the brief said.

Nor can Starr now argue that the board's rejection of derivative claims shows the futility of making a demand: According to AIG, shareholders can either make a demand or argue futility. They can't have it both ways under Delaware law.

Boies Schiller partner Robert Dwyer sent an email comment via a firm representative: "AIG's motion to dismiss, filed Friday in the Court of Federal Claims, only repeats the position taken by

the AIG Board in January when it declined to take over and tried to stop Starr from pursuing derivative claims on behalf of the Company. Starr intends to oppose that motion in a filing on April 26. In any event, AIG's motion does not affect the vitality of the direct claims that Starr is pursuing in that action on behalf of a class of AIG shareholders."

(This story has been updated. A previous version said Starr's response to AIG's motion was due on April 25.)