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"When the Government is the Controlling Shareholder"

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Abstract

As a result of the 2008 bailouts, the United States Government is now the controlling shareholder in AIG, Citigroup, GM, GMAC, Fannie Mae and Freddie Mac. Corporate law provides a complex and comprehensive set of standards of conduct to protect non-controlling shareholders from controlling shareholders who have goals other than maximizing firm value. In this article, we analyze the extent to which these existing corporate law structures of accountability apply when the government is the controlling shareholder, and the extent to which federal "public law" structures substitute for displaced state "private law" norms. We show that the Delaware restrictions on controlling shareholders are largely displaced, but hardly replaced, by federal provisions. Having concluded that the existing accountability structures do not provide sufficient protection of minority shareholder interests, we examine the variety of ways (in the U.S. and elsewhere) in which government ownership has been structured in order to minimize political interference at the expense of non-controlling shareholders, including nonvoting stock, independent directors, dedicated trusts, and separate management companies. Because neither ex ante legal structures nor ex post judicial review hold much promise for controlling political interference, we are left with a choice between developing new structures of accountability and bringing this anomalous era of government control to a speedy conclusion.

When the Government is the Controlling Shareholder

Marcel Kahan & Edward Rock[1]

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I. **Introduction**

An essay question for next year's final exam in Corporations:

> Some background: The Detroit Motor Corporation (DMC or DM) is in trouble. Its cost structure is uncompetitive, the quality of its cars is dubious, and, in the midst of a recession, its sales have dropped dramatically. The US government, through the Department of the Treasury, is determined to rescue it and prepared to take extraordinary steps to do so. First, it makes a substantial loan to DM. Second, it engineers a reorganization by leaning on the major secured creditors – in whom the Treasury happens to own significant stock and warrants – to accept less than the unsecured creditors will end up receiving. In the new DM, the Treasury owns 60% of the common stock. Hundreds of dealers are terminated. Factories are closed. Directors and executives are replaced. Wage rates are frozen. Around the same time, the Treasury rescues the historically related finance company, Detroit Motors Acceptance Corporation (DMAC) and ends up with a 56% controlling interest.
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> Now to the heart of the question: Going forward, the Treasury wants new DM to succeed, both because it believes that the US needs to preserve its "domestic" automobile industry (and the jobs associated with it) and because, after investing $50 billion, it wants to get the money back. To further these goals, the Treasury leans on DMAC to provide financing (on preferential terms) to DM, to customers who buy DM cars and to the remaining DM dealers.
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> At the same time, the Treasury insists on the following. First, it wants DM to make its product mix much greener because it believes that greener cars are the wave of the future. Second, it asks that no further factories be closed in a set of eight states hard hit by the recession and, as it happens, identified by the President's chief pollster as most crucial to the President's chances of winning a second term.
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> Some of the minority shareholders of DMAC are outraged that their company is being run for the benefit of DM, at a substantial cost to their company. They provide evidence that the preferential terms provided to DM and its dealers and customers costs DMAC

about $500 million per year. They would like to sue to recover damages already suffered and to prevent these preferential contracts from continuing. Please advise them on what claims they can bring, against whom, and how they should proceed. Address both substantive and procedural aspects.

Some of the minority shareholders of new DM think that going green will be financially ruinous. They would like to take legal action to prevent the change or, in the event that it goes forward, wonder if they will have any remedy in the event that no one wants to buy new DM's green cars.

Finally, minority shareholders of DM complain about the fact that factories slated for closing seemed to be picked on some basis other than maximizing the corporation's profits.

Please advise them.

For corporate law, the fact pattern raises several issues.[2] First, on account of its shareholding, the U.S. government would be considered a "controlling shareholder" of both DM and DMAC and thus would owe fiduciary duties to the respective minority shareholders. All three requests made by U.S. government – to have DMAC lend money to DM, to revise DM's product mix, and not to have DM close certain factories – raise fiduciary duty issues.

As to DMAC, one worries that the Treasury has used its power over DMAC to benefit another firm in its control, DM, at a cost to the other shareholders of DMAC.[3] In corporate law terms, this raises questions of self dealing and the duty of loyalty. At the same time, shareholders of DM worry that the Treasury is allowing other considerations – reducing global warming, saving jobs in recession battered states, or increasing the president's reelection chances – to lead it to force DM into costly and foolish business decisions that will cost the shareholders huge amounts of money. This raises issues that would normally be analyzed under the duty of care and the duty of good faith.

In posing the corporate law issues, there is an immediate sense that the framework does not quite fit the situation. In the normal self dealing context, the controlling shareholder enriches itself at the expense of the non-controlling shareholders. Here, by contrast, the Treasury leans on DMAC to help DM in order to further certain public policy initiatives. While minority shareholders may well suffer, the Treasury is not lining its pocket on their backs. Although they may object to the Treasury furthering public policy at their expense, that is a different complaint.

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[2] It also raises a host of other issues that are beyond the scope of this article including: the fit between Chapter 11's requirements for the approval of a plan of reorganization and the "363 sale" procedure used in the Chrysler and GM bankruptcies which poses important and unresolved issues under Bankruptcy Law; and issues relating to the effect on competitors of the government's investments in DM and DMAC. Mark Roe & David Skeel, Assessing the Chrysler Bankruptcy (October 29, 2009). Available at SSRN: http://ssrn.com/abstract=1426530.

[3] The background section raises a similar issue with regard to the non-controlling shareholders of the TARP banks.

The U.S. does not have much history with government ownership of private industry.[4] As a result, we do not have a well worked out structure of accountability when the government is a majority holder of a for-profit corporation. The problems raised are an interesting inverse of the problems caused by privatization of key governmental functions. When prisons, public education or delivery of social welfare services are privatized, the normal public law structures of accountability may be displaced. For constitutional or administrative law protections to apply, the threshold requirement is typically "state action," a requirement that may not be met when services are outsourced to private firms. The challenge to public accountability posed by privatization has produced a large literature that examines, in various ways, two main questions: First, is it permissible to outsource particular functions, as a matter of constitutional norms, or public law values more generally?; and, second, if the delegation is permissible, which of the constitutional or administrative law limits, if any, do or should apply to the private actor?[5] In short, can or should the Constitution or the Administrative Procedure Act reach private actors providing public services?

When the government becomes a controlling shareholder of a private firm, we face an inverted set of these issues. Government involvement, as we will see, changes everything. It immediately raises issues of sovereign immunity and its various and sundry waivers. It forces corporate law scholars to venture into the realms of Administrative Law, of the content of the Tucker Act, the Federal Tort Claims Act and the Administrative Procedure Act. These three federal statutes largely displace Delaware's state law structures of accountability. A key challenge posed by government involvement is whether the public law approaches to accountability that government involvement imports can, or can be made to, provide the same sort of protections that have evolved in private law? As we will show, the answer, at least so far, is largely negative. The consequence of this is that when the government is an investor, ex post judicial review under the heading of "fiduciary duties" becomes less effective, and greater attention must be given to the ex ante governance structures used when the government takes an equity position as well as the potential virtues of pre-commitment to early exit.

Understanding and evaluating the alternative accountability structures available under public and private law is important for a variety of reasons. First, we are now in a period of public ownership of controlling positions in major private firms, and issues may arise. Second, in understanding the public policy tradeoffs involved in decisions to rescue private firms rather than allowing them to fail, the extent to which public ownership may lead to "non-commercial" behavior of the firm, or politically motivated behavior by the controlling shareholder, is a significant factor. Indeed, the resulting structures of accountability must be taken into account in

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[4] For a review of that history, see Verret at XX.

[5] For examples of this literature, see Harvard Law Review Symposium: Public Values in an Era of Privatization, 116 Harv. L. Rev. 1212 to XX; Gillian Metzger, Privatization as Delegation, 103 Colum. L. Rev. 1367 (2003); Paul Verkuil,, Privatizing Due Process, 57 Admin. L. Rev. 963 (2005); Jody Freeman, The Private Role in Public Governance, 75 N.Y.U. L. Rev. 543 (2000); Jack Beermann, Privatization and Political Accountability, 28 Fordham Urb. L. J. 1507 (2000-2001).

determining how to structure the intervention. Third, understanding the strength or weakness of the constraints on the behavior of the controlling shareholder will be important to those considering investing in controlled firms as those firms seek to raise additional capital or the government seeks to reduce its stake, and to the amount that investors will be willing to pay.[6] Finally, inadequacies of the public law accountability structures may provide reasons to work for an early exit from this hybrid ownership regime. If we do not have an adequate regulatory structure when the government is the controlling shareholder, we can either develop one or, probably better, sell off the government stakes quickly. Recent developments suggest that the government is seeking to exit from its ownership positions just as quickly as it can, consistent with getting an adequate price for its shares.[7]

In this article, we examine these issues, the extent to which the existing structure of legal regulation addresses them, and the extent to which ex ante transactional structures can prevent them from arising, or limit their severity if they do arise.[8] We proceed as follows. In part I, we review recent events during which the United States Treasury invested vast sums in private firms, including both financial and non-financial institutions and both publicly traded and privately held corporations, as well as some evidence of politically driven involvement in the managing of companies.[9] In Part II, we examine the challenges posed to the existing structure of legal regulation of controlling shareholders when the controlling shareholder is the US Treasury. With regard to claims against the United States, this requires looking at sovereign immunity and its exceptions, as developed in the Federal Tort Claims Act, the Tucker Act, and the Administrative Procedure Act. We also examine the extent to which one could avoid the reach of sovereign immunity by foregoing suit against the controlling shareholder and limiting the defendants to the directors of the controlled corporations. In Part III, we turn to the ex ante governance structures that have been used to try to control the emergence of these problems. In this context we look at a variety of US attempts including the last time we bailed out Chrysler, non-voting stock, share trusts, and commitments to exit; the UK's establishment of the wholly owned UK FI to hold and manage its interests in companies that have received government funds; and the mechanism used by Israel after the bank share trading scandal in the 1980s resulted in government ownership of its banks. Part IV is a conclusion in which we try to draw preliminary lessons from our recent experience with government ownership and our comparative analyses.

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[6] For example, an initial public offering of new GM stock is expected in the middle of 2010. Herbert Allison, assistant secretary of Treasury for financial stability, September 24, 2009 written testimony, available at http://www.treas.gov/press/releases/tg298.htm ("an initial public offering for GM is expected next year.")(accessed 9/25/2009).

[7] Citibank stock sale.

[8] For other work on these issues that overlap to some degree with our analysis here, see J.W. Verret, Treasury Inc." How the Bailout Reshapes Corporate Theory and Practice, SSRN: http://ssrn.com/abstract=1461143; Steven M. Davidoff and David T. Zaring, Regulation by Deal: The Government's Response to the Financial Crisis (November 24, 2008). Available at SSRN: http://ssrn.com/abstract=1306342.

[9] In describing involvement as "politically driven," we do not intend a value judgment but simply to distinguish it from involvement driven by normal financial motives.

II. Some Recent Background

Our starting hypothetical is not simply the product of fevered imaginations, but is based on recent events. In this section, we briefly review some of those developments.

A. The Government's Holdings in Private Companies: some numbers

Since the summer of 2008, the government has invested huge sums into private financial and nonfinancial companies. These investments have taken a variety of forms including debt, nonvoting stock, voting stock and warrants. Although our focus is on the government as controlling shareholder, the threshold of control is vague. Accordingly, we give a broader overview of the government's recent investments.

1. Voting Stock and Control Positions

- The Treasury has invested approximately $100 billion in AIG and now owns preferred stock that has 77.9% of the votes, and warrants that, if exercised, grant it another 2% of the votes.[10]

- At Citigroup, in the wake of the preferred stock share exchange, the Treasury owned around 34% of the outstanding common stock, and, after Citi's recent $20 billion stock issuance, owned 28%.[11] In March 2010, the Treasury announced that it planned to reduce its stock ownership by selling shares during the remainder of 2010.[12]

- As a result of the federal engineered bankruptcy, the US owns 8% of the equity in new Chrysler.[13]

- As a result of the GM bailout, the Treasury owns 60% of the common stock of new GM.[14]

- The Treasury owns 56% of the common stock of GMAC, GM's former financing affiliate.

- The Treasury owns 79.9% of Fannie Mae (FNMA, the Federal National Mortgage Association) and Freddie Mac (FHLMC, the Federal Home Loan Mortgage Corp.), the

[10] See TAN XX, infra.
[11] See TAN XX, infra.
[12] Eric Dash, U.S. to Sell 27% Stake in Citigroup this Year, NY Times March 29, 2010, http://www.nytimes.com/2010/03/30/business/30citi.html?dbk.
[13] See TAN XX, infra. US Treasury April 20, 2009 Press Release, available at: http://www.financialstability.gov/latest/tg_043009.html.
[14] See TAN XX, infra.

formerly "private" government sponsored enterprises (GSEs) which were the largest mortgage intermediaries.[15]

2. **Debt and nonvoting stock**

- Through its Capital Purchase Plan, the Treasury has injected approximately $200 billion of TARP funds in 511 institutions.[16] The CPP investments combine preferred stock with warrants, neither of which carry votes.

- Through the TIP program, the US invested $45 billion in nonvoting preferred stock in Bank of America which has now been paid back.

- The Federal Reserve has committed to purchasing up to $200 billion in direct obligations of Fannie Mae, Freddie Mac and the Federal Home Loan Banks to reduce the cost and increase the availability of credit for the purchase of houses and purchasing up to $1.25 trillion in mortgage-backed securities backed by Fannie Mae, Freddie Mac and Ginny Mae, to be conducted by asset managers. More recently, it has poured even more money into these two GSEs.[17]

And this is but a partial list of the US government's investments.

B. **Some Troubling Anecdotes**

This much federal money could not be invested in private companies without controversy, and without inviting politicians to take a role, directly or indirectly, in the management of these firms. Even though governmental investment started less than three years ago, there are already some troubling anecdotes that we summarize in this section..

Executive compensation, traditionally a matter for the board and shareholders, has attracted a lot of attention in Washington. The outcry over AIG bonuses provides a rich example. After receiving more than $170 billion in bailout funds, AIG announced plans to pay $165 million in bonuses to executives in the company's financial products division, the same division responsible for the near-collapse of AIG.[18] In response, Rep. Earl Pomeroy proclaimed, "Have the recipients of these checks no shame at all? . . . [AIG bonus recipients] are disgraced professional losers. And by the way, give us our money back."[19] Others, such as Rep. Charles

[15] See TAN XX, infra.
[16] See TAN XX, infra. WSJ 3/23/2009: update.
[17] Cite.
[18] Edmund L. Andrews and Peter Baker, At A.I.G., Huge Bonuses After $170 Billion Bailout, N.Y. Times, March 15, 2009, at A1.
[19] Carl Hulse and David M. Herszenhorn, A.I.G. and Wall St. Confront Upsurge of Populist Fury, N.Y. Times, March 20, 2009, at A1.

Rangel, characterized AIG as "getting away with murder,"[20] while Republican Sen. Charles Grassley advised AIG bonus recipients to "resign or go commit suicide."[21] President Obama, in a more measured response intended to "'channel [public] anger in a constructive way,"[22] urged Congress to draft legislation that sends "a strong signal to the executives who run these firms that such compensation will not be tolerated."[23]

But, aside from these predictable and traditional responses to perceived corporate excess, there are a number of more interesting details that illustrate the new dynamics made possible by government ownership. Barney Frank, chairman of the House Financial Services Committee, pushed the idea of suing AIG to get the bonus money back, pointing out that the federal government owns a nearly 80 percent stake in the company after giving it more than $170 billion in aid.[24] "I still believe that we have a right legally to recover this, because we can assert our ownership rights and say, yes, you may have had a contractual right to a bonus but your rotten performance means you should forfeit it," he was quoted as saying.[25]

Frank's notion that the government may have more power – or, at least, different power – as shareholder than as regulator has been picked up by shareholder activists. At AIG, AFSCME lobbied the three trustees of the Treasury trust holding the AIG stock to vote the government's 77.9 percent interest against the AIG director who served on the compensation committee during the period in which the bonuses were granted, as well as to vote against AIG's 2008 compensation in the advisory shareholder vote required of TARP participants, and to support AFSCME's shareholder proposal requiring that executive equity awards be held for two years past departure.[26]

But the attempts to influence portfolio companies have been broader. Congress expected that bailout funds would stimulate lending and revitalize the economy, but later realized that banks were reluctant to lend for fear of continued economic deterioration. As a result, bailout

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[20] Id.

[21] AIG and the President: Easy Does It, The Economist, March 21, 2009, at 50, available at http://www.economist.com/opinion/displaystory.cfm?story_id=13326168.

[22] Jackie Calmes and Louise Story, A.I.G. Seeking Return of Half of its Bonuses, N.Y. Times, March 19, 2009, at A1.

[23] Carl Hulse and David M. Herszenhorn, A.I.G. and Wall St. Confront Upsurge of Populist Fury, N.Y. Times, March 20, 2009, at A1. *See also* Andrew Ross Sorkin, Eric Dash, Rachel L. Swarns, U.S. Rounding Up Investors to Buy Bad Bank Assets, N.Y. Times, March 23, 2009, at A1. On the legislative side, Congress soon responded to the President's challenge. The House of Representatives passed a bill that retroactively imposed a 90% tax on bonuses paid after January 1, 2009 for traders and executives earning in excess of $250,000 a year. The bill applied to companies retaining $5 billion or more in bailout funds. Rep. David Camp said of the legislation, "It is an extreme use of the tax code to correct an extreme and excessive wrong done to the American taxpayer." Id.

[24] http://www.boston.com/news/politics/politicalintelligence/2009/03/frank_not_optim.html

[25] Id.

[26] March 31, 2009 AFSCME letter to Jill Considine, Chester Feldberg and Douglas Foshee, available at http://www.afscme.org/docs/AIG_Trustee_Letter_3.31_re_Vote_No.pdf

recipients faced mounting pressure from the President and Congress to increase lending. President Obama said he would "hold banks 'fully accountable' for the assistance they receive, and that they 'will have to clearly demonstrate how taxpayer dollars result in more lending for the American taxpayer.'"[27] Senators lashed out at banking executives appearing before the Senate Banking, Housing and Urban Affairs Committee for using bailout funds for anything other than increasing lending.[28] At a separate hearing before the House Financial Services Committee, Rep. Judy Biggert questioned whether "the funds [had] been used to get credit flowing again, not just to financial institutions but to consumers and small businesses?"[29] Other committee members "sought promises from the bank executives that they would use the government funds they received to make loans and stimulate the economy, rather than hold onto it to bolster their balance sheets." Rep. Michael Capuano implored executives to "get our money out on the street."[30]

Similar calls from Congress soon followed for banks to stem foreclosures and restrain action against struggling homeowners. Rep. Barney Frank "acknowledged that struggling homeowners [weren't] getting help as fast as many in Congress had hoped,"[31] and urged bank executives to put in place a foreclosure moratorium until the government could implement mitigation programs.[32] Frank also criticized hedge fund managers for reportedly directing mortgage servicers to disregard any government program that undercut investment value.[33] Sen. Charles Schumer told regulators "they seemed to be giving banks 'a little too much dessert and not making them eat their vegetables,'" since banks had not been required to assist homeowners despite receiving bailout funds.[34] In response, many big banks put into operation temporary foreclosure moratoriums in advance of the administration's housing rescue plan announcement.[35]

One adaptation to this intense scrutiny has been to pre-clear any potentially controversial decision with the Treasury or the White House. It was reported, for example, that in the wake of the firestorm of criticism of the AIG bonuses, "senior Treasury officials have been meeting several times a week all spring to review, one by one, the payments to the company's executives. But the time-consuming discussions have never resolved whether any of the executives should

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[27] Christi Parsons and Peter Nicholas, "We will Rebuild, We will Recover," L.A. Times, Feb. 25, 2009, at 1.
[28] Ross Kerber, Banks Draw Heavy Fire from Capitol Hill, Boston Globe, Nov. 14, 2008, available at http://www.boston.com/business/articles/2008/11/14/banks_draw_heavy_fire_from_capitol_hill/.
[29] Maura Reynolds and Jim Puzzanghera, Financial Giants' CEOs, Geithner on Hot Seats, Chicago Tribune, Feb. 12, 2009, at 27.
[30] Ross Kerber, Businesses in N.E. Say Lenders too Strict, Boston Globe, Feb. 21, 2009, at A1.
[31] Ross Kerber, Frank Talks About the Economy, Boston Globe, Oct. 25, 2008, available at http://www.boston.com/business/articles/2008/10/25/frank_talk_about_the_economy/.
[32] Maura Reynolds and Jim Puzzanghera, Economic Crisis: Lawmakers Give Banks a Scolding, L.A. Times, Feb. 12, 2009, at C1.
[33] Ross Kerber, Frank Talks About the Economy, Boston Globe, Oct. 25, 2008, available at http://www.boston.com/business/articles/2008/10/25/frank_talk_about_the_economy/.
[34] David Stout and Brian Knowlton, Senators Press for Action to Stem Foreclosures, N.Y. Times, Oct. 24, 2008, available at http://www.nytimes.com/2008/10/24/business/economy/24cong.html?pagewanted=print.
[35] Maura Reynolds and E. Scott Reckard, Mortgages: Obama Speeds Rescue Plan, L.A. Times, Feb. 14, 2009, at C1.

get paid."[36] Now, even routine bonuses are pre-cleared with Kenneth Feinberg, the "compensation czar."[37]

The Treasury ousted Richard Wagoner as GM's CEO on March 29, 2009. He remained an employee of GM until July 14 because it took that long for the Treasury to decide whether he should receive the severance package that the company had promised him.[38]

The GM and Chrysler bailouts have brought an avalanche of political attention. The Senate has held hearings on GM and Chrysler's plans to reduce their network of dealerships. As the Washington Post summarized, "Empowered by the government's emerging ownership role, members of a Senate committee yesterday excoriated General Motors and Chrysler for their decisions last month to close more than 2,000 dealers."[39] Sen. Mark Warner (D-Va.), although acknowledging the dangers of trying to micromanage government owned companies, nonetheless said that "we've got the right and responsibility to ask these questions."[40] GM and Chrysler also have facilities in many different congressional districts. As the Washington Post reported, "Rep. Barney Frank (D-Mass.) said GM management had agreed to postpone a planned shutdown of a parts distribution center in Norton, Mass., after a meeting he had with its chief executive, Fritz Henderson."[41] The political involvement continues to intensify.[42] Indeed, in May, 2010, GM announced plans to reinstate half of the dealers who challenged GM's terminations.[43]

At Citigroup, the ongoing instability in the top management has been attributed to conflicts with federal regulators:

> Mr. Pandit made the changes under pressure from federal regulators and after discussions with Citigroup Chairman Richard Parsons, who has been trying to defuse a standoff

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[36] Washington Post May 17, 2009: http://www.washingtonpost.com/wp-dyn/content/article/2009/05/17/AR2009051702268.html

[37] Brady Dennis, AIG Plans Millions More in Bonuses, Washington Post July 11, 2009, available at http://www.washingtonpost.com/wp-dyn/content/article/2009/07/11/AR2009071100419.html; Liam Pleven and Deborah Solomon, AIG Seeks Clearance to Release Bonuses, WSJ July 10, 2009, available at http://online.wsj.com/article/SB124718910241620823.html.

[38] Washington Post May 17, 2009: http://www.washingtonpost.com/wp-dyn/content/article/2009/05/17/AR2009051702268.html;
Ex-GM Chief to Get $8.5 million in Retirement Pay, NYTimes July 14, 2009, available at http://www.nytimes.com/2009/07/15/business/15auto.html?scp=4&sq=Rick%20Wagoner&st=cse.

[39] Peter Whoriskey and Kendra Marr, Senators Blast Automakers Over Dealer Closings; GM, Chrysler Defend Massive Shutdowns, Washington Post, June 4, 2009 at A15.

[40] Id.

[41] Anthony Faiola, Test-Driving a Foreign Business Model: Government Stake Could Push GM to Be a High-Flyer or Failure, Washington Post, June 22, 2009 at available at http://www.washingtonpost.com/wp-dyn/content/article/2009/06/21/AR2009062101966_pf.html.

[42] Neal King, Politicians Butt In at Bailed Out GM, WSJ Oct. 29, 2009 (http://online.wsj.com/article/SB125677552001414699.html).

[43] Nick Bunkley, G.M. Plans to Reinstate 661 Dealerships, March 5, 2010 NY Times, http://www.nytimes.com/2010/03/06/business/06dealers.html.

> between the company and some top federal officials, people familiar with the situation say. The federal government will soon own as much as 34% of Citigroup's shares.[44]

More recently, Citigroup sold its profitable PhiBro subsidiary at a bargain price to avoid a conflict with the Treasury over $100 million in compensation owed to Andrew Sullivan.[45]

The Treasury's political considerations have led it to block profitable actions by controlled firms. For example, at Fannie Mae, the Treasury vetoed a sale of $3 billion in tax credits to Goldman Sachs and Berkshire Hathaway. Although these tax credits were worthless to Fannie Mae, the Treasury would have lost tax revenues had they been sold to an entity that could use the credits to offset its taxes. In this way, the financial interests of the Treasury and of Fannie Mae and its (non-governmental) shareholders and creditors were in clear conflict -- and the Treasury's interests prevailed.[46]

These anecdotes raise a variety of concerns, two of which we will focus on.[47] First one worries that the influence or control that comes with a major investment (debt or equity) will be used to achieve goals other than maximizing the value of the firm or ensuring that the debt is repaid. With the polycentric power structure of the federal government, the potential exists for Congressional pressure to be brought to bear on firms to adopt policies favored by politicians without regard to whether they advance the interests of the firm. The automobile dealership hearings provide a concrete example: the political pressure could surely convince GM and Chrysler to preserve some politically well-connected dealerships that they otherwise would close.

The second concern is that the resulting governance structure will be dysfunctional. This may be caused by managers' attempts to be responsive to too many different sources of pressure. With pressures from chairs of Congressional committees, the White House and the Treasury, steering the ship forward becomes even more complicated. Additionally, as noted above, to the extent that, for example, the Treasury expects to sign off on significant business decisions, and does not have the staff or expertise in place to provide this input in a timely or competent manner, the quality of the decisions may be compromised.

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[44] David Enrich and Robin Sidel, Citigroup Shakes Up Leaders to Pacify U.S., WSJ July 10, 2009, available at http://online.wsj.com/article/SB124714471454017995.html;

[45] Eric Dash & Jack Healy, Citigroup Sheds Energy Unit and its $100 million Trader, NYT Oct. 10, 2009 (http://www.nytimes.com/2009/10/10/business/10citi.html?scp=1&sq=Citigroup%20Sheds%20Energy%20Unit%20and%20its%20%24100%20million%20Trader&st=cse).

[46] Nick Timiraos, Treasury Blocks the Sale of Tax Credits by Fannie, WSJ Nov. 7, 2009 (http://online.wsj.com/article/SB125754828200334693.html).

[47] Government ownership in the UK has had very similar effects. See, e.g., Dana Cimilluca and Sara Munoz, In Britain, RBS Comes Under Fire, WSJ Dec. 17, 2009 at (http://online.wsj.com/article_email/SB10001424052748703581204574600251040361552-lMyQjAxMDA5MDEwNzExNDcyWj.html) (Members of Parliament complaining about government controlled RBS's investment banking advisory relationship with Kraft in its hostile bid for Cadbury); Robert Lindsay & Miles Costello, RBS board keeps resignation threat over bonuses alive, Times Online Dec. 15, 2009 (http://business.timesonline.co.uk/tol/business/industry_sectors/banking_and_finance/article6957239.ece).

C. How Did We Get Here?

Government ownership, a product of a fast moving and fast changing crisis, is widespread and extremely complicated. Money has been invested through a variety of programs with a variety of restrictions and a variety of goals. As a result, the terms of the government's ownership positions vary widely among portfolio companies. To describe the broad patterns of ownership, we briefly review the chronology and the relevant legislation.

Beginning in the summer of 2007, troubles in the subprime mortgage sector undermined confidence not just in the asset backed securities that contained those mortgages, but more generally in the credibility of fundamental legal and market structures: the accuracy of the credit ratings; the solvency of the monoline insurers; and the safety and soundness of key financial institutions. As confidence in market institutions collapsed, and with it confidence in the soundness of counterparties, the credit markets froze.

In response, the Treasury and the Federal Reserve intervened in a variety of ways. In the first stage of intervention, they sought to unfreeze the credit markets by providing additional liquidity. In August 2007, the Fed injected $100 billion for borrowing;[48] in November 2007, it injected another $40 billion;[49] in Spring 2008, it cut interest rates;[50] and in the summer of 2008, it opened the discount window to investment banks.[51]

Second, they intervened in an ad hoc way to try to prevent failures of systemically important financial institutions. Thus, in March 2008, the Fed provided financial assistance to J.P. Morgan Chase in its rescue of Bear Stearns.[52] Also during March, the Fed announced measures to provide liquidity to commercial and investment banks. Later, during the summer of 2008, the Treasury acted to shore up the capital structure of Fannie and Freddie and ultimately put them into conservatorship.

These interventions were controversial. Some argued that the government had no business intervening to save firms and that doing so created moral hazard.[53] Others argued that the interventions were indefensible handouts to the rich and powerful.[54]

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[48] CITE.
[49] CITE
[50] CITE
[51] CITE.
[52] Kahan & Rock, Bear Stearns article.
[53] See, e.g., Gretchen Morgenson, Moral hazard tosses out as Fed saves Bear Stearns, NYT March 16, 2008, (http://www.nytimes.com/2008/03/16/business/worldbusiness/16iht-morg.1.11131999.html).
[54] See, e.g., Nouriel Roubini, Public losses for private gain, Guardian online Sept 18, 2008 (http://www.guardian.co.uk/commentisfree/2008/sep/18/marketturmoil.creditcrunch).

Then came the failure of Lehman Brothers on September 15, 2008, and the ensuing panic.

On September 16, 2008, the Fed saved AIG by pledging $85 billion in exchange, inter alia, for a promise to issue preferred stock with 79.9% of the voting rights.[55] Subsequent amounts were ultimately pledged and invested in AIG.

On October 3, 2008, on its second try, Congress enacted the Emergency Economic Stabilization Act of 2008 ("EESA") which gave birth to the TARP program. This set the framework for most of the subsequent investments in firms. Within the TARP framework, a variety of programs were launched including the Capital Purchase Program (CPP, used to invest in banks), the Systemically Significant Failing Institutions Program (SSFIP, used for subsequent investments in AIG), the Targeted Investment Program (TIP, used for Citigroup and Bank of America) and the Term Asset-Backed Lending Facility (TALF).

To understand the terms of the government's portfolio, we need to review briefly the key provisions of the EESA. In doing so, it is critical to keep in mind that when enacted, the stated rationale was that TARP funds would be used to purchase toxic assets from troubled financial institutions. But TARP later morphed into a program to invest directly in troubled financial institutions, a direction that was already contemplated even before the EESA was enacted, but not disclosed to Congress.[56] It is also critical to recall how difficult it was to pass the EESA, and the political obstacles to returning to Congress for additional authority or funding.

With this as background, we turn to the statutory structure. In keeping with the original conception, the EESA authorized the Treasury to buy "troubled assets" from "financial institutions."[57] The Treasury was given additional discretion through the broad definition of "troubled assets", which potentially included any mortgage or related security as well as any other financial instrument so designated by the Treasury Secretary.[58] Finally, in order to allow taxpayers to benefit from the upside of these purchases, section 113(d) required that when the Treasury purchased troubled assets from a financial institution, it must also receive a warrant.[59]

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[55] Subsequently reduced to 77.9%, with an additional 2% in connection with a warrant.

[56] Andrew Ross Sorkin, Too Big to Fail (2009) at pp. 500, 504-05, 510-11, 513-16.

[57] EESA §101(a), 12 USC 5211(a) (The Secretary is authorized to establish the Troubled Asset Relief Program (or ''TARP'') to purchase, and to make and fund commitments to purchase, troubled assets from any financial institution, on such terms and conditions as are determined by the Secretary, and in accordance with this Act and the policies and procedures developed and published by the Secretary.)

[58] Section 3(9), EESA; 12 USC 5202(9): "The term 'troubled assets' means— (A) residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages, that in each case was originated or issued on or before March 14, 2008, the purchase of which the Secretary determines promotes financial market stability; and (B) any other financial instrument that the Secretary, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability, but only upon transmittal of such determination, in writing, to the appropriate committees of Congress."

[59] In the case of publicly held firms, §113(d)(1)(A) provides: "The Secretary may not purchase, or make any commitment to purchase, any troubled asset under the authority of this Act, unless the Secretary receives from the financial institution from which such assets are to be purchased— (A) in the case of a financial institution, the securities of which are traded on a national securities exchange, a warrant giving the right to the Secretary to receive

Note that under the terms of §113(d), the warrant must be for non-voting shares or, if there are not any, the Treasury must agree not to vote the warrant shares.

As noted above, the bailout strategy shifted decisively away from the purchase of troubled assets to the investment in troubled firms. Since the definition of "troubled asset" noted above is very broad, and the prohibition on acquiring voting stock only applied to warrant shares and not to the "troubled assets" themselves, the Treasury had clear authority to buy voting common stock in financial institutions.

This authority was exercised in various ways. In the Capital Purchase Program that channeled funds to banks, the Treasury chose to acquire non-voting preferred stock. Treasury's standard term sheet, developed by private equity lawyers at Simpson Thacher,[60] provided that the senior preferred would be non-voting except for class voting rights on the issuance of more senior securities, on changes to the rights of the preferred or on any merger or other transaction that would adversely affect the rights of the senior preferred.[61] As will be described below, in TARP investments pursuant to other programs, the Treasury has sometimes taken voting stock. Finally, there are situations in which the Treasury has switched from non-voting to voting stock. This has led to a somewhat varied set of terms within the government's portfolio.

The government then used TARP to bail out the automobile industry. In December, 2008, pursuant to the CPP, the Treasury invested $5 billion in GMAC (which had become a bank holding company in order to qualify for the CPP) in exchange for preferred stock and warrants that did not carry voting rights. The Treasury subsequently created the Automotive Industry Financing Program (AIFP). In May 2009, through the AIFP, it invested an additional $7.5 billion in GMAC. As of June 2009, the Treasury held 35% of the GMAC equity, with the ability to increase that stake to more than 50% through the exercise of warrants.[62] At the end of 2009, the Treasury invested an additional $3.8 billion, increasing its total investment to $16.3 billion, and increasing its stock ownership to 56%.[63]

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nonvoting common stock or preferred stock in such financial institution, or voting stock with respect to which, the Secretary agrees not to exercise voting power, as the Secretary determines appropriate." Similar provisions apply to privately held firms.§113(d)(1)(B), 12 USC 5223(d)(1)(B).

[60] http://www.financialstability.gov/latest/hp1217.html.

[61] Term sheet, available at http://www.financialstability.gov/docs/CPP/termsheet.pdf. See also Securities Purchase Agreement §4.6 in which the Treasury commits not to vote warrant shares. http://www.financialstability.gov/docs/CPP/spa.pdf

[62] GMAC June 2009 registration statement at 1; GMAC July 1, 2009 Form 8-K (available at http://www.gmacfs.com/us/en/about/investor/sec_filings.html) (describing GMAC's June 30, 2009 transformation from a Delaware LLC to a Delaware corporation and including GMAC's new certificate of incorporation and bylaws, neither of which indicate any limits on the Treasury's ability to vote its equity stake). See, also, http://www.detnews.com/article/20090520/AUTO01/905200376/Feds-to-inject-$7.5B-more-into-GMAC; GMAC May 21, 2009 press release: http://media.gmacfs.com/index.php?s=43&item=331.

[63] Nick Bunkley, GMAC Gets $3.8 Billion More in Aid, NYT Dec. 30, 2009 (available at http://www.nytimes.com/2009/12/31/business/31gmac.html?_r=1&emc=eta1);

As GMAC became a bank holding company before receiving any TARP funds, the investments fit comfortably within the statutory authority. The use of TARP funds under the AIFP to invest in GM and Chrysler sits on a less secure statutory foundation. Although as noted above, the statutory definition of "troubled asset" is sufficiently broad to include common or preferred stock, the statutory definition of "financial institution" is more problematic. In order to have authority to receive TARP funds, it must be the case that GM and Chrysler are, under the statute, "financial institutions." The EESA's definition of a "financial institution" provides in relevant parts:

> The term ''financial institution'' means any institution, including, but not limited to, any bank, savings association, credit union, security broker or dealer, or insurance company, established and regulated under the laws of the United States or any State … and having significant operations in the United States, but excluding any central bank of, or institution owned by, a foreign government.[64]

For GM and Chrysler to fit this definition, one must read the phase "any institution including, but not limited to" to sweep in institutions that are not financial institutions under any normal understanding of the term. As a matter of statutory interpretation, that argument hardly passes the smell test. As a matter of politics, the Treasury had little choice: Congress had already rejected a request to authorize funds to bail out the auto industry,[65] and had only passed the EESA on its second try. But, however thin the basis under the EESA, it didn't help the secured bondholders who objected in the Chrysler bankruptcy: they found out that they did not have standing to make the argument.

Through its TARP investments, the Treasury now has an 8% voting stake in new Chrysler, and a 60.8% voting stake in the new GM.

In this fluid situation, the size and nature of the government's interest can change. In the fourth quarter of 2008, the Treasury invested $45 billion in Citigroup in exchange for non-voting perpetual preferred stock and warrants convertible into 6.2% of Citi's voting stock.[66] The exercise price of the warrants is well above current stock price and none have so far been exercised.[67] On February 27, 2009, in order to increase its "core" Tier 1 capital, Citi announced plans for an exchange offer to exchange preferred stock for common stock. As part of this exchange offer, the Treasury agreed to exchange up to $25 billion of its preferred stock for common stock, on a dollar for dollar basis with other holders of preferred stock.[68] After the completion of the exchange offer, the Treasury owned approximately 34% of Citigroup's outstanding common stock, not including the exercise of warrants issued as part of the TARP

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[64] Sec. 3(5), 12 USC 5202(5).
[65] David Herszenhorn, Chances Dwindle on Bailout Plan for Automakers, NY Times Nov. 13, 2008, http://www.nytimes.com/2008/11/14/business/14auto.html?_r=1.
[66] 2008 Citi Annual Report at 6, 9, 44. 2009 Citi Proxy at 1 and 19.
[67] Id.
[68] Citi S4, Amendment 4 at 37. Citi Annual Report at 45.

investment.[69] This, of course, can change: Citi recently raised $17 billion in new common equity, while the Treasury was unsuccessful in selling its stake, leaving it, after the dilution from the new stock issuance, of 26-27%.[70] The Treasury hopes to sell these shares during 2010, but has not done so yet.[71]

D. **Purpose v. Effect of Acquiring Stock Position**

So, through a variety of routes, the Treasury has ended up with equity investments in private firms. These range from relatively small non-voting positions to controlling stakes.

There is no evidence that the government took these positions *in order to* gain control. First, as noted above, the original expectation was that the Treasury would be acquiring troubled assets, not equity stakes. The language of the EESA, as well as its legislative history, make clear that the Treasury took warrants in order to be able to profit from any increases in share value. The cleanest and easiest way for the taxpayers to share in the upside of these investments, without exercising control, was through warrants for nonvoting stock.

Moreover, as the sole available lender and as the regulator of many of these entities, the government already had significant power. In the short term, voting rights may not have added much. As the largest and probably only willing lender, and with the normal sorts of covenants (no dividends, veto over acts or transactions that could impair the value of the nonvoting preferred, etc.), the Treasury already had significant control.

But, although only the looniest bloggers would claim that this was all a plot to foist socialism on America,[72] the result of these various initiatives has been, as noted above, that the Treasury now has significant ownership stakes in a variety of firms. And with control comes the temptation and opportunity to interfere. As the earlier illustrations show, once the Treasury owns large or controlling equity stakes in firms, there is a temptation to use those stakes as instruments of control. If Barney Frank can prevent GM from closing a parts distribution facility in his district, he will save jobs of his constituents, and this may be worthwhile even if it interferes with GM's plans to trim costs. While the *incentive* to interfere is obvious, the structure of this temptation has several features.

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[69] Citibank 2009 Q3 10Q at p. 9.

[70] David Enrich & Damian Paletta, Discord Behind TARP Exits, WSJ Dec. 19, 2009 (available at: http://online.wsj.com/article/SB10001424052748703323704574602552053952422.html), Michael Corkery, The Good, Bad, and Ugly of Citigroup's Botched Stock Sale, WSJ Dec. 17, 2009, (http://blogs.wsj.com/deals/2009/12/17/the-good-bad-and-ugly-of-citigroups-botched-stock-sale/).

[71] Eric Dash, U.S. to Sell 27% Stake in Citigroup this Year, NY Times March 29, 2010, http://www.nytimes.com/2010/03/30/business/30citi.html?dbk.

[72] See, e.g., GM Symbol of USA - Obama's Vulture Socialism, , http://redstateeclectic.typepad.com/redstate_commentary/2009/06/gm-symbol-of-usa-obamas-vulture-socialism.html.

First, an equity position, especially a control block, can provide the *power* to interfere. Indeed, because there are so many different means by which a controlling shareholder can exercise control, it rarely must do so. Usually, it is enough for the control shareholder simply to indicate its preference and the managers will acquiesce. Real power need never be overtly exercised. Although it may be that the federal government has sufficient regulatory power to intervene across the full range of issues, a control block provides a different *kind* of power: a power that, depending on how it is structured, can be exercised more informally and with more discretion, outside the formal regulatory process and the accompanying public scrutiny, and more directly by politicians rather than by appointed bureaucrats.

Second, stock ownership provides periodic *opportunities* to interfere. Every year, shareholders elect directors, and vote on shareholder proposals, compensation plans, auditors, etc. A controlling shareholder's vote will typically be decisive.[73] As a result, once one has control, one has virtually no choice except to decide critical issues. At AIG, where a trust holds the Treasury's 77.9% stake, the AIG trustees simply cannot avoid deciding who will be the directors. If they do not attend the meeting, in person or by proxy, no actions can be taken for lack of a quorum. If they do attend, their vote is decisive. When AFSCME submits a shareholder proposal at AIG, the AIG trustees' decision on how to vote the Treasury shares will determine whether the proposal is approved or rejected.

Finally, an existing stock position minimizes the political *cost* of interference. To be sure, in times of crisis – like the last three years – the government as regulator and lender of last resort has ample power over companies to have its way, without any stock ownership at all. The Obama administration could get rid of GM CEO Rick Waggoner by a mere suggestion, even without any stock ownership. The White House and the Treasury surely had the power to force Bank of America's CEO Ken Lewis to step down, even without stock ownership.[74] But this power dissipates quickly. In ordinary times, firms will have allegiances with congressional forces and the political cost of executive interference with internal firm decisions will be high. When, for example, in the wake of Enron and accounting scandals, a Republican administration sought to rein in Fannie and Freddie, their strong Congressional support protected them from interference. The power and periodic opportunities provided by stock ownership will change the cost of interference during ordinary times, even if it will not eliminate those costs.

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[73] Unless one has pre-committed to mirror voting. See TAN infra.

[74] See, e.g., Paulson testimony re the Bank of America – Merrill Lynch deal and the fact that if Lewis had refused to close, he would have been history. http://online.wsj.com/public/resources/documents/WSJ-20090715-PaulsonTestimony.pdf. ; US Regulators to B of A: Obey or Else, WSJ July 16, 2009, available at http://online.wsj.com/article/SB124771415436449393.html#mod=testMod.

III. **When the Government is the Controlling Shareholder: Regulation**

A. **The Problem of the Government as Controlling Shareholder**

Delaware corporate law has long been suspicious of controlling shareholders. Under Delaware law, a shareholder is "controlling" if either the shareholder controls a majority of the votes in a corporation, or if the shareholder controls less than a majority, but there is evidence that the shareholder exercises control over the board (if, for example, the directors defer to the views of the shareholder).[75]

If a shareholder is viewed as controlling, there are two consequences. First, that shareholder is deemed to owe fiduciary duties to the remaining, "minority" shareholders.[76] These duties extend to the shareholder's action in influencing board or management decisions, but not to its actions in voting its shares.

Second, special rules apply to the legal standard for alleged breaches of fiduciary duties, at least some breaches. Transactions that do not enjoy the protection of the business judgment rule – because they entail self-dealing, other material conflicts of interest, or where arrived at in a grossly negligent matter – are evaluated under the entire fairness standard, with the burden of proving entire fairness on the defendant directors (or the defendant controlling shareholder). But generally, if these transactions are approved, after full disclosure, by a majority of disinterested and independent directors or disinterested shareholders, the business judgment rule is reinstated and the transaction must pass only the (lenient) standard of waste.[77] Such approvals are also referred to as "cleansing acts."

However, if the transaction involves a controlling shareholder, the rules on cleansing acts are different. First, as to approval by disinterested directors, the court mandates stricter conduct before their approval "counts." In particular, it is not sufficient that these directors are technically disinterested and independent; they must also devote substantial care to evaluating the transaction, must have the power to say no, and must employ appropriate processes (including, when warranted, the hiring of independent legal and business advisors). Second, as to the effect of the cleansing act (if the approval counts), it is not to reinstate the business judgment rule, but merely to shift the burden on proving entire fairness to the plaintiffs (who have to prove that the transaction was not entirely fair).[78]

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[75] Folk on Corporate Law §151.5.1 GCL-V-34, citing, inter alia, Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1344 (Del. 1987), Tri-Star Pictures, 634 A.2d 319, 328 (Del. 1993). See, also, In re Cysive, 836 A.2d 531 (Del. Ch. 2003); Emerald Partners v. Berlin, 787 A.2d 85, 96-97 (Del. Ch. 2001); Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1114 (Del. 1994).

[76] Folk at §151.5.1.

[77] Cite.

[78] *See, e.g.*, *Lynch Commc'n*, 638 A.2d at 1117. There is some ambiguity in the Delaware case law. *Compare* Kahn v. Tremont Corp., 694 A.2d 422, 428 (Del. 1997) (stating, in context of self-dealing transaction involving

The reason for the skepticism about approval by independent directors is reasonably clear. After all, a majority shareholder controls the board composition and thus effectively appoints the directors, can remove them at any time, and they know it. Even non-majority controlling shareholders have substantial influence over board composition. Directors have sometimes shown excessive deference to controlling shareholders, leading to some skepticism on just how independent they can or will be.[79] In the Delaware case law, controlling shareholders have been likened to "800 pound gorillas" who are so intimidating that they always get their way.[80]

As to the approval by disinterested shareholders, the stated reason for the skepticism is that shareholders may be afraid of retaliation by the controlling shareholder if they fail to grant their approval. A second, unstated reason is that shareholders, without the benefit of the advice by trusted independent directors and subject to their own collective action problem, may make too many mistakes for their approval to justify restoring "business judgment" review.

But whatever the poundage of a regular private controlling shareholders, the problems created – and the weight of the corresponding gorilla – are magnified when the controlling shareholder is the U.S. government. First, for many of the companies in which the U.S. government has obtained a controlling stake, the influence of the government extends beyond its influence as a large shareholder. For banks and other financial companies, the government also acts as the principal regulator.[81] In companies such as AIG, GMAC and Citi, the government also has a significant stake as a creditor, and may be the sole source of additional capital. And for any company, regardless of industry, the potential exists that the government will pass new types of regulation. This potential is not far-fetched. Companies that were recipients of federal TARP funds - several of which were pushed by the government to take these funds – found themselves subject to a new law, not applicable to other companies, that forced them to either limit the amount of executive compensation or to submit their compensation to an advisory shareholder

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controlling shareholder, that approval by properly functioning committee of independent directors would shift burden on entire fairness standard to plaintiffs), *with* Orman v. Cullman, 794 A.2d 5, 20 n.36 (Del. Ch. 2002) (stating, in context of merger involving material conflict of interest on part of controlling shareholder, that entire fairness applies *ab initio* only to freeze-out mergers with controlling shareholders). *Orman v. Cullman* thus raises the possibility that entire fairness does not apply to *all* transactions involving controlling shareholders, but only to a subset, namely, freeze-out mergers.

[79] See, e.g., In re Emerging Communications, Inc. Shareholders Litigation, 2004 Del. Ch. LEXIS 70.

[80] In re Pure Resources, Inc. Shareholders Litigation, 808 A.2d 421, 436 (Del. Ch. 2002) ("The Supreme Court [in Kahn v. Lynch Communications] concluded that even a gauntlet of protective barriers like those would be insufficient protection because of (what I will term) the 'inherent coercion' that exists when a controlling stockholder announces its desire to buy the minority's shares. In colloquial terms, the Supreme Court saw the controlling stockholder as the 800-pound gorilla whose urgent hunger for the rest of the bananas is likely to frighten less powerful primates like putatively independent directors who might well have been hand-picked by the gorilla (and who at the very least owed their seats on the board to his support).")

[81] On the influence this can give, see, e.g., Sorkin, TBTF at 525 (In the meeting of bank CEOs with Treasury Secretary Paulson, he insisted that the major banks accept TARP money, whether they wanted it or not. When Richard Kovacevich, CEO of Wells Fargo, resisted, Sorkin reports that Paulson "told him, 'Your regulator is sitting right there.' John Dugan, comptroller of the currency, and FDIC chair woman Sheila Bair were directly across the table from him. 'And you're going to get a call tomorrow telling you you're undercapitalized and that you won't be able to raise money in the private market.'")

vote. Because the government holds so many levers – as large shareholders, as present and potential future regulator, and sometimes as lender and creditor – it is a much bigger gorilla than a regular private controlling shareholder.

Second, conflicts between the controlling shareholder and the minority shareholders are much harder to monitor when the controlling shareholder is the government. For regular private controlling shareholders, the conflicts of interests are predominantly financial. Such conflicts arise in so-called "self-dealing" transactions – where the controlled entity deals either directly with the controlling shareholders or with another entity in which the controlling shareholder has an interest – or in conflicts transactions, where the controlling shareholder stands to receive some financial benefit that is not proportionally shared with the minority shareholders. Self-dealing transaction and (if the conflict is material) conflicts transactions are subject to review for their entire fairness.

The U.S. government and its various parts, however, have a wide variety of interests other than financial ones. Indeed, the predominant worry, when the U.S. government is the controlling shareholder, will not be that the government wants to enrich itself financially at the expense of the minority shareholders, but that the government will induce the corporation to pursue political or policy goals, rather than maximize its value for the proportionate benefit of all its shareholders. This greatly complicates the task of courts. Self-dealing transactions and material financial conflict transactions are relatively easy to identify by objective standards. By contrast, to determine whether a transaction serves the government's political goals is much harder. The government's political goals are both amorphous and far-reaching, so that a large number of transactions can plausibly be argued to serve these goals. Unless all of these transactions are subjected to entire fairness review, the court would have to determine whether the goal is important enough, and whether the transaction furthers sufficiently to warrant stricter scrutiny. Since neither of these factors is easily and objectively quantifiable, this is a difficult task.

Finally, review of such conflicts is rendered more difficult because the government is not a unitary actor. Private, controlling shareholders, of course, are also not unitary actors when they are corporations. But authority within corporations is hierarchical, so if one agent of the controlling shareholder corporation acts (e.g., asking the CEO or to board to take a certain action), her actions can fairly be attributed to the corporation under normal agency law principles. If the government is the controlling shareholder, however, there are problems with such attribution. Start with actions by members of the executive branch and assume that the controlling stake is held somewhere in the Department of the Treasury. Should all actions by members of the executive branch by attributed to "the government", only those actions originating in the Department of the Treasury, or only those originating from the office within the department that holds the controlling stake (or anyone above it)? What if a regulatory agency (within or without Treasury) requests the CEO to take certain action as regulator? What if that regulator "reminds" the CEO of the interest of the government as shareholder?

Issues are even more complicated if the request for an action originates in the legislative branch. Members of Congress can clearly have substantial influence over the executives and management of the controlled company is well aware of that. When influential members of Congress request executives of a controlled company to take particular actions, the requests will carry special weight because the government is a controlling shareholder. Yet, it is unclear how these requests ought to be treated for purposes of Delaware law.

B. **Introduction: the Delaware Corporate Law Structure**

Return to our original hypo: the government, with 56% of the votes the controlling shareholder of DMAC, leans on DMAC to lend to DM and its dealers and customers on preferential terms in order to benefit DM, with a potential cost to DMAC shareholders. Moreover, the Treasury, with 60% of the votes, leans on DM to make its product line more environmentally friendly.

To understand the distinctive challenges posed by government ownership, we first review the analysis when it only involves private parties. Under current Delaware law, the hypo poses obvious duty of loyalty and potentially duty of care problems. Under the duty of loyalty, the controlling shareholder faces a conflict of interest between its interests in DMAC and its interests in a separate corporation, DM. The key questions under the duty of care are whether the controlling shareholder, in forcing DM to change its product mix, has breached any duty and, if so, whether it has been or could have been exculpated or indemnified against damages.

1. **The Duty of Loyalty claim**

The treatment of this sort of conflict is well developed under Delaware corporate law. A shareholder of DMAC would bring a derivative action in Delaware Chancery Court on behalf of DMAC against the controlling shareholder (assuming that the controlling shareholder had enough contacts with Delaware to support personal jurisdiction), the controlling shareholders' designees/employees on the board of directors and, for good measure, the other directors as well, alleging breach of the duty of loyalty.

As in any derivative suit, demand on the board is required unless it would be excused as futile. In this case, demand would probably be excused. Ordinarily, Delaware courts apply to the so-called *Aronson* test to determine demand futility.[82] Under *Aronson*, a derivative plaintiff must allege specific facts that create a reasonable doubt as to whether (1) a majority of the board is disinterested or independent or (2) the challenged transaction was the product of the board's valid exercise of business judgment.[83] When there is a private controlling shareholder, demand will

[82] Aronson v. Lewis, 473 A.2d 805, 814-15 (Del. 1984).
[83] *Id.*

often be excused under the first prong either because directors have an interest in the transaction or have other business relationships with the controlling shareholder.[84] If the self-dealing transaction involving a controlling shareholder is substantively analyzed under the entire fairness test–and thus *not* protected by the business judgment rule–there is a good argument that demand is excused under the second prong of *Aronson*.[85]

If demand were excused, the court would independently evaluate both the financial terms of the transactions and the process leading to it to determine if they comply with the "entire fairness" standard. In short, if the transaction were unfair, there is a significant likelihood that the plaintiffs would succeed in either enjoining the transaction or recovering damages. The robust protections provided by the duty of loyalty is a function of relatively clear rules enforced by private injunctive and damages actions.

This is not a hard case under Delaware law. With its longstanding focus on controlling self dealing by interested directors and controlling shareholders, Delaware has encountered and analyzed a dizzying range of variations on this basic fact pattern and has develop an intricate set of doctrines that discourage and deter interested fiduciaries from exploiting their control for non-firm purposes. In the private context, when as here the controlling shareholder has, by hypothesis, directly interfered in order to force a transaction with a related party on preferential terms, and without any independent negotiating structures or non-controlling shareholder approval, the liability of the controlling shareholder is so clear that one rarely encounters such behavior.

2. **The Duty of Care Claim**

Let us assume that the DM shareholders turn out to be right that the Treasury's insistence that new DM make its product mix much greener is a catastrophic business decision that costs DM billions of dollars. Moreover, let us assume that, in retrospect, the decision was grossly negligent by any measure: there were no market tests to support the prediction that American consumers would buy such cars from DM; the controlling shareholder had no expertise and no experts with regard to either the development, engineering, manufacturing or marketing of automobiles, much less green automobiles; the decision was rushed through with little deliberation, and over the (muted) opposition of long time executives and directors. The shareholders would now like to sue. Do they have a decent claim under existing Delaware law?

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[84] McPadden v. Sidhu, 964 A.2d 1262, 1270-73 (Del. Ch. 2008) (excusing demand where the board appointed an overseer who solicited sham bids and ultimately awarded a contract to his own company).

[85] To our knowledge, no case directly endorses or rejects the proposition that demand is automatically excused under the second prong of *Aronson* for self-dealing transactions with controlling shareholders that, under *Kahn v. Lynch Commc'n*, are always subjected to entire fairness review. For a further discussion of this point, see Kahan & Rock, -- Del. J. Corp. L. at XX.

This part of the hypo is obviously designed to raise a straightforward duty of care question. There are four parts of the analysis: first, whether the controlling shareholder in the hypo owes a duty of care; second, whether its actions violate the duty of care; third, whether any liability for a violation has been exculpated or otherwise immunized; and fourth, even if it has, is injunctive relief available?[86]

On the first point, Delaware law is clear that when a controlling shareholder exercises control over business decisions, it takes on the same duties of care that other fiduciaries have. [87]

As to the duty of care analysis itself, as recent cases from Delaware confirm, Smith v. Van Gorkom still provides the standard for liability under the duty of care: gross negligence.[88] The hypo paints the unrealistic situation in which the decision making process is grossly negligent (if, as stated above, the negligence is not gross enough, modify it however you wish).

This then moves us to the third issue, namely, whether this conduct could be exculpated under §102(b)(7).[89] Although current Delaware case law wrestles with identifying the border between gross negligence (which can be exculpated) and bad faith (which cannot),[90] the hypo can be decided on a simpler basis: does §102(b)(7) apply to a controlling shareholder? Here, the answer is clearly no. By its terms, it only permits exculpation of directors.[91]

A more interesting issue is posed if we assume that the controlling shareholder is indemnified by DMAC.[92] Under Delaware law, two problems stand in the way of such indemnification. First, under §145, indemnification is only permitted for a person who is sued "by reason of the fact that the person is or was a director, officer, employee or agent of the corporation." In our hypo, it is not obvious that the controlling shareholder is an agent of the corporation and, by design, is not a director, officer or employee. Second, indemnification is limited to situations in which the person "acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation." This latter analysis poses some of the same questions regarding the line between gross negligence and bad faith that have featured in the Delaware case law on 102(b)(7).[93]

Finally, even if the control shareholder is somehow indemnified against liability, injunctive relief against grossly negligent conduct is still available, at least in principle. Although there are no

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[86] As the suit would be derivative, the preceding discussion on whether demand would be excused applies.
[87] *Cinerama, Inc. v. Technicolor, Inc*., 1991 Del. Ch. LEXIS 105, 1991 WL 111134, at *19 (Del. Ch.), *aff'd in part, rev'd on other grounds sub nom*, 634 A.2d 345 (Del. 1993) ("when a shareholder, who achieves power through the ownership of stock, exercises that power by directing the actions of the corporation, he assumes the duties of care and loyalty of a director of a corporation."), cited with approval in Pfeffer v. Redstone, 965 A.2d 676 (Del. 2009).
[88] See, e.g., MCG Capital Corp. v. Maginn, et al, 2010 Del. Ch. LEXIS 87, *79 n. 129.
[89] Lyondell, Del SCt 2009.
[90] Lyondell Chem. Co. v. Ryan, 970 A.2d 235 (Del. 2009).
[91] Del. GCL §102(b)(7).
[92] If new DM goes bankrupt again because of its switch to green cars, the indemnification – even if permitted – will not be any use.
[93] See, e.g., Lyondell.

recent examples of injunctions granted in remotely similar situations,[94] the courts have shown a willingness to enjoin what are, in essence, duty of care violations in the M & A context as, for instance, when a transaction is enjoined because directors have not complied with their "Revlon duties," even if the same conduct will not be considered "bad faith" for purposes of exculpation.[95]

3. The Duty of Good Faith Claim

The request by the Treasury that DM not close factories in certain states deemed important either to national economic policy or to the president's chances of getting reelected is hardest to categorize under Delaware law. One could argue that the Treasury is subject to a material conflict of interest, albeit not a financial one, and thus has the burden of showing the entire fairness of the factory closing policies it is pursuing. While this is doctrinally cogent, we think that the better analytical category for this action can be found in the newly developed Delaware jurisprudence on bad faith. Actions taken in bad faith are not protected by the business judgment rule (nor insulated from liability under section 102(b)(7)) and are a subcategory of breaches of the duty of loyalty.

In the recent Delaware Supreme Court opinion in Stone v. Ritter, the court elaborated on the concept of bad faith. It explained that bad faith may be shown where

> The fiduciary intentionally acts with a purpose other than that of advancing the best interest of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary fails to act in the face of known duty to act, demonstrating a conscious disregard for his duties.

In our hypothetical, the request by the Treasury fits squarely into the first of these categories of bad faith, though in the real world, the facts will rarely be so clear.

C. The Direct Challenge: The U.S. Treasury's Obligations as Controlling Shareholder.

As this brief analysis of Delaware law suggests, a plaintiff could bring a plausible derivative suit alleging a breach of fiduciary duty against a private controlling shareholder in the facts set forth in the hypo, would stand an excellent chance of establishing that demand is excused, and a non-trivial chance of prevailing on the substantive claim.

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[94] For an example in which a court refused to enjoin a fairly transparently foolish business decision, see Shlensky v. Wrigley, 237 N.E. 2d 776 (Ill. App. 1968).
[95] See, e.g., CITE.

How does this change now that the controlling shareholder is the government? The short answer is "in many more ways than you can begin to imagine!" Below, we explore those differences. As we will explain, to sue the government, a private plaintiff would have to overcome the protections the government has granted itself under the heading of sovereign immunity and may not be able to proceed in the Delaware state court. Before we pursue this analysis, however, we want to stress that even in the "ideal" scenario in which a plaintiff could go to a Delaware court which would apply ordinary Delaware law, a suit against the U.S. government as controlling shareholder faces special problems.

1. **Delaware Law and the U.S. Government**

Most lawsuits for breaches of fiduciary duty in a public Delaware corporation are brought in the Delaware Chancery court, a court that specializes in corporate law and has widely acknowledged expertise in dealing which such suits. But even apart from the jurisdictional problems addressed below, the Delaware chancery court is less than the ideal venue for pursuing fiduciary duty claims again the U.S. government. The state of Delaware derives substantial revenues from its franchise tax (paid mostly by public corporations). In 2008, the revenues amounted to $ ___ million, , or __% of the state's budget. Delaware is obviously keen on having these revenues flow into its coffers.

Delaware is able to charge corporations significant franchise fees because its corporate law, and the quality of its judiciary, is considered superior to the law and the judiciary of other states. However, as Mark Roe has forcefully pointed out, Delaware's franchise tax business lives by the grace of the federal government.[96] Congress could, in one fell swoop, wipe out this business by federalizing corporate law. Congress, of course, has not done so, and, as we have argued, is unlikely to do so under ordinary political circumstances.[97] This being said, Delaware clearly has an incentive to avoid annoying the U.S. government, or even to avoid action that may annoy the U.S. government.

The members of Delaware's judiciary are usually former lawyers or governmental officials who are well aware of the state's interest. Thus, one may wonder whether the Delaware court, whether consciously or subconsciously, may deal with suits against the U.S. government for breaches of fiduciary duty less strictly than with equivalent suits against private parties. Where the law or the facts are unclear, there will be an inherent temptation not to pick a fight with someone who can cut off so much of your funding. Thus, even if a plaintiff could bring a lawsuit against the U.S. government in the Delaware state court, she may be well advised to seek a different forum.

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[96] Mark Roe, Delaware's Competition, 117 HARV. L. REV. 588, 600- 607 (2004).
[97] Kahan and Rock, Symbiotic Federalism and the Structure of Corporate Law, 58 Vand. L. Rev. 1573 (2005).

In addition, Delaware doctrinal law is – at least at present – not well equipped to handle the kind of conflicts that would arise when the government is the controlling shareholders. This is illustrated by our hypothetical request to avoid plant closures in states that are politically important for the government, either because of public policy or partisan political considerations. When the government, as controlling shareholder, interferes in business decisions, many conflicts of interest will be based on political interests – such as in this hypothetical – rather than financial – such as in the hypothetical of the loan by DMAC.

But it is hard for judges, including Delaware's, to evaluate such political interference. Virtually any action taken by the government has some plausible political motive. But Delaware law requires, in non self-dealing transactions, that the conflict of interest be material. How does a judge evaluate the materiality of conflicts when the conflict is non-financial? Should the judge determine the importance of the political motive, on its own or in relation to non-political motives? And important to whom? The Secretary of the Treasury, the President, or the President's chief pollster? What evidence can be adduced? Can all governmental officials be deposed and internal records be requested? It is clear that problems abound.

As a result, even if the government were treated doctrinally like any other controlling shareholder, governmental control of companies with minority shareholders would raise special problems. But as discussed below, the government is treated rather differently. This, alas, magnifies the problems. As we have argued elsewhere, because Delaware is bound to lose any confrontation with Washington, it is well advised to avoid such fights, preferably through reliance on discretion within procedural rules, rather than through a distortion of its corporate law doctrine.[98]

2. **Sovereign Immunity and its Limits: Claims Against the US Government.**

The starting point for any analysis involving suits against governmental entities is the doctrine of sovereign immunity which holds that the United States government cannot be sued except in so far as it has waived its immunity.[99] Through various statutes, the US government has waived much of its immunity, but not all, and always with limitations.

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[98] Kahan & Rock, When the Government is the Controlling Shareholder: Implications for Delaware, -- Del. J. Corp. L. – (2010); Kahan & Rock, How to Prevent Hard Cases from Making Bad Law: Bear Stearns, Delaware and the Strategic Use of Comity, 58 Emory L. J. 713 (2009); Kahan & Rock, Symbiotic Federalism and the Structure of Corporate Law, 58 Vand. L. Rev. 1573 (2005)..

[99] See *United States* v. *Sherwood*, 312 U.S. 584, 586 (1941); 14 C. Wright, A. Miller, & E. Cooper, Federal Practice And Procedure § 3654, pp. 156-157 (1976).

Moreover, because of the general immunity, any limitations are narrowly construed and burdened with conditions. The principal waivers of sovereign immunity are contained within the Federal Tort Claims Act, which broadly speaking permits suits against the United States for tortious acts by its agents; the Tucker Act, which permits claims against the US for damages not involving tortious conduct (which includes, inter alia, contract claims and takings claims); and the Administrative Procedure Act which permits actions against the US for review of agency action seeking relief other than money damages. As we'll discuss below, each of these frameworks complicates actions against the US for acts that, under Delaware corporate law, could constitutes breaches of the duty of loyalty or care.

a. **Jurisdiction and Venue: The Limitation of Delaware's Role**

A key dimension of sovereign immunity that remains in force is choice of forum. The US has never waived its immunity to suit in state court. Rather, *all* suits against the US must be brought either in federal district court or the court of federal claims, depending on the cause of action: under 28 USC §1346, all civil cases against the United States must be brought in either federal district court or the court of federal claims, depending on the claim; under 28 USC §1442, any claim against the US filed in state court can be removed to federal district court. Once in the federal system, who, if anyone, *can* plaintiffs sue and for what? Here the real complexity begins. In the following subsections, we will analyze potential claims under the three principal statutory headings: the Federal Tort Claims Act; the Tucker Act; and the Administrative Procedure Act.[100]

[100] These provisions cannot be avoided by suing government agents rather than the government. The *Ex Parte Young* fiction that a suit against a government agent was not a suit against the government was essentially eliminated by the provision for direct review of agency action under 5 USC 702 (as we discuss further below). This is complemented by the "Federal Employee Liability Reform and Tort Compensation Act" which provides that:

> "Upon certification by the Attorney General that the defendant employee was acting within the scope of his office or employment at the time of the incident out of which the claim arose, any civil action or proceeding commenced upon such claim in a State court shall be removed without bond at any time before trial by the Attorney General to the district court of the United States for the district and division embracing the place in which the action or proceeding is pending. Such action or proceeding shall be deemed to be an action or proceeding brought against the United States under the provisions of this title and all references thereto, and the United States shall be substituted as the party defendant. This certification of the Attorney General shall conclusively establish scope of office or employment for purposes of removal."

This is known as the "Westfall Act," and is codified at 28 USC §2679(b)-(d) at 28 USC §2679(d)(2).

b. **Federal Tort Claims Act Claims**

i. **Is a breach of fiduciary duty a "tort"?**

The Federal Tort Claims Act waives sovereign immunity for "tort claims." The key substantive provision is provided by 28 USC §2674 which states that:

> "The United States shall be liable, respecting the provisions of this title relating to tort claims, in the same manner and to the same extent as a private individual under like circumstances, but shall not be liable for interest prior to judgment or for punitive damages."

The key jurisdictional provision is provided by 28 USC 1346(b)(1) which decrees exclusive federal jurisdiction. The first challenge, then, is determining whether breach of fiduciary duty claims are "tort" claims? This is a conceptually interesting and complex question that does not have a clear answer.

As a historical matter, breach of fiduciary duty is not a "tort." It is an equitable rather than a legal claim and predates the sources of modern tort law, namely, trespass and trespass on the case.[101]

As a conceptual matter, it is pretty clear that breaches of fiduciary duties are not torts, at least not in the common law use of that term, although they may be "civil wrongs."[102] Indeed, if one carefully distinguishes between fiduciary duties and the duties of fiduciaries, one can identify core duties created by the fiduciary relationship that are, in fact, separate and apart from duties created by tort or contract law. On the other hand, the conceptual argument may prove too much, at least for Delaware law: when one carefully defines fiduciary duty, many argue that the trustee's or fiduciary's duty of care is not, properly speaking, a *fiduciary* duty at all, although it may well be a duty that a fiduciary has.[103]

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[101] Joshua Getzler, Rumford Market and the Genesis of Fiduciary Obligation, in Mapping the Law: Essays in Memory of Peter Birks (Andrew Burrows and Lord Rodger of Earlsferry, eds) (OUP 2006) at Ch. 31.

[102] Peter Birks, The Content of Fiduciary Obligation, 34 Isr. L. Rev. 3 (2000); P.D. Finn, "The Fiduciary Principle" in T.G. Youdan, Equity, Fiduciaries, and Trusts (Carswell, Toronto, 1989) 1; Sarah Worthington, "Fiduciaries: When is Self-Denial Obligatory?" 58 Cambridge L. J. 500 (1999). R.P. Austin, "Moulding the Content of Fiduciary Duties" in A.J. Oakley, Trends in Contemporary Trust Law (OUP, Oxford, 1996) 153, at 156, quoted in Peter Birks, The Content of Fiduciary Obligation, 34 Isr. L. Rev. 3, 5 (2000). Birks provides a different although related analysis of the content of the fiduciary obligation. For Birks, fiduciary duty is derivative from the duty of the trustee of an express trust. By contrast, Getzler suggests that the evidence equally supports that view that fiduciary duty predates, and forms an essential component to, the creation of express trusts and the duties of the trustee. Joshua Getzler, Rumford Market and the Genesis of Fiduciary Obligation, in Mapping the Law: Essays in Memory of Peter Birks (Andrew Burrows and Lord Rodger of Earlsferry, eds) (OUP 2006) at Ch. 31, 577. For a US perspective, with US cites, see Roy Ryden Anderson & Walter W. Steele, Fiduciary Duty, Tort and Contract: A Primer on the Legal Malpractice Puzzle, 47 S.M.U. L. Rev. 235 (1994).

[103] See the discussion in Birks, with special reference to the leading case of Bristol and West Building Society v. Motthew, [1996] 4 All ER 698 (Millett L.J.).

More recently, the question of whether a breach of fiduciary duty is a tort has arisen in the context of whether a statute of limitations applies to breach of fiduciary duty claims and, if so, which one. Older cases held that statutes of limitations do not apply in equity which, instead, relies on the more flexible doctrine of laches.[104] Over time, as the jurisdiction of equity courts has expanded, as in Delaware, this distinction has broken down. Under current Delaware law, Chancery Court looks to legal statutes of limitation as establishing a presumption for the application of laches to equitable claims, although with a heavy dose of equity in its liberal rules for tolling.[105]

This evolution has forced courts to reach the question of *which* statute of limitations to apply or to look to for guidance. In some states, courts have applied the tort statute.[106] Other courts have applied the statute of limitations for contracts.[107] Finally, others, including Delaware, have applied a more general, catch-all limitation rule, even when a specific tort rule exists.[108] Statutes of limitations, then, provide an uncertain guide to whether breach of fiduciary duty claims are tort claims.

But history, conceptual analysis, or analogous situations under state law cannot alone determine whether the use of the term "tort" in the FTCA was intended to include or should be read to include breaches of fiduciary duty. Rather, the question is whether the FTCA should, as a matter of statutory interpretation, be viewed as waiving immunity for breaches of fiduciary duty. This question is linked to whether breach of fiduciary duty cases can be brought under the second major infringement on sovereign immunity, the Tucker Act, because the Tucker Act is explicitly complementary and non-overlapping.[109] Unfortunately, the legislative history of the FTCA

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[104] For a very perceptive discussion of the older cases, see Kahn v. Seaboard Corp., 625 A.2d 269, (Del. Ch. 1993).

[105] Kahn v. Seaboard; Albert v. Alex. Brown Management Services, 2005 Del. Ch. LEXIS 100 at *37. For a good discussion of the more general phenomenon, see Matthew Dore, Statutes of Limitation and Corporate Fiduciary Duty Claims: A Search for Middle Ground on the Rules/Standards Continuum, 63 Brooklyn L. Rev. 695 (1997).

[106] e.g., FDIC v. Dawson, 4 F.3d 1303 (5th Cir. 1993) (claims against directors and officers of failed bank sounded in tort and were therefore governed by Texas' two year statute of limitations), and Crosby v. Beam, 615 N.E.2d 294 (Ohio Ct. App. 1992) (minority stockholder's claims against corporate directors and officers and corporate entity governed by Ohio's four year tort statute of limitations).

[107] RTC v. Armbruster, 52 F.3d 748 (8th Cir. 1995) (claims against directors of failed savings and loan governed by Arkansas three year limitations provision for contract actions), and Bibo v. Jeffrey's Restaurant, 770 P.2d 290 (Alaska 1989) (claims against corporate directors governed by Alaska's six year statute of limitations for contract actions).

[108] Kahn v. Seaboard Corp., 625 A.2d 269, (Del. Ch. 1993) (looking to general three year limitation period under 10 Del. C. § 8106, rather than the two year period under §8107 (wrongful death or injury to personal property) or §8119 (personal injuries)).
More recently, Travis Laster and Michelle Morris have argued persuasively that, at least in terms of Delaware's Uniform Contribution Among Tortfeasors Act, breaches of fiduciary duty should be treated as "equitable torts." Travis Laster and Michelle Morris, Breaches of Fiduciary Duty and the Delaware Uniform Contribution Act, unpublished draft on file with authors.

[109] 28 U.S.C. § 1491(a)(1) ("The United States Court of Federal Claims shall have jurisdiction to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress or any

seems to be entirely silent on the question, focusing instead on whether the government should assume liability for automobile accidents, "With the expansion of governmental activities in recent years, it becomes especially important to grant to private individuals the right to sue the Government in respect to such torts as negligence in the operation of vehicles."[110]

The "Indian Trust" cases – a line of cases that have been uniformly brought under the Tucker Act (which we will discuss later) – cast some light. In those cases, Indian tribes sued, alleging that the US government breached fiduciary duties owed to the Indian tribes in the stewardship of their land and natural resources. Thus, for example, in U.S. v. Mitchell,[111] members of the Quinault Indian Tribe alleged that the US government breached its fiduciary duties to them by failing to manage their allotted lands properly, a claim the Supreme Court accepted. If, under Mitchell II, a breach of fiduciary duty claim can be brought under the Tucker Act, then it must be a claim for damages "not sounding in tort."

Mitchell II, however, involved an explicit, federal, statutory acceptance of a fiduciary relationship towards the tribe members. It may be that it was the presence of this specific statute, rather than the general nature of the claim, that brought it under the Tucker Act.[112] Indeed, there is some Tucker Act law that narrowly construes the Indian Trust cases and holds that generally, claims of breaches of fiduciary duty, if they give rise to any claim, give rise to torts.[113] Along these same lines, Delaware Chancery Court, interpreting and applying a Massachusetts statute that limited liability of charities for tort actions held that (at least under Massachusetts law) breach of fiduciary duty could be considered a tort for the purposes of the statute.[114] The question of how breaches of fiduciary duty actions fit within the federal waivers of sovereign immunity is thus uncertain.

But suppose, arguendo, that a breach of the duty of loyalty will be viewed as a tort for the purposes of the FTCA. Which state's fiduciary law would apply? Suppose that the plaintiff alleges that the responsible Treasury officials breached their fiduciary duties while in Detroit for a board meeting. According to §1346(b)(1), whether the act or omission is a tort is determined by whether "a private person, would be liable to the claimant in accordance with the law of the place where the act or omission occurred." This provision points to Michigan as the relevant state. But, as a leading Supreme Court case points out, in determining the relevant law for the

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regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases **not sounding in tort**." Emphasis added).

[110] Tort Claims Against the United States, House Report 2245, committee of whole house 1942, H.R. Rep. No. 77-2245, at p. 7 (1942).

[111] 463 U.S. 206 (1983)(generally referred to as "Mitchell II").

[112] Of course, that a state common law based breach of fiduciary duty claim cannot be brought under the Tucker Act does not mean that it can be brought under the FTCA. It could fall between two stools, always a possibility given the background sovereign immunity and the narrow interpretation of any derogations.. See, e.g., the case involving car accident by federal employee outside of U.S. which resulted in no claim.

[113] Am. Ins. Co. v United States (2004) 62 Fed Cl 151.

[114] Olivier v. Boston University, **2005 Del. Ch. LEXIS 14**

FTCA, you take the whole law of the state including its choice of law rules.[115] Because Michigan, like most US states, follows the "place of incorporation" doctrine in determining applicable corporate law,[116] and because DM and DMAC are both, by hypothesis, Delaware corporations, Delaware law would provide the rule of decision.

ii. The "discretionary functions" exception

But we are hardly home free. Under 28 USC § 2680(a), the FTCA does *not* apply to "Any claim . . . based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty on the part of a federal agency or an employee of the Government, whether or not the discretion involved be abused." This defense, known as the "discretionary functions exception," provides a very important limitation on the reach of the FTCA. Indeed, depending on how broadly it is interpreted, the exception could swallow the whole waiver of sovereign immunity.

Assuming, as we do above, that the Treasury officials who make the decision to compel DMAC to lend to DM and its customers and dealers on preferential terms are employees (whether or not they are also directors), does the "discretionary function" exception apply?

There is a fairly long line of Supreme Court cases interpreting this language in an attempt to draw a line between protecting policy choices by public officials that have winners and losers, without also immunizing negligent conduct that injures innocent bystanders. Thus, in *Dalehite v. US*,[117] at issue was a conscious decision to cut corners to reduce costs in the manufacture of fertilizer to ship abroad, a decision that resulted in a cargo ship exploding in the harbor and causing damage. In holding that the decision was protected by the discretionary function exception, the court drew a distinction between the "planning level" which was protected by the exception and the "operational level" which was not. Later, in *US v. Varig Airlines*,[118] the court rejected an FTCA claim for negligent certification of an aircraft, and added that the purpose of the exception was to protect the government from judicial second guessing of legislative and administrative decisions that were grounded in economic and political policy.[119] Even later, in *Berkovitz v. US*,[120] the court examined a claim that the FDA had negligently licensed a vaccine manufacturer and negligently approved the release of a particular batch of vaccine. The court limited the exception to "discretionary" decisions – where the decision involved was a matter of permissible choice for government employee – and refused to apply it to mandatory activities and must be made on the basis of objective criteria when there is no permissible discretion.

[115] Richards v. US, 369 US 1 (1962)
[116] Restatement 2d Conflicts of Laws 306, 309 and 4(2).
[117] 346 US 15 (1953).
[118] 467 US 797 (1984).
[119] Sisk at 145.
[120] 486 US 531 (1988).

The court once again tried to define the limits of the exception in its most recent effort, *US v. Gaubert*,[121] which emerged out of the S & L crisis of the 1980s. In *Gaubert*, the founder and largest shareholder of an S & L accused the Federal Home Loan Bank Board (the now superceded agency then charged with regulating savings and loan associations) with negligence in its supervision of the S & L. According to the shareholder, the FHLBB interfered in day to day operations of the bank, pressured it to merge, threatened to close it unless the managers and board resigned, influenced the selection of new management, and ultimately caused it to fail.

The Supreme Court rejected the claims and stated that:

> when established governmental policy, as expressed or implied by statute, regulation, or agency guidelines, allows a Government agent to exercise discretion, it must be presumed that the agent's acts are grounded in policy when exercising that discretion.[122]

The *Gaubert* standard – criticized in the literature as too deferential in creating a perhaps irrebutable presumption that discretion was exercised when the decision was of a *type* that is susceptible to policy analysis, even when there is no evidence that the agent actually engaged in any such analysis[123] – provides the current boundaries of the exception. Interestingly, for our purposes, it does so in a context that is at least superficially quite similar to the current state of affairs: efforts by government officials to work through a banking crisis.

With respect to the duty of care claim, *Gaubert* would seem to provide a very strong defense. In *Gaubert*, a founder and large shareholder of an S & L alleged that FHLBB's day to day second guessing and interference caused the S & L to fail. Nonetheless, the court held that the FHLBB was protected under the "discretionary functions" exception. Here, as there, the exception would apply because, as *Gaubert* held, "it must be presumed that the agent's acts are grounded in policy when the agent exercises that discretion." The decision to adopt a greener product mix is surely no less entitled to the "discretionary function" exception than interfering in the day to day operation of an S & L.

On the other hand, *Gaubert* involved a governmental agency that used its discretion in the exercise of its regulatory function. Whether the rationale of *Gaubert* and the other cases applies with equal force to governmental officials who act outside their regulatory purview - say Treasury officials with respect to the type of car to be produced and the location of plants to be closed – is unclear.

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[121] 499 US 315 (1991).
[122] 499 US at 322-323.
[123] See, e.g., Harold Krent, Preserving Discretion without Sacrificing Deterrence: Federal Governmental Liability in Tort, 38 UCLA L. Rev. 871, 898 n. 117 (1991).; Peter H. Schuck & James J. Part, The Discretionary Function Exception in the Second Circuit, 20 Quinnipiac L. Rev. 55, 65-66 (2000)

iii. Are the actions in the hypo choices from "a range of permissible courses"?

The duty of loyalty claim is more complicated. Were the actions of the Treasury officials, in leaning on DMAC to lend to DM, its dealers and customers, pursuant to a regulation that allowed the exercise of discretion and policy judgment by the employee or agent? How do the agents' actions compare to those of the FHLBB in overseeing the failing S & L? According to the *Gaubert* court, "day to day management of banking affairs, like the management of other businesses, regularly requires judgment as to which of a range of permissible courses is wisest. Discretionary conduct is not confined to the policy or planning level."[124]

In our hypo, did the Treasury agents exercise judgment in choosing the wisest of a range of *permissible* options? Here we get to a very interesting feature of the Government's involvement in the automobile industry. From a legal/regulatory perspective, it has been ad hoc, even perhaps haphazard. Therefore, under the relevant statutory authority, it is unclear what courses of action are permissible.

When the EESA was enacted in October 2008, Congress was led to believe that the $700 billion would be used to buy up toxic assets, thereby freeing banks to lend again. The original conception for the TARP program, the Troubled Asset Relief Program, and the basis upon which it was presented to Congress,[125] was to give the Treasury authority and funding to purchase illiquid assets from troubled financial institutions.

As noted above, the operative provisions of the statute reflect this understanding. There is plenty of legislative history that is consistent with this reading. Even worse, prior to launching the AIFP, the Treasury sought Congressional approval of an automobile bailout and was sharply rebuffed.[126] As George Will has argued, in November, Paulson told a House committee: "'I've said to you very clearly that I believe that the auto companies fall outside of (TARP's) purpose.' Then advocates of a Detroit bailout proposed legislation to authorize that. It failed."[127]

As Will pointed out, and as the objectors in the Chrysler bailout argued,[128] the creation of the Automotive Industry Financing Program to bail out car companies does not find much of a basis in the statute. One can credibly argue that purchasing equity securities is permitted under the EESA, even though the original plan was to purchase asset backed securities clogging up the

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[124] Gaubert at XX.

[125] According to Sorkin, by the time that Congress approved the EESA, the Treasury had already decided to shift the focus to direct investments in troubled financial institutions. Sorkin TBTF.

[126] David Herszenhorn, Chances Dwindle on Bailout Plan for Automakers, NY Times Nov. 13, 2008, http://www.nytimes.com/2008/11/14/business/14auto.html?_r=1.

[127] George Will, More Judicial Activism, Please, Washington Post, 6/14/2009 available at http://www.washingtonpost.com/wp-dyn/content/article/2009/06/12/AR2009061202755.html.

[128] Corrected Objection of Indiana State Teachers Retirement Fund et al. in In re Chrysler, U.S. Bankruptcy Court (SDNY), Case No. 09-50002 (AJG), available at http://zerohedge.blogspot.com/2009/05/not-so-fast-indiana-state-pension-fund.html.

banks' balance sheets. As discussed above, the statutory definition of "troubled assets" is quite broad, and equity securities could well be a "financial instrument that the Secretary, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability." But this power is limited to purchasing troubled assets from "financial institutions" and it takes extraordinarily creative statutory interpretation to find that automobile companies are financial institutions lurking in the phrase "included but not limited to," however troubled they may be.

Not surprisingly, given the uncertain (absent?) statutory basis for the use of TARP funds for auto company bailouts, EESA does not provide the same sort of comprehensive regulatory structure for the resolution or conservation of troubled auto companies that is provided to bank regulators under the Federal Deposit Insurance Act or the parallel statutes governing other banking agencies. Given this lack, can the Treasury agents who decided to use DMAC funds to help out DM find protection in the "discretionary function" exception? In the words of *Gaubert*, do the operative provisions of EESA provide agents of the Treasury with the sort of discretion that "regularly requires judgment as to which of a range of permissible courses is wisest?"

As before, one can argue it either way. On the one hand, because the Congress that enacted the EESA never thought that the money would be used to buy controlling equity stakes in private companies – neither controlling stakes in financial institutions such as AIG or GMAC, nor controlling positions in automobile companies like GM – there is nothing in EESA that addresses how the Treasury is to manage its equity portfolio. The closest that EESA comes to a provision providing guidance is Section 106, "Rights; Management; Sale of Troubled Assets; Revenues and Sale Proceeds":

> (a) EXERCISE OF RIGHTS.—The Secretary may, at any time, exercise any rights received in connection with troubled assets purchased under this Act.
>
> (b) MANAGEMENT OF TROUBLED ASSETS.—The Secretary shall have authority to manage troubled assets purchased under this Act, including revenues and portfolio risks therefrom.

But, while section 106 authorizes the secretary to manage the assets, it does not address *how* the Secretary is to address relations among portfolio companies, and thus arguably does not provide guidance, even general guidance, to a Treasury agent in exercising discretion in how to achieve the goals.

On the other hand, EESA does address conflicts of interest. Section 108 ("Conflicts of Interests") provides that

> a) STANDARDS REQUIRED.—The Secretary shall issue regulations or guidelines necessary to address and manage or to prohibit conflicts of interest that may arise in

connection with the administration and execution of the authorities provided under this Act, including—

(1) conflicts arising in the selection or hiring of contractors or advisors, including asset managers;

(2) the purchase of troubled assets;

(3) the management of the troubled assets held;

(4) post-employment restrictions on employees; and

(5) any other potential conflict of interest, as the Secretary deems necessary or appropriate in the public interest.

(b) TIMING.—Regulations or guidelines required by this section shall be issued as soon as practicable after the date of enactment of this Act.

On January 21, 2009, the Treasury issued "interim rules" that address "conflicts that may arise during the selection of individuals or entities seeking a contract or financial agency agreement with the Treasury (retained entities), particularly those involved in the acquisition, valuation, management, and disposition of troubled assets."[129] In particular, the interim rules deal with conflicts of interest that individuals and firms who have been retained by the Treasury may face. These rules are reasonably detailed and provide a fairly comprehensive structure for existing and future conflicts of interest faced by individuals or firms retained by the Treasury to work on TARP matters, and impose a variety of restrictions on working for other firms with conflicting interests (§ 31.214) and in the use of confidential information. By contrast, there is nothing at all in the interim rules that relates to the Treasury's own potential conflicts of interest with respect to portfolio companies.

On the other hand, TARP is a work in progress and this lacuna could be remedied easily enough. Suppose additional rules were issued by the Secretary pursuant to EESA §108 that granted Treasury agents managing TARP assets the same flexibility and open ended discretion as provided for in the AIG Trust Agreement: "it is the FRBNY's view that (x) maximizing the Company's ability to honor its commitments to, and repay all amounts owed to, the FRBNY or the Treasury Department and (y) the Company being managed in a manner that will not disrupt financial market conditions, are both consistent with maximizing the value of the Trust Stock."[130] Assume, additionally, that the rules set the same standard of care according to which the agent must: "(i) [act] in good faith in a manner the [agent] reasonably believed to be . . . in

[129] **Federal Register** /Vol. 74, No. 12 /Wednesday, January 21, 2009 /Rules and Regulations **3431,** codified as 31 C.F.R. Part 31, §§31.1 to 31.218.

[130] AIG Trust Agreement at Section 2.04, available at http://www.ny.frb.org/newsevents/news/markets/2009/AIGCFTAgreement.pdf.

or not opposed to the best interests of the Treasury and (ii) ha[ve] no reasonable cause to believe his or her conduct [is] unlawful."[131]

Interestingly, of course, while these provisions would fill out the duties of the Treasury agents managing the Treasury portfolio, they do not provide clear guidance in our situation. In particular, if using power over DMAC to benefit DM clearly violates the controlling shareholder's fiduciary duties under Delaware law, is the conduct "unlawful"? And, if it is unlawful, does it fall outside the stipulated standard of care? And, finally, if it falls outside the standard of care imposed on the Treasury agents, are the agents still entitled to the "discretionary functions" exception?

Consider one final variation. Suppose that the Treasury rules were to state straightforwardly that Treasury agents, in managing the Treasury's equity portfolio, are to respect the principles of corporate law and governance and to act with due care and loyalty. Interestingly, if these were the marching orders, the defense under the "discretionary functions" exception would be very strong. After all, the implementation of the duties of care and loyalty under Delaware law are rife with discretion and fact specific determinations. The entire fairness test is an ex post "standard" as opposed to an ex ante rule. In its various formulations, it sets a broad standard (fairness of price and fairness of process), allocates burdens and examines specific transactions.

After working through the considerable complexity involved in challenging the Treasury's hypothetical conduct under the Federal Tort Claims Act, only two things are clear. First, even with regard to a fairly clear violation of the duty of loyalty or care, success is hardly assured. One can imagine a court coming out either way. Second, given the procedural and substantive complexities described above, one can hardly expect that a FTCA suit will provide the first line of defense against problematic conduct. Put somewhat differently, if we are concerned about the government, using its controlling stake, will take actions driven by policy objectives which are not in the interests of the portfolio company, we probably should not depend on a breach of fiduciary duty action under the FTCA to protect against this possibility.

c. **Potential Tucker Act Fiduciary Duty Claims**

We now turn to the Tucker Act, the second main waiver of sovereign immunity. Specifically, 28 USC §1491(a) provides that:

> The United States Court of Federal Claims shall have jurisdiction to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress or any regulation of an executive department, or upon any express or

[131] Id. at § 3.03.

> implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort.

If a breach of fiduciary duty is not a tort for the purposes of the FTCA, can an action be brought under the Tucker Act in the United States Court of Federal Claims on the grounds that it is a claim for "liquidated or unliquidated damages in cases not sounding in tort"?[132]

Returning to the "Indian Trust" cases, we find the closest and most intriguing analogy. Since the early 1980s, the Supreme Court has decided a number of cases in which Indian tribes have sued the U.S. for damages for improper management of Indian property including timber lands and coal resources. In the leading case of *Mitchell II*, the court traced the history of the U.S. role as custodian of Indian lands back into the 19th century, and found that the relationship was not merely a "naked trust" established by the Allotment Act of 1887 to prevent alienation and not imposing fiduciary duties, as was held in *Mitchell I*, but rather through a variety of subsequent statutes and regulations, established comprehensive federal control over the Indian lands.[133] With this comprehensive control, the court held, came fiduciary duties, duties that had been breached in the mismanagement of the timber resources.[134] Similarly, when, pursuant to statute, the U.S. took full control of Ft. Apache, used it for its own purposes, and neglected it, the Court held that, in doing so, it took on a trustee's duty to preserve and maintain the trust corpus, a duty that it had breached.[135]

But the Navajo coal leasing cases make clear that the level of government involvement must be comprehensive. In the first Navajo Nation case, the Supreme Court held that the Secretary of Interior's obligation to approve mineral leases did *not* impose fiduciary duties in doing so, at least when the tribe and the coal company had negotiated terms.[136] When the Navajo Nation coal leasing case returned to the Supreme Court after remand, the court was even sharper in rejecting the claim, holding that

> The Federal Government's liability cannot be premised on control alone. The text of the Indian Tucker Act makes clear that only claims arising under "the Constitution, laws or treaties of the United States, or Executive orders of the President" are cognizable (unless the claim could be brought by a non-Indian plaintiff under the ordinary Tucker Act). 28 U.S.C. § 1505. In *Navajo I* we reiterated that the analysis must begin with "specific

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[132] Although we often think of the corporation as a nexus of contracting and of fiduciary duties through a contractual framework, this is not sufficient basis to claim that a breach of fiduciary duty claim is a breach of an "implicit" contract. Under the Tucker Act, "implicit contracts" refers to "implied in fact" contracts (i.e., actual contracts "implied from the conduct of the parties in light of the circumstances surrounding their interaction" and not "implied in law" contracts. Sisk at 317.) Because it is difficult if not impossible to conceptualize this case as a breach of contract action, the scope of US v. Winstar, 518 U.S. 839 (1996) and its implications for the limits of sovereign immunity under the Tucker Act do not arise.

[133] Mitchell II.

[134] Mitchell II.

[135] White Mt. Apache Tribe.

[136] United States v. Navajo Nation, 537 U.S. 488 (2003).

> rights-creating or duty-imposing statutory or regulatory prescriptions." 537 U.S., at 506, 123 S. Ct. 1079, 155 L. Ed. 2d 60. *If* a plaintiff identifies such a prescription, and *if* that prescription bears the hallmarks of a "conventional fiduciary relationship," *White Mountain*, 537 U.S., at 473, 123 S. Ct. 1126, 155 L. Ed. 2d 40, *then* trust principles (including any such principles premised on "control") could play a role in "inferring that the trust obligation [is] enforceable by damages," *id.*, at 477, 123 S. Ct. 1126, 155 L. Ed. 2d 40. But that must be the second step of the analysis, not (as the Federal Circuit made it) the starting point.[137]

Thus, while under the Indian Trust cases, the US can become a fiduciary and damages can be awarded for breaches of that duty, there is a high bar.

Does exercising control through the power conveyed by a controlling equity stake cause the US to take on the fiduciary duties of a controlling shareholder, as under Delaware law? The law is not clear. Navajo Nation II, quoted above, holds that control alone is not enough. Rather, the Supreme Court has repeatedly emphasized that the duty must be based in the Constitution or a statutory enactment. As the court held in *Mitchell II*, and subsequently reiterated in Navajo Nation II, quoted above,

> the Tucker Act "'does not create any substantive right enforceable against the United States for money damages.'" *United States* v. *Mitchell, supra*, at 538, quoting *United States* v. *Testan, supra*, at 398. A substantive right must be found in some other source of law, such as "the Constitution, or any Act of Congress, or any regulation of an executive department." 28 U. S. C. § 1491. Not every claim invoking the Constitution, a federal statute, or a regulation is cognizable under the Tucker Act. The claim must be one for money damages against the United States, see *United States* v. *King*, 395 U.S. 1, 2-3 (1969), and the claimant must demonstrate that the source of substantive law he relies upon "'can fairly be interpreted as mandating compensation by the Federal Government for the damage sustained.'" *United States* v. *Testan, supra*, at 400, quoting *Eastport S.S. Corp*. v. *United States*, 178 Ct. Cl. 599, 607, 372 F.2d 1002, 1009 (1967). (footnotes omitted).

In our hypo, there is hardly the same sort of comprehensive statutory framework present in *Mitchell II*. Indeed, the only statutory basis seems to be EESA which provided the Treasury with authority to buy "distressed securities" in "financial institutions." Moreover, Mitchell II seems to suggest that the basis must be either the US Constitution or a *Federal* statute: because it is a waiver of federal sovereign immunity that is at stake, state statutes or common law are an insufficient basis.[138] The Treasury might therefore avoid *Mitchell II* and *White Mt. Apache Tribe* on the grounds that there is no adequate federal statutory basis to ground a claimed fiduciary duty.

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[137] U.S. v. Navajo Nation, -- U.S. --, 129 S. Ct. 1547, 1558 (2009).
[138] Sisk at 292.

But that may be too quick. The Indian Trust cases interpret the part of the "Indian Tucker Act" that is explicitly limited to claims "arising under the Constitution, laws or treaties of the United States, or Executive orders of the President."[139] But the (regular) Tucker Act waives immunity with respect to any claim "founded either upon the Constitution, or any Act of Congress or any regulation of an executive department, or upon any express or implied contract with the United States, *or for liquidated or unliquidated damages in cases not sounding in tort.*"[140] Can one argue that, under that final clause, the acquisition of shares of a Delaware corporation gives rise to liability for damages because, in acquiring shares, the US acquires control by virtue of the network of statute and common law provisions that are Delaware corporate law (e.g., the right to elect directors under Del. GCL §212, 216, etc.), power that brings with it fiduciary duties? One might argue that this situation is much closer to *Mitchell II* and *White Mt. Apache* in which the Supreme Court suggested that governmental fiduciary duties can arise when the government assumes control over property belonging to Indians. Thus, in *Mitchell II*, the court stated that:

> Moreover, a fiduciary relationship necessarily arises when the Government assumes such elaborate control over forests and property belonging to Indians. All of the necessary elements of a common-law trust are present: a trustee (the United States), a beneficiary (the Indian allottees), and a trust corpus (Indian timber, lands, and funds). "[Where] the Federal Government takes on or has control or supervision over tribal monies or properties, the fiduciary relationship normally exists with respect to such monies or properties (unless Congress has provided otherwise) even though nothing is said expressly in the authorizing or underlying statute (or other fundamental document) about a trust fund, or a trust or fiduciary connection." *Navajo Tribe of Indians* v. *United States*, 224 Ct. Cl. 171, 183, 624 F.2d 981, 987 (1980). (footnote omitted).

Later, in *White Mt. Apache*, the court sounded the same themes, allowing actual control to substitute for absent statutory language:

> As to the property subject to the Government's actual use, then, the United States has not merely exercised daily supervision but has enjoyed daily occupation, and so has obtained control at least as plenary as its authority over the timber in *Mitchell II*. While it is true that the 1960 Act does not, like the statutes cited in that case, expressly subject the Government to duties of management and conservation, the fact that the property occupied by the United States is expressly subject to a trust supports a fair inference that an obligation to preserve the property improvements was incumbent on the United States as trustee. This is so because elementary trust law, after all, confirms the commonsense assumption that a fiduciary actually administering trust property may not allow it to fall into ruin on his watch. "One of the fundamental common-law duties of a trustee is to preserve and maintain trust assets," *Central States, Southeast & Southwest Areas Pension*

[139] 28 U.S.C. §1505.
[140] 28 U.S.C. § 1491(a)(1) (emphasis added).

> *Fund* v. *Central Transport, Inc.*, 472 U.S. 559, 572, 86 L. Ed. 2d 447, 105 S. Ct. 2833 (1985) (citing G. Bogert & G. Bogert, Law of Trusts and Trustees § 582, p. 346 (rev. 2d ed. 1980)); see *United States* v. *Mason*, 412 U.S. 391, 398, 37 L. Ed. 2d 22, 93 S. Ct. 2202 (1973) (standard of responsibility is "such care and skill as a man of ordinary prudence would exercise in dealing with his own property") (quoting 2 A. Scott, Trusts 1408 (3d ed. 1967) (internal quotation marks omitted)); Restatement (Second) of Trusts § 176 (1957) ("The trustee is under a duty to the beneficiary to use reasonable care and skill to preserve the trust property"). Given this duty on the part of the trustee to preserve corpus, "it naturally follows that the Government should be liable in damages for the breach of its fiduciary duties." *Mitchell II*, *supra*, at 226.

In Navajo Nation II, the Supreme Court distinguished Mitchell II, without overruling it, on the grounds that in Mitchell II, there was

> a series of statutes and regulations that gave the Federal Government "full responsibility to manage Indian resources [*1554] and land for the benefit of the Indians." 463 U.S., at 224, 103 S. Ct. 2961, 77 L. Ed. 2d 580. Title 25 U.S.C. § 406(a) permitted Indians to sell timber with the consent of the Secretary of the Interior, but directed the Secretary to base his decisions on "a consideration of the needs and best interests of the Indian owner and his heirs" and enumerated specific factors to guide that decisionmaking. We understood that statute -- in combination with several other provisions and the applicable regulations -- to create a fiduciary duty with respect to Indian timber. *Mitchell II*, *supra*, at 219-224, 103 S. Ct. 2961, 77 L. Ed. 2d 580.[141]

Although one clearly cannot argue that there is a similarly comprehensive web of federal statutes that creates obligations on the federal government, one might argue that when the Treasury took a controlling interest in DMAC pursuant to authority granted by the EESA, and then exercised that control pursuant to the General Corporation Law of Delaware to benefit another firm in its portfolio at the expense of DMAC, that it took on the fiduciary duties of a controlling shareholder under Delaware law and "it naturally follows that the Government should be liable in damages for the breach of its fiduciary duties."[142] Indeed, while the case law seems clear that the common law of trusts (or of fiduciary duties) will not be sufficient to ground the Treasury's obligation, it could be used to fill out the details of it especially, as here, when fiduciary duties are an intrinsic part of the (non-federal) statutory framework that creates the governmental power at issue.[143]

Although this seems to be a promising direction, such a claim would clearly be a step beyond current case law even if not precluded by the current Supreme Court jurisprudence. It is, of

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[141] Navajo Nation II at 1553-54,

[142] Mitchell II supra at 226.

[143] Sisk at 292.

course, unclear whether a federal court would choose to take that step, or whether if it did, it would be affirmed on appeal. More to the point, it hardly provides any sort of robust protection that could plausibly substitute for Delaware's fiduciary duty jurisprudence. Again, we are driven to the view that if we are concerned about the government's use of its controlling position, the Tucker Act theories are hardly reassuring.[144]

d. **Claims under the Administrative Procedure Act**

A third basis for challenging the Treasury's actions at DMAC is the Administrative Procedure Act. Section 702 of the APA explicitly waives sovereign immunity for actions against the United States so long as they do not seek money damages:[145]

> "A person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof. An action in a court of the United States seeking relief **other than money damages** and stating a claim that an agency or an officer or employee thereof acted or failed to act in an official capacity or under color of legal authority shall not be dismissed nor relief therein be denied on the ground that it is against the United States or that the United States is an indispensable party. The United States may be named as a defendant in any such action, and a judgment or decree may be entered against the United States . . ."[146]

Under the APA,[147] actions can be brought in federal district court against the US to

> "hold unlawful and set aside agency action, findings, and conclusions found to be - (A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; (B) contrary to constitutional right, power, privilege, or immunity; (C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; (D) without observance of procedure required by law; (E) unsupported by substantial evidence in a case subject to sections 556 and 557 of this title or otherwise reviewed on the record of an agency hearing provided by statute; or (F) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court."[148]

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[144] The Tucker Act also provides a cause of action to challenge a takings in violation of the the Fifth Amendment. Although the opening hypo does not present a takings claim, with a little creativity one could add one (e.g., the Treasury decides to freeze out minority shareholders without compensation). While a takings claim could be a basis for challenging such an action, it hardly provides a regulatory structure that parallels Delaware's fiduciary duty law. Sisk at 4.09(b) provides a brief summary of the applicable law.

[145] Bowen v. Massachusetts, 487 US 879 (1988) blurred this line, but even under Bowen, damages for breach of fiduciary duty would be excluded.

[146] 5 USC §702

[147] Although codified in the APA, this waiver applies more broadly and includes actions to enjoin violations of constitutional rights. In our case, because the Tucker Act permits actions for damages when takings without compensation are involved, this aspect of 702 is marginal to our purposes.

[148] 5 USC §706.

The question, then, is can our plaintiff, a minority shareholder in DMAC, bring an action under 706 to enjoin the decision to require DMAC to provide financing to GM and its dealers and customers on preferential terms?

Fitting the hypo into administrative law categories is not easy. Consider, first, a conceptually easier issue that arises out of the Treasury's decision to invest TARP funds in Chrysler and GM. As noted above, these investments raise two questions. First, whether a troubled auto company falls within the statutory definition of a "financial institution"? Second, whether equity in New GM or New Chrysler falls within the definition of "troubled asset"? Both of these are questions of statutory interpretation and fit comfortably within the basic framework of administrative law.[149] Under *Chevron*, the Treasury could certainly argue that Congress did not address the precise question at issue in the EESA, and, in any event, any Congressional interpretation was certainly not "unambiguously clear." Given this, and moving on to the classic second step of Chevron, the Treasury might argue that its interpretation of the definitions of "troubled asset" and "financial institution" were both "permissible" ones, and thus deserved deference.[150]

But now contrast these typical questions of administrative law with our hypo in which the Treasury leans on DMAC to help DM. Note, first, that the action at issue is a rather different action than the decision to invest TARP funds in GM or Chrysler: it is not a normal exercise of agency authority. The Treasury is acting in the private sector, not in government forums, and using its shareholding to do so. It is not promulgating rules, nor distributing public funds, nor adjudicating matters.

Consider whether Chevron deference will apply. Here, the governing statute – in this case, the EESA – offers no guidance for **how** the Treasury is to manage the portfolio. Although the EESA is clear that the Treasury has power to manage the portfolio – and so managing it is hardly ultra vires – it provides no guidance, no standards, criteria and only the most general goals:

> **SEC. 2. PURPOSES.**
> The purposes of this Act are—
> (1) to immediately provide authority and facilities that the Secretary of the Treasury can use to restore liquidity and stability to the financial system of the United States; and
> (2) to ensure that such authority and such facilities are used in a manner that—
> (A) protects home values, college funds, retirement accounts, and life savings;
> (B) preserves homeownership and promotes jobs and economic growth;
> (C) maximizes overall returns to the taxpayers of the United States; and
> (D) provides public accountability for the exercise of such authority.

[149] I leave to the side the question of who would have standing. In the Chrysler bankruptcy proceeding, the SDNY Bankruptcy court held that secured debt holders did not have standing to challenge the investment because they benefited from it. In re Chrysler LLC, 405 B.R. 79 (Bankr. SDNY 2009), subsequent history?.

[150] Chevron USA v. NRDC, Inc., 467 US 837 (1984) at XX.

Moreover, although the EESA grants the Treasury the authority to exercise any rights associated with acquired assets and to manage the portfolio,[151] no guidance is provided beyond the general purpose clause with regard to how and for what purpose. And this is hardly accidental: it is crystal clear that, when the EESA was debated and eventually enacted, Congress was not thinking about direct investments in equity much less direct and controlling equity investments in auto companies.

Further, in managing the assets, the Treasury has not explicitly interpreted the EESA or any other statute and so there is no agency interpretation of its own statute to which Chevron deference could apply. While one could argue with regard to the investments in GM and Chrysler themselves that the Treasury's act of investing can be understood to be an implicit interpretation of the statutory definitions, that same argument is much harder to make with regard to the hypo because there is so little in the statute that pertains to the management of equity investments.

Considered as a policy judgment, would the Treasury's decision to lean on DMAC to help DM be invalid as "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law" in violation of 706(2)(A)? To the extent that this is another way of saying that agency action must be "reasonable," it begs the question of the relevant standard of reasonableness. Likewise, the final phrase – "or otherwise not in accordance with the law" – is suggestive without being clear on which laws it refers to.

The hypo arises because the federal government acts in the private setting without explicitly taking on the obligations of that position (which would incorporate Delaware law norms) or explicitly opting out through preemptive legislation. One approach to applying 706 in this context would be to argue that, in corporate law as elsewhere, state law applies unless legitimately preempted by federal law, and thus that the Treasury is bound by the same state law limits as any other controlling shareholder. To the extent, then, that the Treasury's actions are inconsistent with Delaware corporate law – as they clearly would be – they are "not in accordance with law" and thus invalid under § 706.

The counter-argument, of course, draws on § 701(a)(2) which precludes judicial review when "agency action is committed to agency discretion by law." As the US Supreme Court held in the *Overton Park* case, the exception for action committed to agency discretion is a "very narrow exception . . . The legislative history of the Administrative Procedure Act indicates that it is applicable in those rare instances where 'statues are drawn in such terms that in a given case there is no law to apply.'"[152] The "no law to apply" language can be understood as itself compelling evidence that a decision has been left to agency discretion or as merely one piece of whether a particular subject has been "committed to agency discretion."[153] In *Heckler v.*

[151] Section 106.
[152] Overton Park quoting S. Rep. No. 752, 79th Cong., 1st Sess., 26 (1945).
[153] Breyer, Stewart, Sunstein & Vermeule casebook (6th edition) at 791.

Chaney, the Supreme Court interpreted the provision as applying when "the statue is drawn so that a court would have no meaningful standard against which to judge the agency's exercise of discretion."

Whether one gives wide or narrow effect to a statute containing "no law to apply," it would not seem to provide a very strong argument in the context of the hypo. While it is true that the EESA provides no guidance in how the Treasury is to exercise its rights as a holder of "troubled assets," there is no evidence that Congress expected the Treasury to acquire equity securities and thus no evidence at all that Congress committed the management of conflicts of interest created by control equity positions to agency discretion.

On the other hand, yet again we see how hard it is to insert the substance of corporate law's fiduciary duty analysis into a public law framework.

e. **Claims under the Freedom of Information Act**

In yet another example of how everything changes when the government is the controlling shareholder, it is worth noting that the definition of "agency" for the purposes of the Freedom of Information Act (5 USC § 552) includes a "government controlled corporation." Indeed, the effect of FOIA may go even further. On President Obama's first day in office, he issued a "Memorandum on the Freedom of Information Act" directing his incoming attorney general to reestablish a presumption in favor of disclosure of government records, as well as ordering agencies to take "affirmative steps to make information public. They should wait for specific requests from the public. All agencies should use modern technology to inform citizens about what is known and done by their Government."

Take New GM, the successor to GM of which the government now owns 60.8%. What information can be secured pursuant to FOIA that is not already available under either SEC disclosure regulations or Delaware GCL 219 and 220?[154]

Particularly relevant for these purposes is the exclusion of "inter-agency or intra-agency memorandums or letters which would not be available by law to a party other than an agency in litigation with the agency."[155] Although this limits the scope of material that can be secured under FOIA, it leaves undisturbed the advantages in timing: FOIA will be most useful in gathering information prior to filing a complaint. Del. 219 and 220 are sharply limited in what can be secured[156] while the FOIA exception provides support for a strong presumption in favor of being able to get all material that WOULD be available by law to a party in litigation.[157]

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[154] New GM is a Delaware corporation: http://gmcourtdocs.gardencitygroup.com/pdflib/amendment_630.pdf.
[155] 5 USC 552(b)(5).
[156] *Security First Corp. v. U.S. Die Casting and Dev. Co.*, 687 A.2d 563, 568, 570 (Del. 1977) ("A Section 220 proceeding should result in an order circumscribed with rifled precision.")
[157] For a fuller treatment of the law governing the scope of this exception see Pierce treatise at §5.11.

D. **An Alternative Strategy: Leaving the US Government Out of the Suit**

So far, we have assumed as inevitable that the lawsuit will end up either in federal district court or the court of federal claims. After the above analysis, one might conclude that trying to sue the federal government as a controlling shareholder is too hard to be worthwhile. Is there an alternative approach that dispenses with the federal government and that would allow the cause of action to remain in Delaware Chancery Court and be adjudicated under Delaware law?

In a related article, we have argued that there are credible claims that could be brought against the directors under Delaware law.[158] But this then raises a subsequent and important question: should Delaware courts want such a case? Should plaintiffs want to bring such a case in Delaware? And, finally, how should Delaware avoid a case should it decide that it puts Delaware in an impossible position?

In our related article, we argue that the plausible claims against the directors hold the potential to threaten Delaware's place in the corporate law landscape. In such a case, the key questions would be how the Treasury behaved, would involve depositions of top Treasury officials, and, were a Delaware court to enjoin the transaction, would risk provoking a confrontation with Washington. In light of Delaware's vulnerable position, plaintiffs would be rise to avoid a Delaware forum and Delaware courts, were such a claim filed, should avoid adjudicating such claims if it can do so.

How, then, might Delaware dodge the bullet? We argue that Delaware Chancery Court Rule 19, the Delaware parallel to Fed. R. Civ. P. 19, the "indispensable party" rule, provides sufficient discretion to avoid a confrontation. By using the discretion provided by this rule of procedure, Delaware could "duck" the question, without significantly compromising Delaware corporate law doctrine, the parties' ability to resolve the dispute, or Delaware's place in the corporate law landscape.

E. **Conclusion**

For a litigator, this is a pretty depressing section. The bottom line is that when the Treasury is the controlling shareholder, the legal basis for challenging conduct that would normally constitute a clear breach of the duty of loyalty or care is very weak. Although the claims against the directors or to enjoin the transaction are stronger, they put Delaware into a no-win situation which Delaware would be well advised to avoid. It may be that a creative and courageous judge will manage within the confines of existing law to enjoin or sanction the conduct in the opening

[158] Kahan & Rock, Del J Corp L article.

hypo, but when one compares the legal structure described above to the robust protections of non-control shareholders in the fully private context, there is not much room for optimism.

For transactional lawyers, the reaction may be even stronger. Even if the legal basis could be strengthened, this seems like a crazy way to handle the conflicts of interest created by government ownership of equity stakes in private companies. Is there a better way to set things up so these impossible problems do not arise? If there is not, then we ought to end the experiment as quickly as possible.

IV. **Structuring Governmental Ownership Ex Ante**

Government ownership is a political decision. How involved should the state be in private industry? To what extent should the government make day to day business decisions or set long term strategy? Is government ownership a long term arrangement or a short term fix? For whom should a government controlled firm be managed? Among countries and over time, one observes a huge variation in attitudes towards, and structures of, government ownership.

Implicit in the preceding sections is the assumption that government use of its controlling interest in one portfolio company to aid another or to influence business strategy is problematic. But that, of course, assumes a particular political choice about the appropriate role of government that is obviously contestable.

The legal structure of governmental ownership – how the shares are held, whether ownership is complete, controlling or minority, the role of courts, etc. – is important in a number of ways. First, it is part of the way in which political choices are implemented – not the whole story, to be sure, but an important piece.

Second, the legal structure, which itself is a product of fundamental political choices, provides a window into what those choices have been.

Third, existing legal "technology" sets a limit on political choices: we cannot choose what we cannot implement.

In this section, we examine a variety of contemporary examples of how government ownership has been structured. In thinking through these questions of organizational design, there are a variety of dimensions – design choices, if you will – to keep in mind:

- What is the goal of government ownership? Profit? Security? Preserving national champions? Consumer welfare?
- What is the term of governmental involvement? Short term? Long term? Indefinite?
- To what extent are firm decisions insulated from political influence?

- How are decision-makers held accountable? Through political mechanisms? Legal mechanism? Not at all?

Given the historical variety of governmental involvement, a striking feature of the current arrangements is the widespread acceptance of a number of features: first, that the goal of government involvement is to preserve or create firms that can thrive in competitive markets without continuing government support; second, that government involvement should be a short term intervention that is justified by extraordinary circumstances; and third, that business decision should be insulated from government influence.

Consider, in this regard, the Obama administration's articulated principles for managing ownership interests in private firms including its 60% ownership stake in the new GM:

- "The government has no desire to own equity stakes in companies any longer than necessary, and will seek to dispose of its ownership interests as soon as practicable."
- "In exceptional cases where the U.S. government feels it is necessary to respond to a company's request for substantial assistance, the government will reserve the right to set upfront conditions to protect taxpayers, promote financial stability and encourage growth."
- "After any up-front conditions are in place, the government will protect the taxpayers' investment by managing its ownership stake in a hands-off, commercial manner."
- "As a common shareholder, the government will only vote on core governance issues, including the selection of a company's board of directors and major corporate events or transactions.'[159]

The current broad consensus on the goal and limits of government investment in private firms is a version of classic liberal political economy. There are sharp disputes about when government intervention is required, and how much should be left to the markets, but one finds few in the contemporary Anglo-American mainstream who will seriously argue for greater state involvement, either through nationalization or through direct decision making. Given this consensus, the design analysis within these bounds becomes more tractable, and more interesting. The key questions become a matter of means: which legal structures for government intervention are more likely to achieve the stipulated goals. As we examine the different structures of government ownership, we will see a variety of approaches.

A. **US Models:**

In the extreme conditions of 2008 and 2009, with the ad hoc and rushed responses to the unfolding crisis, described above, many of the Treasury investments in private corporations were made directly, with no binding governance structure. As a result, the U.S. Treasury directly

[159] http://www.ustreas.gov/press/releases/tg179.htm

holds the stakes in GM, Chrysler, GMAC, Citigroup, Fannie Mae and Freddie Mac. This direct ownership regime, as we discussed earlier, exposed GM and Chrysler to direct lobbying by politicians over GM and Chrysler decisions to close distribution facilities and dealerships in key congressional. As such, "direct ownership" provides the problematic baseline against which alternative ownership structures should be measured.

1. **Chrysler 1.0**

The first Chrysler bailout was in late 1979/early 1980 and was structured as a debt guarantee program rather than a direct injection of capital. Under the "Chrysler Corporation Loan Guarantee Act of 1979,"[160] the US government provided up to a maximum of $1.5 billion in loan guarantees. The structure was somewhat different from what we observe today, partially explained by the fact that although the country was in a recession, debt and equity markets were functioning. The first Chrysler bailout had several important features.

First, a "Chrysler Corporation Loan Guarantee Board" was established, comprised of the Secretary of the Treasury, the Chair of the Federal Reserve, and the Comptroller General, with the Secretaries of Labor and Transportation as ex officio nonvoting members.[161]

Second, the board had authority to provide loan guarantees "on such terms and conditions as it deems appropriate," but only if the board determines that Chrysler has met a variety of conditions, including an energy savings plan, a satisfactory operating plan, and a financing plan that will raise equivalent amounts of non-federally guaranteed debt.[162]

Loan guarantees could be issued under the Act only if the board determined that credit was not otherwise available on reasonable terms, and that there was reasonable assurance that Chrysler would pay the money back. Chrysler was charged a guarantee fee (of not less than .5% per year) and the board was expected "to the maximum extent feasible [to] ensure that the Government is compensated for the risk assumed in making guarantees" including "enter[ing] into contracts under which the Government, contingent upon the financial success of the Corporation, would participate in the gains of the Corporation or its security holders."[163] The US government received 14.4 million warrants to purchase Chrysler stock at $13 per shares until 1990.[164] In 1983, the US government auctioned these warrants and Chrysler purchased them for $311 million.[165]

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[160] Public Law 96-185 (Jan. 7, 1980), 93 Stat. 1324, codified at 15 USC 1861 et seq.
[161] Sec. 3, 15 USC 1862.
[162] Section 4, 15 USC 1863.
[163] Section 5(d), 15 USC 1864(d).
[164] Brickley, Congressional Research Service, Chrysler Corporation Loan Guarantee Act of 1979: Background, Provisions and Cost, at p. 5. Available at http://assets.opencrs.com/rpts/R40005_20081217.pdf.
[165] Brickley, at 5.

Finally, a variety of creditor protective covenants were imposed including veto rights over unapproved sales of assets, large contracts (including future collective bargaining agreements), and a limitation on dividends.[166] In addition, no guarantees could be issued after December 31, 1983,[167] and all guarantees expired, and all loans had to be repaid, before Dec. 31, 1990.[168]

The most striking difference between first Chrysler and the current bailouts is the contrast between the debt model used in the 1970s and the private equity model used this time around. Although debt holders certainly are able to control firms, the private equity model typically puts control at its center. In choosing the private equity model, and relying on modifications of Simpson Thacher's private equity documents, the current intervention was tilted, from the outset, towards control.

2. The AIG Structure: An Explicit Trust

On September 16, 2008, the Federal Reserve rescued AIG by pledging $85 billion.[169] As part of the package, stated the Fed's press release, "The U.S. government will receive a 79.9 percent equity interest in AIG and has the right to veto the payment of dividends to common and preferred shareholders."[170] On October 8, 2008, as AIG continued to spiral downward, Fed pledged another $37.8 billion.[171] On November 10, 2008, additional funds were invested through TARP.[172]

The equity stake, noted in the initial press release, was not issued until March 2009. When the stock was ultimately issued on March 4, 2009 as Series C Preferred Stock, it represented 77.9% of the voting power.[173] It was issued to a trust established for the sole benefit of the Treasury.

The terms of the stock issuance and the Trust are both interesting. As to the stock, Series C Preferred Stock, in addition to carrying 77.9% of the votes and an equivalent right to dividends,

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[166] Section 11, 15 USC 1870.
[167] Section 16, 18 USC 1875.
[168] Section 9(a), 15 USC 1868.
[169] http://www.federalreserve.gov/newsevents/press/other/20080916a.htm. (September 16, 2008)
[170] Id.
[171] http://www.federalreserve.gov/newsevents/press/other/20081008a.htm
[172] http://www.federalreserve.gov/newsevents/press/other/20081110a.htm

[173] March 30, 2009 AIG 10Q at p. 10; The government stake was reduced to approximately 77.9% from the original 79.9% because of warrants for approximately 2% that were issued to the Treasury in November 2008. Id. at 10-11. There are two explanations for why it was important to keep the Treasury's ownership to less than 80%.. First, under Section 163 of the Internal Revenue Code, interest paid on debt is deductible except when it is paid to a shareholder which controls 80% or more of the voting power and value of a corporations total shares. Adam Levitin, Why Have the Government Bailouts Involved Only a 79.9% Equity Position? http://www.creditslips.org/creditslips/2008/09/why-have-the-go.html. Second, under Federal Accounting Standards, the Treasury wished to keep its total voting power to less than 80% to avoid having to file consolidated accounts under US government accounting rules. CHECK. LEVITIN SAYS NOT TRUE.

also requires that "AIG and AIG's Board of Directors are obligated to work in good faith with the Trust to ensure that AIG's corporate governance arrangements are satisfactory to the Trust."[174]

The stock was issued to the "AIG Credit Facility Trust," which was established by the Federal Reserve Bank of NY. In the trust agreement, there is an explicit recognition of the potential conflicts of interests that can arise from the stock ownership:

> "**WHEREAS**, to avoid any possible conflict with its supervisory and monetary policy functions, the FRBNY does not intend to exercise any discretion or control over the voting and consent rights associated with the Trust Stock."

In addition, there is also a recognition of the dangers of excessive interference:

> "**WHEREAS**, the FRBNY anticipates that the Trustees will leave the day-to-day management of the Company to the persons charged with such management, and will limit their involvement in the corporate governance of the Company to the exercise of the rights set forth in this Trust Agreement"

In the operative provisions of the Trust, the trustees, appointed by the FRBNY in consultation with the Treasury, are given the power to exercise all shareholder rights including rights to vote on charter amendments, bylaw amendments, election of directors, removal of directors and anything else.[175] Although given complete discretion, the FRBNY included provisions expressing its views on the proper goals of the Trust:

> "In exercising their discretion hereunder with respect to the Trust Stock, the Trustees are advised that it is the FRBNY's view that (x) maximizing the Company's ability to honor its commitments to, and repay all amounts owed to, the FRBNY or the Treasury Department and (y) the Company being managed in a manner that will not disrupt financial market conditions, are both consistent with maximizing the value of the Trust Stock."[176]

At the same time, there are a few restrictions built in. The Trustees may not themselves serve as directors,[177] nor vote to elect as directors anyone who is or has recently been an employee of the FRBNY or the Treasury.[178] The Trustees may not be officers or employees of the FRBNY, the Treasury or AIG, or be the parent spouse or child of anyone who is.[179]

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[174] AIG March 2, 2009 10Q at p. 11.
[175] Trust at §2.04.

[176] Trust at §2.04(d).

[177] Trust at §2.04(f).
[178] Trust at § 2.04(e).
[179] Trust at § 3.01.

The standard of care imposed on the trustees is extremely capacious:

> A Trustee shall have no liability hereunder for any action taken or refrained from or suffered by such Trustee, provided that such Trustee (i) acted in good faith in a manner the Trustee reasonably believed to be in accordance with the provisions of this Trust Agreement and in or not opposed to the best interests of the Treasury and (ii) had no reasonable cause to believe his or her conduct was unlawful . . ."[180]

The initial and, to date, only trustees of the AIG trust are Jill Considine, Chester Feldberg and Douglas Foshee. Considine formerly was the Chair and CEO of the Depository Trust & Clearing Corporation, and currently serves as a director of the Interpublic Group of Companies and Ambac Financial Group.[181] Chester Feldberg was chair of Barclays Americas from 2000 to 2008, after having been executive vice president in charge of bank supervision at the NY Fed.[182] Douglas Foshee is president and CEO of El Paso Corporation, a publicly held gas pipeline company, and previously worked at Halliburton.[183]

How well does this approach protect against the temptations identified above? AIG, from the outset, has fought to run its business "on a commercial basis." The initial "bonus scandal" exposed it to political condemnation and forced changes in compensation policies prospectively. Indeed, compensation has been such a salient issue that the current CEO, Robert Benmosche, reportedly threatened to resign if he was not permitted to pay key employees market rates.[184] The continuing involvement of Ken Feinberg, the "compensation czar" with authority over compensation in firms that have received TARP funding, has complicated the management tasks, and interfered with running the business "on a commercial basis," at least if this refers to how non-TARP financial institutions are managed.

3. **Another US Model: Limited Voting and Predetermined Exit at Citigroup**

The Treasury has owned as much as 34% of Citigroup, as a result of exchanging its preferred stock purchased with TARP funds for common stock. As part of the exchange offer, the Treasury agreed to two interesting provisions. First, it limited its voting rights slightly by agreeing to vote its shares in the same proportions as other common stockholders, except with respect to major decisions including election or removal of directors, amendments to the charter

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[180] Trust at § 3.03(a).
[181] http://www.newyorkfed.org/newsevents/news/markets/2009/an090116.pdf
[182] Id.
[183] Id.
[184] Mary Williams Lash, A.I.G. Chief's Mission: Save Executive Pay, Nov. 11, 2009 NY Times http://www.nytimes.com/2009/11/12/business/12aig.html.

and any sale of the company.[185] Second, the Treasury committed to disposing of the stock within ten years.[186]

How well has this worked out for the Treasury or for Citigroup? Although it is early days yet, there are grounds for concern. Like other TARP banks, Citigroup has sought to free itself from restrictions associated with government involvement (mainly, one thinks, those having to do with compensation) by paying back the TARP investments. To do so, Citigroup recently raised $17 billion by issuing new common stock.[187] At the same time, the Treasury backed away from its plan to sell its Citigroup stake as it turned out that Citigroup's stock issuance demonstrated that market demand was not strong.[188] The real concern should be that Citi, to avoid the TARP restrictions on executive compensation, is paying back the TARP funds before it is strong enough to do so.

B. **UK Financial Investments Ltd**

In the fall of 2008, as AIG, Lehman and other US financial institutions were collapsing, so too were major institutions in the UK. With government investments or bailouts of, inter alia, Royal Bank of Scotland, Lloyds, Northern Rock and Bradford & Bingley, the UK government found itself with significant and sometimes controlling equity stakes. In response, UK Financial Investments Limited was set up on November 3, 2008 to manage those investments.[189]

UKFI is set up as a company under the Companies Act with the Treasury as the sole shareholder. The stated goal of the structure is to adopt "Robust institutional arrangements for keeping UKFI at arm's-length from Government, centred on a heavyweight UKFI board to take all major

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[185] Citigroup Exchange Offer S4, June 18, 2009 Amendment at 75 (*Voting of Common Stock*. The U.S. Treasury has agreed that it will vote all of its Common Stock in the same proportion as all other shares of Common Stock are voted, with respect to each matter on which holders of Common Stock are entitled to vote or consent other than with respect to the following matters: (i) the election and removal of directors, (ii) the approval of any merger, consolidation, statutory share exchange or similar transaction that requires the approval of Citigroup's stockholders, (iii) the approval of a sale of all or substantially all of the assets or property of Citigroup, (iv) the approval of a dissolution of Citigroup, (v) the approval of any issuance of securities of Citigroup on which holders of Citigroup's common Stock are entitled to vote and (vi) the approval of any amendment to the charter or bylaws of Citigroup on which holders of Common Stock are entitled to vote.)

[186] Citigroup Exchange Offer S4, June 18, 2009 Amendment at 76 (*Mandatory Sale Date*. If the U.S. Treasury owns any Common Stock or warrants convertible into such Common Stock on the tenth anniversary of the closing date of the Exchange Offers, then the U.S. Treasury agrees to use reasonable efforts to transfer to non-governmental entities on an annual basis at least 20% of the aggregate number of such shares owned by the U.S. Treasury until all of such shares are transferred.)

[187] Matthias Rieker, Citi, Wells Repay TARP Funds, WSJ Dec. 24, 2009 (http://online.wsj.com/article/SB10001424052748704254604574614082322331944.html).

[188] Eric Dash, Government Reconsiders Quick Sale of Citigroup Stake, NYT Dec. 16, 2009 at http://www.nytimes.com/2009/12/17/business/global/17citi.html?_r=1&scp=4&sq=Citigroup&st=cse.

[189] The description in this section is drawn from the Framework Document between UKFI and HM Treasury, available at http://www.ukfi.gov.uk/publications/.

decisions relating to UKFI's business and its management of the investments."[190] The board includes, as acting chair, Glen Moreno who is chairman of Pearson plc, and previous served as CEO of Fidelity International and worked for Citigroup in a variety of senior positions. The CEO is John Kingman who previously "was Second Permanent Secretary to the Treasury, where he was responsible for oversight and control of some £600 billion of public spending annually." The remainder of the board includes an impressive group of directors with experience in business and government, a mix that is clearly intentional.

The "Framework Document" establishes the relationship between the Treasury and UKFI, and provides guidelines to UKFI in managing the portfolio of Treasury shareholdings. It opens with the Treasury's overarching objective, namely, to dispose of the investments as soon as possible and, in the meantime to preserve their value: "The Company should, in compliance with the Investment Mandate described in Section 4, develop and execute an investment strategy for disposing of the Investments in an orderly and active way through sale, redemption, buy-back or other means within the context of an overarching objective of protecting and creating value for the taxpayer as shareholder, paying due regard to the maintenance of financial stability and to acting in a way that promotes competition." It follows with a commitment by the Treasury to produce an "investment mandate" in consultation with the board, which the company is to comply with in managing the investments, taking into account the overarching objective. The board is then tasked with producing a business plan for the management of UKFI, to recommend to the Treasury.

With regard to management of the portfolio companies, UKFI is expected to concern itself with corporate governance by working with boards "to strengthen their membership through the appointment of suitably qualified, independent non-executives." The Framework Document also commits to preserve the independence of portfolio companies: "The Company will manage the Investments on a commercial basis and will not intervene in day-to-day management decisions of the Investee Companies (including with respect to individual lending or remuneration decisions). The Investee Companies will continue to be separate economic units with independent powers of decision and, in particular, will continue to have their own independent boards and management teams, determining their own strategies and commercial policies (including business plans and budgets)."[191] With respect to wholly owned companies, UKFI expects to act like a private equity firm. With respect to partially owned public companies, it expects to "engage actively . . . in accordance with best institutional shareholder practice" including exercising voting rights. To avoid any distortion of competition, UKFI will ensure that there are no interlocking directors among its portfolio companies, and is expected to takes steps to ensure that portfolio companies comply with codes of conduct, abide by insider trading prohibitions and, most intriguingly, "exercise its rights in relation to each Investee Company

[190] http://www.ukfi.gov.uk/publications/.
[191] 7.1.

individually and will not co-ordinate its actions in relation to Investee Companies in a way that might distort competition between them."[192]

Immediately after the paragraph ensuring independence, the Framework Document commits UKFI to "monitor and work to secure compliance with the following: (A) (i) the non-lending conditions attached to the accessing by RBS and Lloyds (including HBOS plc) of the Government's bank recapitalisation fund and any other financial institutions accessing the fund and (ii) the conditions attaching to any decisions of the European Commission or national regulatory authorities in relation to state aid or merger control and any commitments given by HM Treasury in that context, as notified by HM Treasury to the Company (together, the "Recapitalisation Conditions")." This section refers to obligations that these firms took on in agreeing to a bailout, "including maintaining, over the next three years, the availability and active marketing of competitively-priced lending to home owners and small businesses at 2007 levels."[193] Thus, for example, when the Treasury took 65% of the voting shares of Lloyds Banking Group in return for insuring £260bn of the group's toxic assets, Lloyds agreed "to lend at least £28bn over the next few years."[194]

The remainder of the document commits UKFI to establish corporate governance structures at portfolio companies that comport with "best practices" and expect UKFI itself to model these best practices.

The Treasury retains a veto over any disposal or acquisition of investments, any variation in the terms of any agreements with portfolio companies, and any action which may prejudice the Treasury's role as creditor. Finally, the Treasury has the "power of direction" and can give general or specific instructions at any time. The board agrees to comply with such instructions or to resign. Any such directions will be in writing and promptly published.

In the short time that UKFI has been up and running, it has already taken some firm public positions. Thus, for example, it voted its 57.9% stake in the Royal Bank of Scotland against the resolution to approve RBS's retrospective Remuneration Report because of the former board's decision to treat two outgoing executives' departures as retirements thereby enabling them to take undiscounted and highly controversial pensions.[195]

The UKFI Framework Document embraces what one might optimistically call "constructive ambiguity" or more pessimistically view as incoherence. On the one hand, it adopts a model of "commercial" as distinguished from "political" management of the share portfolio and sets up a certain separation between the Treasury and the share portfolio. It seemingly adopts a goal of increasing the value of the portfolio companies in order to the facilitate the prompt sale of the

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[192] 7.3(c).
[193] UKFI Dec. 1, 2008 press release, available at http://www.ukfi.gov.uk/press-releases/index.php?Year=2008.
[194] Guardian March 7, 2009 at http://www.guardian.co.uk/business/2009/mar/07/government-takes-over-lloyds.
[195] UKFI March 31, 2009 press release, available at http://www.ukfi.gov.uk/press-releases/. The "Remuneration Report " EXPLAIN WHAT IT IS.

ownership stakes. On the other hand, it leaves open numerous avenues of political influence, albeit with the potential safeguard of requiring that influence to be public, while also directing UKFI to fulfill the mandate to lend. During a recessionary period, when lending opportunities decline, the two goals are in some tension.

Put somewhat differently, the UK model relies on non-legally enforceable norms as opposed to binding legal structures to provide insulation. How well that will work will depend sensitively on the underlying norms relating to government interference in business decisions. The model, then, even if it works, can only be transplanted to systems with a similar set of norms.

Indeed, the structure, based as it is on norms, does little to insulate "commercial" decisions in the management of the portfolio from political pressure. The populist outcry over executive compensation provides a nice example. Fred Goodwin and Johnny Cameron's departures from RBS were highly controversial. When Goodwin, the CEO of RBS, stepped down after RBS's collapse, he received an approximately £700,000 per year pension. Although, by US standards, this was hardly extreme, it generated a huge public outcry, in part because, though manipulation of his departure date and other inputs to the pension determination, he received twice as much as he otherwise would have.[196] Goodwin became a symbol of excess and greed, and his house was vandalized.[197] UKFI then voted against the "Directors' Remuneration Report" at the next annual meeting.[198]

Other examples are also revealing. In the summer of 2009, the Treasury apparently pressured Lloyds, of which it owns 43%, to restructure a loan to JJB Sports, a UK health club chain with 9,000 employees, rather than selling the debt to a U.S. restructuring firm which apparently was willing to pay face value.[199]

Later, when RBS, also controlled by the Treasury, announced that it was advising Kraft in its hostile bid for Cadbury, and providing financing for the bid, severe pressure was brought to bear by two senior Labour politicians, Lord Mandelson, the Secretary of State for Business,

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[196] Wearden and Treanor, Ex-RBS chief Goodwin faces legal challenge to £693k pension. Guardian, February 26, 2009 available at http://www.guardian.co.uk/business/2009/feb/26/sir-fred-goodwin-royalbankofscotlandgroup.

[197] http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/5048091/Sir-Fred-Goodwin-attack-Bank-Bosses-Are-Criminals-group-claims-responsbility.html

[198] In the UK, public companies must publish and submit an annual "Directors' Remuneration Report" detailing the compensation of top executive to the annual general meeting for approval. Directors' Remuneration Report Regulations, 2002 No. 1986 (U.K.) (regulations made by the Secretary of State pursuant to §257(2) of the Companies Act, 1985) available at http://www.opsi.gov.uk/si/si2002/20021986.htm. A rejection has purely symbolic effect.

[199] David Wighton, Hester hits out at interference, Times (London) Dec. 17, 2009 at 51; Elizabeth Rigby, JJB nearer to fitness club sale, Financial Times (London), march 23, 2009 at 18.

Innovation and Skills, and President of the Board of Trade, and Lord Myners, the Financial Services Secretary (or City Minister) in the Treasury, as well as members of parliament.[200]

Political pressure, especially in the absence of binding legal restrictions, can be very persuasive.

C. **The Israeli Approach: the 1983 Bank Bailout**

In 1983, after a scheme by the major Israeli banks to manipulate the price of their shares collapsed and the banks were left holding huge blocks of their own shares, the government stepped in and assumed control of the banks. This led to a period, now essentially ended, during which the Israeli government owned controlling positions in the major banks.[201]

By 1983, and at least with regard to the bank bailouts, Israel had accepted the "liberal consensus."[202] To avoid government involvement in the day-to-day management of the banks, and to facilitate the subsequent sale of the shares, the Bank Shares under Arrangement Law adopted an innovative structure. For each bank, a "public committee" and a "share committee" were created. The members of the "public committee" were appointed by the government and charged with drawing up a list of candidates to serve as directors.[203] The members of the public committee must, by statute, include a judge (appointed by the Justice Minister after consulting with the president of the Supreme Court) who serves as chair, with the other four members who must include an academic and a business person, chosen by the Treasury Minister with agreement of the president of the Bank of Israel. The members must meet the qualifications for directors set forth for directors of government corporations, and a variety of other competence and independence requirements.[204]

The "share committee," appointed by the public committee, is given both the power and responsibility to vote the shares for the state.[205] The members of the share committee likewise must meet standards of competence and independence.[206] The share committee nominates directors from the list of candidates prepared by the public committee, and then votes for them at the annual meeting.[207] A person cannot serve on more than one share committee; a director may

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[200] Andrew Hill, Mandelson on Cadbury: pure politics, impure policy, Financial Times, December 5, 2009 at 15; Jonathan Guthrie, Jonathan Birchall and Jenny Wiggins, MPs aim to block RBS financing of Kraft bid, Financial Times, December 16, 2009 at 22.

[201] For an overview of the bank share scheme, see Asher Blass and Richard Grossman, Financial Fraud and Banking Stability: The Israeli Bank Crisis of 1983 and Trial of 1990, International Review of Law and Economics 16:461-472, 1996; Ehud Ofer, Glass-Steagall: Israeli Dream, 9 Fordham J. Corp. & Fin. L. 559 (2003-04) at 559-63.

[202] CITE.

[203] Section 6(a).

[204] Section 7.

[205] Section 3, 12(a), 25.

[206] Section 12.

[207] Sections 17-19/

not serve on more than one bank board.[208] On proposals to change fundamental corporate documents, the share committee is to exercise its own discretion, except that it is directed to vote against all proposals that directly or indirectly weaken the rights attached to the government shares or the ability to sell those shares.[209]

When it comes to selling the shares, the Treasury Minister retains the power to order their sale and to approve any other plan to sell them, and the share committee is precluded from engaging in any share transaction except according to written instructions from the Treasury Minister or his agent and with the approval of the Kenneset (parliament) Finance Committee.[210]

The Israeli statute provides a very detailed structure designed to insulate the day-to-day management of the banks from political interference by giving share voting decisions to the share committee. At the same time, critical decisions – such as whether and when to sell the shares – are reserved for the political branches. Moreover, the structure, with its multiple agents and reporting requirements makes it nearly certain that significant attempts to breach the firewalls will be publicly disclosed, and thereby trigger public comment and debate. Finally, the Israeli structure provides a process for identifying and vetting director candidates that is independent from both the banks themselves as well as from the political branches. According to anecdotal reports, the system works quite well.

Interestingly, Israel also has a separate "Government Corporations" statute that is designed for corporations in which the government owns more than 50%, with some provisions applying to "mixed corporations" (defined as corporations in which the government owns less than 50%). The key features of the statute include specific government approval rights including changes in the purposes of the corporation, its capital, and issuance of preferred stock or convertible bonds.[211] The statute also contains provisions governing government directors serving on the board,[212] provisions establishing a government corporation authority, provisions addressing subsidiaries and mixed corporations, as well as provisions governing privatization.[213] A subsection addresses "defense of essential governmental interests."[214]

The best known example of a government corporation is El Al Israel Airlines which was bailed out by the government in the early 1980s, and privatized beginning in 2003. It has passed through each stage of government ownership. The government currently holds a X% ownership interest along with a golden share giving it specific veto rights.

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[208] Section 20(a).
[209] Section 26.
[210] Section 30.
[211] Government Corporation Act at §11.
[212] §§16-23A.
[213] 59A – 59V.
[214] Chapter Het 2 (§§59z++)

D. **The Design Choices & the Background Politics**

Earlier, we pointed out that government ownership of equity can encourage political interference by providing the *power* to interfere, regular *opportunities* to do so, and at a low political *cost*. Taking the "liberal consensus" as given, one can analyze the various design choices according to their capacity to block political interference by reducing the power to interfere, minimizing the opportunities to do so, and increasing the political cost. The principal design choices seem to be:

- Equity v. debt
- Voting v. nonvoting stock
- Direct v. indirect ownership
- Indefinite v. time-limited ownership

Once one lays out the alternatives, the task of implementing the "liberal consensus" is actually quite straightforward: a legally binding structure that insulates the firm from political pressure coupled with a quick exit. The fact that the available means are so rarely adopted suggests that, as a political matter, we may not in fact wish to implement the "liberal consensus" even as we pay homage to it.

1. **Insulation Through Binding Separation**

Suppose one takes the liberal consensus at face value. How would ownership be structured? Here, we have at least two alternatives. First, as with Chrysler 1.0, one could build the investment on the debt model, and impose a relatively short time limit. Putting these together, one provides very substantial insulation from political pressure. Debt provides far fewer opportunities for interference because debtholders do not typically vote for directors, on shareholder proposals, or to approve major transactions. If one wishes to give the taxpayer a share in the upside, that is easily done with warrants, as in Chrysler 1.0 and TARP. These warrants provide no control rights until exercised and even then can be limited to non-voting stock. The public can benefit from increases in firm value either through exercising the warrants or, more typically, by selling the warrants back to the company or in an auction.

An additional advantage of investing through debt rather than equity is that it prevents shareholders of insolvent firms from benefiting from government bailouts. In the recent bailouts, why did the government limit its ownership to 79.9%, leaving 20.1% in the hands of existing shareholders? There are two explanations. One is that government accounting rules, like GAAP, require the consolidation of accounts when the government owns 80% or more. Had the government acquired 100% of AIG, Fannie Mae and Freddie Mac, their massive debts would have had to be included in the national debt, and would have required legislation raising the

permissible ceiling. Because such legislation is always politically controversial,[215] it was politically easier (although economically costly) to leave the existing shareholders with 20%. An alternative explanation is that capping government ownership at 79.9% was necessary to maintain the deductibility of interest payments to the Treasury (although why it would matter to the government that such payments would be deductible is unclear).[216]

A second approach is to insulate firms from interference through a legally binding process for the appointment of directors and the voting of shares. The Israeli bank shares model, with two separate independent committees, provides an example of how this can be implemented. Here, again, by limiting politicians' power to interfere, and their opportunities, one can provide for very substantial insulation. For banks and other financial institutions with capital adequacy requirements, government purchases of debt will not, typically, suffice. In such cases, the Israeli bank shares model provides an alternative structure of binding insulation.

These approaches, when implemented properly, trump investments in non-voting stock for two reasons. First, non-voting stock gives the (non-governmental) holders of the voting shares the residual control rights. By creating a dual class capital structure, one divides cash flow rights from control rights, with the well known problems that that can cause.[217] Second, because nonvoting shares trade at a discount to voting shares, the government will get less when it ultimately sells its stake. By contrast, government ownership of voting shares allows it to exit either by selling the block to a new controller or into the market.

2. **Mandating a Quick Exit**

In June, S.1280, the TARP Recipient Ownership Trust Act of 2009, was introduced in the Senate.[218] The proposed statute grants the Secretary of Treasury authority (and provides inducements to exercise that authority) to delegate the management of TARP positions of 20% or more to a management company run by three "independent trustees" who are expected to hold and manage the assets "in trust on behalf of the United States taxpayers." Under the proposed statute, the duties of the trust would be to exercise the voting rights and select the representation on the boards of TARP recipients, with "the purpose of maximizing the profitability of the designated TARP recipient." Somewhat mysteriously, the proposed statute states that the trust shall "have a fiduciary duty to the American taxpayer for the maximization of the return on the

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[215] See, e.g., Carl Hulse, Senate Passes an Increase in Debt Limit, NYT Dec. 24, 2009 (http://www.nytimes.com/2009/12/25/business/25debt.html?emc=eta1); Corey Boles and Martin Vaughan, Congress Increases Debt Limit, WSJ Dec. 26, 2009 (http://online.wsj.com/article/SB126166163113304249.html).

[216] Adam Levitin, supra.

[217] Jeffrey Gordon, Ties that Bond: Dual Class Common Stock and the Problem of Shareholder Choice, 76 Cal. L. Rev. 1 (1988); Ronald Gilson, Evaluating Dual Class Common Stock: The Relevance of Substitutes, 73 Va. L. Rev. 807 (1987).

[218] S. 1280, 111th Congress, 1st Session (June 17, 2009), available at http://www.govtrack.us/congress/billtext.xpd?bill=s111-1280.

investment of the taxpayer made under the Emergency Economic Stabilization Act of 2008, in the same manner and to the same extent that any director of an issuer of securities has with respect to its shareholders under the securities laws and all applications of State law." Finally, the statute provides for the liquidation of the trust by the end of 2011, unless the trustees believe "that liquidation would not maximize the profitability of the company and the return on the investment to the taxpayer."

The bill raises as many questions as it answers, but the general outlines are reasonably clear: a politically independent vehicle to hold and vote the shares; a 2011 sunset; and some vague instructions to manage the assets with an eye towards profitability and, by implication, not with political motivations or goals. The bill has been referred to committee where it will undoubtedly be modified if it does not die.

Binding time limits on government ownership are the single most powerful means of insulating firms from political pressure. However troubling interference may be, a short time horizon minimizes the damage. On the other hand, while tempting, the obvious problem with mandating a sale is the tradeoffs. Exit cannot be so quick as to jeopardize the firms that we are trying to save. On the other hand, because we want to maximize the return to taxpayers, a forced sale will rarely maximize the price.

V. Conclusion

The preceding discussion shows that our current regulatory structure is ill adapted to government ownership of controlling stakes in private companies. Delaware's nuanced jurisprudence of fiduciary duty is not, and probably cannot be, duplicated or transplanted into the public law categories that come to the fore with public ownership.

This gap raises two possibilities. One might argue that because bail outs are inevitable, we should come up with a better system for holding government controlling shareholders accountable for the effects of their actions on non-controlling shareholders. If one went in this direction, one might argue that Delaware corporate law should be incorporated by reference through some sort of inverse preemption. Alternatively, in recognition of the different incentives and goals of government controlling shareholders, one might argue for the development of a new set of standards better suited to the distinctive issues posed by government ownership of controlling stakes.

An alternative view is that, given the difficulties inherent in government ownership, the last thing we should do is make it easier. On this view, providing a better accountability system will only serve to encourage government intervention and further reduce whatever political taboos remain against it. Because no regulatory structure can adequately control the political forces at play, it

may even be the case that we should preserve the current, ill-fitting system as is. The worse the outcome, one might argue, the better for the long term health of the body politic because there is no other way to reestablish the necessary taboos.

However one comes out on the direction forward, one thing is clear: we do not currently have adequate legal tools to address the problems posed when the government is the controlling shareholder.