

University of Pennsylvania Carey Law School

## Penn Carey Law: Legal Scholarship Repository

---

Faculty Scholarship at Penn Carey Law

---

5-1-2011

### When the Government is the Controlling Shareholder

Marcel Kahan  
*New York University*

Edward B. Rock  
*University of Pennsylvania Carey Law School*

Follow this and additional works at: [https://scholarship.law.upenn.edu/faculty\\_scholarship](https://scholarship.law.upenn.edu/faculty_scholarship)



Part of the American Politics Commons, Business Law, Public Responsibility, and Ethics Commons, Business Organizations Law Commons, Law and Economics Commons, Law and Politics Commons, Law and Society Commons, Political Economy Commons, Public Administration Commons, and the Public Policy Commons

---

#### Repository Citation

Kahan, Marcel and Rock, Edward B., "When the Government is the Controlling Shareholder" (2011). *Faculty Scholarship at Penn Carey Law*. 316.

[https://scholarship.law.upenn.edu/faculty\\_scholarship/316](https://scholarship.law.upenn.edu/faculty_scholarship/316)

This Article is brought to you for free and open access by Penn Carey Law: Legal Scholarship Repository. It has been accepted for inclusion in Faculty Scholarship at Penn Carey Law by an authorized administrator of Penn Carey Law: Legal Scholarship Repository. For more information, please contact [PennlawIR@law.upenn.edu](mailto:PennlawIR@law.upenn.edu).

# When the Government Is the Controlling Shareholder

Marcel Kahan & Edward B. Rock\*

*As a result of the 2008 bailouts, the U.S. government became the controlling shareholder of some major U.S. corporations: AIG, Citigroup, GM, GMAC, Fannie Mae, and Freddie Mac. Corporate law provides a complex and comprehensive set of standards of conduct to protect noncontrolling 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 United States and elsewhere) in which government ownership has been structured in order to minimize political interference at the expense of noncontrolling 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. As the U.S. Treasury moves forward with its plans for taking some of these companies public again, understanding the legal restrictions on the government as controlling shareholder is critically important to the decision to buy shares in an IPO and, if so, at what price.*

---

\* Marcel Kahan is the George T. Lowy Professor of Law at NYU Law School. Edward Rock is the Saul A. Fox Distinguished Professor of Business Law at the University of Pennsylvania Law School. We are grateful for comments from Bill Allen, Heitor Almeida, Ed Baker, and Cathie Struve, and to workshop and conference participants at Harvard, Hebrew University, NYU, Penn, Stanford, and Yale. Thanks to Andrew Egan, Natus Navrat, Stephen Pratt, and Michal Yevnin for research help. Marcel Kahan would also like to thank the Milton and Miriam Handler Foundation for financial support. Edward Rock’s research was supported by the University of Pennsylvania’s Institute for Law and Economics and the Saul A. Fox Research Endowment.

I.	Introduction.....	1295
II.	Some Recent Background.....	1299
	A. The Government’s Holdings in Private Companies: Some Numbers.....	1299
	1. <i>Voting Stock and Control Positions.</i> .....	1299
	2. <i>Debt and Nonvoting Stock.</i> .....	1301
	B. Some Troubling Anecdotes.....	1301
	C. How Did We Get Here? .....	1307
	D. Purpose Versus Effect of Acquiring Stock Position .....	1313
III.	When the Government Is the Controlling Shareholder: Regulation .	1315
	A. The Baseline: The Problems Posed by Ordinary Controlling Shareholders.....	1315
	B. The Problem of the Government as a Controlling Shareholder ....	1317
	C. Introduction: The Delaware Corporate Law Structure.....	1319
	1. <i>The Duty-of-Loyalty Claim</i> .....	1319
	2. <i>The Duty-of-Care Claim</i> .....	1320
	3. <i>The Duty-of-Good-Faith Claim</i> .....	1322
	D. The Direct Challenge: The U.S. Treasury’s Obligations as Controlling Shareholder.....	1323
	1. <i>Delaware Law and the U.S. Government</i> .....	1324
	2. <i>Sovereign Immunity and Its Limits: Claims Against the U.S. Government</i> .....	1325
	a. <i>Jurisdiction and Venue: The Limitation of Delaware’s Role.</i> .....	1326
	b. <i>FTCA Claims.</i> .....	1326
	i. Is a Breach of Fiduciary Duty a “Tort”?.....	1326
	ii. The “discretionary function” exception.....	1330
	iii. Are the actions in the hypo choices from “a range of permissible courses”? .....	1332
	c. <i>Potential Tucker Act Fiduciary-Duty Claims</i> .....	1336
	d. <i>Claims Under the APA</i> .....	1341
	e. <i>Claims Under the Freedom of Information Act</i> .....	1345
	E. An Alternative Strategy: Leaving the U.S. Government Out of the Suit.....	1346
	F. Conclusion .....	1346
IV.	Structuring Government Ownership Ex Ante.....	1347
	A. U.S. Models .....	1349
	1. <i>Chrysler 1.0</i> .....	1349
	2. <i>The AIG Structure: An Explicit Trust</i> .....	1351
	3. <i>Another U.S. Model: Limited Voting and Predetermined Exit at Citigroup</i> .....	1353

B.	U.K. Financial Investments Limited .....	1354
C.	The Israeli Approach: The 1983 Bank Bailout .....	1358
D.	The Design Choices and the Background Politics .....	1360
	1. <i>Insulation Through Binding Separation</i> .....	1361
	2. <i>Mandating a Quick Exit</i> .....	1362
V.	Conclusion .....	1363

## I. Introduction

General Motors has returned to the public capital markets with an initial public offering of shares. The U.S. Treasury remains and will remain a controlling shareholder of GM for the foreseeable future. To what extent will Delaware law constrain the federal government in its role as controlling shareholder? Will GM's minority shareholders be able to sue the U.S. Treasury for breach of the duty of loyalty if the Treasury abuses its controlling position? This Article addresses these and related issues.

Imagine 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 U.S. government, through the Department of the Treasury, is determined to rescue it and prepared to take extraordinary steps to do so. First, the government 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 in DMAC.

Now to the heart of the question: Going forward, the Treasury wants new DM to succeed, both because it believes that the United States needs to preserve its “domestic” automobile industry (and the jobs associated with it) and because, after investing \$50 billion, the government 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.

At the same time, the Treasury insists on the following: First, it wants DM to make DM's 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 hit hard 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.

Some of the minority shareholders of DMAC are outraged that their company is being run for the benefit of DM. They provide evidence that the preferential terms provided to DM and its dealers and customers cost 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 if 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.<sup>1</sup> First, on account of the size 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 the 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 the Treasury's control, DM, at a cost to the other shareholders of DMAC.<sup>2</sup> 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 the Treasury 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.

---

1. 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. See Mark J. Roe & David Skeel, *Assessing the Chrysler Bankruptcy*, 108 MICH. L. REV. 727, 734–36, 746–49 (2010).

2. The background section raises a similar issue with regard to the noncontrolling shareholders of the TARP banks. See *infra* subpart II(B).

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 noncontrolling 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 the minority shareholders may object to the Treasury furthering public policy at their expense, that is a different complaint.

The United States does not have much history with government ownership of private industry.<sup>3</sup> As a result, we do not have a well-worked-out structure of accountability when the government is the 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? Second, if the delegation is permissible, which of the constitutional or administrative law limits, if any, do or should apply to the private actor?<sup>4</sup> In short, can or should the Constitution or the Administrative Procedure Act<sup>5</sup> (APA) 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—the content of the Tucker Act,<sup>6</sup> the Federal Tort Claims Act<sup>7</sup> (FTCA), and the APA. These three federal statutes largely displace Delaware’s state law structures of accountability. A key challenge posed by government involvement is

---

3. For a review of that history, see J.W. Verret, *Treasury Inc.: How the Bailout Reshapes Corporate Theory and Practice*, 27 YALE J. ON REG. 283, 289–93 (2010).

4. For examples of this literature, see generally Jack Beermann, *Privatization and Political Accountability*, 28 FORDHAM URB. L.J. 1507 (2001); Jody Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. REV. 543 (2000); Gillian Metzger, *Privatization as Delegation*, 103 COLUM. L. REV. 1367 (2003); Symposium, *Public Values in an Era of Privatization*, 116 HARV. L. REV. 1212 (2003); Paul Verkuil, *Privatizing Due Process*, 57 ADMIN. L. REV. 963 (2005).

5. 5 U.S.C. §§ 551–559, 701–706 (2006).

6. 28 U.S.C. §§ 1491–1503 (2006).

7. 28 U.S.C. §§ 2671–2680 (2006).

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 to the potential virtues of precommitment 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 trade-offs involved in decisions to rescue private firms rather than allowing them to fail, the extent to which public ownership may lead to “noncommercial” 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 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, as in GM’s 2010 IPO, and to increase the amount that investors will be willing to pay.<sup>8</sup> 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.<sup>9</sup>

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.<sup>10</sup> We proceed as follows. In Part I, we review recent events

---

8. GM made an initial public offering of new stock in November 2010. Sharon Terlep, Randall Smith & Aaron Lucchetti, *GM’s IPO May Raise Record Amount*, WALL ST. J., Nov. 17, 2010, <http://online.wsj.com/article/SB10001424052748704312504575619004098993666.html>.

9. See, e.g., Liz Moyer, *Citi Sale Stokes New Trading Dynamic*, WALL ST. J., Dec. 7, 2010, <http://online.wsj.com/article/SB10001424052748703296604576005431476850972.html> (discussing the Treasury’s sale of its 2.4 billion shares in Citigroup stock and the “expected wave of institutional buying” that followed).

10. For other work on these issues that overlaps to some degree with our analysis here, see Steven M. Davidoff & David Zaring, *Regulation by Deal: The Government’s Response to the Financial Crisis*, 61 ADMIN. L. REV. 463, 466 (2009), and Verret, *supra* note 3, at 285–89.

during which the U.S. Treasury invested vast sums in private firms, including both financial and nonfinancial institutions and both publicly traded and privately held corporations, as well as some evidence of politically driven involvement in the managing of companies.<sup>11</sup> In Part II, we examine the challenges posed to the existing structure of legal regulation of controlling shareholders when the controlling shareholder is the U.S. Treasury. With regard to claims against the United States, this requires looking at sovereign immunity and its exceptions, as developed in the FTCA, the Tucker Act, and the APA. We also examine the extent to which one could avoid the reach of sovereign immunity by forgoing 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 U.S. structures, including the previous Chrysler bailout that relied on loan guarantees, as well as more recent use of nonvoting stock, share trusts, and commitments to exit; the United Kingdom's establishment of the wholly owned U.K. Financial Investments Limited to hold and manage its interests in financial institutions bailed out with 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.

## II. Some Recent Background

Our starting hypothetical is not simply the product of fevered imaginations but is based on recent events. In this Part, 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.*

- In September 2008, the Treasury invested \$85 billion in AIG, in partial exchange for which it received preferred stock that has 77.9% of the votes and warrants that, if exercised, grant it

---

11. 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.



another 2% of the votes.<sup>12</sup> If and when the recapitalization announced on September 30, 2010, is completed, the Treasury will own approximately 92.1% of AIG common stock.<sup>13</sup>

- At Citigroup, in the wake of the preferred-stock share exchange, the Treasury owned around 34% of the outstanding common stock,<sup>14</sup> and after Citi's \$17 billion stock issuance, owned 26%.<sup>15</sup> During 2010, the Treasury sold off shares so that, by the end of September 2010, its ownership was down to 12.4%.<sup>16</sup> The Treasury subsequently disposed of its remaining interests.<sup>17</sup>
- As a result of the federally engineered bankruptcy, the United States owns 8% of the equity in new Chrysler.<sup>18</sup>
- As a result of the GM bailout, the Treasury owned 61% of the common stock of new GM.<sup>19</sup> After GM's November 2010 IPO, the Treasury's stake dropped to 26%.<sup>20</sup>
- The Treasury owns 56% of the common stock of GMAC, GM's former financing affiliate.<sup>21</sup>
- The Treasury owns 79.9% of Fannie Mae (FNMA, the Federal National Mortgage Association) and Freddie Mac (FHLMC, the Federal Home Loan Mortgage Corporation), the formerly

12. Press Release, Bd. of Governors of the Fed. Reserve Sys. (Sept. 16, 2008), available at <http://www.federalreserve.gov/newsevents/press/other/20080916a.htm>. For further details, see *infra* notes 240–44 and accompanying text.

13. Pallavi Gogoi & Daniel Wagner, *AIG Bailout Exit Doesn't Resolve Losses from TARP*, BLOOMBERG BUSINESSWEEK, Sept. 30, 2010, <http://www.businessweek.com/ap/financialnews/D9IIHADO0.htm>.

14. Citigroup, Inc., Quarterly Report (Form 10-Q), at 9 (Nov. 6, 2009).

15. David Enrich & Damian Paletta, *Discord Behind TARP Exits*, WALL ST. J., Dec. 19, 2009, <http://online.wsj.com/article/SB10001424052748703323704574602552053952422.html>; see also Michael Corkery, *The Good, Bad, and Ugly of Citigroup's Botched Stock Sale*, WSJ BLOGS (Dec. 17, 2009), <http://blogs.wsj.com/deals/2009/12/17/the-good-bad-and-ugly-of-citigroups-botched-stock-sale/> (“As a result of that capital raise, taxpayers were diluted from a 33% stake in Citigroup to 26% . . .”).

16. *U.S. Treasury to Earn \$2.25 Billion on Citi Securities*, REUTERS (Sept. 30, 2010), <http://www.reuters.com/article/idUSN3011328720101001>.

17. Tom Barkley, *TARP Profit on Citigroup: \$12.3 Billion*, WALL ST. J., Jan. 27, 2011, <http://online.wsj.com/article/SB10001424052748703293204576105763449264874.html>.

18. Press Release, U.S. Dep't of the Treasury, Obama Administration Auto Restructuring Initiative: Chrysler–Fiat Alliance (Apr. 30, 2009), available at <http://www.treasury.gov/press-center/press-releases/Pages/tg115.aspx>.

19. See Bill Vlasic & Nick Bunkley, *Obama Is Upbeat for G.M. Future on a Day of Pain*, N.Y. TIMES, June 2, 2009, at A1.

20. Michael J. de la Merced & Bill Vlasic, *U.S. Recovers Billions in Sale of G.M. Stock*, N.Y. TIMES, Nov. 17, 2010, at A1.

21. Binyamin Appelbaum, *U.S. to Give \$3.6 Billion More in Aid to GMAC; Move Makes Government the Majority Owner of Troubled Auto Lender*, WASH. POST, Dec. 31, 2009, at A1.

“private” government sponsored enterprises (GSEs) that were the largest mortgage intermediaries.<sup>22</sup>

2. *Debt and Nonvoting Stock.*

- Through its Capital Purchase Program (CPP), the Treasury injected approximately \$200 billion of Troubled Asset Relief Program (TARP) funds into 707 institutions.<sup>23</sup> The CPP investments combine preferred stock with warrants, neither of which carries votes.
- Through the Targeted Investment Program (TIP), the United States invested \$20 billion in nonvoting preferred stock in Bank of America that has now been paid back.<sup>24</sup>

And this is but a partial list of the U.S. 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 subpart.

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 collapse of AIG.<sup>25</sup> In response, Representative 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.”<sup>26</sup> Others, such as Representative Charles Rangel, characterized AIG as “getting away with murder,”<sup>27</sup> while Republican Senator Charles Grassley advised AIG bonus recipients to

22. Louise Story, *New Aid for Fannie and Freddie*, N.Y. TIMES, Dec. 25, 2009, at B1.

23. *Investment Programs: Capital Purchase Program*, U.S. DEP’T TREASURY, <http://www.treasury.gov/initiatives/financial-stability/investment-programs/cpp/Pages/capitalpurchaseprogram.aspx>.

24. *Investment Programs: Targeted Investment Program*, U.S. DEP’T TREASURY, <http://www.treasury.gov/initiatives/financial-stability/investment-programs/tip/Pages/targetedinvestmentprogram.aspx>; see also Securities Purchase Agreement Between Bank of America Corp. and U.S. Dep’t of the Treasury (Jan. 15, 2009), available at [http://www.treasury.gov/initiatives/financial-stability/investment-programs/tip/Documents\\_Contracts\\_Agreements/BAC%20III%20Binder.pdf](http://www.treasury.gov/initiatives/financial-stability/investment-programs/tip/Documents_Contracts_Agreements/BAC%20III%20Binder.pdf).

25. Edmund L. Andrews & Peter Baker, *At A.I.G., Huge Bonuses After \$170 Billion Bailout*, N.Y. TIMES, Mar. 15, 2009, at A1.

26. Carl Hulse & David M. Herszenhorn, *A.I.G. and Wall St. Confront Upsurge of Populist Fury*, N.Y. TIMES, Mar. 20, 2009, at A1.

27. *Id.*

“[r]esign or go commit suicide.”<sup>28</sup> President Obama, in a more measured response intended to “channel [public] anger in a constructive way,”<sup>29</sup> urged Congress to draft legislation that sends “a strong signal to the executives who run these firms that such compensation will not be tolerated.”<sup>30</sup>

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. Representative 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 nearly an 80% stake in the company after giving it more than \$170 billion in aid.<sup>31</sup> “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.<sup>32</sup>

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, where a Treasury trust holds 77.9% of the stock, the American Federation of State, County, and Municipal Employees (AFSCME) lobbied the three trustees to withhold the trust’s votes from the AIG director who served on the compensation committee during the period in which the bonuses were granted, 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.<sup>33</sup>

But the attempts to influence portfolio companies have been broader. Congress expected that bailout funds would stimulate lending and revitalize

---

28. *AIG and the President: Easy Does It*, ECONOMIST, Mar. 21, 2009, [http://www.economist.com/opinion/displaystory.cfm?story\\_id=13326168](http://www.economist.com/opinion/displaystory.cfm?story_id=13326168).

29. Jackie Calmes & Louise Story, *A.I.G. Seeking Return of Half of Its Bonuses*, N.Y. TIMES, Mar. 19, 2009, at A1.

30. Hulse & Herszenhorn, *supra* note 26; *see also* Andrew Ross Sorkin et al., *U.S. Rounding Up Investors to Buy Bad Bank Assets*, N.Y. TIMES, Mar. 23, 2009, at A1 (reporting the Obama Administration’s intent to increase oversight of executive compensation at financial institutions). 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. Representative 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.” Hulse & Herszenhorn, *supra* note 26.

31. Foon Rhee, *Liddy: Some “Distasteful” Bonuses Will Be Returned*, BOSTON.COM (Mar. 18, 2009), [http://www.boston.com/news/politics/politicalintelligence/2009/03/frank\\_not\\_optim.html](http://www.boston.com/news/politics/politicalintelligence/2009/03/frank_not_optim.html).

32. *Id.*

33. Letter from Gerald W. McEntee, President, AFSCME, Denise L. Nappier, Treasurer, State of Conn. & Richard L. Trumka, Sec’y Treasurer, AFL-CIO, to Jill M. Considine, Chester B. Feldberg & Douglas L. Foshee, Majority S’holders, AIG (Mar. 31, 2009), *available at* [http://www.afscme.org/docs/AIG\\_Trustee\\_Letter\\_3.31\\_re\\_Vote\\_No.pdf](http://www.afscme.org/docs/AIG_Trustee_Letter_3.31_re_Vote_No.pdf).

the economy but later realized that banks were reluctant to lend for fear of continued economic deterioration. As a result, bailout 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.’”<sup>34</sup> 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.<sup>35</sup> At a separate hearing before the House Financial Services Committee, Representative 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.”<sup>36</sup> 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.” Representative Michael Capuano implored executives to “get our money out on the street.”<sup>37</sup>

Similar calls from Congress soon followed for banks to stem foreclosures and restrain action against struggling homeowners. Barney Frank “acknowledged that struggling homeowners [were not] getting help as fast as many in Congress had hoped”<sup>38</sup> and urged bank executives to put in place a foreclosure moratorium until the government could implement mitigation programs.<sup>39</sup> Frank also criticized hedge fund managers for reportedly directing mortgage servicers to disregard any government program that undercut investment value.<sup>40</sup> Senator Charles Schumer told regulators that “they seemed to be giving the banks ‘a little too much dessert and not making them eat their vegetables,’” because banks had not been required to assist homeowners despite receiving bailout funds.<sup>41</sup> In response, many big

---

34. Christi Parsons & Peter Nicholas, “*We Will Rebuild, We Will Recover*,” L.A. TIMES, Feb. 25, 2009, at A1.

35. Ross Kerber, *Banks Draw Heavy Fire from Capitol Hill*, BOS. GLOBE, Nov. 14, 2008, [http://www.boston.com/business/articles/2008/11/14/banks\\_draw\\_heavy\\_fire\\_from\\_capitol\\_hill](http://www.boston.com/business/articles/2008/11/14/banks_draw_heavy_fire_from_capitol_hill).

36. Maura Reynolds & Jim Puzzanghera, *Financial Giants’ CEOs, Geithner on Hot Seats*, CHI. TRIB., Feb. 12, 2009, at 27.

37. Ross Kerber, *Businesses in N.E. Say Lenders Too Strict*, BOS. GLOBE, Feb. 21, 2009, at A1.

38. Ross Kerber, *Frank Talks About the Economy*, BOS. GLOBE, Oct. 25, 2008, [http://www.boston.com/business/articles/2008/10/25/frank\\_talk\\_about\\_the\\_economy/](http://www.boston.com/business/articles/2008/10/25/frank_talk_about_the_economy/).

39. Maura Reynolds & Jim Puzzanghera, *Economic Crisis: Lawmakers Give Banks a Scolding*, L.A. TIMES, Feb. 12, 2009, at C5.

40. Kerber, *supra* note 38.

41. David Stout & Brian Knowlton, *Senators Press for Action to Stem Foreclosures*, N.Y. TIMES, Oct. 24, 2008, <http://www.nytimes.com/2008/10/24/business/economy/24cong.html?pagewanted=print>.

banks put into operation temporary foreclosure moratoriums in advance of the Obama Administration's housing-rescue-plan announcement.<sup>42</sup>

One adaptation to this intense scrutiny has been to preclear 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 get paid."<sup>43</sup> This led to preclearance of even routine bonuses by Kenneth Feinberg, the "compensation czar."<sup>44</sup>

The Treasury ousted Rick 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.<sup>45</sup>

The GM and Chrysler bailouts have brought an avalanche of political attention. The Senate has held hearings on GM's and Chrysler's plans to reduce their networks 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."<sup>46</sup> Senator Mark Warner, 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."<sup>47</sup> 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."<sup>48</sup> The political

---

42. Maura Reynolds & E. Scott Reckard, *Obama Speeds Rescue Plan*, L.A. TIMES, Feb. 14, 2009, at C1.

43. David Cho, *At Geithner's Treasury, Key Decisions on Hold*, WASH. POST, May 18, 2009, <http://www.washingtonpost.com/wp-dyn/content/article/2009/05/17/AR2009051702268.html>.

44. Brady Dennis, *AIG Plans Millions More in Bonuses*, WASH. POST, July 11, 2009, <http://www.washingtonpost.com/wp-dyn/content/article/2009/07/11/AR2009071100419.html>; see also Liam Pleven & Deborah Solomon, *AIG Seeks Clearance to Release Bonuses*, WALL ST. J., July 10, 2009, <http://online.wsj.com/article/SB124718910241620823.html>.

45. Cho, *supra* note 43; see also Bloomberg News, *Ex-GM Chief to Get \$8.5 Million in Retirement Pay*, N.Y. TIMES, July 14, 2009, <http://www.nytimes.com/2009/07/15/business/15auto.html>.

46. Peter Whoriskey & Kendra Marr, *Senators Blast Automakers over Dealer Closings: GM, Chrysler Defend Massive Shutdowns*, WASH. POST, June 4, 2009, at A15.

47. *Id.*

48. Anthony Faiola, *Test-Driving a Foreign Business Model*, WASH. POST, June 22, 2009, [http://www.washingtonpost.com/wp-dyn/content/article/2009/06/21/AR2009062101966\\_pf.html](http://www.washingtonpost.com/wp-dyn/content/article/2009/06/21/AR2009062101966_pf.html).

involvement continues to intensify.<sup>49</sup> Indeed, in May 2010, GM announced plans to reinstate half of the dealers who challenged GM's terminations.<sup>50</sup>

But it is worth keeping in mind that the government can give as well as take. In a little-noticed ruling at the time of the GM Section 363 sale, the IRS decided, contrary to general practice, that old GM's "net operating loss" tax-carry-forwards would pass to new GM.<sup>51</sup> The effect of this ruling is that the first \$45.4 billion of new GM's profits will be tax free.

More recently, the political dance has become even more complex. After a pause during its expedited bankruptcy, government-controlled GM has resumed its lobbying and campaign contributions. Federal Election Commission records indicate that GM contributed \$90,500 to lawmakers during the current election cycle.<sup>52</sup> It has also rebuilt its lobbying force, spending \$6.9 million in the year following its exit from bankruptcy.<sup>53</sup>

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 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.<sup>54</sup>

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.<sup>55</sup>

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

49. *Id.*

50. Nick Bunkley, *G.M. Plans to Reinstate 661 Dealerships*, N.Y. TIMES, Mar. 5, 2010, <http://www.nytimes.com/2010/03/06/business/06dealers.html>.

51. Randall Smith & Sharon Terlep, *GM Could Be Free of Taxes for Years*, WALL ST. J., Nov. 3, 2010, <http://online.wsj.com/article/SB10001424052748704462704575590642149103202.html>; see also Ted Reed, *What About GM's Tax Losses?*, THE STREET (June 9, 2010), <http://www.thestreet.com/story/10510986/what-about-gms-tax-losses.html> (quoting a senior administration official as stating that the net operating loss "would be transferred to the new company").

52. Josh Mitchell, *GM Resumes Political Giving*, WALL ST. J., Sept. 22, 2010, <http://online.wsj.com/article/SB10001424052748704129204575506352139305206.html>.

53. Silla Brush, *GM Rebuilds D.C. Lobbying Force as It Enters Post-bailout Era*, THE HILL (Sept. 21, 2010), <http://thehill.com/business-a-lobbying/119885-gm-rebuilds-its-lobbying-force-for-post-bailout-era>.

54. David Enrich & Robin Sidel, *Citigroup Shakes Up Leaders to Pacify U.S.*, WALL ST. J., July 10, 2009, <http://online.wsj.com/article/SB124714471454017995.html>.

55. Eric Dash & Jack Healy, *Citi Averts Clash over Huge Bonus*, N.Y. TIMES, Oct. 10, 2009, <http://www.nytimes.com/2009/10/10/business/10citi.html>.

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 (nongovernmental) shareholders and creditors were in clear conflict—and the Treasury's interests prevailed.<sup>56</sup>

These anecdotes raise a variety of concerns, two of which we will focus on.<sup>57</sup> 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 those policies 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.

We close this subpart with GM's straightforward articulation of the potential conflicts of interest:

*The UST (or its designee) will continue to own a substantial interest in us following this offering, and its interests may differ from those of our other stockholders.*

Immediately following this offering, the UST will own approximately 36.9% of our outstanding shares of common stock (33.3% if the underwriters in the offering of common stock exercise their over-allotment option in full). As a result of this stock ownership

---

56. Nick Timiraos, *Treasury Blocks the Sale of Tax Credits by Fannie*, WALL ST. J., Nov. 7, 2009, <http://online.wsj.com/article/SB125754828200334693.html>.

57. Government ownership in the United Kingdom has had very similar effects. See, e.g., Dana Cimilluca & Sara Schaefer Munoz, *RBS Draws Fire in U.K. over Its Role in Kraft Deal*, WALL ST. J., Dec. 17, 2009, at C1 (describing Parliament members' objections to government-controlled Royal Bank of Scotland's lending and advisory relationship with Kraft in Kraft's 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](http://business.timesonline.co.uk/tol/business/industry_sectors/banking_and_finance/article6957239.ece) (describing Royal Bank of Scotland directors' threats to resign if the government took action to reduce the size of the bank's employee bonus pool).

interest, the UST has the ability to exert control, through its power to vote for the election of our directors, over various matters. To the extent the UST elects to exert such control over us, its interests (as a government entity) may differ from those of our other stockholders and it may influence, through its ability to vote for the election of our directors, matters including:

- The selection, tenure and compensation of our management;
- Our business strategy and product offerings;
- Our relationship with our employees, unions and other constituencies; and
- Our financing activities, including the issuance of debt and equity securities.

In particular, the UST may have a greater interest in promoting U.S. economic growth and jobs than other stockholders of the Company. For example, while we have repaid in full our indebtedness under the UST Credit Agreement, a covenant that continues to apply until the earlier of December 31, 2014 or the UST has been paid in full the total amount of all UST invested capital requires that we use our commercially reasonable best efforts to ensure, subject to exceptions, that our manufacturing volume in the United States is consistent with specified benchmarks.

In the future we may also become subject to new and additional laws and government regulations regarding various aspects of our business as a result of participation in the TARP program and the U.S. government's ownership in our business. These regulations could make it more difficult for us to compete with other companies that are not subject to similar regulations.<sup>58</sup>

### *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 fi-

---

58. GEN. MOTORS CO., PROSPECTUS 27 (2010), available at <http://www.sec.gov/Archives/edgar/data/1467858/000119312510263635/d424b11.pdf>.



ancial 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 Federal Reserve, along with the European Central Bank, injected \$100 billion for borrowing;<sup>59</sup> in November 2007, it injected another \$41 billion;<sup>60</sup> in the Spring of 2008, it cut interest rates<sup>61</sup> and opened the discount window to investment banks.<sup>62</sup>

Second, the Treasury and the Federal Reserve intervened in an ad hoc way to try to prevent failures of systemically important financial institutions. Thus, in March 2008, the Federal Reserve provided financial assistance to J.P. Morgan Chase in the rescue of Bear Stearns.<sup>63</sup> Also during March, the Federal Reserve announced measures to provide liquidity to commercial and investment banks. Later, during the summer of 2008, the Treasury acted to shore up the capital structures of Fannie Mae and Freddie Mac and ultimately put both into conservatorship.<sup>64</sup>

These interventions were controversial. Some argued that the government had no business intervening to save firms and that doing so created moral hazard.<sup>65</sup> Others argued that the interventions were indefensible handouts to the rich and powerful.<sup>66</sup>

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

---

59. See Scott Lanman & Christian Vits, *Central Banks Add Cash to Avert Crisis of Confidence*, BLOOMBERG (Aug. 10, 2007), <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=ah7K.eFz9xiU&refer=home> (describing emergency measures performed in tandem by central banks to avert a global crisis).

60. Michael M. Grynbaum, *In Wild Swing, Stocks Give Up Rate-Cut Gains*, N.Y. TIMES, Nov. 2, 2007, at A1.

61. Steven R. Weisman, *Fed Cuts Rate but Hints About a Pause*, N.Y. TIMES, May 1, 2008, at C1.

62. Michael J. de la Merced, *Fed Extends Emergency Borrowing Program*, N.Y. TIMES, July 31, 2008, at C12.

63. See Marcel Kahan & Edward Rock, *How to Prevent Hard Cases from Making Bad Law: Bear Stearns, Delaware, and the Strategic Use of Comity*, 58 EMORY L.J. 713, 717 (2009) (describing the Fed's involvement in the Bear Stearns collapse).

64. Stephen Labaton & Edmund L. Andrews, *In Rescue to Stabilize Lending, U.S. Takes Over Mortgage Finance Giants*, N.Y. TIMES, Sept. 8, 2008, at A1.

65. See, e.g., Gretchen Morgenson, Op-Ed., *Rescue Me: A Fed Bailout Crosses a Line*, N.Y. TIMES, Mar. 16, 2008, Sunday Business, at 1 (criticizing the Federal Reserve's bailout of Bear Stearns, especially because the bank "operated in the gray area of Wall Street and with an aggressive, brass-knuckles approach").

66. See, e.g., Nouriel Roubini, *Public Losses for Private Gain*, GUARDIAN.CO.UK (Sept. 18, 2008), <http://www.guardian.co.uk/commentisfree/2008/sep/18/marketturmoil.creditcrunch> (calling the bailouts "the biggest government intervention and nationalizations in the recent history of humanity, all for the benefit of the rich and the well connected").

On September 16, 2008, the Federal Reserve saved AIG by pledging \$85 billion in exchange, *inter alia*, for a promise to issue preferred stock with 79.9% of the voting rights.<sup>67</sup> 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<sup>68</sup> (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.<sup>69</sup> 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."<sup>70</sup> 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.<sup>71</sup> Finally, in order to allow taxpayers to benefit from the upside of these purchases, § 113(d) required that when the Treasury purchased troubled assets from a

---

67. It was subsequently reduced to 77.9%, with an additional 2% in connection with a warrant.

68. Emergency Economic Stabilization Act (EESA) of 2008, Pub. L. No. 110-343, 122 Stat. 3765.

69. ANDREW ROSS SORKIN, *TOO BIG TO FAIL* 508–16 (2009).

70. EESA § 101(a), 122 Stat. at 3767 (to be codified at 12 U.S.C. § 5211(a)).

71. The EESA also provides,

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.

*Id.* § 3(9), 122 Stat. at 3767 (to be codified at 12 U.S.C. § 5202).

financial institution, the Treasury must also receive a warrant.<sup>72</sup> Under the terms of § 113(d), the warrant must be for nonvoting shares or, if no nonvoting shares are provided for in the certificate of incorporation, 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 investment in troubled firms. Because the definition of *troubled asset* noted above is very broad<sup>73</sup> and the prohibition on acquiring voting stock only applied to warrant shares and not to the troubled assets themselves,<sup>74</sup> the Treasury had clear authority to buy voting common stock in financial institutions.

This authority was exercised in various ways. In the CPP, which channeled funds to banks, the Treasury chose to acquire nonvoting preferred stock. The Treasury's standard term sheet, developed by private equity lawyers at Simpson Thacher,<sup>75</sup> provided that the senior preferred stock would be nonvoting except for class voting rights on the issuance of more senior securities, on changes to the rights of the senior preferred stock, or on any merger or other transaction that would adversely affect the rights of the senior preferred stock.<sup>76</sup> As described above, in TARP investments pursuant to other programs, the Treasury has sometimes taken voting stock.<sup>77</sup> Finally, there are situations in which the Treasury has switched from nonvoting to voting stock.<sup>78</sup> This has led to a somewhat varied set of terms within the government's portfolio.

---

72. 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 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.”

*Id.* § 113(d)(1)(A), 122 Stat. at 3778 (to be codified at 12 U.S.C. § 5223). Similar provisions apply to privately held firms. *Id.* § 113(d)(1)(B).

73. *See supra* note 71 and accompanying text.

74. EESA § 113(d), 122 Stat. at 3778.

75. Press Release, U.S. Dep't of the Treasury, Treasury Hires Legal Adviser Under the Emergency Economic Stabilization Act (Oct. 16, 2008), *available at* <http://www.treasury.gov/press-center/press-releases/Pages/hp1217.aspx>.

76. U.S. Dep't of the Treasury, TARP Capital Purchase Program: Summary of Preferred Terms 4, *available at* <http://www.treasury.gov/press-center/press-releases/Documents/term%20sheet%20%20private%20c%20corporations.pdf>; *see also* U.S. Dep't of the Treasury, Securities Purchase Agreement: Standard Terms § 4.6, at 30, *available at* <http://www.treasury.gov/initiatives/financial-stability/investment-programs/cpp/Documents/spa.pdf> (referring to the Treasury's commitment not to vote warrant shares).

77. *See supra* section II(A)(1).

78. *See infra* text accompanying notes 87–93.

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.<sup>79</sup> The Treasury subsequently created the Automotive Industry Financing Program (AIFP). In May 2009, through the AIFP, the Treasury invested an additional \$7.5 billion in GMAC.<sup>80</sup> As of June 2009, the Treasury held 35% of GMAC's equity with the ability to increase that stake to more than 50% through the exercise of warrants.<sup>81</sup> 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%.<sup>82</sup>

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 part,

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.<sup>83</sup>

For GM and Chrysler to fit this definition, one must read the phrase "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

---

79. Edmund L. Andres & Bill Vlasic, *U.S. Agrees to a Stake in GMAC*, N.Y. TIMES, Dec. 30, 2008, at B1.

80. Glenn Somerville, *New Multi-Million Bailout Coming for GMAC: Report*, REUTERS (May 21, 2009), <http://www.reuters.com/article/idUSTRE54K6DL20090521>.

81. See Jordan Fabian, *U.S. to Take Majority Stake in GMAC*, THE HILL (Dec. 30, 2009), <http://thehill.com/blogs/blog-briefing-room/news/73969-federal-government-to-take-majority-stake-in-gmac> (describing the Treasury's increase in ownership stake in GMAC from 35% to 56%).

82. Nick Bunkley, *Treasury to Give 3.8 Billion More to GMAC in a Third Taxpayer Bailout*, N.Y. TIMES, Dec. 30, 2009, [http://www.nytimes.com/2009/12/31/business/31gmac.html?\\_r=2&emc=eta1](http://www.nytimes.com/2009/12/31/business/31gmac.html?_r=2&emc=eta1).

83. Emergency Economic Stabilization Act (EESA) of 2008, Pub. L. No. 110-343, § 3(5), 122 Stat. 3765, 3766-67 (to be codified at 12 U.S.C. § 5202(5)).

rejected a request to authorize funds to bail out the auto industry<sup>84</sup> and had only passed the EESA on its second try. But however thin the basis under the EESA, it did not help the secured bondholders who objected in the Chrysler bankruptcy; they found out that they did not have standing to make the argument.<sup>85</sup>

Through its TARP investments, the Treasury currently has an 8% voting stake in new Chrysler<sup>86</sup> and a 26% voting stake in new GM.<sup>87</sup>

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 nonvoting perpetual preferred stock and warrants convertible into 6.2% of Citigroup's voting stock.<sup>88</sup> The exercise price of the warrants is well above current stock price, and none have so far been exercised.<sup>89</sup> On February 27, 2009, in order to increase its "core" Tier 1 capital, Citigroup 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.<sup>90</sup> 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 investment.<sup>91</sup> This, of course, can change: Citigroup recently raised \$17 billion in new common equity while the Treasury was unsuccessful in selling its stake, leaving the Treasury's stake, after the dilution from the new stock issuance, at 26%.<sup>92</sup> In

---

84. David M. Herszenhorn & David E. Sanger, *Senate Abandons Automaker Bailout Bid*, N.Y. TIMES, Dec. 12, 2008, at A1.

85. *See In re Chrysler LLC*, 405 B.R. 79, 83 (Bankr. S.D.N.Y. 2009) ("[T]he Court finds that the Indiana Funds do not have standing under EESA to challenge the actions of the U.S. Treasury pursuant to TARP.").

86. Amended and Restated Limited Liability Company Operating Agreement of Chrysler Group LLC (June 10, 2009) (Schedule of Members), *available at* [http://www.treasury.gov/initiatives/financial-stability/investment-programs/aifp/Documents\\_Contracts\\_Agreements/Chrysler%20LLC%20Corporate%20as%20of%2012-01-10.pdf](http://www.treasury.gov/initiatives/financial-stability/investment-programs/aifp/Documents_Contracts_Agreements/Chrysler%20LLC%20Corporate%20as%20of%2012-01-10.pdf); *see also* Press Release, U.S. Dep't of the Treasury, *supra* note 18 (referencing the Treasury's plan to receive 8% of the equity of Chrysler).

87. Merced & Vlastic, *supra* note 20.

88. Citigroup, Inc., Annual Report (Form 10-K), at 6, 9, 44 (Feb. 22, 2008) [hereinafter Annual Report]; *see also* Citigroup, Inc., Proxy Statement 1, 19 (Mar. 20, 2009) [hereinafter Proxy Statement].

89. Proxy Statement, *supra* note 88, at 1.

90. Citigroup, Inc., Exchange Offer (Form S-4), at 37 amend. 4 (June 18, 2009); *see also* Annual Report, *supra* note 88, at 45.

91. Citigroup, Inc., *supra* note 14, at 9.

92. *See supra* note 15 and accompanying text.

further sales during 2010, the Treasury disposed of the remainder of its stake.<sup>93</sup>

#### *D. Purpose Versus 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 nonvoting 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 covenants (no dividends, veto over acts or transactions that could impair the value of the nonvoting preferred stock, 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,<sup>94</sup> 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 the 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.

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

---

93. Randall Smith, Aaron Lucchetti & Michael R. Crittenden, *U.S. Unloads Citi Stake for a \$12 Billion Profit*, WALL ST. J., Dec. 7, 2010, <http://online.wsj.com/article/SB10001424052748704156304576003884177348202.html>.

94. See, e.g., Georg Thomas, *GM Symbol of USA: Obama's Vulture Socialism*, REDSTATEELECTIC (June 4, 2009), [http://redstateeclectic.typepad.com/redstate\\_commentary/2009/06/gm-symbol-of-usa-obamas-vulture-socialism.html](http://redstateeclectic.typepad.com/redstate_commentary/2009/06/gm-symbol-of-usa-obamas-vulture-socialism.html) ("Obama is the figurehead of the accelerating takeover of the United States by vulture socialists.").

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 of 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.<sup>95</sup> As a result, once one has control, one has virtually no choice but 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's 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 Wagoner 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.<sup>96</sup> 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 Mae and Freddie Mac, 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.

---

95. Unless one has precommitted to mirror voting, as for example, the Treasury did at Citigroup over certain matters. See *infra* note 259 and accompanying text.

96. See *Bank of America and Merrill Lynch: How Did a Private Deal Turn Into a Federal Bailout? Part III: Joint Hearing Before the H. Comm. on Oversight and Gov't Reform and the Subcomm. on Domestic Policy of the H. Comm. on Oversight and Gov't Reform*, 111th Cong. 24–25 (2009) (statement of Henry M. Paulson, Secretary of the Treasury) (detailing the process by which Bank of America's management could be removed and acknowledging that Paulson threatened removal); Dan Fitzpatrick, *U.S. Regulators to B of A: Obey or Else*, WALL ST. J., July 16, 2009, <http://online.wsj.com/article/SB124771415436449393.html#mod=testMod> (discussing the influence that the government exerted upon Bank of America).

### III. When the Government Is the Controlling Shareholder: Regulation

#### A. *The Baseline: The Problems Posed by Ordinary Controlling Shareholders*

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).<sup>97</sup>

If a shareholder is viewed as controlling, there are two consequences. First, that shareholder is deemed to owe fiduciary duties to the remaining “minority” or “noncontrolling” shareholders.<sup>98</sup> These duties extend to the shareholder’s action in influencing board or management decisions<sup>99</sup> but not to its actions in voting its shares.<sup>100</sup>

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, involve other material conflicts of interest, or were 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).<sup>101</sup> But generally, if, after full disclosure, these transactions are approved by a majority of disinterested and independent directors or disinterested shareholders, the business-judgment rule is

---

97. RODMAN WARD, JR. ET AL., *FOLK ON THE DELAWARE GENERAL CORPORATION LAW* § 151.5.1 (5th ed. 2006) (citing *In re Tri-Star Pictures, Inc.*, 634 A.2d 319, 328 (Del. 1993), and *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1344 (Del. 1987)); see also *Emerald Partners v. Berlin*, 787 A.2d 85, 94 (Del. 2001) (“[A] shareholder who owns less than 50% of a corporation’s outstanding stock, without some additional allegation of domination through actual control of corporat[e] conduct, is not a “controlling stockholder.”” (quoting *Emerald Partners v. Berlin*, 726 A.2d 1215, 1221 n.8 (Del. 1999))); *Kahn v. Lynch Commc’n Sys., Inc.*, 638 A.2d 1110, 1114 (Del. 1994) (holding that Alcatel was a controlling shareholder because it held a 43.3% stake in Lynch and controlled Lynch’s business affairs); *In re Cysive, Inc. S’holders Litig.*, 836 A.2d 531, 551–53 (Del. Ch. 2003) (holding that Cysive’s CEO, though a minority shareholder, was nevertheless the controlling shareholder because he was the founder, CEO, had family members in executive positions, and controlled enough shares to cast the decisive vote in any contested matter).

98. WARD ET AL., *supra* note 97, at § 151.5.1.

99. *Ivanhoe Partners*, 535 A.2d at 1344.

100. See HARRY G. HENN & JOHN R. ALEXANDER, *LAW OF CORPORATIONS* § 240, at 653 (3d ed. 1983) (clarifying that shareholders can vote as they desire because their shares are their private property).

101. For a discussion of the shifting burden of persuasion under the entire-fairness standard, see Bud Roth, *Entire Fairness Review for a “Pure” Breach of the Duty of Care: Sensible Approach or Technicolor Flop?*, 15 DEL. L. REV. 145, 165–67 (2000). See also Cathy L. Reese & Kelly A. Herring, *Recent Developments in Delaware Corporate Law*, 7 DEL. L. REV. 177, 192, 197 (2004) (summarizing cases where the entire-fairness burden was at issue).



reinstated, and the transaction must pass only the (lenient) standard of waste.<sup>102</sup> Such approvals are also referred to as “cleansing acts.”<sup>103</sup>

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 does not reinstate the business-judgment rule but merely shifts the burden of proving entire fairness to the plaintiffs (who have to prove that the transaction was not entirely fair).<sup>104</sup>

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 and can remove them at any time, and the directors know it. Even nonmajority 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 the directors can or will be.<sup>105</sup> In the Delaware case law, controlling shareholders have been likened to “800-pound gorilla[s]” who are so intimidating that they always get their way.<sup>106</sup>

102. WARD ET AL., *supra* note 97, § 151.5.4 (citing *Harris v. Carter*, 582 A.2d 222, 235–36 (Del. Ch. 1990)).

103. See David B. Feirstein, Note, *Parents and Subsidiaries in Delaware: A Dysfunctional Standard*, 2 N.Y.U. J.L. & BUS. 479, 488 (2006) (citing *Weinberger v. UOP, Inc.*, 457 A.2d 701, 703 (Del. 1983)) (“[T]he court noted that an informed vote of a majority of disinterested shareholders (a ‘Cleansing Act’) could serve to shift this burden of proving entire fairness (or the lack thereof) to the plaintiff . . .”).

104. See, e.g., *Kahn v. Lynch Commc’n Sys., Inc.*, 638 A.2d 1110, 1117 (Del. 1994) (holding that approval by disinterested directors shifts the burden of proof to the plaintiff but does not change the entire-fairness standard). There is some ambiguity in the Delaware case law. Compare *Kahn v. Tremont Corp.*, 694 A.2d 422, 428 (Del. 1997) (stating, in the context of a self-dealing transaction involving the controlling shareholder, that approval by a properly functioning committee of independent directors would shift the burden of the entire-fairness standard to plaintiffs), with *Orman v. Cullman*, 794 A.2d 5, 20 n.36 (Del. Ch. 2002) (stating, in the context of a merger involving a material conflict of interest on the part of the controlling shareholder, that entire fairness applies *ab initio* to “a squeeze out merger or a merger between two companies under the control of a controlling shareholder”). *Orman v. Cullman* thus raises the possibility that entire fairness does not apply to *all* transactions involving controlling shareholders but only to a subset.

105. See, e.g., *In re Emerging Commc’ns, Inc. S’holders Litig.*, No. Civ.A. 16415, 2004 WL 1305745, at \*33–35 (Del. Ch. May 3, 2004) (describing shareholders’ contentions that the board was unfairly beholden to the controlling shareholder in approving an unfair privatization).

106. See *In re Pure Res., Inc. S’holders Litig.*, 808 A.2d 421, 436 (Del. Ch. 2002). In the words of one court,

The Supreme Court [in *Kahn v. Lynch Communication Systems, Inc.*] 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

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 of trusted independent directors and subject to shareholders' own collective-action problems, may make too many mistakes in their approval to justify restoring business-judgment review.

*B. The Problem of the Government as a Controlling Shareholder*

Whatever the poundage of a regular, private controlling shareholder, the problems created—and the weight of the corresponding gorilla—are potentially 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.<sup>107</sup> In companies such as AIG, GMAC, and Citigroup, 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 submit their compensation to an advisory shareholder 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 potentially 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

---

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).

*Id.*

107. On the influence this can give, see, for example, SORKIN, *supra* note 69, at 524–25. In a meeting with major bank CEOs, Treasury Secretary Paulson insisted that the banks accept TARP money, whether they wanted it or not. When Richard Kovacevich, CEO of Wells Fargo, resisted, Sorkin reports,

Paulson told him, “Your regulator is sitting right there.” John Dugan, comptroller of the currency, and FDIC chairwoman 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 markets.”

*Id.* at 525.

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 transactions and conflicts transactions (if the conflict is material) 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 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 the corporation's value for the proportionate benefit of all of its shareholders. This greatly complicates the task of courts. Self-dealing transactions and material-conflicts 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 it sufficiently to warrant stricter scrutiny. Because neither of these factors is easily or 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 (i.e., asking the CEO or the 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 Treasury. Should all actions by members of the Executive Branch be attributed to "the government," only those actions originating in 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 the Treasury) requests that the CEO take certain action? What if that regulator "reminds" the CEO of the government's interest as a 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 that executives of a controlled company 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.

Cutting in the other direction, government interference is likely to have different goals than will the classic, overreaching private shareholder who seeks private gain. When the government interferes, it will typically be in order to further some conception of the public interest or to reward a favored actor. In either case, it is not directly lining its own pocket. As we will discuss below, these differences make the fit with Delaware doctrine particularly awkward.

### *C. Introduction: The Delaware Corporate Law Structure*

Return to our original hypo: the government, the controlling shareholder of DMAC with 56% of the votes, 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 involves only private parties. Under current Delaware law, the hypo poses obvious duty-of-loyalty and potential 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 the controlling shareholder 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 the so-called *Aronson*<sup>108</sup> test to determine demand futility. Under *Aronson*, a derivative plaintiff must allege specific facts that create a reasonable doubt as to (1) whether a majority of the board is disinterested or independent, or (2) whether the challenged transaction was the product of the board's valid exercise of business judgment.<sup>109</sup> When there is a private controlling shareholder, demand will often be excused under the first prong because directors either have an interest in the transaction or have other business relationships with the controlling shareholder.<sup>110</sup> 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*.<sup>111</sup>

If demand were excused, the court would independently evaluate both the financial terms of the transaction and the process leading up to the transaction to determine if both 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 are a function of relatively clear rules enforced by private injunctive and damages actions.

This is not a hard case under Delaware law. With its long-standing 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 developed an intricate set of doctrines that discourage and deter interested fiduciaries from exploiting their control for nonfirm 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 noncontrolling 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

---

108. *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984).

109. *Id.* at 814–15.

110. *See, e.g., Kahn v. Tremont Corp.*, No. 12339, 1994 WL 162613, at \*4–5 (Del. Ch. Apr. 21, 1994) (finding a group of directors interested for purposes of *Aronson*'s first prong because of their various business ties to the controlling shareholder).

111. 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 Communication Systems, Inc.*, are always subjected to entire-fairness review. For a further discussion of this point, see Marcel Kahan & Edward Rock, *When the Government Is the Controlling Shareholder: Implications for Delaware*, 35 DEL. J. CORP. L. 409, 415 (2010).

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; and 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?

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 the shareholder's 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, whether injunctive relief is available.<sup>112</sup>

On the first point, Delaware law is clear that when a controlling shareholder exercises control over business decisions, the shareholder takes on the same duties of care that other fiduciaries have.<sup>113</sup>

As to the duty-of-care analysis itself, as recent cases from Delaware confirm, *Smith v. Van Gorkom*<sup>114</sup> still provides the standard for liability under the duty of care: gross negligence.<sup>115</sup> 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 section 102(b)(7).<sup>116</sup> Although current Delaware case law wrestles with identifying the border between gross negligence (which can be exculpated) and bad faith (which cannot),<sup>117</sup> the hypo can be decided on a simpler basis: section 102(b)(7) does not apply to a controlling shareholder. By its terms, it only permits exculpation of directors.<sup>118</sup>

---

112. As the suit would be derivative, the preceding discussion on whether demand would be excused applies.

113. *Cinerama, Inc. v. Technicolor, Inc.*, No. 8358, 1991 WL 111134, at \*19 (Del. Ch. June 24, 1991) (“[W]hen 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 the corporation.”), *aff’d in part, rev’d in part on other grounds sub nom. Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. 1993); *see also Pfeffer v. Redstone*, 965 A.2d 676, 691 n.52 (Del. 2009) (citing *Cinerama, Inc.* approvingly for this proposition).

114. 488 A.2d 858 (Del. 1985).

115. *See, e.g., MCG Capital Corp. v. Maginn*, No. 4521-CC, 2010 WL 1782271, at \*21 n.129 (Del. Ch. May 5, 2010) (citing *Van Gorkom*, 488 A.2d at 873) (“Typically one cannot prove a breach of the duty of care without demonstrating that the directors were grossly negligent with respect to a particular transaction.”).

116. *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 239 (Del. 2009).

117. *Id.* at 239–42.

118. DEL. CODE ANN. tit. 8, § 102(b)(7) (2009).

A more interesting issue is posed if we assume that the controlling shareholder is indemnified by DMAC.<sup>119</sup> Under Delaware law, two problems stand in the way of such indemnification. First, under section 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.”<sup>120</sup> 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.”<sup>121</sup> This latter analysis poses some of the same questions regarding the line between gross negligence and bad faith that have been featured in the Delaware case law on section 102(b)(7).<sup>122</sup>

Finally, even if the controlling shareholder is somehow indemnified against liability, injunctive relief against grossly negligent conduct is still available, at least in principle. Although there are no recent examples of injunctions granted in remotely similar situations,<sup>123</sup> the courts have shown a willingness to enjoin what are, in essence, duty-of-care violations in the mergers-and-acquisitions 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.<sup>124</sup>

3. *The Duty-of-Good-Faith Claim.*—The request by the Treasury that DM not close factories in certain states that are deemed important either to national economic policy or to the President’s reelection 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 bur-

119. If new DM goes bankrupt again because of its switch to green cars, the indemnification—even if permitted—will not be of any use.

120. DEL. CODE ANN. tit. 8, § 145(a).

121. *Id.*

122. See, e.g., *Lyondell*, 970 A.2d at 240 (discussing the “range of conduct” that encompasses bad faith and gross negligence).

123. 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, 781 (Ill. App. Ct. 1968).

124. See, e.g., *Malpiede v. Townson*, 780 A.2d 1075, 1095 (Del. 2001) (noting that a section 102(b)(7) waiver “would not affect injunctive proceedings based on gross negligence”); *Paramount Commc’ns, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 35–37, 56–58 (Del. 1994) (affirming a preliminary injunction granted for the breach of so-called *Revlon* duties); *Leslie v. Telephonics Office Techs., Inc.*, 1993 WL 547188, at \*9 (Del. Ch. 1993) (“[T]o the extent plaintiffs seek equitable relief for any alleged breaches of the duty of care, . . . [a section 102(b)(7) waiver] would not bar them.”); cf. E. Norman Veasey et al., *Delaware Supports Directors with a Three-Legged Stool of Limited Liability, Indemnification, and Insurance*, 42 BUS. LAW. 399, 403 (1987) (arguing that, in spite of section 102(b)(7), the duty of care “will continue to be vitally important in injunction and rescission cases”).

den 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 *Stone v. Ritter*,<sup>125</sup> the court elaborated on the concept of bad faith. It explained that bad faith may be shown where

[t]he fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of known duty to act, demonstrating a conscious disregard for his duties.<sup>126</sup>

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.

#### *D. 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 would have a nontrivial chance of prevailing on the substantive claim.

How does this change now that the controlling shareholder is the government? The short answer: in 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.<sup>127</sup> 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 that would apply ordinary Delaware law, a suit against the U.S. government as controlling shareholder faces special problems.

---

125. 911 A.2d 362 (Del. 2006).

126. *Id.* at 369 (quoting *In re Walt Disney Co.*, 906 A.2d 27, 67 (Del. 2006)).

127. For an excellent and comprehensive analysis of the substantive and procedural law governing claims against the federal government, see GREGORY C. SISK, *LITIGATION WITH THE FEDERAL GOVERNMENT* (4th ed. 2006). Much of the following discussion is indebted to Sisk's analysis.



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 Court of Chancery, a court that specializes in corporate law and has widely acknowledged expertise in dealing with such suits. But even apart from the jurisdictional problems addressed below, the Delaware Court of Chancery is less than the ideal venue for pursuing fiduciary-duty claims against the U.S. government. The state of Delaware derives substantial revenues from its franchise tax (paid mostly by public corporations). In 2010, Delaware received revenues of \$633.1 million or about 20% of the state's budget.<sup>128</sup> 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 are 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.<sup>129</sup> 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.<sup>130</sup> 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 government officials who are well aware of the state's interest. Thus, one may wonder whether the Delaware court, 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. When 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. Accordingly, 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.

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 shareholder. This is illustrated by our hypothetical request to avoid factory closures in states that are politically important for the government, either because of public policy or partisan political

---

128. DEL. DEP'T OF FIN., DELAWARE FISCAL NOTEBOOK 29 (2010), available at [http://finance.delaware.gov/publications/fiscal\\_notebook\\_10/fiscal\\_notebook\\_10.pdf](http://finance.delaware.gov/publications/fiscal_notebook_10/fiscal_notebook_10.pdf).

129. See Mark Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 600–07 (2004) (explaining that federal legislation could easily displace Delaware corporate law and that the mere fear of this possibility influences Delaware lawmakers to avoid provoking federal authorities).

130. See Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573, 1576 (2005) (“We argue that the possibility of federal preemption constitutes a threat to Delaware, but this threat is significant only in times . . . when systemic change is seen as generating a significant populist payoff.”).

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. How does a judge evaluate the materiality of conflicts when the conflict is nonfinancial? Should the judge determine the importance of the political motive on its own or in relation to nonpolitical 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 government 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.<sup>131</sup>

2. *Sovereign Immunity and Its Limits: Claims Against the U.S. Government.*—The starting point for any analysis involving suits against government entities is the doctrine of sovereign immunity, which holds that the U.S. government cannot be sued except insofar as it has waived its immunity.<sup>132</sup> Through various statutes, the U.S. government has waived much of its immunity, but not all, and always with limitations.

Moreover, because of the general immunity, any waivers are narrowly construed and burdened with conditions. The principal waivers of sovereign immunity are contained within the FTCA, which, broadly speaking, permits suits against the United States for tortious acts by its agents;<sup>133</sup> the Tucker Act, which permits claims against the United States for damages not involv-

---

131. See Kahan & Rock, *supra* note 63, at 756 (commenting favorably on Delaware Vice Chancellor Parsons's decision to allow a New York court to decide a question of Delaware law in order to avoid a dilemma that pitted state precedent against prudent public policy); Kahan & Rock, *supra* note 130, at 1621 ("If Delaware is not able to regulate certain conduct effectively, it is probably in its interest to have this conduct regulated on the federal level (or by other states) to fill the lacunae in its own law."); Kahan & Rock, *supra* note 111, at 410 (urging Delaware to "duck" confrontations with Washington and providing suggestions on how to do so).

132. See *United States v. Sherwood*, 312 U.S. 584, 586 (1941) ("The United States, as sovereign, is immune from suit save as it consents to be sued . . ."); 14 CHARLES ALAN WRIGHT, ARTHUR R. MILLER & EDWARD H. COOPER, *FEDERAL PRACTICE AND PROCEDURE* § 3654 (3d ed. 1998) ("[T]he United States may not be sued without its consent.").

133. 28 U.S.C. § 2674 (2006).

ing tortious conduct (which includes, *inter alia*, contract claims and takings claims);<sup>134</sup> and the APA, which permits actions against the United States for review of agency action seeking relief other than money damages.<sup>135</sup> As we will discuss below, each of these frameworks complicates actions against the United States for acts that, under Delaware corporate law, could constitute 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 United States has never waived its immunity to suit in state court. Rather, under 28 U.S.C. § 1346, *all* suits against the United States must be brought either in federal district court or the Court of Federal Claims, depending on the cause of action. Under 28 U.S.C. § 1442, any claim against the United States 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 FTCA, the Tucker Act, and the APA.<sup>136</sup>

*b. FTCA Claims.*

*i. Is a Breach of Fiduciary Duty a "Tort"?*—The FTCA waives sovereign immunity for "tort claims." The key substantive provision is provided by 28 U.S.C. § 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.

---

134. 28 U.S.C. § 1491 (2006).

135. 5 U.S.C. § 702 (2006).

136. These provisions cannot be avoided by suing government agents rather than the government. The *Ex parte Young*, 209 U.S. 123 (1908), fiction that a suit against a government agent is not a suit against the government was essentially eliminated by the provision for direct review of agency action under 5 U.S.C. § 702 (as we discuss further below). This is complemented by the Federal Employees Liability Reform and Tort Compensation Act, Pub. L. No. 100-694, 102 Stat. 4563 (1988), 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.

28 U.S.C. § 2679(d)(2). This Act is commonly known as the Westfall Act.

The key jurisdictional provision is provided by 28 U.S.C. § 1346(b)(1), which decrees exclusive federal jurisdiction. The first challenge, then, is determining whether breach-of-fiduciary-duty claims are “tort” claims.<sup>137</sup> 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.<sup>138</sup>

As a conceptual matter, it is also 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.”<sup>139</sup> 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.<sup>140</sup>

---

137. Sovereign immunity to claims under the Securities Exchange Act has not been waived for two reasons. First, under § 3(c), the U.S. Treasury is exempt from liability under § 10(b). 15 U.S.C. § 78c(c) (2006). Second, the FTCA explicitly exempts claims of misrepresentation or deceit from the waiver of sovereign immunity. 28 U.S.C. § 2680(h). This includes both negligent and intentional misrepresentations, as well as omissions of material fact. *McNeily v. United States*, 6 F.3d 343, 347 (5th Cir. 1993).

138. *Cf.* Joshua Getzler, *Rumford Market and the Genesis of Fiduciary Obligation* (describing how fiduciary law was created in equity and stretches further back than originally expected and even precedes the law of trusteeship itself), in *MAPPING THE LAW: ESSAYS IN MEMORY OF PETER BIRKS* 577, 596–97 (Andrew Burrows & Alan Rodger eds., 2006).

139. *See, e.g.*, Peter Birks, *The Content of Fiduciary Obligation*, 34 *ISR. L. REV.* 3, 3 (2000) (“Fiduciary obligations form a sub-set of those primary obligations the breach of which constitutes a civil wrong.”); P.D. Finn, *The Fiduciary Principle*, in *EQUITY, FIDUCIARIES, AND TRUSTS* 1, 24–25 (T.G. Youdan ed., 1989); Sarah Worthington, *Fiduciaries: When Is Self-Denial Obligatory?* 58 *CAMBRIDGE L.J.* 500, 503 (1999) (“In short, fiduciary terminology should be used carefully and restrictively, so that fiduciary law operates *only* to exact loyalty; it does not concern itself with matters of contract, tort, unjust enrichment and other equitable obligations (such as breach of confidence).”); *cf.* R.P. Austin, *Moulding the Content of Fiduciary Duties* (“The fiduciary duties relate to improper profits and the avoidance of conflicts of interest, and we should no longer use fiduciary terminology to describe other duties to which fiduciaries and others may be subject.”), in A.J. OAKLEY, *TRENDS IN CONTEMPORARY TRUST LAW* 153, 156 (1996). 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. Birks, *supra*, at 3. By contrast, Getzler suggests that the evidence equally supports the view that fiduciary duty predates, and forms an essential component of, the creation of express trusts and the duties of the trustee. Getzler, *supra* note 138, at 577. For a U.S. perspective with U.S. citations, 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, 235 (1994).

140. *See, e.g.*, Birks, *supra* note 139, at 5 (discussing how imprecise definitions of fiduciary obligations could cause the law governing fiduciary obligations to “duplicat[e] the work of the

More recently, the issue of how to categorize a breach of fiduciary duty has arisen in connection with the question of whether a statute of limitations applies to breach-of-fiduciary-duty claims and, if so, which statute. Older cases held that statutes of limitations do not apply in equity, which instead relies on the more flexible doctrine of laches.<sup>141</sup> Over time, as the jurisdiction of equity courts has expanded, as in Delaware, this distinction has broken down. Under current Delaware law, the Delaware Court of Chancery looks to legal statutes of limitations as establishing a presumption for the application of laches to equitable claims,<sup>142</sup> although with a heavy dose of equity in its liberal rules for tolling.

This evolution has forced courts to reach the question of *which* statute of limitations to apply or look to for guidance. In some states, courts have applied the tort statute.<sup>143</sup> Other courts have applied the statute of limitations for contracts.<sup>144</sup> Finally, others, including Delaware, have applied a more general, catch-all limitation rule, even when a specific tort rule exists.<sup>145</sup> 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

---

ordinary law of tort” and referencing the leading case, *Bristol & West Bldg. Soc’y v. Motthew*, [1996] Ch. 1 (Eng.), against such “indefensible duplication”).

141. *See Kahn v. Seaboard Corp.*, 625 A.2d 269, 271–75 (Del. Ch. 1993) (providing a very perceptive discussion of the older cases pertaining to this doctrine).

142. *Albert v. Alex Brown Mgmt. Servs.*, No. Civ.A. 762-N, 2005 WL 1594085, at \*12 (Del. Ch. Aug. 26, 2005); *see also Kahn*, 625 A.2d at 275. For a good discussion of the more general phenomenon, see Matthew G. Dore, *Statutes of Limitation and Corporate Fiduciary Duty Claims: A Search for Middle Ground on the Rules/Standards Continuum*, 63 BROOK. L. REV. 695, 720–41 (1997).

143. *See, e.g., FDIC v. Dawson*, 4 F.3d 1303, 1310 (5th Cir. 1993) (addressing claims against the directors and officers of a failed bank that sounded in tort and were therefore governed by Texas’s two-year statute of limitations); *Crosby v. Beam*, 615 N.E.2d 294, 299–300 (Ohio Ct. App. 1992) (holding that a minority stockholder’s claims against corporate directors, officers, and the corporate entity were governed by Ohio’s four-year tort statute of limitations).

144. *See, e.g., RTC v. Armbruster*, 52 F.3d 748, 750 (8th Cir. 1995) (holding that claims against the directors of a failed savings and loan were governed by Arkansas’s three-year limitations provision for contract actions); *Bibo v. Jeffrey’s Rest.*, 770 P.2d 290, 295 (Alaska 1989) (addressing claims, against corporate directors, that were governed by Alaska’s six-year statute of limitations for contract actions).

145. *See, e.g., Kahn*, 625 A.2d at 277 (applying a general three-year limitation period rather than the two-year period governing torts such as wrongful death, injury to personal property, and 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.” *See J. Travis Laster & Michelle D. Morris, Breaches of Fiduciary Duty and the Delaware Uniform Contribution Act*, 11 DEL. L. REV. 71 (2010).

brought under the second major infringement on sovereign immunity, the Tucker Act, because the Tucker Act is explicitly complementary and nonoverlapping.<sup>146</sup> Unfortunately, the legislative history of the FTCA 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.”<sup>147</sup>

The *Indian Trust* cases<sup>148</sup>—a line of cases that have been uniformly brought under the Tucker Act (which we will discuss later)—cast some light. In those cases, Native American tribes sued, alleging that the U.S. government had breached fiduciary duties owed to the Indian tribes in the stewardship of tribes’ land and natural resources. Thus, for example, in *United States v. Mitchell (Mitchell II)*,<sup>149</sup> members of the Quinault Tribe alleged that the U.S. government had breached its fiduciary duties to them by failing to manage their allotted lands properly, a claim the Supreme Court accepted.<sup>150</sup> 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.”<sup>151</sup>

*Mitchell II*, however, involved an explicit, federal statutory acceptance of a fiduciary relationship toward 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.<sup>152</sup> 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.<sup>153</sup> Along these same lines, the Delaware Court of Chancery, interpreting and applying a Massachusetts statute that limited the liability of charities in tort actions, held that (at least under Massachusetts law) breach of

---

146. See 28 U.S.C. § 1491(a)(1) (2006) (“The United States Court of Federal Claims shall have jurisdiction to render judgment upon any claim against the United States . . . for liquidated or unliquidated damages in cases *not sounding in tort*.” (emphasis added)).

147. H.R. REP. NO. 77-2245, at 7 (1942).

148. See *infra* subsection III(D)(2)(c).

149. 463 U.S. 206 (1983).

150. *Id.* at 210–11.

151. *Id.* at 212.

152. 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 of sovereign immunity and the narrow interpretation of any derogations. See, e.g., *Kashin v. Kent*, 457 F.3d 1033, 1037, 1044 (9th Cir. 2006) (holding that a tort action against a federal employee involved in a car accident in Russia was barred by the FTCA’s foreign-country exception).

153. See *Am. Ins. Co. v. United States*, 62 Fed. Cl. 151, 158 (2004) (“For one thing, such general breaches of claimed fiduciary or equitable duties are ordinarily viewed as giving rise, if anything, to torts, the subject matter of which plainly is outside this court’s jurisdiction.”).

fiduciary duty could be considered a tort for the purposes of the statute.<sup>154</sup> The question of how breach-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."<sup>155</sup> 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 FTCA, you take into account the whole law of the state, including its choice-of-law rules.<sup>156</sup> Because Michigan, like most states, follows the "place of incorporation" doctrine in determining applicable corporate law<sup>157</sup> and because DM and DMAC are both, by hypothesis, Delaware corporations, Delaware law would provide the rule of decision.

*ii. The "discretionary function" exception.*—But a plaintiff is hardly home free. Under § 2680(a), the FTCA does not apply to "[a]ny 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."<sup>158</sup> This defense, known as the "discretionary function 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 public officials' policy choices that have winners and losers, without also immunizing negligent conduct that injures innocent bystanders. Thus, in *Dalehite v. United States*,<sup>159</sup> at issue was a conscious decision to cut corners in order to reduce

---

154. *Oliver v. Boston Univ.*, C.A. No. 16570-NC, 2005 Del. Ch. LEXIS 14, at \*9–11 (Del. Ch. Jan. 28, 2005).

155. 28 U.S.C. § 1346(b)(1) (2006).

156. *Richards v. United States*, 369 U.S. 1, 11 (1962).

157. RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 306, 309 (1971).

158. 28 U.S.C. § 2680(a).

159. 346 U.S. 15 (1953).

costs in the manufacture of fertilizer to be shipped abroad, a decision that resulted in a cargo ship exploding in the harbor and causing damage.<sup>160</sup> 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.<sup>161</sup> Later, in *United States v. Varig Airlines*,<sup>162</sup> 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.<sup>163</sup> Even later, in *Berkovitz v. United States*,<sup>164</sup> 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.<sup>165</sup> The Court limited the exception to “discretionary” decisions—where the decision involved was a matter of permissible choice for a government employee—and refused to apply it to mandatory decisions that must be made on the basis of objective criteria when there is no permissible discretion.<sup>166</sup>

The Court once again tried to define the limits of the exception in its most recent effort, *United States v. Gaubert*,<sup>167</sup> which emerged out of the Savings and Loan Crisis of the 1980s. In *Gaubert*, the founder and largest shareholder of a savings and loan accused the Federal Home Loan Bank Board (FHLBB) (the now-superseded agency then charged with regulating savings and loan associations) of negligence in its supervision of the savings and loan. According to the shareholder, the FHLBB interfered in day-to-day operations of the savings and loan, pressured the savings and loan to merge, threatened to close it unless the managers and board resigned, influenced the selection of new management, and ultimately caused the savings and loan 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.”<sup>168</sup>

The *Gaubert* standard—criticized in the literature as too deferential in creating a perhaps irrebuttable presumption that discretion was exercised

---

160. *Id.* at 22–23.

161. *Id.* at 42.

162. 467 U.S. 797 (1984).

163. *Id.* at 814.

164. 486 U.S. 531 (1988).

165. *Id.*

166. *Id.* at 535–37.

167. 499 U.S. 315 (1991).

168. *Id.* at 324.



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<sup>169</sup>—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 a savings and loan alleged that the FHLBB's day-to-day second-guessing and interference caused the savings and loan to fail. Nonetheless, the court held that the FHLBB was protected under the discretionary function exception.<sup>170</sup> Here, as there, one could argue, the exception would apply because, as *Gaubert* held, "it must be presumed that the agent's acts are grounded in policy when exercising that discretion."<sup>171</sup> 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 a savings and loan.

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 factories to be closed—is unclear.

*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 its 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 savings and loan? 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 the wisest. Discretionary conduct is not confined to the policy or planning level."<sup>172</sup>

---

169. See, e.g., Harold J. Krent, *Preserving Discretion Without Sacrificing Deterrence: Federal Governmental Liability in Tort*, 38 UCLA L. REV. 871, 898 n.117 (1991) (arguing that the *Gaubert* standard "provides an insufficient limiting principle" because nearly any action can somehow be shown to be tied to a policy motivation); Peter H. Schuck & James J. Park, *The Discretionary Function Exception in the Second Circuit*, 20 QUINNIPIAC L. REV. 55, 65–66 (2000) (illustrating how even the most routine actions can be grounded in general policy concerns).

170. *Gaubert*, 499 U.S. at 326.

171. *Id.* at 324.

172. *Id.* at 325.

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 and regulatory perspective, that involvement has been ad hoc, even perhaps haphazard. As a result, the relevant statutory authority provides unclear guidance on 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 and the basis upon which it was presented to Congress<sup>173</sup> 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.<sup>174</sup> As George Will has argued, in November 2008, Paulson specifically 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.”<sup>175</sup>

As Will pointed out, and as the objectors in the Chrysler bailout argued,<sup>176</sup> the creation of the AIFP 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 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.”<sup>177</sup> 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 finan-

---

173. 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, *supra* note 69, at 508–16.

174. David Herszenhorn, *Chances Dwindle on Bailout Plan for Automakers*, N.Y. TIMES, Nov. 13, 2008, at A1.

175. George F. Will, *More Judicial Activism, Please*, WASH. POST, June 14, 2009, at A15 (alteration in original).

176. *See, e.g.*, Corrected Objection of Ind. Pensioners to Debtor's Motion for an Order at 17–27, *In re Chrysler, LLC*, No. 09-50002 (AJG), (Bankr. S.D.N.Y. May 19, 2009).

177. Emergency Economic Stabilization Act (EESA) of 2008, Pub. L. No. 110-343, § 3(9)(B), 122 Stat. 3765, 3767 (to be codified at 12 U.S.C. § 5202(9)(B)).

cial institutions lurking in the phrase “included but not limited to,” however troubled they may be.

Not surprisingly, given the uncertain (or perhaps 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 automobile 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 the wisest”?<sup>178</sup>

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 the EESA comes to a provision providing guidance is § 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.<sup>179</sup>

But, while § 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 to achieve the goals.

On the other hand, EESA does address conflicts of interest. Section 108, “Conflicts of Interest,” provides,

(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;

---

178. *United States v. Gaubert*, 499 U.S. 315, 325 (1991).

179. EESA § 106(a)–(b), 122 Stat. at 3773 (to be codified at 12 U.S.C. § 5216(a)–(b)).

- (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.<sup>180</sup>

On January 21, 2009, the Treasury issued an “interim rule” that addresses “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.”<sup>181</sup> 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 and on 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:

[I]t 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.<sup>182</sup>

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 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.”<sup>183</sup>

---

180. *Id.* § 108, 122 Stat. at 3774 (to be codified at 12 U.S.C. § 5218).

181. TARP Conflicts of Interest, 74 Fed. Reg. 3,431, 3,431 (Jan. 21, 2009) (to be codified at 31 C.F.R. pt. 31). To date, the “interim rules” have not been updated or made “final.”

182. AIG Credit Facility Trust Agreement § 2.04 (Jan. 16, 2009), *available at* <http://www.ny.frb.org/newsevents/news/markets/2009/AIGCFTAgrreement.pdf>.

183. *Id.* § 3.03.

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 function 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 function exception would be very strong. After all, the implementation of the duties of care and loyalty under Delaware law is 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 FTCA, 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 an FTCA suit will provide the first line of defense against problematic conduct. Put somewhat differently, if we are concerned that the government, using its controlling stake, will take actions driven by policy objectives that 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, § 1491(a) provides,

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 implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort.<sup>184</sup>

---

184. 28 U.S.C. § 1491(a) (2006).

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”?<sup>185</sup>

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 Native American tribes have sued the United States for damages for improper management of tribal 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 tribal lands back into the 19th century, finding that the relationship was not merely a “naked trust” established by the Allotment Act of 1887 to prevent alienation and did not impose fiduciary duties, as was held in *Mitchell I*,<sup>186</sup> but rather through a variety of subsequent statutes and regulations, established comprehensive federal control over the Native American lands.<sup>187</sup> With this comprehensive control, the Court held, came fiduciary duties, duties that had been breached in the mismanagement of the timber resources.<sup>188</sup> Similarly, when, pursuant to statute, the United States took full control of Fort Apache, used the Fort for the government’s own purposes, and neglected it, the Court held that, in doing so, the United States took on a trustee’s duty to preserve and maintain the trust corpus, a duty that it had breached.<sup>189</sup>

But the Navajo coal-leasing cases make clear that the level of government involvement must be comprehensive. In the first *Navajo Nation* case,<sup>190</sup> the Supreme Court held that the Secretary of the 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.<sup>191</sup> When the *Navajo Nation* case returned to the Supreme Court after remand, the Court was even sharper in rejecting the claim:

The Federal Government’s liability cannot be premised on control alone. The text of the Indian Tucker Act makes clear that only claims

---

185. Although we often think of the corporation as a nexus of contracting and of fiduciary duties through a contractual framework, this is not a 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. *United States v. Mitchell (Mitchell II)*, 463 U.S. 206, 218 (1983). Because it is difficult if not impossible to conceptualize this case as a breach-of-contract action, the scope of *United States v. Winstar*, 518 U.S. 839, 909 (1996), and its implications for the limits of sovereign immunity under the Tucker Act, do not arise.

186. *United States v. Mitchell (Mitchell I)*, 445 U.S. 535, 542 (1980).

187. *Mitchell II*, 463 U.S. at 228.

188. *Id.* at 211.

189. *United States v. White Mountain Apache Tribe*, 537 U.S. 465, 471 (2003).

190. *United States v. Navajo Nation (Navajo Nation I)*, 537 U.S. 488 (2003).

191. *Id.* at 506–08.

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). . . . In *Navajo I* we reiterated that the analysis must begin with “specific rights-creating or duty-imposing statutory or regulatory prescriptions.” . . . *If* a plaintiff identifies such a prescription, and *if* that prescription bears the hallmarks of a “conventional fiduciary relationship,” . . . *then* trust principles (including any such principles premised on “control”) could play a role in “inferring that the trust obligation [is] enforceable by damages” . . . . But that must be the second step of the analysis, not (as the Federal Circuit made it) the starting point.<sup>192</sup>

Thus, though under the *Indian Trust* cases the United States 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 United States 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:

[T]he Tucker Act “does not create any substantive right enforceable against the United States for money damages.” . . . 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.” . . . 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, . . . 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.”<sup>193</sup>

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 the EESA, which provided the Treasury with authority to buy troubled assets in financial institutions. Moreover, *Mitchell II* seems to suggest that the basis must be either the U.S. Constitution or a *federal* statute: because it is a waiver of federal sovereign immunity that is at stake, state statutes or

---

192. *United States v. Navajo Nation (Navajo Nation II)*, 129 S. Ct. 1547, 1558 (2009) (citations omitted).

193. *Mitchell II*, 463 U.S. at 216–17 (citations omitted).

common law are an insufficient basis.<sup>194</sup> The Treasury might therefore avoid *Mitchell II* and *White Mountain Apache Tribe* on the grounds that there is no adequate federal statutory basis on which to ground a claimed fiduciary duty.

But that may be too quick. The *Indian Trust* cases interpret the part of the Tucker Act that is explicitly limited to claims founded “upon the Constitution, or any Act of Congress or any regulation of an executive department.”<sup>195</sup> But the (regular) Tucker Act also 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.*”<sup>196</sup> 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 United States acquires control by virtue of the network of statutory and common law provisions that are Delaware corporate law (e.g., the right to elect directors under sections 212, 216, etc.), power that brings with it fiduciary duties? One might argue that this situation is much closer to *Mitchell II* and *White Mountain Apache Tribe*, 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,

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). “[W]here 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.”<sup>197</sup>

Later, in *White Mountain Apache Tribe*, 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

---

194. *See id.* at 216–18 (referring exclusively to Tucker Act claims against the United States “founded either upon the Constitution, or any Act of Congress, or any regulation of an executive department”).

195. 28 U.S.C. § 1491(a)(1) (2006); *see also, e.g., Mitchell II*, 463 U.S. at 216–18.

196. 28 U.S.C. § 1491(a)(1) (emphasis added).

197. *Mitchell II*, 463 U.S. at 225 (alteration in original) (citation and footnote omitted).



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.” . . . 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.”<sup>198</sup>

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 and land for the benefit of the Indians.” . . . 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.<sup>199</sup>

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, 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.”<sup>200</sup> 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, the common law could be used to fill out the details of that obligation, especially, as here, when fiduciary duties are an

---

198. *United States v. White Mountain Apache Tribe*, 537 U.S. 465, 475–76 (2003) (citations omitted).

199. *United States v. Navajo Nation (Navajo Nation II)*, 129 S. Ct. 1547, 1553–54 (2009) (citations omitted).

200. *Mitchell II*, 463 U.S. at 226.

intrinsic part of the (nonfederal) statutory framework that creates the governmental power at issue.

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 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, fiduciary-duty law 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.<sup>201</sup>

*d. Claims Under the APA.*—A third basis for challenging the Treasury's actions at DMAC is the APA. Section 702 of the APA explicitly waives sovereign immunity for actions against the United States so long as those actions do not seek money damages.<sup>202</sup>

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 . . . .<sup>203</sup>

Under the APA,<sup>204</sup> actions can be brought in federal district court against the United States to

hold unlawful and set aside agency action, findings, and conclusions found to be—

201. The Tucker Act also provides a cause of action to challenge a taking in violation of the Fifth Amendment. Although the opening hypothetical 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 does not provide a regulatory structure that parallels Delaware's fiduciary-duty law. For a brief summary of the applicable law, see *SISK*, *supra* note 127, § 4.09(b).

202. *Bowen v. Massachusetts*, 487 U.S. 879 (1988), blurred this line, but even under *Bowen*, damages for breach of fiduciary duty would be excluded. *Id.* at 899–900.

203. 5 U.S.C. § 702 (2006).

204. 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.

- (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.<sup>205</sup>

The question, then, is whether our plaintiff, a minority shareholder in DMAC, can bring an action under § 706 to enjoin the decision that requires DMAC to provide financing to GM and its dealers and its 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, does a troubled auto company fall within the statutory definition of a "financial institution"? Second, does equity in new GM or new Chrysler fall within the definition of "troubled asset"? Both of these are questions of statutory interpretation and fit comfortably within the basic framework of administrative law.<sup>206</sup> Under *Chevron*,<sup>207</sup> the Treasury could certainly argue that Congress did not address the precise question at issue in the EESA, and, in any event, any congressional intent was certainly not unambiguously clear.<sup>208</sup> Given this and moving on to the classic second step of *Chevron*,<sup>209</sup> the Treasury might argue that its interpretations of the definitions of "troubled asset" and "financial institution" were both "permissible" ones and thus deserve deference.

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

205. 5 U.S.C. § 706.

206. I leave to the side the question of who would have standing. In the Chrysler bankruptcy proceeding, the Southern District of New York 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, 83 (Bankr. S.D.N.Y. 2009).

207. *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

208. *See id.* at 842–43 ("First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.").

209. *See id.* at 843 ("[I]f the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.").

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, no 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 home ownership 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.<sup>210</sup>

Moreover, although the EESA grants the Treasury the authority to exercise any rights associated with acquired assets and to manage the portfolio,<sup>211</sup> 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, 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

---

210. Emergency Economic Stabilization Act (EESA) of 2008, Pub. L. No. 110-343, § 2, 122 Stat. 3765, 3766 (to be codified at 12 U.S.C. § 5201).

211. *Id.* § 106, 122 Stat. at 3773 (to be codified at 12 U.S.C. § 5216).

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)?<sup>212</sup> 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, 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 counterargument, of course, draws on § 701(a)(2), which precludes judicial review when "agency action is committed to agency discretion by law."<sup>213</sup> As the Supreme Court held in the *Overton Park* case,<sup>214</sup> the exception for action committed to agency discretion is a "very narrow exception. . . . The legislative history of the APA indicates that it is applicable in those rare instances where 'statutes are drawn in such broad terms that in a given case there is no law to apply.'"<sup>215</sup> 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."<sup>216</sup> In *Heckler v. Chaney*,<sup>217</sup> the Supreme Court interpreted the provision as applying when "the statute is drawn so that a court would have no meaningful standard against which to judge the agency's exercise of discretion."<sup>218</sup>

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

---

212. 5 U.S.C. § 706(2)(A) (2006).

213. *Id.* § 701(a)(2).

214. *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402 (1971).

215. *Id.* at 410 (quoting S. REP. NO. 79-752, at 26 (1945)).

216. STEPHEN G. BREYER ET AL., *ADMINISTRATIVE LAW AND REGULATORY POLICY* 791 (6th ed. 2006).

217. 470 U.S. 821 (1985).

218. *Id.* at 830.

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.

We see, yet again, 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<sup>219</sup> (FOIA) includes a “[g]overnment controlled corporation.”<sup>220</sup> 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 not 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.”<sup>221</sup>

Take new GM, the successor to GM, of which the government still owns 26%. What information can be secured pursuant to FOIA that is not already available under either SEC disclosure regulations or sections 219 and 220 of Delaware General Corporation Law?<sup>222</sup>

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.”<sup>223</sup> Although this limits the scope of material that can be secured under FOIA, it leaves undisturbed the advantages in timing: the FOIA will be most useful in gathering information prior to filing a complaint. Sections 219 and 220 of Delaware law are sharply limited in what can be secured,<sup>224</sup> while the FOIA

---

219. 5 U.S.C. § 552 (2006).

220. *Id.* § 552(f)(1).

221. Memorandum on the Freedom of Information Act, 2009 DAILY COMP. PRES. DOC. 9 (Jan. 21, 2009).

222. New GM is a Delaware corporation. See First Amendment to Amended and Restated Master Sale and Purchase Agreement (June 30, 2009), available at <http://www.nclc.org/autobankruptcies/AmendmenttoGMARMSPA.pdf>.

223. 5 U.S.C. § 552(b)(5).

224. See, e.g., *Sec. First Corp. v. U.S. Die Casting & Dev. Co.*, 687 A.2d 563, 570 (Del. 1997) (“A Section 220 proceeding should result in an order circumscribed with rifled precision.”); *Rainbow Navigation, Inc. v. Pan Ocean Navigation, Inc.*, 535 A.2d 1357, 1360 (Del. 1987) (“[E]stablishing oneself as a stockholder of record [under Section 219] is a mandatory condition precedent to the right to make a demand for inspection . . .”).

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.<sup>225</sup>

*E. An Alternative Strategy: Leaving the U.S. 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 that would allow the cause of action to remain in the Delaware Court of Chancery to 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.<sup>226</sup> But this then raises subsequent and important questions: 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 the case 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.<sup>227</sup> In such a case, the key questions would be (1) how the Treasury behaved, (2) would the case involve depositions of top Treasury officials, and (3) were a Delaware court to enjoin the transaction, would this risk provoking a confrontation with Washington? In light of Delaware's vulnerable position, plaintiffs would be wise to avoid a Delaware forum, and Delaware courts, were such a claim filed, should avoid adjudicating such claims if they can do so.

How, then, might Delaware dodge the bullet? We argue that Delaware Chancery Court Rule 19, the Delaware parallel to Federal Rule of Civil Procedure 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.

*F. Conclusion*

For a litigator, this is a pretty depressing Part. 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

---

225. For a fuller treatment of the law governing the scope of this exception, see RICHARD J. PIERCE, JR., *ADMINISTRATIVE LAW TREATISE* § 5.11 (5th ed. 2010).

226. Kahan & Rock, *supra* note 111, at 410.

227. *Id.* at 427–28.

loyalty or care is very weak. GM's S-1 concisely and conclusorily takes an even more negative view when, after explaining that shareholders will not have any redress under the federal securities laws, it concludes,

Further, any attempt to assert a claim against the UST or any of its officers, agents or employees alleging any other complaint, including as a result of any future action by the UST as a stockholder of the Company, would also likely be barred under sovereign immunity unless specifically permitted by act of Congress.<sup>228</sup>

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 hypothetical, but when one compares the legal structure described above to the robust protections of noncontrolling 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 Government 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 toward, and structures of, government ownership.

Implicit in the preceding Parts 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 government 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.

---

228. General Motors Co., Amendment No. 9 (Form S-1), at 35 (Nov. 17, 2010), *available at* [http://www.sec.gov/Archives/edgar/data/1467858/000119312510262471/ds1a.htm#from45833\\_2](http://www.sec.gov/Archives/edgar/data/1467858/000119312510262471/ds1a.htm#from45833_2).



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 Part, 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 mechanisms? Not at all?

Given the historical variety of government involvement, a striking feature of the current arrangements is the widespread acceptance of a number of features, at least at the rhetorical level: 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 decisions 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 then-61% 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.”<sup>229</sup>

The Organisation for Economic Co-operation and Development (OECD) Guidelines on Corporate Governance of State-Owned Enterprises takes a similarly “liberal” approach.<sup>230</sup>

Although one might doubt the sincerity of some of these utterances, the desire of the U.S. government to exit government ownership seems genuine. Substantial steps have been taken to reduce government ownership of Citigroup, GM, and AIG (although with the perverse effect of increasing it, at least temporarily, to 92.1%). The articulated goals of the Obama Administration are a version of classic liberal political economy. If we take this (perhaps merely rhetorical) consensus as given, 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. *U.S. 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 U.S. Treasury’s investments in private corporations were made directly with no binding governance structure. As a result, the U.S. Treasury directly 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 districts. 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 and 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,<sup>231</sup> the U.S. government provided up to a maximum of \$1.5 billion in loan guarantees. The structure was somewhat different from what we ob-

---

229. Press Release, White House, Obama Administration Auto Restructuring Initiative: General Motors Restructuring (May 31, 2009), <http://www.whitehouse.gov/the-press-office/fact-sheet-obama-administration-auto-restructuring-initiative-general-motors>.

230. OECD, OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES (2005), available at <http://www.oecd.org/dataoecd/46/51/34803211.pdf>. Because the OECD guidelines are long on goals and short on recommended institutional arrangements, the guidelines do not represent an independent model for structuring government ownership.

231. 15 U.S.C. §§ 1861–1875 (1982).

serve 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.<sup>232</sup>

Second, the board had authority to provide loan guarantees “on such terms and conditions as it deemed appropriate” but only if the board determined that Chrysler had met a variety of conditions, including an energy-savings plan, a satisfactory operating plan, and a financing plan that would raise equivalent amounts of nonfederally guaranteed debt.<sup>233</sup>

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.”<sup>234</sup> The U.S. government received 14.4 million warrants to purchase Chrysler stock at \$13 per share until 1990.<sup>235</sup> In 1983, the U.S. government auctioned these warrants, and Chrysler purchased them for \$311 million.<sup>236</sup>

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.<sup>237</sup> In addition, no guarantees could be issued after December 31, 1983,<sup>238</sup> and all guarantees expired and all loans had to be repaid before December 31, 1990.<sup>239</sup>

The most striking difference between the first Chrysler bailout and the current bailout 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 in certain circumstances, the private-equity model typically puts control at its center. In choosing the private-equity

---

232. *Id.* § 1862.

233. *Id.* § 1863.

234. *Id.* § 1864(d).

235. JAMES M. BICKLEY, CONG. RESEARCH SERV., R 40005, CHRYSLER CORPORATION LOAN GUARANTEE ACT OF 1979: BACKGROUND, PROVISIONS AND COST 5 (2008).

236. *Id.*

237. 15 U.S.C. § 1870.

238. *Id.* § 1875.

239. *Id.* § 1868.

model and relying on modifications of Simpson Thacher's private-equity documents, the current intervention was tilted, from the outset, toward control.

2. *The AIG Structure: An Explicit Trust.*—On September 16, 2008, the Federal Reserve rescued AIG by pledging \$85 billion.<sup>240</sup> As part of the package, stated in the Federal Reserve'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."<sup>241</sup> On October 8, 2008, as AIG continued to spiral downward, the Federal Reserve pledged another \$37.8 billion.<sup>242</sup> On November 10, 2008, additional funds were invested through TARP.<sup>243</sup>

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.<sup>244</sup> 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, it 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."<sup>245</sup>

The stock was issued to the "AIG Credit Facility Trust," which was established by the Federal Reserve Bank of New York (FRBNY). 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."<sup>246</sup>

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

240. Press Release, Bd. of Governors of the Fed. Reserve Sys., *supra* note 12.

241. *Id.*

242. Press Release, Bd. of Governors of the Fed. Reserve Sys. (Oct. 8, 2008), *available at* <http://www.federalreserve.gov/newsevents/press/other/20081008a.htm>.

243. Press Release, Bd. of Governors of the Fed. Reserve Sys. (Nov. 10, 2008), *available at* <http://www.federalreserve.gov/newsevents/press/other/20081110a.htm>.

244. Am. Int'l Grp., Inc., Quarterly Report (Form 10-Q) (Mar. 2, 2009). 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.

245. *Id.*

246. AIG Credit Facility Trust Agreement, *supra* note 182, at 2.

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.<sup>247</sup>

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.<sup>248</sup> 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.<sup>249</sup>

At the same time, there are a few restrictions built in. The Trustees may not themselves serve as directors<sup>250</sup> nor vote to elect as directors anyone who is or has recently been an employee of the FRBNY or the Treasury.<sup>251</sup> 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.<sup>252</sup>

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 . . . .<sup>253</sup>

The initial and, at the time of this writing, only trustees of the AIG trust are Jill Considine, Chester Feldberg, and Douglas Foshee.<sup>254</sup> Considine formerly was the Chair and CEO of the Depository Trust & Clearing Corporation and currently serves as a director of the Interpublic Group of

---

247. *Id.*

248. *Id.* § 2.04.

249. *Id.* § 2.04(d).

250. *Id.* § 2.04(f).

251. *Id.* § 2.04(e).

252. *Id.* § 3.01.

253. *Id.* § 3.03(a).

254. *Who Are the Trustees?*, INFO. ABOUT THE AIG TRS., [http://www.aigcreditfacilitytrust.com/Home\\_1121\\_238661.html](http://www.aigcreditfacilitytrust.com/Home_1121_238661.html).

Companies and Ambac Financial Group Inc.<sup>255</sup> Chester Feldberg was Chair of Barclays Americas from 2000 to 2008 after having been executive vice president in charge of bank supervision at the New York Federal Reserve.<sup>256</sup> Douglas Foshee is president and CEO of El Paso Corporation, a publicly held gas-pipeline company, and previously worked at Halliburton.<sup>257</sup>

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.<sup>258</sup> The continuing involvement of Ken Feinberg, the compensation czar with authority over compensation in firms that have received TARP funding, 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.

As noted above, the trust is in the process of being dissolved, with the Treasury resuming direct ownership as a preliminary step to selling its shares.

3. *Another U.S. Model: Limited Voting and Predetermined Exit at Citigroup.*—The Treasury owned as much as 34% of Citigroup as a result of exchanging the preferred stock it purchased with TARP funds for common stock. As part of that 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, and any sale of the company.<sup>259</sup> Second, the Treasury committed to disposing of the stock within ten years.<sup>260</sup>

---

255. Press Release, Fed. Reserve Bank of N.Y., Statement Regarding Establishment of the AIG Credit Facility Trust: Trustees’ CVs (Jan. 16, 2009), <http://www.newyorkfed.org/newsevents/news/markets/2009/an090116.pdf>.

256. *Id.*

257. *Id.*

258. Serena Ng et al., *Benmosche ‘Committed’ to AIG*, WALL ST. J., Nov. 12, 2009, at C1.

259. An amendment to Citigroup’s S-4 filing contains this provision:

*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

How well has this worked out for the Treasury or for Citigroup? It is hard to say. Like other TARP banks, Citigroup 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.<sup>261</sup> At the same time, the Treasury was keen to sell its shares so that it could show a profit on its TARP investments. With the sale of the final block of Citigroup stock and the associated warrants at the end of 2010, the Treasury no longer has an equity stake. The real concern should be whether Citigroup, to avoid the TARP restrictions on executive compensation, has repaid the TARP funds before it was strong enough to do so.

*B. U.K. Financial Investments Limited*

In the fall of 2008, as AIG, Lehman, and other U.S. financial institutions were collapsing, so too were major institutions in the United Kingdom. With government investments or bailouts of, *inter alia*, Royal Bank of Scotland (RBS), Lloyds, Northern Rock, and Bradford & Bingley, the U.K. government found itself with significant and sometimes controlling equity stakes. In response, U.K. Financial Investments Limited (UKFI) was set up on November 3, 2008, to manage those investments.<sup>262</sup>

UKFI was set up as a company under the Companies Act with the U.K. Treasury as the sole shareholder. A key stated goal of the structure was to adopt “[r]obust institutional arrangements for keeping UKFI at arm’s-length from Government, centred on the creation of a heavyweight UKFI board which will take all major decisions relating to UKFI’s business and its management of the investments.”<sup>263</sup> The board included, as acting chair, Glen Moreno, who is chairman of Pearson plc, previously served as CEO of Fidelity International, and worked for Citigroup in a variety of senior positions.<sup>264</sup> The CEO was John Kingman, who previously “was Second Permanent Secretary to the Treasury, where he was responsible for oversight

---

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.

Citigroup, Inc., Amendment No. 5 (Form S-4), at 75–76 (July 17, 2009).

260. Another filing by Citigroup in connection with this transaction contains this provision:

*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.

*Id.* at 76.

261. Smith, Lucchetti & Crittenden, *supra* note 93.

262. U.K. FIN. INVS. LTD., AN INTRODUCTION: WHO WE ARE, WHAT WE DO, AND THE FRAMEWORK DOCUMENT THAT GOVERNS THE RELATIONSHIP BETWEEN UKFI AND HM TREASURY 1 (2009), available at <http://www.ukfi.co.uk/releases/UKFI%20Introduction.pdf>.

263. *Id.* at 11.

264. *Id.* at 3.

and control of some £600 billion of public spending annually.”<sup>265</sup> The remainder of the board included an impressive group of directors with experience in business and government, a mix that was clearly intentional.

The “Framework Document” established the relationship between the Treasury and UKFI and provided 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.<sup>266</sup>

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.<sup>267</sup> The board is then tasked with producing a business plan for the management of UKFI to recommend to the Treasury.<sup>268</sup>

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.”<sup>269</sup> 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).<sup>270</sup>

With respect to wholly owned companies, the Framework Document expects UKFI to act like a private-equity firm. With respect to partially owned public companies, it is expected to “engage actively . . . in accordance with best institutional shareholder practice,” including exercising voting

---

265. *Id.*

266. *Id.* at 9.

267. *Id.* at 11.

268. *Id.* at 15.

269. *Id.*

270. *Id.*



rights.<sup>271</sup> To avoid any distortion of competition, UKFI will ensure that there are no interlocking directors among its portfolio companies and is expected to take 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 individually and will not co-ordinate its actions in relation to Investee Companies in a way that might distort competition between them.”<sup>272</sup>

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”).<sup>273</sup>

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.”<sup>274</sup> Thus, for example, when the Treasury took 65% of the voting shares of Lloyds Banking Group in return for insuring £260 billion of the group’s toxic assets, Lloyds agreed “to lend at least £28bn over the next few years.”<sup>275</sup>

The remainder of the document commits UKFI to establish corporate-governance structures at portfolio companies that comport with “best practices” and expects 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 that 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 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

---

271. *Id.*

272. *Id.* at 16.

273. *Id.*

274. Press Release, U.K. Fin. Invs. Ltd., UKFI Takes On Management of RBS Shares (Dec. 1, 2008), available at [http://www.ukfi.co.uk/releases/ukfi\\_takes\\_on\\_mngmnt\\_rbs\\_shares.pdf](http://www.ukfi.co.uk/releases/ukfi_takes_on_mngmnt_rbs_shares.pdf).

275. Jill Treanor & Nick Mathiason, *Government Takes Over Lloyds*, GUARDIAN (U.K.), Mar. 7, 2009, <http://www.guardian.co.uk/business/2009/mar/07/government-takes-over-lloyds>.

RBS 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 the executives to take undiscounted and highly controversial pensions.<sup>276</sup>

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.<sup>277</sup> It seemingly adopts a goal of increasing the value of the portfolio companies in order to facilitate the prompt sale of the 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.<sup>278</sup> During a recessionary period, when lending opportunities decline, the two goals are in some tension.

Put somewhat differently, the U.K. model relies on nonlegally 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 a pension of approximately £700,000 per year.<sup>279</sup> Although, by U.S. standards, this was hardly extreme, it generated a huge public outcry, in part because through manipulation of his departure date and other inputs to the pension determination, he received twice as much as he otherwise would have.<sup>280</sup> Goodwin became a symbol of excess and greed, and his house was vandalized.<sup>281</sup> UKFI then voted against the "Directors' Remuneration Report" at the next annual meeting.<sup>282</sup>

---

276. Press Release, UK Fin. Invs. Ltd., UKFI Statement Re: RBS AGM Voting (Mar. 31, 2009), available at [http://www.ukfi.co.uk/index.php?URL\\_link=press-releases&Year=2009](http://www.ukfi.co.uk/index.php?URL_link=press-releases&Year=2009).

277. U.K. FIN. INVS. LTD., *supra* note 262, at 19.

278. *Id.* at 20.

279. Myles Neligan, *Former RBS CEO Goodwin Agrees to Pension Cut*, REUTERS (June 18, 2009), <http://www.reuters.com/article/idUSLI58536320090618>.

280. Graeme Wearden & Jill Treanor, *Ex-RBS Chief Goodwin Faces Legal Challenge to £693k Pension*, GUARDIAN (U.K.), Feb. 26, 2009, <http://www.guardian.co.uk/business/2009/feb/26/sir-fred-goodwin-royalbankofscotlandgroup>.

281. Aislinn Simpson, *Sir Fred Goodwin Attack: Bank Bosses Are Criminals Group Claims Responsibility*, TELEGRAPH (U.K.), Mar. 25, 2009, <http://www.telegraph.co.uk/finance/>

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 U.K. 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.<sup>283</sup>

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, 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 by other members of parliament.<sup>284</sup>

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.<sup>285</sup>

By 1983, at least with regard to the bank bailouts, Israel had accepted the “liberal consensus.” 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 Arrangement Law<sup>286</sup> adopted an innovative structure. For

newsbysector/banksandfinance/5048091/Sir-Fred-Goodwin-attack-Bank-Bosses-Are-Criminals-group-claims-responsibility.html.

282. In the United Kingdom, public companies must publish and submit an annual “Directors’ Remuneration Report” detailing the compensation of top executives for approval at the annual general meeting. The Directors’ Remuneration Report Regulations, 2002, S.I. 2002/1986, art. 3, ¶ 3 (U.K.), available at <http://www.legislation.gov.uk/ukSI/2002/1986/made> (providing regulations made by the Secretary of State pursuant to section 257 of the Companies Act 1985). A rejection has purely symbolic effect.

283. Elizabeth Rigby, *JJB Nearer to Fitness Club Sale*, FIN. TIMES, Mar. 23, 2009, at 18; see also David Wighton, *Hester Hits Out at Interference*, TIMES (U.K.), Dec. 17, 2009, <http://business.timesonline.co.uk/tol/business/columnists/article6959732.ece> (discussing the JJB Sports deal and stating that Lloyds failed to take advantage of an “apparently attractive” offer by a U.S. restructuring firm).

284. Jonathan Guthrie et al., *MPs Aim to Block Financing of Bid for Cadbury*, FIN. TIMES, Dec. 15, 2009, <http://www.ft.com/cms/s/0/0e272be8-e9b5-11de-9f1f-00144feab49a,s01=1.html>; see also Andrew Hill, *Mandelson on Cadbury: Pure Politics, Impure Policy*, FIN. TIMES, Dec. 5, 2009, at 15.

285. For an overview of the bank-share scheme, see Asher Blass & Richard Grossman, *Financial Fraud and Banking Stability: The Israeli Bank Crisis of 1983 and Trial of 1990*, 16 INT’L REV. L. & ECON. 461, 461–72 (1996), and Ehud Ofer, *Glass-Steagall: The American Nightmare that Became the Israeli Dream*, 9 FORDHAM J. CORP. & FIN. L. 527, 559–63 (2003).

286. Bank Shares Arrangement Law, 1438-1993, SH No. 2207 p. 378 (Isr.).

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.<sup>287</sup> 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 the agreement of the president of the Bank of Israel. The members must meet the qualifications set forth for directors of government corporations and a variety of other competence and independence requirements.<sup>288</sup>

The “share committee,” appointed by the public committee, is given both the power and responsibility to vote the shares for the State.<sup>289</sup> The members of the share committee likewise must meet standards of competence and independence.<sup>290</sup> The share committee nominates directors from the list of candidates prepared by the public committee and then votes for them at the annual meeting.<sup>291</sup> A person cannot serve on more than one share committee; a director may not serve on more than one bank board.<sup>292</sup> 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.<sup>293</sup>

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 Knesset (parliament) Finance Committee.<sup>294</sup>

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

---

287. *Id.* § 6(a).

288. *Id.* § 7.

289. *Id.* §§ 3, 12(a), 25.

290. *Id.* § 12.

291. *Id.* §§ 17–19.

292. *Id.* § 20(a).

293. *Id.* § 26.

294. *Id.* § 30.

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 over changes in the purposes of the corporation, its capital, and issuance of preferred stock or convertible bonds.<sup>295</sup> The statute also contains provisions governing government directors serving on the board,<sup>296</sup> provisions establishing a government corporation authority, provisions addressing subsidiaries and mixed corporations, as well as provisions governing privatization.<sup>297</sup> A subsection addresses “defense of essential governmental interests.”<sup>298</sup>

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 no equity ownership aside from a “special state share.”<sup>299</sup>

#### *D. The Design Choices and the Background Politics*

Earlier, we pointed out that government ownership of equity can encourage political interference by providing the *power* to interfere, the regular *opportunities* to do so, and 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.

---

295. Government Companies Law, 5735-1975, SH No. 770 p. 132, § 11 (Isr.).

296. *Id.* §§ 12–23.

297. *Id.* §§ 51–59(6).

298. *Id.* §§ 59(7)–59(2).

299. El Al Israel Airlines, Ltd., 2009 Annual Report at a-15, [http://www.elal.co.il/NR/rdonlyres/DD3C12EE-AF21-448D-B732-4FED20ED922D/0/ELALFINANCIALSTATEMENTS2009\\_new.pdf](http://www.elal.co.il/NR/rdonlyres/DD3C12EE-AF21-448D-B732-4FED20ED922D/0/ELALFINANCIALSTATEMENTS2009_new.pdf). On the requirements imposed by the special state share, see *id.* § 9.11.9 at a-134 to a-137.

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 debt holders 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 nonvoting 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, or 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,<sup>300</sup> 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).<sup>301</sup>

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

---

300. See, e.g., Corey Boles & Martin Vaughan, *Congress Increases Debt Limit*, WALL ST. J., Dec. 26, 2009, at A8; Carl Hulse, *Senate Passes an Increase in Debt Limit*, N.Y. TIMES, Dec. 24, 2009, <http://www.nytimes.com/2009/12/25/business/25debt.html?emc=eta1>.

301. Adam Levitin, *Why Have the Government Bailouts Involved Only a 79.9% Equity Position?*, CREDIT SLIPS (Sept. 18, 2008), <http://www.creditslips.org/creditslips/2008/09/why-have-the-go.html>.

committees, provides an example of how this can be implemented. Here, again, by limiting politicians' power and their opportunities to interfere, 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 nonvoting stock for two reasons. First, nonvoting stock gives the (nongovernmental) holders of the voting shares the residual control rights. By creating a dual-class capital structure, one divides cash-flow rights from control rights, resulting in the well-known problems that such division can cause.<sup>302</sup> 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 by selling the block either to a new controller or into the market.

2. *Mandating a Quick Exit.*—In June 2009, Senate Bill 1280, the TARP Recipient Ownership Trust Act of 2009, was introduced in the Senate.<sup>303</sup> The proposed statute granted the Secretary of Treasury authority (and provided 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.”<sup>304</sup> 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.”<sup>305</sup> Somewhat mysteriously, the proposed statute stated that the trust shall

have a fiduciary duty to the American taxpayer for the maximization of the return on the 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.<sup>306</sup>

---

302. See Ronald Gilson, *Evaluating Dual Class Common Stock: The Relevance of Substitutes*, 73 VA. L. REV. 807, 832–40 (1987) (noting that dual-class transactions create neutral or negative impacts on shareholder wealth and offering two possible explanations based on coercion of public shareholders by a dominant group); Jeffrey Gordon, *Ties that Bond: Dual Class Common Stock and the Problem of Shareholder Choice*, 76 CALIF. L. REV. 1, 23 (1988) (reporting statistical evidence that dual-class recapitalizations may decrease shareholder wealth).

303. S. 1280, 111th Cong. (2009).

304. *Id.* § 3.

305. *Id.*

306. *Id.*

Finally, the statute provided 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 investment to the taxpayer.”<sup>307</sup>

The bill raised 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 toward profitability and, by implication, without political motivations or goals. The bill was referred to committee where it seems to have died.

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 trade-offs. Exit cannot be so quick as to jeopardize the firms that we are trying to save. 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 bailouts are inevitable, we should come up with a better system for holding governmental controlling shareholders accountable for the effects of their actions on noncontrolling 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.

---

307. *Id.*



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.