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Article

Uncomfortable Embrace: Federal Corporate Ownership in the Midst of the Financial Crisis

Steven M. Davidoff[†]

The federal government struggled mightily to rescue the financial system during the panic of fall 2008. The government's hurried, frenetic response can be described as "regulation by deal," a term David Zaring and I coined to explain the ad hoc process by which the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and the U.S. Department of the Treasury (Treasury Department) attempted to rescue failing financial firms and resolve the market crisis within the limits of their legal power.¹ When the government concluded its dealmaking, it was left an unwilling holder of debt and equity interests throughout the financial sector. For good measure, it also owned sizable equity stakes in two of the country's three largest automotive manufacturers.

The structure of this ownership was a product of the Treasury Department's "regulation by deal" approach. The Treasury Department did not use any single template. Instead, each new rescue and deal brought different ownership terms and models. The government effectively nationalized Fannie Mae and Freddie Mac; took controlling equity interests in General Motors (GM), GMAC, and American International Group, Inc. (AIG); acquired noncontrolling equity and debt interests in Citigroup and Chrysler; and purchased nonvoting preferred securities in

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1. See Steven M. Davidoff & David Zaring, *Regulation by Deal: The Government's Response to the Financial Crisis*, 61 ADMIN. L. REV. 463, 463 (2009); see also STEVEN M. DAVIDOFF, GODS AT WAR: SHOTGUN TAKEOVERS, GOVERNMENT BY DEAL, AND THE PRIVATE EQUITY IMPLOSION (2009).

the 707 banks that received Troubled Asset Relief Program (TARP) funds. In each case, the acting government agency utilized different mixtures of common, preferred, and debt securities, and negotiated divergent corporate governance terms. The agencies arranging this assistance also failed to maximize the economic and legal terms of each investment in its origination when measured against what a private sector participant would likely have negotiated.

Both the Bush and Obama Administrations repeatedly professed unease with this ownership. The Obama Administration was the more vocal of the two. In a series of memos and pronouncements, the Obama Administration disavowed any socialist or corporatist intent. The Administration publicly set forth the following principles: (1) the federal government acquired these ownership stakes solely due to the exigent circumstances, (2) would adopt a hands-off approach in monitoring its investments, and (3) would seek to dispose of these investments as soon as practicable.² These principles were sometimes formalized in agreements with invested companies.³ Yet again, both the Bush and Obama Administrations took different approaches to implement these principles depending upon the investment.

The Bush and Obama Administrations' frenetic responses raise the more fundamental issue of how the government should actually structure its investments. Must the government structure its investments as a commercial shareholder—on arms-length, commercial terms? Alternatively, should it recognize the inherently political nature of such ownership and attempt to limit undue political influence through a voluntary cession of control? If so, what is the appropriate measure of control the government should retain? Regardless of its investment model, to what extent should market terms dictate the government's investment?

2. See Press Release, The White House, Obama Administration Auto Restructuring Initiative, General Motors Restructuring (Mar. 30, 2009) [hereinafter Press Release, General Motors Restructuring], available at http://www.whitehouse.gov/the_press_office/Fact-Sheet-on-Obama-Administration-Auto-Restructuring-Initiative-for-General-Motors; Press Release, Written Testimony of Herbert M. Allison, Jr., Assistant Secretary for Financial Stability, Domestic Policy Subcommittee of the Oversight and Government Reform Committee (Dec. 17, 2009), available at <http://www.treasury.gov/press-center/press-releases/Pages/tg453.aspx>.

3. See *infra* Part II.A.

This Article tackles these questions.⁴ It draws early lessons from the government's corporate ownership during the financial crisis and develops principles to guide the structure, monitoring, and retention of future investments. Part I sets forth the different models of government ownership during the financial crisis, highlighting the Treasury Department's regulation-by-deal approach to ownership.⁵

Part II assesses the government's ownership experience and provides a near-term critique of the corporate governance structures the government utilized. These programs lost relatively small sums compared to the economic harm averted. This success was in part due to the Bush and Obama Administrations' preinvestment structuring principles that relied on commercial norms to set the terms of these investments. Still, the Treasury Department—the government agency primarily responsible for these investments—left money on the table by failing to negotiate full commercial terms and by repeatedly spurning opportunities to acquire substantial equity stakes in its investments. The Treasury Department also unduly forfeited significant post-investment control over these investments in order to limit future political influence. It instead relied on soft-control mechanisms such as independent directors and their willingness to heed the government's wishes due to corporate social norms. These mechanisms had value, but we do not and may not ever definitively know their true worth; their impact is difficult to calculate and the facts of the inner workings of the structures have yet to be disclosed.

The limits of soft control were never fully tested due to the timely market upturn that salvaged the government's investments. In this light, the Bush and Obama Administrations' failure to negotiate a level of ultimate control in many cases appears to have been an error, though one for which the government did not have to pay the consequences. My criticism is quite directed. Control comes in all shapes and sizes, and in this context, when I refer to ultimate control, I mean the ability to remove and replace a majority of directors at some time in-

4. For articles looking at the issue of government ownership from the shareholder perspective, see Marcel Kahan & Edward Rock, *When the Government Is the Controlling Shareholder: Implications for Delaware*, 35 DEL. J. CORP. L. 409 (2010), and J.W. Verret, *Treasury Inc.: How the Bailout Reshapes Corporate Theory and Practice*, 27 YALE J. ON REG. 283, 287 (2010).

5. For another cogent analysis of government ownership, see Barbara Black, *The U.S. as "Reluctant Shareholder": Government, Business and the Law*, 5 ENTREPRENEURIAL BUS. L.J. 561 (2010).

terval. This fallback level of control together with softer governance forces would have provided the government all the control it likely needed, while actually giving it a control mechanism in case soft and other governance forces did not succeed. But the government was so skittish about any level of control that it forfeited even this fundamental investor right.

The final part of this Article draws on the analysis in Part II to offer some lessons for future government corporate ownership. The ultimate lesson of government ownership during the financial crisis is that such constructs are inherently unstable given U.S. citizens' current political attitudes toward public ownership of private enterprise. Understanding beforehand what the goals of such ownership are and having a holistic view of societal wealth maximization can lead to the creation of better corporate structures to govern such ownership and more effectively maximize these investments. United States government corporate ownership will remain quite rare. When it does occur, however, the government should adhere to these general goals while adopting the mantra of a commercial investor as the starting point for its investments. No other model is likely to have as much legitimacy.

The lessons of the financial crisis also point to flexibility in such ownership structures. Simply advocating the private equity model may not be sufficient when a back-door influence model can work in a similar manner with greater overall political effectiveness. This jibes with the practical reality that future government ownership is likely to adopt similarly heterogeneous patterns as each crisis is its own unique entity shaped by political, market, and legal realities. In other words, each crisis brings its own form of "regulation by deal" that drives the ownership structures the government devises. Because each crisis will be different, any set ownership rules are likely futile, leaving us with basic principles to rely upon—principles which assume future flexible implementation. This insight ultimately informs academic theory on firm governance, illustrating that no single model alone can explain or is appropriate for all corporate governance arrangements.

I. THE STRUCTURE OF GOVERNMENT OWNERSHIP

This Part outlines the structure of government ownership in its various forms through the financial crisis. The government's investments were not only numerous, but heterogeneous in form and structure. This Part sets forth the terms of each

significant investment and also outlines the corporate governance terms the government negotiated in each case.

A. AIG

The government began its ownership experience with Fannie Mae and Freddie Mac (together, the government-sponsored enterprises or GSEs). However, these were quasi-public entities, which were effectively nationalized. The federal government only truly embraced private ownership when it acquired a controlling interest in AIG amidst the financial panic of 2008. Financial assistance to AIG was patterned on a failed, private rescue effort for the company as well as the government's prior investment in the GSEs.⁶ But this time the government was much more circumspect about acquiring full control or eliminating the private nature of a corporate enterprise.

The keystone of the federal government's initial assistance was an \$85 billion loan extended by the Federal Reserve Bank of New York.⁷ The interest rate was 8.5 percent over the London Interbank Offered Rate (LIBOR) plus 8.5 percent on undrawn funds and a commitment fee of \$1.7 billion.⁸ These loan terms were initially based on private sector terms, but the Federal Reserve later eased them as AIG continued to decline financially. The Treasury Department would subsequently authorize additional assistance up to \$69.8 billion under the Emergency Economic Stabilization Act of 2008 (EESA).⁹ Ulti-

6. See generally ANDREW ROSS SORKIN, *TOO BIG TO FAIL* (2009).

7. AIG, Current Report (Form 8-K) (Sept. 22, 2008) [hereinafter AIG 2008 September Form 8-K], available at <http://sec.gov/Archives/edgar/data/5272/000095012308011496/y71452e8vk.htm>. This loan was subsequently reduced to a maximum amount of \$60 billion. See AIG, Current Report (Form 8-K) (Oct. 27, 2008), available at <http://www.sec.gov/Archives/edgar/data/5272/000095012308013926/y72249e8vk.htm>; Press Release, Bd. of Governors of the Fed. Reserve Sys. (Nov. 10, 2008), available at <http://www.federalreserve.gov/newsevents/press/other/20081110a.htm>. For a more in-depth analysis of the AIG bailouts, see William K. Sjostrom, Jr., *The AIG Bailout*, 66 WASH. & LEE L. REV. 943 (2009).

8. See Credit Agreement exhibit 99.1, Sept. 22, 2008, between American International Group, Inc. and Federal Reserve Bank of New York [hereinafter AIG 2008, exhibit 99.1], available at <http://sec.gov/Archives/edgar/data/5272/000095012308011496/y71452exv99w1.htm>; see also Matthew Karnitschnig et al., *U.S. to Take over AIG in \$85 Billion Bailout; Central Banks Inject Cash as Credit Dries Up*, WALL ST. J., Sept. 17, 2008, at A1, available at <http://online.wsj.com/article/SB122156561931242905.html>.

9. Hugh Son, *AIG Rescue Cost Narrows by \$2.9 Billion, U.S. Says*, BUS. WK., May 21, 2010, <http://www.businessweek.com/news/2010-05-21/aig-rescue-cost-narrows-by-2-9-billion-u-s-says-update2-.html>.

mately, the government would authorize up to \$182.3 billion in direct assistance through these and other programs.¹⁰

In connection with the origination of the initial \$85 billion loan, AIG also issued to the Federal Reserve preferred securities equivalent to a 79.9 percent voting and dividend interest in AIG.¹¹ These shares were convertible into AIG common stock upon the amendment of AIG's certificate of incorporation to permit this conversion.¹² The ownership interest would later be reduced to a 77.9 percent interest (with a 79.77 percent voting interest) when, in connection with a TARP investment, the Treasury Department was issued a warrant equivalent to two percent of AIG's common stock.¹³

Like Fannie Mae and Freddie Mac, AIG also left outstanding in public hands a 20.1 percent effective interest in its equity.¹⁴ The reason for this outstanding interest was not announced, but it was likely attributable to perceived and actual budgetary and legal limitations.¹⁵ The AIG common stock remained in public hands and traded on the New York Stock Exchange (NYSE). AIG even performed a reverse stock split to ensure that its stock continued to qualify for listing on the NYSE under its listing standards.¹⁶ The trading in AIG stock rose to such volumes that the *Wall Street Journal* subsequently characterized it as a "casino," with people placing uninformed bets on whether AIG's equity was worthless or not.¹⁷

10. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-10-475, REPORT TO CONGRESSIONAL COMMITTEES, TROUBLED ASSET RELIEF PROGRAM: UPDATE OF GOVERNMENT ASSISTANCE PROVIDED TO AIG 13 (2010), available at <http://www.gao.gov/new.items/d10475.pdf>.

11. AIG 2008, exhibit 99.1, *supra* note 8.

12. *Id.*

13. AIG, Current Report (Form 8-K) (Nov. 25, 2008) [hereinafter AIG 2008 November Form 8-K], available at <http://www.sec.gov/Archives/edgar/data/5272/000095012308016447/y72888e8vk.htm>. The government's use of preferred stock in this and other circumstances is reviewed in Joan MacLeod Heminway, *Federal Interventions in Private Enterprise in the United States: Their Genesis in and Effects on Corporate Finance Instruments and Transactions*, 40 SETON HALL L. REV. 1489-505 (2010).

14. See AIG 2008, exhibit 99.1, *supra* note 8.

15. The ownership level was kept below eighty percent in order to prevent AIG's liabilities from being consolidated onto the federal government's balance sheet.

16. *Frequently Asked Questions*, AIG, http://www.aigcorporate.com/investors/rev_split_faqs.html (last modified Feb. 9, 2011).

17. See Susan Pulliam & Tom Lauricella, *Traders Seek Fortune in AIG, Stock Once Left for Dead*, WALL ST. J., Sept. 23, 2009, at A1, available at <http://online.wsj.com/article/SB125366502247832417.html> ("AIG, arguably, has

The AIG preferred securities issued to the Federal Reserve were subsequently placed into an irrevocable trust for the benefit of the Treasury Department.¹⁸ The Federal Reserve appointed three trustees to administer the trust.¹⁹ The trust instrument provided the trustees with complete power to vote and dispose of the government's shares.

The government effectively ceded control over both its ownership interest and AIG by placing its shares into this trust. The government also narrowly directed the trustees to operate the company with a view toward repaying amounts owed to the government.²⁰ The only other management direction was to not disrupt the financial markets.²¹ These were light touches and an almost complete cessation of control. The Federal Reserve maintained a measure of control through its loan agreements, although the covenants here were similar to those applicable to a credit-worthy borrower rather than the more lengthy covenants contained in the high-yield debt that AIG would now be required to provide in the private market—if it could even raise debt.²² The Treasury Department also retained the right under the terms of its preferred shares to appoint two directors to the board if AIG missed dividend payments on the preferred shares for four consecutive quarters.²³ AIG did indeed miss these payments, and on April 1, 2010, the Treasury Department appointed independent, retired corporate executives.²⁴ Meanwhile, at AIG's 2010 shareholder meeting, the trustees directly recommended five directors to AIG's elev-

been the biggest casino of all. In the past seven weeks, its common shares have careened between \$13 and \$55, surging past \$54 on Tuesday before closing at \$45.80.”)

18. See AIG, Current Report (Form 8-K), exhibit 10.1 (Jan. 16, 2009) [hereinafter AIG Trust Agreement], available at <http://www.sec.gov/Archives/edgar/data/5272/000095012309001128/y74153exv10w1.htm>.

19. Press Release, Fed. Reserve Bank of N.Y., Statement Regarding Establishment of the AIG Credit Facility Trust (Jan. 16, 2009), available at <http://www.newyorkfed.org/newsevents/news/markets/2009/an090116.html>.

20. AIG Trust Agreement, *supra* note 18.

21. *Id.*

22. *Government Investment, Role of the Federal Reserve Bank of New York, the U.S. Department of Treasury, and the Trustees*, AIG, http://www.aigcorporate.com/GInAIG/role_trustees.html (last modified Feb. 9, 2011).

23. AIG 2008 November Form 8-K, *supra* note 13.

24. See James Sterngold & Rebecca Christie, *AIG Board Grows with Two New Directors Named by U.S.*, BUS. WK., Apr. 1, 2010, <http://www.businessweek.com/news/2010-04-01/treasury-to-name-layton-rittenmeyer-to-aig-board-update1-.html>.

en-member board with the remainder being recommended by the AIG board itself.²⁵

After the deposit of the preferred shares with the trust, the only remaining direct control the government exerted over AIG was through the executive compensation requirements administered by special master Kenneth Feinberg.²⁶ Behind the scenes, though, the government still exerted real control. It is still unknown whether AIG's board or executives directly spurned any government request. But both the board and top executives were repeatedly replaced at the behest of either the Federal Reserve or the Treasury Department.²⁷ News reports gave the impression that the Treasury Department still wielded great day-to-day authority, and the Assistant Treasury Secretary for Financial Stability regularly met with AIG executives, including AIG's chief executive officer.²⁸

The government thus operated AIG in a queasy vacuum. AIG was to be a private company but the government's ownership brought political considerations into its operating decisions. Its quasi-public nature often left the public wondering about the measure of control the government asserted. At times it also affected employee morale.²⁹ Meanwhile, it was an open question about how this ambiguity affected the day-to-day performance of the company and its ability to create value for its largest stakeholder, the federal government.

On September 30, 2010, AIG announced an agreement with the Treasury Department to restructure these invest-

25. *AIG: Where Is the Taxpayers' Money Going? Hearing Before the H. Comm. on Oversight and Governmental Reform*, 111th Cong. 122–23 (2009) (statement of Douglas L. Foshee) [hereinafter *AIG: Where Is the Taxpayers' Money Going*], available at <http://www.gpo.gov/fdsys/pkg/CHRG-111hhr53019/pdf/CHRG-111hhr53019.pdf>.

26. See, e.g., Press Release, U.S. Dep't of the Treasury, The Special Master for TARP Executive Compensation Issues First Rulings (Oct. 22, 2009), available at <http://www.treasury.gov/press-center/press-releases/Pages/tg329.aspx>.

27. See, e.g., Andrew Clark, *Outgoing AIG Chief Gives Up \$22m Payoff*, *GUARDIAN*, (Sept. 22, 2008), <http://www.guardian.co.uk/business/2008/sep/22/insurance.marketturmoil> (“Wilmstad was told to step aside in a phone call made personally by the treasury secretary, Henry Paulson.”).

28. See, e.g., *AIG: Where is the Taxpayer's Money Going*, *supra* note 25, at 13 (statement of Edward M. Liddy, Chairman and CEO, AIG) (noting that officials of the Treasury Department regularly met with AIG executives to discuss the company's business).

29. Richard Beales et al., *A.I.G. Needs A.I.A. Deal Soon*, *N.Y. TIMES*, June 11, 2010, at B2, available at 2010 WLNR 11918633.

ments to facilitate a disposition of the government's positions.³⁰ The Federal Reserve Bank of New York would be repaid the approximately \$46 billion it was owed. While \$20 billion would come from asset sales, approximately \$22 billion would come from newly borrowed TARP funds.³¹ The remainder of the proceeds used to repay the government would come from asset sales by AIG.³² If the restructuring is completed on these terms, only the Treasury Department would maintain an interest in AIG in the form of a number of series of preferred stock.³³ The parties have also agreed that this preferred stock would subsequently be repaid by asset sales, including the sale of AIG's interest in Asian insurer AIA.³⁴ In connection with this restructuring, the other outstanding preferred shares in the amount of \$49.1 billion would be converted into common shares of AIG, comprising 92.1 percent of the company.³⁵

AIG also announced that the AIG Trust would be liquidated upon completion of this restructuring and that the Treasury Department would directly hold this 92.1 percent interest.³⁶ The Treasury Department did not agree to any restrictions on its ability to appoint directors—such as a requirement that they be independent. This was a remarkable turn. Not only had the Treasury Department surpassed the eighty percent threshold in terms of ownership, it no longer actively sought to restrict its control rights.

B. CITIGROUP

The government's investment in Citigroup also evolved as the financial crisis continued and the bank's financial state deteriorated. On October 14, 2008, the Treasury Department announced that it would purchase \$25 billion worth of preferred securities in Citigroup under the TARP Capital Purchase Program (CPP).³⁷ This investment was part of the government's \$125 billion initial TARP investment in the country's nine larg-

30. Press Release, AIG, AIG Announces Plan to Repay U.S. Government (Sept. 30, 2010), *available at* http://www.aigcorporate.com/newsroom/2010_September/AIGAnnouncesPlantoRepay30Sept2010.pdf.

31. *Id.*

32. *Id.*

33. AIG 2008 exhibit 99.1, *supra* note 8.

34. Press Release, *supra* note 30.

35. AIG 2008 September Form 8-K, *supra* note 7.

36. *Id.*

37. Floyd Norris, *Another Crisis, Another Guarantee*, N.Y. TIMES, Nov. 25, 2008, at B1, *available at* 2008 WLNR 22496172.

est financial institutions.³⁸ Subsequently, and in order to recapitalize Citigroup, the Treasury Department was forced to twice rework its investment and provide further assistance under the TARP Targeted Assistance Program.³⁹ The Treasury Department eventually exchanged \$12.5 billion worth of TARP preferred securities for Citigroup common stock.⁴⁰ The exchange was first announced on February 27, 2009 during the final days of the Bush Administration.⁴¹ After this exchange concluded on September 10, 2009, the Treasury Department owned approximately 7.7 billion shares of Citigroup common stock, \$27.059 billion in preferred securities, and warrants to purchase 465.1 million shares of Citigroup common stock.⁴²

The Treasury Department also became the largest shareholder of Citigroup with a 33.6 percent ownership interest upon the completion of this exchange.⁴³ Unlike its stake in AIG, the government did not place this ownership position into an irrevocable trust. An official at the Treasury Department would later assert that the reason for the difference was that the EESA prohibited such a trust arrangement.⁴⁴ This interpretation was a stretch, however, as the law did not directly address

38. *Id.*

39. See Citigroup, Inc., Current Report (Form 8-K) (Feb. 27, 2009), available at http://www.sec.gov/Archives/edgar/data/831001/000095010309000421/dp12698_8k.htm.

40. See Citigroup, Inc., Current Report (Form 8-K), exhibit 99.9 (July 23, 2009), available at <http://www.sec.gov/Archives/edgar/data/831001/000095012309024819/y78424exv99w1.htm> (“Citi Completes Exchange Transaction with Private Holders and U.S. Government Matching Exchange”).

41. Press Release, Citigroup, Inc., Citi to Exchange Preferred Securities for Common, Increasing Tangible Common Equity to as Much as \$81 Billion (Feb. 27, 2009), available at <http://www.citigroup.com/citi/press/2009/090227a.htm>.

42. Citigroup, Inc., Annual Report (Form 10-K) (Feb. 26, 2009) [hereinafter Citigroup 2009 February Form 10-K], available at http://www.sec.gov/Archives/edgar/data/831001/000120677410000406/citi_10k.htm.

43. See Press Release, Citigroup, Inc., Citi Announces Shareholder Approval of Increase in Authorized Common Shares, Paving Way to Complete Share Exchange (Sept. 3, 2009), available at <http://www.citigroup.com/citi/press/2009/090903a.htm> (“Upon completion, the U.S. government will own 7,692,307,692 shares, or 33.6 percent of outstanding shares.”).

44. See *Troubled Asset Relief Program, The U.S. Government Role as Shareholder in AIG, Citigroup, Chrysler, and General Motors and Preliminary Views on Its Investment Management Activities, Testimony Before the Subcomm. on Domestic Policy of the H. Comm. on Oversight and Gov't Reform*, 111th Cong. 18 (2009) (statements of Orice Williams Brown, Director of Financial Markets and Community Investment, and A. Nicole Clowers, Acting Director of Physical Infrastructure) [hereinafter *GAO Testimony*], available at <http://www.gao.gov/new.items/d10325t.pdf>.

the issue. More likely, criticism of the government's actions with respect to AIG had made the Treasury Department more wary of forfeiting its ownership interest.

Despite the Treasury Department's retention of ownership, the government still contractually limited its control rights. The Treasury Department agreed with Citigroup that it would vote its shares in proportion to all other shares cast except for certain designated matters, which included "the election and removal of directors."⁴⁵ Even then the Treasury Department never publicly nominated or removed any directors to the Citigroup board or otherwise acted in a forthright manner to exercise these reserved rights. After the conclusion of the exchange offer, the only crisis-originated power the government asserted upon Citigroup was with respect to the executive compensation requirements under the TARP.⁴⁶ This authority was removed on December 23, 2009, when Citigroup redeemed \$20 billion in outstanding preferred securities held by the Treasury Department.⁴⁷

The government again wielded significant soft and indirect power outside of its formal arrangements—primarily exercised through its ability to oversee the company under its bank supervisory powers.⁴⁸ In addition, members of the Treasury Department were briefed on Citigroup's major decisions and helped to select new board members.⁴⁹ Here, as with AIG, politicians also repeatedly acted to assert the government's ownership position by way of financing to pursue their own political endeavors.⁵⁰ For example, one widely quoted article in the *New*

45. Exchange Agreement exhibit 10.3, June 9, 2009, between Citigroup, Inc. and United States Department of the Treasury [hereinafter Citibank 2009 Exchange Agreement], available at <http://www.sec.gov/Archives/edgar/data/831001/000119312509128765/dex103.htm>.

46. See *GAO Testimony*, *supra* note 44, at 3.

47. Citigroup 2009 February Form 10-K, *supra* note 42.

48. See Eric Dash, *Citi Is Urged to Replace Its Chairman*, N.Y. TIMES, Jan. 12, 2009, at B1, available at 2009 WLNR 581479.

49. Deborah Solomon & David Enrich, *U.S. to Take Big Citi Stake and Overhaul the Board*, WALL ST. J., Feb. 27, 2009, at C1, available at <http://online.wsj.com/article/SB123570659457790823.html?KEYWORDS=take+big+Citi+stake+and+overhaul+the+board> ("[T]he government is demanding that the New York company overhaul its board of directors, the people said. Treasury will call for Citigroup's board to be comprised of a majority of independent directors.").

50. See Steven Brill, *What's a Bailed-Out Banker Worth?*, N.Y. TIMES, Jan. 3, 2010 (Magazine), at 32, available at 2010 WLNR 84978 (discussing specific examples related to Senator Barney Frank and others).

York Times Magazine detailed how individual Congress members exercised significant authority over the company.⁵¹

The Treasury Department contractually committed to dispose of Citigroup's common stock by the ten-year anniversary of the exchange offer's completion.⁵² It would not take that long.⁵³ On December 14, 2009, Citigroup announced that the government intended to sell its stake over the following six to twelve months.⁵⁴ The first sale took place on April 26, 2010,⁵⁵ and by December 2010 the Treasury Department had disposed of its entire interest—an investment that ultimately realized a \$12 billion gain.⁵⁶

C. GM AND CHRYSLER

The government provided financial assistance to GM and Chrysler in two stages.⁵⁷ In the first stage, it provided sufficient financing for the companies to operate through the transition from the Bush to the Obama Administration.⁵⁸ Under the TARP Automotive Industry Financing Program, GM and Chrysler received loans from the Treasury Department of \$13.4 billion and \$4 billion, respectively.⁵⁹ In both instances the Bush Administration extended the loans under the assumption that they would not be sufficient for the continued operation of the company.⁶⁰ Under the terms of each loan, each company was

51. *Id.* (highlighting Senator Barney Frank's and other members of Congress's attempts to influence Citigroup's compensation plans for their executives).

52. Citibank 2009 Exchange Agreement, *supra* note 45, exhibit 10.3.

53. See Citigroup, Inc., Current Report (Form 8-K), exhibit 99.1 (Dec. 14, 2009), available at <http://www.sec.gov/Archives/edgar/data/831001/000095012309070361/y80976exv99w1.htm>.

54. See *id.*

55. See David Lawder & Maria Aspan, *Treasury Begins Sale of Citigroup Stake*, REUTERS, Apr. 26, 2010, available at <http://www.reuters.com/article/2010/04/26/us-citigroup-treasury-idUSTRE63P4KD20100426>.

56. Press Release, U.S. Dep't of the Treasury, Treasury Announces Pricing of Citigroup Common Stock Offer (Dec. 6, 2010), available at <http://www.treasury.gov/press-center/press-releases/Pages/TG995.aspx>.

57. See OFFICE OF FIN. STABILITY, U.S. DEP'T OF THE TREASURY, AGENCY FINANCIAL REPORT: FISCAL YEAR 2009, at 35 [hereinafter OFS FINANCIAL REPORT 2009], available at http://www.treasury.gov/about/organizational-structure/offices/Mgt/Documents/OFS%20AFR%2009_24.pdf.

58. See David Cho & Lori Montgomery, *Bush Prepares Request for Rest of Bailout Funds*, WASH. POST, Jan. 10, 2009, <http://www.washingtonpost.com/wp-dyn/content/article/2009/01/09/AR2009010902846.html>.

59. OFS FINANCIAL REPORT 2009, *supra* note 57, at 102–03.

60. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-553, AUTO INDUSTRY:

required to develop a plan for “financial viability” for the Obama administration to consider by February 17, 2009.⁶¹

In the second stage, after the presidential transition, the Obama Administration decided to provide significant additional financial assistance to both companies.⁶² The full background behind the decision to provide additional assistance to the two automakers has yet to be publicly disclosed, but it appears to have been based on two fundamental assumptions. First, the Automotive Task Force headed by Steven Rattner and headquartered in the Treasury Department concluded that the overall costs of liquidating the automakers would be greater than providing assistance.⁶³ Second, the Treasury Department’s investment was based on the assumption that each of the automakers would be able to function independently after their restructuring.⁶⁴ With respect to the latter decision, some

SUMMARY OF GOVERNMENT EFFORTS AND AUTOMAKERS’ RESTRUCTURING TO DATE 2 (2009), *available at* <http://www.gao.gov/new.items/d09553.pdf>.

61. *See id.* at 2 (discussing the GM and Chrysler loan programs); General Motors Corp., Current Report (Form 8-K) (Dec. 31, 2008) [hereinafter GM 2008 December Form 8-K], *available at* <http://www.sec.gov/Archives/edgar/data/40730/000095015209000103/k47265e8vk.htm> (detailing GM’s loan agreement); Loan and Security Agreement, Dec. 31, 2008, between General Motors Corporation and U.S. Department of the Treasury [hereinafter GM 2008 Loan Agreement], *available at* http://www.treasury.gov/initiatives/financial-stability/investment-programs/aifp/Documents_Contracts_Agreements/Posted%20%20Contract%20-%20GM%20Original%20Loan%20and%20Security%20Agreement%20with%20amendments%2009-09-09.pdf; Loan and Security Agreement, Dec. 31, 2008, between Chrysler Corporation and U.S. Department of the Treasury [hereinafter Chrysler 2009 Loan Agreement], *available at* http://www.treasury.gov/initiatives/financial-stability/investment-programs/aifp/Documents_Contracts_Agreements/Chrysler%20LSA%20as%20of%2005-26-10.pdf.

62. Between these two stages, another \$6.36 billion in loans would be extended to GM, including \$361 million for a warranty program and \$280 million in loans to Chrysler for a similar warranty program. CONG. OVERSIGHT PANEL, SEPTEMBER OVERSIGHT REPORT: THE USE OF TARP FUNDS IN THE SUPPORT AND REORGANIZATION OF THE DOMESTIC AUTOMOTIVE INDUSTRY 9–10 (2009) [hereinafter COP REPORT].

63. *See* JONATHAN ALTER, THE PROMISE: PRESIDENT OBAMA, YEAR ONE 183 (2010) (“With 225,000 employees, 500,000 retirees, 11,500 suppliers and 6,000 dealers, liquidation was never an option.”); STEVEN RATTNER, OVERHAUL: AN INSIDER’S ACCOUNT OF THE OBAMA ADMINISTRATION’S EMERGENCY RESCUE OF THE AUTO INDUSTRY 52–53 (2010).

64. *See* RATTNER, *supra* note 63, at 53; *Obama Administration New Path to Viability for GM & Chrysler*, U.S. DEPARTMENT TREASURY, http://www.treasury.gov/initiatives/financial-stability/investment-programs/aifp/Documents_Contracts_Agreements/autoFactSheet.pdf (last visited March 23, 2010) (“While GM’s current plan is not viable, the Administration is confident that with a more fundamental restructuring, GM will emerge from this process as a

in the Administration doubted the Automotive Task Force's conclusion as to the viability of Chrysler.⁶⁵ The viability conclusion for Chrysler thus appears to have been driven by political and macroeconomic considerations regarding the effects of its collapse on state economies.⁶⁶

To achieve these goals, the Automotive Task Force ultimately decided to restructure each of these entities through use of the § 363 sale provisions in the Bankruptcy Code.⁶⁷ Its use of this procedure was quite novel and controversial.⁶⁸ To ensure that there were minimal legal challenges to this device, the Automotive Task Force brokered significant compromises with unsecured and secured lenders as well as other stakeholders, including employees.⁶⁹ This approach affected the terms of the actual ownership position the government took in each entity.⁷⁰ In order to ensure a quick bankruptcy process and viable post-bankruptcy companies, the Treasury Department converted a large portion of its initial investments from debt to equity.⁷¹

The post-bankruptcy ownership of GM is set forth in the following diagram:

stronger more competitive business Chrysler has reached an understanding with Fiat that could be the basis of a path to viability.”).

65. Steven Rattner, *The Auto Bailout: How We Did It*, FORTUNE, Nov. 9, 2009, at 55 (describing the characterization of government intervention as “creeping socialism” in the eyes of some observers).

66. See RATTNER, *supra* note 63, at 120–23; Rattner, *supra* note 65, at 55, 61 (elaborating on some of the “hard hit” communities that could potentially shoulder most of the burden associated with a collapse of the automotive industry).

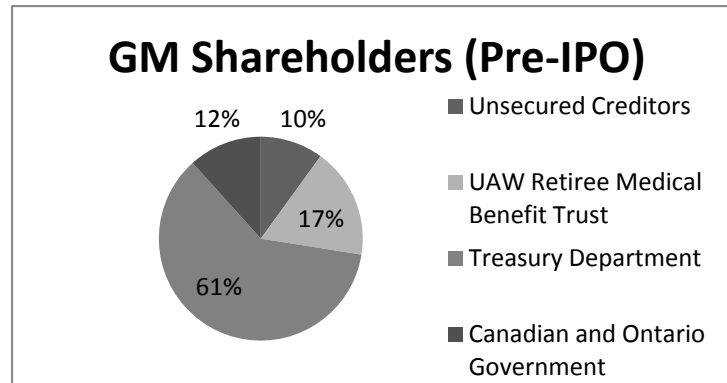
67. See Mark J. Roe & David A. Skeel, *Assessing the Chrysler Bankruptcy*, 108 MICH. L. REV. 727, 731–32 (2010) (elaborating on the government's decision to use § 363 as a tool in the restructuring of Chrysler).

68. See *id.* at 729 (“The Chrysler bankruptcy process used undesirable mechanisms that federal courts and Congress struggled for decades to suppress at the end of the nineteenth and first half of the twentieth centuries”); Todd J. Zywicki, *Chrysler and the Rule of Law*, WALL ST. J., May 13, 2009, at A19, available at <http://online.wsj.com/article/SB124217356836613091.html>. But see Stephen J. Lubben, *No Big Deal: The GM and Chrysler Cases in Context*, 83 AM. BANKR. L.J. 531, 532 (2009) (suggesting that this use of a § 363 sale is “entirely within the mainstream of chapter 11 practice for the last decade”).

69. Roe & Skeel, *supra* note 67, at 733–34.

70. See COP REPORT, *supra* note 62, at 19–20.

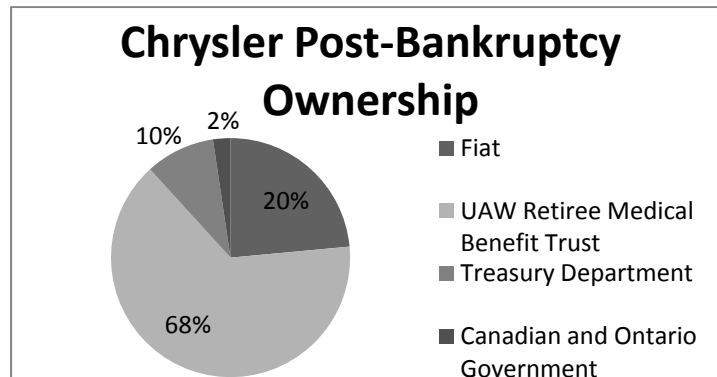
71. See *id.* For details on the terms set forth, see generally Master Transaction Agreement, Apr. 30, 2009, between Fiat S.p.A., New CarCo. Acquisition LLC, Chrysler LLC, and the Other Sellers Identified Herein, available at <http://www.ohiopragticalbusinesslaw.com/uploads/file/Chrysler%20Purch%20Agmt%281%29.pdf>.



72

Unsecured creditors received a ten percent stake in GM plus warrants to purchase an additional fifteen percent ownership interest; the UAW Retiree Medical Benefit Trust (UAW Trust) received a seventeen percent stake plus a warrant to purchase 2.5 percent of the new company; the Treasury Department received a sixty-one percent stake; and the governments of Canada and Ontario received a twelve percent ownership interest.⁷³ The Treasury Department also received debt and preferred securities worth \$9.2 billion and extended a loan of up to \$30.1 billion.⁷⁴

The post-bankruptcy ownership of Chrysler is set forth in this diagram:



72. These figures assume that the warrants issued by GM are not exercised. See Gen. Motors Co., Registration Statement (Form S-1) (Aug. 18, 2010), available at <http://www.sec.gov/archives/edgar/data/1467858/000119312510192195/ds1.htm>.

73. COP REPORT, *supra* note 62, at 20–21.

74. *Id.*

The Treasury Department received a ten percent ownership stake in Chrysler; the governments of Canada and Ontario received a two percent ownership stake; Fiat received a twenty percent ownership interests with a right to raise its stake up to thirty-five percent of the company upon its achievement of certain milestone events; and the Chrysler Voluntary Benefit Employment Association received a sixty-eight percent stake. The Treasury Department also extended a new loan in the amount of \$8.5 billion to the post-bankruptcy Chrysler.⁷⁵

In both cases the Treasury Department maintained direct ownership of these interests and did not deposit them into a trust.⁷⁶ The Treasury Department also contractually agreed to forego direct control over each company.⁷⁷ The Treasury Department limited its right to appoint directors in a stockholder agreement to ten of the twelve directors in the case of GM.⁷⁸ However, the agreement required that two-thirds of the board be comprised of independent directors. After July 10, 2009, any new members appointed by the government were required to be independent.⁷⁹ Any subsequent directors would be appointed by these independent directors and not the government, though the government retained the right to vote against their election or remove them.⁸⁰ If the government removed a director, it could act to replace him or her with another independent director.⁸¹

In the case of Chrysler, the Treasury Department also negotiated a stockholders agreement providing it the right to ap-

75. OFS FINANCIAL REPORT 2009, *supra* note 57, at 35.

76. *See* COP REPORT, *supra* note 62, at 3 (suggesting that at least some consideration was given to placing these equity interests into an independent trust where they would be “insulated from political pressure and government interference”).

77. *Id.* at 29 (describing the relatively passive control the government maintained over the day-to-day decisions of the companies).

78. *Id.* at 15.

79. Stockholders Agreement § 2.2, Oct. 15, 2009, between General Motors Holding Company (to be renamed General Motors Company), United States Department of the Treasury, 7176384 Canada Inc., UAW Retiree Medical Benefits Trust & solely for purposes of Section 6.20, General Motors Company (to be converted to General Motors LLC) [hereinafter GM Stockholders Agreement], *available at* http://www.treasury.gov/initiatives/financial-stability/investment-programs/aifp/Documents_Contracts_Agreements/GM%20Corporate%20Docs.pdf.

80. For GM, the UAW Trust received one board seat, the Canadian government received one seat, and the U.S. government received ten seats. *Id.*

81. *See id.*

point three of the nine initial directors.⁸² Two of these directors were required to be independent and would pick a third independent director.⁸³ In Chrysler's case, the Treasury Department gave up its rights to remove or replace any of these directors. The independent directors on the board would replace them.⁸⁴ The board was also required to be independent until Fiat obtained majority control of the company.⁸⁵

In GM's case, the above arrangements were specifically set up to coincide with an initial public offering (IPO) of the company's stock.⁸⁶ The Automotive Task Force negotiated intricate governance mechanisms for post-IPO GM, but not Chrysler, which further restricted the government's ability to exercise control.⁸⁷ In the case of GM, the Treasury Department agreed to give up the vote on its shares except for key governance matters after an IPO, election and removal of directors, a sale or change of control of the company and any amendment to GM's certificate of incorporation or bylaws affecting such rights.⁸⁸ The Voluntary Employee Benefits Association divested itself of all voting rights agreeing to vote its shares proportionately both before and after an IPO.⁸⁹ In addition, the agreement provided for a joint slate nomination process after the IPO with the Canadian government in which both the Treasury Department and Canadian governments would attempt to jointly nominate directors after the IPO was consummated in proportion to their shares owned.⁹⁰ The Treasury Department also commit-

82. The other directors were appointed as follows: the UAW Trust received one board seat, the Canadian government entities one seat, and Fiat three seats rising to four seats (and replacing one government entity) when its ownership rose to thirty-five percent or above. See 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>.

83. Draft Form of Amended and Restated Limited Liability Company Operating Agreement § 5.3(d), May 12, 2009, New CarCo Acquisition LLC (on file with author).

84. *Id.* § 5.3.

85. *Id.* § 5.3(e).

86. See GM Stockholders Agreement, *supra* note 79, § 3.1 (establishing an IPO time frame consistent with the requirements mentioned earlier regarding board composition).

87. See *id.* (discussing voter agreement requirements).

88. *Id.*

89. *Id.* § 4.2(b).

90. *Id.*

ted to force GM toward an IPO by July 10, 2010, unless GM was already taking reasonable steps to effect one.⁹¹

The government again wielded great political influence over GM and Chrysler, both behind the scenes and overtly through other means.⁹² Even before this transaction, the Automotive Task Force had arranged the resignation of the GM and Chrysler CEOs.⁹³ The Treasury Department also put provisions in the automakers' financing documents to ensure that jobs stayed in the United States.⁹⁴ Similar to what occurred in the case of Citigroup, Congress acted overtly to influence the automakers and even legislatively reversed the automakers' attempts to shut down a number of automotive dealerships.⁹⁵ Post-investment, both automakers disclosed that they regularly consulted with the government on significant decisions.⁹⁶ Indeed, the Treasury Department acted under its registration rights agreement to cut back the number of shares sold in the GM IPO in order to attempt to secure a greater return.⁹⁷ Moreover, the Treasury Department's loan agreements contained rights to periodic financial information.⁹⁸ Much of this authori-

91. *Id.* § 3.1.

92. See Micheline Maynard, *The Steadfast Optimist Who Oversaw G.M.'s Long Decline*, N.Y. TIMES, Mar. 30, 2009, at B1, available at 2009 WLNR 5935410 (detailing a specific instance of influence over the automakers).

93. See *id.* (attributing Rick Wagoner's resignation to heavy pressure from the Obama Administration).

94. See GM 2008 Loan Agreement, *supra* note 61 (requiring that the agreement be construed in a way that "preserves and promotes the jobs of American workers employed directly by [GM] and in related industries"); see also RATTNER, *supra* note 63, at 240–41.

95. See William Ehart, *Spending Bill Lets Dealers Fight to Regain Chrysler Franchises*, WASH. TIMES, Dec. 16, 2009, at A1, available at 2009 WLNR 25326064.

96. See David Shepardson, *GM's Latest Plan Would Cede Control to U.S.*, DETROIT NEWS, Apr. 28, 2009, [http://detnews.com/article/20090428/AUTO01/904280361/GM-s-latest-plan-would-cede-control-to-U.S.](http://detnews.com/article/20090428/AUTO01/904280361/GM-s-latest-plan-would-cede-control-to-U.S;); see also Bill Vlasic, *In G.M.'s Comeback Story, a Pivotal Role Played by Washington*, N.Y. TIMES, Nov. 3, 2010, at B1, available at 2010 WLNR 21952943.

97. Nick Bunkley & Michael J. de la Merced, *U.S. Is Said to Rein in G.M. Stock Offering*, N.Y. TIMES, Sept. 24, 2010, at B1, available at 2010 WLNR 18994162.

98. For the details of these reporting requirements, see generally GM 2008 Loan Agreement, *supra* note 61 and GM 2008 December Form 8-K, *supra* note 61. See generally Loan and Security Agreement, Jan. 16, 2009, General Motors Corporation and U.S. Dep't of the Treasury [hereinafter GM 2009 Loan Agreement], available at http://www.treasury.gov/initiatives/financial-stability/investment-programs/aifp/Documents_Contracts_Agreements/Redacted%20LSA%20and%20Amendment%20and%20Termination%2001-16-09.pdf; Chrysler 2008 Loan Agreement, *supra* note 61.

ty, however, apparently originated from the Treasury Department rather than other government actors.⁹⁹

D. GMAC

On December 24, 2008, the Federal Reserve Board of Governors approved GMAC's application to become a bank holding company.¹⁰⁰ In connection with this approval, GMAC received a TARP investment under the Automotive Industry Financing Program.¹⁰¹ The Treasury Department purchased \$5 billion in preferred securities with an eight percent dividend and received a warrant to purchase preferred equity valued at \$250 million and with a nine percent dividend.¹⁰² The Treasury Department also extended GM a loan under the TARP program to fund GM's purchase of up to \$1 billion in additional equity in GMAC.¹⁰³ The GMAC investment was a purchase of nonvoting, cumulative preferred securities with an interest rate of eight percent.¹⁰⁴ Like other TARP CPP investments, the Treasury Department would only be entitled to appoint two directors (managers) of GMAC if the company missed six aggregate dividend payments.¹⁰⁵

In May 2009 the Automotive Task Force restructured the Treasury Department's investment. The Treasury Department purchased an additional \$7.875 billion in preferred securities in

99. As GM recovers financially, it has asserted its independence from the government, most notably by making the AmeriCredit acquisition against the Treasury Department's wishes. See Josh Kosman, *GM Drive-By Deal—AmeriCredit Acquisition Annoys Feds*, N.Y. POST, Sept. 7, 2010, at 25, available at 2010 WLNR 17771655.

100. See Emily Kaiser, *GMAC Gets Fed's OK to Become a Holding Company*, REUTERS, Dec. 24, 2008, available at <http://www.reuters.com/article/2008/12/24/us-financial-gmac-idUSTRE4BN4BL20081224>.

101. See Press Release, U.S. Dep't of the Treasury, Treasury Announces TARP Investment in GMAC (Dec. 29, 2008), available at <http://www.treasury.gov/press-center/press-releases/Pages/hp1335.aspx> (announcing the Treasury Department's TARP investment in GMAC).

102. See *id.*

103. GM 2009 Loan Agreement, *supra* note 98.

104. Securities Purchase Agreement annex A, Dec. 29, 2008, between GMAC LLC & U.S. Department of the Treasury [hereinafter GMAC December Investment Terms], available at http://www.treasury.gov/initiatives/financial-stability/investment-programs/aifp/Pages/initiatives/financial-stability/investment-programs/aifp/Documents_Contracts_Agreements/GMAC%20Agreement%20Dated%2029%20December%202008.pdf.

105. *Id.*

GMAC.¹⁰⁶ Part of this sum was provided to allow GMAC to assume the financing obligations of Chrysler Financial.¹⁰⁷ After this transaction, GMAC renamed itself Ally Financial.¹⁰⁸ The newly renamed company would provide financial services to both GM and Chrysler.¹⁰⁹ The Treasury Department also exercised rights it had under its loan to GM to convert this loan into a fifty-six percent ownership interest in GMAC (from a previous thirty-five percent ownership stake).¹¹⁰

On December 30, 2009, the Treasury Department's investment was restructured a third time. The Treasury Department purchased an additional \$2.54 billion in trust preferred securities yielding eight percent and \$1.25 billion in mandatory convertible preferred securities yielding nine percent which automatically converted to common stock after seven years.¹¹¹ At the same time, the Treasury Department also converted \$3 billion of its mandatory convertible preferred securities into GMAC common stock, which raised its ownership interest to 56.3 percent.¹¹² The remaining 43.7 percent of GMAC was held as follows: 16.6 percent of GMAC remained in the hands of GM, which put 9.9 percent of this interest into a trust.¹¹³ GM also agreed to sell these shares over a three-year period. Cerberus, GMAC's former controlling shareholder held the remaining shares, but distributed out 12.2 percent of these shares directly to investors in its relevant funds leaving Cerberus with a 14.9 percent interest.¹¹⁴

In connection with this third investment, the Treasury Department agreed that it would appoint four of the nine board

106. Glenn Somerville & Corbett Daly, *U.S. Pours \$7.5 Billion into Auto Lender GMAC*, REUTERS, May 21, 2009, available at http://www.reuters.com/article/2009/05/22/us-financial-gmac-capital-idUSTRE54K6NF20090522?feedType=RSS&feedName=businessNews&utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+reuters%2FbusinessNews+%28News+%2F+US+%2F+Business+News%29.

107. Master Transaction Agreement, *supra* note 71.

108. See Aparajita Saha-Bubna & Nathan Becker, *Ally to Phase Out GMAC Brand Name*, WALL ST. J., July 13, 2010, <http://online.wsj.com/article/SB10001424052748704518904575365273082277584.html>.

109. *Id.*

110. CONG. OVERSIGHT PANEL, MARCH OVERSIGHT REPORT: THE UNIQUE TREATMENT OF GMAC UNDER THE TARP 43 (2010) [hereinafter GMAC COP REPORT].

111. GMAC December Investment Terms, *supra* note 104, sched. A.

112. See GMAC COP REPORT, *supra* note 110, at 43.

113. See *id.* at 43 n.248.

114. *Id.*

members on the GMAC board.¹¹⁵ On December 29, 2009, the Treasury Department converted \$5.5 billion of the preferred securities to raise its stake in GMAC (now Ally Financial) to 73.8 percent.¹¹⁶ In connection with this increase in its ownership provision, the Ally board of directors was increased to eleven members and the Treasury Department became entitled under the stockholders agreement to appoint six members of this board.¹¹⁷

There was no independence requirement for these directors.¹¹⁸ The Cerberus affiliates and management also each designated one director.¹¹⁹ The remaining directors were required to be independent and were designated by the other directors with a requirement that at least one Treasury Department nominee concur.¹²⁰ The Treasury Department never established a trust to hold and vote the government's ownership interest, despite the government's earlier intimations. Indeed, the true control rights the government asserted over GMAC are unknown and the Congressional Oversight Panel (COP) has been particularly critical of the Treasury Department's management of this investment.¹²¹

Similar to the GM and Chrysler investments, the government also maintained a veto over certain material stockholder decisions such as a sale or the issuance of more senior debt or

115. This right existed so long as the Treasury Department held between fifty percent and 70.8 percent of GMAC. If the Treasury Department went above this threshold, the board size would increase to eleven members and the Department would become entitled to designate six members. *See* Amended and Restated Governance Agreement exhibit 10.2, May 21, 2009, between GMAC LLC, FIM Holdings LLC, GM Finance Co. Holdings LLC, and U.S. Department of the Treasury [hereinafter GMAC FIM Agreement], available at <http://www.sec.gov/Archives/edgar/data/40729/000119312509117131/dex102.htm>.

116. Maya Jackson Randall, *Treasury Converts \$5.5 Billion of Ally Preferred Stock*, WALL ST. J., Dec. 30, 2010, <http://online.wsj.com/article/SB10001424052748704543004576052241726394886.html>.

117. Ally Financial Inc., Current Report (Form 8-K) (Dec. 30, 2010), available at <http://www.sec.gov/Archives/edgar/data/40729/000119312510291571/d8k.htm>.

118. *See* GMAC FIM Agreement, *supra* note 115, exhibit 10.2 (requiring fewer independent managers as the Treasury Department's ownership increased).

119. *Id.*

120. *Id.*

121. *See* GMAC COP REPORT, *supra* note 110, at 2 (criticizing the "missed opportunities" to increase accountability and protect the taxpayer).

equity securities.¹²² Unlike the GM investment in this case, the government did not prenegotiate a postinvestment IPO date.¹²³

E. BANK OF AMERICA

The Treasury Department's initial investment in Bank of America was a \$25 billion purchase of preferred securities in connection with its \$125 billion investment in the nine largest financial institutions.¹²⁴ Bank of America would come more firmly under the government's foot when it controversially agreed to complete its acquisition of Merrill Lynch with the understanding that it would obtain additional government assistance.¹²⁵ On January 15, 2009, and after it had acquired Merrill Lynch, Bank of America received another \$20 billion investment from the Treasury Department under the TARP Targeted Assistance Program.¹²⁶ The Treasury Department also received warrants to purchase 150.3 million shares of Bank of America common stock in connection with both investments.¹²⁷

The Treasury Department never obtained control rights or equity ownership beyond its warrant interests in Bank of America. Nonetheless, as with its other investments, the government still wielded great influence. In connection with the acquisition of Merrill Lynch, Secretary of the Treasury Henry Paulson threatened to remove the CEO of Bank of America, Ken Lewis, and its board if they attempted to terminate the acquisition.¹²⁸ This threat came despite Paulson's lack of regulatory authority. Meanwhile, Bank of America's board was subsequently restructured at the government's behest and Mr.

122. GMAC FIM Agreement, *supra* note 115, at 10.

123. *Id.*

124. See Mark Landler, *U.S. Investing \$250 Billion to Bolster Banks; Dow Surges 936 Points*, N.Y. TIMES, Oct. 14, 2008, at A1, available at 2008 WLNR 19535647.

125. David Mildenberg & Bradley Keoun, *Bank of America to Acquire Merrill as Crisis Deepens (Update 4)*, BLOOMBERG, Sept. 15, 2008, http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a909JGOLdI_U.

126. David Goldman et al., *BofA: \$20B Bailout, Huge Merrill Loss*, CNNMONEY, Jan. 16, 2009, http://money.cnn.com/2009/01/16/news/companies/bofa_new_bailout/index.htm?postversion=2009011604.

127. Greg Robb, *U.S. Makes 1.54 Bln from Bank of America Warrants*, MARKETWATCH, Mar. 4, 2010, <http://www.marketwatch.com/story/us-makes-154-bln-from-bank-of-america-warrants-2010-03-04-90360>.

128. See Liz Rappaport, *Lewis Testifies U.S. Urged Silence on Deal*, WALL ST. J., Apr. 23, 2009, at A1, available at <http://online.wsj.com/article/SB124045610029046349.html?KEYWORDS=Lewis+Testifies+US+Urged+Silence+on+Deal> (discussing allegations that Mr. Paulson made such a threat).

Lewis resigned under government pressure.¹²⁹ The bank also came under special supervision pursuant to a secret memorandum of understanding among the bank, the Office of Comptroller of the Currency, and the Federal Reserve.¹³⁰

F. TARP RECIPIENTS

The final significant government investment was through the CPP. Seven hundred and seven financial institutions eventually participated.¹³¹ The Treasury Department purchased nonconvertible preferred securities at a discounted market rate that paid an initial dividend of five percent and a dividend of nine percent after five years.¹³² The Treasury Department also received warrants or their equivalent convertible into common stock equal to fifteen percent of the value of the investment.¹³³

The Treasury Department's control rights were quite limited. The preferred securities were initially nonvoting, except for limited voting rights in cases where more senior securities were authorized, the rights of the preferred security holders were amended, or the financial institution took any action to adversely affect the preferred securities.¹³⁴ If an issuer missed six dividend payments then the government received the right to appoint two directors.¹³⁵ The Treasury Department also negotiated protective provisions preventing dividends or other corporate maneuvers that would deprive the Treasury Department of its dividend payment. The preferred securities were redeemable by the company but did not contain a put feature allowing the Treasury Department to force the company to

129. Dan Fitzpatrick & Joann S. Lublin, *Bank of America Chief Resigns Under Fire*, WALL ST. J., Oct. 1, 2009, at A1, available at <http://online.wsj.com/article/SB125434715693053835.html?KEYWORDS=Bank+of+America+Chief+Resigns+Under+Fire>.

130. Dan Fitzpatrick, *BofA Seeks Sanction's End*, WALL ST. J., Aug. 6, 2010, at C1, available at <http://online.wsj.com/article/SB10001424052748704657504575411602370266826.html?KEYWORDS=BofA+seeks+sanction%27s+end>.

131. U.S. DEP'T OF THE TREASURY, TROUBLED ASSETS RELIEF PROGRAM (TARP): MONTHLY 105(A) REPORT 9 fig.5 (2010) [hereinafter TARP STATUS REPORT].

132. See U.S. DEP'T OF THE TREASURY, SUMMARY OF SENIOR PREFERRED TERMS, TARP CAPITAL PURCHASE PROGRAM: SENIOR PREFERRED STOCK AND WARRANTS, available at <http://www.treasury.gov/initiatives/financial-stability/investment-programs/cpp/Documents/termsheet.pdf>.

133. *Id.* at 4.

134. *Id.* at 3.

135. *Id.*

repurchase the shares.¹³⁶ The redemption provisions allowed for half the warrants to be cancelled if they were redeemed by December 31, 2009, and so created an incentive for banks to raise private capital before that date if it was economical for them to redeem the shares.¹³⁷

II. ASSESSING GOVERNMENT OWNERSHIP

Part I highlighted the diversity of government ownership during the financial crisis. No single investment was identical in structure or type. This Part sets forth the principles that the Bush and Obama Administrations announced to guide government ownership and assesses the government's adherence to these principles. It then concludes by critiquing the government's corporate governance arrangements. These investments were an economic achievement, but it is questionable whether the government's corporate governance decisions were in the public's best interests.

A. THE GOVERNMENT'S PRINCIPLES

1. Ex Ante Structuring Principles

In the midst of the panic of 2008, the only relevant guidelines for government investment were the EESA's mandate "to restore liquidity and stability to the financial system of the United States" and in doing so to "maximize . . . overall returns to the taxpayers of the United States."¹³⁸ This mandate was loose and subject to interpretation. Initially, the Bush Administration adopted no formal policies further outlining its approach. Officials, including Treasury Secretary Henry Paulson, would later assert that the government attempted to erect commercially negotiated ownership structures.¹³⁹ As the finan-

136. *Id.* at 4–5.

137. *Id.* at 5.

138. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 2, 122 Stat. 3765, 3766. The COP would later broadly interpret this mandate to include more general economic assistance, forming the basis of the bulk of the COP's criticism of TARP. See Steven M. Davidoff, *As TARP Fades, a Look at Its Flaws and Its Success*, N.Y. TIMES DEALBOOK (Sept. 17, 2010, 3:26 PM), <http://dealbook.nytimes.com/2010/09/17/as-tarp-expires-a-look-at-its-flaws-and-success/> (discussing these criticisms).

139. See HENRY M. PAULSON, ON THE BRINK: INSIDE THE RACE TO STOP THE COLLAPSE OF THE GLOBAL FINANCIAL SYSTEM 307–08, 337–38 (2010) (explaining why the government preferred a hands-off ownership approach and why it chose to invest in preferred stocks rather than simply buying "toxic assets" or common stock, which came with voting rights); RATTNER, *supra* note

cial crisis progressed, the Obama Administration formalized these principles in a memorandum written by Diana Ferrell, Deputy Director of the National Economic Council. The memo advocated the two-stage approach discussed in the introduction: investments should initially be structured on commercial terms; thereafter, the government would take a hands-off commercial approach.¹⁴⁰

Then, on March 30, 2009, the Obama White House issued a press release in connection with the GM bankruptcy, stating:

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. When necessary, these conditions may include restructurings similar to that now underway at GM as well as changes to ensure a strong board of directors that selects management with a sound long-term vision to restore their companies to profitability and to end the need for government support as quickly as is practically feasible.¹⁴¹

The GM press release was the first time the government had publicly announced any policy with respect to the preinvestment structuring of its financial crisis investments. The release also marked a reversion from the commercial approach officials initially described.¹⁴² Instead of commercial arrangements, the GM press release asserted that the government's goals were to "protect taxpayers, promote financial stability and encourage growth."¹⁴³ None of these involved commercial terms in the investment itself; instead, these were general goals consistent with the government's desire to act in ways benefitting the entire economy rather than any individual company. The only wealth-maximizing statement with respect to the actual investments was to the effect that the government's goal was to "restore their companies to profitability and to end the need for government support as quickly as is practically feasible."¹⁴⁴ In other words, the government was more interested in exiting these investments promptly than in earning a re-

63, at 132 (quoting President Obama as stating he wanted Chrysler assistance to be "tough" and "commercial").

140. ALTER, *supra* note 63, at 184.

141. Press Release, General Motors Restructuring, *supra* note 2; *see also* OFS FINANCIAL REPORT 2009, *supra* note 57, at 42 (listing the government's four "principles to guide its actions as a common shareholder").

142. *Cf.* PAULSON, *supra* note 139 (describing the initial desire for a commercial approach).

143. Press Release, General Motors Restructuring, *supra* note 2.

144. *Id.*

turn. For example, the instrument for the AIG trust referred only to the Federal Reserve and the Treasury Department being repaid their investments; it did not mention a return.¹⁴⁵

This press release was in reality a statement of the principles the Bush and Obama Administrations followed even prior to that time when structuring their investments. The government did periodically operate as a commercial actor. The AIG bailout was modeled on a privately negotiated financial assistance package.¹⁴⁶ The government's private commercial aspirations, though, were often superseded by public considerations. For example, the CPP program extended preferred financing to the financial sector on generous terms in order to foster financial stability.¹⁴⁷

The Treasury Department and other government agencies did largely adhere to the Bush and Obama Administrations' commitment to restructure management and boards of directors. The CEOs of AIG, Chrysler, Fannie Mae, Freddie Mac, General Motors, and GMAC were all replaced in connection with the government's investment.¹⁴⁸ The boards of all of these companies, as well as Bank of America's and Citigroup's, were also significantly restructured.¹⁴⁹ In particular, the government encouraged the appointment of strong board chairmen as a

145. See AIG Trust Agreement, *supra* note 18 (outlining the nonbinding views of the Federal Reserve Bank of New York that the voting power of the "Trust Stock" should be exercised with an eye toward benefitting the public).

146. See Sjostrom, Jr., *supra* note 7, at 964 (describing the package in detail). Fannie and Freddie were also designed to mimic a commercial transaction although the government did not attempt to wipe out the GSE's senior-preferred stockholders or secured debt for political and economic reasons.

147. See René M. Stulz & Luigi Zingales, *The Financial Crisis: Comments and Discussion an Inside View*, in BROOKINGS PAPERS ON ECONOMIC ACTIVITY, 1, 67 (2009); Lei Li, TARP Funds Distribution and Bank Loan Growth, 7 (June 21, 2010) (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1515349 ("To encourage banks to participate in CPP, the Treasury made the terms of CPP investments quite attractive.")

148. See Dan Fitzpatrick & David Enrich, *GMAC Chief Ousted by Board*, WALL ST. J., Nov. 17, 2009, at A1, available at <http://online.wsj.com/article/SB10001424052748704538404574540032497128084.html> (reporting the firing of GMAC CEO Alvaro de Molina); *supra* notes 27–28, 92 and accompanying text.

149. See Eric Dash, *As It Works to Find Its Stride and Renew Confidence, Citigroup Shuffles Its Board*, N.Y. TIMES, Feb. 27, 2010, at B3, available at 2010 WLNR 4145189; Stephen Labaton & Andrew Ross Sorkin, *U.S. Rescue Seen at Hand for Two Mortgage Giants*, N.Y. TIMES, Sept. 6, 2008, at A1, available at 2008 WL 16910682; *supra* notes 23–25, 76–81, 105, 118 and accompanying text.

counterweight to the CEO influence.¹⁵⁰ The government did at times act politically and less than effectively in these restructurings—particularly with the automakers. But in large part the government acted in accordance with its principles to replace and restructure the companies in which it made significant investments.

The government's failure to negotiate full commercial terms resulted in significantly diminished returns on its investments.¹⁵¹ In particular, the Treasury Department generally eschewed taking equity in institutions.¹⁵² It only did so in extreme circumstances or if the post-investment capital structure of the company could not tolerate other securities.¹⁵³ The TARP warrant requirements were only inserted at the insistence of Congress.¹⁵⁴ Some investments such as those in Bank of America and Chrysler Financial were deliberately structured so that the government did not take an equity interest.¹⁵⁵ Consequent-

150. See, e.g., Bill Vlasic, *G.M. Chairman Vows to Defend Market Share*, N.Y. TIMES, Aug. 5, 2009, at B1, available at 2009 WLNR 15091209 (detailing the objectives of GM's board, over half of which was chosen by the government, and which aimed to get the company's management to repay the U.S. taxpayers for their financial assistance); Alistair Barr, *AIG CEO Wins Power Struggle as Chairman Resigns*, MARKETWATCH, July 15, 2010, <http://www.marketwatch.com/story/aig-gets-new-chairman-golub-resigns-after-spat-2010-07-15> (detailing the conflicts between AIG's chairman and CEO).

151. Jeffrey McCracken et al., *Chrysler Financial's Value Jumped 33% After U.S. Exit*, BLOOMBERG, Dec. 22, 2010, available at <http://www.bloomberg.com/news/2010-12-22/chrysler-financial-value-jumped-33-after-u-s-exit-cerberus-s-sale-shows.html>.

152. See, e.g., Press Release, U.S. Dep't of the Treasury, Treasury Department Releases Text of Letter from Secretary Geithner to Hill Leadership on Administration's Exit Strategy for TARP (Dec. 9, 2009) [hereinafter Dep't of the Treasury Press Release], available at <http://www.treasury.gov/press-center/press-releases/Pages/tg433.aspx>.

153. In cases such as Bank of America and Chrysler Financial the government deliberately decided to avoid an equity stake. See *supra* note 75 and accompanying text (Chrysler), and *supra* note 128 and accompanying text (Bank of America).

154. 154 CONG. REC. H10712-02 (daily ed. Oct. 3, 2008) (statement of Rep. Barney Frank). Congress also directed the Treasury Department not to vote with any stock it may acquire, pursuant to these warrants. See Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 113(d)(1)(A), 122 Stat. 3765, 3778.

155. In the case of Chrysler Financial, the Treasury Department extended a TARP Automotive Industry Financing Program loan on January 16, 2009, for \$1.5 billion. The mandatory warrants issued in connection with this transaction, however, were for additional notes to be issued by the special purpose vehicle. See Press Release, U.S. Dep't of the Treasury, Treasury Announces TARP in Chrysler Financial (Jan. 16, 2009), available at <http://www.treasury.gov/press-center/press-releases/Pages/hp1362.aspx>.

ly, when the market rebounded, the government did not reap as significant gains as it otherwise could have.¹⁵⁶

The Treasury Department's "regulation by deal" approach also encouraged drift from purer commercial principles.¹⁵⁷ Each investment was negotiated as a unique enterprise due to differing legal, political, and commercial factors.¹⁵⁸ This approach was partly unavoidable due to the circumstances of the rescue and the government's limited statutory authority. But it encouraged an excessive amount of dealmaking—dealmaking that provided the government latitude to bestow private benefits to stakeholders and outside parties.¹⁵⁹

Despite the heterogeneous nature of its investments and the implementation problems described above, the government largely met its self-announced goal to "encourage financial stability."¹⁶⁰ These investments were part of a broader program that succeeded in halting the financial panic.¹⁶¹ The government's success in meeting these principles was largely due to their definitional breadth. These successes say nothing of the legitimacy of the underlying principles.

2. Ex Post Facto Structuring Principles

The government adopted principles to govern its conduct *after* its investments as well.¹⁶² In these circumstances, the government took great pains to forfeit control over these corporate enterprises. In its monthly TARP reports the Treasury Department regularly reiterated that it would vote its shares only with respect to the election or removal of directors and other significant matters, but would otherwise abstain from voting.¹⁶³

This policy was largely in line with the post-investment principles that the Treasury Department announced when it

156. McCracken et al., *supra* note 151.

157. *See infra* notes 205–31.

158. *See, e.g.*, RATTNER, *supra* note 63, at 120–23.

159. *See* Steven M. Davidoff, *Valuing Ally Financial*, N.Y. TIMES DEALBOOK (Jan. 3, 2011, 9:05 AM), <http://dealbook.nytimes.com/2011/01/03/valuing-ally-financial/> (discussing how different government actions might have resulted in large benefits for taxpayers rather than private investors).

160. *See infra* notes 191–92 and accompanying text.

161. *See infra* notes 191–92 and accompanying text.

162. *See, e.g.*, Press Release, General Motors Restructuring, *supra* note 2 (articulating standards for the Treasury Department's conduct post-acquisition).

163. TARP STATUS REPORT, *supra* note 131, at 23; *see also* Dep't of the Treasury Press Release, *supra* note 152.

announced the GM bankruptcy. At that time, the Treasury Department stated:

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. The government will not interfere with or exert control over day-to-day company operations. No government employees will serve on the boards or be employed by these companies.¹⁶⁴

In practice, the government, including the Treasury Department, surpassed these principles. In its AIG, Bank of America, Chrysler, Citigroup, GM, and GMAC investments, the government deliberately ceded even more control than this policy envisioned.¹⁶⁵

In some measure, the varying approaches were due to the government's shifting policies as the financial crisis progressed and presidential Administrations changed. The Bush Administration settled upon and implemented the complete forfeiture of control in the case of AIG.¹⁶⁶ It was also the only ownership interest held by the Federal Reserve. But this policy changed at some point. The Obama Administration's Treasury Department refrained from the use of trust mechanisms and otherwise retained the right to appoint directors in instances where it obtained majority control.¹⁶⁷ Even then, however, the Obama Administration adopted mechanisms to deprive it of majority control in the case of GMAC.¹⁶⁸ The government's aversion to control thus continued throughout the financial crisis.

Why did the Treasury Department take such extreme steps? Why did it even feel the need to divest itself of control at all? The government never directly answered these questions, and the subject is a topic for an entire book.¹⁶⁹ The summary answer likely involves a mixture of ideological, political, and practical rationales. First, we live in a society that almost uniformly understands itself as capitalist.¹⁷⁰ Whether or not one

164. Press Release, General Motors Restructuring, *supra* note 2.

165. See generally Davidoff & Zaring, *supra* note 1 (discussing government attempts to handle the effects of the financial crisis).

166. The trust instrument specifically stated that it was established "to avoid any possible conflict with [the New York Fed's] supervisory and monetary policy functions." AIG Trust Agreement, *supra* note 18.

167. See Black, *supra* note 5, at 592 (explaining that the Treasury Department only acquired the right to appoint four of nine directors).

168. See Verret, *supra* note 4, at 295–96.

169. See generally RATTNER, *supra* note 63, *passim*.

170. "Capitalism" Not So Sacred to Americans as Mood Sours, BUS. WK., July 13, 2010, <http://www.businessweek.com/news/2010-07-13/-capitalism-not>

believes that state ownership of enterprise can legitimately exist in a capitalist environment, the American public defines capitalism in a manner that excluded this possibility.¹⁷¹ Under most political theories, the Bush and Obama Administrations were incentivized to cater to a viewpoint held by almost all interest groups.¹⁷² Conservative commentators repeatedly tagged the Obama Administration in particular with the mantra of socialism.¹⁷³ By committing to quickly dispose of these entities and exercise little control, the Obama Administration could attempt to dispel this stigma.

Second, the government's position also had a real wealth-maximizing benefit. The government's position limited undue, wealth-destroying political influence beyond the Treasury Department and presidential administration.¹⁷⁴ It also jibed with the apparent economic beliefs of Henry Paulson, Timothy Geithner, and Larry Summers that these businesses should not be politicized.¹⁷⁵ Indeed, Geithner and Summers adopted this ethos during the currency and country financial crises of the 1990s.¹⁷⁶ The specter of politicization in the financial crisis was a real threat as politicians repeatedly attempted to influence or act legislatively to operate these entities.¹⁷⁷ Market actors also appeared to view the government's forfeiture of control as re-

-so-sacred-to-americans-as-mood-sours.html (noting that seventy percent of Americans support free enterprise and free markets).

171. See Anthony Faiola, *The End of American Capitalism?*, WASH. POST, Oct. 10, 2008, available at <http://www.washingtonpost.com/wp-dyn/content/article/2008/10/09/AR2008100903425.html> (noting the intensely hands-off approach of government in American capitalism).

172. Gregory P. Magarian, *Market Triumphalism, Electoral Pathologies, and the Abiding Wisdom of First Amendment Access Rights*, 35 HOFSTRA L. REV. 1373, 1414 (2007) (noting that due to our political process, interest groups can "capture" elected officials).

173. See, e.g., *Glenn Beck: Barack Obama, Socialist?* (Fox News television broadcast Apr. 6, 2010) ("But if you're into redistribution of wealth, I'm sorry, but that is a Marxist principle . . . Marx said that. Madison never said that. Our Founders all warned against that. They didn't think it was better to 'spread the wealth around.'"), transcript available at <http://www.foxnews.com/story/0,2933,590532,00.html>.

174. See Press Release, General Motors Restructuring, *supra* note 2.

175. Cf. ROBERT RUBIN & JACOB WEISBERG, IN AN UNCERTAIN WORLD: TOUGH CHOICES FROM WALL STREET TO WASHINGTON 14–16 (2003) (expressing surprise about political opposition to assisting Mexico during its financial crisis).

176. *Id.*

177. Verret, *supra* note 4, at 296 ("[T]he President's Auto Task Force determined that Chrysler's restructuring plan was not likely to permit it to emerge from bankruptcy, and pressured Chrysler to arrange a merger deal with Fiat.").

storing faith in the troubled companies and in capitalism generally.¹⁷⁸

In contrast to the mixed adherence to its control principles, the government rigorously followed its stated goal to quickly (as soon as practicable) disentangle itself from the private sector. At the time of this writing, the government has already disposed of its Citigroup shares and orchestrated an initial public offering for GM.¹⁷⁹ In addition, the Federal Reserve and Treasury Department effectively encouraged financial institutions to repay TARP money as soon as possible.¹⁸⁰ The Treasury Department struggled mightily to end its other programs with similar haste.¹⁸¹ Though the calculation is uncertain, it appears that this effort diminished the returns the government otherwise could have received from its investments.¹⁸² This headlong rush to dispose of these interests was again a product of the same factors that led the government to deliberately forego control over its investments.¹⁸³

B. ASSESSING THE GOVERNMENT'S CORPORATE GOVERNANCE ARRANGEMENTS

The Treasury Department and other government agencies adopted a bifurcated approach to corporate governance. At the time of its investment, the government repeatedly acted to remove and replace executives and restructure boards of directors.¹⁸⁴ Afterwards, the government took great pains to divest itself of day-to-day control, or even any direct control.¹⁸⁵

The government's approach appeared to be successful. It largely exited from these investments with an economic return,

178. Clare Baldwin & Soyoung Kim, *GM Shares Lose Momentum in Post-IPO NYSE Return*, REUTERS, Nov. 18, 2010, available at <http://www.reuters.com/article/2010/11/18/us-gm-ipo-idUSTRE6AB43H20101118?pageNumber=2> (noting that the GM IPO points toward renewed confidence in the industry).

179. Michael de la Merced & Bill Vlasic, *U.S. Recovers Billions in Sale of G.M. Stock*, N.Y. TIMES, Nov. 17, 2010, at A1, available at 2010 WLNR 22969625.

180. Edmund L. Andrews, *Calling on Big Banks to Repay Bailout Now*, N.Y. TIMES, Oct. 15, 2009, at B1, available at 2009 WLNR 20328304.

181. See Michael J. de la Merced, *Picking Up Pieces of the Bailout Stock Sale Action*, N.Y. TIMES DEALBOOK (Feb. 4, 2011, 4:42 PM), <http://dealbook.nytimes.com/2011/02/04/picking-up-pieces-of-the-bailout-stock-sale-action/?src=dlbksb>.

182. See McCracken et al., *supra* note 151.

183. See *supra* notes 165–79 and accompanying text.

184. See Sterngold & Christie, *supra* note 24.

185. See generally Davidoff & Zaring, *supra* note 1 (discussing government attempts to handle the effects of the financial crisis).

and the companies themselves returned to profit. For example, the government has made \$22 billion on the \$85 billion it invested in AIG during the financial crisis.¹⁸⁶ The net loss from the entire TARP program is currently estimated by the COP to be \$66 billion.¹⁸⁷ Compare these figures to some early predictions that the United States would lose the \$700 billion initial EESA investment commitment and be required to expend additional sums to alleviate the financial and banking crisis.¹⁸⁸ In addition, the Treasury Department obtained more money than it invested with respect to Bank of America, Citigroup, and the 707 CPP recipients on the whole.¹⁸⁹ With respect to AIG, GM, and GMAC, the government is likely to recover near its total investment. Chrysler is an unknown at this time but is likely to result in a significant loss. The real aggregate loss from these investments is probably, at worst, less than one percent of the gross domestic product of the nation.¹⁹⁰ This is a small sum to pay to halt a running financial panic and credit crisis.

The Treasury Department's ex ante restructurings were effective,¹⁹¹ but it remains unknown how these post-transaction structures worked in actuality. The governance mechanics of these entities and the government's interaction with the company's management and boards remain largely undisclosed. We must await the historians and journalists to write a record of what occurred behind the scenes to definitively assess how the Treasury Department's corporate governance decisions functioned. In particular, without knowledge of the internal workings of these companies during that time, we do not know the impact of the administrations' soft control of these investments.

186. Editorial, *Our View on TARP: Hated Bank Bailout Is About to Turn a Profit*, USA TODAY, Feb. 8, 2011, available at http://www.usatoday.com/news/opinion/editorials/2011-02-09-editorial09_ST_N.htm.

187. CONG. OVERSIGHT PANEL, SEPTEMBER OVERSIGHT REPORT: ASSESSING THE TARP ON THE EVE OF ITS EXPIRATION 108 (2010) (citation omitted); Douglas Elmendorf, *CBO's Latest Projections for the TARP*, CONG. BUDGET OFF. DIRECTOR'S BLOG (Aug. 20, 2010, 10:06 AM), <http://cboblog.cbo.gov/?p=1322>.

188. Paul Craig Roberts, *A Futile Bailout as Darkness Falls on America*, DAILY TIMES, Oct. 8, 2008, http://www.dailytimes.com.pk/default.asp?page=2008\10\08\story_8-10-2008_pg5_47 ("As the economy declines and mortgage default rates rise, the US Treasury and the American taxpayers could end up with a \$700 billion loss.").

189. See Editorial, *supra* note 186.

190. See Sewell Chan, *In Study, 2 Economists Say Intervention Helped Avert a 2nd Depression*, N.Y. TIMES, July 28, 2010, at B8, available at 2010 WLNR 14973281.

191. See CONG. OVERSIGHT PANEL, *supra* note 187, at 22.

The Treasury Department may have been so willing to give up direct control because it still exercised significant force behind the scenes.¹⁹² We do not yet know how the deliberations played out within each administration.

Assessments are also difficult because the Treasury Department's negotiated governance mechanisms were divergent in practice.¹⁹³ While it is clear that issues arose with unique companies and particularly AIG, it is still unknown if any particular control mechanism worked better than others. In other words, and with respect to the government's significant investments: did the trust mechanism provide greater "space" to AIG to restructure and perform on a more economical basis than independent directors? When independent directors were appointed, did this mechanic work better when the government appointed a majority of these directors or when more commercial investors were present, as in the case of Fiat and the Chrysler board? Even once more information about these governance mechanisms becomes available, our comparative assessment will be hampered because these divergent arrangements were never truly tested.

There are some indicia that the government was able to assert effective restructurings through soft control and through its independent director and trustee governance mechanisms.¹⁹⁴ The government's lack of formal control also served to be a useful political device to provide cover for the government's actions or inaction with respect to these companies.¹⁹⁵

192. The government's power in the case of financial institutions was also buttressed by the regulatory control the government asserted through the stress tests and other regulatory supervisory powers. Edmund L. Andrews & Eric Dash, *Treasury Sets Out Bank Test Guidelines*, N.Y. TIMES, Feb. 26, 2009, at B1, available at 2009 WLNR 3695725.

193. See generally Davidoff & Zaring, *supra* note 1 (outlining the different government responses employed during the financial crisis).

194. See *supra* note 192 and accompanying text.

195. The best example of this occurred when the country erupted in fury over the payment of \$165 million to employees at AIG Financial Products, the AIG subsidiary that originated the derivative products that felled the company. President Obama ordered Treasury Secretary Timothy Geithner "to use that leverage and pursue every single legal avenue to block these bonuses and make the American taxpayers whole." *Obama Tells Geithner to Block A.I.G. Bonuses*, N.Y. TIMES DEALBOOK (Mar. 16, 2009, 12:50 PM), <http://dealbook.blogs.nytimes.com/2009/03/16/obama-tells-geithner-to-block-aig-bonuses/>. However, Larry Summers, head of the National Economic Council, would later claim that this could not be accomplished due to legal limitations and the lack of government control over AIG. Henry Blodget, *Larry Summers' Ludicrous View on*

This lack of control, but continued ownership, nonetheless imposed its own costs. For example, AIG executives at times adopted an us-versus-them approach. The general counsel of AIG attempted to organize a mass executive resignation to protest the TARP compensation requirements.¹⁹⁶ Employees at other firms such as Citigroup also often took public stands against the government.¹⁹⁷ It also appears that the government's lack of direct control and power over executive compensation allowed these entities to pay undue amounts to their employees at the government's expense.¹⁹⁸ Failure to exercise control meant that in many cases government policies, such as home ownership and small business loan programs, were not implemented to the full extent the government may have wished.¹⁹⁹ In other cases, it meant that these corporate enterprises failed to take business decisions the government otherwise viewed as commercially preferable.²⁰⁰

The success or failure of the government's approach was never truly publicly tested. Instead, the economic upturn caused by other government programs and the Treasury Department's quick exit from the majority of these enterprises meant that the government never was directly opposed by the boards of these companies. The government's corporate governance mechanisms were largely untested. Nonetheless, the quick exit of many companies from government ownership provides some evidence and a caveated conclusion that the government's approach to control functioned to its stated effect.²⁰¹

The evidence is more robust with respect to the government's more commercial pre-ownership restructurings than its

AIG Bonuses, HUFFINGTON POST (Mar. 17, 2009, 1:34 PM), http://www.huffingtonpost.com/henry-blodget/larry-summers-ludicrous-v_b_175867.html.

196. See Debra Cassens Weiss, *AIG GC Reportedly Threatens to Resign if Pay Czar Cuts Her Compensation*, A.B.A. J., Dec. 8, 2009, http://www.abajournal.com/news/article/aig_gc_reportedly_threatens_to_resign_if_pay_czar_cuts_her_compensation/.

197. For an example of tension between Citigroup and the U.S. government, see Krishna Guha & Francesco Guerrero, *Treasury Pushes Citi to Cancel Jet Order*, FIN. TIMES, Jan. 27, 2009, <http://www.ft.com/cms/s/0/e4093646-eca6-11dd-a534-0000779fd2ac.html#axzz1DTzm6WKk>.

198. Steven Rattner, for example, writes of the post-restructuring GM and its initial failures to continue the reorganizing measures he advocated. RATTNER, *supra* note 63, at 253.

199. See, e.g., *id.* at 273–87 (discussing GM's failure to sell GM's German division, Opel).

200. *Id.*

201. See Editorial, *supra* note 186.

continued ex ante operation and ownership of these companies. The government may have signaled its own dissatisfaction with its corporate governance arrangements in its 2010 restructurings of AIG and GMAC. In the case of AIG, the Treasury Department abandoned trust and independent director mechanisms in favor of direct control.²⁰² Similarly, at the end of 2010 the Treasury Department raised its stake in GMAC and obtained the right to appoint a majority of GMAC's directors without an independence requirement.²⁰³

III. LESSONS FOR FUTURE GOVERNMENT OWNERSHIP

The government's ownership experience resulted in a relatively small economic loss.²⁰⁴ But as noted in Part II, this success—due in significant part to other government actions—may have otherwise obscured defects in the government's approach. This Part attempts to draw some lessons from the ownership experience. Part III first discusses the theoretical implications of the government's ownership experience and then turns to more practical lessons.

A. GOVERNMENT OWNERSHIP AND CORPORATE GOVERNANCE THEORY

The economic and political literature on state-owned enterprises is thick, but it is almost exclusively devoted to long-term, intentional ownership of private entities.²⁰⁵ In the financial crisis, ownership—forced unwillingly on the government—was episodic. Theoretical observations are thus more aptly confined to dealmaking and corporate design. In the dealmaking realm, the government structured one-off solutions to each enterprise, negotiating agreements within the law and the prior contractual arrangements that bound the parties.²⁰⁶

202. Davidoff & Zaring, *supra* note 1, at 497–98.

203. See David Welch, *GMAC Chairman Merkin: On the Way Out*, BUS. WK., Dec. 31, 2008, http://www.businessweek.com/bwdaily/dnflash/content/dec2008/db20081231_175310.htm.

204. See McCracken et al., *supra* note 151.

205. For a discussion of this theory, see generally D. Daniel Sokol, *Competition Policy and Comparative Corporate Governance of State-Owned Enterprises*, 2009 B.Y.U. L. REV. 1713.

206. See generally Davidoff & Zaring, *supra* note 1 (discussing the government's response to the financial crisis as taking on a "dealmaker" role, and detailing the approach taken by the government in some specific incidents).

Corporate design in the financial crisis was a different beast than ordinary, private models of investment.²⁰⁷ Theorizing about this ownership within existing corporate archetypes is difficult.²⁰⁸ The government's ownership during the financial crisis simply did not fit exclusively within any existing corporate ownership typology.²⁰⁹ Nor did the government's ownership model fit within a corporatism or director primacy framework.²¹⁰

The government asserted that it acted akin to a private equity firm in adopting hands-off governance models post-investment.²¹¹ But private equity firms are defined by the control they assert post-acquisition through which they eliminate many of the agency costs associated with public, dispersed ownership.²¹² The government may have acted like a private equity firm prior to obtaining control, but its forfeiture of post-ownership control instead appears to be more akin to an institutional investor. Like an institutional investor, the government relied on extrinsic market forces and norms to ensure that it could continue to exert control over these entities after acquisition of ownership.²¹³

The analogy with an institutional investor also breaks down though, because the government did not have the same exit potential as these investors. If the institutional investor disagrees with management, it typically has the option of selling its investment in the public market.²¹⁴ The government did not have this alternative, at least at the time it made these investments. In some cases, the entities in which the government invested were private, which eliminated a public-sale option altogether.²¹⁵ But even for investments in public companies, the government was effectively barred from selling its stakes during the financing crisis. The sale of a significant stake (or even a small stake) in a public entity like Citigroup would likely

207. Verret, *supra* note 4, at 285.

208. *Id.*

209. *Id.*

210. *Id.*

211. ALTER, *supra* note 63, at 184.

212. Davidoff & Zaring, *supra* note 1, at 539.

213. *See id.* at 538–40.

214. Black, *supra* note 5, at 585 (noting government sales of private stocks).

215. *Id.* at 573; *see also* Aaron Elstein, *Largest U.S. Privately Held Bank Still Hasn't Paid Back TARP Loan*, INVESTMENT NEWS, Feb. 28, 2010, at 18, available at 2010 WLNR 4498809.

have spurred further market distress, thus undermining the very purpose of the government's investments.²¹⁶

In the private context, comparisons with institutional investor governance are less appropriate due to the government's reliance on independent directors.²¹⁷ In the public sphere, independent directors are increasingly the norm as well as a regulatory requirement under stock exchange rules.²¹⁸ However, the same market pressures which act as a force on independent directors in public companies are absent in the private sphere.²¹⁹ There are no stockholder activists, analysts, stock price movements, or ratings agencies for a private company.

The government at times also acted like a venture capitalist.²²⁰ A venture capitalist often foregoes direct governance rights but exercises power through the ability to withhold later, necessary capital.²²¹ Though the government's investments were initially structured along these lines, the government subsequently attempted to invest on the assumption that no further capital would be needed.²²² Part of the reason why the government was forced to continuously restructure many investments was that each one was structured as a complete and final investment. When circumstances changed, the government lacked the flexibility to adjust its investments without entirely restructuring them.²²³

Government corporate ownership during the crisis ultimately did not fit neatly into any single-investor model.²²⁴ Government ownership also did not fit within any unifying theory

216. See Nicole Bullock et al., *Trading Goes Wild on Wall Street*, FIN. TIMES, May 7, 2010, <http://www.ft.com/cms/s/0/0cbdc2-5966-11df-99ba-00144feab49a.html#axzz1DTzm6WKK> (citing a rumor "that a Citigroup trader had typed 'billions' instead of 'millions' . . . prompting . . . panic selling").

217. Solomon & Enrich, *supra* note 49 (noting that the Treasury Department called for the appointment of independent directors to Citigroup's governing board).

218. Black, *supra* note 5, at 566–67.

219. See *id.* at 567 (discussing the effects of shareholders and other stakeholders on independent directors).

220. Davidoff & Zaring, *supra* note 1, at 538–41.

221. *Id.*

222. *Cf. id.* at 540–41 (noting that the a model the government adopted in the bailouts intentionally hindered further investment by the Treasury Department, presumably for political reasons).

223. See *id.*

224. See generally *id.* (discussing the various forms of government corporate ownership coming out of the financial crisis).

of corporate governance.²²⁵ In the initial stages of the financial crisis, some theorists postulated that the government had taken a corporatist turn.²²⁶ The state had entered a new era of progressivism, using its power and influence to direct and shape corporations. However, the government deliberately deprived itself of its corporatist overtones through its formal ownership arrangements.²²⁷ It may have exercised a measure of control through soft and regulatory-supervisory powers, but in its contractual arrangements the government divested itself of control.²²⁸ Even this exercise of indirect control was a direct product of the financial crisis and accompanying panic. As the crisis and panic dissipated, companies' reliance on the government for survival faded, and the Treasury Department's ability to interfere with companies diminished.²²⁹ Corporatism may have thrived in other areas of the U.S. economy during this time, but in the arena of government ownership it was a fleeting affair.²³⁰

Nor does the government's conduct provide significant support for the director primacy model.²³¹ The Treasury Department utilized independent directors to govern its corporate investments.²³² In its main formulation, the efficacy of this theory relies on the forces of public markets to hold directors accountable. These forces did not exist for the government's main investments.²³³ The Treasury Department's control struc-

225. *Id.* at 540 (“[T]he government’s deals looked quite different from traditional privately negotiated deals.”).

226. See William W. Bratton & Michael Wachter, *Shareholder Primacy’s Corporatist Origins: Adolf Berle and The Modern Corporation*, 34 J. CORP. L. 99, 103 (2008) (“Corporatism implies a radical restatement of the purpose of the business corporation But it does this only at the threshold, the point at which corporations come to the state-directed table where the groups determine the public interest.”).

227. See Press Release, General Motors Restructuring, *supra* note 2.

228. See *supra* notes 182–83 and accompanying text.

229. See, e.g., Josh Kosman, *GM’s AmeriCredit Acquisition Irks Feds*, N.Y. POST, Sep. 7, 2010, at 25, available at 2010 WLNR 17771655.

230. See generally DAVID SKEEL, *THE NEW FINANCIAL DEAL* (2011) (discussing the corporatist nature of the Dodd-Frank reforms).

231. See Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 550 (2003) (“[D]irector primacy claims that shareholders are the appropriate beneficiaries of director fiduciary duties. Hence, director accountability for maximizing shareholder wealth remains an important component of director primacy.”).

232. Black, *supra* note 5, at 569.

233. Chrysler, GM, and GMAC all became privately held companies. See Verret, *supra* note 4, at 295.

tures or lack thereof were also never tested. Its performance is thus at best an endorsement—rather than a validation—of independent directors.

Despite the lack of validation for corporatist and director primacy governance theories, the government's ownership provides measured support for a social norms theory of corporate governance. Jonathan Macey argues that what we often call fiduciary duties do not have the force of law.²³⁴ Rather, they are simply promises which are kept and enforced through social norms.²³⁵ The government may have forfeited formal control because it could still exert sufficient control through the board's adherence to norms.²³⁶ These norms themselves may have been strengthened due to the presence of the government and notions of civic duty associated with it.²³⁷ It appears that the government was relying more on a "norms" theory of board governance than a director primacy one.

In the wake of the financial crisis, the effectiveness of these norms remains unclear. Reports arose of dissension among the AIG board and its executives against government control.²³⁸ Citigroup and other entities rushed to remove themselves from TARP executive compensation restrictions.²³⁹ GM referred to its need to escape government ownership and its nickname of "Government Motors" for commercial purposes.²⁴⁰ The Administration expressed frustration with the management of Bank of America and Citigroup about their lending practices.²⁴¹ Without more information about the internal workings of the company's governance, however, the best we can conclude at

234. See JONATHAN R. MACEY, *CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN* 22–23 (2010).

235. *Id.*

236. For an alternative source of soft power, consider *supra* note 192 and accompanying text.

237. See MACEY, *supra* note 234, at 23, 26–27.

238. See, e.g., Op-ed., *Dear A.I.G., I Quit!*, N.Y. TIMES, Mar. 25, 2009, at A29, available at 2009 WLNR 5575910 (transcribing a letter from Jake DeSantis, the AIG Vice-President, to Edward M. Liddy, the CEO of AIG).

239. Eric Dash & Andrew Martin, *Wells Fargo to Repay U.S., a Coda to the Bailout Era*, N.Y. TIMES, Dec. 15, 2009, at B1, available at 2009 WLNR 25221011.

240. See Charles Lane, *GM Moves Away from "Government Motors,"* WASH. POST VOICES (Jan. 28, 2011, 6:22 PM), http://voices.washingtonpost.com/postpartisan/2011/01/gm_moves_away_from_government.html.

241. See *Crisis Panel Blames Wall Street, Washington*, BUS. WK., Jan. 26, 2011, <http://www.businessweek.com/news/2011-01-26/crisis-panel-report-blames-wall-street-washington.html> (noting that Democrats blamed the "dramatic failures of corporate governance and risk management").

this point was that the efficacy of reliance on norms for corporate governance in these circumstances is uncertain, and again the government's conduct was an endorsement of this theory more than a validation of it.

Ultimately, the government's ownership was a cobbling together of different models of governance, structures which varied depending upon the particular investment. In some cases, the government acted in line with the venture capital model by ensuring governance compliance through rounds of capital.²⁴² At other times the government veered toward the private equity model through its *ex ante* corporate restructurings.²⁴³ Still other times the government adopted a hands-off approach as an institutional investor would.²⁴⁴ The government also relied on the soft power it could assert through lending, as well as its regulatory authority, to maintain the potential for control over its investments.

B. LESSONS OF GOVERNMENT CORPORATE OWNERSHIP IN THE MIDST OF THE FINANCIAL CRISIS

The lessons of government ownership in the recent crisis are best characterized as general principles, not detailed guidelines or rules. The nature of the next financial crisis is inherently uncertain.²⁴⁵ This reality means that the government is likely to require flexibility in structuring any investment. The particular features of individual corporations as well as legal limitations in effect at the time will also force the government to diverge in the structure of its investment. Broad principles are thus more appropriate rather than rigid rules.²⁴⁶

Government ownership of private enterprise is historically rare.²⁴⁷ Before the current bout of ownership, there were few prior examples in the post-World War II era. The government investment in Chrysler was the most prominent.²⁴⁸ Also nota-

242. Davidoff & Zaring, *supra* note 1, at 538–41.

243. PAULSON, *supra* note 139, at 307–08, 337–38.

244. See Davidoff & Zaring, *supra* note 1, at 539–40.

245. Sebastian Mallaby, *Financial Reform's Uncertain Promise*, COUNCIL ON FOREIGN REL. (May 21, 2010), <http://www.cfr.org/united-states/financial-reforms-uncertain-promise/p22183>.

246. See Davidoff & Zaring, *supra* note 1, at 463–70.

247. Verret, *supra* note 4, at 293 (“We find no example from among this rich history in which the government owned a controlling stake in a publicly traded business incorporated under state law.”).

248. See Paul E. Tsongas, *Did the Chrysler Bailout Work?*, N.Y. TIMES, Aug. 2, 1983, at A19, available at 1983 WLNR 504926.

ble were the assistance the FDIC provided to Continental Illinois and the liquidation and work-out authority the Resolution Trust Corporation established.²⁴⁹ The government apparently did not rely on those experiences to structure its current ownership bout—notwithstanding some similarities.²⁵⁰

Government ownership is likely to continue to remain rare for both legal and political reasons. Legally, the government is restricted in its ability to own private companies.²⁵¹ The Government Corporation Control Act of 1945 requires congressional authorization for the government to own private companies.²⁵² The Act is one reason why the government initially utilized a trust mechanism to hold the AIG interest.²⁵³ The new financial reform bill also limits the ability of the Federal Reserve to use its section 13(3) power in the manner it did during the financial crisis to provide financial assistance to companies.²⁵⁴ It is thus difficult for the government to find a statutory hook on which to hang authority to own private enterprise.

This does not mean that government ownership of private enterprise will not reoccur. It will instead take a crisis and the forces it creates to push the government to stretch the law or congressional authorization to justify future ownership.²⁵⁵ But either case is apt to occur only in exigent circumstances.²⁵⁶ Ownership is therefore not only likely to be extraordinary due

249. See Black, *supra* note 5, at 576–78 (setting forth the history of government assistance provided to Continental Illinois in the 1980s).

250. See *id.* at 576–92 (comparing the government’s involvement in Continental Illinois with the government’s involvement in AIG and other financial institutions).

251. 31 U.S.C. § 9102 (2006) (“An agency may establish or acquire a corporation to act as an agency only by or under a law of the United States specifically authorizing the action.”).

252. *Id.*

253. See Davidoff & Zaring, *supra* note 1, at 496–97. The government appeared to back away from this position when it took a 92.1 percent position in the restructuring. Lynn Cowan et al., *U.S. Treasury to Audit Bankers for AIG Offering*, WALL ST. J., Jan. 8, 2011, at B3, available at 2011 WLNR 518471.

254. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 129(d), 122 Stat. 3765, 3797 (“The provisions of this section shall be in force for all uses of the authority provided under section 13 of the Federal Reserve Act . . .”). Section 13 of the Federal Reserve Act gives the Federal Reserve the power to discount securities in “unusual and exigent circumstances.” 12 U.S.C. § 343 (2006).

255. An example is how government involvement in the financial markets expanded during the financial crisis. See Davidoff & Zaring, *supra* note 1, at 466–67.

256. See *id.*

to the political atmosphere, but also because the law makes such ownership difficult.²⁵⁷ There is thus no need at this point to wade into the debate about whether government ownership is ever appropriate, and if so, under what circumstances it is justified. The question of when the government should take ownership (rather than how it should govern once it obtains ownership) is left for another article.

With these caveats in mind, several lessons from government ownership can be distilled. The Obama Administration's principles were largely implemented as announced, and effective as implemented.²⁵⁸ The government's resort to commercial principles to guide its *ex ante* investment structures was appropriate and economically beneficial to the government and the nation.²⁵⁹ The Treasury Department did not always remain true to these commercial principles—particularly in its post-investment governance structures.²⁶⁰ More often than not, though, these principles guided the Treasury Department's actions.²⁶¹ In future government investment, resort to commercial principles is, absent full nationalization, likely to provide the greatest benefit to the government and the nation and to ensure the continued viability of these corporate enterprises.²⁶² These principles should apply both pre and postinvestment.

A commercial touchstone is a normative device designed to frame optimal outcomes. It is the better initial principle because it provides an objective measure for this investment, and ensures that the investment is wealth maximizing to the nation as a whole and possibly on an individual basis.²⁶³ By implementation of commercial principles the government ensures that the investment is a net gain for both the country and for individual investors.²⁶⁴ A commercial approach also limits private

257. 31 U.S.C. § 9102 (2006).

258. See *supra* notes 156–59 and accompanying text.

259. See generally PAULSON, *supra* note 139.

260. See AIG Trust Agreement, *supra* note 18.

261. I leave for others the issues of Fannie Mae and Freddie Mac, which were effectively nationalized and operated not for commercial rehabilitation but rather for a public purpose. See Dale Arthur Oesterle, *The Collapse of Fannie Mae and Freddie Mac: Victims or Villains?*, 5 ENTREPRENEURIAL BUS. L.J. 733, 753 (2010).

262. Consider for example the outcome of the government's investment in AIG. McCracken et al., *supra* note 151.

263. This view is reflected in Secretary Geithner's statement of purpose in connections to the TARP bailout. See Dep't of the Treasury Press Release, *supra* note 152.

264. *Id.*

benefits by ensuring a return similar to what a commercial investor would reap.²⁶⁵ Moreover, consistent with the beliefs of key officials such as Timothy Geithner and Larry Summers, it ensures that the businesses are not politicized.²⁶⁶ The Treasury Department's application of these principles in its preinvestment restructurings illustrates how commercial principles can ensure valid government investments.

The main observable defects in the government's approach lay in three areas. The government (1) failed to negotiate terms and structure its investments to ensure an appropriate commercial-like return,²⁶⁷ (2) unduly forfeited and limited its control rights post-investment,²⁶⁸ and (3) allowed excess private benefits to accrue to outside parties.²⁶⁹

The Treasury Department's failure to negotiate terms that could yield returns commensurate with a commercial transaction can be explained in part by political and economic considerations.²⁷⁰ The Treasury Department, however, often either eschewed taking equity or structured its investments to avoid acquiring control.²⁷¹ Even in less intrusive investment programs when control was not a factor, such as the CPP, the Treasury Department provided generous terms for its financing.²⁷² The Department's failure to negotiate full commercial terms resulted in reduced returns.²⁷³ This failure appears to be attributable to the Bush and Obama Administrations' desire to avoid control due to the political optics of government ownership.²⁷⁴ The Treasury Department's aversion to control and private ownership also led to accusations that it disposed of the government's investments too quickly—further reducing the government's return on its investments.²⁷⁵ This charge was made in the case of Citigroup and the CPP program. In both

265. See Davidoff, *supra* note 159.

266. See RUBIN & WEISBERG, *supra* note 175, at 14–16.

267. See *supra* notes 156–59 and accompanying text.

268. See, e.g., Dep't of the Treasury Press Release, *supra* note 152.

269. See Davidoff, *supra* note 159 (discussing how different government actions might have resulted in large benefits for taxpayers rather than private investors).

270. See RATTNER, *supra* note 63, at 120–23.

271. See, e.g., Dep't of the Treasury Press Release, *supra* note 152.

272. See *supra* Part I.D.

273. See McCracken et al., *supra* note 151.

274. Consider the Treasury Department's initial choice to delegate interest in AIG to a trust. Davidoff & Zaring, *supra* note 1, at 496–97.

275. See, e.g., McCracken et al., *supra* note 151.

cases, the government would have earned greater returns had it held onto its investments only six months to a year longer.²⁷⁶

If control was the government's problem, the Treasury Department itself revealed an alternative approach to managing this problem. Rather than forfeit equity, privately negotiated stockholders agreements can function to delimit control.²⁷⁷ Alternatively, the Treasury Department could have acquired equity through warrants providing it with the same measure of return but without the voting and ownership interests of equity. The problem of equity (and the control that goes with it) is thus manageable through private ordering. The government should address the problem of control in the future through these mechanisms rather than through equity forfeitures. The government should invest and acquire equity as a commercial actor would do in any distressed investment.

The Treasury Department still appeared to unduly limit its control. Soft power and other corporate governance mechanisms may provide potential for sufficient control, but this is again an unknown. True control through the appointment of board members is a more significant check on a corporation's actions. While soft control may often suffice, in situations where the size of the government's stake warrants control—majority or near majority ownership—the government should negotiate the ability to freely remove and replace its appointed directors. This level of control would provide a back-up route to exert control over the enterprise. In such situations, there should also be a tendency to take majority control if the investment warrants it. In other scenarios where majority control is not acquired, the government should exercise the control that accompanies less significant investments. Loan agreements should be negotiated with appropriate covenants and preferred share arrangements, which have quasi-market terms as to governance.

There remains the question of the efficacy of the government's alternative approach: independent directors. Independent directors may have been effective, though this is ultimately unknowable. The use of independent directors also avoided issues raised by others as to a conflict of fiduciary duties between the directors and the government and possible litigation.²⁷⁸ But

276. *Id.*

277. Other mechanisms are also available, such as amendments to organizational documents of the company.

278. Black, *supra* note 5, at 569 (discussing how independent directors al-

this appears to be an issue of low risk given that state courts are unlikely to interfere with any government arrangement.²⁷⁹ Ultimately, while the means to replace these directors was valuable, the same forces that exert power on these directors in the public sphere may not have existed.²⁸⁰

The government's failure to fully exercise control and acquire equity reallocated this wealth to private actors. If the government had implemented its investments in a purely commercial manner these benefits would have been reduced, particularly in the case of the automakers and GMAC.²⁸¹ The corollary, of course, is that these benefits would have accrued to the investor—the American public. While some private benefits are inevitable in this type of government intervention, the consequence during the financial crisis was not only reduced government benefits but public backlash against the government's program. The willingness of the Bush and Obama Administrations to tolerate this wealth allocation in connection with the government ownership spurred passionate popular discontent with the economic rescue package and provided significant ammunition to critics of both Administrations.²⁸² If there is a principle to be derived here, it is that not only should private benefits be limited to ensure an economic return for the public, but that perception also matters. The government should, in the future, limit these benefits not only in adherence to commercial principles but also for political necessity.

CONCLUSION

A fish in the midst of the ocean is unable to discern that it is in water or even wet.²⁸³ We are still at sea amidst the finan-

lowed the government to maintain a "hands off" shareholder policy).

279. See Davidoff & Zaring, *supra* note 1, at 468 ("Nor can one find much of a role for states in this epic corporate reorganization and insurance crisis, even though state law is the basis of corporate and insurance regulation."); see also Marcel Kahan & Edward B. Rock, *How to Prevent Hard Cases from Making Bad Law: Bear Stearns, Delaware and the Strategic Use of Comity*, 58 EMORY L.J. 713, 758 (2008) (finding that because of its efficiency, Delaware will decide cases first and most state courts will defer to Delaware on novel matters).

280. Davidoff & Zaring, *supra* note 1, at 540 ("[T]he government's deals looked quite different from traditional privately negotiated deals.").

281. See Davidoff, *supra* note 159.

282. *Id.*

283. This analogy is an old one, but a speech by former Federal Reserve Governor Kevin Warsh brought it to mind. See Kevin Warsh, Governor, Fed. Reserve, Speech at the New York University School of Law Global Economic Policy Forum: Financial Market Turmoil and the Federal Reserve: The Plot

cial crisis, and like fish we lack the perspective to make definitive assessments of the government's financial crisis ownership until significant time has passed. The true lessons of government ownership are thus left to history. Still, this Article has attempted to highlight possible defects in the government's ownership experience as well as to draw early lessons. The Treasury Department and other government agencies may have appropriately relied on soft and alternative governance forces to forfeit some level of control over its corporate investments. These agencies likely went too far, however, in forfeiting ultimate control over these enterprises. These defects must be set against the backdrop that the government's investments were largely repaid on an aggregate basis. This is a significant accomplishment. It is a success which should be acknowledged.