



2008

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Recommended Citation

Templin, Benjamin A. (2008) "The Public Trust in Private Hands: Social Security and the Politics of Government Investment," *Kentucky Law Journal*: Vol. 96 : Iss. 3 , Article 3.

Available at: <https://uknowledge.uky.edu/klj/vol96/iss3/3>

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The Public Trust in Private Hands: Social Security and the Politics of Government Investment

*Benjamin A. Templin*¹

INTRODUCTION

THE funding crisis facing Social Security² could be dramatically reduced if the money accumulating in the Trust Fund were invested in a diversified portfolio of stocks, bonds and other assets³ rather than in

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² The current form of funding Social Security is the Pay As You Go (PAYGO) model where most of the monies collected from the FICA payroll tax immediately go out to pay benefits to current retirees. What is not immediately paid out as benefits is invested in government bonds in a Trust Fund. The Trust holds \$1.9 trillion in government bonds, but it's not nearly enough to fund the expected benefits of future retirees under one set of predictions by the Social Security Administration. Actuaries and economists predict that payroll tax will be insufficient to pay benefits by 2017 and that the Social Security Trust Fund reserves will be exhausted by 2041. THE 2007 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE FEDERAL OLD-AGE AND SURVIVORS INSURANCE AND FEDERAL DISABILITY INSURANCE TRUST FUNDS, H.R. DOC. NO. 110-30, at 2 (2007), available at <http://www.ssa.gov/OACT/TR/TR07/tro7.pdf>. Some scholars challenge the predictions that a crisis exists in Social Security financing. See Neil H. Buchanan, *Social Security and Government Deficits: When Should We Worry?*, 92 CORNELL L. REV. 257, 288 (2007) (arguing that no radical change should be made to Social Security since the demographic shifts resulting in fewer workers per retiree paying into the system will be offset by increases in productivity). Even if the scholars asserting that a problem doesn't exist are correct, policymakers should manage the Trust Fund in a way to maximize the wealth. Benjamin A. Templin, *Comment on Neil H. Buchanan's Social Security and Government Deficits: When Should We Worry?*, 92 CORNELL L. REV. 291, 291 (2007).

³ Over long periods of time, a fully diversified portfolio will not only outperform a portfolio of only bonds, it will do so with less risk. Professor Jeremy Siegel analyzed 200 years of market data and discovered that over 17 year periods, stocks have never had a negative return whereas bonds have been at risk of inflation outpacing the interest rate and therefore actually losing money in some time periods studied. Stocks generally outperform bonds as well. During 30 year periods, stocks outperform bonds over 99% of the time. JEREMY J. SIEGEL, *STOCKS FOR THE LONG RUN* 26-28 (3d ed. 2002). Estimates vary on the effect that investment will have on delaying the funding crisis. The estimates often depend on the percentage that the Trust Fund invests in stocks as well as other structural changes made to the system in terms

government bonds.⁴ While the long-term economic benefits of a diversified portfolio are undisputed,⁵ the politics of government investment in the private markets has been debated nearly as long as Social Security has been in existence.⁶ Republicans and Libertarians are concerned that the government will engage in politically motivated investing,⁷ interfere in corporate governance⁸ and that an inherent conflict of interest exists

of raising taxes and reducing benefits. A conservative GAO report suggests that investment will delay the crisis only eleven years. Lewis D. Solomon & Bryan L. Berson, *Private Market Reforms for Social Security: A Comprehensive Guide for Composing Reform Legislation*, 11 S. CAL. INTERDISC. L.J. 117, 136 (2001). Whereas, Bosworth and Burtless calculated that the funding crisis could be averted for as long as 53 years if 70 percent of the assets of the Trust Fund were invested and an immediate tax rate hike of 2% occurred. Barry Bosworth & Gary Burtless, *The Effects of Social Security Reform on Saving, Investment, and the Level and Distribution of Worker Well-Being*, Ctr. for Ret. Research at Boston Coll., Working Paper No. 2000-02, at 6 (2000).

4 The investment of the Trust Fund in government bonds is controversial. Some commentators maintain that the bonds are merely IOUs which will require further taxation or an increase in the deficit by issuing more debt to pay off the amount owed to the Trust Fund. ALLEN W. SMITH, *THE LOOTING OF SOCIAL SECURITY: HOW THE GOVERNMENT IS DRAINING AMERICA'S RETIREMENT ACCOUNT* 43-44 (2004).

5 The economic questions are not controversial. To improve funding, the central trust should diversify assets into a broader portfolio. The controversy arises in "the ability of Social Security to invest well and to avoid improper interference in corporate governance." Peter A. Diamond, *The Economics of Social Security Reform*, in *FRAMING THE SOCIAL SECURITY DEBATE* 38, 39-40 (R. Douglas Arnold et al. eds., 1998).

6 Solomon & Berson, *supra* note 3, at 123.

7 The 1994-1996 Advisory Council on Social Security contended that politicians would assert political pressure on the managers of the Social Security Trust Fund to forgo investments based on the potential return and make decisions based on criteria that would "achieve other economic, social, or political purposes." U.S. GOV'T ACCOUNTABILITY OFFICE, *SOCIAL SECURITY FINANCING: IMPLICATIONS OF GOVERNMENT STOCK INVESTING FOR THE TRUST FUND, THE FEDERAL BUDGET, AND THE ECONOMY* 3 (1998), available at <http://www.gao.gov/archive/1998/a398074.pdf>. President Bush's Commission on Social Security emphasized in a 2001 report that "Government *must not* invest Social Security funds in the stock market." See PRESIDENT'S COMM'N TO STRENGTHEN SOC. SEC., *STRENGTHENING SOCIAL SECURITY AND CREATING PERSONAL WEALTH FOR ALL AMERICANS* 13 (2001), available at http://www.csss.gov/reports/Final_report.pdf (emphasis added). For a more detailed discussion of social investments, see *infra* notes 364-420 and accompanying text.

8 Examples of shareholder activism include filing proxy statements seeking to direct management to engage in certain activities or bringing derivative lawsuits alleging a breach of a fiduciary duty. State legislators have sought to influence public pension plans so as to vote stock in order to prevent a corporate takeover if the merger would result in a loss of jobs to the region. Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795, 814-15 (1993). The sheer size of the Trust Fund at its current size of \$1.9 trillion will make the government one of the largest investors in the world. Estimates vary but it could hold anywhere from 2% to 27.5% of all U.S. equities. Kent A. Smetters, *Thinking About Social Security's Trust Fund*, in *PROSPECTS FOR SOCIAL SECURITY REFORM* 201, 207 (Olivia S. Mitchell, Robert J. Myers & Howard Young eds., 1999). The government could significantly impact corporate decision even if it held as little as 2% of the outstanding equity of a company. Michael Tanner, *The Perils of Government Investing*, CATO INST. BRIEFING PAPER NO. 43, at 3 (Dec. 1, 1998), available at <http://www.cato.org/pubs/briefs/bp-043es.html>. Although studies

when the government owns an interest in private enterprise.⁹ Most commentators have considered only two solutions to the problem of government investment—private accounts¹⁰ and passive investing.¹¹ Both solutions address the fundamental problems of government involvement

show social investing can result in lower than market return, shareholder activism doesn't necessarily result in negative returns. Romano, *supra* note 8, at 829. In fact, commentators contend that activist shareholders will increase corporate profits since shareholders will limit management's misuse of corporate assets. Michael P. Smith, *Shareholder Activism by Institutional Investors: Evidence from CalPERS*, 51 J. FIN. 1, 227–52 (1996). Whether shareholder activism results in better returns or not, critics of government investing are still philosophically opposed to government investments in private enterprise since it runs counter to the ideological foundation of a capitalist system. Krzysztof M. Ostaszewski, *Privatizing the Social Security Trust Fund? Don't Let the Government Invest*, CATO INST., Jan. 14, 1997, <http://www.cato.org/pubs/ssps/ssp6es.html>. Investment by the government of Trust Fund assets has been suggested to be a form of socialism. SYLVESTER J. SCHIEBER & JOHN B. SHOVEN, *THE REAL DEAL: THE HISTORY AND FUTURE OF SOCIAL SECURITY* 69–70 (1999).

9 Since the government regulates commerce, a conflict of interest arises when the regulator becomes a shareholder. SCHIEBER & SHOVEN, *supra* note 8, at 348. The decisions by governmental regulatory bodies often have an effect on share price, consequently the government will be conflicted if its objective decisions will affect the performance of the fund. Conflicts exist across many public agencies including regulatory bodies such as the Food and Drug Administration (approval of drugs often results in an uptick in a company's stock), in antitrust investigations (company stock often dips when antitrust charges are brought), in Securities and Exchange Commission (SEC) oversight, and in the Federal Reserve's decisions on interest rates (lowering the Fed rate usually results in a bull market). Theodore J. Angelis, *Investing Public Money in Private Markets: What Are the Right Questions?*, in *FRAMING THE SOCIAL SECURITY DEBATE* 287, 312–14 (R. Douglas Arnold et al. eds., 1998).

10 Private accounts (also referred to as personal accounts or defined contribution plans) were an important agenda item for President Bush's administration. Under the proposal a portion of the FICA payroll tax would go into an account owned by the taxpayer, who would then choose from a selection of different investment options. President Bush argued that private investment would yield a high rate of return in order to offset the reductions in Social Security benefits projected under the PAYGO system. Solomon & Berson, *supra* note 3, at 117, 121. Privatization would have changed the nature of Social Security by creating a traditional right of ownership in one's account, including the right of one's heirs to inherit the balance remaining after death. *Id.* For private accounts, "decisional power [is] diffused across numerous plan beneficiaries, [so] the likelihood that political pressure will push substantial pension fund assets into high-risk, low-return projects decreases." Romano, *supra* note 8, at 844.

11 Passive investing, also known as indexing, is an investment strategy where funds are automatically invested in a broad based stock market index such as those represented by the Russell or Wilshire indexes. Solomon & Berson, *supra* note 3, at 137. Passive investing reduces the pressure on "public pension fund managers to engage in social investing or non-value-maximizing share voting." Romano, *supra* note 8, at 842. The Federal Thrift Savings Fund (TSP) for federal employees has a passive investment strategy in order to eliminate political pressure on the investment decision. Deborah M. Weiss, *The Regulation of Funded Social Security*, 64 BROOK. L. REV. 993, 997 (1998). Moreover, event studies show that passive investing yields the same or greater returns than most mutual funds; consequently, a passive strategy may actually lead to better returns than an actively managed fund. Romano, *supra* note 8, at 842–43.

in private investment, but neither is politically viable.¹² President Bush's private accounts proposal ran into opposition from commentators who claimed, among other things, that it favored rich taxpayers and exposed the needy to unnecessary risks of market downturns;¹³ whereas conservatives are adamantly opposed to any solution where the government makes the investment decision.¹⁴

A third solution which has not received as much attention is the notion of creating a private federal government corporation (FGC) formed to invest the Trust Fund in a broadly diversified portfolio of stocks, bonds and other assets.¹⁵ Such a model is used effectively by the state of Alaska to invest

¹² Stephen F. Befort, *The Perfect Storm of Retirement Insecurity: Fixing the Three-Legged Stool of Social Security, Pensions, and Personal Savings*, 91 MINN. L. REV. 938, 987 (2007); see also Jackie Calmes, *Will Bush Bargain to Save Social Security?*, WALL ST. J., Nov. 22, 2006, at A6.

¹³ Private accounts came under criticism for numerous reasons. Charges were made that benefits would be cut for the elderly poor—the group less able to withstand cuts in benefits. See Kathryn L. Moore, *President Bush's Personal Retirement Accounts: Saving or Dismantling Social Security*, in 2005 N.Y.U. REV. OF EMP. BENEFITS & EXECUTIVE COMP. § 5-1, 5-24 to 5-25. It has been contended that certain groups, principally women and African Americans, would fare poorly under the system. Greg Anrig, Jr. & Bernard Wasow, *Twelve Reasons Why Privatizing Social Security is a Bad Idea*, THE SOCIAL SECURITY NETWORK, Dec. 14, 2004, available at <http://www.socsec.org/publications.asp?pubid=503>. Also, the promise of higher returns was cast in doubt given the anticipated management fees charged by brokerage houses and the costs incurred in setting up the system. *Id.* Based on recent history of the effectiveness of 401(k) plans, workers also will likely “have difficulty making prudent decisions concerning investment and withdrawal of funds in their individual accounts.” Karen C. Burke & Grayson M.P. McCouch, *Social Security Reform: Lessons From Private Pensions*, 92 CORNELL L. REV. 297, 320-21 (2007). Moreover, private account proposals will change the historic balance that Social Security maintains between equity and adequacy. Kathryn L. Moore, *Redistribution Under a Partially Privatized Social Security System*, 64 BROOK. L. REV. 969, 988-89 (1998). Although reasonable people could disagree on these issues, the fact remains that private accounts ran up against opposition from both Democrats and Republicans. The option remains politically unviable given strong Democratic opposition. Befort, *supra* note 12, at 963-64; see also, e.g., DEMOCRATIC NAT'L CONVENTION COMM., STRONG AT HOME, RESPECTED IN THE WORLD: THE 2004 DEMOCRATIC NATIONAL PLATFORM FOR AMERICA 26 (2004), <http://www.democrats.org/pdfs/2004platform.pdf>.

¹⁴ The indexing strategy for Social Security investing has been criticized because: (1) investing \$1.9 trillion into an index will increase the share price for some companies beyond the real value, SIEGEL, *supra* note 3, at 352, (2) passive investment typically prevents the voting of shares on corporate governance issues and the Trust Fund should actively participate in corporate governance in order to limit waste by managers, Weiss, *supra* note 11, at 997-98, and (3) an actively managed portfolio that is fully diversified can yield better returns than a passive approach with proper management since indexes don't exist for many high yield investment such as private equity funds, Benjamin A. Templin, *Full Funding: The Future of Social Security*, 22 J.L. & POL. 395, 448 (2007).

¹⁵ Proposals which provide for investment by the central trust fund are generally referred to as “full funding” or pre-funding of the Social Security Trust Fund. Full funding proposals generally combine raising taxes, benefit cuts, and prudent, diversified investment by a centralized trust fund in order to create a fund with enough assets to cover future benefits given estimated taxes collected and a reasonable rate of return on investments. Laurence S. Seidman, *Making the Case For Funding Social Security*, 81 TAX NOTES 241, 245 (1998). The lack of

oil and gas revenues¹⁶ and by Canada for its social insurance system.¹⁷ The Canada Pension Plan (CPP), and the government corporation which invests on its behalf, has recently received interest from scholars and lobbying groups as a potential solution for the U.S. funding problem.¹⁸

In the government corporation model, the \$1.9 trillion in the Social Security Trust Fund would be shifted to a federally owned corporation which would then act as the investment vehicle for the Social Security Administration. This solution presents a compromise between the Republican and Democratic approaches to leveraging the private markets in an attempt to fix the Social Security funding crisis. Although the Republican administration favors personal accounts as a solution to the funding crisis, centralizing investment through an FGC may appeal to the Republican base since it promotes a key Republican ideology to adopt market solutions for social problems yet still manages to limit government involvement in the investment decision. Democrats might accept the compromise solution since such a centralized investment model addresses many of their objections to personal accounts. The risk of loss in stock market investments is shifted away from the individual and diversified collectively over several cohorts and among a greater number of investments.¹⁹ The centralized approach also maintains the collectivist character of Social Security whereas private accounts would signal a return to private autonomy rather than group responsibility.²⁰ Moreover, both parties should find the

attention to this idea may be understandable since the phenomenon of a government-owned corporation has not been widely studied in academia, see Donna M. Nagy, *Playing Peekaboo with Constitutional Law: The PCAOB and Its Public/Private Status*, 80 NOTRE DAME L. REV. 975, 981 (2005), despite the fact that Congress has authorized many private FGCs with even more expected in the future. See A. Michael Froomkin, *Reinventing the Government Corporation*, 1995 U. ILL. L. REV. 543 (1995).

16 THE ALASKA PERMANENT FUND CORP., 2005 ANNUAL REPORT 1 (2005), available at http://www.apfc.org/iceimages/publications/2005_AR_nocov.pdf.

17 CANADA PENSION PLAN INV. BD., ANNUAL REPORT 2005, at 1 (2005), available at http://www.cppib.ca/info/annual/ar_2005.pdf.

18 See R. Kent Weaver, *Pension Reform in Canada: Lessons for the United States*, 65 OHIO ST. L.J. 45, 73 (2004); Daniel Béland, *The Politics of Social Learning: Finance, Institutions, and Pension Reform in the United States and Canada*, 19 GOVERNANCE: AN INT'L J. OF POL., ADMIN., & INSTS. 559, 559–83 (2006), available at <http://www.danielbeland.org/pubs/Governance%202006.pdf> (both articles suggesting that the Canadian experience in developing the CPP Investment Board could hold valuable policy lessons for U.S. lawmakers). The politically powerful American Association of Retired Persons (AARP), a major player in derailing President Bush's private accounts proposal, has recently showed interest in the CPP as an alternative to private accounts. Am. Assoc. of Retired Pers., *The Canada Pension Plan: A Model of Reform* (April 2007), http://www.aarp.org/research/international/events/apr19_07_CPPIB.html; see also Nancy J. Altman, *Social Security and the Low-Income Worker*, 56 AM. U. L. REV. 1139, 1154–58 (2007) (stating the Canada Pension Plan serves as precedent for “responsible investment in equities by today’s public pension plans”).

19 Templin, *Full Funding*, *supra* note 14, at 419–24.

20 *Id.* at 401–07.

solution palatable since investment is the best solution available to address funding requirements while mitigating anticipated benefit cuts and tax hikes.²¹ It should be noted that many commentators contend that Social Security's funding problems can be addressed without investment through "a combination of estate tax revenue financing, a higher taxable wage base, and a higher normal retirement age."²² However, this article focuses purely on investment vehicles as one of the solutions to financing Social Security.

FGCs are not without their own set of problems, constraints and controversies. Although widely used for a variety of legitimate public purposes, FGCs are controversial because of constitutional questions over the state action doctrine, nondelegation doctrine and Appointments Clause.²³ Although there has been a trend in recent years to privatize government services²⁴ there are also normative questions regarding whether such privatization actually results in efficiency gains. Finally, shifting the nations' \$1.9 trillion retirement nest egg into the hands of a private corporation—even a government-owned one—is likely to be enormously controversial given the recent past history of corporate manager and director criminal malfeasance, nonfeasance, self-dealing and poor performance. This article addresses those questions and issues and analyzes a prescriptive solution whereby a privatized Social Security Trust Fund could operate

21 *Id.* at 415–19. Although investment might mitigate tax increases and benefit cuts, the most realistic reform minded commentators state that some amount of tax increases and benefit cuts are inevitable. Jeffrey R. Brown, Kevin A. Hassett, & Kent Smetters, *Top Ten Myths of Social Security Reform*, 13 ELDER L.J. 309, 338 (2006).

22 Kathryn L. Moore, *Social Security Reform: Fundamental Restructuring of Incremental Change?*, 11 LEWIS & CLARK L. REV. 341, 341 (2007). "A combination of these three reforms would retain the current structure of the system and distribute the costs of reform so that no single class of participants or beneficiaries would bear the entire brunt of reform." *Id.* There are numerous combinations of how taxes and benefits should be adjusted. Some proposals combine tax and benefit adjustments with other retirement related reforms not tied to Social Security funding. Professor Befort suggests that in addition to tax increases, benefit adjustments, and an increase in the retirement age, that reforms also be made to encourage a higher rate of participation and security in defined benefit contribution plans, such as employer 401(k) plans, and by giving low and middle-income taxpayers a "modest refundable tax credit that would encourage [them] to save for retirement." Befort, *supra* note 12, at 940. Still another proposal suggests that Social Security should incentivize workers to work longer and save more by creating a two-tiered system where the first tier pays out a "basic Social Security benefit to every older American" and a second tier which "would provide an additional earnings-related Social Security benefit based on payroll tax contributions made to individual accounts." Jonathan Barry Forman, *Making Social Security Work*, 65 OHIO ST. L.J. 145, 183 (2004). Towards the end of motivating taxpayers to save and invest to supplement Social Security benefits, Professor Medill suggests that the Social Security Administration take on the role of educating the public in "how to plan, save, and invest for retirement." Colleen E. Medill, *Transforming the Role of the Social Security Administration*, 92 CORNELL L. REV. 323, 326 (2007).

23 Froomkin, *supra* note 15, at 560–61.

24 *Id.* at 546.

within constitutional bounds and the corporate governance issues could be resolved to hold the entity and its managers and directors accountable while promoting a maximum return on investment.

Part I of this article explores the history and controversies that have surrounded FGCs. Part II considers the constitutional and theoretical issues facing FGCs as well as the normative issue of whether the privatization trend is consistent with democratic principles. Part III offers a prescriptive analysis of the corporate structure that comports with constitutional requirements. Part IV continues the prescriptive analysis and considers what legal regimes would hold a privatized Trust Fund accountable while still giving managers freedom from the political process so that they can make decisions that maximize the wealth of the trust.

I. FEDERAL GOVERNMENT CORPORATIONS: HISTORY, TRENDS AND CONTROVERSIES

Historically, the United States—more than other governments—has trusted the markets and private corporations to make decisions of “national importance.”²⁵ In *Lebron v. National Railroad Passenger Corp.*,²⁶ Justice Scalia traces the history of the government chartered corporation. As early as the 18th century, the U.S. government was a shareholder in private corporations whose purpose was to carry out public functions.²⁷ But it wasn’t until the 20th century that government-owned corporations emerged in force.²⁸ The First World War²⁹ and the Great Depression³⁰ saw an increase in the use of the government corporate entity in order to respond to the national economic crisis.³¹ During this era, the FGC was thought of as an agency within the government which could take advantage of private sector business practices better than the agency under which it operated.³² However, starting in 1962 with the creation of the Communications Satellite Corporation (Comsat), the government sought to form entities outside the influence of public agencies and the political process.³³ A slew of FGCs

²⁵ *Id.* at 633.

²⁶ *Lebron v. Nat’l R.R. Passenger Corp.*, 513 U.S. 374 (1995).

²⁷ *Id.* “The first was the Bank of the United States, created by the Act of Feb. 25, 1791, ch. 10, 1 Stat. 191, which authorized the United States to subscribe 20 percent of the corporation’s stock . . .” *Id.* at 386.

²⁸ *Id.* at 388.

²⁹ “In 1917 and 1918, Congress created, among others, the United States Grain Corporation, the United States Emergency Fleet Corporation, the United States Spruce Production Corporation, and the War Finance Corporation. These entities were dissolved after the war ended.” *Id.* (citation omitted).

³⁰ *Id.*

³¹ *Id.*

³² *Id.* at 390.

³³ *Id.* at 391. Comsat was notable in that only 3 of the 15 directors on the board were

followed Comsat and, in most cases, the enabling legislation specifically stated that the corporations were not “agencies or instrumentalities of the Government.”³⁴ Even though the statute might specify that the FGC was not an agency, in some cases the federal government retained full control of the board of directors.³⁵

The purpose of any given FGC has varied from the provision of goods and services³⁶ to addressing the lending needs of various populations such as farmers, homeowners or students³⁷ to creating a private regulatory body for the accounting profession.³⁸ FGCs are predicted to grow in number³⁹ since such “a corporation can more efficiently apply the techniques of modern business management.”⁴⁰

In his seminal article on FGCs, Professor Froomkin identifies four reasons for creating an FGC—efficiency, political insulation, subsidy and subterfuge.⁴¹ Only the first two reasons—efficiency and political

appointed by the President. *Id.*

34 *Id.*

35 *Id.* (“[S]ee, e.g., 47 U.S.C. § 396(b) (Corporation for Public Broadcasting (CPB)); 42 U.S.C. § 2996d(e) (1) (Legal Services Corporation (LSC)), and . . . were (unlike Comsat) managed by boards of directors on which Government appointees had not just a few votes but voting control”). As will be discussed in Part II *infra*, the degree of control that the government retains is a turning point on whether the entity is a government actor for the purpose of determining constitutional rights.

36 *Id.* at 388. The Tennessee Valley Authority (TVA) was established to provide electrical power and Amtrak was established to maintain the railroads for passenger use in a time of economic decline for the transportation system. *Id.* at 383–84.

37 Froomkin, *supra* note 15, at 555–56. These FGCs go by a special designation known as Government Sponsored Enterprises (GSEs) and include such entities as the Federal Home Loan Mortgage Corporation (Freddie Mac), the Federal Agricultural Mortgage Corporation (Farmer Mac), and the Student Loan Marketing Association (Sallie Mae). The corporations “benefit from specialized lending powers coupled with an explicit or implicit federal guarantee which allows them to provide subsidized credit to, or for the use of, a target group.” *Id.* at 555.

38 As part of the 2002 Sarbanes–Oxley Act, Congress created the Public Company Accounting Oversight Board (PCAOB which is pronounced as “peekaboo” by some) in response to the corporate governance and accounting scandals such as Enron and Worldcom. PCAOB has “broad governmental powers and responsibilities, including the authority to register accounting firms . . . ; enact rules . . . ; inspect [accounting firms] . . . ; investigate accounting firms . . . for possible violations of PCAOB rules or the federal securities laws; and impose discipline . . . including censures, temporary suspensions, permanent bars, and substantial monetary fines.” Nagy, *supra* note 15, at 977–78 (citations omitted).

39 Froomkin, *supra* note 15, at 546. FGCs are part of a larger trend to privatize government services. Professor Metzger notes that “[p]rivatization is now virtually a national obsession.” Gillian E. Metzger, *Privatization as Delegation*, 103 COLUM. L. REV. 1367, 1369 (2003).

40 JAMES D. COX & THOMAS LEE HAZEN, COX & HAZEN ON CORPORATIONS § 1.16, at 65 (2d ed. 2003).

41 Froomkin, *supra* note 15, at 557. Professor Froomkin notes that FGCs, such as the GSEs, are created as a subsidy to a special interest group. Consequently, farmers and students borrow money at a lower rate than if they had to go out into the market. *Id.* at 558–59. In

insulation—concern the creation of a privatized Social Security Trust Fund. The inefficiencies of government are often cited as one of the key reasons to form an FGC.⁴² A government-run trust fund is likely to be subject to political influence which likely results in lower returns.⁴³ Moreover, when it comes to investing the assets of the Social Security Trust Fund, even big government advocates are skeptical⁴⁴ of whether the entity that has created the largest deficit in world history would deliver a return on investment that is competitive with the marketplace.

The historic track record bears out the intuition that government is more inefficient than an FGC. Some FGCs which are profit-oriented “have a far higher return on equity than do most large private firms.”⁴⁵ However, critics suggest the results are misleading. While an FGC might be more efficient than the government itself, the entities have some advantages over the private sector since FGCs are “ordinarily immune from state tax; and sometimes they have unique abilities to operate on [a] national scale.”⁴⁶

Government employees are not likely to be as profit motivated as private sector professional investors. In order to have the incentive to choose the best investments, government employees would need to be subject to the type of competition that exists between private companies in the mutual fund or trust industry⁴⁷—i.e. the pressure to maximize the portfolio drives stock pickers to invest the time and effort into making wise investment choices. At the closing bell on Wall Street every portfolio manager goes home knowing that her performance is easily calculated. Without competitive pressure, government managers will not likely take the calculated risks that private investors would take to increase performance. Professional money managers will be better equipped to do the research and make the decisions on where to invest than government employees who are not incentivized to seek higher returns. Such professional money managers, of course, should be qualified.⁴⁸ If government employees do handle the investment

discussing subterfuge as a reason for establishing FGCs, Professor Froomkin notes that some corporations are created as accounting devices to hide deficit spending since the “off-budget items are usually excluded from the official total ‘spent’ by the government.” *Id.* at 559.

42 *Id.* at 577.

43 See Angelis, *supra* note 9, at 292.

44 Weiss, *supra* note 11, at 999.

45 Froomkin, *supra* note 15, at 579.

46 *Id.* at 584. A privatized Trust Fund would surely have economies of scale and may have some unfair advantages over other large investors—i.e. investment banks, retail investors, mutual funds, etc. However, such unfair advantages may be viewed as normal in the market when the government is viewed just as a competitor rather than a regulator of competition. *Id.* at 576–77.

47 *Id.*

48 In writing about private accounts, Professor Weiss suggests that the professional money managers who would work with individuals be subject to the Investment Advisors Act and provide a guarantee that they are not judgment proof. Weiss, *supra* note 11, at 1011.

decisions, then such managers should be “professionally trained, highly skilled, and selected on the basis of proven track records.”⁴⁹

Political insulation is probably the most imperative reason to privatize the Social Security Trust Fund.⁵⁰ “Congress may feel that a small single-mission agency will be more zealous in furthering a given goal than a department in a multimission agency.”⁵¹ Moreover, the interference of politics in the investment decision and corporate governance has led to lower returns for state run pension plans.⁵² President Bush’s position could not have been made clearer when the President’s Commission to Strengthen Social Security issued its 2001 reports. The Republican administration was adamant that government stay out of the investment business.⁵³ Consequently, the only politically feasible route to harness the private markets to help build the Social Security Trust Fund is to take the investment decision out of the hands of the government. One solution to do that would be through President Bush’s private accounts proposal, but that too ran into political opposition from both Democrats and Republicans.⁵⁴ That leaves the FGC as the primary option in order to invest the Trust Fund without government influence.

Although there has been a trend to privatize government services for the purposes of efficiency gains and political insulation, administrative law scholars have called for greater control and regulation of private actors wielding government power.⁵⁵ The scholarly literature shows a great deal of disagreement over the normative question of whether the “advantages of privatization are outweighed by its disadvantages.”⁵⁶ The fear is that the constitutional restraints on governmental coercive power are absent when power is conveyed onto a private actor.⁵⁷

49 Solomon & Berson, *supra* note 3, at 132.

50 Froomkin, *supra* note 15, at 595. “For many years there has been a consensus that certain areas of public life, notably the money supply, should be insulated from direct political control and entrusted to autonomous bodies such as the Federal Reserve Board.” *Id.*

51 *Id.* at 558.

52 Romano, *supra* note 8, at 811.

53 See PRESIDENT’S COMM’N TO STRENGTHEN SOC. SEC., *supra* note 7, at 11.

54 See Calmes, *supra* note 12, at A6.

55 Jody Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. REV. 543, 574 (2000).

56 Nagy, *supra* note 15, at 1030 n.312.

57 Metzger, *supra* note 39, at 1371–72. Professor Metzger notes that one facile argument makes the case that constitutional restraints on privatized government programs are not needed since “the Constitution does not impose affirmative duties on government.” *Id.* at 1405. Under this theory, since the government does not have a duty to provide benefits under a program, “[w]hy should it matter whether government programs become exempt from constitutional constraints as a by-product of the government transferring these programs to private hands?” *Id.* As Professor Metzger points out, though the government may not have a duty to act, when it does act it must do so within constitutional boundaries. *Id.*

Much has been written on government outsourcing of certain government functions to privately owned corporations including extensive commentary on Medicare and Medicaid Managed Care, welfare privatization, the transition from public schools to charter schools and private prisons.⁵⁸ However, less has been written about the phenomena of FGCs even though government-owned corporations are pervasive and give rise to both normative and constitutional issues.⁵⁹ One normative question is whether the FGC “stands in tension with democratic values such as accountability, transparency, and legitimacy.”⁶⁰ The principal constitutional question is whether the corporate entity, although nominally private, is considered to be a state actor when and if the entity infringes on a right afforded by the Constitution.⁶¹ If the privatized Trust Fund was found to be the government under the state action doctrine, then does that designation lessen the ability of the Trust Fund to remain apart from political influence in its investment decisions? The resolution of the issue is imperative as to whether an FGC is a politically acceptable solution.

II. CONSTITUTIONAL ISSUES AND THE PUBLIC-PRIVATE DISTINCTION

The Constitutional issues facing FGCs, as well as other sorts of privatization, are complicated by the Supreme Court’s reliance on the public-private distinction, which posits that there is a clearly divided public sector subject to constitutional and other public law constraints and a private sector subject to private law rules. Administrative law scholars argue that the public-private distinction results in an accountability problem given the complex relationships between government agencies and private actors.⁶² The inadequacy of current conceptions of constitutional constraints on FGCs may require a rethinking of administrative law to embody not only government oversight, but also contractual constraints and an interdependent aggregate accountability involving “internal procedural rules, . . . market pressures, . . . agreements . . . with other actors, informal norms of compliance, and third-party oversight.”⁶³ Such a regime suggests that there is an emerging new conceptualization of a “public/private” entity subject to constitutional constraints in some instances and private law for other purposes.⁶⁴

58 See generally Metzger, *supra* note 39, at 1376–94.

59 See generally Froomkin, *supra* note 15; Nagy, *supra* note 15.

60 Nagy, *supra* note 15, at 980.

61 *Id.* at 1030–31.

62 Paul R. Verkuil, *Public Law Limitations on Privatization of Government Functions*, 84 N.C. L. Rev. 397, 405 (2006).

63 Freeman, *supra* note 55, at 665.

64 Nagy, *supra* note 15, at 1061.

The threshold constitutional issue for FGCs is whether they are a government actor under the state action doctrine. This article first examines the state action doctrine then proceeds to analyze other constitutional issues including the nondelegation doctrine and the consequences of being a state actor. Throughout this analysis the article addresses the normative question of whether FGCs in general and a privatized Trust Fund in particular are consistent with democratic principles.

A. State Action Doctrine

Whether an FGC is a state actor or private actor is uncertain⁶⁵ but the answer to the question has ramifications for its “relationship with the rest of the world: the President, Congress, the public, and even its own directors.”⁶⁶ The determination of an FGC’s legal status as a public agency establishes whether constitutional provisions such as due process constrain the corporation.⁶⁷ If the entity is deemed to be a private corporation, then the constitutional and legislative restraints placed on federal agencies do not apply.⁶⁸ Whereas, an FGC that is deemed a state actor is subject to the same constitutional restraints and possibly, unless the legislation specifically exempts the entity, the federal laws governing administrative agencies.

The doctrinal question of whether an FGC is a governmental entity subject to constitutional constraints is answered through a state action doctrine analysis,⁶⁹ which separates entities into two camps—the “state” actor on which constitutional restraints are imposed and the private actor. There is a growing body of scholarship which suggests that the public-private distinction of the state action doctrine is anachronistic and does not

65 Froomkin, *supra* note 15, at 564. The answer turns in part on whether the *Lebron* decision is controlling, given the purpose of the corporation and the appointment process of its directors. *See Lebron v. Nat’l R.R. Passenger Corp.*, 513 U.S. 374 (1995).

66 Froomkin, *supra* note 15, at 560.

67 *Id.* at 562.

68 *Id.* There is an additional question of whether federal laws which govern federal agencies would apply to an FGC. It appears that if Congress specified in the enabling legislation that the corporation was not a federal agency, then laws governing federal agencies, such as the Administrative Procedure Act, would not apply. *See Lebron*, 513 U.S. at 394.

69 Professor Froomkin provides the framework to analyze the constitutional status of government corporations. *See Froomkin, supra* note 15, at 563–69. The origins of the state action doctrine find their basis in the post-Civil War Thirteenth and Fourteenth Amendments. While the Thirteenth Amendment prohibiting slavery and involuntary servitude applied to both public and private actors, the Fourteenth Amendment’s equal protection and due process clauses apply only to government action and not private actors. RONALD D. ROTUNDA & JOHN E. NOVAK, *TREATISE ON CONSTITUTIONAL LAW: SUBSTANCE AND PROCEDURE* § 16.1 (3d ed. 1999). The Fourteenth Amendment provides that: “[n]o State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.” U.S. CONST. amend. XIV, § 1.

recognize that “expanded privatization has served to blur the distinction between the spheres of public and private.”⁷⁰ However, the Supreme Court has not yet recognized the academic critique of the state action doctrine and precedent clearly relies on a public–private distinction.⁷¹

The traditional analysis for the state action doctrine asks whether “there is a sufficiently close nexus between the State and the challenged action” that the action may be fairly characterized as one of the government.⁷² However, constitutional law scholars have been critical of its application.⁷³ To a large degree, the courts have been reluctant to find a state action even in the presence of extensive involvement by the government.⁷⁴

Unlike most state action cases, FGCs require another layer of analysis.⁷⁵ Instead of inquiring into whether the action in question can be traced to the state, the court added a preliminary question of whether the entity itself is the state.⁷⁶ The controlling decision is *Lebron v. National Railroad Passenger Corp.*⁷⁷ In *Lebron*, the Court held that when “the Government creates a corporation by special law, for the furtherance of governmental objectives, and retains for itself permanent authority to appoint a majority of the directors of that corporation, the corporation is part of the Government for

⁷⁰ Nagy, *supra* note 15, at 1030.

⁷¹ *Id.* at 1030–31.

⁷² *Id.* at 1033 (quoting *Am. Mfrs. Mut. Ins. Co. v. Sullivan*, 526 U.S. 40, 52 (1999)). There are actually several tests that have emerged from the Court but no single test has proven “adequate to predict whether state action will be found in a new case.” ROTUNDA & NOVAK, *supra* note 69, § 16.5. Rather, the Court relies on a weighing of the facts and circumstances of each case, though the predominant issue throughout the cases is “whether sufficient state contacts do, or do not, exist.” *Id.*

⁷³ Nagy, *supra* note 15, at 1033.

⁷⁴ Freeman, *supra* note 55, at 577 n.124 (citing *Rendell-Baker v. Kohn*, 457 U.S. 830, 841 (1982)). Professor Nagy notes that state actions were found by the Court in three scenarios:

- (1) when the challenged activity resulted from the government’s exercise of “coercive power” or “significant encouragement, either overt or covert,”
- (2) when the private entity performed a traditional governmental function; or
- (3) when the challenged activity resulted from a “symbiotic” interdependence between the government and the private entity.

Nagy, *supra* note 15, at 1033 (citations omitted).

⁷⁵ Froomkin, *supra* note 15, at 564.

⁷⁶ *Id.*

⁷⁷ *Lebron v. Nat’l R.R. Passenger Corp.*, 513 U.S. 374 (1995). In *Lebron*, a political activist entered into a contract with an agent of Amtrak to display an ad on a prominent billboard sign in New York City’s Penn Station, which is owned by Amtrak, the defendant. Amtrak executives later refused to honor the contract when they discovered the politically controversial nature of the ad. The ad criticized the conservative politics of the Coors family, the founders of the Coors Brewing Company.

purposes of the First Amendment.”⁷⁸ In an 8 to 1 majority opinion, Justice Scalia rejected the notion that Amtrak⁷⁹ was a private entity merely because Congress designated it as such in the legislation creating the corporation.⁸⁰ Justice Scalia wrote that such a disclaimer in the enabling legislation could certainly exempt an FGC from federal laws that Congress created⁸¹ and the FGC would lose sovereign immunity status because of the disclaimer,⁸² but that Congress could not “evade the most solemn obligations imposed in the Constitution by simply resorting to the corporate form.”⁸³

Professor Nagy summarized the post-*Lebron* cases to conclude that “lower courts have differed as to whether the Court’s holding demands application of a three-prong test or permits a more flexible analysis.”⁸⁴ The three-prong test states that: “[o]nly if (1) the government created the corporate entity by special law, (2) the government created the entity to further governmental objectives, and (3) the government retains permanent authority to appoint a majority of the directors of the corporation will the corporation be deemed a government entity for the purpose of the state action requirement.”⁸⁵

In the more flexible analysis, courts would consider the “totality of the circumstances” where “no one factor or set of factors [is] dispositive by itself.”⁸⁶ In applying either test to a privatized Trust Fund, it is likely that the corporate form would be deemed a state actor. Two of the prongs are easily satisfied. Special legislation would need to be passed by Congress and signed by the President to create the corporate entity.⁸⁷ As will be discussed in Part III below, a majority of the directors should be appointed by the government given the size and importance of the Trust Fund. Thus, the third prong would also be satisfied.

⁷⁸ *Lebron*, 513 U.S. at 400.

⁷⁹ Amtrak is the common designation for the legal entity which is the defendant, the National Railroad Passenger Corp.

⁸⁰ *See Lebron*, 513 U.S. at 392. The enabling legislation for Amtrak states that the corporation “will not be an agency . . . or establishment of the United States Government.” 45 U.S.C. § 541 (repealed 1994). This sort of disclaimer became more common for FGCs starting in the 1960s with Comsat. *See Lebron*, 513 U.S. at 390.

⁸¹ Justice Scalia notes that such a disclaimer would remove an FGC from oversight of federal laws “such as the Administrative Procedure Act, 5 U.S.C. § 551 et seq. (1988 ed. and Supp. V), the Federal Advisory Committee Act, 5 U.S.C. App. § 1 et seq., and the laws governing Government procurement, see 41 U.S.C. § 5 et seq. (1988 ed. and Supp. V).” *Lebron*, 513 U.S. at 392.

⁸² *Id.*

⁸³ *Id.* at 397.

⁸⁴ Nagy, *supra* note 15, at 1040.

⁸⁵ *Id.* (citing *Horvath v. Westport Library Ass’n*, 362 F.3d 147, 153 (2d Cir. 2004)).

⁸⁶ *Id.* at 1040 n.377.

⁸⁷ *See* discussion on formation *infra* notes 159–165 and accompanying text.

The second factor of whether the government created the entity to further government objectives could be reasonably debated, though in the final analysis, this factor too weighs in the balance toward finding that a government entity exists. In *Lebron*, the Court found that Amtrak furthered government objectives by placing the entity into its historical context of other government-created corporations.⁸⁸ The Court noted that FGCs have been created to build the Panama Canal,⁸⁹ make distress loans during the Great Depression,⁹⁰ and to insure bank deposits and liquidate the assets of failed banks⁹¹—all of which were considered furthering government objectives. The Court also found that Amtrak was created to “avert the threatened extinction of passenger trains in the United States” in the interest of “public convenience and necessity.”⁹²

Certainly social insurance, in the form of Social Security, as a collectivist response to the issue of poverty⁹³ is a government objective. If it is a government objective to make loans to individual citizens during a time of economic crisis, then an entity created to further the funding of poor peoples’ retirement is likewise a government objective. Although providing for retirement is also the province of traditionally private entities, such as insurance companies, mutual funds, etc., the literature on the development of Social Security is replete with references that in the 1930s, it was recognized that government had a role to play in providing a safety net for its elderly poor.⁹⁴

The Court, however, has also found that some FGCs do not operate to further a government objective. In *San Francisco Arts & Athletics, Inc. v. United States Olympic Committee*, Justice Powell noted that “[t]his Court also has found action to be governmental action when the challenged entity performs functions that have been ‘traditionally the *exclusive* prerogative’ of the Federal Government.”⁹⁵ However, the Court declined to find that the

88 See *Lebron*, 513 U.S. at 386.

89 *Id.* at 387.

90 *Id.* at 388.

91 *Id.*

92 *Id.* at 383–84.

93 See MARK HYDE & JOHN DIXON, *Welfare Ideology, the Market and Social Security: Toward a Typology of Market-Oriented Reform*, in *THE MARKETIZATION OF SOCIAL SECURITY I* (John Dixon & Mark Hyde eds., 2001).

94 DANIEL BÉLAND, *SOCIAL SECURITY: HISTORY AND POLITICS FROM THE NEW DEAL TO THE PRIVATIZATION DEBATE* 63–64 (2005).

95 *San Francisco Arts & Athletics, Inc. v. U.S. Olympic Comm.*, 483 U.S. 522, 544 (1987). The case arose when an amateur gay and lesbian athletics association formed in 1981 with the objective of holding the first “Gay Olympics.” The USOC filed suit to prevent the organization from using the name “Olympics.” The Court noted that “[s]ection 110 of the Amateur Sports Act (Act), 92 Stat. 3048, 36 U.S.C. § 380, grants [the] United States Olympic Committee (USOC) the right to prohibit certain commercial and promotional uses of the word ‘Olympic’ and various Olympic symbols.” *Id.* at 526 (citation omitted). *San Francisco*

United States Olympic Committee, a corporation chartered and funded in part by Congress, was acting for the government since “[n]either the conduct nor the coordination of amateur sports has been a traditional governmental function.”⁹⁶ In a similar vein, investing in the private stock market is widely considered—even by liberal advocates of social insurance—to not be a function of the government.⁹⁷ Following this line of thinking, one might analogize to the nondelegation doctrine cases, which address the issue of whether some governmental powers cannot be delegated and should be reserved to the government.

An argument can be advanced that if the function of the FGC is not a traditional government function then the function does not threaten individual liberty and should not weigh heavily when considering the second prong of the *Lebron* test. In commenting on what constitutes a governmental power, Professor Lawrence finds that “certain powers [are] essentially governmental: rulemaking, adjudication of rights, seizure of person or property, licensing and taxation.”⁹⁸ Criticism of the privatization trend has for the most part focused on transferring authority to private organizations which might inflict harm on due process rights, such as the trend to privatize the provision of government funded health care benefits,⁹⁹ federal prisons¹⁰⁰ and the ceding of government regulatory functions in important areas like the accounting profession.¹⁰¹ Here, there are no regulatory functions being ceded to the Trust Fund. The Trust Fund’s corporate powers would be limited to investing Social Security assets into a widely diversified portfolio of investments. While those investments—in the aggregate—are likely to have broad positive macroeconomic effects, the purpose behind the trust is not to create economic policy for the government.¹⁰² Given that the government traditionally does not use tax

Arts & Athletics, Inc. challenged the exclusive use in part on an argument that the USOC was a governmental actor.

96 *Id.* at 545.

97 Libertarians and many Republicans are adamant that it is not the role of the government to invest in equities. See PRESIDENT’S COMM’N TO STRENGTHEN SOC. SEC., *supra* note 7. Even Robert Ball, the legendary New Deal Democrat and former SSA head, questioned the wisdom of investing the Trust Fund in the market because of concerns over government’s participation in corporate governance, though he later supported the idea of limited investing in a broad index that would represent the “entire American economy.” EDWARD D. BERKOWITZ, ROBERT BALL AND THE POLITICS OF SOCIAL SECURITY 350 (2003).

98 See Nagy, *supra* note 15, at 977 n.5 (quoting David M. Lawrence, *Private Exercise of Governmental Power*, 61 IND. L.J. 647, 648 (1986)).

99 See Freeman, *supra* note 55, at 594–625.

100 *Id.* at 625–30.

101 See Nagy, *supra* note 15, at 975.

102 For a discussion of the broader macroeconomic consequences of investing the Trust Fund in the markets, see Diamond, *supra* note 5, at 58 n.71; Seidman, *Making the Case For Funding Social Security*, *supra* note 15, at 246; Bosworth & Burtless, *supra* note 3, at 6.

revenues to make investments for the purpose of generating more income, it can be argued that the creation of the Trust Fund was not furthering a government objective.

Yet in all likelihood, the government objective of Social Security will not be judged in such narrow terms. The objective of the Trust Fund is not to foster private investment for its economic gains. Rather, the larger objective is clearly the government's interest in the funding crisis facing the collectivist program of Social Security—clearly a government objective. Moreover, *San Francisco Arts & Athletics, Inc. v. United States Olympic Committee* can be distinguished from the present case. First, the Court was split on the issue of whether the USOC performed a “traditional governmental function.” Justice Brennan, in the dissent, argued that the USOC did perform a “traditional governmental function” by representing the United States within the international community at sporting events. “Although the Olympic ideals are avowedly nonpolitical, Olympic participation is inescapably nationalist.”¹⁰³ The majority also noted that the U.S. government did not maintain control over the USOC, whose governance structure is independent.¹⁰⁴ If *San Francisco Arts & Athletics, Inc. v. United States Olympic Committee* were decided under *Lebron*, it would probably fail the third prong of the three-part test since the government did not appoint a majority of the directors.

Even under the stricter three-prong test used by courts interpreting *Lebron*, it is likely the Trust Fund would be deemed a state actor since all three elements are present. In this case, the corporation would take on a status like that of Amtrak—i.e. a “public/private entity”¹⁰⁵ not unlike an agency but formed in the private sector to take advantage of techniques and political insulation that public agencies cannot achieve. Justice Scalia commented on the unique character of such a corporation when discussing the government corporations formed in the 1930s and 1940s to address the needs posed by the Great Depression and World War II.

A remarkable feature of the heyday of those corporations . . . was that, even while they were praised for their status “as agencies separate and distinct, administratively and financially and legally, from the government itself, [which] has facilitated their adoption of commercial methods of accounting and financing, avoidance of political controls, and utilization of regular procedures of business management,” it was fully acknowledged that they were a “device” of “government,” and constituted “federal corporate agencies” apart from “regular government departments.”¹⁰⁶

¹⁰³ *San Francisco Arts & Athletics, Inc. v. U.S. Olympic Comm.*, 483 U.S. 522, 550 (1987).

¹⁰⁴ *Id.* at 545 n.27.

¹⁰⁵ See Nagy, *supra* note 15, at 1038.

¹⁰⁶ See *Lebron v. Nat'l R.R. Passenger Corp.*, 513 U.S. 374, 394–95 (1995) (citing C.

So, while the Trust Fund might be considered a state actor for constitutional purposes, it can be, absent another decision by the Supreme Court, given the appropriate legislation by Congress designating it as such,¹⁰⁷ a private actor for all other purposes.

B. *Nondelegation Doctrine*

Another possible constitutional constraint on FGCs is the nondelegation doctrine.¹⁰⁸ The constitutional provisions of due process and separation of powers gave rise to the nondelegation doctrine which prevents a delegation of congressional "legislative power to other institutions, whether public or private."¹⁰⁹ The doctrine, however, seems to be rarely used to constrain congressional delegation of policy making power to administrative agencies so long as Congress "lay[s] down . . . an intelligible principle to which the person or body authorized to take action is directed to conform."¹¹⁰ Scholars contend that the rare use of the doctrine is "troubling because administrative agencies are less accountable to the public than Congress or the President."¹¹¹ The nondelegation doctrine also proscribes congressional delegation of legislative power to private entities, though most delegations seem to be upheld.¹¹²

It is unlikely that a privatized Trust Fund would be held constitutionally invalid under the nondelegation doctrine. Scholars contend that the modern nondelegation doctrine, as an offspring of the separation of powers, "is primarily concerned with congressional actions that aggrandize its own power at the President's expense."¹¹³ If a delegation merely lessens presidential power, then it is less likely to be held unconstitutional.¹¹⁴ Here, the decision making power to invest the Trust Fund assets shifts from

Herman Pritchett, *The Government Corporation Control Act of 1945*, 40 AM. POL. SCI. REV. 495, 495 (1946)).

107 Justice Scalia noted in *Lebron* that a congressional designation in the enabling legislation of a FGC that the entity was not an agency of the government would likely exempt the FGC from the constraints imposed by federal legislation limiting the ability of agencies to contract, setting up reporting relationship and other actions. *Id.* at 394.

108 Froomkin, *supra* note 15, at 574.

109 Nagy, *supra* note 15, at 1057.

110 *Id.* (quoting *J.W. Hampton, Jr., & Co. v. United States*, 276 U.S. 394, 409 (1928)).

111 *Id.* at 1058.

112 While the leading case invalidating delegation of state power to private entities *Carter v. Carter Coal Co.*, 298 U.S. 238 (1936), has not been overruled and is "alive in theory, it is all but dead in practice. Almost all private delegations [of state power] are upheld." Metzger, *supra* note 39, at 1440. Certain government functions remain "nondelegable, or at least not delegable without continuing government oversight." Verkuil, *supra* note 62, at 421.

113 Froomkin, *supra* note 15, at 576.

114 *Id.*

the executive branch to a private entity. Such an action does not increase congressional authority and therefore should be held constitutional.

Moreover, the power to invest Trust Fund assets is not the type of delegation that the Supreme Court is concerned with in applying the nondelegation doctrine since investing fund assets is not legislating, issuing regulations or a power traditionally reserved to the states. A more controversial transfer of government power to a private entity is the creation of private prisons, since “the right to physically constrain and coerce others is ordinarily reserved for the state.”¹¹⁵ An argument could be made that the use of \$1.9 trillion in government funds to invest in the market acts as a form of regulation. With such a large amount to invest, the Trust will likely be able to set market prices or otherwise compete where others cannot. However, as Professor Froomkin notes, “[c]ompetition alone, even competition by an FGC powerful enough to set the market price, is not a constitutional violation.”¹¹⁶

Professor Metzger argues that control over government resources, such as Medicare benefits, is considered government power when in the hands of the government, so the transfer of such power to private hands “does not inherently change the nature of the power at issue.”¹¹⁷ However, clearly the potential for coercive behavior would be less when the government cedes management of the Trust Fund to a private corporation for investment purposes than when the government transfers resources, such as the delivery of Medicare benefits, to a private third party. In the latter case, the private corporation is making decisions on the allocation of benefits; whereas in the former, the corporation is attempting to create wealth for funding programs and leaving the allocation decision to the government.

Professor Metzger proposes a new private delegation doctrine in order to address the deficiencies of the state action doctrine.¹¹⁸ Professor Metzger uses agency theory to identify areas where a state delegation of government power amounts to a principal–agent relationship which demands accountability of the principal—i.e. the government—for the agent’s actions.¹¹⁹ Under this proposed analysis, if a private actor is wielding government power, then appropriate accountability mechanisms must be put in place so that the exercise of that power comports with constitutional requirements.¹²⁰ “If such mechanisms are lacking, the appropriate judicial response is not subjecting private entities to direct constitutional scrutiny, but instead requiring that the government create such mechanisms as the constitutionally–imposed price of delegating government power to private

115 Metzger, *supra* note 39, at 1397.

116 Froomkin, *supra* note 15, at 577.

117 Metzger, *supra* note 39, at 1399.

118 *Id.* at 1501–02.

119 *Id.* at 1464.

120 *Id.* at 1374.

hands.”¹²¹ If the government still does not create such mechanism, then it is the delegation of authority to the private actor which is found to be unconstitutional rather than the designation of a private entity as a state actor.¹²² Since this article proposes that the Trust Fund concede that it is a state actor for constitutional purposes, the constitutional rights that Professor Metzger seeks to protect should be enforceable through a judicial action so long as the party has standing.

C. Consequences of Being a State Actor

If the Trust Fund is found to be a state actor, what are the constitutional implications? Given that a privatized Trust would not be engaged in traditional governmental regulatory or investigative functions, there are likely only four primary constitutional constraints: (1) the FGC must give employees the constitutional rights of other governmental workers,¹²³ (2) the enabling legislation must comport with the Appointment Clause of the Constitution,¹²⁴ (3) the organization must not violate the “structural safeguard” provided by the separation of powers doctrine,¹²⁵ (4) in some limited circumstances the Trust Fund could be subject to a Takings Clause challenge in the event that the fund was accused of underbidding for an asset. Aside from the question of employees, Fifth Amendment due process rights and First Amendment free speech rights of other citizens are not likely to be infringed from the buying and selling of assets. Congress would not be delegating rule-making power or regulation power as it might to an administrative agency; therefore, the Trust Fund is not likely to be put in the position of ever denying a citizen any constitutional due process or free speech rights. Rather, the purpose of the corporate entity is merely to invest the funds in order to help achieve solvency for the Trust Fund.

For each of the four constitutional issues mentioned, one primary concern is whether the constitutional requirements interfere with the principle of political insulation. The purpose of the privatization of the Trust Fund is to achieve political insulation in the investment decision and voting of shares. If these constitutional requirements inhibit that goal, then some other structure is needed.

As to the first issue—protecting government employee constitutional rights—there is little concern that this would impact the goals of political insulation. In writing about the Public Company Accounting Oversight Board (PCAOB) and its probable status as a state actor, Professor Nagy identifies three possible ways in which the entity must protect workers’

¹²¹ *Id.*

¹²² *Id.*

¹²³ Nagy, *supra* note 15, at 1044.

¹²⁴ Froomkin, *supra* note 15, at 609; Nagy, *supra* note 15, at 1049.

¹²⁵ Nagy, *supra* note 15, at 1053–54.

constitutional rights, including: (1) a Fifth Amendment Due Process Clause protection to “protect . . . employees from being disciplined or terminated without the opportunity for a hearing,” (2) guarantees of freedom of speech under the First Amendment to “protect [an employee’s] ability to criticize elected officials (including the President)” and (3) “the Fourth Amendment’s prohibition of unreasonable searches and seizures may afford . . . employees a zone of limited privacy in the workplace (prohibiting, for instance, mandatory random drug testing).”¹²⁶ None of these protections for individual employees should affect the goal of political insulation. To the contrary, First Amendment freedom of speech rights and Fifth Amendment due process rights may actually strengthen the political insulation by giving the directors and managers of the Trust Fund more latitude in what they say publicly and more security in the knowledge that their job safety rests on performance and not on politics. Moreover, the Trust Fund, like any employer, could strengthen due process rights for its employees beyond those afforded public employees through private contract law.¹²⁷

As to the second issue, if the Trust is a state actor, then it must comport with the Appointments Clause. The Appointments Clause of the U.S. Constitution provides that the President shall appoint all officers of the executive branch with the advice and consent of the Senate.¹²⁸ Congress may delegate the appointment of “inferior Officers” to the President, the courts or heads of departments. Thus, if the board and managers of a privatized Trust Fund were deemed to be inferior officers, the appointment process could bypass the political process of a Presidential appointment with advice and consent of the Senate.

The courts and Constitution provide little guidance in determining whether a particular position is that of a principal officer or inferior officer.¹²⁹ In *Morrison v. Olson*, the majority considered three reasons in determining

¹²⁶ *Id.* at 1044–45.

¹²⁷ *Id.* at 1045.

¹²⁸ U.S. CONST. art. II, § 2, cl. 2. In addition to the two categories of officers and inferior officers, a third subordinate category of employee, who are not subject to the Appointments Clause, has emerged “[a]s a pragmatic concession to the needs of the government bureaucracy.” See ROTUNDA & NOVAK, *supra* note 69, § 9.4.

¹²⁹ “The line between ‘inferior’ and ‘principal’ officers is one that is far from clear, and the Framers provided little guidance into where it should be drawn. (‘In the practical course of the government there does not seem to have been any exact line drawn, who are and who are not to be deemed inferior officers, in the sense of the Constitution, whose appointment does not necessarily require the concurrence of the senate’).” *Morrison v. Olson*, 487 U.S. 654, 671 (1988) (citation omitted). Despite the lack of an absolute test to determine who is an inferior officer, the court has, at times, created a laundry list of types of offices that are not principal officers. “Among the offices that we have found to be inferior are that of a district court clerk, an election supervisor, a vice consul charged temporarily with the duties of the consul, and a ‘United States commissioner’ in district court proceedings.” *Edmond v. United States*, 520 U.S. 651, 661 (1997) (citations omitted). The Court also noted that “the independent counsel created by provisions of the Ethics in Government Act of 1978” was an inferior officer. *Id.*

whether an office was an inferior officer: (1) whether the officer was “subject to removal by a higher Executive Branch official,” (2) the extent to which the officer is “empowered by the Act to perform only certain, limited duties” and (3) if the officer was “limited in jurisdiction” and “limited in tenure.”¹³⁰ Following his textualist tradition, Justice Scalia, in his dissent, argued that “one is not an ‘inferior officer’ within the meaning of the provision under discussion unless one is subject to supervision by a ‘superior officer.’”¹³¹ Justice Scalia argued that while this standard was not a “sufficient condition,” it was a “necessary condition.”¹³² In *Edmond v. United States*, Justice Scalia, now writing for the majority, stated that “in the context of a clause designed to preserve political accountability relative to important Government assignments, we think it evident that ‘inferior officers’ are officers whose work is directed and supervised at some level by others who were appointed by Presidential nomination with the advice and consent of the Senate.”¹³³

It is not likely the directors of a \$1.9 trillion and growing Trust Fund for America’s most favored entitlement will be considered a job of an inferior officer for constitutional purposes. The appointment of such an important social, economic, and politically sensitive position is not likely to be delegated to other principal officers. Instead, the President is likely to want direct control. Thus, Scalia’s “necessary condition” that is required to find a position to be an inferior officer would not be met. Moreover, from a populist perspective, the average American, given their self-interest in the outcome of the performance of the fund, will more likely follow the performance of the Trust Fund with keener interest than the acts of the Secretary of State or even the President. It is not likely the electorate would stand for any lower status and would demand the people who run the Trust Fund be held accountable through the political process.

Consequently, to the extent that the Trust is a public agency and therefore subject to the constitutional requirements of appointment of officers, any attempt to move the appointment process out of the hands of the President would undermine the President’s constitutional power.¹³⁴ In the landmark Appointments Clause case, *Buckley v. Valeo*, the Supreme Court held that Congress could not “usurp for itself the President’s appointing

¹³⁰ *Morrison*, 487 U.S. at 671–72.

¹³¹ *Id.* at 720 (Scalia, J., dissenting).

¹³² *Id.* at 722.

¹³³ *Edmond*, 520 U.S. at 663.

¹³⁴ Froomkin, *supra* note 15, at 610. Although he admits that the “possibility . . . is remote,” Professor Froomkin argues that any designation of a federal government agency as a private actor would mean that “[t]heoretically, Congress could authorize the Speaker of the House, or a congressional Joint Committee, to appoint directors of an FGC. The consequences would devastate presidential power.” *Id.*

authority.”¹³⁵ The Court would even go to the lengths of invalidating the actions of an “agency headed by an invalidly appointed official”¹³⁶—a course of action that could be harmful for the financial health of the Trust Fund if the entity were compelled to unwind investments before the value had been received.¹³⁷

As the head of the executive branch, the President has “formal control over most federal agencies” and his plenary power extends not only to appointment but also to “remove nearly all[] principal officers in the executive branch.”¹³⁸ The exceptions to the rule of removal are found in several independent agencies, such as the Federal Reserve, SEC, FBI and CIA among others, for which the President appoints a head for a fixed term. The head can only be removed for cause.¹³⁹ Setting up a system for the Trust Fund which comports with the Appointments Clause yet maintains political insulation will be discussed in Part III below.

As to the third issue, the Trust Fund’s oversight, reporting structure and corporate organization must not violate any of the structural constitutional doctrine of the separation of powers¹⁴⁰ or it will be declared unconstitutional. Any legislation authorizing a privatized Trust Fund would need to make certain that the structure does not infringe on power ceded by the Constitution to the President “to ‘take care that the laws be faithfully executed.’”¹⁴¹ The uncertain status of FGCs may also affect congressional oversight of government administrative agencies.¹⁴² Specific controls to address separation of powers issues, such as the voting of shares in the corporation, will be discussed in Part III below.

As to the fourth issue, some limited circumstances that occur in hostile corporate takeovers may lead to accusations that the Trust Fund engaged in a Fifth Amendment “taking” requiring “just compensation.” Eminent domain allows the government to take private property for a public use. This power is limited by the Fifth Amendment, which provides that private property will not “be taken for public use, without just compensation.”¹⁴³ In the context of a Trust Fund acquisition of corporate stock, issues arise as to whether a taking occurred. If that issue is resolved, then it’s likely that the public use requirement will be satisfied given the goal of the Trust Fund

135 *Id.* at 608 (citing *Buckley v. Valeo*, 424 U.S. 1, 127–28 (1976)).

136 *Id.* at 608–09 (citing *Buckley*, 424 U.S. at 142).

137 A buy and hold strategy will typically return more for an investor since transaction costs of trades cut into the yield on returns.

138 Froomkin, *supra* note 15, at 608.

139 *Id.*

140 Nagy, *supra* note 15, at 1054.

141 *Id.* at 1055–56.

142 Froomkin, *supra* note 15, at 548.

143 U.S. CONST. amend V.

to provide funding for social insurance.¹⁴⁴ Thus, the remaining issue would be whether the Trust Fund gave just compensation when it acquired the shares.

Typically, the purchase of an asset on the open market by the government does not constitute an exercise of eminent domain. When the government negotiates to purchase pencils at a discount from a supplier, the transaction is merely bargaining in the marketplace and the supplier is free to reject the government's offer. However, in the context of hostile takeovers, some coercive corporate tactics might be construed as takings when the acquirer is a government actor. Large hedge funds routinely use financial leverage to take over troubled corporations. These buy-out funds might make a tender offer for a company which is trading at or below book value, sell off some of the assets, and manage others in a way to make them more profitable than the previous owners. During a hostile takeover, often the management of the target company and/or minority shareholders resist the takeover attempt. Removing managers and directors who resist a takeover requires that the acquirer gain effective control of the board of directors and then comply with both statutory and contractual procedures regarding removal. The percentage ownership needed to gain effective control of a board depends on the articles of incorporation, bylaws, classes of share and other factors that can effectively cede control to a shareholder or group of shareholders even if they own less than a majority of the shares. In contrast, forcing a sale of stock by minority shareholders requires that the buyer of the shares either possess a contractual right (such as a right of redemption) or a statutory right to purchase the shares. Most state statutes allow a 90% majority shareholder to compel minority shareholders to sell their shares in what is commonly called the "short form merger."¹⁴⁵ In the short form merger, minority shareholders who dissent to the forced sale typically have "appraisal rights" where the court makes a determination whether the shareholders received the "fair value" for their shares.¹⁴⁶ If a privatized Trust Fund began to buy out troubled companies, such dissenting

¹⁴⁴ The U.S. Supreme Court recently expanded the powers of eminent domain in *Kelo v. City of New London* when it held that the "public use" requirement was satisfied even when the government planned to transfer the property from one private owner to another who would make better economic use of the property. 545 U.S. 469, 483–84 (2005) (holding that economic revitalization of a residential area was a legitimate reason for eminent domain). Given the collectivist nature of social insurance, acquiring a company for the purpose of funding the program would clearly benefit the public and satisfy the public use requirement. That said, in no way does this article suggest that a privatized Trust Fund should be imbued with eminent domain powers. In fact, the enabling legislation should prohibit the exercise of such powers if this is a concern among lawmakers.

¹⁴⁵ See DEL. CODE ANN. tit. 8, § 253 (2007).

¹⁴⁶ See DEL. CODE ANN. tit. 8, § 262. If there is a public market for the shares, then the price at the time of merger is deemed to be the fair value. *Id.* Such a cause of action would be covered by the state law of the target company.

shareholders who are forced to sell might argue that the sale was really a government taking and later dispute the buy-out price as to whether it was “just compensation” in the hope that the standard of just compensation under a constitutional cause of action would yield more than that afforded by corporate law’s appraisal rights.¹⁴⁷

Similar to the “appraisal rights” available under a corporate law regime, “just compensation” under the Fifth Amendment merely requires that the government give “market value fairly determined.”¹⁴⁸ Scholars, however, have suggested that the constitutional fair market value standard under-compensates since owners may incur economic losses not compensated by the purchase price (e.g. transaction costs incurred by replacing the item purchased), the purchase price, although deemed to be the market value, may not reflect the owner’s justified valuation, and subjective losses as to sentimental value and dignitary harms.¹⁴⁹ In the corporate law context, commentators have also suggested that appraisal rights might under-compensate minority shareholders since behavioral finance theory suggests that the public markets—the key indicator of fair market value—include irrational actors who routinely misprice securities.¹⁵⁰ Under current standards, however, courts are likely to view recovery under either a corporate law regime or a constitutional regime as netting out to the same number—i.e. the fair market value of the shares as determined by the public market. Consequently, in order to recover economic losses not reflected in the fair market value plus subjective losses a plaintiff would need to persuade the court that scholars are correct and those losses should be recoverable in the takings context because the right being protected is a constitutional one. Courts are likely to reject such an argument since a sale forced by a government entity seems less coercive if the same sale could have been compelled by a private actor. Even so, the ability of plaintiffs to plead a takings challenge might add to the litigation costs of the Trust Fund. For these reasons, it is might be best to avoid the scenario entirely

147 Although the property being discussed here is stock in a company rather than land, the Takings Clause applies since the government would be physically taking title to the asset. Frank I. Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of “Just Compensation” Law*, 80 HARV. L. REV. 1165, 1184–85 (1967).

148 *United States v. Miller*, 317 U.S. 369, 374 (1943) (quoting *Olson v. United States*, 292 U.S. 246, 255 (1934)).

149 Nicole Stelle Garnett, *The Neglected Political Economy of Eminent Domain*, 105 MICH. L. REV. 101, 106–09 (2006). The article provides an overview of scholarship which suggests increased awards but rejects such hypotheses arguing that in public use takings “overcompensation may become problematic . . . when it undermines resistance to questionable projects.” *Id.* at 142. In most eminent domain proceedings federal law provides that there must be precondemnation bargaining over the price of the asset before resorting to eminent domain. In some litigation, citizens have protested the use of pre-condemnation bargaining as attempts by the government to “force them out for pennies on the dollar.” *Id.* at 127.

150 Lawrence A. Cunningham, *Behavioral Finance and Investor Governance*, 59 WASH. & LEE L. REV. 767, 772–86, 833–34 (2002).

and prevent the Trust Fund statutorily from purchasing all of the stock in a company. Such a strategy avoids other possible constitutional law issues though there are trade-offs in terms of possible returns which are discussed in more detail in Part IV(D)(1).¹⁵¹

D. Towards New Identity: The Public-Private Entity

Since the Trust Fund is likely to be designated a state actor, it might best be designated as a “public/private” entity.¹⁵² Professor Nagy describes the PCAOB as a public/private entity, which is “public for purposes of the rights, liberties, and structures protected by the Constitution, and private for other purposes.”¹⁵³ Applying the public/private entity label to the Trust Fund should not affect the political insulation needed for active investing; yet it would subject the entity to constitutional accountability. It may be wise to designate the Trust Fund as an independent agency of the federal government, even though it would technically be a private corporation. The Federal Deposit Insurance Corporation is structured in this fashion.¹⁵⁴ In this way, the constitutional uncertainty is bypassed.

¹⁵¹ The possibility of the Trust Fund actually being the sole shareholder of a for-profit corporation brings up other constitutional law issues beyond the possible takings problem since such sole ownership would likely impute state actor status to those corporations. For example, if the Trust Fund bought out a corporation that owns and leases space on billboards, as in *Lebron*, and a court found that the Trust Fund operated as an owner, then the same First Amendment analysis in *Lebron* would apply to the wholly owned subsidiary of the Trust Fund. Such constitutional restraints on a subsidiary could lead to a devaluation of the subsidiary's worth thereby defeating the principle aim of the entity—i.e. to maximize the wealth of the Trust Fund.

¹⁵² Recently, there have been several calls from administrative law scholars for a jurisprudence that takes into account a public-private or quasi-public entity. Administrative law scholars have actively suggested alternative theories to deal with the public-private dichotomy. Professor Metzger recognizes the realities of the nondelegation doctrine and suggests that an agency relationship between public and private actors be imposed in order to preserve constitutional accountability. See Metzger, *supra* note 39, at 1369–76. Professor Minow's examination of public accountability for privatization efforts suggests that to maintain pluralistic values and constitutional accountability, there need to be creative ways to ensure full disclosure of information regarding privatization and participation by citizens in the process. Martha Minow, *Public and Private Partnerships: Accounting for the New Religion*, 116 HARV. L. REV. 1229, 1270 (2003). Professor Freeman proposes that the realities of public-private interdependence require a rethinking of administrative law to embody not only government oversight, but also contractual constraints and an interdependent aggregate accountability involving “internal procedural rules, . . . market pressures, . . . agreements . . . with other actors, informal norms of compliance, and third party oversight.” Freeman, *supra* note 55, at 664–65. Professor Verkuil provides arguably the most concrete solution by examining how existing legislation and administrative rules might be strengthened to prevent the delegation of “inherent[ly] government[al] activities.” Verkuil, *supra* note 62, at 467–69.

¹⁵³ Nagy, *supra* note 15, at 1061.

¹⁵⁴ Professor Nagy compares the PCAOB with the FDIC to further her argument that the PCAOB should be designated as a state actor. Nagy, *supra* note 15, at 1027.

The corporation is deemed a state actor legislatively for purposes of the U.S. Constitution. The upside is that it avoids the inevitable litigation on the question of whether the Trust Fund is treated like an agency for purposes of constitutional question. However, in order to leverage the best of the private side of corporations—taking advantage of commerce—while maintaining political insulation, the entity should be exempt from many of the constraints of public agencies. Republicans and libertarians may feel more comfortable with centralized investing if the entity is deemed, much like Amtrak and other FGCs formed after the 1960s,¹⁵⁵ specifically not to be an arm of the government in order to give greater protection against pressure for politically motivated investments. Such a designation will not ultimately exempt the Trust Fund from constitutional constraints, though it might make the privatization process more politically feasible.

III. ORGANIZATIONAL STRUCTURE OF AN INCORPORATED TRUST FUND

The challenge in privatizing the Social Security Trust Fund is whether an organization can be structured to achieve the optimum returns of investing in the market without political interference yet still maintain “democratic values such as accountability, transparency, and legitimacy.”¹⁵⁶ The structure of such an organization would have to comport with the Constitution but also be flexible and independent enough to take advantage of the “commercial methods of accounting and financing, . . . and utilization of regular procedures of business management.”¹⁵⁷ Thus, while the organization would meet the structural constitutional requirements and be held accountable for infringement of personal liberties as much as a public agency, the privatized Trust Fund could still seek to “insulate [trustees] from the political process.”¹⁵⁸

This article will first examine corporate formation requirements for a privatized trust fund—i.e., the enabling legislation and choice of legal regime issues for legal problems that arise. The article then inquires into the thorny problem of keeping politics out of the board of director appointment and removal processes while still comporting with constitutional requirements.

A. Corporate Formation

The authority of the federal government to create a private corporation to carry out a public purpose comes from the Necessary and Proper Clause

155 *Lebron v. Nat'l R.R. Passenger Corp.*, 513 U.S. 374 (1995).

156 Nagy, *supra* note 15, at 980.

157 *See Lebron*, 513 U.S. at 394–95.

158 *Solomon & Berson*, *supra* note 3, at 140.

of the Constitution and the landmark Supreme Court case *McCulloch v. Maryland*.¹⁵⁹ Instead of operating as a federal agency, the entity would operate like as a private corporation not unlike the U.S. Post Office, Tennessee Valley Authority (TVA) or Amtrak.¹⁶⁰ Though widely perceived as not profitable (especially in the case of Amtrak), such government corporations need not operate at a loss. In the fiscal years from 2004 to 2006 the U.S. Post Office had annual net income running from \$900 million to over \$3 billion.¹⁶¹

The Government Corporation Control Act of 1945 requires an act of Congress to create an FGC.¹⁶² Such legislation would create the FGC as a legal person separate from the government for all purposes except for applicable constitutional restraints as discussed above and any applicable statutes that might apply to government agencies which the enabling legislation does not exempt. Normally, one purpose in creating a corporation is to remove liability from the shareholder for corporate debts and obligations. To the extent that the privatized Trust Fund is deemed to have a fiduciary duty to the beneficiaries of Social Security, that duty would not relieve the federal government of political responsibility for funding the program under the Social Security Act.

While the FGC must be authorized by federal statute, the corporate regulatory regime for an FGC is governed by the federal charter or “may specify incorporation under the laws of the District of Columbia.”¹⁶³ However the federal enabling legislation could specify that only certain provisions of the District of Columbia Business Corporation Act (BCA) apply to the FGC. Amtrak is a perfect example of this FGC structure. Although the District of Columbia BCA provides the appointment of

¹⁵⁹ Froomkin, *supra* note 15, at 551. The Necessary and Proper Clause states that, among other enumerated powers, Congress shall have the power “[t]o make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof.” U.S. CONST. art. I, § 8, cl. 18. In *McCulloch v. Maryland*, 17 U.S. 316, 325–26 (1819), the court held that the Necessary and Proper Clause of the Constitution conferred upon the government the power to create a private corporate entity to handle the nation’s banking needs despite the fact that such authority was not among the enumerated federal powers. Froomkin, *supra* note 15, at 551.

¹⁶⁰ Each example corporation was created in a different manner. The Post Office was spun out from an agency; whereas Amtrak was taken over from a private enterprise. The TVA was created from scratch. ALFRED F. CONRAD, CORPORATIONS IN PERSPECTIVE 141 (1976).

¹⁶¹ U.S. POSTAL SERV., 2006 UNITED STATES POSTAL SERVICE ANNUAL REPORT 3 (2006), available at http://www.usps.com/financials/_pdf/anrpt2006_final.pdf. Commentators dispute whether the earnings are comparable to private industry since the Post Office is exempt from taxes and certain other costs.

¹⁶² 31 U.S.C. § 9102 (2000). The Government Corporation Control Act of 1945 was passed because of concerns of accountability over the large number of FGCs created during World War II. See *Lebron*, 513 U.S. at 389–90.

¹⁶³ Froomkin, *supra* note 15, at 552.

directors, the Rail Passenger Service Act of 1970 which created Amtrak trumps the District of Columbia BCA by specifying how directors are to be selected.¹⁶⁴ Given the *sui generis* nature of the Social Security Trust Fund as a private entity, federal legislation should probably define many if not most of the parameters of the corporate body, its powers and appointment of officers rather than the District of Columbia BCA. Although the BCA would certainly be a fine fallback position for any areas not addressed by the enabling legislation.¹⁶⁵

Also, the enabling legislation need not mirror current statutes governing FGCs. Principles found in nonprofit corporation law or, in the case of the Social Security Trust Fund, the law of trusts, may be necessary to incorporate into the enabling legislation to ensure a robust and accountable organization.

B. Appointments: Models for Success

Perhaps the greatest threat to political insulation is through the appointment and removal of directors and officers for the privatized Trust Fund. Since the privatized Trust Fund is likely a state actor, the process to appoint directors must comport with the constitutional requirements of the Appointments Clause,¹⁶⁶ yet also provide for enough safeguards that the Trust Fund is shielded from political influence on the investment decision. The appointment and removal of directors of a corporation is generally governed by the state's corporations' code as well as any provisions in the articles of incorporation and bylaws. Here, the enabling legislation would preclude the District of Columbia BCA for purposes of appointment and removal. This article first examines the dangers of political appointees and then discusses some entity models that have withstood political interference, including the Canada Pension Plan Investment Board and the Federal Reserve Board. U.S. public pension plans also provide models for the governance structure of a private Social Security Trust Fund. Finally, this article proposes an appointments and removal model for the Social Security Trust Fund which would comport with constitutional requirements while minimizing the risks of exposing the Trust Fund to political influence through the appointment process.

In her seminal article on public pension fund activism, Professor Roberta Romano noted that appointments of board members to public pension plans tend to "fall into one of three categories: gubernatorial appointees; representatives elected by fund beneficiaries; and individuals

¹⁶⁴ See *Lebron*, 513 U.S. at 385.

¹⁶⁵ Any given charter for a FGC in the United States Code reads like a mix of articles of incorporation, bylaws and the corporations' code of any given state. See generally 36 U.S.C. §§ 101–2401 (2000) (providing examples of Congressionally chartered corporations).

¹⁶⁶ Froomkin, *supra* note 15, at 610.

named by virtue of their office.”¹⁶⁷ When political appointments govern the appointment process of trustees, investment decisions and voting of shares become corrupted by political rather than economic concerns. In an empirical study of fifty state pension funds, Professor Romano discovered that a fund’s earnings decrease when board membership consists of political appointees.¹⁶⁸ “This finding is consistent with the hypothesis that public pension funds experience political demands that adversely affect their performance.”¹⁶⁹ Professor Romano noted that in the case of the California public pension fund, Calpers, attempts have been made by Republican governors to reorganize the board of trustees in order to reduce the fund’s shareholder activism. Calpers has routinely criticized management of several large public companies over compensation packages¹⁷⁰ as well as other issues.¹⁷¹ Professor Romano concluded that “[t]he political affiliation of a significant number of fund trustees renders public pension funds especially vulnerable to pressure by other [government] officials.”¹⁷² Professor Romano concludes that “[i]t is quite possible that fund boards comprised of political appointees will capitulate to local interest groups’ investing and voting demand in order to forestall frontal attacks on fund organization and assets.”¹⁷³

In contrast, boards consisting of members elected by beneficiaries yield better performance.¹⁷⁴ Professor Romano posits that politically appointed—i.e. non-independent boards—choose social investments that are riskier thus yielding a lower return; whereas independent boards choose “a different asset allocation as well as a different mix within asset classes,” thus yielding a more diversified portfolio that is likely to yield higher returns.¹⁷⁵ Thus, one method “to mitigate political influence on public fund investments” is to require that at least some of the fund board members are elected by beneficiaries.¹⁷⁶ In contrast, other commentators have made it clear that “power must be vested in a nonelected, nonpartisan body.”¹⁷⁷

167 Romano, *supra* note 8, at 800–01.

168 *Id.* at 825.

169 *Id.*

170 *Id.* at 818.

171 See HILARY ROSENBERG, A TRAITOR TO HIS CLASS (1999).

172 Romano, *supra* note 8, at 801.

173 *Id.* at 819. Professor Romano looks at behavior by California public pension fund giant Calpers in committing funds to public housing even after an unsuccessful attempt by a Republican governor to replace the board. Despite the unsuccessful attempt, Calpers may have been influenced by the governor’s wishes in order to prevent further attacks. *Id.* at 818–20.

174 *Id.* at 827.

175 *Id.*

176 *Id.* at 840.

177 Solomon & Berson, *supra* note 3, at 132. Professor Solomon suggests that removal of a manager be provided for in the event of malfeasance or nonfeasance and that the government

Where the solution of beneficiary–elected board members might work for a public pension fund, the prospect of establishing a nationwide election for the forty–nine million people receiving benefits¹⁷⁸ from the Social Security Trust Fund is daunting at best. One could have an election concurrent with national elections so as to cut down on administrative costs, but the likely result would be the politicization of the Trust Fund where the aim of elected beneficiaries is to rid the Trust Fund of political influence. The nominees would likely split out along party lines and seek endorsements from their own party. The nomination process would probably be folded into the current process for party nomination for an office and require a certain minimum number of signatures on a petition or a vote by a caucus in order to get on the ballot. Such a process would involve both state party primaries and national elections. At the local level, parties would come under pressure to put nominees for the Trust Fund board on a political slate along with candidates for other offices. These nominees would then be beholden to presidents, congressmen, governors and mayors for their nomination and election. The nominees would need money in order to run for election as well and this would likely come from donors, special interest groups and other politicians. As a result, the eventual boards would be more reliant and beholden to their political donors. Still, one would expect that voters would take into account the financial expertise of a particular candidate since their retirement income is at stake.¹⁷⁹ The downside may be more of the cost incurred in elections rather than a decrease in the quality of the candidates.

Moreover, the most troublesome problem is that an election of directors by the beneficiaries of the Trust Fund may be unconstitutional and undermine presidential power since such a process does not comport with the Appointments Clause.¹⁸⁰ That said, the spirit of Professor Romano's observation that beneficiary representation improves performance is that an independent board performs better than a non–independent board—the election of directors by beneficiaries is merely one path to an independent board. The independence that fosters great performance might possibly be maintained by providing requirements in the enabling legislation that some director's seat appointments be made with the advice of interest groups which represent the beneficiaries. Several models for success exist.

should purchase insurance or be willing to indemnify any significant losses caused by a trustee. *Id.*

178 Referring to the number of people receiving benefits at the end of 2006. THE 2007 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE FEDERAL OLD–AGE AND SURVIVORS INSURANCE AND FEDERAL DISABILITY INSURANCE TRUST FUNDS, H.R. DOC. NO. 110–30, at 2 (2007), available at <http://www.ssa.gov/OACT/TR/TR07/tr07.pdf>.

179 Romano, *supra* note 8, at 840–41.

180 Froomkin, *supra* note 15, at 610.

The Canada Pension Plan (CPP) system holds a number of important lessons for U.S. lawmakers who are intent on reforming the Social Security Trust Fund.¹⁸¹ In 1997, the CPP, the Canadian equivalent of Social Security, was in nearly the same situation as that facing the U.S. Social Security system now. CPP funding was based on a pay-as-you-go model which restricted the investment of excess contributions to non-negotiable government securities. The plan to move to a partially funded system included reductions in benefits and increases in contribution, but the most salient feature was an investment fund managed “at arm’s length from [the] government” through a private government-owned corporation.¹⁸² The fund would seek higher returns by investing excess contributions in a well-diversified portfolio of stocks and bonds.

The Canada Pension Plan Investment Board (CPPIB) is the corporate entity which invests the trust fund. The Canada Pension Plan Investment Board Act (CPPIBA) governs the appointment of the directors to the CPPIB by delegating the appointment power to the executive branch with certain legislatively mandated restraints.¹⁸³ The structure of the appointment process attempts to weed out political influence by requiring consultation among a diverse set of stakeholders. The board consists of twelve members including the chairman. The board has oversight over the day-to-day manager and is also charged with establishing investment policies and ethical and conflict of interest codes. Board members are selected by the Governor in Council upon the recommendation of the Minister of Finance, who is the Canadian equivalent of the U.S. Treasury Secretary. The Minister vets candidates through a committee composed of representatives from each province and one representative appointed by the Minister. The Act mandates that the Minister give consideration to having representatives on the board who represent the different regions of Canada and enough board members who have “proven financial ability or relevant work experience.” Terms last for three years and are subject to “good behavior.” Directors may be reappointed. In an effort to remove government influence, no one who works for the government or is a Canadian politician may be on the board.¹⁸⁴ Although the government appoints the board, the board appoints the day-to-day managers of the CPPIB.¹⁸⁵ Consequently, appointments of

181 Weaver, *supra* note 18, at 73 (arguing that the Canadian system holds lessons not only on funding through investment, but also on how benefits are assigned, and how default policy shifts can create fail-safe devices for funding during times of political gridlock and in the rules surrounding 401(k) plans).

182 David W. Slater, *Prudence and Performance: Managing the Proposed CPP Investment Board*, C.D. HOWE INST. 2 (Oct. 30, 1997), available at <http://www.cdhowe.org/pdf/slater-1.pdf>.

183 Canada Pension Plan Investment Board Act, R.S.C., ch. 40, § 10 (1997).

184 *Id.*

185 CANADA PENSION PLAN INV. BD., 2007 ANNUAL REPORT 78 (2007), available at http://www.cppib.ca/files/PDF/Annual_reports/ar_2007.pdf.

the people running the fund and making investment decision are at least one step removed from the political process of appointment.

The Federal Reserve provides another model of appointment by the executive branch in which politics is minimized.

C. Federalism, Representation and the Trust Fund

Although the Federal Reserve Board is an independent federal government agency rather than an FGC, the Federal Reserve System has a quasi public–private persona that helps inform how the Trust Fund might be managed. Congress created the Federal Reserve System in order to manage the nation’s money supply.¹⁸⁶ The organization operates as an autonomous body within the government—having both public and private roles. The Federal Reserve promotes its governance as a federalist system in which decision making is divided between a centralized body (the Board of Governors) and sub–units (the twelve regional Federal Reserve Banks). Both the Board of Governors and the Federal Reserve Banks share responsibility for regulating the money supply through membership on the Federal Open Market Committee.¹⁸⁷ The twelve Federal Reserve Banks are corporate entities where the shareholders are the member banks but the Reserve System does not operate for a profit. All earnings are remitted to the U.S. Treasury. For some purposes, the Federal Reserve Banks are not considered to be part of the government.¹⁸⁸ Some governance characteristics of the Federal Reserve System can serve as a model for a privatized Social Security Trust Fund. Although the investment decision making structure for privatized Trust Fund should likely be centralized rather than using a federalist model,¹⁸⁹ the appointment process of the Federal Reserve System, which takes into account representation of diverse economic and national interests, would likely help generate national support and legitimacy for the Trust Fund.

The appointment to seats on the Board of Governors is made by the President with the advice and consent of the U.S. Senate. In selecting the

¹⁸⁶ 12 U.S.C. §§ 221, 222 (2000).

¹⁸⁷ BD. OF GOVERNORS OF THE FED. RESERVE SYS., *THE FEDERAL RESERVE SYSTEM: PURPOSES & FUNCTIONS* 3 (9th ed. 2005), available at http://www.federalreserve.gov/pf/pdf/pf_complete.pdf.

¹⁸⁸ Courts have ruled that “the Reserve Banks are not federal instrumentalities for purposes of the [Federal Tort Claims Act], but are independent, privately owned and locally controlled corporations,” in light of fact that direct supervision and control of each bank is exercised by board of directors. *Lewis v. United States*, 680 F.2d 1239, 1241 (9th Cir. 1982).

¹⁸⁹ Using a federalist model for investment decisions (i.e. having both a centralized investment board and regional boards) would likely be counter–productive to preventing politically motivated investment which favors local companies. A more objective centralized management would more likely be free from regional influence and thus optimize the wealth of the Trust Fund. Templin, *Full Funding*, *supra* note 14, at 434–39.

Board of Governors, the Federal Reserve Act requires that the President give “due regard to a fair representation of the financial, agricultural, industrial, and commercial interests, and geographical divisions of the country.”¹⁹⁰ The Board of Governors is comprised of seven members who serve no longer than one fourteen year term. The appointments are staggered such that one term expires on every even-numbered year.¹⁹¹ Even a two term President can appoint only four of the seven members of the Fed. The Chairman and Vice-Chairman serve four year terms and are also appointed by the President with confirmation by the Senate. This system of appointment is widely thought to be disassociated from the political process.¹⁹² The decisions of the Board of Governors of the Fed need no ratification by the executive branch and the only oversight comes from Congress. While the Federal Reserve must work within the economic objectives and policy established by the government, the organization tends to describe itself as being “independent within the government.”¹⁹³

In applying the Federal Reserve appointment model to the Social Security Trust Fund, the President would appoint members to the board on staggered terms. It might make sense to limit any given President’s influence even more than the Fed to make sure that even a two term President could not appoint a majority of the Board. If there were a nine person board with eighteen year terms then only one seat would come up every two years and even a two-term President could only appoint four of the nine person board. This should reduce the possibility of stacking the board with a majority for political purposes. Requiring the consent of the Senate to the appointment will, by proxy, achieve the principles of federalism in that each state will have a voice in the selection of the board and ensure that regional considerations are taken into account.

The President should be required to consider regional representation on the Trust Fund board in order to help generate national support and legitimacy for the entity. The Canada Pension Plan recognized the need for some regional input in comprising its board. The Canadian Minister of Finance makes recommendations for appointments to the Board with the advice of a committee comprised of representatives from each province.¹⁹⁴ One might envision a U.S. Social Security Trust Fund board comprised of representatives from major regions (possibly mirroring the twelve regional Federal Reserve Banks) in order to provide a check against the threat of a

190 Federal Reserve Act, 12 U.S.C. § 241 (2000). The Act also requires that the President select only one member “from any one Federal Reserve district.” However, it has been opined that this phrase did not set out a residency requirement. 2 Op.Off. Legal Counsel 391, 391 (1977).

191 BD. OF GOVERNORS OF THE FED. RESERVE SYS., *supra* note 187, at 4.

192 Solomon & Berson, *supra* note 3, at 160.

193 BD. OF GOVERNORS OF THE FED. RESERVE SYS., *supra* note 187, at 2-3.

194 Canada Pension Plan Investment Board Act, R.S.C., ch. 40, § 10 (1997).

board weighted with New York investment bankers, Boston mutual fund managers and Silicon Valley venture capitalists.¹⁹⁵ A board weighted only with representatives from the two coasts could result in investments that favored the two coasts. Similar to the CPPIBA, the enabling legislation could require that the President consult with and review recommendations by a board comprised of investment professionals from each state. The investment professionals would be appointed by the governor of each state and would be charged with vetting candidates. While this process may add to the cost and time involved in choosing candidates, the layered review process should ensure that politicization remains remote and that each candidate has the background and experience required to be on the board.

D. Other Requirements for Board Membership

Even if these measures are implemented, what if someone with political clout but with no financial savvy gets appointed to the board? Minimum requirements could be established for the job—i.e. they would need some financial credentials in order to have the job.¹⁹⁶

Once again, lessons can be learned from the CPPIB and the Fed. The CPPIBA requires enough members on the board who have “proven financial ability or relevant work experience . . . that the Board will be able to effectively achieve its objects.”¹⁹⁷ In terms of implementing such a standard for the Trust Fund, one might require any board member to be certified as a “Chartered Financial Analyst” by the CFA Institute.¹⁹⁸ Common sense suggests that the President and Congress will take into account the financial expertise of a particular candidate.¹⁹⁹

This level of specificity, however, may preclude some expert candidates from becoming members. Rather, factors to consider might include

195 A look at the map of the Federal Reserve regions reveals that the split heavily favors eastern states (with five regions) while the west coast has only one, *see* FED. RESERVE BD., THE TWELVE FEDERAL RESERVE DISTRICTS, <http://www.federalreserve.gov/otherfrb.htm> (last visited Apr. 24, 2006), even though California has the largest economy of all of the states. *See* LEGISLATIVE ANALYST’S OFFICE, CAL FACTS 2004, http://www.lao.ca.gov/2004/cal_facts/2004_calfacts_econ.htm (last visited Apr. 24, 2006).

196 Romano, *supra* note 8, at 841.

197 Canada Pension Plan Investment Board Act, R.S.C., ch. 40, § 10(4).

198 *See* CFA Institute Homepage, <http://www.cfainstitute.org/> (last visited Nov. 11, 2007). The CFA runs a rigorous exam which certifies analysts in the areas of “ethical and professional standards, tools and inputs for investment valuation and management, asset valuation, and portfolio management and performance presentation.” CFA INST., FACT SHEET, <http://www.cfainstitute.org/aboutus/pdf/CFAInstituteFactSheet.pdf> (last visited Nov. 11, 2007).

199 Professor Romano suggests that in the event that board members do not have financial expertise, that lack of expertise could be supplemented with advisory councils composed of investment professionals in order to make recommendations. Romano, *supra* note 8, at 841.

academic credentials, professional credentials, work experience and references. Although these safeguards may take away political pressure to engage in social investing, there still is likely to be more pressure on such a public fund when the economy is suffering than on a private fund.²⁰⁰

Another alternative to depoliticize the appointment process, again by legislative mandate, would be to appoint a bipartisan board of trustees. Post Office appointments operate through this method. Of the nine governors that the President can appoint to the eleven-person U.S. Post Office Board of Governors, only five can come from the same political party.²⁰¹ In addition, the appointment process for the U.S. Post Office Board of Governors is staggered like the Federal Reserve.²⁰² The Social Security Trust Fund could adopt similar provisions though, anecdotally, the perception is that most financial professionals who would excel at investment favor the Republican party rather than Democrats. In reality, there are enough skilled professionals in both parties to meet the needs of a Board of Directors. Yet, this solution just mirrors the political process rather than disassociating itself from it.

E. Removal: "At the pleasure of the President" or "For Good Cause"

Unfortunately, most of the statutes that authorize FGCs and a Presidential appointment of directors do not provide for a mechanism to remove the directors. All civil officers are subject to removal from office on impeachment by Congress for "[c]onviction of, [t]reason, [b]ribery, or other high [c]rimes and [m]isdemeanors."²⁰³ The Constitution is silent on the matter of the President's power to remove; though, the Supreme Court has noted "that as a constitutional principle the power of appointment carried with it the power of removal"²⁰⁴ Congress, however, can limit this implicit removal power to require that the President have "cause" before removing an officer in a "quasi-legislative or quasi judicial agencies;" for purely executive agencies, the President has full power of removal.²⁰⁵ It is the President's power to appoint and remove officers, which makes federal agencies formally accountable to the executive branch.²⁰⁶ The enabling legislation should provide a removal power to the President for cause and designate that the officers of the corporation are public officials for purposes of impeachment in the case of malfeasance or nonfeasance.²⁰⁷

²⁰⁰ *Id.*

²⁰¹ 39 U.S.C. § 202 (2000).

²⁰² *Id.*

²⁰³ U.S. CONST. art. II, § 4.

²⁰⁴ *Myers v. U.S.*, 272 U.S. 52, 119 (1926).

²⁰⁵ *Humphrey's Ex'r v. U.S.*, 295 U.S. 602, 629 (1935).

²⁰⁶ Froomkin, *supra* note 15, at 608.

²⁰⁷ *Id.* at 625.

In summary, the appointment process can and should be an executive process which is constrained through legislation. Appointments should be staggered so as to be disassociated from the political process and ensure that no sitting President has the ability to appoint a majority. In addition, to avoid imbalance politically, restrictions should be drawn up which prevent too many members from one political party serving on the board. The President's choices would be subject to the advice and consent of the Senate. However, given the importance of the Trust Fund, the President would also be required to consult with a commission in which each state has a representative. That commission would vet the candidates to make sure that only those with financial experience significant enough to handle the investment would be appointed to the board. The removal power of the President and the impeachment power of Congress should be imposed through the statute to ensure that Trust Fund employees can be removed if they are underperforming.

IV. ACCOUNTABILITY: POLICING THE CORPORATION

Accountability of managers and directors is a dominant theme in corporate governance scholarship. In the wake of accounting scandals at leading companies like Enron and Worldcom, mistrust of corporate executives is at an all-time high. Putting the nation's retirement nest egg into the hands of corporate managers is likely to be controversial and require a number of controls in order to be politically feasible with the electorate. Although FGCs are governed by the enabling legislation, corporate law principles should form at least part of the legal regime holding the entity accountable. Yet, some laws which might hold a privatized Trust Fund accountable may also expose the entity to risk of political influence which could lead to lower returns. Any regime developed to regulate a privatized Trust Fund needs to strike a balance between accountability and freedom from political influence. Such a regime is likely to draw upon corporate law, administrative law, and constitutional law as well other disciplines.²⁰⁸

The problems that arise in corporate mismanagement are rooted in the common law of agency. One could view the corporation as an agent for the shareholder, the principal. Under the common law of agency, the principal exerts control over the agent, the agent has a duty and is liable to the principal, and the principal is liable for acts of the agent when the agent is acting with authority.²⁰⁹ However, given that the shareholder seeks to shield himself from liability for the corporation's act, a disconnect has occurred between the principal-shareholder and agent-corporation. The

²⁰⁸ K.A.D. Camara & Paul Gowder, *Quasipublic Executives*, 115 *YALE L.J.* 2254 (2006) (calling for control mechanisms that arise from both constitutional law and corporate law in order to regulate a new breed of "quasipublic executives").

²⁰⁹ RESTATEMENT (THIRD) OF AGENCY §§ 1.01, 2.01, 7.04, 8.01–12 (2005).

principal exerts little control over the agent's actions, and the agent is accountable to the principal only in extraordinary situations.

To compensate for this lack of accountability, judges and lawmakers developed a set of mechanisms within the corporate law doctrine to prevent manager self-dealing, mismanagement and inefficiencies. These mechanisms include: (1) shareholder voting rights and contractual regimes, (2) market mechanisms (i.e. takeovers of inefficient firms), (3) judicial remedies, such as the shareholder derivative lawsuit, (4) disclosure requirements, and (5) government regulation. Despite the availability of these mechanisms, corporate scholars are troubled that “[a] combination of substantive doctrines and procedural requirements embodied in corporate law has made it nearly impossible for shareholders to prevail when challenging the decisions and practices of corporate management.”²¹⁰ This lack of shareholder control over corporate decision making is made more difficult when the corporation is an FGC and governance issues are covered by constitutional law and the enabling legislation rather than a well-developed body of corporate law.²¹¹ Unless the commonly used mechanisms to control management are built into the enabling legislation, the FGC may not be held accountable through either internal governance or external policing. This article examines each of the five mechanisms for policing the corporation and concludes that a higher standard of accountability than what is available in current corporate law regimes is necessary for corporate managers and directors of a privatized Trust Fund.

However, any regime should stop short of a direct principal-agent relationship where the government exerts control over the Trust Fund. Agency theory is useful in order to give a basis whereby the government must set up systems of accountability to ensure constitutionality.²¹² However, direct control by the government destroys the political insulation

210 Renee M. Jones, *Law, Norms, and the Breakdown of the Board: Promoting Accountability in Corporate Governance*, 92 IOWA L. REV. 105, 108 (2006).

211 Richard Scott Carnell, *Handling the Failure of a Government-Sponsored Enterprise*, 80 WASH. L. REV. 565, 601-02 (2005). Although discussing Government-Sponsored Enterprises (GSEs) rather than FGCs, Professor Carnell notes that the enabling legislation for specific GSEs is largely inferior to the generic banking and insolvency laws which are designed to apply to many different firms. Professor Carnell contends that

[f]raming laws generically promotes accountability. Without generic law, the government tends to deal ad hoc with “each institution and set of circumstances” in ways that tend to favor the narrow interests of the institution’s owners, managers, and clientele. Generic law “can help to shift the political debate to questions about whether exceptions to general rules are warranted”—a context less favorable to those interest groups.

Id. (citations omitted).

212 Metzger, *supra* note 39, at 1464.

sought by the government corporate structure. While corporate managers must be held accountable, there also exists a need to grant flexibility for manager decision making. Despite the best attempts to insulate the Trust Fund, Congress could require regular mandatory hearings in order to pressure managers to make politically motivated investments. While any regime governing an FGC should include principles of corporate law, such law should be strengthened, through the enabling legislation, in order to ensure accountability. Yet while a modified corporate regime may ensure political accountability, the need to prevent political influence on the investment process may require a constitutional amendment mandating that the Trust Fund be free from such influence.

A. Shareholder Voting Rights

Shareholders theoretically control management by exercising voting rights to appoint directors²¹³ and for major events, such as dissolution, merger, the sale of substantially all of the assets, amendment of the articles of incorporation, and anything else specified in the articles.²¹⁴ The degree to which shareholder voting is effective has been the subject of many articles for both legal and economic academics.²¹⁵ Voting to appoint new directors is, at best, an inefficient mechanism. Removal of a director through a shareholder vote must occur at a shareholder meeting.²¹⁶ Although corporations must hold an annual meeting,²¹⁷ special meetings require a call either by the board of directors or at least 10% of the shares of the corporation.²¹⁸ A court order may also convene a meeting.²¹⁹

Weak voting rights benefit the corporation by giving managers the latitude they need to make business decisions without convening all of the shareholders for a vote. Although the shareholders are provisionally the owners of the corporation, control is ceded to the managers for the sake of efficiency. The argument goes that to the extent a shareholder is dissatisfied with management, she can sell her shares—voicing dissent through the sale. If the sale is a large one or enough shareholders dissent by selling, then the share price of the firm will likely fall, thus sending a signal to the market that the firm's managers are inefficient. If the corporation's business has value, then a more efficient corporation will purchase the company and remove the inefficiency. This market control is discussed in more detail in the next section. If there is no market for the stock—as is often the

213 MODEL BUS. CORP. ACT § 8.03 (2004).

214 *Id.* §§ 2.02, 10.03, 11.04, 12.02, 14.02.

215 Froomkin, *supra* note 15, at 585.

216 MODEL BUS. CORP. ACT § 8.08(d).

217 *Id.* § 7.01.

218 *Id.* § 7.02.

219 *Id.* § 7.03.

case with closely held corporations—then shareholders can seek greater control of managers through the proxy process or by amending the articles of incorporation.

In a privatized Trust Fund, the government should be the sole shareholder and therefore would hold all voting rights.²²⁰ When the federal government is the shareholder, there is usually no longer the ability (or desirability) to sell its stock in the event of inefficient managers. The whole point of the government holding the stock in an FGC is political rather than economic.²²¹ So, while the government has an interest in maximizing the wealth of the Trust Fund, the creation of the corporation and the holding of stock by the government are done for reasons of political insulation. If the shareholder of a corporation is the one to reap either the literal or figurative dividends (i.e. the returns on investment), then the government shareholder of a federal corporation is in the odd position of not being the one for whom the dividends should flow. It is the workers who paid into Social Security through the payroll tax who reap the figurative dividend—not the government. So, if contributors to Social Security rather than the government shareholder reap the economic benefit of the corporation, should the contributors, rather than the government shareholder, also have the shareholder vote? Yet, it would be neither practical nor in all likelihood constitutional for a national shareholder vote by taxpayers on corporate matters.²²²

In the absence of a provision in the enabling legislation, a dilemma develops in who should vote the shares—should it be the President or an act of Congress?²²³ “In the absence of legislation, the President, or his delegate, is presumably the nation’s proxy-holder” for voting shares in an FGC.²²⁴ However, conceptually, shares in a corporation have both voting rights and economic rights that can be separated and the voting rights can then be delegated to another party.²²⁵ The voting rights can, within certain constraints, be the subject of private contract so that the voting rights are

220 In some FGCs there is a mixture of both government and private shareholders. Froomkin, *supra* note 15, at 554–55. It does not seem likely (in terms of political hurdles) that the Trust Fund would ever be jointly owned by the government and a private entity. However, such joint ownership might be an innovative way to solve the funding crisis. A private co-owner of the Trust Fund would be more profit-motivated and could drive returns higher, given the profit incentive. In order to be politically viable, such a private co-owner would need to offer guarantees if investment decisions went sour.

221 *Id.* at 586.

222 See *supra* Part II for a discussion of citizen voting for the appointment of directors.

223 Froomkin, *supra* note 15, at 590.

224 *Id.*

225 At the common law, courts disfavored the separation of the economic interest from the voting interest, holding that it was against public policy. Modern statutes allow such arrangements. J.G. Deutsch, *The Teaching of Corporate Law: A Socratic Investigation of Law and Bureaucracy*, 97 YALE L.J. 96, 99–100 (1987).

exercised by proxy, voting trusts or vote pooling agreements.²²⁶ However, the nature of the shareholder vote may dictate who exercises the proxy. If the directors of the Trust Fund are officers of the executive branch, then the President can vote the shares only with the advice and consent of the Senate in order to comport with the Appointments Clause of the U.S. Constitution.²²⁷ If Congress votes the shares, then it must comply with the constitutional requirements of bicameralism and presentment.²²⁸ Congress could be deemed the holder of the right to vote shares on non–appointment issues if a bill authorizing a particular vote on the shares passes successfully through the legislative process.

Related to shareholder rights, the mechanism of contractual regimes is often used in corporate law to ensure compliance by managers and directors. Here, the Trust Fund would be contractually bound to prevent misdealing. Contractual mechanisms such as this are useful for policing the government’s delegation to purely private entities.²²⁹ One could certainly bind the corporation and its officers and directors to contracts which would specify certain duties. Such a contract would provide a ready basis for bringing a lawsuit for breach. Breach of contract is typically easier to prove in court than a breach of a fiduciary duty. However, such contractual duties are likely to inhibit rather than compel investment managers to take necessary investment risks. That said, contracts could be used to incentivize managers to behave in the best interests of the fund by delineating performance–based compensation. The idea of aligning manager interests with the interest of the Trust Fund is explored in more detail below.

B. Market Controls

Efficient market theorists suggest that corporate governance is aided by an efficient market since incompetent managers are displaced by hostile takeovers.²³⁰ This mechanism of control relies on the assumptions of the Efficient Capital Market Hypothesis (ECMH), which asserts that the American capital markets are efficient and the price of a security always reflects all public information.²³¹ The market price of a firm reflects the performance of an under–performing manager or a manager who shirks their duties. Simply put, the value of the firm is less because the managers

226 MODEL BUS. CORP. ACT §§ 7.22, 7.30, 7.31 (2004).

227 U.S. CONST. art. II, § 2, cl. 2.

228 Froomkin, *supra* note 15, at 590.

229 See Freeman, *supra* note 55, at 606.

230 Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target’s Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1169–70 (1981).

231 See generally Christopher Paul Saari, *The Efficient Capital Market Hypothesis, Economic Theory and the Regulation of the Securities Industry*, 29 STAN. L. REV. 1031 (1977).

are not performing optimally. Yet, the cost of replacing the incompetent manager through derivative suits is high.

ECMH theorists argue that hostile takeovers act as a check against incompetent managers. In the hostile takeover, a competitor has the ability to evaluate the potential value of the firm without the incompetent managers. The bidder typically runs up the price of shares by offering to purchase all or a controlling interest in the firm. If successful, the incompetent managers are fired and the new owners run the firm more profitably. Under this theory, corporate governance regimes should allow hostile takeovers as a check against incompetent managers.²³² ECMH was well accepted by economists, politicians and legal scholars during the 1970s and 1980s; however, the evolution of economic theory as well as empirical studies in behavioral finance suggests that the markets are not efficient.²³³ Regardless of whether markets are efficient, market controls are not meaningful in the case of an FGC since the acquisition of the Trust Fund by a private entity would make Trust Fund assets vulnerable to a third party's misuse and therefore should be prohibited by the enabling legislation. As unlikely as a merger might seem, the enabling legislation should specifically prohibit, without an act of Congress, the possibility of any merger.

Although the market control of a takeover should be pre-empted legislatively, other market controls might be mandated by the legislation. One way in which the market regulates is through a variety of ingenious "early warning mechanisms" which might "signal Congress that a particular [corporation] is in financial trouble."²³⁴ For instance, if a company's stock is publicly traded on a stock exchange then the pricing of the cumulative assessment of all buyers and analysts of a stock help inform the public on the company's prospects.²³⁵ If there are enough buyers and sellers in a market then the price of the trade becomes the equivalent of a national election in which the question of whether a firm is solvent is put on the agenda.²³⁶

232 Easterbrook & Fischel, *supra* note 230, at 1169-74.

233 Lynn A. Stout, *The Mechanisms of Market Inefficiency: An Introduction to the New Finance*, 28 J. CORP. L. 635, 636-38 (2003). Professor Stout explores recent finance literature and suggests that "ECMH simplifies a complex reality." Stout suggests that ECMH is inadequate to explain the markets since (1) investors have heterogeneous expectations, (2) information does not move into the share price as quickly as first thought and (3) behavioral finance studies illustrate that not all actors in the market have "rational expectations." *Id.* at 638.

234 Froomkin, *supra* note 15, at 621. Professor Froomkin analyzes market mechanisms as they apply to government sponsored enterprises (GSEs), a special breed of FGC which are "limited by Congress to lending to a particular constituency (farmers, students, homeowners), or for a particular purpose (such as recapitalizing insolvent savings and loans)." *Id.* at 555-56. The Social Security Trust Fund corporation could be considered a species that falls into the later category since its specific purpose is to provide for funding Social Security.

235 *Id.* at 621.

236 One might accomplish this by having the Trust Fund issue a non-voting, tracking

The problem with the pricing of an FGC stock on a public exchange is that such an entity carries with it an “implicit federal guarantee” on the corporation’s debt²³⁷ and therefore a true reflective price is illusory. However, proposals have been made to “pay rating agencies, such as Standard & Poor’s (who are presumably experts at assessing financial risk) to issue regular credit ratings . . . on the assumption that no federal rescue is available.”²³⁸ While a mandated rating by an independent agency will help in providing an early warning system to financial insolvency, the signal by itself will not be enough to police the corporate entity. Another innovative suggestion to put market controls on FGCs would be to create competing federally owned companies with “identical powers and missions.”²³⁹ While economies of scale might be lost,²⁴⁰ such competition might lead to efficiencies and higher returns on investment.

If shareholder voting and market controls are an inadequate means of policing the corporation, then recourse to the courts and government oversight must fill in the gap.

C. Judicial Remedies

Litigation or the threat of litigation for a breach of a fiduciary duty or *ultra vires* acts is both a popular and controversial method for keeping directors and officers in check.²⁴¹ In corporate law, the shareholder derivative lawsuit is the corporation’s “judicial remedy for mismanagement or other wrongful acts of directors, officers, or third parties.”²⁴² Commentators suggest that shareholder litigation is ineffective as an accountability mechanism because of judicial deference to managers and directors.²⁴³ However, recent decisions suggest a trend towards holding directors more culpable for acts of mismanagement if they ignore their duty of good faith.²⁴⁴

Whether or not litigation is an effective deterrent to officer and director mismanagement will in large part be controlled by the complex issues of

stock that reflects the performance of the fund. Issuing the track stock would also be another way to raise money for the Fund, and would serve as an alternative investment choice to mutual funds for workers who want to build their retirement savings.

²³⁷ Froomkin, *supra* note 15, at 621.

²³⁸ *Id.* at 622.

²³⁹ *Id.* at 628.

²⁴⁰ *Id.*

²⁴¹ COX & HAZEN, *supra* note 40, § 15.01.

²⁴² *Id.* § 15.03.

²⁴³ See Jones, *supra* note 210, at 108.

²⁴⁴ Sarah Helene Duggin & Stephen M. Goldman, *Restoring Trust in Corporate Directors: The Disney Standard and the “New” Good Faith*, 56 AM. U. L. REV. 211, 213 (2006) (arguing that a more vigorous duty of good faith has emerged recently in Delaware corporate law, such that directors who consciously ignore good faith may be held personally liable for mismanagement).

justiciability of claims against the government. Some of the issues raised when judicial remedies are sought against an FGC include: (1) whether the status of the FGC as a state actor confers sovereign immunity, (2) who has standing to bring a suit and (3) the causes of action that will lead to a suit.

1. *Sovereign Immunity*.—The U.S. federal government is immune from lawsuits under the well-established doctrine of sovereign immunity²⁴⁵ unless, of course, the government waives its immunity and consents to the lawsuit. Notable situations where the government has waived immunity include the Federal Tort Claims Act (FTCA)²⁴⁶ and the Tucker Act for contract claims.²⁴⁷ If the FGC is deemed to be a state actor, then it should logically follow that the entity would likewise be immune from suit under the doctrine of sovereign immunity subject to the well-established exceptions.²⁴⁸

Sovereign immunity for an FGC could be precluded merely by designating the corporation as a private actor which can sue and be sued for such purposes in the enabling legislation.²⁴⁹ However, without such a disclaimer, a privatized Trust Fund could be thrown into an anomalous role where the FGC can claim sovereign immunity as an instrumentality of the federal government but still be excluded from the FTCA which provides a limited waiver of such immunity for some torts committed by employees of federal agencies. Professor Froomkin highlighted this “peculiar result” by tracking decisions concerning the Federal Home Loan Mortgage Corporation (Freddie Mac), an FGC providing home loans.²⁵⁰ Federal courts have held that the Merrill Doctrine, which precludes estoppel arguments from being used against federal agencies, also applies to Freddie Mac because of that organization’s public purpose.²⁵¹ However, those same federal agencies that are protected by the Merrill Doctrine waive their sovereign immunity under the FTCA. Yet, courts held that

²⁴⁵ *Kawananakoa v. Polyblank*, 205 U.S. 349, 353 (1907) (“A sovereign is exempt from suit, not because of any formal conception or obsolete theory, but on the logical and practical ground that there can be no legal right as against the authority that makes the law on which the right depends”).

²⁴⁶ 28 U.S.C. § 1346(b) (2000) (allowing a lawsuit for tort damages against the United States if “caused by the negligent or wrongful act or omission of any employee of the Government while acting within the scope of his office or employment, under circumstances where the United States, if a private person, would be liable to the claimant”).

²⁴⁷ 28 U.S.C. § 1491 (2000) (allowing a party to sue the government for damages in a breach of contract lawsuit).

²⁴⁸ Froomkin, *supra* note 15, at 594.

²⁴⁹ *See* *Lebron v. Nat'l R.R. Passenger Corp.*, 513 U.S. 374, 392 (1995) (holding that a disclaimer in the enabling legislation could exempt an FGC from sovereign immunity status).

²⁵⁰ Froomkin, *supra* note 15, at 591–94.

²⁵¹ *Id.* at 593.

Freddie Mac, while enjoying sovereign immunity, was not subject to the FTCA waiver of sovereign immunity since it was not an agency of the United States government.²⁵² The result is that an FGC might “have greater immunity from suit than is available to either private [corporations] or [federal] agencies.”²⁵³

Aside from tort claims, there is judicial review of federal agency actions (and government corporations designated as federal agencies) through the Administrative Procedures Act (APA).²⁵⁴ Such review consists of challenges to agency actions giving standing for mandatory or injunctive relief to a person “suffering legal wrong because of agency action.”²⁵⁵ The grounds for bringing such actions are similar to the standard used if the entity was a business—i.e. “an abuse of ‘business judgment’ or a failure to fulfill the imposed duties or perform the required functions” of the entity.²⁵⁶ For FGCs not designated as federal agencies, there is no comparable statutory right. While the enabling legislation of FGCs typically allow the entity to sue and be sued, federal courts may exercise their judicial discretion to bar suits against FGCs since “judicial policy limitations effectively operate to bar the use of federal courts as a forum for the airing of generalized grievances about the conduct of the government.”²⁵⁷

If the privatized Trust Fund is designated as a state actor in the enabling legislation, as was suggested above in order to comport with constitutional requirements, and is also deemed to be entitled to sovereign immunity, then the enabling legislation should provide situations where sovereign immunity is waived. Courts have held that when the powers provision of a national corporation’s charter includes the power to “sue or be sued in courts of law and equity, State or Federal, within the jurisdiction of the United States” then sovereign immunity is waived.²⁵⁸ Such language by Congress would give federal courts original jurisdiction over any disputes to which the Trust Fund was a party²⁵⁹ and so should be part of the enabling legislation. In order to prevent abuse of process, the enabling legislation may prohibit state court actions altogether and require that any suit be brought in federal court.²⁶⁰ It may be that some limited sovereign immunity is called for in order to preclude opportunistic plaintiffs’ lawyers, but at the same time, there should be carve-outs to reign in the officers and directors

²⁵² *Id.* at 592.

²⁵³ *Id.* at 594.

²⁵⁴ Administrative Procedure Act, 5 U.S.C. §§ 551–76, 701–06 (2000).

²⁵⁵ 5 U.S.C. § 702.

²⁵⁶ Diane Hobbs, Note, *Personal Liability of Directors of Federal Government Corporations*, 30 CASE W. RES. L. REV. 733, 770 (1980).

²⁵⁷ *Id.* at 768.

²⁵⁸ *Barton v. Am. Red Cross*, 826 F. Supp. 412, 414 (M.D. Ala. 1993).

²⁵⁹ *Gonzales v. Commonwealth*, 726 F. Supp. 10, 12 (D.P.R. 1989).

²⁶⁰ *City of Middlesboro v. Ky. Utils. Co.*, 146 S.W.2d 48, 52 (Ky. 1940).

who engage in malfeasance or nonfeasance. The derivative suit is one such carve-out.

2. *Judicial and Statutory Determination of Standing.*—The derivative suit is a cause of action brought as a “representative suit on behalf of the corporation.”²⁶¹ The derivative suit stands in contrast to an individual lawsuit against a corporation where the plaintiff asserts that the corporation has harmed the plaintiff by a tort, violation of the law or breach of contract. In a derivative suit, the plaintiff asserts that a director or officer has harmed the corporation and seeks relief for the corporation from the director or officer personally. In the context of FGCs, scholars have commented that holding directors personally liable will encourage accountability since other enforcement means “do not seem to be uniformly effective.”²⁶²

A plaintiff in a derivative suit has standing to bring the action to court only if she is a shareholder;²⁶³ consequently, in the context of an FGC owned wholly by the government only the government would theoretically be able to bring a derivative suit against the Trust Fund. Yet, the government as shareholder is not the direct beneficiary of the investments made by the Trust Fund—it is the taxpayers who have paid into Social Security who will reap the rewards of the corporation’s investments. A question arises over whether the government should even have the ability to sue the Trust Fund given that the goal is to eliminate political influences over the Trust Fund. A politically motivated lawsuit by the Attorney General could inhibit the freedom of the directors and officers to make investment decisions that maximize the wealth of the Trust Fund.

If wealth maximization is the primary purpose of the Trust Fund (as this paper argues that it should be) then it is the taxpayers who have a direct interest in holding directors and officers accountable for mismanagement, malfeasance and nonfeasance since they have more to lose. Instead of a derivative suit, such a plaintiff might bring a citizen or taxpayer lawsuit against the FGC, as an agency of the government, alleging that the officers and directors have violated a law or constitutional right, breached a duty, or caused harm to the plaintiffs. In this context, the lawsuit is akin to the corporate derivative suit in that the taxpayer is asserting a “public right” rather than a “private right.”²⁶⁴ In other words, the individual is bringing a suit on behalf of the general good rather than for specific redress.

In such cases, the constitutional issues surrounding standing limit taxpayer ability to bring lawsuits. Limitations on lawsuits, whether against corporations or the government, are an attempt to reduce needless costs and frivolous claims. Lawsuits are, of course, costly and “plaintiffs initiate

261 COX & HAZEN, *supra* note 40, § 15.03.

262 Hobbs, *supra* note 256, at 779.

263 MODEL BUS. CORP. ACT §§ 7.40, 7.41 (2004).

264 Hobbs, *supra* note 256, at 771.

representative actions in a somewhat fortuitous manner.”²⁶⁵ Moreover, courts may want to limit the burden put on the judiciary and, as a policy matter, limit “judicial intrusion into agency action.”²⁶⁶ However, given the need to protect the assets of the taxpayer beneficiary, some rights to bring derivative suits should be specified in the enabling legislation to grant standing to a class of individuals to the extent that it is constitutional to do so.

Standing is a judicially created limitation on the ability of a litigant to bring a case to court. The U.S. Supreme Court has established that in order for a party to bring a case or controversy in federal court, the party must establish Constitutional Article III requirements of an injury in fact,²⁶⁷ causation²⁶⁸ and redressability.²⁶⁹

Even if Article III requirements are satisfied, courts may refuse standing based on “prudential principles.”²⁷⁰ “[U]nder the prudential principles . . . the judiciary seeks to avoid deciding questions of broad social import where no individual rights would be vindicated and to limit access to the federal courts to those litigants best suited to assert a particular claim.”²⁷¹ To the extent that the lawsuit alleges a violation of federal law, “the interest sought to be protected by the complainant [must be] arguably within the zone of interests to be protected or regulated by the statute . . . in question.”²⁷²

In addition, the claim must be isolated to an identifiable group. The courts have been reluctant to grant standing for matters that amounted to a “generalized injury to the public.”²⁷³ Often called citizen suits, the Supreme Court has consistently rejected allowing standing for a “generalized grievance” where “the impact on [plaintiff] is plainly undifferentiated and ‘common to all members of the public.’”²⁷⁴ The rationale is that in matters where the public at large is affected, the role of oversight of

265 COX & HAZEN, *supra* note 40, § 15.01.

266 Hobbs, *supra* note 256, at 769.

267 Gladstone Realtors v. Vill. of Bellwood, 441 U.S. 91, 99 (1979) (“[P]laintiff must show that he personally has suffered some actual or threatened injury as a result of the putatively illegal conduct of the defendant”).

268 Lujan v. Defenders of Wildlife, 504 U.S. 555, 560 (1992) (“[T]here must be a causal connection between the injury and the conduct complained of—the injury has to be ‘fairly . . . trace[able] to the challenged action of the defendant, and not . . . th[e] result [of] the independent action of some third party not before the court’”).

269 *Id.* at 561 (“[I]t must be ‘likely,’ as opposed to merely ‘speculative,’ that the injury will be ‘redressed by a favorable decision’”).

270 Gladstone Realtors, 441 U.S. at 99–100.

271 *Id.*

272 Nat’l Credit Union Admin. v. First Nat’l Bank & Trust Co., 522 U.S. 479, 488 (1998) (quoting Ass’n of Data Processing Serv. Orgs., Inc. v. Camp, 397 U.S. 150, 153 (1970)).

273 Hobbs, *supra* note 256, at 771.

274 Lujan, 504 U.S. at 575 (quoting United States v. Richardson, 418 U.S. 166, 171, 176–77 (1974)).

a government agency or an FGC is that of Congress and the Executive branch.²⁷⁵ Commentators suggest that the political process rather than the courts should monitor FGCs.²⁷⁶ However, that brings up the thorny issue of political influence in the investment decision.

In the context of the Trust Fund, if a plaintiff or group of plaintiffs were to plead a valid breach of fiduciary cause of action (as discussed below), then the Article III standing requirements might be satisfied if the evidence shows a direct injury. To prove injury in fact, “the plaintiff must have suffered an ‘injury in fact’ — an invasion of a legally protected interest which is (a) concrete and particularized, and (b) ‘actual or imminent,’ not ‘conjectural’ or ‘hypothetical.’”²⁷⁷ The types of injuries that have met this requirement include both economic harm²⁷⁸ and non-economic harm.²⁷⁹ Non-economic harm injuries have successfully satisfied the injury in fact requirement in suits against FGCs.²⁸⁰ Any likely lawsuit by taxpayers would be the result of mismanagement of the assets of the Trust Fund which resulted in a reduction of the value. The direct harm would be either the probability of a reduction of benefits or an increase in taxes on taxpayers because of the mismanagement. Economists and actuaries would need to establish the effect that the mismanagement would have on funding Social Security benefits in order to eliminate the conjectural or hypothetical nature of the harm.

Since Social Security contributions are part of the FICA tax, such claims are likely to be scrutinized using the precedent for taxpayer lawsuits. In these suits, taxpayers assert that some action of an agency has resulted in a misuse of funds that affected the taxpayer’s interest. To the extent that such suits assert protection of the interests of the public at large, the courts have consistently rejected taxpayer standing.²⁸¹ The Supreme

275 *Id.* at 576 (“‘The province of the court,’ as Chief Justice Marshall said in *Marbury v. Madison*, ‘is, solely, to decide on the rights of individuals.’ Vindicating the *public* interest (including the public interest in Government observance of the Constitution and laws) is the function of Congress and the Chief Executive”).

276 Hobbs, *supra* note 256, at 773.

277 *Lujan*, 504 U.S. at 560 (citations omitted).

278 *Pershing Park Villas Homeowners Ass’n v. United Pac. Ins. Co.*, 219 F.3d 895, 901 (2000) (“[E]conomic loss from a defendant’s conduct can give rise to constitutional standing, even when that loss would not itself give rise to prudential standing to assert a cause of action against the defendant”).

279 *Friends of the Earth, Inc. v. Laidlaw Envtl. Servs. (TOC), Inc.*, 528 U.S. 167, 183 (2000) (“[E]nvironmental plaintiffs adequately allege injury in fact when they aver that they use the affected area and are persons ‘for whom the aesthetic and recreational values of the area will be lessened’ by the challenged activity”).

280 *Friends of the Earth, Inc. v. Mosbacher*, 488 F. Supp. 2d 889 (N.D. Cal. 2007) (allowing environmental groups to sue two wholly owned FGCs, the Overseas Private Investment Corp. and the Export-Import Bank, for violating the National Environmental Policy Act by investing in foreign energy projects that contributed global warming).

281 *Hein v. Freedom From Religion Found., Inc.*, 127 S. Ct. 2553, 2563 (2007).

Court has ruled that “a taxpayer has standing to challenge the *collection* of a specific tax assessment as unconstitutional.”²⁸² But the court rejects the notion that taxpayers have “a continuing, legally cognizable interest” in taxes that have been “lawfully collected.”²⁸³ The Court reasons that “[i]nterest in the moneys of the Treasury . . . is shared with millions of others; is comparatively minute and indeterminable; and the effect upon future taxation, of any payment out of the funds, so remote, fluctuating and uncertain, that no basis is afforded for an appeal to the preventive powers of a court of equity.”²⁸⁴

The Social Security tax is somewhat different than other forms of taxation in that FICA is levied as a separate accounting entry from income tax deductions and the moneys paid in can be traced to the operations and assets of the SSA. Moreover, not all of the “public at large” are covered by Social Security though the SSA estimates that 162 million workers paid into the system in 2006.²⁸⁵ Even so, the courts are likely to follow the generally accepted policies that the court should not interfere into the management of other agencies.

Given that courts are reluctant to grant standing in taxpayer suits and the burden is high to prove injury in fact, an alternative needs to develop if beneficiaries of the Trust Fund are to be given the right to sue. One solution is to grant the right of standing to contributors in the enabling legislation. However, Congress may not weaken the standing requirements by legislating that a party has standing when no injury in fact has occurred as a result of the agency action.²⁸⁶ To do so would grant to Congress the ability to limit the oversight power of the administrative executive in violation of the separation of powers doctrine.²⁸⁷

If public law is inadequate to address the need to give Trust Fund beneficiaries a judicial remedy, then perhaps corporate law offers an alternative. While corporate law does not allow plaintiffs who are not shareholders to bring a derivative suit, one might consider giving each contributor to Social Security a limited equity interest in the privatized Trust Fund. “Some FGCs are wholly or partly owned by persons whom the FGCs were designed to benefit. Vesting ownership in the targeted beneficiaries has the advantage of greatly increasing the chance that any profits . . . will go to those groups.”²⁸⁸ The status as shareholders would then

²⁸² *Id.*

²⁸³ *Id.*

²⁸⁴ *Id.* (quoting *Massachusetts v. Mellon*, 262 U.S. 447, 487 (1923)).

²⁸⁵ THE 2007 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE FEDERAL OLD-AGE AND SURVIVORS INSURANCE AND FEDERAL DISABILITY INSURANCE TRUST FUNDS, H.R. DOC. NO. 110–30, at 2 (2007), available at <http://www.ssa.gov/OACT/TR/TR07/tr07.pdf>.

²⁸⁶ *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 576–77 (1992).

²⁸⁷ *Id.* at 577.

²⁸⁸ *Froomkin*, *supra* note 15, at 586.

give the beneficiaries standing to bring a derivative suit; however, such a structure becomes problematic since the beneficiary owners then develop an interest in retaining control of the corporation.²⁸⁹

To address this problem, each Social Security beneficiary could be given a special class of non-voting, non-transferable corporate stock for the purpose of creating a beneficial interest which gives rise to the standing requirements. The non-voting status would avoid dealing with administrative and constitutional issues surrounding voting for the appointment of directors, such as those discussed in Part III. Such an equity interest would increase as the taxpayer paid into the system. Given the non-transferability, their interest could never be sold or mortgaged and would revert to the FGC upon the death of the taxpayer. Tracking a contributor's beneficial interest is not likely to add any significant additional administrative cost since contributions are already tracked by the SSA and sent to taxpayers automatically starting at the age of twenty-five years.²⁹⁰

Adopting such a structure, however, may still lead to overzealous plaintiff lawyers filing nuisance suits. One possible solution would be to designate within the enabling legislation an organization who would act as the plaintiff working on behalf of the beneficiaries in a corporate derivative suit. This solution finds some support in the doctrine surrounding non-profit corporate law. There are parallels between the typical public benefit nonprofit corporation and a Trust Fund operating as an FGC. The corporate structure of a public benefit nonprofit corporation typically has voting members who elect the board of directors. However, the beneficiaries of a public benefit nonprofit corporation, for whom the charity was created, typically have no voting rights or control over the corporation. In the same way contributors to Social Security would have no voting rights in an FGC based Trust Fund.

Given these similarities, an examination of derivative lawsuits against the directors of a nonprofit corporation may help in understanding how to hold a privatized Trust Fund accountable. In the nonprofit context, the equivalent of a derivative lawsuit is usually brought by the statutory members of the nonprofit corporation or directors and officers.²⁹¹ Members who can bring suits are typically only those members who have voting rights and not those who are members in name only. Moreover, donors and supporters of a charity who do not have voting rights typically do not have standing.

Both profit and nonprofit corporations are also subject to examination by the attorney general who has standing to bring a suit.²⁹² Likewise, by

289 *Id.*

290 *See* SOC. SEC. ADMIN., INFORMATION ABOUT YOUR STATEMENT, <http://www.ssa.gov/mystatement/> (follow "What is the Statement?" hyperlink) (last visited July 9, 2007).

291 *See, e.g.*, CAL. CORP. CODE §§ 5142, 7142, 9142 (West 2007).

292 *See, e.g.*, CAL. CORP. CODE § 5250.

the statute forming the corporation, the Attorney General of the United States should be empowered to bring a suit against the Trust Fund in much the same way that a shareholder would bring a derivative suit. However, this delineation of power should be seen as expansive rather than limiting. The Attorney General would, of course, be able to bring any criminal proceedings which might be warranted against the corporation or its officers and directors. In fact, one method to ensure that managers and directors do not breach the public trust would be to have heightened sentencing guidelines for any misuse of public funds by directors and officers.

One concept sometimes used to give standing to third parties is the relator who sues on behalf of another party. In nonprofit corporation law, some jurisdictions allow the Attorney General to grant “relator status” to a party to bring actions that the Attorney General would normally bring.²⁹³ Using the doctrine of *parens patriae*, the state generally acts on behalf of its citizens who cannot protect themselves, but the state also has the power to grant to another person—the relator—to be a party in interest who takes on the role of the plaintiff in the suit.²⁹⁴ Likewise, the enabling legislation could specify a separate party in interest who is authorized to bring suit on behalf of the beneficiaries. That party, would in effect, become a third-party watchdog organization. Likely candidates might be the National Academy of Social Insurance, American Association of Retired Persons²⁹⁵ or an organization consisting of financial professionals who would be best able to make a determination if investments were not well diversified and optimized to meet the purpose of the organization—i.e. wealth maximization. Perhaps a watchdog group could be formed comprised of representatives from the various stock exchanges, commodity exchanges, venture capital community, and real estate investment professionals. Like the board of directors or trustees, such a relator should be politically neutral or at least be composed of members of each party so that political concerns in bringing lawsuits are neutralized.

The relator status would not confer any personal interest in the entity on the assets of the trust. Rather, any remedy sought by the suit would probably be an equitable injunction to compel the corporation to act or refrain from

293 See, e.g., CAL. CORP. CODE §§ 5142(a)(5), 7142(a)(5).

294 *Brown v. Mem'l Nat'l Home Found.*, 329 P.2d 118, 162 Cal. App. 2d 513, 536–39 (Cal. Ct. App. 1958).

295 AARP is a powerful lobbying group representing people over the age of 50. AARP adamantly opposed the Republican private accounts proposal. See Marie F. Smith, President, Am. Ass'n of Retired Persons, *The Future of Social Security* (July 18, 2005), http://www.aarp.org/research/international/speeches/jul18_05_mariesmithremarks.html. The problem with designating the AARP as a relator is that the organization is viewed as a political lobbying organization with its own agenda. See JAMES L. MARTIN, *AARP: ASSOCIATION AGAINST RETIRED PERSONS*, <http://www.60plus.org/about-aarp.asp> (last visited Apr. 10, 2007). The 60 Plus Association advocates for private accounts as the best reform for social security. See SOCIAL SECURITY HERE TO STAY (June 1, 2005), <http://www.60plus.org/news.asp?docID=454>.

acting, restitution by the officers or directors if there has been self-dealing or a constructive trust over some of the assets of the corporation. Damages to the relator would not be contemplated though surely some provision must be made for attorneys fees in order to prevent the deterrent effect of bringing lawsuits—i.e. the cost—to inhibit the relator from bringing an otherwise worthy lawsuit.

Another related idea would be to provide for a *qui tam*²⁹⁶ action which allows an individual to bring an action on behalf of the government. The False Claims Act confers standing on an individual to bring a suit in the name of the government to recover the misappropriation of government funds by government contractors and employees.²⁹⁷ Such a whistleblower suit might be useful in policing any subcontractors that the Trust Fund uses to invest Social Security revenues. If the Trust Fund is deemed a state actor, it may be subject to *qui tam* suits unless the enabling legislation specifically exempts the Trust Fund from the False Claims Act. *Qui tam* suits allow the individual who brings the suit to share in the recovery of damages—sometimes as much as 30% of the recovery but no less 15%.²⁹⁸ Considering the amount of money likely to be involved, such a potential recovery will motivate less scrupulous plaintiffs' attorneys to file suits regardless of the merit. While Social Security funds should not be diverted to plaintiffs' lawyers' pockets, whistleblowers should be encouraged to come forward with information of misappropriation of funds. Any potential *qui tam* suit which is authorized under the enabling legislation should be limited in the amount of recovery to avoid disproportionate awards.

The principal advantage of the relator lawsuit outlined above is that a board of investment professionals will make the decision as to whether the Trust Fund has breached its fiduciary duty. Yet that strength is also a weakness. In the clubby atmosphere of finance, it is possible the watchdog group and the Trust Fund will be so intertwined professionally that meaningful checks in the system could be overlooked in the name of relationships. *Qui tam* suits, on the other hand, may provide an additional check though the recovery should be strictly limited so as to avoid opportunistic and costly litigation. Finally, the Attorney General must have the ability to monitor the Trust Fund as well as other agencies as discussed below.

One likely issue to come up for managers and directors is the extent to which they will be indemnified in lawsuits. Corporate law provides that the articles of incorporation may indemnify directors and officers to limit or eliminate liability for legal fees and judgments provided that they have not

296 The term *Qui tam* is based on the Latin phrase "*qui tam pro domino rege quam pro se ipso in hac parte sequitur*" which translates into "who as well for the king as for himself sues in this matter." BLACKS LAW DICTIONARY (8th ed. 2004).

297 31 U.S.C. § 3730(b) (2000).

298 31 U.S.C. § 3730(d).

breached a fiduciary duty, committed a crime or intentionally caused harm to the corporation.²⁹⁹ In some circumstances, a corporation must indemnify directors and officers if they are “wholly successful, on the merits” of a lawsuit.³⁰⁰ Since lawsuits are inevitable, indemnification of officers and directors will have to be provided for in the enabling legislation. Otherwise, the Fund will be unable to attract suitable candidates for the position for fear of being personally liable in a lawsuit.

The reality is that a privatized Trust Fund will sometimes be operating as a government entity and sometimes operating more like a private sector entity, such as a hedge fund. Therefore, ascribing one single path to judicial remedies may be “ill–advised” for FGCs.³⁰¹ The path to judicial redress should certainly allow private actions in the form of breach of contract and tort claims, derivative actions via a beneficiary representative for breach of fiduciary duties, criminal charges through the office of the Attorney General and constitutional challenges where there has been an injury in fact. One way to make judicial challenges efficient will be to clearly set out the fiduciary duties under which a derivative action would be brought.

3. *Causes of Action: Breach of Fiduciary Duties.*—A set of common law and statutory rules have evolved which state that officers and directors owe shareholders a set of fiduciary duties—principally the duty of care and the duty of loyalty, though some courts also speak to a duty of obedience. Breach of a duty gives rise to a derivative suit brought by a shareholder on behalf of the corporation. However, in the context of an FGC, the duties owed by the directors are uncertain.³⁰² Should presidentially appointed directors have duties not only to the shareholders and corporation but also to the broader national interest?³⁰³ This article first discusses the traditional duties of care and loyalty that officers and directors owe the corporation and its shareholders and addresses the question of whether those duties should be heightened by including an explicit duty of good faith as the basis of a cause of action. Second, the article examines how trust law and non–profit corporate law help heighten the fiduciary duties of directors and officers. In particular, the article discusses duties of the directors and officers in relationship to making decisions to maximize the wealth of the Trust in order to avoid political influence. Finally, the article reviews the literature on whether directors and officers of an FGC owe a duty to the national interest.

299 MODEL BUS. CORP. ACT § 2.02(b)(4)–(5) (2004).

300 *Id.* § 8.52.

301 Hobbs, *supra* note 256, at 778.

302 Froomkin, *supra* note 15, at 587.

303 *Id.* at 588.

There are few precedents within federal law to define the duties of an FGC's officers and directors.³⁰⁴ The Securities Acts might provide some guidance. FGCs are not reporting companies, so the Securities Exchange Act of 1934 doesn't apply and there is no federal corporations' code and little in the way of federal common law.³⁰⁵ In fashioning federal common law, the courts might draw upon state corporate law.³⁰⁶ Delaware has the most highly developed set of cases regarding the fiduciary duties of managers and directors and provides the best starting point for discussion of the standards. The two most often-cited duties of directors and officers of private corporations are the duty of care and the duty of loyalty.³⁰⁷

The duty of care operates to ensure that directors and management operate in good faith as "ordinarily prudent persons managing their own affairs" and use decision making that "best advances *the interests of the corporation*."³⁰⁸ The duty of care is limited by the business judgment rule where if the decision is the result of an informed judgment then a rebuttable presumption exists that the officers or director did not breach the duty of care.³⁰⁹ Some scholars contend that the classic duty of care "no longer exists in Delaware" as a device to hold managers accountable.³¹⁰ Directors can make a decision that ends badly for the corporation merely by conducting a "ritualistic consideration of the relevant data."³¹¹ For purposes of an FGC, a standard for fiduciary duties that is higher than that found in corporate law is advisable.³¹²

The duty of care is enhanced by and intertwined with the duty of loyalty so that the ordinarily prudent director does not act in his own self-interest.³¹³ The duty of loyalty prevents directors and management from profiting at the expense of the corporation unless the self-interested party shows "entire fairness" which consists of both fair dealing and fair price.³¹⁴ Ratification of the self-interested transaction by a majority of the disinterested directors or disinterested shareholders satisfies the

304 Froomkin, *supra* note 15, at 587.

305 *Id.*

306 *Id.* at n.224.

307 Duggin & Goldman, *supra* note 244, at 219. Granted there are many other duties cited in corporate law including the duty of good faith, duty to investigate, duty to inform and duty of obedience, among others, but the duty of care and duty of loyalty are typically the duties which give rise to a cause of action. The other duties are normally subsumed under these two broader concepts.

308 *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 746 n.402 (Del. Ch. 2005).

309 *Id.* at 746-47.

310 Stephen J. Lubben & Alana Darnell, *Delaware's Duty of Care*, 31 DEL. J. CORP. L. 589, 591 (2006).

311 *Id.*

312 Hobbs, *supra* note 256, at 779.

313 *In re Walt Disney*, 907 A.2d at 745-746.

314 Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1115 (Del. 1994).

defendant's burden to prove fairness, though some states provide that even if there is ratification, judicial relief will be granted if a plaintiff shows that the transaction was not fair.³¹⁵

The duty of loyalty deserves special attention given the nature of the privatized trust fund as an entity with the principal purpose of engaging in investments. The potential for abuse by the sophisticated investors running the fund is high. Officers and directors would naturally be statutorily subject under the enabling legislation to a duty of loyalty as least as strong as that found in for-profit corporate law. The duty of loyalty is meant to prevent self-dealing transactions, yet such transactions are typically sanctioned if a majority of the disinterested directors ratify the transaction.³¹⁶ That duty of loyalty might be symbolically, as well as legally, enforced if the legislation requires that both the board and officers of the Trust be mandated to take an oath of office.³¹⁷ Since the Trust Fund, even though it is a private corporation, would still be a state actor, then such an oath would be consistent with that taken by heads of agencies.

The application of the duty of loyalty has a peculiar application in the context of an investment trust fund. One application of the duty of loyalty is the corporate opportunity doctrine—i.e. that management will not usurp opportunities of the corporation for their own benefit.³¹⁸ So, in the case of an investment trust, one might fashion a rule which prevents the manager from investing in the same stock as that of the fund. If allowed to do so, he could engage in “front-running”—the practice of purchasing stocks for one's own account before the fund purchases the stock thus driving up the price. The enabling legislation should restrict what stocks investment advisors can purchase for their own accounts since the Trust Fund is likely to move markets.

However, such a rule could backfire. If investment advisors cannot purchase for their own accounts, will they then bypass some opportunities that the Trust Fund should invest in so that they can reap the gains of the investment in their own accounts? Any rule should attempt to align the interests of management with the interests of the beneficiaries of the corporation. While the legislation should prevent managers from front-running, managers should be required to keep a large portion of their wealth in a shadow fund that mimics the Trust Fund. The Yale Trust addresses the agency problem by requiring that its managers invest a significant amount

315 *Id.* at 1117 (“[A]n approval of the [interested] transaction by an independent committee of directors or an informed majority of minority shareholders shifts the burden of proof on the issue of fairness from the controlling or dominating shareholder to the challenging shareholder-plaintiff”).

316 COX & HAZEN, *supra* note 40, § 10.11.

317 The board of governors of the Federal Reserve must take an oath of office. 12 U.S.C. § 242 (2000).

318 COX & HAZEN, *supra* note 40, § 10.11.

of their own wealth in the same investments as Yale.³¹⁹ By doing so, they align the interests of the managers and the Yale Fund to avoid a breach of fiduciary duty in any given investment. Consequently, in an odd twist, it would result in more loyalty if the managers were required to invest side by side with the Trust Fund rather than being prevented from investing in stocks that will move markets.

Current standards surrounding the duties of care and loyalty may not be enough to ensure the prohibition of all director and officer misconduct.³²⁰ The current corporate law conception of the breach of the duty of care allows too much latitude in the decision making of directors to be an effective standard to govern the directors of a privatized Social Security Trust Fund. In creating standards to address issues of agency, the enabling legislation for the Social Security Trust Fund needs to go beyond for-profit corporate law to create higher standards for fiduciary duties. Given the unique nature of the entity, a higher standard approaching that of a trustee is necessary. Probably the most quoted standard for a fiduciary's duty comes from Justice Benjamin Cardozo: "[a] trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior."³²¹ While current court decisions regarding for-profit corporate director duty do not likely reach the standard that Cardozo articulated, some trends are encouraging.

In the wake of highly publicized cases of director mismanagement, the Delaware courts have struggled with whether the duty of good faith gives rise to a separate cause of action.³²² Although many scholars maintain that there should be a heightened duty of good faith,³²³ recent decisions resolve that a breach of the duty of good faith does not give rise to a separate cause of action though breaches of the duty of good faith are a precondition of the breach of the duty of care.³²⁴ For purposes of the privatized Social Security Trust Fund, the duty of good faith should stand as an independent cause of action along the duties of care and loyalty. Historically, the duty of good faith has been articulated in both statutes and case law.³²⁵ Allowing

319 YALE CORP. INV. COMM., THE YALE ENDOWMENT: 2006, at 6 (2006), available at http://www.yale.edu/investments/Yale_Endowment_06.pdf.

320 Melvin Eisenberg, *The Duty of Good Faith in Corporate Law*, 31 DEL. J. CORP. L. 1, 5 (2006).

321 *Meinhard v. Salmon*, 249 N.Y. 458, 464 (1928).

322 Gordon Smith, *Remember the "Triads of Fiduciary Duty"? Just Kidding!*, CONGLOMERATE, Nov. 7, 2006, http://www.theconglomerate.org/2006/11/remember_the_tr.html.

323 Eisenberg, *supra* note 320, at 1. The duty of good faith has been incorporated into statutes and implied in the common law for a long time as a method by which the other duties can be explained. Arguing that the duty of good faith should form a separate cause of action since some conduct which constitutes a breach of the duty falls outside the duties of care and loyalty. *Id.*

324 See Smith, *Remember the "Triads of Fiduciary Duty"? Just Kidding!*, *supra* note 322.

325 Eisenberg, *supra* note 320, at 10–11.

a breach of the duty of good faith as a separate cause of action would hold directors and officers accountable for actions where there is no bad faith or “improper motivation.”³²⁶ Under present conceptions of the duty of care and the business judgment rule, corporate directors might not be liable even for gross negligence.³²⁷ A stronger conception of good faith would “hold[] that conscious disregard of duty exposes directors to personal liability.”³²⁸ In discussing the evolving role of good faith, Professors Duggin and Goldman noted “[t]his new good faith focuses on ‘true faithfulness and devotion to the interests of the corporation and its shareholders.’”³²⁹ Raising the importance of good faith as fiduciary duty would bring the standard closer to the Cardozo’s original conception.

In addition to for-profit corporate law, other bodies of law help inform the legal duties that should be imposed statutorily on the Social Security Trust Fund to make sure that the managers and directors do not breach their fiduciary duty to the beneficiaries. In addition to the for-profit corporate law standard already discussed, this article will examine: the law of trusts as expressed in the *Restatement (Third) of Trusts* and economic theory regarding risk and return,³³⁰ the duty of obligation under non-profit corporate law and even standards under ERISA. From a practical point of view, the enabling legislation will have to explicitly state that the board and management owe a fiduciary duty to the beneficiaries and contributors to Social Security so that any watchdog group who has standing can enforce that duty through litigation. Second, the legislation would need to specify what standards govern that fiduciary duty.

Trust law deals with the agency problem in situations where the trustee, who has control over the assets, acts in his own self-interest rather than the interest of the beneficiaries. The privatization of the Social Security Trust Fund would create yet another altogether unique agency problem. The Social Security Fund is not a real trust in the usual sense of the term,³³¹ yet it carries many of the same characteristics of a conventional trust. While the Trust Fund under this proposal would be a corporation with a shareholder (i.e. the U.S. government), the managers of the corporation should be working for someone altogether different than the shareholder—i.e. the public who contributes to or receives benefits from the Trust Fund. Consequently, in an ironic twist, what could be labeled as breach of fiduciary duty to the beneficiaries—e.g. investment in low-return governmental assets—is actually a benefit to the shareholder—i.e. the federal government.

326 Duggin & Goldman, *supra* note 244, at 274.

327 *Id.* at 265.

328 *Id.* at 273.

329 *Id.*

330 Weiss, *supra* note 11, at 1003–11.

331 George W. Bush, Speech at the West Virginia University at Parkersburg (Apr. 5, 2005), available at <http://www.ssa.gov/history/gwbushstmts5b.html>.

The Prudent Investor Rule as embodied in *Restatement (Third) of Trusts* section 227 provides that trustees have a duty to beneficiaries to manage the funds as a “prudent investor would, in light of the . . . circumstances of the trust.”³³² The standard of care is a reasonable one that is applied to the overall investment strategy rather than each individual investment,³³³ thus individual investments might be risky so long as the overall portfolio is diversified. One key feature of the Prudent Investor Rule is that it mandates a diversified portfolio yet it allows an exception to the rule when it is prudent not to diversify. By mandating diversification, the *Restatement (Third) of Trusts* aligns with modern portfolio theory.³³⁴ Consequently, a trust could maximize returns while eliminating risk.³³⁵

Yet the exception gives cause for concern. This standard and exception has been incorporated into ERISA,³³⁶ where it has “wrought havoc with . . . fiduciary law.”³³⁷ Courts have been reluctant to hold fiduciaries responsible for bad investment decisions so long as there was a good faith belief³³⁸ that an investment would yield a good return. In part, the problem is that ERISA provides no explanation of modern portfolio theory, therefore, the courts do not have any guidance on what diversification means.³³⁹ The exception transforms itself into a fundamental flaw in the standard when it comes to a Social Security Trust Fund portfolio. Commentators would not apply this exception to diversification for any form of privatized Social Security since it is “almost impossible to imagine circumstances under which a retirement account should assume diversifiable risk.”³⁴⁰

In discussing the fiduciary standard to be applied to private investment companies handling personal Social Security accounts, Professor Weiss proposes a higher fiduciary standard than required by the *Restatement (Third) of Trusts* or ERISA. Professor Weiss proposes that “[i]n making and implementing investment decisions, the trustee has a duty to diversify the investments of the trust so as to eliminate unique or diversifiable risk.”³⁴¹ The overarching fiduciary duty standard for the Social Security Trust could still be mandated to be the *Restatement (Third) of Trusts* since section 227

332 RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 227 (1992).

333 *Id.*

334 Weiss, *supra* note 11, at 1004–05.

335 There is some debate as to whether the Restatement standard requires the elimination of unique risk. The Reporters’ comment describes unique risk, but the standard of section 227 does not explicitly mention unique risk. *Id.* at 1008–09.

336 Employment Retirement Income Security Act, 29 U.S.C. § 1104(a) (2000).

337 Weiss, *supra* note 11, at 1006.

338 *Id.* at 1007 (stating courts find no breach of duty occurs if a good faith effort exists, even in the face of disastrous results).

339 *Id.* at 1006.

340 *Id.* at 1007.

341 *Id.* at 1010; *see also* Solomon & Berson, *supra* note 3, at 132.

provides that its standard is modified by the principles of section 228 which in turn provides that the trustees must “conform to any applicable statutory provisions governing investment by trustees.”³⁴² Thus, the Trust Fund could be ruled by the well-developed body of law surrounding the *Restatement of Trusts* as modified by the legislation providing for a higher standard in terms of diversification.

Non-profit corporate law also helps inform how risks might be minimized since a privatized Trust Fund has similar characteristic to a public benefit non-profit corporation. Here, the contributors to Social Security would be like the beneficiaries of a public benefit non-profit. They would have no voting rights but in essence gain all of the benefit of the corporation. Non-profit corporate law theory struggles with the very issue of whether to apply corporate law or trust law in the matter of breaches of fiduciary duty when there is no one to oversee the overseers and hold them accountable. Non-profit law theorists conclude that “corporate law parallelism—the policy of modeling nonprofit corporate law after for-profit corporate law—seems to aggravate concerns about mission accountability in charitable corporations.”³⁴³ Yet “trust law as the organizational mechanism for nonprofit corporations has little to commend it.”³⁴⁴

When the issue is addressed for the non-profit charitable corporation, scholars conclude that issues of accountability of directors and management are largely “neglected[,] . . . muddled [and] unsettled.”³⁴⁵ Non-profit corporate law in the majority of states apply the same standard used in for-profit corporations to the non-profit corporation for both the duty of care and the duty of loyalty,³⁴⁶ which ultimately means that directors and officers are favored. In addition, however, non-profit law applies a duty of obligation “to observe and advance the mission of the charitable corporation by adhering to its purposes, usually as set forth in the entity’s articles of incorporation or bylaws.”³⁴⁷ Although popular among theorists of non-profit law, the application of the duty of obligation has appeared “in only a handful of cases.”³⁴⁸

In for-profit corporations, the concept of the duty of obligation is referred to as the duty of obedience and prevents directors from conducting an *ultra*

342 RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 228 (1992).

343 Robert A. Katz, *Let Charitable Directors Direct: Why Trust Law Should Not Curb Board Discretion Over a Charitable Corporation’s Mission and Unrestricted Assets*, 80 CHI.-KENT. L. REV. 689, 720 (2005).

344 Thomas L. Greaney & Kathleen M. Boozang, *Mission, Margin, and Trust in the Nonprofit Health Care Enterprise*, 5 YALE J. HEALTH POL’Y L. & ETHICS 1, 73 (2005).

345 *Id.* at 1.

346 *Id.* at 41–43.

347 *Id.* at 44.

348 *Id.* at 43–44.

vires act.³⁴⁹ In the private corporate world, suits based on *ultra vires* act are rarer than breaches of other fiduciary duties. An *ultra vires* suit must allege that the corporation operated outside of its designated powers. Historically, the charter or articles of incorporation of a corporation spelled out limited powers for the entity so as to prevent directors from taking the corporation into areas that the investors or the state granting the charter did not intend. More modernly, corporation codes allow a corporation to operate in “any lawful business”³⁵⁰ so as to give entities the flexibility to change business plans as the market changes.

The enabling legislation for a privatized Trust Fund should state a narrow purpose and the duty of obligation should be strengthened to ensure accountability. Fiduciary duties are strengthened in non-profits when “‘mission primacy’ [is] recognized as a central objective of the . . . enterprise” and the focus on mission creates a higher standard—a “duty of obedience . . . to advance [the entity’s] public purpose.”³⁵¹ What is the public purpose or mission of the Trust Fund? As previously stated, this paper argues that the purpose, first and foremost, should be to maximize the wealth of the Trust in order to achieve full funding.

Professor Froomkin suggests that “[t]he profit motive alone is probably an insufficient constitutional justification for an [FGC] because the applicable federal powers are only incidental to other Article I powers.”³⁵² Professor Froomkin notes that the U.S. has never created a corporation “solely or primarily to produce revenue,” although a proposal in the Clinton administration to create a Technology Transfer and Commercialization Financing Corporation would have been profit motivated.³⁵³ A privatized Trust Fund, might at first blush, seem to be created solely for the purpose of making a profit given that the duties of the directors and officers will be to maximize the wealth of the Trust Fund. Seen solely through this lens, the Trust Fund would not fit the notion that government should not participate in free market competition in the private sector. However, the Trust Fund’s larger purpose of funding social insurance through the vehicle of an FGC justifies the creation of the corporation apart from its profit motive.

The mandated goal of maximizing return has been effective in limiting social investing. ERISA’s fiduciary standard as interpreted by the Department of Labor (DOL) “prohibits trustees from investing for

349 The duty of obedience is sometimes mentioned as an additional fiduciary duty held by directors and officers of “for profit” corporations. COX & HAZEN, *supra* note 40, § 10.01.

350 MODEL BUS. CORP. ACT § 3.01 (2004). The Act also provides that corporations can limit their purpose to specific acts in the articles of incorporation. *Id.*

351 Greaney & Boozang, *supra* note 344, at 83–84.

352 Froomkin, *supra* note 15, at 581 (suggesting that nationalization of a corporation is an appropriate model for the FGC when the government intends to take over an unprofitable business, such as the passenger railroads, in order to maintain service).

353 *Id.* at 581 & n.198.

any object other than achieving the highest return at the proffered risk level.”³⁵⁴ Commentators have maintained that ERISA’s fiduciary standard forbids social investing³⁵⁵ consequently eliminating one of the dangers of government-based investments.

The Canada Pension Plan Investment Board Act also provides guidance. The objective of the CPPIB is to “invest its assets with a view to achieving a maximum rate of return, without undue risk of loss, having regard to the factors that may affect the funding of the Canada Pension Plan and the ability of the Canada Pension Plan to meet its financial obligations on any given business day.”³⁵⁶ The Canadian objectives are rightly limited by forbidding “undue risk of loss” and that concept, if not the actual language, should be incorporated into an objective statement for the Trust Fund. While such language may seem limiting, in actuality it is consistent with the fiduciary duties discussed above. The Prudent Investor Rule as modified by full diversification would address the “the undue risk of loss” language contained in the statement of purpose since a fully diversified portfolio achieves the greatest return with the least amount of risk.

Finally, given the public nature of the Trust Fund and its purpose to further the national interest by funding Security, the question arises whether the officers and directors owe a separate duty to the national interest. Historically, a corporation owes a strict duty to its shareholders to maximize profit.³⁵⁷ However, some modern state corporation codes provide that directors and officers can consider other constituencies, such as the corporation’s employees, suppliers, creditors, the economy of the state and nation and other community and societal interests.³⁵⁸ The American Bar Association declined to put such a statute into the Model Business Corporation Act since it is “not an appropriate way to regulate corporate relationships.”³⁵⁹ Delaware, the leading state for incorporation, also declines to include “other constituencies” statutes.

In discussing the duties of presidentially appointed directors in a mixed ownership FGC (i.e. a corporation in which both the government and private investor have an ownership interest and in which there are some government appointed directors and directors elected by the private shareholders) Professor Froomkin argues that government directors “may feel—and should feel—a duty to represent the public interest.”³⁶⁰ Professor Froomkin hypothesizes the situation where “the corporation is considering

354 Romano, *supra* note 8, at 841 n.146.

355 *Id.* at 811.

356 Canada Pension Plan Investment Board Act, R.S.C., ch. 40, § 5(c) (1997).

357 *Dodge v. Ford Motor Co.*, 170 N.W. 668 (Mich. 1919).

358 *See, e.g.*, OHIO REV. CODE ANN. § 1701.59(E) (2007).

359 Am. Bar Ass’n Comm. on Corporate Laws, *Other Constituencies Statutes: Potential for Confusion*, 45 BUS. LAW. 2253, 2270–71 (1990).

360 Froomkin, *supra* note 15, at 588.

trade-offs between profit maximization and nonpecuniary social interests such as environmental quality or compliance with current government policy.”³⁶¹

There is a fine line to be drawn when it comes to the purpose of the investment vehicle and determining what is the public interest. On the one hand, financing Social Security and seeking maximum financial returns is clearly in the public interest; yet there are many other valid public interests such as environmentally sound business practices. However, allowing such nonpecuniary social investments has led some public pension plans to be swayed to invest in politically motivated, low-return investments which aid lobbying groups.³⁶² This is a principal fear of the Republican leadership in opposing government investment. A better, and more politically viable, approach will be to define the public interest as maximizing the financial returns of the Trust Fund for the purpose of funding Social Security. To the extent that the federal government wishes to regulate business, it should do so through the legislative and political process and not through investments.

In summary, the fiduciary duties are incorporated into the enabling legislation should include, at minimum, the following ideas: (1) the beneficiaries (i.e. both contributors and those receiving benefits) are owed a set of fiduciary duties by the directors and managers which include: (a) the duty of care, (b) the duty of loyalty, (c) the duty of good faith, and (d) the duty of obligation; (2) one standard to judge breach of the fiduciary duties being the Prudent Investor Rule from the *Restatement (Third) of Trusts* modified so that “[i]n making and implementing investment decisions, the trustee has a duty to diversify the investments of the trust so as to eliminate unique or diversifiable risk”³⁶³ and (3) that the articulated purpose of the Trust Fund be to achieve a maximum rate of return for the beneficiaries of the Trust Fund.

D. Regulation of Corporate Powers and Strategies

The federal government, will, of course, have an important role in regulating a privatized Trust Fund. Some administrative law scholars contend that in thinking creatively about regulating privatized government services, we need to drop our collective conceptualization of a hierarchical government structure where there is one central authority in absolute control.³⁶⁴ Instead, accountability includes a number of actors and norms, in which the government plays a role.

³⁶¹ *Id.* at 589.

³⁶² See *supra* note 7 for a discussion of social investing; see also Templin, *Full Funding*, *supra* note 14, at 434-39.

³⁶³ Weiss, *supra* note 11, at 1010.

³⁶⁴ Freeman, *supra* note 55, at 671-74.

The starting point for government oversight is, of course, the enabling legislation which will specify the powers and authority of the corporation. Typically, an FGC will be granted a perpetual existence, the power “to sue and be sued (and to settle cases without Justice Department authorization), to make contracts, to hold property, and to borrow.”³⁶⁵ Some powers which are natural to most corporate entities, such as the power to issue stock in the corporation, should be prohibited under the enabling legislation. In the case of issuing stock, no other non-governmental owner is anticipated under this proposal therefore, the issuing of securities, including debt, should be prohibited without an express approval by Congress.

One likely issue, however, is the extent to which the corporate entity should be subject to the same rules and regulation as government agencies. Although the entity will be considered the state for constitutional purposes,³⁶⁶ the privatized Trust Fund should be treated as a hybrid public-private entity for purposes of regulation. In order to maximize return on investment, some of the rules affecting government agencies should probably not apply to the Trust Fund, while, at the same time, some constraints should be put on the powers of the corporate entity in order to prevent corporate malfeasance.

1. *Statutorily Mandated Investment Restrictions.*—It is inevitable that special interests will seek to influence the investment choices of the Trust Fund in order to promote certain social agendas. It has become popular to label such an investment strategy as “social investing.” Social investing bases the investment decision on values rather than on expected return. Such a strategy seeks investments that will promote particular social purposes or limits investment in companies that are unethical or immoral. For example, “legislation might prohibit investments in companies that use child labor or commit egregious environmental violations.”³⁶⁷ Other examples include investing in geographical regions that are economically depressed.³⁶⁸ Likewise, such a strategy would avoid investment in tobacco companies or firms that have operations in countries with poor human rights records.³⁶⁹

Research shows, however, that “social investing may adversely affect fund performance.”³⁷⁰ Moreover, if social investing results in lower returns, such a strategy may be a breach of a fiduciary duty to maximize the wealth

365 Froomkin, *supra* note 15, at 553.

366 See *supra* notes 62–155 and accompanying text.

367 Solomon & Berson, *supra* note 3, at 140.

368 State legislatures put pressure on public pension plans to invest in local companies in order to promote regional employment. Romano, *supra* note 8, at 796. Such investments might keep a struggling company alive for awhile, but often there are competitive issues which make such a company unprofitable, thus leading to an eventual loss of the investment.

369 Angelis, *supra* note 9, at 290–92.

370 Romano, *supra* note 8, at 829.

of a trust.³⁷¹ Of course, there are times when pursuing a socially responsible or political agenda results in better returns. For example, by investing in more efficient pollution control systems a company might save money in the long term by having fewer clean-up costs. Moreover, some investments that were once thought to have a purely social agenda without much profit potential, such as alternative energy companies and other environmentally sound technology, are now considered among the better investment opportunities.³⁷²

Many of these proposals appear sound. However, putting socially responsible constraints on investment leads to lower returns and opens the door to the political manipulation to determine what is considered “socially responsible” or moral. When investment criteria is based on ethics, the debate turns away from prudent economics to what constitutes ethical corporate behavior. Social investing “would add an ad hoc moral component with no clear boundaries.”³⁷³ While we can all agree that corporations should not violate child labor laws, the line becomes less clear when the morality debate turns to less clear cut issues. Some corporations now offer benefits to the domestic partners of gay employees. Should a conservative Congress and President mandate that investing in such companies be forbidden by the Trust Fund?³⁷⁴

Sometimes, the pressure from legislatures on public pension plans is purely political. As political tensions rose between Iran and the United States in 2007, several state legislatures passed measures that would compel state pension plans to divest their holdings in foreign companies that operate in Iran, a country which the U.S. State Department labels as a supporter of terrorism. A coalition of state pension plans responded by treating the matter not as a political issue but as one of corporate governance. The coalition is urging such companies to consider whether the rewards of operating in a country such as Iran outweigh the risks.³⁷⁵

Whether the social policy being advanced is sound social or even foreign policy, such influence over the Trust conflates the government role of regulator with that of investor. If the government wishes to advance a certain social policy, then Congress should pass a bill and the President should sign the legislation in order to regulate all investment and not just the Trust

371 *Id.* at 811–12.

372 Mark Veverka, *Cleaning Up*, BARRON'S, July 16, 2007, available at http://online.barrons.com/article_print/SB118420428429964109.html.

373 Angelis, *supra* note 9, at 292.

374 Mutual funds exist which “prohibit investing in companies involved in abortion and/or pornography, non-married lifestyles, as well as companies involved in the production of alcohol, tobacco or gambling.” FUND OVERVIEW FOR THE TIMOTHY PLAN FAMILY OF FUNDS, <http://www.timothyplan.com/Funds/frame-OurFunds-overview.htm> (last visited Aug. 14, 2006).

375 Craig Karmin, *Pension Funds Weigh In on Iran*, WALL ST. J., July 24, 2007, at A3.

Fund. As already noted, the mission of the Trust Fund will be to maximize stakeholder value while reducing risk. With that in mind, managers, so long as they invest legally and seek a fully diversified portfolio, should be empowered to engage in any investment which falls into those parameters. That would mean that the Trust Fund could invest in anything—from the latest high-risk technology stock to businesses in China and India which compete with American firms to the local pizza parlor. Of course, the investment must be made legally—i.e. if a private hedge fund or trust fund could not invest in the company then the privatized Social Security Trust Fund should likewise be unable to invest.

Even if social investing produces better returns, specific restraints could cause irregular pricing in a stock. For example, if the Trust Fund invests in a company before the company commits the violations, then it would be required to sell its holdings off at a time when the stock price might be depressed when the violations become public knowledge. The sale of stock by the Trust Fund will, in turn, put downward pressure on the stock price since other investors holding the securities would know that the government was poised to begin selling. Day traders, who are in the business of predicting what institutional investors will do in the sale and purchase of a security, could put additional downward pressure by shorting the stock; thereby causing the company to be valued at less than its true worth and probably hurting the portfolios of smaller and less sophisticated investors.

That said, the Trust Fund should have a policy regarding ethical investing. Many businesses maintain codes of conduct which restrict them from certain practices and subject them to audits by private non-governmental agencies.³⁷⁶ Even though the CPPIB's first stated objective is to "maximize investment returns without undue risk," the policy also includes the statement: "[l]ong-term responsible corporate behavior with respect to environmental, social and governance (ESG) factors can generally have a positive influence on long-term corporate financial performance."³⁷⁷ The CPPIB also requires that its employees, officers and directors adhere to a code of conduct which prohibits any illegal investment practices including but not limited to any conflicts of interest with personal investments. Following the CCPIB's lead, as previously noted, will more likely lead to solvency for the Trust Fund.

Another common suggestion to control governmental or quasi-governmental investing is to pass regulations on putting caps on ownership of a stock. Rather than absolutely banning the purchase of stock, these

³⁷⁶ Archon Fung, *Making Social Markets: Dispersed Governance and Corporate Accountability*, in *MARKET-BASED GOVERNANCE* 145, at 152 (John D. Donahue & Joseph S. Nye, Jr. eds., 2002).

³⁷⁷ CPP INV. BD., *RESPONSIBLE INVESTING* (2007), http://www.cppib.ca/Responsible_Investing/policy.html.

regulations cap the percentage that the government could own of any particular stock.³⁷⁸ The primary purpose behind such regulations is to cut down on the ability of the government to pressure the company to adopt certain policies through shareholder voting rights. Such a restriction, however, could affect returns for the Trust Fund. For instance, if a company is a good investment, then a large shareholder will want to purchase the entire company and take it private. The famed value investor Warren Buffet has routinely done this in his investment career.

If such a shareholder cannot invest at his discretion, then perhaps he might be forced to make less than desirable investments. A cap on percentage ownership, in effect, interferes with any express or implied fiduciary duty to maximize shareholder value. On the other hand, if the Trust Fund owns a company outright, then the Trust Fund's status as a state actor would then be conferred onto the company and subject it to constitutional constraints which then might hamper its ability to be profitable.³⁷⁹ Subjecting a company to constitutional constraints could expose it to additional costs and possibly reduce its competitiveness.³⁸⁰ Outright ownership of a company by a privatized Trust Fund is likely to make conservative politicians uncomfortable since the FGC is only one step removed from the political process. For political expediency, if for no other reason, the privatized Trust Fund should probably be limited in the amount of ownership interest it can take in any given investment.

Similar restrictions might specify that the fund hold a maximum allocation in any given asset class—e.g. a maximum percentage would be held in stocks, bonds and real estate. While on the face of the proposal, this seems to be in line with the principles of diversification, too much control might lead to lower returns. Despite modern portfolio theory and the attempt to quantify risk in order to diversify it away, money management can “involve as much art as science.”³⁸¹ There are a number of subjective decisions that have to be made when investing in an asset. At different times, it might make more sense to be overweight in one class and underweight in another.

In her analysis of legal regimes to cover private professional investors for a private accounts system, Professor Weiss wisely suggests that no specific legislation be drafted as to asset allocation in order to reduce risk.³⁸² Instead, she asserts that personal liability for fund managers as well as a broad fiduciary duty to eliminate unique risk should be the basis of such a

378 Solomon & Berson, *supra* note 3, at 140.

379 See *supra* notes 123–51 and accompanying text for a discussion of the consequences of being deemed a state actor.

380 See *supra* note 153.

381 YALE CORP. INV. COMM., *supra* note 319, at 4.

382 Weiss, *supra* note 11, at 1014.

system.³⁸³ She prefers a less interventionist approach into the investment decision by the government since she mistrusts the government's ability to make sound or for that matter rapid asset class decisions in response to the market.³⁸⁴ If wealth maximization is the goal of the fund, then investment professionals need freedom to make choices without preset limits as to asset classes so long as there is a well-diversified portfolio.

Another common method to prevent government interference would be to statutorily prohibit the government from voting on corporate governance matters. In fact, the Thrift Savings Fund for federal employees has just such a provision.³⁸⁵ However, this solution presents the same problem of too few active investors in corporate governance as the passive investing option. Preventing the Trust Fund from voting shares would sideline an important institutional shareholder. Given the rise of the institutional investor as an important check against management waste, it is critical that the Trust Fund not be silent if it enters the market. To do so, would essentially mean that the world's largest shareholder would sidestep any issues regarding management waste. An important player in the check against management control would be absent during a time when there is increasing need to monitor the activities of private corporate managers.

Rather than making the Trust Fund subject to additional government regulation, it would be consistent with the treatment of many FGCs to exempt a privatized Trust Fund from some of the regulations governing government agencies.³⁸⁶ Ironically, some FGCs are even exempt from the very legislation meant to regulate government corporations—the Government Corporation Control Act.³⁸⁷ Congress' attempt in 1945 to bring order, consistency and accountability to FGCs is largely thought to be inadequate³⁸⁸ and there have been calls to reform and reassert the Act.³⁸⁹

In order to accomplish the Trust Fund's mission to fund Social Security, the investment managers' decisions should not be constrained by regulations which do not apply to private hedge funds. Imposing regulations may amount to social investing which inevitably lowers returns. In some cases, such regulations on government agencies make sense. A recent example involves the Overseas Private Investment Corp. (OPIC), an FGC which provides financing and insurance for economic development in countries

383 *Id.* at 1013.

384 *Id.* at 1014.

385 *Id.* at 999–1000.

386 Froomkin, *supra* note 15, at 553–54 (“In keeping with the long-held theory that FGCs should be run on “business-like” principles, many FGCs are exempted from civil service rules regarding pay, employee tenure, and other rules such as the Freedom of Information Act”).

387 *Id.* at 554.

388 *Id.* at 605–06.

389 Harold Seidman, *United States Experience: the Need to Reassert the Government Corporation Control Act 1945*, 18 PUB. ADMIN. & DEV. 295 (1998).

where political and economic risk make the projects undesirable to private sector finance. In *Friends of the Earth, Inc. v. Mosbacher*, standing was granted to an environmental group suing OPIC for violating the National Environmental Policy Act (NEPA) by investing in foreign energy projects that contributed to global warming.³⁹⁰ Since OPIC's enabling legislation designates it as a federal agency, it should be subject to the NEPA. Moreover, the mission of OPIC is not to make money, but to further the economic development of third world nations. Encouraging environmental responsibility in those countries is consistent with long-term responsible nation-building goals.

However, the privatized Trust Fund would differ from OPIC in its goals. The purpose to the Trust Fund's investment will be wealth maximization. In all likelihood, given the current interest in eco-friendly businesses, this may very well mean that the Trust Fund invests in "green" companies. That said, the Trust Fund would have to compete with private hedge funds, mutual funds and other private actors in terms of finding worthwhile investments. To constrain the Trust Fund with regulations that do not apply to private entities would make the Fund less competitive. The freedom of the Trust Fund managers to make investment decisions should be unfettered. They should, of course, be subject to the same laws and policies as private investors. This should not be viewed as an anti-environment policy any more than investing in overseas works against American labor interests. Rather, the acknowledgement is that the Trust Fund's primary mission is wealth creation.

2. *Mandatory Reports and Minimum Returns.*—Rather than unduly restrict managers in their investment choices, the enabling legislation should mandate full exposure on the often quoted principle by Justice Brandeis that "[s]unlight is said to be the best of disinfectants; electric light the most efficient policeman."³⁹¹ However, the mandate of full disclosure should be timed so that the disclosure of the investment does not lead to instability and speculation in the markets. Moreover, the reporting requirement should not transform itself into a political tool to shape investment policy by the Trust Fund.

The enabling legislation for the creation of the Trust Fund could specify the requirements for record keeping, annual reports and audits.³⁹² The

³⁹⁰ *Friends of the Earth, Inc. v. Mosbacher*, 488 F. Supp. 2d 889 (N.D. Cal. 2007). NEPA requires federal government agencies to prepare an environmental impact statement before proceeding with a project and to consider alternatives. 42 U.S.C. § 4332 (2000).

³⁹¹ LOUIS D. BRANDEIS, *OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT* 92 (1914).

³⁹² See, e.g., 36 U.S.C. § 10101 (2000) (providing an example of the reporting requirements and record keeping for some types of FGCs).

Government Corporation Control Act,³⁹³ to which many FGCs are subject, requires that wholly owned government corporations submit annual budgets,³⁹⁴ management reports consisting of statements of its financial position, operations and cash flows³⁹⁵ and have its financial statements audited.³⁹⁶ It certainly makes sense that a privatized Trust Fund be subject to at least this level scrutiny if not more.

However, as is the case of all paperwork, reports and reviews have a way of becoming an outlet for political pressure. It would be easy to see how Congress might pass a law requiring that the periodic review also include impact statements, such as those suggested by a New York state task force looking to control the investment decisions of the public pension plan.³⁹⁷ The impact statements would “require public reports analyzing the effect of fund investment and voting decisions on a variety of factors, including local employment and the . . . economy.”³⁹⁸ Such impact statements might have potential consequences for future investment decisions by highlighting the effects on special interest groups, which in turn could heighten political pressure for social investing. Any periodic review in which management is judged must be limited to rates of returns and financial metrics that are generally accepted guidelines for the private fund industry. Any attempt to measure social goals will result in politicizing the investment process.

Additionally, management should be required to give periodic reviews of portfolio performance.³⁹⁹ An Audit Committee could be mandated and given specific responsibilities to audit investments and performance.⁴⁰⁰ In the case of underperformance, the fiduciary or trustee would be removed. Some minimal level of performance might be mandated; however, the period of time between evaluations should be enough to allow for a return, otherwise, the managers may not take calculated long-term risks.⁴⁰¹ Legislation should also provide for methods to remove managers or directors for any “malfeasance or nonfeasance” in regard to the management of the Trust Fund.⁴⁰²

393 The Government Corporation Control Act was enacted in 1945 in order to “impose a modicum of uniformity on and control over the financial autonomy of government corporations.” Hobbs, *supra* note 256, at 735.

394 31 U.S.C. §§ 1105, 9103, 9104. The corporation submits an annual budget to the President who then submits the budget to Congress for the necessary appropriations.

395 *Id.* § 9106.

396 *Id.* § 9105.

397 Romano, *supra* note 8, at 815–16.

398 *Id.* at 816.

399 Solomon & Berson, *supra* note 3, at 133.

400 *See, e.g.*, Canada Pension Plan Investment Board Act, R.S.C., ch. 40, §§ 30, 34, 39 (1997).

401 Solomon & Berson, *supra* note 3, at 133.

402 *Id.* at 132.

Some records should not be made available right away and the Trust Fund should be exempt from some federal and state open records laws.⁴⁰³ One risk of full and timely disclosure is that traders will take advantage of price swings as the Trust Fund moves investments in and out of stocks. It may lead to instability in the price of some stocks if traders speculate on which way the Trust Fund is going to invest in or divest out of stocks. Consequently, while investments should not be hidden, some thought should go into when and how such investments are reported.

3. *Oversight by Executive Branch Agencies and Congress.*—Finally, the question arises over which Executive branch agency should oversee a privatized Trust Fund and what oversight role Congress should play.⁴⁰⁴ Moreover, to what extent should executive agencies or Congress be able to exert control over the board of directors (apart, of course, from the appointment process) and force the Trust Fund to act or forbear from acting? As with agencies, Congress should have a role in seeing that the entity does not depart from its mission. A mandatory report gives Congress the “convenient excuse . . . to hold hearings to monitor the FGC’s performance; in turn, the threat of hearings gives FGCs reason to believe they have to account for their actions.”⁴⁰⁵

But what role will the executive branch have? Typically, there is no centralized executive branch supervision of government corporations as a class.⁴⁰⁶ The predecessor to the present Office of Management and Budget (OMB) stopped oversight of government corporations in the 1960s, even though the lack of collective oversight “runs counter to the intentions of the sponsors of the [Government Corporation Control Act].”⁴⁰⁷ The enabling legislation could certainly designate an agency to which the Privatized Trust would report. Likewise, the Trust’s mere presence in the investment arena will subject it to the regulation of certain agencies, unless it is made exempt.

What government agencies will have a role in oversight of the privatized Trust Fund? As previously mentioned, the Justice Department should have a role in overseeing the entity in order to bring lawsuits for breaches

403 Georgia state law “exempts certain records of the Office of Treasury and Fiscal Services—particularly records involving electronic fund transfers—from the Open Records Act by stating that they are not public and are not subject to inspection by the general populace.” W. Kent Davis, *State Debt, Investment, and Depositories: Prohibit Access to Certain Records of the Office of Treasury and Fiscal Services by Exempting Them from the Open Records Act*, 14 GA. ST. U. L. REV. 306, 306 (1997).

404 Roberta S. Karmel, *The Challenge to Financial Regulators Posed by Social Security Privatization*, 64 BROOK. L. REV. 1043 (1998).

405 Froomkin, *supra* note 15, at 626.

406 Ronald C. Moe & Kevin R. Kosar, *Federal Government Corporations: An Overview*, CONGRESSIONAL RESEARCH SERVICE 12 (Mar. 23, 2006).

407 *Id.* at 12–13.

in fiduciary duty. But which government agency should oversee the fund? Since the Trust Fund operates somewhat like a mutual fund, investing on behalf of beneficiaries, perhaps the SEC should be the outside government watchdog agency. Yet, the Trust Fund also shares attributes with pension plans, which are governed by the IRS and the Department of Labor.⁴⁰⁸ Bank and federal insurance regulators might also claim some regulatory oversight. During the public debate over private accounts, when thousands of financial intermediaries were contemplated to handle the millions of private accounts, it was suggested that federal agency consolidation might be needed to insure the solvency of Social Security accounts.⁴⁰⁹

While the SEC, Department of Labor, IRS and, of course, the Social Security Administration could certainly lay claim to some degree of oversight, the *sui generis* nature of the Trust Fund suggests that some of the regulations of those bodies would not apply. While some rules would certainly need to be followed since the Trust Fund is investing in the markets—i.e. there should be no exemption from trading rules, etc.—some other rules may not be as applicable since the beneficiaries are stakeholders rather than shareholders.

There is a risk of politicization by the executive if the Trust Fund is overseen by the SEC. The executive branch might influence the SEC to promulgate rules which force the Trust Fund to act in ways which benefit a certain political party. For example, 31 U.S.C. § 9108 provides that a government corporation “may buy or sell a direct obligation of the United States Government . . . of more than \$100,000 only when the Secretary approves the purchase or sale.”⁴¹⁰ As previously noted, the Trust Fund needs flexibility to make financial decisions as to when and how it sells certain assets. While it may be mandated that a certain portion of the Trust Fund be invested in government bonds, there will no doubt be some leeway in which the Trust Fund might operate and requiring approval by the executive branch whenever a sale is contemplated could hinder the operation of the fund and the attainment of its principle purpose—to garner a high return from a highly diversified portfolio. If a privatized Trust Fund is to work, a review of the applicable laws and regulations governing such an entity need to be reviewed so as to specifically exclude those regulations meant to govern the non-governmental corporations but which, for policy reasons, would not be justified to apply to an FGC such as this one.

Instead of yielding oversight to the SEC, a better solution might be to mandate that both the OMB (as an executive branch investigator) and the Government Accountability Office (as the investigator on behalf of Congress) take on the role of auditor to ensure that two independent bodies

408 Karmel, *supra* note 404, at 1071.

409 *Id.* at 1073.

410 31 U.S.C. § 9108 (2000).

look over the books and analyze both quarterly and annual reports. It may also make sense to contract out with one of the big four accounting firms to audit the books as well. Regardless of the governmental agency cast in the role of overseer, (and it may be best to have several agencies—each in its specialty—overseeing the Trust Fund) there is a tension in that what might be considered an oversight role could easily turn into political investing. The most obvious protection against the politicization of the investment process would be a constitutional amendment, which is discussed in Section E of this Part IV.

One of the most politically charged issues to face any overseeing agency will be the compensation of the managers who run the fund. The people best equipped to make investment decisions are generally those who could make a handsome wage in the private sector working for mutual funds, investment banks, venture capital firms or hedge funds. The salaries in the private sector tend to be astronomical compared to the income of citizens who survive on Social Security.

In 2006, the top twenty Wall Street equity and hedge fund managers had an average compensation package of \$658 million each, ranging from \$1.5 billion to \$260 million at the low end.⁴¹¹ Even with nonprofit funds such as the Harvard Fund, salaries for six of the top managers were a combined \$107.5 million for 2003 when the fund soared 21%.⁴¹² The Canada Pension Plan Investment Board paid its President and CEO a total of \$2.3 million Canadian in fiscal 2007 while the CEO, COO and the top three other highest paid executives totaled \$7.8 million Canadian.⁴¹³ The CEO's salary went up 123% over fiscal 2006 because of bonuses related to the high performance of the fund as well as the board's estimation of his personal performance.⁴¹⁴ At best, it is ethically troublesome to have a million dollar plus compensation package for the managers of a fund when some beneficiaries are struggling at below the poverty level. It is possible that bright, motivated and altruistic money managers will want to take on

⁴¹¹ Scott DeCarlo, *Executive Pay: Big Paychecks*, FORBES, May 3, 2007, http://www.forbes.com/2007/05/03/ceo-executive-compensation-lead-07ceo-cx_sd_0503ceo_compensationintro.html. The large compensation packages for hedge funds are largely due to the industry-wide practice of "two and twenty" where managers receive a 2% management fee plus 20% of the returns each year.

⁴¹² Charles Stein, *Harvard Pays 2 Top Money Managers \$25m*, BOSTON GLOBE, Nov. 23, 2004, *available at* http://www.boston.com/business/articles/2004/11/23/harvard_pays_2_top_money_managers_25m/. The salaries were so soundly criticized by alumni and the press that the manager resigned even though his salary was less than what he would have earned in the private sector. Charles Stein, *Harvard Fund Earns 19.2% Return*, BOSTON GLOBE, Oct. 1, 2005, at B5, *available at* http://www.boston.com/business/articles/2005/10/01/harvard_fund_earns_192_return/.

⁴¹³ CANADA PENSION PLAN INV. BD., 2007 ANNUAL REPORT 50 (2007), *available at* http://www.cppib.ca/files/pdf/Annual_reports/ar_2007.pdf.

⁴¹⁴ *Id.* at 50–51.

the challenge of investing the Trust Fund for the pure status that it confers. Certainly some public servants choose government service over Wall Street. The chairman of the Federal Reserve could make much more than his government salary of \$180,100 if he switched to the private sector.⁴¹⁵

Assuming that a team of altruistic fund managers cannot be found, how much should top flight fund managers of the Trust Fund earn? As a threshold issue, the enabling legislation for a privatized Trust Fund would have to explicitly exclude Trust Fund employees from the civil service compensation limits.⁴¹⁶ It is not the purpose of this article to get to a single figure but to suggest some guidelines for compensation. Most modern models in executive compensation strive to create a system that pays for performance. In the context of the Trust Fund, management would be incentivized through a bonus system if they made substantial gains in closing the deficit gap. Such incentives will likely attract the best investment analysts. The danger presented by such bonuses may be that the managers make highly risky investments without diversification for the chance of making a large bonus. Thus, any system must try to achieve a balance to encourage behavior that maximizes the wealth of the Trust Fund by attracting while rewarding the most successful money managers.

In order to align the interests of the Fund and managers, bonuses should be paid for long-term performance rather than short-term swings in value. To do otherwise would put the Trust Fund at risk of market manipulation since share prices can be pumped up to show a short increase in value. Investments on which a bonus is paid must prove out over time. An effective restraint might mean tying up the bonus until long after the manager leaves the fund.

To avoid politicizing the decision, the determination of compensation should not be controlled by Congress or the President. This will have an eventual effect of turning away the bright and ambitious people who are attracted to the game of money management. The determination should be based on metrics contained in the enabling legislation with any subjective decisions being yielded to the board of directors. The negotiation over salary should be conducted as an arms length transaction. In recent years the pay packages for executives favored them because “directors’ incentives to enhance shareholder value are not generally sufficient to outweigh the various factors that induce boards to favor executives.”⁴¹⁷ What might be legislated are similar controls in terms of compensation review as are being discussed for private corporations—i.e. a set of compensation committee

415 Barbara Hagenbaugh, *Greenspan Steps Up to Microphone Immediately*, USA TODAY, Feb. 14, 2006, at 02B, available at http://www.usatoday.com/money/economy/2006-02-13-greenspan-usat_x.htm.

416 Froomkin, *supra* note 15, at 553–54 (“many FGCs are exempted from civil service rules regarding pay”).

417 LUCIAN BECHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE 189 (2004).

procedures which require review of the corporation's goals in light of executive compensation coupled with review by outside consultants and attorneys along with public disclosure of the steps taken in the decision-making process.⁴¹⁸

The salaries paid should be commensurate with Wall Street salaries but with caps in order to prevent windfalls based on the pure size of the Trust Fund. The hedge fund industry typically gives managers a 2% management fee plus 20% of the returns in a given year. Under such a metric, a modest increase of 4% on the \$1.9 trillion Trust Fund would pay out an unjustified \$76 billion pay package. Even with a cap on the salaries, it runs counter to the collectivist nature of Social Security to award million dollar plus bonuses to managers while beneficiaries subsist at the poverty level. On the other hand, if a team of brilliant and motivated managers were able to reduce the funding shortfall in order to prevent benefits cuts, then a \$100 million bonus, although it sounds unconscionable, over the course of ten years might pale in comparison to the potential tax hikes necessary to maintain benefits.⁴¹⁹

Finally, the managers' personal wealth should track the investments made by the Social Security Trust Fund. This is not necessarily a compensation issue (though if the Trust Fund is successful then so is the managers' portfolio), rather it acts as a constraint so that managers do not take unnecessary risks in the hope of garnering a large bonus. As noted above, when managers are required to keep a majority of their personal wealth in a fund that shadows investments made by the Trust Fund, it encourages wealth maximization behavior.⁴²⁰

E. Constitutional Protections

The strongest protection against government or political interference will always be constitutional restraints on the government. A constitutional amendment could prevent the government from interfering in the investment decisions of a privatized Trust Fund. A constitutional amendment may not make the Trust Fund impervious to political meddling,

⁴¹⁸ *Id.* at 195.

⁴¹⁹ Under the intermediate actuarial assumptions, the projected shortfall in funding could be erased if current and future payroll taxes were raised from the current combined employer and employee rate of 12.4% to 14.35%. THE 2007 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE FEDERAL OLD-AGE AND SURVIVORS INSURANCE AND FEDERAL DISABILITY INSURANCE TRUST FUNDS, H.R. DOC. NO. 110-130, at 56 (2007), *available at* <http://www.ssa.gov/OACT/TR/TR07/tr07.pdf>. Applying an additional 1.95% FICA tax to a hypothetical \$6 trillion worth of taxable wages would cost taxpayers and employers an additional \$117 billion in a single year, clearly dwarfing the highest paid hedge fund managers on Wall Street.

⁴²⁰ The managers of the Yale Trust are required to put a large portion of their personal wealth in the same investments as the trust they manage. YALE CORP. INV. COMM., *supra* note 319, at 6.

but it is the best protection available to ensure that Social Security money is wisely invested for the benefit of American workers. Given the amount of money in the Trust Fund and even modest projections of what those funds could earn if invested, politicians will naturally want to tap into the Trust Fund for pet projects. The only sure protection of the Trust Fund will be through the courts, and the surest protection in the courts will be through the Constitution.

To “constitutionalize the independence of fund boards” is one method to keep politics out of the Trust Fund.⁴²¹ Two examples where state public pension plans managed to give constitutional protection to autonomy in investment decisions and shareholders voting are in California and Oklahoma.⁴²² Moreover, the measure mandates that the “board’s fiduciary duty to its participants and beneficiaries has precedence over any other duty.”⁴²³ That fiduciary duty—to maximize the wealth of the fund while maintaining a fully diversified portfolio—could be constitutionally mandated. The California provisions also give protection to legislative manipulation of the composition of the board by requiring a vote by the electorate for any changes in the composition of an elected board.⁴²⁴

While amending the constitution of a state is no small task, amending the U.S. Constitution requires an enormous amount of political willpower and time. On the other hand, if the one thing that the American public agrees on, it is to not cut benefits to Social Security. If an amendment which protects the Trust Fund from the political process is, as is argued here, a necessary step toward guaranteeing benefits, then it is likely to find widespread support among the electorate.

Would a constitutional amendment actually work? While constitutional protections are likely to prevent “flagrant forms of legislative interference in fund affairs, such as redeployment of fund assets or changes in board composition,” more subtle manipulation in the form of influencing “politically sensitive board members” in making social investment decisions may occur despite the constitutional protection.⁴²⁵ Even so, a well-devised constitutional amendment which clearly gives independence to the Trust Fund will help to ensure that the money in the trust has the best chance of flowing to its intended beneficiaries rather than some political purpose.

421 Romano, *supra* note 8, at 843.

422 *Id.* at 843–44.

423 *Id.* at 843.

424 *Id.* at 844.

425 *Id.*

CONCLUSION

Social Security is facing an inevitable funding crisis; yet lawmakers lack the political will to reform the Social Security Act.⁴²⁶ In the meantime, the Trust Fund is invested in low yield government bonds when it could be earning a higher rate of return if it were invested in a diversified portfolio of stocks, bonds and other assets. Economists agree that over the long term a diversified portfolio earns a higher return than a bond only portfolio and it does so with less risk. Investing the Trust Fund in the private and public markets remains the best hope for Social Security to address the funding crisis without substantially raising taxes or cutting benefits.

At that time of this writing, the current Republican administration fundamentally believes that the only way to leverage the stock market is through personal accounts where the individual taxpayers make investment choices. The fear of the Republicans is that if the government controls the portfolio, there will be political interference in corporate governance; thereby hampering business decisions. Moreover, the Republicans contend that investment decisions will be subject to political pressure which results in high-risk, low-return investments thereby benefiting special interest groups with lobbying power. The Democratically controlled Congress, however, refuses to even discuss reform proposals with the President if personal accounts are on the agenda. Among the several complaints, the Democrats believe that shifting social insurance into individual accounts fundamentally changes the collectivist responsibility of social insurance such that it exposes low-income earners to a higher risk of poverty.

One middle ground approach that addresses Republican fears of government interference in private markets would be to create a private FGC to act as the investment vehicle for the \$1.9 trillion in the Social Security Trust Fund. The United States has a long history of using such corporate entities in order to achieve political insulation when managing the country's financial needs and goals. The solution should be politically feasible to the Republicans since it leverages the markets through an arguably private entity, and the Democrats should accept it since it keeps Social Security centralized as a collectivist response to poverty in old age.

FGCs give rise to a number of normative, constitutional and practical issues. While much has been written by scholars questioning whether the privatization trend of government service is normatively sound and consistent with democratic principles, the application of an FGC to financial management has deep roots in our country's history—dating back to the establishment of the Bank of the United States in 1791. The constitutional

⁴²⁶ Kathryn L. Moore, *Reforming Retirement Systems: Why the French Have Succeeded When Americans Have Not*, 22 ARIZ. J. INT'L & COMP. L. 251, 289 (2005) (arguing that reform in the U.S. has not been forthcoming in part because of a lack of an unwavering political commitment to reform).

questions of whether the state action doctrine applies—i.e. whether the a privatized Trust Fund would be a private entity or a state actor—can be easily addressed by merely conceding that this FGC is a state actor and then building a structure that comports with the Appointments Clause and other constitutional requirements. Such a structure need not lead to political influence in the appointment process if certain requirements for directors and managers are maintained.

Finally, corporate managers can be held accountable through a rigorous series of controls including: (1) legislating a high standard of the fiduciary duties of care and loyalty on officers and directors and making such officers and directors personally liable for breaches of those duties, (2) mandating judicial review of corporate action by conferring relator status on organizations charged with being watchdogs of the fund, (3) allowing congressional and agency oversight of certain functions and (4) restricting corporate actions so that the sole purpose and requirement of the fund is to invest Trust Fund assets in a broadly diversified portfolio of stocks, bonds and other assets.

While issues surrounding corporate accountability continue to be an important legal issue, FGCs have aided the United States in implementing financial policy for over 200 years without serious fallout. Moreover, the model of a government-owned corporation investing social insurance tax proceeds is used in Canada with success. Not only is the Canadian entity free from political influence, but it is also yielding a higher rate of return than the previous investments in government bonds. Whatever is done about the crisis in Social Security funding, it needs to be done soon.⁴²⁷ If investment is to work, there needs to be enough time for those investments to mature. While some commentators, without understanding diversification, criticize the markets as too risky for Social Security funds, the real risk is in doing nothing. The failure to act shifts an unworkable tax burden onto future generations and will likely result in benefit cuts and a return to the social problem of poverty among the elderly.

427 DAVID M. WALKER, U.S. GOV'T ACCOUNTABILITY OFFICE, PUBL'N No. GAO-05-397T, SOCIAL SECURITY REFORM: EARLY ACTION WOULD BE PRUDENT (2005), *available at* <http://www.gao.gov/new.items/d05397t.pdf>.

